

# A COMPREHENSIVE BLUEPRINT FOR RESIDENTIAL APPRAISAL REFORM

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# **A COMPREHENSIVE BLUEPRINT FOR RESIDENTIAL APPRAISAL REFORM**

**National Association of Home Builders**

**February, 2013**

## **Overview**

The current residential appraisal system is impaired due to inconsistent and conflicting standards and guidance; inadequate and uneven oversight and enforcement; a shortage of qualified and experienced residential appraisers; and, the absence of a robust and standardized data system. The National Association of Home Builders (NAHB)<sup>1</sup> believes these problems must be addressed in order to restore confidence in the residential real estate market and to establish a foundation for sustainable growth of the U.S. economy. This can only be accomplished through sound valuation practices, policy, and procedures that produce more credible valuations under all economic circumstances.

The National Association of Home Builders' *A Comprehensive Blueprint for Residential Appraisal Reform* contains the following recommendations:

- Streamline and coordinate the current regulatory framework and devote adequate resources to ensure effective oversight and enforcement.
- Create a real estate data superhighway with a national real property registry and supporting networks.
- Reaffirm and streamline the key residential appraisal principles contained in the Uniform Standards of Professional Appraisal Practice (USPAP).
- Establish uniform credentialing standards that are specific to each area of residential appraisal practice and create clear education and career paths for residential appraisers.
- Establish a single, consistent set of rules and guidelines for residential appraisals.
- Urge residential appraisers to consider all three valuation approaches—cost, income and sales comparison-- in estimating values, and ask them to report a range rather than a single point of value.
- Set standards and processes to ensure the engagement of the best residential appraiser for the assignment.
- Establish workable procedures for expedited appeals of inaccurate or faulty residential appraisals.

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<sup>1</sup> The National Association of Home Builders (NAHB) is a Washington D.C. – based trade association whose broad mission is to enhance the climate for housing, homeownership and the residential building industry. A federation of more than 800 state and local associations, NAHB represents more than 140,000 members nationwide.

# **A Comprehensive Blueprint for Residential Appraisal Reform**

## **Introduction**

The U.S. housing finance system is operating under unprecedented uncertainty. A multitude of legislative and regulatory measures have been launched in response to the severe dislocations in financial markets here and abroad that were the result of extreme excesses in the mortgage credit process. However, there has been little progress in pursuing comprehensive housing finance reform and the profusion of uncoordinated and sometimes conflicting piecemeal remedies has only intensified the housing market malaise.

At the center of this ongoing crisis in confidence is an appraisal system that remains dysfunctional and is a major impediment to reestablishing a vibrant and stable housing finance framework. NAHB believes that fundamental appraisal system reform must be a principal element of efforts to rebuild the nation's housing finance system.

In 2012, NAHB formed an Appraisal Working Group, consisting of home builders and representatives from the financial and appraisal sectors, to develop recommendations for comprehensive appraisal reform and produce a White Paper with specific recommendations. In this process, there was extensive dialogue with all stakeholders in the residential appraisal process.

The Appraisal Working Group addressed the need for reform in four areas:

- Regulatory Framework and Oversight
- Data & Technology
- Professional Standards
- Practice, Process and Procedures

## **I. Regulatory Framework**

### ***Current Environment***

The system for overseeing and regulating real estate valuations is inadequate and ineffective. The current regulatory structure was constructed in a piecemeal fashion. Coordination and accountability currently are lacking and there are major gaps in the system.

At the federal level, the Appraisal Subcommittee (ASC) of the Federal Financial Institutions Examination Council (FFIEC) oversees the appraiser regulatory programs established by the states; monitors the requirements addressing appraisal standards for federal financial institutions; maintains the National Registry of State certified and licensed appraisers and monitors and reviews operations of the Appraisal Foundation.

The Appraisal Foundation (TAF) is a private, non-profit entity which is charged with appointing members, providing financial support and oversight of the Appraisal Standards Board (ASB), the Appraisal Qualifications Board (AQB) and the recently formed Appraiser Practices Board (APB). The ASB develops, interprets and amends the Uniform Standards of Professional Appraisal Practice (USPAP). The AQB establishes the minimum education and examination requirements for real property appraisers to obtain a state certification. The APB offers voluntary guidance in topic areas that appraisers and users of appraisal services feel are most pressing.

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Oversight of appraiser qualifications and appraisal practices falls to the individual states, and many jurisdictions have inadequate resources to adequately perform this function. In some states, fees collected for appraiser licensing and certification are swept into a general fund and are not utilized in appraisal/appraiser oversight and enforcement.

FFIEC published Interagency Appraisal and Evaluation Guidelines (IAG) in December 2010, the first update since 1994. The IAG is a vast improvement from prior versions of safety and soundness guidance; however, stakeholders report that interpretations of the guidance vary from regulator to regulator. While it is a stated goal to have effective enforcement there is no evidence that consistent enforcement is actually occurring.

In January 2012, the Government Accountability Office (GAO) released a report, “Real Estate Appraisals – Appraisal Subcommittee Needs to Improve Monitoring Procedures.” The report identified several weaknesses that have limited the ASC’s effectiveness, including weak enforcement tools and reporting procedures; inadequate policies and procedures for monitoring appraisal requirements; no written policies to determine if TAF’s activities are consistent with the statutory mandates; and not fully addressing statutory requirements.

### ***Solutions***

#### **Reform the regulatory framework for real estate valuation to more effectively oversee standards, guidance and enforcement.**

The goal is to better integrate and streamline the jumble of existing entities to ensure the valuation of collateral in housing finance transactions occurs in a coordinated and effective manner. This would contribute to uniform and consistent standards and avoid the current multitude of conflicting and confusing requirements.

A more unified and functional system is required to:

- Establish ethics and uniform standards
- Promulgate best practices
- Monitor the activities of state appraisal boards
- Establish licensing and certification standards
- Set minimum education requirements
- Support independent education and training programs
- Create policies to ensure appraiser independence
- Enforce and oversee authority for anyone who engages an appraiser
- Establish a standards body responsible for setting data and technology standards

#### **Develop a new appraisal report that is understandable and useful to all interested parties in real estate transactions.**

Current appraisal reports were not designed to be read by those outside the lending institution that ordered the valuation and potentially create more confusion than clarity. A website should be established that would detail the appraisal process, practices and procedures. Information would be made available on how to read an appraisal, who is the client, the intended user and how to file a complaint against any or all parties to the transaction. A new appraisal report should be designed that considers the information needs of all interested parties in real estate transactions and that is simpler and easier to read.

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## **Improve the effectiveness of state appraisal oversight.**

States should retain primary responsibility for certifying and overseeing appraisers and the quality of their work. Enforcement actions against licensees should continue to occur at the state level. Federal policy should dictate that disciplinary actions are meted out in a consistent manner. States must have an independent appraisal board with funding from license activities and fines. Board chairpersons must be an appraiser. States should be prohibited from commingling appraisal license fees with general funds.

## **II. Data and Technology**

### ***Current Environment***

With the established fact that U.S. real estate is the largest asset class in the world, it is astounding that so little is known about it, especially in real time.

There are two considerations to creating a modern real estate data infrastructure. First, is the recordation of all real property. There needs to be a mandatory registry of all real property in the U.S. with a unique identifier. A single data standard needs to be established. This is essential for creating the real estate infrastructure on which to transact business. The technology exists through sophisticated Geographic Information Systems (GIS) based upon satellite imagery.

The second consideration to modernizing real estate information is the mortgage backed securities (MBS) markets. Beyond the registration of all of the “sticks and bricks” and the raw land beneath, data exchanges for real estate transactions must be created.

Appraisers generally obtain data from local Multiple Listing Services (MLS) and public record data verified through conversations with parties to the transaction. The verification of data and conversations are an important component of the analysis of the transaction. Motivations of buyers and sellers are difficult to ascertain otherwise. In recent years, MLS data has become less reliable. More recent efforts by Fannie Mae and Freddie Mac (the Enterprises) and their regulator, the Federal Housing Finance Agency (FHFA), to aggregate data have been criticized for not being an open universally accessible database.

### ***Solutions***

## **Develop and build a real estate data superhighway with a national real property registry and supporting networks.**

The development of a real estate superhighway would facilitate the safe and efficient transfer of real property. The proposed data system would include:

- **Terra.gov-** a national real property registry (terra.gov) with access by all stakeholders.
- **National Collateral Valuation Repository** - a valuation repository (NCVR).
- **Real Estate Exchange-** a public/private Real Estate Exchange (REX).
- **Standards-** The reformed regulatory system would be responsible for the establishment of standards for data, methodology and practice.

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Terra.gov would serve as the official record of the factual details of both the structure and the regulatory constraints on the land such as land use, land restrictions, zoning and easements, Homeowner Associations (HOA) and Condominium documents and so on. New Construction data would be a subset of the database. The database would incorporate green components in the data standards. Time stamped photographs, satellite images, floor plans, and other exhibits would remain permanent archives.

Stakeholders would be able to view all valuations and secondary market participants would have access with proper rights established. Access rights would be granted to any registered purchaser, securitizer or servicer.

### **The exchange should provide real time data and allow transparency to transactions.**

If these events were all recorded in a NCVR, a transparent view into national property values could be measured in real time. The real time aspect is vitally important and would replace today's imperfect house price indexes that measure a limited number of markets with at least a six month lag time. Mandatory reporting of all real estate transactions would be required of all jurisdictions. A National Property Identifier (NPID), once calculated, would be clear and remain globally unique.

### **Establish a not-for-profit Real Estate Exchange (REX) to serve industry participants.**

A Real Estate Exchange (REX) would be established as a not-for-profit data exchange consortium comprised of commercial and private data providers and sources to serve industry participants (e.g. builders, appraisers, lenders, etc.) by facilitating information exchange on both a commercial and contributed basis.

### **Promote technology and the use of Interactive Valuation Models.**

REX would promote the use of Interactive Valuation Models and other leading edge technologies to produce more credible appraisal reports, and build risk engines based upon the open exchange of information.

### **Establish universal standards.**

Data standards collaboration is a key vehicle to empower technology to the benefit of all stakeholders in and near the real estate industry. A standards body should be established with responsibility for setting the guidance for data and technology standards. This is to ensure that systems are adaptable and flexible to meet changing regulatory and market needs without allowing any single business entity to drive a universally applied business requirement that limits the flow of commerce.

### **Develop the science of collateral risk through academia and professional trade associations.**

The science of collateral risk needs to be developed through academia and professional trade associations.

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## **III. Professional Standards**

### ***Current Environment***

Central to professional standards is appraiser competency. The Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) mandated USPAP as the generally accepted appraisal standards and require USPAP compliance for appraisers in federally related transactions. Additionally, State Appraiser Certification and Licensing Boards; federal, state, and local agencies; appraisal services; and appraisal trade associations require compliance with USPAP.

The problem is many appraisers do not fully grasp USPAP and it has changed every two years since 2006. A key criticism of USPAP is that it is a complex document that often conflicts with practical application.

Appraiser career and educational paths are not clear and, according to the Appraisal Subcommittee, the number of credentialed appraisers is down significantly. Appraiser licensing and credentialing is another area of concern. At present the AQB sets minimum credential standards. Some states establish more stringent standards and are consequently not inclined to approve reciprocal licenses.

### ***Solutions***

A clear and simple road map of professional standards needs to be established. A path for attainment of requisite training and skills, education and credentials must be clear and practical.

**In establishing standards, the key principles in USPAP should be reaffirmed but the standards must be streamlined to be clear and readily understood.**

Appraisal standards should be broadly written and best practices developed for each area of practice that would clearly delineate minimum reporting requirements.

USPAP should be publicly available to all stakeholders. It is currently a copyrighted document. It should be available universally online free of charge in a searchable format, as well as in hard copy. The objective should be to clarify, simplify, and illuminate.

**Establish a clear education and career path, including mentorship programs, to become a licensed appraiser.**

Colleges and universities should offer programs that allow a student to graduate with a degree that satisfies the educational component for a licensed appraiser.

**Establish uniform credentialing standards that would be applied across all jurisdictions.**

Reciprocity should be automatic provided the appraiser license status is in good standing. An appropriate and standard background check should be required at time of application and renewed each year. Disciplinary actions imposed upon appraisers should be made available to any and all parties charged with engaging an appraiser.



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### **Create professional certification programs with education and examinations around each area of practice.**

There are areas of expertise in appraising that minimum licensing requirements do not address. In the area of new construction, appraisal guidelines should be developed that account for the presence of (or lack of) installed energy and water saving features, designed durability, or other attributes that financially impacts the present value of future costs of ownership

### **Establish a clear path to obtain a license with mandatory recertification.**

A clear path to obtain a license with mandatory recertification every five years would address the complaint that the current stock of appraisers is not well trained or well educated. A recertification program should be subject to continuing education, reexamination and peer review.

## **IV. Practices, Processes and Procedures**

### ***Current Environment***

For all intents and purposes, residential appraisers for mortgage transactions appraise by using Fannie Mae/Freddie Mac form reports. These forms have transformed appraisers into form fillers. The Enterprises' appraisal rules tend to short circuit the flexible application of USPAP standards.

In an attempt to achieve better quality appraisals lenders have created overlay rule sets that have exacerbated the problem. An example would be a requirement that the appraiser take a photo indicating that the lights are on in the subject property, the toilets flush and the water is on. This requirement has significantly impeded the appraisal process.

Technically speaking, little advancement has occurred around the appraisal process. Appraisal theory posits three approaches to value—Cost, Income and Sales Comparison. While not technically abandoned, both the Cost Approach and the Income Approach were diminished when the Enterprises dropped their requirements for any approach except the Sale Comparison Approach. Sole reliance on the Sale Comparison Approach to value contributed considerably to the real estate bubble. The practice of asking appraisers to produce a single point of value is also fundamentally flawed.

Many have argued that the definition of market value should be reexamined. The flaws in the definition went mostly unnoticed during stable economic times, but there remain problematic defects. The market value definition by itself is not a single point of failure. However, this definition resides in a regulatory vacuum, devoid of monitoring and with archaic appraisal practices that reinforce the reporting of sale price rather than market value.

### ***Solutions***

The experience with the housing boom and bust demonstrates what went wrong in the appraisal process and the need for reforms to appraisal practices, processes and procedures. Appraisal practices can be realigned with sound policy and clear guidance. Reforms must make a dramatic and immediate impact.

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### **Establishment of a single set of rules is paramount.**

Eliminate current impediments by removing the Enterprises' de facto appraisal authority. The reformed regulatory framework should develop a single set of appraisal rules accessible through a web portal with new reporting requirements, templates and guidance.

### **All three approaches to value—Cost, Income, and Sales Comparison Approach should be considered.**

All three approaches to value should be considered based on the scope and type of project. There also should be a re-examination of the definition of market value.

### **Produce a range of value with a most probable spot value and a confidence score.**

Appraisers should be asked to report a range of value. A single point of value could be estimated with a confidence score. Allowing the appraiser to report a range of value would promote independence.

### **Promote use of Interactive Valuation Models (IVM) that deploy the use of statistical analysis of large data sets.**

One of the advantages today provided by the Internet is access to large datasets, yet current appraisal practices dictate that appraisers report very limited data. IVMs would introduce the concept of large dataset analysis, when possible.

### **Set standards and processes to ensure the engagement of the best appraiser for the assignment.**

Rethink the role of the appraiser. Does the inspector need to be the same person as the appraiser and the analyst? Require appraisals to be ordered at the time of application, not near the end of the process.

### **Develop a workable process for appealing inaccurate or faulty appraisals.**

It is extremely important to establish a timely dispute resolution process that is fair, balanced and appropriate to allow borrowers to appeal appraisals that do not meet USPAP standards or are based on inaccurate data or assumptions.

## **Conclusion**

Today's residential appraisal system remains in a state of uncertainty. The current patchwork system cannot continue indefinitely. A key consideration must be to establish stability and restore confidence in the system that determines the value of mortgage collateral.

NAHB remains committed to residential appraisal reform and looks forward to working with industry stakeholders to address the problems and implement solutions to the current U.S. residential appraisal system.

## **A Comprehensive Blueprint for Residential Appraisal Reform**

NAHB wishes to thank the members of NAHB's Appraisal Working Group and select members of the Collateral Risk Network (CRN)<sup>2</sup> for their contributions to the development of this paper, especially Joan Trice.

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<sup>2</sup> The Collateral Risk Network (CRN) is a group of dedicated chief appraisers, collateral risk managers, regulators, and valuation experts who are focused on resolving the many challenges facing the appraisal profession. [www.collateralrisknetwork.com](http://www.collateralrisknetwork.com)



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