Home Valuation Code of Conduct

Myths and Realities

The Home Valuation Code of Conduct (HVCC) is scheduled to take effect May 1, 2009. As of that date, institutions that deliver loans to Fannie Mae or Freddie Mac must represent and warrant that the appraisals obtained adhere to the requirements found in the HVCC regarding appraisal management, ordering and review by lenders.

For more information on the HVCC, visit the following websites:

- Fannie Mae (HVCC and Frequently Asked Questions)
  https://www.efanniemae.com/sf/guides/ssg/relatedsellinginfo/appcode/

- Freddie Mac (HVCC and Frequently Asked Questions)
  http://www.freddiemac.com/singlefamily/hvcc_faq.html

- Federal Housing Finance Agency
  http://www.fhfa.gov/webfiles/277/HVCC122308.pdf

The release of the Home Valuation Code of Conduct has raised many questions on the part of lenders, appraisers, and others involved in mortgage lending activities. Lenders that sell loans to Fannie Mae or Freddie Mac are likely reviewing their internal appraisal operations, and some may have to retool or restructure their operations to achieve compliance.

Unfortunately, there is confusion and misinformation in the marketplace regarding HVCC compliance and appraisal policies in general, particularly in regard to use of third party vendor management firms. To help bring clarity to these issues, the information below is intended to identify some of the myths we have identified and state the reality. The will likely be additional questions and more information available on this issues in the coming weeks and months. Look for further or post inquires at: For further information, please contact: insidethebeltway@appraisalinstitute.org.

Myth: The HVCC requires lenders to use Appraisal Management Companies.
Reality: Use of appraisal management companies is not required under the Home Valuation Code of Conduct (HVCC). Lenders may engage appraisers directly without the use of third parties.

Myth: Mortgage sellers cannot achieve compliance without outsourcing the appraisal function.
Reality: Sellers may achieve compliance by establishing meaningful risk management practices, including separation between risk management (appraisal) and loan production. The Code requires that loan production staff not be involved in ordering the appraisal. This separation is currently required under existing federal bank regulation.

Myth: "Loan Correspondents" or "correspondent lenders" are the same as mortgage brokers and they too cannot order appraisals.
Reality: Unlike mortgage brokers, loan correspondents fund loans in their own name and, therefore, have "skin in the game." They are allowed to order appraisals on loans sold to Fannie Mae and Freddie Mac like other sellers that fund loans in their own name or with their own funds. Mortgage brokers no longer will be able to engage real estate appraisers directly.

Myth: Sellers cannot maintain the appraisal function internally (as an in-house operation), without loan production involvement.
Reality: There are several ways in which sellers may staff appraisal functions internally without outsourcing the function to a third party, so long as they maintain separation between risk management functions and loan production staff. To achieve compliance the appraisal function should report to an individual or department outside of loan production. Some examples of eligible individuals or entities within institutions include, but are not limited to, the following:

- the risk management department,
- the credit department,
- the consumer lending department (with no loan production responsibilities),
- the compliance office, or
- the chief executive office.

For many institutions, the HVCC will not require any changes. However, whether the appraisal function is a fully staffed appraisal department or an individual assigned with the appraisal responsibility, the function can be maintained internally where the reporting line is to someone other than loan production (e.g., any of the entities listed above). Sellers also should make sure that their policies are in compliance with any applicable federal bank regulatory policies by contacting their appropriate bank regulatory agency.

Myth: Loan Production staff is prohibited from communicating with appraisers.
Reality: Loan production staff may communicate with the appraisers, but they cannot be involved in selecting, retaining, recommending or influencing the selection of any appraiser for a particular appraisal assignment. Further, loan production staff cannot have any "substantive communications with an appraiser or appraisal management company relating to or having an impact on valuation, including ordering or managing an appraisal assignment."

Myth: Outsourcing appraisal functions to an appraisal management company can reduce costs.
Reality: Given the diversity in the size and structure of lending institutions, it is difficult to conclude that outsourcing necessarily will reduce costs. Lenders incur costs for appraisal risk management whether done in-house or outsourced. Lenders should consider all the costs of compliance, including the costs associated with ensuring appraiser competence and appraisal quality, before making a decision to outsource their risk management functions.

Myth: Outsourcing appraisal management to a third party reduces lender risk.
Reality: Federal bank regulatory agencies have cautioned against reliance on third-party relationships by reaffirming that such relationships may significantly *increase* a bank's risk profile, notably its strategic, reputation, compliance and transaction risks[1]. According to federal banking guidelines, "Increased risk most often arises from poor planning, oversight and control on the part of the bank and inferior performance or service on the part of the third party, and may result in legal costs or loss of business. To control these risks, management and the board must exercise appropriate due diligence prior to entering the third-party relationship and effective oversight and controls afterward."

Myth: Use of third party vendors ensures the use of competent appraisers.
Reality: Lenders traditionally have been responsible for ensuring the competency of the appraisers and reliability of the appraisals they use for credit decisions. However, the competency of an appraiser is not measured by scoring compliance with seller servicer guidelines. Processing appraisal orders is a separate function that does not specifically include a review of competency. The function of competency review is best performed by individuals with significant education in appraisal standards and theory.

Further, institutions should consider any potential reductions in quality that might result from outsourcing the appraisal function. To this point, federal bank regulatory agencies recently reminded institutions to consider an appraiser's competency for any given appraisal assignment.[2]

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[1] *OCC Guidance Cautions National Banks on Third Party Relationships.* (2001, November 2). Office of the Comptroller of the Currency, United States Department of the Treasury. Available at http://www.occ.treas.gov/ftp/bulletin/2001-47.txt

[2] *2006 Revisions to the Uniform Standards of Professional Appraisal Practice*. (2006, June 22). OCC, FRB, FDIC, OTS, NCUA. Available at http://www.occ.treas.gov/ftp/bulletin/2006-27a.pdf

Myth: The licensing of an appraiser ensures his or her competency.
Reality: Licensing does not necessarily ensure the competency of an appraiser. The Fannie Mae and Freddie Mac Selling Guides require lenders to review the appraiser's education and experience. Specifically, the Fannie Mae Selling Guides state:

"A lender must not assume—simply based on the fact that an appraiser is state-licensed or state-certified—that the appraiser is qualified and knowledgeable about a market area or is aware of the appropriate market data sources for the area and will be able to obtain access to them. If an appraiser is not knowledgeable about a particular location, is not experienced in appraising a particular type of property, or is not familiar with (or does not have access to) the appropriate data sources, a lender should not give the appraiser assignments in that market area or for that particular type of property."[3]

Myth: Professional appraisal designations cannot be used when evaluating the qualifications, education and experience of an appraiser.
Reality: The Fannie Mae Selling Guides state that designations may be helpful in evaluating an appraiser's qualifications, particularly when the designation is from a nationally recognized organization. Specifically, the Fannie Mae Selling Guide states:

"Professional appraisal designations can be helpful to the lender in evaluating an appraiser's qualifications, particularly when the designation is from a nationally recognized organization that has formal experience, education, and ethics requirements that are strongly administered. If the lender considers an appraisal designation in its evaluation, it should be familiar with the appraisal organization's specific requirements to ensure that the designation is evaluated appropriately."[4]

Myth: "Comp checks" – which are prohibited under the HVCC without an engaged appraisal assignment – are the only way to determine if there is sufficient value in the collateral before proceeding with a loan application.
Reality: Lenders often want to know if there is sufficient value in the collateral before proceeding with a loan application. To determine this in the past, lenders and brokers would request "comp checks" of the appraiser. The HVCC bars lenders from ordering "comp checks" without engaging an appraiser in an appraisal assignment.

Lenders may engage appraisers in appraisal assignments that involve a scope of work that is significantly narrow. For example, the appraiser could provide an answer to the question "is the property worth at least $XX" or "is it within a certain range," rather than a single point value estimate? This still would be an appraisal; the appraiser would need to complete the necessary research and analysis to answer such a question, and would have to document that analysis properly. Alternatively, the appraiser could be engaged in a consulting assignment to provide raw data to the client to help with their analysis.

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[3] *Knowledge and Experience Requirements*. (2003, August 24). Fannie Mae Single Family Selling Guide, XI, 101.02. Available at www.efanniemae.com

[4] *Selection of Appraisers*. (2002, June 30). Fannie Mae Single Family Selling Guide, XI, 101. Available at www.efanniemae.com

Final Note: The HVCC is intended to promote independence in the appraisal process and, thus, help ensure that appraisers and the appraisal process may be relied upon as part of sound underwriting for financial institutions.

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