



**Testimony presented on behalf of the**

**Appraisal Institute  
American Society of Appraisers  
American Society of Farm Managers and Rural Appraisers  
National Association of Independent Fee Appraisers**

**Before the House Committee on Financial Services**

**On**

**“Legislative Proposals on Reforming Mortgage Practices”**

**Presented by**

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**October 24, 2007**

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Joint Testimony Presented by

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Before the

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United States House of Representatives

Chairman Frank, Ranking Member Bachus and members of the Committee on Financial Services. I am Alan E. Hummel, SRA, Senior Vice President and Chief Appraiser of Forsythe Appraisals, LLC in Minneapolis, Minnesota. I am the Chair of the Appraisal Institute's Government Relations Committee and Past President of the Appraisal Institute. Today, I am pleased to be here on behalf of the Appraisal Institute, American Society of Appraisers, American Society of Farm Managers and Rural Appraisers, and the National Association of Independent Fee Appraisers, the four largest professional appraisal organizations in the United States, representing 30,000 real estate appraisers.

Thank you for the opportunity to testify before this joint subcommittee hearing on "Legislative Proposals on Reforming Mortgage Practices". There is a bill currently before this committee that would protect consumers and financial institutions from mortgage, by addressing shortcomings in the appraisal regulatory structure, H.R. 3837, the Escrow, Appraisal, and Mortgage Servicing Bill, co-authored by Representatives Paul Kanjorski, Barney Frank, Paul Hodes and Charlie Wilson. We appreciate the work of the bill sponsors because mortgage fraud is an issue that deserves the attention of Congress. It is also an issue that requires a holistic

solution, as it involves all aspects of the real estate industry, including real estate appraisal. H.R. 3837 specifically addresses appraiser and appraisal-related concerns by modifying Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), the law enacted by Congress in 1989 which created the current appraiser regulatory structure. We support these provisions, and we urge they be enacted.

For years, professional real estate appraisers have been warning Congress about the endless schemes perpetrated on consumers and the financial markets by real-estate rogues, including some mortgage brokers, realty agents, and property flip investors. Bad appraisers deserve blame, too. Our organizations have been leading the fight to protect our members and ultimately the public from intense pressure from commission paid participants to make these deals work. This intense pressure had undermined the integrity of safeguards which have been designed into the appraisal component of the lending process for the past 75 years. Appraisers with integrity have found themselves frozen out of the market while weak, inexperienced appraisers became the darlings of some lenders. Too often, appraisers, either through incompetence or by turning a blind eye, have helped facilitate bad mortgage loans. The entire real estate industry faces critical problems. We urge Congress to curb these abuses.

The appraiser is a vital independent service provider in mortgage transactions. Our fees are not contingent upon whether the loan goes through or based on the loan amount. Independent, competent and qualified real estate appraisers are a crucial safeguard to this portion of our economy. A professional appraiser's objectivity, experience and ethics are fundamental in ensuring that participants in residential and commercial real estate mortgage transactions know the value of the real estate involved and understand the risks inherent in collateral lending. It is of paramount importance that an appraiser be properly qualified, adequately trained and have sufficient experience in the type of property appraised.

Unfortunately, mortgage fraud exists, and in many of our communities it is rampant, costing consumers, lenders and taxpayers more than \$1 billion annually<sup>2</sup> and suspicious activity

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<sup>1</sup> *Financial Crimes Report to the Public*. (2005, May). Criminal Investigative Division, Federal Bureau of Investigation. Retrieved from [http://www.fbi.gov/publications/financial/fcs\\_report052005/fcs\\_report052005.htm#d1](http://www.fbi.gov/publications/financial/fcs_report052005/fcs_report052005.htm#d1)

reports have increased an astounding 1,411 percent since 1997<sup>2</sup> according to the FBI and Department of the Treasury respectively. Loan fraud also threatens our nation's communities, leaving individuals with overvalued properties and burdensome loans. Artificially inflated sales can cause property taxes to rise while true property values decrease due to foreclosures, abandoned houses and uncared-for properties.

We are not happy to report that mortgage fraud can be perpetrated because of faulty appraisals. For this reason, we believe that any legislation addressing abusive mortgage lending practices must include reforms for the appraiser regulatory structure. Specifically, we believe appraiser-related mortgage fraud continues largely because of the following reasons:

- ❖ Unscrupulous third parties are allowed to pressure appraisers to meet predetermined values;
- ❖ Appraiser regulators provide inadequate oversight over licensed appraisers;
- ❖ Very little attention is paid to mitigating appraisal problems through improving appraisal quality.
- ❖ In some areas of lending, appraisals have been reduced from an important safeguard role to merely a speed bump in the process of closing a loan.

Proposals addressing these issues are included in H.R. 3837, specifically in Title IV. I am happy to provide further explanation of our position below.

### **Inappropriate Pressure of Appraisers**

Appraiser pressure has received a great deal of media attention in recent months, and it was the subject of an independent study conducted earlier this year by the October Research Corporation<sup>3</sup>. This study found that 90 percent of appraisers were pressured by mortgage brokers, lenders, realty agents, consumers and others to raise property valuations to enable deals to go through. This was nearly double the abuse findings of a similar study three years ago. Moreover, the survey found that 75 percent of appraisers reported "negative ramifications" if they

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<sup>2</sup> *Mortgage Loan Fraud, an Industry Assessment based upon Suspicious Activity Report Analysis*. (2006, November). Financial Crimes Enforcement Network, Regulatory Policy and Programs Division, Department of the Treasury<sup>2</sup>.

<sup>3</sup> National Appraisal Survey, October Research Corporation, December 2006. [www.octoberresearch.com](http://www.octoberresearch.com)

did not cooperate, alter their appraisal, to provide an artificial valuation. The prime culprits of pressure, according to the survey, were mortgage brokers (71 percent), real estate agents/brokers (56 percent), consumers (35 percent), lenders (33 percent), and appraisal management companies (25 percent). Pressure comes from every direction. We must do everything we can to ensure an independent appraisal process in mortgage transactions. We cannot do that in a market half regulated.

Pressure is especially strong when appraisals are delivered to parties whose compensation depends on getting people to the closing table to complete the sale and mortgage. If the loan doesn't close, these parties don't get paid. They do what they can to be sure they get paid.

Unfortunately, these parties with a vested interest in the transaction are often the same people managing the appraisal process within many financial institutions, and therein is a terrible conflict of interest. In this situation our members experience systemic problems with coercion. Appraisers are ordered to doctor their reports or else never see work from those parties again.

Coercion can be subtle or blatant. Some parties boldly demand overlooking material issues or property conditions to make the appraisal arrive at the desired number - or else. Such direct threats typically occur over the phone or through an informal communication. And as a result, it is very difficult to document instances of inappropriate pressure on appraisers.

I have personally experienced such threats. On several occasions clients have told me that failing to comply with their wishes will result in my firm's not being paid or never receiving work from that institution in the future. In these cases, for not bowing to these pressures, I lost clients and was not paid for my services. I am one of many appraisers with this experience.

Our organizations are also concerned about the subtler practice of "blacklists" or "exclusionary appraiser lists," particularly when they are used as levers to pressure appraisers. It is one thing to maintain a list of reputable businesses to work with, or to maintain a list of firms to avoid as the result of poor performance; it is another to place an appraiser on an exclusionary list for no other reason than the appraiser failed to hit a predetermined value. Worse yet, these

blacklists are shared by lenders in a formal, organized system with no notice provided to the affected appraiser, nor any ability of that appraiser to defend his or her reputation.

Subtle tactics may fall short of outright coercion, but the implication is the same. For instance, it is common for a client to ask an appraiser to remove details about the material condition of the property to avoid problems in qualifying the home for a certain type of mortgage. However, this omission amounts to a violation of appraiser ethical requirements. Just last week, I received the following email from a broker client:

*Greetings,*

*I have a question on the following: "...with the exception of an area of the front porch flooring which decayed. According to the owner, the basement gets some dampness during storms through the newer area of the foundation..." Page 1of 6.*

*Do you guys know Appraisals 101? This statement should never be on the report. Now we face a big problem with the lender here and this makes the customer very unhappy as well. This decayed area, is this essential to notice? What if it was covered with a rug? I need to know what to do here. How can you help us get this in line? What is the exact? problem? What is cost to cure? Anything?*

*Please respond ASAP Thanks.*

I can assure members of the Committee that the cost to "cure" the decaying front porch flooring is a little more than the cost of an area rug to cover up the damage.

### Weak or non-existent enforcement

Where there are few rules prohibiting appraiser coercion, little enforcement takes place. Outside of some diligent law enforcement officials and observant legislators who have recognized the importance of maintaining appraisal independence, we see very little enforcement occurring on these issues. For several years, our organizations have highlighted the importance of this issue on the state level, achieving some results.

For instance, the issue between 40-plus states and Ameriquest largely involved breakdowns in appraisal independence. Investigators found that, between 1999 and 2005,

Ameriquest employees deceived thousands of consumers with high-pressure tactics to boost their monthly quotas and commissions. Consumers accused the company of engaging in unfair and deceptive lending practices such as misrepresenting the actual amount of interest, inflating their home appraisals, delaying funding of consumers' loans after closing and failing to clearly disclose fees or penalties associated with paying the loans off ahead of schedule.

In the settlement, Ameriquest denied all allegations but agreed to adhere to new standards to prevent what the states alleged were unfair and deceptive practices. Ameriquest had to overhaul its appraisal practices by removing branch offices and sales personnel from the appraiser selection process, by instituting an automated system to select appraisers from panels created in each state, by limiting the company's ability to get second opinions on appraisals, and by prohibiting Ameriquest employees from influencing appraisals.

In the past twelve months, four states passed laws prohibiting brokers and lenders from pressuring appraisers to reach value. This month, the California governor signed SB 223 which explicitly forbids persons involved in the real estate transaction from pressuring an appraiser to hit a target value. The bill punishes violators with license suspension or revocation and with potential civil action. Last June, Ohio passed a law that prohibits a person or business from improperly influencing the judgment of an appraiser with respect to value. Following suit, the Attorney Generals of two other states, backed by our chapters, pushed for the passage of similar provisions. The Colorado legislature passed a bill that says no person shall improperly influence an appraiser, while Iowa passed a more extensive provision, banning appraiser coercion or attempted appraiser coercion. These laws join the list of state laws protecting appraisers from undue pressure, in Arkansas, Kansas, North Carolina, Utah and West Virginia. Legislatures and public officials in other states are exploring similar actions.

The new Ohio predatory lending law has produced the recent indictments of 10 mortgage brokers, mortgage lenders and an appraisal management company, charged with improperly influencing the appraisal process. New York's attorney general is now investigating whether home appraisers were improperly pressured by mortgage brokers and lenders to inflate estimates, damaging the New York real estate market's integrity.

Outside of these cases, we are not aware of any administrative action taken by a state regulator of mortgage lenders, mortgage brokers or others involving improper influence over the appraisal process. However, this may change as the result of the recent laws passed in the last year, and several others currently pending in Michigan and Florida.

By strictly prohibiting coercion of appraisers by interested third parties, H.R. 3837 makes it clear that appraisers are to remain objective third parties in a transaction.

### **Oversight and Enforcement of Licensed Appraisers**

Another area that deserves more scrutiny and attention is enforcement by federal and state appraiser regulators. One of the results of the savings and loan crisis of the late 1980s was the passage of FIRREA in 1989, and its Title XI established the current appraisal regulatory structure. While created with the best of intentions, the attempt to tie federal and state regulators and the private sector together to oversee appraisers in the U.S has left us, eighteen years later, with a configuration that is, without question, extremely convoluted.

Title XI created the federal Appraisal Subcommittee to oversee the activities of the state appraisal boards and commissions. Yet, the only real power the Appraisal Subcommittee has over state appraisal boards is the authority to “decertify” a state if it is found to be out of conformance with Title XI. This specific power is called by some the “atomic hammer,” because if it were invoked, virtually all mortgage lending in that state would cease. Because of its severity, the Appraisal Subcommittee has never used this power, and it is unlikely that it ever will. This is why we support the concept put forth in H.R. 3837 that would grant the Appraisal Subcommittee authority to impose interim sanctions and suspensions on the State appraiser certifying and licensing agencies develop sanctioning power of state appraisal boards through a public rulemaking process. Such powers include the ability to write rules and regulations, powers currently not granted to the Appraisal Subcommittee.

### State Appraisal Board Funding

In addition, many state appraisal boards are having acute difficulties maintaining effective regulatory systems. According to the 2006 Annual Report of the Appraisal Subcommittee, 60 percent of the state appraisal regulatory agencies failed to uphold their responsibilities in conducting enforcement activities. Time and again, most states relate that while they do their best to keep up with the demanding workload, they simply don't have the resources to perform effectively.

That lack of resources creates a system that allows some unscrupulous and unqualified appraisers to continue practicing and provides little or no recourse for their actions. Some of these appraisers have been linked to mortgage fraud schemes throughout the country. For example, within the last few years, a real estate appraiser in New York was found guilty and convicted of a felony for grossly inflating appraisals. His state license was revoked, and he served a jail sentence for one year. Upon his release, he challenged the state appellate court to have his license reinstated. The court overturned the ruling of license revocation, determining that he had served his time sufficiently and that he must return to becoming a "beneficial member of society." Amazingly, this fraudulent appraiser charged with participating in numerous land-scam schemes is now a practicing appraiser--sanctioned--in New York.

New York is not alone in handling such cases carelessly. In Maryland in June of 2003, an appraiser who pled guilty to appraisal fraud admitted that the government lost between \$500,000 and \$800,000 due to his actions. In the fall 2003, he applied to renew his license. On the online application, he answered "no" to whether or not he had ever been convicted of a felony. According to his attorney, he answered the question honestly because in the federal system, one is not convicted until sentenced, and the appraiser was not sentenced until February 2004. Thus the Maryland Commission of Real Estate Appraisers and Home Inspectors renewed his license last October for another three years. A spokesperson for the Maryland Commission said to the Baltimore Sun, "All we have to go by is the honesty of the licensee. We are not required to perform background checks; moreover, the financial and personnel resources are not available at this time."

The Government Accountability Office conducted a lengthy investigation on the appraiser regulatory structure, and one of the findings in their report was that funding of state appraisal board activities was a major hindrance to enforcement. A GAO survey of state appraisal boards reported resource limitations as the primary impediment in carrying out their oversight responsibilities. For example, of the 54 states and territories that responded to the survey, 26 (48 percent) reported that the current number of investigators was insufficient for meeting its regulatory responsibilities, 37 (69 percent) cited a need for increasing the staff directed at investigations, and 22 (41 percent) cited a need for more resources to support litigation.

According to this survey, the average state appraisal board had approximately three staff members who were responsible for overseeing almost 2,000 appraisers. Many of these state agencies reported that they needed to share resources—administrative staff, office space, investigators, or all three—with other state agencies in order to perform their Title XI duties. The majority of states sharing resources were sharing investigators, who often had no real estate appraisal experience. The survey results indicated that investigations of complaints about problem appraisers suffered most from these shortages. The GAO report recommended that the Appraisal Subcommittee explore potential options for funding or otherwise assisting states in carrying out their Title XI activities, particularly the investigation of complaints against appraisers. We are not currently aware of the status of this directive.

Presently, the Appraisal Subcommittee's operations are funded exclusively by individual state certified and licensed appraisers through license fees collected by states appraisal boards. Individual appraisers are assessed a \$25 annual fee passed through to the Appraisal Subcommittee, which has resulted in a sizable reserve fund that exists with no identified purpose. The Appraisal Subcommittee told the GAO that it did not believe it had the legal authority to use these funds for grants to state appraisal boards. We see a few options available to Congress in this area:

- ❖ Granting the Appraisal Subcommittee the authority to establish and manage a grant program to state appraisal boards for the purpose of conducting enforcement activities;

- ❖ Requiring state appraiser licensing fees to be used for state appraiser licensing and enforcement. Currently, it is common for appraiser licensing fees to go into a state's general fund, causing the state appraisal board to compete with other state discretionary programs for funding. Self funded Boards are found to have significantly more enforcement capability.
- ❖ Requiring the Appraisal Subcommittee to add "funding" as one criterion it looks at when monitoring a state program.

We encourage this committee to explore these options to help with the current state appraisal board funding crisis.

It is our view that problem appraisals are being allowed, and in some ways even encouraged, by a regulatory structure that promotes lax enforcement and ineffective oversight. H.R. 3837 would provide the Appraisal Subcommittee with a more robust oversight system for state appraisal programs, including a full range of supervisory sanctioning powers over state appraisal regulators. We believe this modification, if implemented fairly and through an open and public process by the Appraisal Subcommittee, will help encourage state appraisal boards to take action against unethical and fraudulent appraisers and improve enforcement in our profession.

### **Increasing Appraisal Quality and Professionalism**

Important for discussions about new laws and increasing various federal and state enforcement powers is the need to mitigate problems before they occur so that less enforcement needs to take place. This is true in the real estate industry and appraisal community, where there is a great deal of competition and cost and turnaround times are critical to the success of a business. As they say: "You get what you pay for." We believe this to be true in the appraisal community where the cheapest and fastest appraisal may not be the best or most accurate appraisal. While cost and turnaround times should always be factors in a business decision, we believe quality should be as well.

An important goal of FIRREA was to ensure that appraisals are performed by competent appraisers. However, in practice, FIRREA has had the opposite effect because it stresses

minimum qualifications. This emphasis has severely curtailed the continuing development of professionalism in the appraisal community. As we reflect upon FIRREA, it is clear that the requirements for licensing and certification were set too low.

FIRREA unfortunately settled for a minimum level of education and experience and failed to recognize the need for continuing professionalism beyond the licensed minimum. Accordingly, appraisers who have met only minimum state licensing and certification requirements tend to be less experienced and less qualified than appraisers with professional designations; 84 percent of users of appraisal services say this is the case.

In a poll conducted recently by the Appraisal Institute of significant users of appraisal services from which the above-mentioned statistic is gleaned, fully 50 percent responded that the quality of appraisal services and appraisal reporting has declined, whereas only 28 percent said appraisal services and reporting have improved. This is consistent with discussions various appraisal organizations have had with users of appraisal services for the past several years.

Interestingly, though, many of these users perceive the possession of a license to be the only necessary qualification on which to base whether or not an appraiser is “qualified” to perform an assignment, and stop short of fully considering the issue of competency for a particular appraisal.

It is our view that the culprit, at least in part, is a provision formulated against designated appraisers contained in (Section 1122(d)) of FIRREA, ironically referenced as the “Anti-Discrimination” clause. Under this provision federal financial institution regulatory agencies may not exclude a licensed or certified appraiser from consideration for an assignment in a federally related transaction solely by virtue of membership or lack of membership in any particular appraisal organization. Unfortunately, some financial institutions and individuals around the country have misinterpreted this clause to mean that users of appraisal services cannot establish qualifications criteria that would permit any consideration of an appraiser’s membership in a professional organization. This misinterpretation is inconsistent with FIRREA’s intent to enhance the quality of appraisal services and harms the public by discriminating against appraisers who hold hard earned professional designations and who may be the very best qualified to perform a

particular assignment. Under this misinterpretation, for example, a federally regulated financial institution would not be able to consider a professional designation in deciding whether to award an assignment, despite the fact its achievement represents a strong commitment to professionalism.

While minimum standards and qualifications are a good place to start, limiting clients to only the minimally qualified makes no sense. Currently, nearly 40 percent of the approximately 80,000 licensed and certified appraisers in the United States belong to a professional appraisal organization, clear evidence that greater professionalism is being sought by many practitioners. H.R. 3837 would make certain that professional designations can be considered by clients to help determine an appraiser's proficiency. This would not exclude anyone without a designation from receiving an assignment, but rather promote professionalism for the industry and place an emphasis back on quality.

### **Education & Best Practices**

The industry as a whole must improve communication and understanding among the components of real estate financing. Lenders and brokers ordering appraisals should understand basic appraisal processes, while appraisers should understand how their work product is being used by lenders and brokers and for underwriting purposes. Consumers deserve to have a full understanding of the documents they are signing. They should know whether multiple appraisals were performed for their loan, and why they were ordered. We support more resources being applied to consumer education about the mortgage process.

We are circulating an industry-wide statement of "best practices" on real estate appraisals and mortgage lending, which we believe is crucial to educate all parties involved about the importance of an independent appraisal process. We hope we can work with our industry partners to jointly develop and adopt such a statement for all major participants involved in the mortgage lending appraisal process.

## **Conclusion**

Our organizations have long held that current law relative to appraiser licensing and certification is in need of modification and revision, and that Congress should consider and enact legislation designed to uphold integrity in the real estate valuation process while protecting government-related financial interests and consumers. We have advocated for a regulatory system where federal and state appraiser regulatory bodies are provided the resources and authority necessary to fulfill vital oversight of the profession. We have also made a case for professionalism to be fostered and encouraged and for states to streamline their operations to allow for the efficient flow of commerce.

Any legislation directed at curbing and preventing predatory lending and mortgage fraud must address current weaknesses in the appraiser regulatory structure. H.R. 3837 addresses these concerns by prohibiting inappropriate pressure of appraisers, providing greater accountability of federal and state appraiser regulators and promoting professionalism among appraisers. We stand prepared to work with Congress, consumer groups, and banking interests to help secure its passage.

Thank You