Demise of the Bank Appraisal Industry and the Rise of AMCs

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A 25-year flow chart of the slippery slope
(a work in progress)

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How the appraiser fits into the mortgage lending process.

Appraisal Fee Paid by Consumer at time of Mortgage Application

Appraiser receives 100%

pre-1989

Appraiser engaged directly by lender's appraisal department, interacting with experienced valuation experts.

Appraisal societies and organizations promoted standards and sharing of information for the public good.

1989

FIRREA (Financial Institutions Reform, Recovery, and Enforcement): Federal appraisal licensing created that was administered on a state level after S&L Crisis. The crisis was caused by deregulation and reduction of capital requirements.

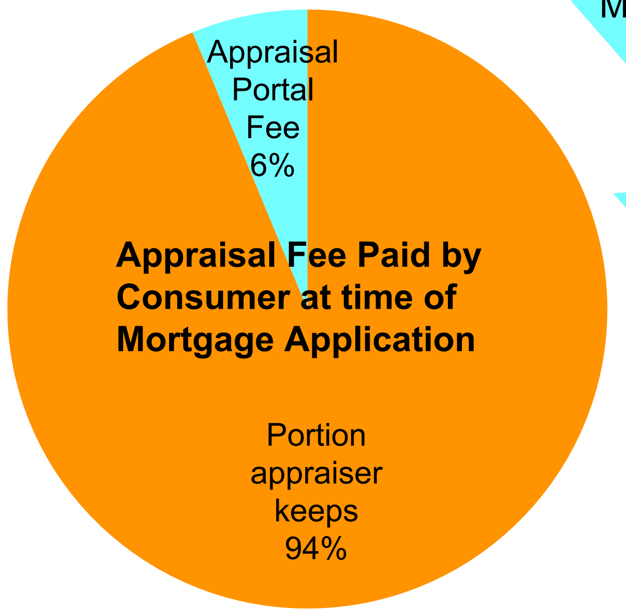
Appraisal trade groups missed the coming wave of licensing which effectively killed the need for trade groups - although licensing degraded competency of industry by creating a "false-positive" effect.

Funds designated for appraisal oversight moved to other areas of government to fill budget shortfalls.

1999

Introduction of portals to deliver reports. Interactive platform for banks and appraisers, signifies beginning of end of trust-building relationships on valuation competency.

2000



2001

Mortgage rates fall.

Concerns about risk steadily erode.

2003

Credit *aka* Housing Boom, systemic breakdown, risk perception evaporates. Lenders and mortgage brokers view appraiser as "deal enabler."

The nexus between fear and greed goes all full-on greed.

2004

"Greater Fool Theory" is in full swing as housing prices ramp up and sales volume drops and affordability falls.

Lenders continued to reduce mortgage underwriting standards to keep mortgage pipeline full. Concerns about risk evaporated. Appraisals reduced to a form for the file and no longer a tool for risk assessment.

2005

Banks start to close in-house appraisal departments as "cost centers" removing most institutional valuation expertise. Mortgage brokers brought in majority (about 2/3) of residential mortgages to banks who also ordered appraisals used to estimate value of collateral for bank and only got paid if the mortgage closed. Banks saw or ignored the obvious conflict of interest.

2006

U.S. housing prices peak and banks begin to become risk averse. Foreclosure volume begins to ramp up.

Limited, if any, in-house lender valuation expertise remains.

Appraisal management companies (AMCs), long a bit player in bank appraisal industry, begin to see more volume, marketing their

2007

New Century Financial, the largest subprime lender, goes bankrupt.

American Home Mortgage, a top ten lender, goes bankrupt.

Two Bear Stearns Mortgage Hedge Funds collapse.

Countrywide, the largest U.S.mortgage lender, begins to collapse. They owned Landsafe, the largest U.S. AMC - largely created to enable the bank to "control" the appraisal mortgage process.

Home sales volume collapses.

The then New York State Attorney General Cuomo begins to investigate collusion between mortgage brokers and appraisers as banks remained indifferent to the conflict of interest.

Cuomo opted to "follow the mortgage" which leads to Fannie Mae, making it a national issue.

Home Valuation Code of Conduct (HVCC) is the result of an agreement with FNMA - no national appraisal organizations were believed to have provided input to the initial agreement.

2008

Bear Stearns Collapses

Lehman Bros Collapses

AIG bailed out.

Fannie Mae and Freddie Mac bailed out and placed in federal government conservatorships.

2009

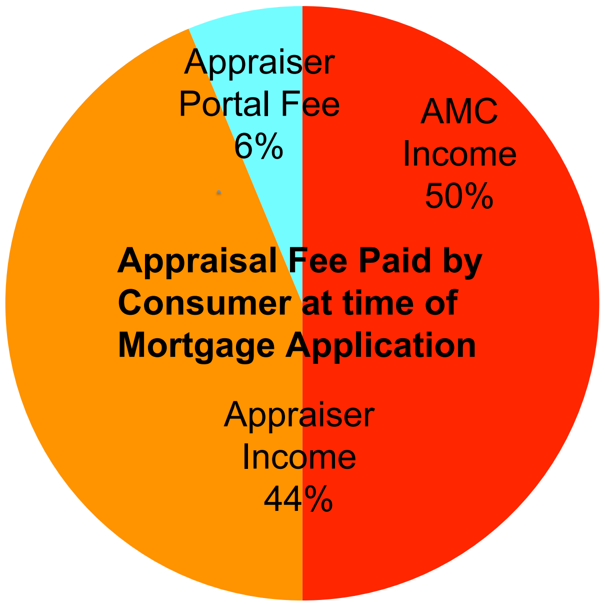
May 1, 2009:

HVCC goes live and the AMC ("institutional middleman") industry soon thrives, growing from an estimated market share of 10% to >80% of bank appraisal volume flows.

Cuomo has now opened Pandora's box, unintentionally destroying bank appraisal quality.

Appraisers begin to interact with AMC clerical staff that have little or no valuation experience.

AMCs only "value add" is perceived cost savings to valuation process. Their only revenue upside will come out of appraiser's share of appraisal fee.



2010

HVCC sunsets, but fully emebbed in regulatory policy across all bank regulators.

Federal regulators send a reminder that mortgage lenders were to use appraisers with "local market knowledge." AMC trade group claims no deterioration in appraisal quality after taking half of appraisal fee from appraiser. New AMCs flood into market.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 carries HVCC torch. Ironically both U.S. senators on title of act were early champions of deregulation that allowed Wall Street to play in the mortgage sandbox. One was actually part of the "Friends of Angelo" program where Countrywide gave preferential treatment to politicians.

2011

"Competent" appraisers continue to be driven out of industry from 50% pay cut. No real protection or effort by appraisal trade groups or government agencies to ensure reliable values applied to federally insured collateral.

In-house staff appraisers are generally given simple assignments and outside appraisers are given more complex assignments at half the market rate. However in-house staff are often paid less than fee appraisers but are drawn to benefit packages.

Bank reviewer "backlash" begins to emerge as senior valuation executives begin to hire "competent" non-AMC appraisers to review generally poor AMC product. The hope is to sell the idea to upper management of the growing risk of incompetent valuations. Many banking executives still believe that they are required by Dodd-Frank to use AMCs.

2013

Housing market sales volume and prices expand.

Independent exerienced appraisers continue to leave the business and the average age of appraisers continues to skew higher. Because of the collapse of revenues, experienced appraisers are no longer able to "mentor" new staff.

As appraisal quality erodes, AMCs begin to heavily tout use of sophisticated analytics to control for quality. The reality is that quality is so poor that analytics are needed to help manage a poor product.

2015

AMC status quo continues. No action by financial regulators of institutions to change AMC system to provide a reliable valuation benchmark for the collateral of federally insured mortgages.

AMCs and federal regulators view higher licensing standards as replacement for experience and continue to use '03-'08 housing bubble as reason to maintain status quo even though appraisal quality was far better before 1991 licensing.

Wish List

Banks need to have more liability for mortgages sold outside their portfolio and given little if any hope of a bailout if they fail to properly assess the risk of their mortgage portfolios.

AMC appraisal services should no longer be permitted for mortgages without significant bank-side infrastructure to provide expertise and oversight that does not currently exist.

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Licensing and classroom hours have little to do with experience. Disable the instutional (banking and regulatory) machine that wants to mandate appraisal expertise when market forces are what is preventing it from being nurtured.

Market forces *aka* "common and customary fees" should be used (rather than paid lip service) to determine AMC appraisal fees, an industry that is a monopoly and dominates an appraisal industry comprised of 1-2 person shops.

Perhaps one day bank regulators, banks and consumers will understand that appraisal expertise is not a commodity but rather a professional service. Until then, experienced and competent appraisers are more likely to avoid the bank appraisal process, especially through AMC channels.