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Issues in Appraisal Regulation: The Cracks in the Foundation of the Mortgage Lending Process

J. Kevin Murray

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ISSUES IN APPRAISAL REGULATION: THE CRACKS IN THE FOUNDATION OF THE MORTGAGE LENDING PROCESS

*J. Kevin Murray**

Although inflated appraisals played a key role in each of the last two major national financial crises, regulators have been unable to ensure appraisal accuracy. As a result, self-interested parties to loan transactions can coerce appraisers to inflate appraisal values for nothing more than the promise of future business. What's more, the complex and convoluted appraisal regulatory system is powerless to detect and prevent such inappropriate conduct. As Congress once again examines the financial industry and explores meaningful reform, it is imperative that self-interested parties be removed from the appraiser-selection process and appraisal regulatory responsibilities be consolidated at the federal level.

* J.D. Candidate, May 2010, Loyola Law School Los Angeles; B.S. Biology, United States Air Force Academy, May 2002. I would like to extend my deepest thanks to Lauren E. Willis, Professor of Law at Loyola Law School Los Angeles, Josh Rosenberg, Julien Kern, and Elena DeCoste Grieco. Their guidance and support made this Article possible. I would also like to thank all the staffers and editors of *Loyola of Los Angeles Law Review* for their tireless efforts and patience in preparing this Article for publication.

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I. INTRODUCTION

During the savings and loan crisis of the 1980s, inaccurate real estate appraisals played a significant role in the collapse of hundreds of financial institutions and the loss of billions of dollars.¹ Banks and lending institutions relied upon inflated appraisals in providing large loans that were not fully secured by actual collateral values.² In 1985, the portfolios of more than eight hundred federally insured lending institutions contained under-secured loans supported by real estate appraisals that overvalued collateral properties by an aggregate of \$3 billion.³ When borrowers defaulted on these loans, lending institutions were unable to recoup loan balances that exceeded collateral values.⁴ Consequently, many of these institutions were severely weakened or declared insolvent.⁵

In the wake of the savings and loan crisis, Congress conducted an extensive examination of the appraisal industry.⁶ The examination revealed a number of factors that contributed to the inaccuracy of real estate appraisals.⁷ One factor of particular concern was the frequency with which appraisers submitted to pressure exerted by parties involved in the loan-origination process.⁸ In exchange for explicit or implicit promises of future business, many appraisers supplied predetermined values rather than independent and accurate opinions of market value.⁹ Such misconduct often went unchecked within the fragmented structure of the real estate appraisal industry.¹⁰ Because individual participants in the appraisal industry maintained policies and procedures independent of one another, appraisal regulation was fragmented and inconsistent.¹¹ The inability or unwillingness of real estate industry participants to cooperate with one another inhibited the detection and discipline of dishonest and

1. H.R. REP. NO. 99-891, at 4 (1986).

2. *Id.*

3. *Id.*

4. *Id.* at 4-7.

5. *Id.* at 1-2, 4.

6. *Id.* at 1-2.

7. *Id.* at 7-12.

8. *Id.* at 8, 41-42; Vernon Martin III, *Appraisal Fraud and How It Works*, 108 BANKING L.J. 144, 145-46 (1991).

9. H.R. REP. NO. 99-891, at 8, 41-42; see Martin, *supra* note 8, at 145-46.

10. See H.R. REP. NO. 99-891, at 8, 42-44.

11. *Id.* at 42-44.

incompetent appraisers.¹² Under those circumstances, appraisers could generate inaccurate appraisals without fear of retribution.¹³ Consequently, appraisal inaccuracy became so pervasive that Congress declared it a “serious national problem” requiring broad corrective measures.¹⁴

Congress responded with legislation.¹⁵ Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (“Title XI”)¹⁶ was created specifically to promote the accuracy and reliability of appraisals used in connection with federally related¹⁷ transactions.¹⁸ In an effort to prevent appraisal inaccuracies resulting from pressure exerted upon appraisers by third parties, Congress included a provision in Title XI mandating that all appraisals be independently and impartially prepared.¹⁹ Additionally, in an attempt to ensure effective regulation of the appraisal industry under Title XI, Congress created a complex regulatory system within which regulatory responsibilities are distributed among federal, state, and private agencies.²⁰

In spite of the passage of Title XI, inaccurate appraisals remain problematic. During the past decade, inflated appraisals were commonly used to support loans that were packaged as mortgage-backed securities and sold to investors on the secondary market.

12. *Id.*

13. *Id.* at 43.

14. *Id.* at 4.

15. U.S. GEN. ACCOUNTING OFFICE, GAO-04-580T, REGULATORY PROGRAMS: OPPORTUNITIES TO ENHANCE OVERSIGHT OF THE REAL ESTATE APPRAISAL INDUSTRY I (2004); see Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, §§ 1101–22, 103 Stat. 183, 511–19 (codified as amended at 12 U.S.C. §§ 3331–3352 (2006)).

16. Financial Institutions Reform, Recovery, and Enforcement Act §§ 1101–22.

17. 12 U.S.C. § 3350(4) (“The term ‘federally related transaction’ means any real estate-related financial transaction which—(A) a federal financial institutions regulatory agency or the Resolution Trust Corporation engages in, contracts for, or regulates; and (B) requires the services of an appraiser.”).

18. *Id.* § 3331 (“The purpose of [Title XI] is to provide that Federal financial and public policy interests in real estate related transactions will be protected by requiring that real estate appraisals utilized in connection with federally related transactions are performed in writing, in accordance with uniform standards, by individuals whose competency has been demonstrated and whose professional conduct will be subject to effective supervision.”).

19. *Id.* § 3350(10) (defining a written appraisal as “a written statement . . . that is independently and impartially prepared”).

20. See *id.* §§ 3331–3352; see generally Cherokee W. Wooley, *Regulation of Real Estate Appraisers and Appraisals: The Effects of FIRREA*, 43 EMORY L.J. 357, 358–59 (1994) (outlining the distribution of regulatory responsibilities under Title XI).

These inflated appraisals fueled rapid and unsustainable growth in the housing market.²¹ When the market crashed in 2006 and housing prices fell, the consequences of inflated appraisals became painfully apparent.²² At present, mortgage balances exceed home values by an estimated \$745 billion.²³ Moreover, new research suggests that when home values fall below 75 percent of the amounts owed on mortgages, many homeowners walk away.²⁴ With the values of 4.5 million homes currently below this critical threshold, desperate homeowners are defaulting on their mortgages at an increased rate, leaving financial institutions and investors to absorb enormous losses.²⁵ Indeed, a number of established financial institutions have either declared bankruptcy or been severely weakened.²⁶

In the aftermath of the current home mortgage crisis, mortgage-industry participants and regulators have initiated a dialogue to identify the sources and causes of the crisis.²⁷ Once again inaccurate appraisals are receiving considerable attention.²⁸ Appraisers, lenders, brokers, agents, and regulators all agree that loan origination parties extensively pressured appraisers²⁹ to deliver appraisal values necessary to close transactions.³⁰ Industry participants and regulators also agree that appraisal inflation became pervasive under the inconsistent and fragmented regulatory system of Title XI.³¹

21. David Schmudde, *Responding to the Subprime Mess: The New Regulatory Landscape*, 14 FORDHAM J. CORP. & FIN. L. 709, 725 (2009).

22. See *id.* at 709–10, 741–43.

23. David Streitfeld, *No Help in Sight, More Homeowners Walk Away*, N.Y. TIMES, Feb. 3, 2010, at A1; see also Schmudde, *supra* note 21, at 742.

24. Streitfeld, *supra* note 23.

25. Andrew J. Ceresney et al., *Regulatory Investigations and the Credit Crisis: The Search for Villains*, 46 AM. CRIM. L. REV. 225, 227–28 (2009).

26. *Id.*

27. See, e.g., *Strengthening Oversight and Preventing Fraud in FHA and Other HUD Programs: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Financial Servs.*, 111th Cong. 5–7 (2009) [hereinafter *Strengthening*] (statement of Kenneth M. Donohue, Sr., Inspector Gen., U.S. Department of Housing and Urban Development).

28. See, e.g., *id.*

29. For the purposes of this Article, the term “loan origination party” refers to participants involved in the origination of new loans and the refinancing of existing loans.

30. Schmudde, *supra* note 21, at 742.

31. See, e.g., *The Real Estate Appraisal Industry: Hearing on Certain Private Entities as Outlined in Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, That Establish Uniform Rules for Real Estate Appraisals and Set Minimum Criteria for Certifying Appraisers Before the Subcomm. on Housing and Transportation of the S. Comm. on Banking*,

Appraisal standards were not adequately enforced in the absence of effective federal oversight.³² As a result, appraisers who overvalued properties were able to navigate loopholes and exploit inefficiencies without repercussions.³³

The similarities between the savings and loan crisis and the current home mortgage crisis are troubling. Inaccurate appraisals played identical roles in both crises, demonstrating the systemic and recurring nature of the problem. Although well-intentioned, the Title XI regulatory system failed to ensure the accuracy and reliability of appraisals. As such, appraisal inaccuracy will inevitably continue to cause devastating financial consequences unless broad and decisive corrective measures are taken. In order to prevent such future harm, appraisals must be insulated from pressure exerted by self-interested loan origination parties, and appraisal regulatory responsibilities must be consolidated at the federal level. Given the importance of accurate and reliable appraisals, such action is long overdue.

This Article addresses circumstances within the mortgage and appraisal industries that facilitate the production of inaccurate appraisals. Part II examines the nature and importance of appraisals, and it outlines some of the ways in which they are manipulated. Part III discusses conflicts of interest in the loan origination process and proposes a means of eliminating the influence of those interests on appraisals. Part IV examines deficiencies in the appraisal regulatory structure under Title XI and proposes consolidation of regulatory responsibilities at the federal level. Part V concludes that appraisal procedures and regulations must be drastically reformed to avoid another real property bubble and ensuing financial crisis.

Housing, and Urban Affairs, 108th Cong. 92 (2004) (statement of the National Association of Realtors).

32. See *Legislative Solutions to Abusive Mortgage Lending Practices: Joint Hearing Before the Subcomm. on Housing and Community Opportunity and the Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial Servs.*, 109th Cong. 200–02 (2005) [hereinafter *Legislative Solutions*] (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company).

33. See *id.* at 201.

II. THE ROLE OF APPRAISALS IN REAL ESTATE FINANCE

When appraisers overvalue homes in response to pressure, key mortgage industry participants are exposed to increased risk.³⁴ When inflated appraisals are used to support home mortgages, borrowers are saddled with debts that exceed home values.³⁵ If borrowers are unable or unwilling to repay these excessive mortgages, lenders, secondary market investors, and federal mortgage insurers suffer substantial financial losses when actual home values cannot cover outstanding mortgage balances.³⁶ As such losses mount, major financial institutions collapse, and federal financial resources are severely jeopardized.³⁷

A. *The Typical Home Mortgage Transaction*

To better understand the critical function of appraisals in the context of real estate finance, it is helpful to consider two typical home mortgage transactions. At the outset of a home sale, a buyer and seller agree on the price of a home and the buyer approaches a mortgage broker or proceeds directly to a lender to obtain a mortgage to finance the purchase of the home. Alternatively, a homeowner wishing to access home equity might obtain a home equity loan or access cash through refinancing an existing mortgage. In either case, the lender considers the borrower's creditworthiness and the value of the home in assessing the soundness of the requested mortgage or refinance. The borrower promises to make periodic payments on the loan and gives the lender a lien on the home as collateral to secure the mortgage. In the event that the borrower defaults, the lender relies upon the value of the home to recover the outstanding balance.

To ensure its recovery of the outstanding mortgage balance, the lender typically lends only a percentage—typically 80 percent—of the market value of the home.³⁸ This is the maximum amount that

34. *Id.* at 197–98; *Strengthening*, *supra* note 27, at 67–68 (statement of Kevin K. Nunnink, Chairman, IRR-Residential, LLC, and Chairman, Integra Realty Resources).

35. *Legislative Solutions*, *supra* note 32, at 198 (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company).

36. *See Strengthening*, *supra* note 27, at 67 (testimony of Kevin K. Nunnink, Chairman, IRR-Residential, LLC, and Chairman, Integra Realty Resources); Schmutde, *supra* note 21, at 742.

37. *See supra* Part I.

38. *Legislative Solutions*, *supra* note 32, at 199 (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company); Schmutde, *supra* note 21, at 742

can be extended while reasonably ensuring the lender's ability to recoup the outstanding loan balance through a foreclosure sale in the event of default.³⁹ Accordingly, the lender seeks an appraiser to determine the market value of the home. If the requested loan amount is within the maximum percentage of the appraised market value, the lender will likely approve the loan.

After extending the loan, the lender can sell the loan to government-sponsored entities (GSEs), such as Fannie Mae and Freddie Mac.⁴⁰ The GSEs use mortgages to create mortgage-backed securities to sell to investors on the secondary market.⁴¹ In such transactions, investors indirectly rely on appraisals in evaluating the quality of the loans supporting the securities they purchase.⁴²

B. The Appraisal Preparation Process

In preparing real estate appraisals, appraisers must collect, verify, and analyze all information necessary to develop and support credible opinions of value. To aid in this task, appraisers employ one or more of three valuation approaches, depending on the type of property being appraised; these consist of the sales comparison approach,⁴³ the cost approach, and the income capitalization approach.⁴⁴ For residential property appraisals, appraisers most commonly use the sales comparison approach.⁴⁵ Under the sales comparison approach, the appraiser deems a property to have approximately the same value as similar properties in the area,⁴⁶ which are commonly referred to as "comparables."⁴⁷ An appraiser

("The industry standard has been that the maximum amount of a mortgage given on a specific property should not exceed 80% of the appraised value.").

39. See Schmutde, *supra* note 21, at 742.

40. See *id.* at 737-38.

41. *Id.*

42. See Wooley, *supra* note 20, at 361.

43. This is also referred to as the "market data approach." See WILLIAM L. VENTOLO, JR. & MARTHA R. WILLIAMS, *FUNDAMENTALS OF REAL ESTATE APPRAISAL* 68 (1975).

44. See Schmutde, *supra* note 21, at 741 n.114; Jason S. Kirwan, *Appraising a Presumption: A Modern Look at the Doctrine of Specific Performance in Real Estate Contracts*, 47 WM. & MARY L. REV. 697, 712-16 (2005).

45. U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 4; see VENTOLO & WILLIAMS, *supra* note 43, at 67.

46. UNIF. STANDARDS OF PROF'L APPRAISAL PRACTICE R. 1-4 (Appraisal Standards Bd. 2008).

47. See, e.g., *id.*; VENTOLO & WILLIAMS, *supra* note 43, at 77.

using the sales comparison approach must first identify recently sold comparables.⁴⁸ The sale prices of these comparables establish a baseline value for the property.⁴⁹ The appraiser then adjusts this baseline value to reflect the value of any major differences⁵⁰ between the comparables and the property being appraised.⁵¹ The resulting figure serves as the preliminary appraisal value.⁵²

In addition to using comparable sales data, appraisers must identify and analyze any other variables affecting the property's market value.⁵³ For example, an appraiser might consider the effects of existing or reasonably probable land-use regulations or trends in the local real estate market.⁵⁴ These variables, which are often dynamic and ambiguous, can be difficult to quantify. As such, an appraiser must make assumptions that are supported by available information.⁵⁵ For example, an appraiser evaluating a property subject to a potential zoning ordinance would need to make assumptions regarding both the likelihood of the ordinance's enactment and of the effect of the ordinance on the property's market value.⁵⁶ After carefully analyzing comparable sales data and adjusting for other relevant variables, the appraiser should arrive at a figure that accurately reflects the market value of the appraised property.

C. *The Subjective Nature of Appraisals*

Although appraisers use methods such as the sales comparison approach to enhance objectivity and accuracy, appraising is an imperfect science. The accuracy of any appraisal is subject to a number of variables, including the availability and reliability of information.⁵⁷ The potential for inaccuracy in the preparation of real estate appraisals is especially evident in the sales comparison

48. See VENTOLO & WILLIAMS, *supra* note 43, at 77.

49. *See id.*

50. *See id.*

51. *See id.*

52. *See id.*

53. UNIF. STANDARDS OF PROF'L APPRAISAL PRACTICE R. 1-4 (Appraisal Standards Bd. 2008).

54. *Id.* R. 1-3(a).

55. *Id.* R. 1-2(f).

56. *See id.* R. 1-3(a).

57. *See* Wooley, *supra* note 20, at 362.

approach, where the selection and adjustment of comparables provide baseline values for the final appraisal. The utility of this approach is constrained by the availability of comparable sales data.⁵⁸ If no recent comparable sales data is available, appraisers cannot use the approach.⁵⁹ Furthermore, even where adequate comparable sales data is available, the data may not be reliable.⁶⁰ For example, if the sale of a comparable is not a valid arm's length transaction, the sale price will not reflect the true market value of the property.⁶¹ An appraisal based on such a transaction will not accurately indicate the property's market value. Consequently, where information is limited or unreliable, even appraisals prepared by the most competent and conscientious appraisers are prone to inaccuracy.

In addition to limitations in the availability and reliability of information, the competency and judgment of individual appraisers can also affect the accuracy of real estate appraisals. Within the sales comparison approach, the selection of comparable property sales and the evaluation of adjustment features are products of each appraiser's knowledge, experience, and discretion in assessing similarity and value. As such, an appraiser's subjective evaluations can directly influence the final determination of a property's value. For example, two independent appraisers evaluating the same piece of property might choose different comparables. Alternatively, even if the two appraisers were to choose the same set of comparables, each might estimate different adjustment values or identify different adjustment features altogether. In either case, the appraisers would likely arrive at different final appraisal values, one or both of which would necessarily be inaccurate.⁶²

Given the extensive subjectivity and ambiguity inherent in the appraisal process, there is an abundance of legitimate reasons for inaccuracy in real estate appraisals. Because an appraisal is an opinion of value, often based on imperfect information and undefined variables, perfect accuracy cannot be expected. A margin of error must be assumed. As such, an inaccurate appraisal based on

58. *See id.*

59. *See id.*

60. *See id.*

61. *See id.*

62. Theoretically, there can be only one true market value.

erroneous but good-faith assumptions can nonetheless be valid as an opinion of value. However, a problem arises when appraisers intentionally exploit the subjectivity and ambiguity in the appraisal process to reach predetermined values. Such misconduct corrupts the valuation function of appraisals and can have severe consequences for those who rely on them.⁶³

Unfortunately, unscrupulous appraisers can manipulate the subjective appraisal process in a number of ways to reach predetermined values. An appraiser wishing to inflate an appraisal can exaggerate the size or condition of a property.⁶⁴ For example, an appraiser might misrepresent an unfinished basement as a habitable space and overvalue the home accordingly.⁶⁵ Additionally, appraisers often overlook deferred maintenance or defective construction.⁶⁶ In the Poconos area of Pennsylvania, appraisers ignored the deficient construction of hundreds of homes in order to satisfy the developers who hired them.⁶⁷ Accordingly, buyers who could not detect the faulty construction relied on inflated appraisals in purchasing homes at prices that seemed reasonable compared to those in nearby New York City.⁶⁸ Later, when the borrowers tried to sell or refinance their homes, they discovered that the difference between the prices they paid and their homes' market values was as much as \$80,000.⁶⁹ Since 1995, one in five mortgaged homes in the area—nearly 6,000 in total—has been foreclosed on.⁷⁰

Appraisals can also be manipulated in more subtle ways. As previously discussed, an appraiser can intentionally make poor assumptions about unavailable or incomplete information relevant to

63. See *supra* Part I.

64. See Martin, *supra* note 8, at 154.

65. *Id.*

66. See *id.* at 154–55.

67. See *Broken Dreams in the Poconos: The Response of the Secondary Markets and Implications for Federal Legislation: Hearing Before the Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises of the H. Comm. on Financial Servs.*, 108th Cong. 200–01 (2004) [hereinafter *Poconos*] (statement of Gary P. Taylor, President, Appraisal Institute).

68. Debbie Nathan, *Buying a Piece of Hell*, CITY LIMITS, Oct. 15, 2003, http://www.citylimits.org/news/article.cfm?article_id=2978.

69. See *id.*

70. See *Poconos*, *supra* note 67, at 200 (statement of Gary P. Taylor, President, Appraisal Institute).

property valuation.⁷¹ For instance, an appraiser might assume that a property will be subject to favorable re-zoning or high market demand, either of which would increase the property's market value.⁷² Alternatively, an appraiser could select comparables dissimilar to a property being appraised.⁷³ During an economic downturn in Denver, Colorado in the early 2000s, appraisers used outdated comparable sales data to support high appraisal values.⁷⁴ Although actual home values declined as a result of the troubled economy, appraisers justified inflated appraisals with comparable sales data from a more prosperous period.⁷⁵ As a result, appraisers artificially propped up the Denver real estate market at an unsustainable level for a full year, during which many homebuyers purchased overvalued homes.⁷⁶ Although such misconduct is subtle, the resulting harm is severe.

III. CONFLICTS OF INTEREST PROMOTE APPRAISAL INFLATION

Although accurate appraisals are critical to the health of the home mortgage industry, parties involved in the mortgage-origination process often compromise the independence of appraisers and corrupt the accuracy of appraisals.⁷⁷ Under traditional underwriting principles, the appraisal is a crucial factor in determining whether parties can complete loan transactions.⁷⁸ As such, the parties have conflicting interests in obtaining appraisals that "hit the numbers" needed to complete transactions.⁷⁹ In pursuit of these incentives, many loan-origination parties pressure appraisers to deliver the predetermined values required to close transactions.⁸⁰ As

71. See Martin, *supra* note 8, at 152.

72. See *id.*

73. See *id.* at 155–56.

74. See DAVID CALLAHAN, DEMOS, HOME INSECURITY: HOW WIDESPREAD APPRAISAL FRAUD PUTS HOMEOWNERS AT RISK 6 (2004).

75. See *id.*

76. See *id.*

77. See Martin, *supra* note 8, at 145–46.

78. *Legislative Solutions*, *supra* note 32, at 198–99 (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company).

79. See *id.*; H.R. REP. NO. 99-891, at 8 (1986).

80. See *Legislative Solutions*, *supra* note 32, at 198–99 (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company); H.R. REP. NO. 99-891, at 8.

appraisers succumb to this pressure at an alarming rate,⁸¹ it seems that regulations intended to maintain appraiser independence and appraisal accuracy are ineffective. Consequently, if independent and accurate appraisals are to safeguard financial interests in mortgage transactions, appraisal regulation must be reformed to remove interested parties from positions of influence over appraisers.

A. *Self-Interested Parties Influence Appraisals*

Unfortunately, the interests of parties involved in the loan origination process often conflict with the preparation of accurate appraisals.⁸² At times, these parties exploit the subjective appraisal preparation process by pressuring appraisers to deliver favorable appraisals.⁸³ Because appraisers rely on loan origination parties for continuous work, many inflate appraisals to meet expectations.⁸⁴

One party with an interest in inflated appraisals is the borrower. As previously discussed, the typical home sale involves a prospective homebuyer who agrees to purchase a home and seeks a mortgage in the amount of the agreed-upon price.⁸⁵ For the buyer to complete the purchase, the home's appraisal value must support a mortgage in the requested amount.⁸⁶ Similarly, many homeowners refinance their homes to obtain equity for specific purposes, such as to pay off credit card debt or purchase a car.⁸⁷ In such cases, the appraisal determines the maximum amount of equity available to the refinancing homeowner. Thus, the borrower's ability to pay off debts or make purchases depends on the sufficiency of the appraisal to support the refinance.⁸⁸ Even though independent and accurate appraisals protect borrowers from overvalued homes and overwhelming debt, those interests are often overcome by borrowers' more immediate interests

81. See *Legislative Solutions*, *supra* note 32, at 198–99 (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company) (citing recent survey that showed 55 percent of appraisers have felt pressure to overstate an appraisal, with a quarter of those saying it happens nearly half of the time, and many appraisers actually succumbing to that pressure).

82. See *id.* (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company).

83. See *id.*

84. See *id.*

85. See *supra* Part II.A.

86. See *Legislative Solutions*, *supra* note 32, at 198–99 (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company).

87. See CALLAHAN, *supra* note 74, at 2.

88. See *id.* at 3.

in purchasing homes or paying off smaller debts.⁸⁹ For these reasons, borrowers have strong incentives to pressure appraisers to inflate home values.

In addition to the borrower, other mortgage-origination parties often stand to benefit from appraisal inflation. Loan officers and mortgage brokers, who are compensated upon the completion of mortgage transactions, have an obvious interest in ensuring that mortgage transactions close quickly and without issue.⁹⁰ An appraisal value insufficient to support the desired loan amount could jeopardize the completion of a mortgage transaction and prevent the loan officers and brokers from being paid.⁹¹ Furthermore, because loan officers and brokers are generally paid a commission based on a percentage of the loan amount, these parties have an interest in obtaining inflated appraisals that support elevated loan amounts and translate to increased fees.⁹² Accordingly, loan officers and brokers have incentives to pressure appraisers to overvalue collateral properties in order to ensure the quick completion of high-volume mortgage transactions.

Although lenders appear to have firm interests in obtaining accurate appraisals, those interests have been undermined by changes in the mortgage industry. With the advent of the secondary loan market, lenders can now sell loans to GSEs and thereby pass on the underlying risk to investors.⁹³ As a result, the risk-mitigation function of the appraisal has become much less important to many lenders.⁹⁴ Because lenders may not bear the long-term risks of the loans they make, many are willing to overlook or even promote appraisals inflated to satisfy the GSEs and secondary market investors.⁹⁵ Such complacency is especially problematic because loan officers who

89. See Martin, *supra* note 8, at 145.

90. *Legislative Solutions*, *supra* note 32, at 198–99 (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company).

91. *Ending Mortgage Abuse: Safeguarding Homebuyers: Hearing on Exploring How Homebuyers and Homeowners Can Be Safeguarded From Predatory and Abusive Mortgage Products and Practices Before the Subcomm. on Housing, Transportation, and Community Development of the S. Comm. on Banking, Housing, and Urban Affairs*, 110th Cong. 171 (2007) [hereinafter *Ending Mortgage Abuse*] (testimony of Alan E. Hummel, Senior Vice President and Chief Appraiser, Forsythe Appraisals, LLC).

92. Schudde, *supra* note 21, at 734; see Martin, *supra* note 8, at 145–46.

93. *Supra* notes 40–42 and accompanying text.

94. See Ceresney, *supra* note 25, at 227; Schudde, *supra* note 21, at 709.

95. See Ceresney, *supra* note 25, at 227; Schudde, *supra* note 21, at 742.

facilitate lenders' appraisal processes already have substantial interests in obtaining inflated appraisals.⁹⁶

Unfortunately, appraisers are vulnerable to the pressure that these self-interested parties exert. Because appraisers must analyze local market data, they develop experience and familiarity within limited geographic regions.⁹⁷ As a consequence, appraisers rely on continuous work from employers in their areas and are highly susceptible to threats of discontinued work.⁹⁸ When faced with such threats, appraisers must choose between delivering accurate appraisals despite the prospect of discontinued work or ostracism in the marketplace and deliberately falsifying appraisals. Some appraisers who have refused to give in to such pressure have been forced out of the industry.⁹⁹ Many others have succumbed.¹⁰⁰ Given that their livelihoods are at stake, it is not surprising that many appraisers are making the wrong choice.

Recognizing the extent to which appraisers rely on continued work, borrowers, lenders, and brokers have leveraged their authority over appraiser selection and compensation.¹⁰¹ Indeed, pressure exerted by borrowers became so pervasive during the savings and loan crisis that borrower-solicited appraisals were prohibited.¹⁰² More recently, the responsibility for selecting and compensating appraisers has resided with lenders and brokers.¹⁰³ But evidence suggests that lenders and brokers have pressured appraisers to inflate property values at an alarming rate. One recent survey showed that 90 percent of appraisers have felt pressure to overvalue property.¹⁰⁴ This data is

96. *Supra* notes 90–92 and accompanying text.

97. *See* Martin, *supra* note 8, at 154.

98. Richard D. Powers, President, Appraisal Inst., Address at the Appraisal Foundation Valuation Fraud Symposium (Oct. 13, 2006).

99. Letter from Brian A. Glanville, President, Appraisal Inst., to The Honorable Paul Sarbanes, Chairman, Senate Comm. on Banking, Hous., and Urban Affairs (Jul. 27, 2001) (on file with author).

100. *Legislative Solutions*, *supra* note 32, at 199 (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company).

101. *Ending Mortgage Abuse*, *supra* note 91, at 171–72 (testimony of Alan E. Hummel, Senior Vice President and Chief Appraiser, Forsythe Appraisals, LLC).

102. *See, e.g., Ending Mortgage Abuse*, *supra* note 91, at 171–73 (testimony of Alan E. Hummel, Senior Vice President and Chief Appraiser, Forsythe Appraisals, LLC).

103. *Id.*

104. OCTOBER RESEARCH CORPORATION, 2007 NATIONAL APPRAISER SURVEY: EXECUTIVE OVERVIEW 3 (2007), available at http://www.appraisalinstitute.org/newsadvocacy/downloads/ltrs_tstmnny/2007/Ntntl_Apprsl_Srvy.pdf.

in agreement with investigations and anecdotal surveys performed by the Appraisal Institute, a private appraiser professional organization.¹⁰⁵ The Appraisal Institute claims that instances of client pressure doubled between 2005 and 2007 despite two decades of regulatory efforts aimed at promoting appraisal accuracy.¹⁰⁶

Lenders and brokers pressure appraisers in a variety of ways. Sometimes they apply pressure that is forceful and direct. According to appraisers, lenders and brokers often refuse to hire appraisers who do not agree in advance to meet predetermined values—often before the appraisers have even seen the properties.¹⁰⁷ Furthermore, when appraisers submit honest appraisal values that are insufficient to support mortgages, lenders often inform appraisers of the values needed to complete the transactions.¹⁰⁸ If appraisers refuse to revise their appraisals to hit the numbers, lenders may refuse to pay them.¹⁰⁹ Even worse, some lenders threaten to blackball honest appraisers, preventing them from working with other local lenders in the future.¹¹⁰ When one appraiser refused to deliver a predetermined value, his broker client threatened to “let the 170 loan officers that operate out of this branch know that you are by the book and lack the intelligence to effectively get around the law.”¹¹¹ Given the limited geographic scope of appraiser qualifications and experience, such threats are especially compelling.¹¹²

In other instances, the pressure is more subtle and difficult to document. Lenders and brokers can apply pressure through no more than a hint in a conversation. For instance, a lender or broker might suggest that an appraiser consider different comparables that would

105. *Legislative Solutions*, *supra* note 32, at 199 (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company).

106. *Ending Mortgage Abuse*, *supra* note 91, at 17–18 (statement of Wade Henderson, President and Chief Executive Officer, Leadership and Conference on Civil Rights).

107. John W. Schoen, *Home Appraisal Fraud Is Costing You Money*, MSNBC.COM, Jul. 15, 2007, http://www.msnbc.msn.com/id/19750780/ns/business-personal_finance.

108. *See Ending Mortgage Abuse*, *supra* note 91, at 172 (testimony of Alan E. Hummel, Senior Vice President and Chief Appraiser, Forsythe Appraisals, LLC).

109. *See id.*

110. *Ending Mortgage Abuse*, *supra* note 91, at 17–18 (statement of Wade Henderson, President and Chief Executive Officer, Leadership and Conference on Civil Rights); *Legislative Solutions*, *supra* note 32, at 199 (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company).

111. *Legislative Solutions*, *supra* note 32, at 86 (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company).

112. Powers, *supra* note 98.

yield higher-value estimates.¹¹³ A lender or broker might also imply that future work is contingent on the outcome of pending appraisals.¹¹⁴ Such hints and implications may be nothing more than casual comments or even legitimate communications aimed at ensuring the quality of appraisals.¹¹⁵ As such, appraisers may have difficulty responding appropriately. For example, after he had noted some decay on the front porch of a home, Alan E. Hummel, Chair of the Government Relations Committee of the Appraisal Institute, received the following e-mail from a broker:

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 1 of 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 the cost to cure?

Anything?

Please respond ASAP.

Thanks.¹¹⁶

Such communications are especially troubling for appraisers. On one hand, this broker questioned Hummel’s competency and suggested that the decay be covered with a rug. Thus, it appears clear that the broker expected Hummel to overlook the decay and thereby inflate the appraisal value. On the other hand, it is possible that this

113. *Legislative Solutions*, *supra* note 32, at 199 (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company).

114. *See id.*

115. *Id.*

116. *Ending Mortgage Abuse*, *supra* note 91, at 172 (testimony of Alan E. Hummel, Senior Vice President and Chief Appraiser, Forsythe Appraisals, LLC).

was a legitimate inquiry meant to determine the extent and nature of a problem. The broker may have intended only to explore possible solutions in pursuit of the customer's interests. However, for the appraiser who is frequently pressured and whose livelihood is on the line, it is reasonable to assume the lender or broker expects overvaluation and compliance. When asked, "How can you help us get this in line?" it is no wonder that many appraisers respond by inflating appraisals.

B. Challenges in Regulating Pressure

Despite the importance of independent and accurate appraisals, regulatory efforts have failed to prevent loan-origination parties from pressuring appraisers to deliver predetermined values. Appraisal regulations under Title XI mandate that appraisals be performed independently and impartially.¹¹⁷ These regulations place the onus for ensuring appraisal accuracy on appraisers, who must ensure that their opinions of value are unbiased. In addition, fraud laws broadly proscribe the deliberate production of inflated appraisals that do not reflect market values.

Although well-intentioned, these regulatory mechanisms are ineffective for two reasons. First, they fail to insulate appraisers from undue pressure to conform to the wishes of self-interested third parties in order to receive future assignments. Second, appraiser independence regulations and fraud laws are difficult to enforce.¹¹⁸ Because an appraisal is a subjective opinion of value, total accuracy cannot be expected and a margin of error must be accepted.¹¹⁹ In all but the most egregious cases, it would be difficult to prove that an inflated appraisal is the product of improper influence and not merely an independent opinion of value within the margin of error.¹²⁰ This is even more problematic in actions for fraud, which require intentional misrepresentations of material fact.¹²¹ Unless there were clear and convincing evidence that an appraiser intentionally deviated from his

117. See 12 U.S.C. § 3350(10) (2006); 12 C.F.R. § 323.2(a), 323.5 (2009).

118. Ceresney, *supra* note 25, at 227–28.

119. *Id.*; Martin, *supra* note 8, at 148.

120. Ceresney, *supra* note 25, at 227–28.

121. *E.g.*, 37 AM. JUR. 2D *Fraud and Deceit* § 23 (2001).

or her independent estimate of value, it would be difficult to prove fraud.¹²²

Recent regulatory efforts such as Regulation Z of the 2008 Amendments to the Truth in Lending Act (“Regulation Z”) and the Home Valuation Code of Conduct (HVCC) include provisions that expressly prohibit lenders and brokers from pressuring appraisers to deliver predetermined values.¹²³ Although it is too early to tell whether these regulations will be effective, they are prone to the same enforcement difficulties as appraisal independence requirements. Because lenders and brokers can exert pressure in subtle ways, there is a fine line between legitimate communications and improper attempts to influence appraisals. Regulators will likely struggle to prove the latter.

C. Proposed Solution

Improper influence exerted on appraisers is a serious problem that is exacerbated by the agendas of self-interested loan origination parties. Existing regulatory efforts that require appraisal independence or prohibit the pressuring of appraisers are impractical to enforce. Effective appraisal regulation must eliminate the *opportunity* for interested parties, such as lenders and brokers, to influence appraisal preparation. If this is to be accomplished, the responsibility for selecting appraisers cannot reside with parties who have incentives to condition future work on the delivery of favorable appraisals. Instead, appraisers must be assigned in a fair and neutral manner regardless of whether they hit the numbers.

1. Early Efforts and Missteps of the FHA

A neutral and independent appraisal assignment system is not a new concept. For example, the Federal Housing Administration (FHA)¹²⁴ used such a system prior to 1994.¹²⁵ Under that system, homes financed with loans insured by the FHA were appraised

122. *Id.*; Martin, *supra* note 8, at 148.

123. 12 C.F.R. § 226.36 (2009).

124. U.S. Dep’t of Hous. and Urban Dev., Federal Housing Administration, <http://www.hud.gov/offices/hsg/fhahistory.cfm> (last visited Mar. 4, 2010) (explaining FHA and its subordinate position to HUD).

125. U.S. GEN. ACCOUNTING OFFICE, GAO/RCED-97-176, HOMEOWNERSHIP: INFORMATION ON CHANGES IN FHA’S NEW SINGLE-FAMILY APPRAISAL PROCESS 2 (1997).

almost exclusively by appraisers assigned from a fee panel (FHA Fee Panel).¹²⁶ Each loan was assigned by the FHA on a rotational basis to one of approximately 6,000 appraisers on the FHA Fee Panel.¹²⁷ Lenders paid appraisers for completed appraisals and charged the cost to borrowers.¹²⁸ The rotational basis assured appraisers of receiving regular work. Accordingly, lenders had no power to influence appraisers with promises or denials of future work.¹²⁹

Unfortunately, in 1994, the Department of Housing and Urban Development (HUD) implemented legislation that allowed lenders to choose appraisers in the origination of single-family home mortgages insured by the FHA.¹³⁰ Accordingly, the FHA established a national roster (FHA Roster) from which lenders could select appraisers.¹³¹ To assist lenders, the FHA provided an electronic database tool with which lenders could search for appraisers in their localities.¹³² In 1996, HUD noted that lender-selected appraisers were performing the vast majority of appraisals and terminated the FHA Fee Panel.¹³³ Since then, lenders have selected appraisers from the FHA Roster to perform all FHA appraisals.¹³⁴

In 2008, the Housing and Economic Recovery Act of 2008 (HERA) revised FHA standards for placement on the FHA Roster.¹³⁵ To be eligible for placement on the FHA Roster, appraisers must be certified in their state of practice and cannot be listed on any federal sanctions lists.¹³⁶ To ensure the implementation of these requirements, the FHA developed a website—FHA Connection—through which appraisers can apply for placement on the FHA Roster

126. *Id.* at 5. A “fee panel” appraiser is one was assigned to lenders by the FHA. *See id.* at 1.

127. *Id.*

128. *Id.*

129. *See* Letter from Brian A. Glanville to Paul Sarbanes, *supra* note 99, at 10.

130. U.S. GEN. ACCOUNTING OFFICE, *supra* note 125, at 5.

131. *Id.* These appraisers were required to be state-certified or state-licensed. *Id.*

132. Letter from Nicolas P. Retsinas, Assistant Sec’y for Hous.—Fed. Hous. Comm’r, U.S. Dep’t of Hous. and Urban Dev., to All Approved Mortgagees (Jan. 29, 1996) (on file with author) (“locality” is defined as the city or nearest city in which the property is located).

133. *Id.*; U.S. GEN. ACCOUNTING OFFICE, *supra* note 125, at 6.

134. U.S. GEN. ACCOUNTING OFFICE, *supra* note 125, at 6.

135. Letter from Brian D. Montgomery, Assistant Sec’y for Hous.—Fed. Hous. Comm’r, U.S. Dep’t of Hous. and Urban Dev., to All Approved Mortgagees and All FHA Roster Appraisers (Dec. 17, 2008) (on file with author).

136. *Id.*

and lenders can select appraisers.¹³⁷ Through the website and its underlying hardware and software, appraiser certification is verified in real time.¹³⁸ Additionally, the website references federal sanctions lists to ensure that the FHA Roster lists only trustworthy applicants.¹³⁹ Lenders can use FHA Connection to search for appraisers by name, license number, city, or state.¹⁴⁰

Although the FHA Roster system has been in use for more than fifteen years, recent market developments have raised doubts about the wisdom of allowing lenders to select appraisers.¹⁴¹ During 2008, the volume of FHA-insured single-family home mortgages tripled from \$59 billion to \$180 billion.¹⁴² Between 2006 and 2008, FHA approval of new lenders increased by 525 percent.¹⁴³ According to Kenneth M. Donohue, then-Inspector General of HUD, the surge in FHA loans and new lenders will likely overwhelm the oversight resources of the FHA, making lender monitoring difficult.¹⁴⁴ If so, the FHA would be unable to prevent lenders from abusing their appraiser-selection authority. In light of these risks, Donohue recommended that the FHA eliminate lenders' influence on appraisers by returning to an independent appraiser assignment system similar to the FHA Fee Panel.¹⁴⁵ Donohue asserted that "[s]uch a move would relieve pressures on appraisers to return predetermined values and would change a system based on misplaced incentives."¹⁴⁶

2. An Industry-Wide Solution Is Needed

The FHA's difficulties illustrate devastating developments in the overall home mortgage industry and highlight the importance of

137. U.S. Dep't of Hous. and Urban Dev., FHA Connection, <http://www.hud.gov/offices/hsg/connect.cfm> (last visited Mar. 4, 2010).

138. U.S. Dep't of Hous. and Urban Dev., Appraiser Roster FAQs, http://www.hud.gov/offices/hsg/sfh/appr/faqs_appraiser.cfm (last visited Mar. 4, 2010).

139. *Id.*

140. *Id.*

141. *Strengthening*, *supra* note 27, at 50 (statement of Kenneth M. Donohue, Sr., Inspector Gen., U.S. Department of Housing and Urban Development).

142. *Id.* at 42.

143. *Id.* at 44.

144. *Id.* at 42.

145. *Id.* at 50.

146. *Id.* at 51.

independent and accurate appraisals. Appraisals will always be susceptible to some inaccuracy resulting from the subjectivity of the appraisal process and the unreliability of market data. However, the improper influence of lenders *could* be eliminated through the adoption of an independent appraiser assignment system akin to the FHA Fee Panel. As such, it would be foolish to ignore appraiser-assignment reforms that could reinforce the independence and accuracy of appraisals.

One potential way to improve appraisal accuracy is to implement an appraiser-assignment system capable of assigning appraisers in a neutral manner. Such a system would need to account for appraiser qualifications and the needs of individual appraisal assignments. The FHA's current assignment of appraisers through FHA Connection is promising because it is based on a national roster with uniform eligibility requirements, it leverages automation, and it matches appraiser qualifications with lender needs.¹⁴⁷ These capabilities should be incorporated into a comprehensive automated appraisal-assignment system capable of randomly assigning qualified appraisers in connection with all federally related transactions. Under such a system, lenders could submit appraisal-assignment information to be matched with appraiser qualifications.

For instance, a lender could provide information about the type and location of the property to be appraised. Then, the system could identify all appraisers on a federal appraisal roster with experience in appraising properties of the specified type and in the specified location. Finally, the system would randomly assign a qualified appraiser to prepare the appraisal. The system could also categorize and match lender needs with other appraiser qualifications and characteristics, such as education and performance history. By randomly assigning qualified appraisers in connection with federally related transactions, appraisers would be assigned in a neutral manner based on legitimate lender needs.

3. Potential Benefits of Randomly Assigning Qualified Appraisers

Randomly assigning qualified appraisers used in connection with federally related transactions would improve the accuracy and

147. U.S. Dep't of Hous. and Urban Dev., *supra* note 138.

reliability of appraisals. In such a random assignment system, appraisers meeting the eligibility requirements of a national appraiser roster would have an equal probability of receiving work regardless of whether they are willing to deliver lenders' predetermined values. These appraisers would prepare appraisals independently without the concern that they must overvalue properties to receive future work. As a result, appraisers would deliver appraisals that reflect true market values with greater accuracy.

Moreover, matching legitimate lender needs with the skill and experience necessary to appraise each unique property would result in more accurate market value estimations and minimize risks associated with mortgage transactions. The increased accuracy would provide a more robust safeguard for the nation's financial system. This would enhance both the legitimacy of the mortgage process and the public's confidence in the national mortgage industry.

Lenders would also benefit from the use of a random assignment system. Recent regulatory schemes such as Regulation Z and the HVCC prohibit lenders from influencing appraisers.¹⁴⁸ In addition to a general prohibition, Regulation Z lists a number of specifically forbidden communications.¹⁴⁹ For example, lenders cannot inform appraisers of the values necessary to complete loan transactions.¹⁵⁰ While such well-intentioned provisions could prevent the pressuring of appraisers, they could also deter valuable and legitimate communication between the lender and the appraiser intended to protect the consumer. Because consumers ultimately pay appraisal costs, consumers benefit when lenders can confirm at the outset whether a property could not support a requested loan. In such cases, the cost of an appraisal could be avoided. When lenders hold influence over appraisers, these legitimate communications are suspicious and could have repercussions under new appraisal regulations. As such, lenders must walk a fine line in conducting necessary and legitimate communications with appraisers to ensure that their actions are not perceived as improper. However, if lenders were removed from the appraisal selection process through a random

148. 12 C.F.R. § 226.36 (2006); HOME VALUATION CODE OF CONDUCT § IB (Fannie Mae 2008).

149. 12 C.F.R. § 226.36.

150. *Id.*

assignment system, the incentive to overvalue would be eliminated and legitimate communications would be above suspicion.

4. Potential Drawbacks of Randomly Assigning Qualified Appraisers

Despite the potential benefits of a random assignment system, lenders have advocated for the right to select appraisers. In fact, the FHA adopted its current lender select system in response to lender concerns about the timeliness and quality of appraisals under the FHA Fee Panel.¹⁵¹ Lenders argued that lender selection of appraisers would simplify and accelerate the appraisal process by eliminating the need to contact a HUD field office to be assigned an appraiser each time an appraisal is needed.¹⁵² According to lenders, consumers would benefit from having appraisals performed faster because loans could close sooner.¹⁵³

While lender selection of appraisers accelerates the appraisal process, the enormous damage that has resulted from lender pressure suggests that acceleration is imprudent. Indeed, the benefit of acceleration is insignificant when compared to the complex and costly disciplinary actions that will be necessary to repair the harm the mortgage industry has suffered as a result of lender pressure.¹⁵⁴ Furthermore, by leveraging automated capabilities, qualified appraisers could be assigned quickly and efficiently without the risk that lenders would coerce predetermined values.

In addition to their concerns about the timeliness of the appraisal process, lenders argued that appraisal quality suffers when appraisers are assigned in a neutral manner. In advocating lender selection of appraisers, FHA lenders raised concerns that Fee Panel appraisers acted unprofessionally and submitted appraisals of varying quality.¹⁵⁵ Because appraisers were guaranteed future work on a rotational basis after being placed on the Fee Panel, lenders believed that Fee Panel appraisers who did not have to market themselves or compete with other appraisers for work were complacent in preparing appraisals.¹⁵⁶

151. U.S. GEN. ACCOUNTING OFFICE, *supra* note 125, at 6.

152. *Id.*

153. *Id.* at 8.

154. *See supra* Part I.

155. U.S. GEN. ACCOUNTING OFFICE, *supra* note 125, at 6.

156. *Id.* at 6; Letter from Brian A. Glanville to Paul Sarbanes, *supra* note 99, at 11.

Even if some Fee Panel appraisers were complacent, the speculative extent and impact of that complacency pales in comparison to the demonstrated harm suffered by the mortgage industry as a result of widespread appraisal inflation in response to lender pressure. Furthermore, random assignment of appraisers possessing particular qualifications will incentivize appraisers to gain knowledge, experience, and a positive performance history in order to qualify for more assignments.

Moreover, any panel or roster of appraisers will inevitably include some complacent, dishonest, or incompetent appraisers. Indeed, a recent survey of the FHA Roster revealed 3,480 appraisers with expired licenses and 199 appraisers who had been sanctioned by one or more states for various civil and criminal infractions.¹⁵⁷ To maintain the integrity of the appraisal industry, an effective appraiser assignment system must include quality-control mechanisms to ensure only honest and competent appraisers are placed on the appraiser panel or roster. The capabilities of FHA Connection to search appraiser characteristics, verify qualifications in real time, and cross-reference external databases could be leveraged to ensure a high-quality national roster of appraisers. Substandard appraisers could be identified and removed without delay. The moral character of roster appraisers could be substantiated by referencing state and federal databases containing civil and criminal histories.

With recent regulatory reforms such as Regulation Z and the HVCC, lender-selection advocates might argue that further reforms are not needed to prevent the pressuring of appraisers. However, both Regulation Z and the HVCC have unnecessarily complicated the appraisal process. As previously discussed, the express prohibition of influential communications contained in Regulation Z may inhibit legitimate communications between lenders and appraisers.¹⁵⁸ Similarly, in order to avoid violating the express prohibition of appraiser pressuring in the HVCC, many lenders have outsourced the appraisal function to independent appraisal management companies (AMCs) that employ, assign, and compensate appraisers.¹⁵⁹ Because

157. *Strengthening*, *supra* note 27, at 50 (statement of Kenneth M. Donahue, Sr., Inspector Gen., U.S. Department of Housing and Urban Development).

158. 12 C.F.R. § 226.36 (2006).

159. *Strengthening*, *supra* note 27, at 87 (testimony of Marc Savitt, President, National Association of Mortgage Brokers).

AMCs underpay appraisers, the appraisers who are willing to work with AMCs are often less experienced and less likely to accurately determine market value.¹⁶⁰ Furthermore, because AMCs only perform the administrative functions of the appraisal process and do not actually prepare appraisals, they are not subject to the full slate of appraisal regulations, guidelines, and policies.¹⁶¹ Indeed, AMCs are entirely unregulated at the federal level and are subject to appraisal-related regulation in only three states.¹⁶²

IV. DEFICIENCIES IN THE APPRAISAL REGULATORY STRUCTURE

Unfortunately, improper appraisal practices such as client pressure have become pervasive under existing appraisal regulations. Structural deficiencies severely weaken the effectiveness of regulation under Title XI. The distribution of regulatory responsibilities among independent entities has resulted in a patchwork system plagued by inefficiency and inconsistency. No single entity has sufficient authority to effectively regulate the appraisal industry. If improper and harmful appraisal practices are to be identified and addressed in a timely manner, the uniform appraisal standards envisioned under Title XI must be enforced consistently. It is imperative that appraisal regulatory responsibilities be consolidated at the federal level where adequate knowledge and resources can be devoted to ensuring the accuracy and reliability of appraisals used in connection with federally related transactions.

A. The Distribution of Regulatory Responsibilities Under Title XI

Title XI distributes appraisal regulatory responsibilities among various private, state, and federal entities.¹⁶³ The Appraisal Foundation, a private nonprofit organization composed of groups from the real estate industry, established minimum appraisal requirements.¹⁶⁴ These requirements are articulated in both the Uniform Standards of Professional Appraisal Practice (USPAP),

160. *Id.* at 88.

161. *Id.* at 87.

162. *Id.*

163. *See generally* 12 U.S.C. §§ 3331–3352 (2006).

164. *See id.* § 3345; U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 6.

which sets forth minimum standards for performing appraisals, and the Appraiser Qualification Criteria (AQC), which outlines minimum education, experience, and examination requirements for appraisers.¹⁶⁵ The states are responsible for enforcing compliance with appraisal standards and also for certifying appraisers.¹⁶⁶ At a minimum, state certification criteria must incorporate the AQC.¹⁶⁷ In addition, states have the option to license appraisers using state-established criteria that need not incorporate the AQC.¹⁶⁸ The federal financial institution regulators¹⁶⁹ are responsible for establishing and enforcing appraisal requirements for insured institutions¹⁷⁰ in their jurisdictions.¹⁷¹ Finally, the Appraisal Subcommittee of the Federal Financial Institutions Examination Council is the principal federal agency responsible for monitoring the activities of the other entities under Title XI.¹⁷²

1. Rulemaking Responsibilities Under Title XI

The separation of rulemaking and enforcement responsibilities within the complex regulatory structure of Title XI is problematic. While the Appraisal Foundation establishes and maintains minimum appraisal standards and appraiser criteria, state and federal regulators are responsible for enforcement.¹⁷³ As such, the Appraisal Foundation is not optimally situated to identify and address changing market conditions and circumstances relevant to the appraisal profession that become apparent through enforcement.¹⁷⁴ Indeed, the pervasiveness of lender pressure may be due, at least in part, to an inability of the Appraisal Foundation to recognize and address the

165. U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 5–6; see 12 U.S.C. §§ 3345–3346; APPRAISAL STANDARDS BD., APPRAISAL FOUND., APPRAISAL STANDARDS BOARD & USPAP, available at <https://appraisalfoundation.sharefile.com/d-sd342877f2794368a> (last visited Mar. 4, 2010).

166. See 12 U.S.C. § 3346.

167. See *id.* § 3345(a).

168. See *id.* §§ 3342–3343, 3345–3346.

169. See *id.* § 3350(6).

170. See *id.* § 3350(7).

171. See *id.* §§ 3339, 3341–3342, 3345(d).

172. See *id.* § 3347.

173. See *id.* § 3345(a) (defining Appraisal Foundation rulemaking authority); *id.* § 3346 (defining state enforcement authority); *id.* § 3339 (defining federal financial institutions regulatory agency (“FedFin”) enforcement authority).

174. U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 11.

problem before it became widespread. Other problems arise when the rulemaking activities of the Appraisal Foundation and the enforcement activities of the states and the federal financial institution regulators are out of sync. In a 2004 survey, 70 percent of states reported that USPAP updates were so frequent that state appraiser regulatory agencies¹⁷⁵ could not keep pace in revising state law to reflect the most current USPAP as Title XI requires.¹⁷⁶

Even more problematic than the separation of rulemaking and enforcement responsibilities is the concurrent rulemaking authority granted to the states and the federal financial institution regulators. Under Title XI, the Appraisal Foundation establishes only minimum appraisal standards and appraiser criteria.¹⁷⁷ Each of the states and the federal financial institution regulators is free to establish additional appraisal standards and criteria.¹⁷⁸ To date, more than half of the states and all five federal financial institution regulators have adopted appraisal standards criteria that exceed the Appraisal Foundation's guidelines.¹⁷⁹ Additionally, the state appraisal regulatory agencies take a variety of approaches in implementing Title XI.¹⁸⁰ These variations complicate national oversight and enforcement of the appraisal industry, as federal regulators and mortgage-industry participants must navigate myriad inconsistent regulatory schemes. Moreover, appraisers who cross state lines, as contemplated by Title XI,¹⁸¹ must parse out the appraisal regulations specific to each individual state. Under this convoluted system, it is unsurprising that appraisal accuracy has suffered.

A prime example of this inconsistency is the state-appraiser-licensing system, which has been the target of much criticism from

175. See 12 U.S.C. § 3350(1); Letter from Brian A. Glanville to Paul Sarbanes, *supra* note 99, at 3.

176. See U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 13.

177. See 12 U.S.C. § 3345.

178. See *id.* § 3339 (defining FedFin authority to implement additional standards); *id.* § 3345 (defining FedFin authority to establish additional appraiser qualification criteria).

179. U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 6–7. See generally 12 C.F.R. §§ 34.42–47, 323.1–7, 564.1–6, 722.1–7 (2009) (promulgating additional appraisal criteria for the OCC, FDIC, OTS, and NCUA, respectively); Fed. Deposit Ins. Corp., FDIC Law, Regulations, Related Acts: Statements of Policy, <http://www.fdic.gov/regulations/laws/rules/5000-4800.html> (last updated Dec. 3, 2009).

180. U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 13.

181. See 12 U.S.C. § 3351 (contemplating temporary practice and reciprocity).

appraisers and regulators alike.¹⁸² Title XI requires federal financial institution regulators to prescribe categories of federally related transactions that should use a state-certified appraiser and categories that may use a state-licensed appraiser.¹⁸³ Pursuant to this requirement, federal financial institution regulators have determined that certified *or* licensed appraisers may prepare non-complex¹⁸⁴ residential-property appraisals in connection with transactions below \$1 million in value.¹⁸⁵ Title XI mandates that state-certification criteria must incorporate the AQC at a minimum.¹⁸⁶ In contrast, licensing criteria are left entirely to the discretion of the states. Accordingly, licensing criteria vary significantly from state to state. Some states' licensing criteria are similar to their certification criteria,¹⁸⁷ while other states' licensing criteria are significantly less demanding.¹⁸⁸ Indeed, some states do not require appraiser licensing at all.¹⁸⁹ Under such lenient or non-existent licensing criteria, appraisers of lesser competence can be licensed. Because the national median home value¹⁹⁰ is well below the \$1 million threshold above which the federal financial institution regulators require the use of

182. U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 14.

183. *See* 12 U.S.C. §§ 3341–3343.

184. An appraisal of a one- to four-family residential property is complex if the property to be appraised, the form of ownership, or the market conditions are atypical. *See* 12 C.F.R. 323.2(e).

185. *See* 12 U.S.C. §§ 3342–3343; 12 C.F.R. §§ 34.43, 323.3, 564.3, 722.3 (outlining transactions for which appraisals may be prepared by state certified or licensed appraisers as mandated by the OCC, FDIC, OTS, and NCUA, respectively).

186. 12 U.S.C. § 3345(a).

187. Most states require 300 hours of education and 3000 hours of experience for certification compared to 150 hours of education and 2000 hours of experience for licensing. Appraisal Subcommittee, Fed. Fin. Insts. Exam. Council, State Operations and Requirements, <https://www.asc.gov/State-Appraiser-Regulatory-Programs/StateOperationsAndRequirements.aspx> (last visited Mar. 3, 2010).

188. Connecticut requires 300 hours of education and 3000 hours of experience for certification compared to 75 hours of education and no experience for licensing. *Id.*

189. Alaska, Florida, Illinois, Indiana, Iowa, Louisiana, North Carolina, Pennsylvania, and Wyoming have voluntary licensing programs. *Id.*

190. In the fourth quarter of 2009, the national median home price for existing homes was \$172,900. National Association of Realtors Metropolitan Median Prices, <http://www.realtor.org/research/research/metroprice> (last visited Mar. 4, 2010) (follow “Current Report: Single-family 4th Quarter 2009” hyperlink). In January 2010, the national average home price for new homes was \$254,500. U.S. Census Bureau News, New Residential Sales in January 2010, Feb. 24, 2010, <http://www.census.gov/const/newressales.pdf>.

certified appraisers, licensed appraisers of questionable competence could participate in a significant number of mortgage transactions.¹⁹¹

2. Enforcement Responsibilities Under Title XI

The failure of appraisal regulators to collect and share information frustrates the detection of improper appraisal practices¹⁹² and ultimately prevents the enforcement of appraisal regulations. Improper appraisal practices, such as appraisal inflation, often go undetected unless a pattern of defaults is associated with an appraiser.¹⁹³ Because inflated appraisals increase risks of default, such a pattern can indicate a corresponding pattern of appraisal inflation.¹⁹⁴ Similarly, a pattern of rapid property appreciation or an appraiser's extensive disciplinary history can raise red flags.¹⁹⁵ Unfortunately, many appraisal regulators do not collect this information.¹⁹⁶ Those that do are unwilling or unable to share it with other regulators and mortgage-industry participants.¹⁹⁷ As a result, appraisal regulators working with incomplete data cannot see the big picture necessary to detect improper appraisal practices. Meanwhile, unscrupulous and unqualified appraisers may continue practicing without consequences.

Reporting deficiencies also limit the detection of improper appraisal practices. If appraisal regulators do not receive complaints about improper appraisal practices, they cannot take corrective action.¹⁹⁸ Unfortunately, because there is no central reporting

191. U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 7, 14–15; Letter from Brian A. Glanville to Paul Sarbanes, *supra* note 99.

192. Unless otherwise indicated, “improper appraisal practices” includes both incompetence and misconduct.

193. *Mortgage Fraud and Its Impact on Mortgage Lenders: Hearing Before the Subcomm. on Housing and Community Opportunity of the H. Comm. on Financial Servs.*, 108th Cong. 4–5 (2004) (statement of Hon. Kenneth M. Donahue, Sr., Inspector Gen., Department of Housing and Urban Development).

194. *Id.* at 21 (statement of Hon. John C. Weicher, Assistant Secretary, Housing/Federal Housing Comm'r, Department of Housing and Urban Development).

195. Mark Simpson, Dir. of Prop. Standards, Fannie Mae, Address at the Appraisal Found. Valuation Fraud Symposium (Oct. 13, 2006); Brad Davis, Vice President and Chief Appraiser, Morgan Stanley, Address at the Appraisal Found. Valuation Fraud Symposium (Oct. 13, 2006).

196. See *Strengthening*, *supra* note 27, at 50, 57 (statement of Kenneth M. Donahue, Sr., Inspector Gen., U.S. Department of Housing and Urban Development).

197. *Id.*

198. Larry Disney, Executive Dir., Ky. Real Estate Appraisers Bd., Address at the Appraisal Foundation Valuation Fraud Symposium (Oct. 13, 2006); David Deverman, Nat'l Ass'n of Realtors, Address at the Appraisal Foundation Valuation Fraud Symposium (Oct. 13, 2006);

repository for complaints, improper appraisal practices often go unreported.¹⁹⁹ Although appraisers can report instances of lender pressure to state banking regulators or federal financial institution regulators, the appraisers must submit those reports in writing and in accordance with the procedures of the regulatory agency that has jurisdiction over the offending lender.²⁰⁰ The myriad independent appraisal regulators can make determining the correct agency and procedure overwhelming. State appraisal regulatory agencies rarely receive complaints from lenders and federal financial institutions.²⁰¹ When state appraisal regulatory agencies do receive complaints, those complaints are frequently submitted in formats or manners that the agency cannot readily process.²⁰² At the same time, disparities in states' complaint filing requirements frustrate financial institutions.²⁰³ Some states require only the submission of an allegation of misconduct, while others require specific forms, notarization, or witness testimony. These disparities place a serious burden on entities attempting to report appraisal fraud²⁰⁴ and prevent many instances of improper appraisal practice from being detected and corrected.

Even when improper appraisal practices are detected, state appraisal regulators lack the resources necessary to investigate and take corrective action.²⁰⁵ In one year, more than 60 percent of state appraisal regulatory agencies failed to perform their enforcement responsibilities.²⁰⁶ Most states cite staffing deficiencies as the primary impediment to their investigation of appraisal misconduct.²⁰⁷

William Stern, Supervisory Special Agent, Fed. Bureau of Investigation and Dir. of Prop. Standards, Fannie Mae, Address at the Appraisal Found. Valuation Fraud Symposium (Oct. 13, 2006).

199. Douglas Vincent, Chief Collateral Officer, Countrywide Bank, Address at the Appraisal Foundation Valuation Fraud Symposium (Oct. 13, 2006); Letter from Brian A. Glanville to Paul Sarbanes, *supra* note 99.

200. Letter from Brian A. Glanville to Paul Sarbanes, *supra* note 99, at 6.

201. Disney, *supra* note 198.

202. U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 18–19.

203. *Id.* at 18.

204. *Id.*

205. *Id.* at 3; Douglas Vincent, Chief Collateral Officer, Countrywide Bank, Address at the Appraisal Found. Valuation Fraud Symposium (Oct. 13, 2006).

206. *Ending Mortgage Abuse*, *supra* note 91, at 178 (testimony of Alan E. Hummel, Senior Vice President and Chief Appraiser, Forsythe Appraisals, LLC).

207. U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 3, 12–13.

The average state appraisal agency employs three staff members responsible for supervising approximately 2,000 appraisers.²⁰⁸ Furthermore, many state agencies report that they share administrative staff, office space, and even investigators—many of whom have no appraisal experience—with other state agencies.²⁰⁹ Indeed, some state agencies police all licenses granted under their jurisdiction, whether the licenses are for appraisers, contractors, or hairdressers.²¹⁰ Although appraisal enforcement activities are funded at the state level by appraiser registration and licensing fees, many states reallocate these fees to their general funds, leaving state appraisal agencies with insufficient funding.²¹¹

Even when they receive appropriately submitted complaints, state appraisal agencies often fail to resolve them in a timely manner.²¹² A representative of Fannie Mae has asserted that one-third of state appraisal agencies take three years to address complaints.²¹³ Of 860 complaints submitted by Fannie Mae between 2001 and 2002, 469 remained unresolved four years later.²¹⁴ In some states, statutes of limitation preclude disciplinary action by the time enforcement agencies conclude their lengthy investigations.²¹⁵

Moreover, unscrupulous and incompetent appraisers may continue to practice until regulators complete investigations and impose discipline.²¹⁶ For example, after pleading guilty to appraisal fraud in federal court and admitting responsibility for government losses of \$500,000 to \$800,000, a Maryland appraiser brazenly applied for a renewal of his appraisal license.²¹⁷ While he was

208. *Id.* at 12.

209. *Id.*

210. Powers, *supra* note 98.

211. Letter from David L. Ledford, Senior Vice President, Hous. Fin. and Land Dev. to National Association of Home Builders, to the Appraisal Foundation (Mar. 2, 2009) (on file with author).

212. U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 18; *Ending Mortgage Abuse*, *supra* note 91, at 178 (testimony of Alan E. Hummel, Senior Vice President and Chief Appraiser, Forsythe Appraisals, LLC).

213. Mark Simpson, Dir. of Prop. Standards, Fannie Mae, Address at the Appraisal Foundation Valuation Fraud Symposium (Oct. 13, 2006).

214. *Id.*

215. U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 18.

216. *Legislative Solutions*, *supra* note 32, at 201 (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company).

217. *Id.*

awaiting sentencing, he submitted an online application for license renewal in which he indicated that he had not been convicted of any felonies.²¹⁸ A year later, the Maryland Commission of Real Estate Appraisers and Home Inspectors renewed his license for three years despite his conviction, which became official shortly after he submitted the renewal application.²¹⁹

3. Oversight Responsibilities Under Title XI

Title XI charges the Appraisal Subcommittee with monitoring state appraisal activities.²²⁰ However, the Subcommittee's only means for ensuring state compliance with Title XI is state decertification, which would prohibit all appraisers in a state from performing appraisals in conjunction with federally related transactions.²²¹ Such a severe penalty would devastate and cripple the real estate and mortgage markets in a decertified state.²²² Accordingly, the Appraisal Subcommittee's decertification authority—often referred to as the “atomic hammer”²²³—has never been tested.²²⁴

B. Appraisal Regulatory Responsibilities Must Be Consolidated at the Federal Level

Two prominent themes among the multitude of federal appraisal regulatory schemes are the protection of federal financial interests and the promotion of public confidence in federally related transactions. Given this concern for federal interests, it is surprising that appraisal regulatory responsibilities have been dispersed among federal, state, and private entities without effective federal oversight. This curious structure has led to confusion, inconsistency, and, ultimately, a system incapable of ensuring the accuracy of

218. *Id.* Because he was not officially convicted of a felony until he was sentenced, the appraiser's assertion was technically correct. *Id.*

219. *Id.*

220. 12 U.S.C. §§ 3332, 3347 (2006).

221. *See id.* § 3347; U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 3, 13 (2004).

222. U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 13–14 (2004).

223. *Legislative Solutions*, *supra* note 32, at 200 (testimony of Alan E. Hummel, Chief Executive Officer, Iowa Residential Appraisal Company).

224. U.S. GEN. ACCOUNTING OFFICE, *supra* note 15, at 14 (2004).

appraisals.²²⁵ In order to improve appraisal regulation and safeguard national interests, appraisal regulatory responsibility must be consolidated under a federal entity capable of maintaining, monitoring, and enforcing appraisal standards.

1. Potential Benefits of Consolidating Appraisal Regulatory Responsibilities at the Federal Level

The benefits of consolidating supervision of the appraisal industry at the federal level include enhanced cohesion between the establishment, oversight, and enforcement of appraisal standards and appraiser qualifications criteria. A central federal entity would be responsible for amending appraisal standards and would also play a direct role in monitoring and enforcing those standards. Accordingly, that federal entity would be better informed about the applicability and feasibility of those standards, allowing it to identify deficiencies and respond with appropriate reforms while retaining consistent standards.

Under the direction of a federal entity with consolidated regulatory authority, parties involved in the loan-origination process could submit complaints to a single centralized agency. Without obstacles to reporting and sharing appraisal-related information, such information could be compiled and manipulated in a comprehensive database that provides early warning signals of instances of appraisal misconduct. With access to such a database, a federal regulator could routinely review a set percentage of appraisals and appraisers. Thus, a federal body could detect appraisal misconduct sooner, thereby enabling timely and consistent appraiser discipline and preventing problem appraisers from maintaining status on federal rosters. Most importantly, by identifying and disciplining liable appraisers, a cohesive and adequately funded federal agency would deter future appraisal misconduct and limit the potential for mortgage fraud.

2. Potential Drawbacks of Consolidating Appraisal Regulatory Responsibilities at the Federal Level

In spite of the substantial benefits of a central federal appraisal regulatory agency, some might argue that the diverse inputs of private, state, and federal entities employed under the current

225. *Strengthening*, *supra* note 27, at 57 (statement of Kenneth M. Donohue, Sr., Inspector Gen., U.S. Department of Housing and Urban Development).

regulatory structure are indispensable. The benefit of private-industry input would be lost if the Appraisal Foundation no longer had responsibility for establishing and amending appraisal standards. Arguably, the unique circumstances of each state and the varying interests of institutions under the purview of federal financial institution regulators require flexibility to tailor appraisal standards and disciplinary procedures to their varying needs.

While these arguments warrant some consideration, a central federal regulatory agency would retain these benefits. Such an agency could establish procedures and mechanisms to capture and implement the concerns of the private appraisal industry, the states, and the federal financial institution regulators. Indeed, the current Title XI structure contains many such mechanisms.²²⁶ Although the federal financial institution regulators currently maintain the authority to individually specify standards and criteria above and beyond the Appraisal Foundation's minimal requirements, the regulations set forth by the federal financial institution regulators have long been identical.²²⁷

Further, while some states have adopted regulations above and beyond those codified in Title XI, such tailoring seems unnecessary in the context of appraisals prepared for federally related mortgage transactions. Because virtually all modern mortgage transactions are funded, insured, and sold at the national level, supporting appraisals should be prepared under a uniform federal standard. Accordingly, consolidated regulation by a central federal body communicating with the private sector, states, and federal financial institution regulators would be optimal.

Dissenters may also oppose consolidated federal regulation of the appraisal industry on the ground that funding is unavailable for a federal entity with such broad responsibilities. Even if annual registry fees such as those accumulated by the Appraisal Subcommittee were allocated to a federal regulatory body, those funds would likely prove insufficient. On the other hand, a federal agency performing licensing and certification functions could

226. *Supra* notes 16–20 and accompanying text.

227. *See generally* 12 U.S.C. §§ 34.42–33.47 (OCC), 323.1–323.7 (FDIC), 564.1–564.6 (OTS), 722.1–722.7 (NCUA); Fed. Deposit Ins. Corp., *supra* note 179.

allocate those fees exclusively to appraisal regulatory activities rather than to state general funds.

A federal regulatory agency could also receive funding by collecting a nominal fee for appraisals prepared in connection with federally related transactions. If such a “tax” remained minimal, loan-origination costs would not increase significantly and the real estate lending market likely would not suffer. Moreover, given the volume of appraisals prepared nationwide, a minimal “tax” would accrue into a substantial fund.

Finally, increased federal funding for a federal regulatory entity could be made available. The feasibility of increased funding seems especially plausible in light of the substantial funding provided to law enforcement agencies through the Fraud Enforcement Recovery Act of 2009, which Congress enacted to prosecute mortgage fraud.²²⁸ Given the great potential of effective appraisal regulation to deter mortgage fraud, the legislature should provide at least as much funding for proactive prevention as has been provided for reactive prosecution.²²⁹ Thus, funding for supervision of the appraisal industry should not be a serious hurdle to the creation of a central federal body.

V. CONCLUSION

Given the importance of the appraisal process, as evidenced by the devastating consequences of its neglect in the past two major national financial crises, restoration of the independence and quality of appraisals is imperative. Regulators must carefully examine the nature of appraisals and their role in the real estate lending process to promote independent and accurate appraisals. With an understanding of the subjectivity inherent in the appraisal process and the conflicting interests of the parties whom the process is meant to protect, regulators can identify the reasons why appraisal regulation has failed thus far. Accordingly, regulators must recognize that broad and decisive action is necessary to ensure the soundness of the appraisal process and the national mortgage industry that depends on it.

228. *See id.* at 1617.

229. John D. Arterberry, Executive Deputy Chief, U.S. Dep’t of Justice, Keynote Address at the Appraisal Foundation Valuation Fraud Symposium (Oct. 13, 2006).

Effective regulatory reforms must eliminate loan origination parties' ability to improperly influence appraisers' determinations of value. To achieve this end, regulators must draft and enforce regulations that will remove interested parties from positions of influence in the appraisal selection process. Additionally, to ensure that appraisal regulations are adequately maintained, monitored, and enforced, regulatory responsibilities must be consolidated at the federal level.

These reforms are substantial and will be met by resistance from some members of the mortgage industry. The changes will come at a cost and will present logistical challenges at the outset. In the long run, however, these measures will prevent the disastrous financial consequences that have stemmed from appraisal regulatory shortcomings in the past. Ultimately, the enhanced soundness and public perception of the mortgage industry will justify the sacrifice.

