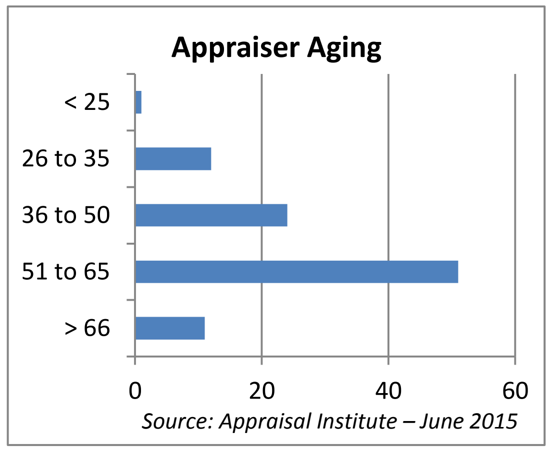
Strategic Information Resources

Compliance Toolkit

Solving the Looming Crisis in Real Estate Appraisal Services

An Aging Appraiser Population



Source: Appraisal Institute – June 2015

As the increasing age and retirement demographics of the baby boomer generation continue to materialize, the 78,500 member real estate appraisal profession is experiencing similar aging trends with 62% of the profession being at least 51 years of age or older. Given this trend, it should not be surprising that the appraisal industry has suffered annual declines of 3% in licensed populations and faces the risk of accelerating losses over the next 5-10 years as more professionals retire. The resulting 25% decline in the appraisal profession over the past decade has been compounded by an increasing average age of 53 years, a past decade of declining work volumes, undeserved blame for inflated values as leading to the housing collapse, new secondary market quality control demands and the constant drum beat of changing licensing burdens. These factors have combined to assault the appraisers' earning ability resulting in longtime professionals exiting the trade while the ranks of new trainees fall far short of the required replacement numbers just to stay even.

The ironic part of these negative trends is that now more than ever, the skill set and services of a professional appraiser for traditional first mortgage loans are growing in ever greater demand. Since the housing collapse, lenders and regulators have again recognized the real world value of an appraiser who personally conducts a property inspection and market analysis, then renders a detailed report with professional integrity. This traditional approach far outweighs any of the automated valuation models, data products and other short cuts that were in vogue and were thought to eventually threaten the appraisal profession's viability due to the low price and fast response they offered. Unfortunately, these fast alternatives – standing on their own - lacked the quality and accuracy of practiced appraisal professionals which ultimately manifested in high risk loans on marginal properties. This is not to say that there weren't some very bad actors in the appraisal profession that sought to maximize their income by providing unsupported, biased reports and, in the worst case, truly fraudulent values in the overheated housing frenzy. Just ask any REO portfolio manager who has distressed real estate assets which they cannot sell at any price due to neighborhood or abutter negative influences which were not accounted for in the heavy use of AVM models, appraisal waivers, unscrupulous appraisers and various forms of broker price opinions.

Choosing the Appraisal Profession

There was a day when many banks and lenders directly supported the appraisal profession by having internal employees or owning a subsidiary appraisal company. In these captive professional firms of 25-30 years ago, there was a culture of training and apprenticeship often times associated with chapters of the Appraisal Institute, the Society of Real Estate Appraisers or other state level real estate appraisal boards providing fundamental education tied to a well-defined career path and monthly professional industry networking events. Being hired into one of these corporate firms allowed the trainee to benefit from the daily training and influence of industry veterans as mentors which was critical to establishing one's individual success in the profession. Before appraiser licensing came about in the late 1980s, the mystery of how one became an established real estate appraiser respected by peers was very much like the apprenticeships of old where you had to know someone who would become your mentor in order to gain entry to the profession.

With the advent of licensing and certification, the pathway to a career in appraisal became clearer, but the profession lost much of the mentoring and apprentice training as the quick path to income for a newly licensed individual was to become fixated on completing the 1004 appraisal form for residential lenders. Lost along the way was the notion of appraisal as a much broader profession which relied on the passing generations for teaching, advising and growing professionally.

The Appraisal Foundation, as the industry's appointed professional standards organization, has been moving steadily towards raising the educational and experience bar for new entrants. At present, the four classes of professional qualification are Trainee, Licensed Residential, Certified Residential and Certified General Appraiser. The minimum education is an Associate's Degree for licensing and Bachelor's Degree for Certification. In addition a trainee needs 2500 hours (approximately two years) of supervised work credits to gain final licensing status. The difficulty of economically justifying the expense and distraction of supporting a trainee program coupled with the lending industry's bias against having trainees conduct any work has led to a dramatic fall off in new people entering the profession.

The prestige of one's mentors or being affiliated with a respected bank's professional development program no longer mattered as the production economics of the residential mortgage industry became the driving force and led to many of the influence abuses we saw a decade ago. Unfortunately, today the regulatory demands of the business make it generally undesirable, if not impractical to go back to the "old school" days when a national bank might invest in and own an appraisal firm because, under todays' regulations, having a financial interest in the "appraisal fee" as a non-shopped settlement service requires the lender to include the cost in the test for a QM (Qualified Mortgage) loan. Few lenders want the risk of appraisal and settlement fees paid to captive subsidiaries being the reason a loan becomes ineligible for sale to the secondary QM market.

Additional Regulatory Burden

Effective October 3, 2015, the TILA RESPA Integrated Disclosure (TRID) doubled down on the regulatory burden of the appraisal process by declaring the appraisal fee a "Zero-tolerance" fee meaning it cannot change from the initial "Closing Estimate" disclosure unless there are a limited number of factors giving rise to a "change in circumstance" which no lender wants to trigger.

Likewise, as an example of unintended consequences, what were originally viewed by the professional appraisal community as beneficial reforms (e.g. Home Value Code of Conduct, Appraiser Independence rules, Interagency Appraisal Guidelines, Customary & Reasonable Fees) resulted in the creation of Appraisal Management Companies. Now often viewed as unnecessary middlemen by lenders and appraisers alike.

In the same way regulatory changes have consequences for the appraisal profession, so too do the demands from the secondary mortgage market to escalate the quality control of loan originations. Following the lessons learned in the housing market struggles, quality control demands have been moved to pre-processing and pre-funding in the form of Collateral Underwriter. Collateral Underwriter (CU) was deployed by FNMA in January 2015. It essentially gathers and analyzes every data point on a1004/1073 appraisal report then renders a risk rated exception report critiquing the appraiser's work. The appraiser is then given the opportunity to explain the anomalies cited to the satisfaction of the lender before the loan can be approved for closing. While not a surprising development given the re-purchase demands many investors initiated following the housing collapse, the process does create an additional post-delivery review and defense burden on the appraiser for no additional compensation.

Finally, regarding future regulatory impact, the federal agencies governed by FIRREA released the final Appraisal Management Company regulations in May 2015 which require individual states to adopt AMC rules on or before August 2018 for federally related transactions. Within these regulations are new registration fees, annual compliance burdens and business process audit requirements designed to protect the integrity of the consumer experience in the loan origination process. In working with an AMC, the appraiser will need to be cognizant as to their standing because the rules will govern many forms of an AMC from a tech only model to a full service approach. In addition, there are accommodations for a Hybrid AMC (combination staff and 1099 contract affiliates) or a small Appraisal Firm (less than 25 appraisers in 2 or more states). All of these various business formats will be subject to individual state, IRS and national Consumer Financial Protection Bureau review.

Challenging Economics

What has also become quite apparent to many appraisers is that they are working harder, longer and paying for more education than ever before while earning the same or less income. Efficiencies of production are challenged by additional review demands from AMCs and questions prompted by Collateral Underwriter risk reviews. Whereas an appraiser may have been able to produce 8-10 reports per week a decade ago, today they are challenged to complete 5-6 in that same week's time. The added entry level educational costs of attaining an Associates or Bachelor's degree further challenges the career path. Lastly, the 2500 hours of trainee experience required for licensure is extremely difficult in a world where lenders are rightfully demanding the best people conduct their appraisal work, not the new trainees (despite Supervisory Appraiser inspection and oversight). Most AMCs that invest in supporting a trainee program do so at an economic loss and risk that the individual might leave at any point, but know the need to support the next generation of professionals is vital to their small business and critical to the lending industry.

Navigating the coming business complexity

What's a sole proprietor appraisal shop to do? The appraisal industry remains a largely cottage based business with few national or regional firms offering a staff employee model due to the seasonality of volumes and the costs of carrying fulltime benefits. With few employee options, the 1099 contractor status is most common and many firms are made up of a sole proprietor who manages a team of 1099 contractors. Given the pending FIRREA AMC rules and the emergence of Customary and Reasonable Fees under the Appraiser Independence Guidelines, this all too common 1099 AMC Independent Contractor model is highly questionable as a viable business entity unless the appraisers are being paid full Customary & Reasonable fees. Anything less than that such as unjustified "fee splitting" could be construed as violating C&R or, conversely, risk having the IRS declare the firm's 1099 Independent Contractors as employees due to the amount of control exerted, and therefore holding the business owner liable for employment taxes under the IRS independent contractor test.

Why preserving the appraisal profession matters

The recent financial crisis has exposed the failures of data driven valuation algorithms, desktop valuations and sight unseen collateral scores as substitutes for the traditional appraisal. If anything, the market facts have reinforced the need for a trained professional to visually inspect the home and neighborhood to assess the influences that will impact the property as collateral security for a loan. Supporting and training the next generation of appraisal professionals is vital to the housing industry which is the largest driver of long term economic wealth for consumers. At a time when other industries are leveraging technology for speed and improved client service experiences, the housing industry remains burdened with long closing cycles, tremendous paperwork, increasing regulatory costs and inconsistent service delivery. All stakeholders in the lending transaction need to recognize the path toward a healthy industry requires all players to be current in skills sets, professionally compensated and motivated to constantly improve. As AMCs and appraisal firms invest monetarily and professionally in training and educating new entrants to the appraisal profession to fill the worrisome service gap, we will need lenders, regulators and industry peers to assist, encourage and accommodate those educational and apprenticeship processes. Teaching the next generation of appraisers is not only an economic need and generational obligation, but should once again become the rewarding experience we all share in passing on our knowledge and contribution to a uniquely American housing industry that made our collective and personal success possible.

The Call to Action for responsible AMC's

For Strategic Information Resources, Inc. our goal as an AMC is to provide the kind of professional environment that fosters new entrants to the profession by sponsoring complete benefits including healthcare, 401K savings, internal training, professional education and daily mentoring. Our staff appraiser model is among the best in the industry for assuring compliance with all Appraisal Independence regulations, while providing professional growth opportunities and strong earnings. Our ability to manage large panels of 1099 contractors in a compliant Customary & Reasonable model which complements our growing employee staff provides the best options to the individual appraiser and the lender alike.

Despite the challenging demographic trends and potential turmoil in the macro appraisal profession, SIR is committed to investing in our professional, ever expanding appraisal services model focused on compliance and outstanding service. By doing so, SIR assures that its lender clients have a unique resource to rely on for valuation expertise, professional integrity, process efficiency, industry intelligence and excellent borrower experiences.

Related resources:

1. **Appraisal Institute: US Valuation Profession FACT SHEET - June 2015**
   http://www.appraisalinstitute.org/assets/1/7/AI_Fact_Sheet_US_Real_Estate_Valuation_Profession_Dec_31_2014.pdf

About the Author

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