



**Testimony presented on behalf of the**

**Appraisal Institute  
American Society of Appraisers  
American Society of Farm Managers and Rural Appraisers**

**Before the House Committee on Financial Services  
Subcommittee on Housing and Community Opportunity  
and the  
Subcommittee on Financial Institutions and Consumer Credit**

**On**

**"Legislative Solutions to Abusive Mortgage Lending Practices"**

**Presented by  
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Chief Executive Officer, Iowa Residential Appraisal Company  
West Des Moines, Iowa**

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Joint Testimony Presented by  
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On Behalf of the  
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Chairmen Ney and Bachus, Ranking Members Waters and Sanders and members of the Subcommittee on Housing and Community Opportunity and the Subcommittee on Financial Institutions and Consumer Credit, I am Alan E. Hummel, SRA, President and Chief Executive Officer of the Iowa Residential Appraisal Company in West Des Moines, Iowa. I am the Chair of the Appraisal Institute's national Government Relations Committee and Past President of the Appraisal Institute. I am pleased to be here today on behalf of the Appraisal Institute, American Society of Appraisers, and the American Society of Farm Managers and Rural Appraisers, three of the largest professional appraisal organizations in the United States, representing more than 25,000 real estate appraisers.

Thank you for the opportunity to testify before this joint subcommittee hearing on legislative solutions to abusive mortgage lending practices. There are two bills currently before this committee that answer many of the questions posed by the issue of mortgage fraud, The Responsible Lending Act, H.R. 1295, co-authored by Representatives Ney and Kanjorski and The Prohibit Predatory Lending Act, H.R. 1182, co-authored by Representatives Miller, Watt and Frank. We appreciate the work of both bill sponsors and cosponsors 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. At this point, only H.R. 1295 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.

Real estate generates nearly a third, or \$2.9 trillion, of the U.S. GDP. It creates jobs for over 9 million Americans. The appraiser is a vital independent service provider in mortgage transactions and their fee is not contingent upon whether the loan goes through or on the loan amount. Accordingly, through this independence, 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 under consideration.

Unfortunately, mortgage fraud exists, and in many of our communities it is rampant. The Federal Bureau of Investigation recently testified before this committee warning that “mortgage fraud is pervasive and growing.”<sup>1</sup> When mortgage fraud occurs, financial institutions often recover only a portion of a fraudulent loan and can be saddled with additional costs, such as brokers’ commissions and attorneys’ fees. 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, either because they were performed incompetently or, worse, fraudulently. For these reasons, 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.

Proposals addressing these issues are included in H.R. 1295, specifically in Title IV. I am happy to provide further explanation of our position below.

### **Inappropriate Pressure of Appraisers**

As an important impartial third party in a residential transaction, real estate appraisers play a critical role in helping both lenders and consumers make sound investment decisions when purchasing homes and mortgages. An unbiased appraisal is important to the lender because it helps determine the loan-to-value (LTV) ratio, and is typically a part of a bank’s risk management program. As with any investment, consumers typically should not pay (or borrow) more than the investment is worth, and the appraisal helps them determine the market value of this investment. It is in their best interest not to take out a mortgage that will cost more than a home is worth, as this is typically the largest investment they will ever make. Such a situation would place them “upside down” on their mortgage, meaning they owe more than the market value of the property, leaving them in a precarious situation.

Because artificially inflated appraisals may be used as comparable sales in future transactions, they have the potential to hurt not only the parties in the transaction but eventually the entire community. Despite

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<sup>1</sup> Statement of Chris Swecker, Assistant Director, Criminal Investigative Division, Federal Bureau of Investigation, before the House Financial Services Subcommittee on Housing and Community Opportunity, October 7, 2004.

this, it is common for mortgage brokers, lenders, realty agents and others with a vested interest to seek out inflated appraisals to facilitate transactions because it pays them to do so. Lenders typically do not loan 100 percent of the market value of a home but more often at a certain percentage (80 percent, for example). The LTV ratio determines how much a lender is willing to lend on a particular property, and the “value” component of the LTV is determined by the appraisal. It is common for negotiated contract prices to be greater than the market value of a property, particularly in an appreciating market, as we have seen in many areas of the country recently. It is also common for the LTV ratio to be higher than the lender's limit, meaning that the homebuyer and seller might have to renegotiate a contract price or face that contract being null and void. If the contract is voided, the broker and loan officer and others whose compensation is dependent upon the closing of the loan do not get paid.

Should the appraiser artificially increase the value of a home, the result may decrease the LTV to the point of allowing a lender to (artificially) feel more comfortable about making a loan and all compensation to be paid to the vested parties. It is at this point where many brokers, lenders and others turn the screws on appraisers. Brokers might ask an appraiser if a certain comparable sale was used in their appraisal report, or a loan officer might ask if the appraiser applied a proper adjustment. While there are legitimate questions to ask of appraisers, a line is crossed when a predetermined value is required of an appraiser or when future work for the appraiser is contingent upon this value being met, and coercion, threats and intimidation are used as a means to an end.

Appraisers will frequently explain to lenders that national appraisal practice standards and state and federal laws require appraisers to perform assignments ethically and competently and that they are open to discuss and resolve any concerns or issues.<sup>2</sup> If the appraiser is acting ethically, they should be reporting an opinion of the market value of the property, not whatever value is needed to close the loan. Too frequently, this dialogue spirals downward to involve coercive tactics and intimidation, amounting more or less to a threat that if the predetermined value is not met, future work will not be forthcoming. Some have gone so far as to threaten that the appraiser's reputation will be damaged with other financial institutions ordering appraisals.

Such practices are unacceptable in our view, yet they occur all too common. A recent survey of appraisers by an independent research organization showed that 55 percent of appraisers have felt pressure to overstate an appraisal, with a quarter of those saying it happens nearly half of the time<sup>3</sup>. This corresponds with anecdotal surveys taken by our organizations of our respective memberships.

Unfortunately, it is also true that some unethical appraisers give into this pressure out of fear of losing a client and a steady stream of income. We believe appraisers who give into such pressures should be disciplined by the appropriate regulatory authority (state appraisal board, federal financial institution regulator, etc). We also believe that it should be made clear that such practices by clients are inappropriate and strictly prohibited. H.R. 1295 does this by strictly prohibiting coercion of appraisers by interested third parties, making it clear that appraisers are to remain objective third parties in a

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<sup>2</sup> The Uniform Standards of Professional Appraisal Practice (USPAP) states: “An appraiser must not accept an assignment that includes the reporting of predetermined opinions and conclusions. An appraiser must not communicate assignment results in a misleading or fraudulent manner. An appraiser must not use or communicate a misleading or fraudulent report or knowingly permit an employee or other person to communicate a misleading or fraudulent report.”

<sup>3</sup> National Appraisal Survey, October Research Corporation, December 2003. [www.octoberresearch.com/ai\\_survey](http://www.octoberresearch.com/ai_survey).

transaction.

We read the Appraiser Independence provision of H.R. 1295 to authorize and empower the federal financial institution regulators to issue a regulation prohibiting various inappropriate practices against real estate appraisers. The new regulations would make clear that coercion, extortion, bribery and collusion (currently not addressed in the bill) by individuals pursuant to their appraisal duties is strictly prohibited. It would also define the specific sanctions against banks and other individuals involved with inappropriate conduct. As a regulation, this would have the force of law, which is absent from all current guidelines and statements issued on this subject to date.

The entire real estate industry can be a part of the solution to this problem as well, and should be encouraged to develop and articulate a best practices statement relative to the engagement of appraisers. We stand committed to work with Congress and our industry partners to achieve this goal.

### **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, sixteen years later, with a configuration that is, without question, extremely convoluted. (See Attachment One for a graphic depiction.)

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. 1295 that would grant the Appraisal Subcommittee authority to develop intermediate 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 2003 Annual Report of the Appraisal Subcommittee, 43 percent of the state appraisal regulatory agencies that were reviewed either failed to resolve complaints against real estate appraisers expeditiously or were inconsistent in applying disciplinary sanctions; failed to pursue all alleged violations of the Uniform Standards of Professional Appraisal Practice; or did not adequately document enforcement-related files. 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."<sup>4</sup>

The Government Accountability Office recently 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<sup>5</sup>. 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

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<sup>4</sup> John B. O'Donnell, "Real Estate Appraiser Faces Sentencing Pleading Guilty," *Baltimore Sun*, February 27, 2004.

<sup>5</sup> "Opportunities to Enhance Oversight of the Real Estate Appraisal Industry," Government Accountability Office, May, 2003.

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:

1. Granting the Appraisal Subcommittee the authority to establish and manage a grant program to state appraisal boards for the purpose of conducting enforcement activities;
2. 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.
3. Requiring the Appraisal Subcommittee to add "funding" as one criterion it looks at when monitoring a state program.

We encourage your committees 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. 1295 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.

#### **Mitigation: 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<sup>6</sup>.

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 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 that it was earned and 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. 1295 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.

## **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

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<sup>6</sup> "Appraisal Quality Post-FIRREA," *A Survey of the Appraisal Institute's 2000-2004 Client Advisory Committee Members*, March 21, 2004.

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. 1295 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.