



FHA Independence Policy and FHA appraisal requirements **By: George K. Demopulos**

Mr. Demopulos is the President, Chief Corporate Appraiser and Co-founder of Lincoln Appraisal & Settlement Services. He is a certified, residential appraiser licensed in 5 states and has over 20 years experience in the real estate business. Lincoln Appraisal & Settlement Services provides real estate valuation, appraisal and settlement services throughout the United States for many of the country's largest banks, wholesale lenders and mortgage companies. Website is at: www.LincolnAppraisal.com

Background of the Appraisal Independence Policy

By now, the mortgage and appraisal industry has settled into and is working within the Home Valuation Code of Conduct (HVCC) which became effective on April 1, 2009 following an agreement between Fannie Mae, Freddie Mac and The New York Attorney General. Since April, all mortgage brokers and appraisers have found themselves working with new requirements to provide for appraisal independence for Fannie and Freddie loans.

The market has faced several obstacles with the implementation of the HVCC; appraiser-panel management, paying appraisers, geographic competency issues, value issues, mortgage brokers with "no control" of the appraisal process, etc. The market is working through these issues and most of the issues are being solved.

The New Federal Housing Administration (FHA) Appraisal Policy

Beginning February, 15 2010, FHA Appraisal Independence Policies very similar to the HVCC go into effect for all FHA-insured loans. The FHA policy and the HVCC have established standards for solicitation, selection, compensation, conflicts of interest and appraiser independence. They also prohibit the loan production staff from selecting, retaining, recommending, or influencing the selection of appraisers and prevent them from participating in any direct and substantive conversations with appraisers or appraisal management companies regarding the appraisal valuation.

The FHA, which is the largest insurer of mortgages in the country, provides mortgage insurance on loans made by the FHA-approved lenders throughout the US. As of February 15, 2010 new FHA policy states that FHA-approved lenders are now prohibited from accepting appraisals prepared by FHA approved appraisers who have been selected, retained or compensated in any manner by a mortgage broker or any member of a lender's staff who's commissioned compensation is directly tied to the successful completion of a mortgage loan insured by FHA.

The FHA Appraisal Process compared to Conventional Loans

The appraisal is the lenders tool for making a determination if the property meets the Federal Housing Administration's (FHA) minimum property requirements for an FHA insured mortgage. FHA is part of the Dept. of Housing and Urban Development. The FHA Valuation Protocol, which delineates Residential appraisal requirements, is found in Appendix D of the FHA 4150.2 Handbook.



The FHA appraisal process has traditionally asked more of the appraiser than is asked in the completion of an inspection for a conventional appraisal. The 139 page Valuation protocol identifies line by line what the expectations are regarding the inspection. *One of the major differences between a regular inspection and an FHA inspection is that a property inspection will involve and in-depth visual inspection of all areas of the subject property including the attic.* It is always advisable for the lender to inform the homeowner of this requirement. The appraiser MUST inspect the attic even if access is available only through a scuttle.

In addition, another major difference from a conventional loan appraisal is that in the performance of an FHA appraisal the appraiser MUST report any deficiencies noted during the inspection. *Required FHA repairs (deficiencies) are those that impact the Safety of the occupants; the Security of the property or the Soundness of the structure.* In cases where such items are identified it is the appraiser's responsibility to make the value opinion of the property "subject to" the repair of the item. Such appraisals that mandate a repair item will then require a compliance inspection to insure the deficiency has been corrected.

While potential repairs do cause a delay to the transaction they are essential to eliminate conditions that threaten the physical security of the property. FHA appraisals, however, are "no guarantee" that the property is free from defects. The appraisal only establishes the value of the property for mortgage insurance purposes. In fact, Buyers are generally encouraged to engage a qualified home inspector to obtain a more detailed physical (rather than visual) property inspection.

Responsibilities of Appraisal Management Companies (AMC's)

High-quality AMC's and their mortgage industry partners have teamed quickly and efficiently leading up to and after April 1, 2009 making the HVCC transition as seamless as possible. The same will hold true as the February 15, 2010 FHA policy goes into effect. Lenders, brokers, AMC's, appraisers and many others in this evolving mortgage industry have invested multi-millions of dollars in a short period of time to comply with the HVCC and the upcoming FHA policy and this transition has not always been perfectly smooth.

However, at the end of the day high-quality AMC's provide a desired, necessary and cost-effective service to the mortgage industry all while managing the service requirements of lenders, brokers, consumers and governmental regulations. By working with a high-quality AMC and high-quality FHA appraisers, the appraisal process will add value to the loan process and will provide important information regarding the collateral of a loan.

AMC's are also included in the new FHA policies and FHA-approved lenders must ensure that:

- FHA Appraisers are not prohibited by the lender, AMC or other third party, from recording the fee the appraiser was paid for the performance of the appraisal in the appraisal report.
- FHA Roster appraisers are compensated at a rate that is customary and reasonable for



appraisal services performed in the market area of the property being appraised.

- The fee for the actual completion of an FHA appraisal may not include a fee for management of the appraisal process or any activity other than the performance of the appraisal.

- Any management fees charged by an AMC or other third party must be for actual services related to ordering, processing or reviewing of appraisals performed for FHA financing.

- AMC and other third party fees must not exceed what is customary and reasonable for such services provided in the market area of the property being appraised.

Conclusion

The goal of the new FHA policies is to clearly and affirmatively establish appraiser independence which, in turn, should minimize the opportunity for collusion between the parties involved in the mortgage transaction and eliminate the pressure which potentially could be exerted on the appraiser to “hit value”. It has been stated many times that these unfortunate occurrences have tangibly contributed to the current real estate crisis.

Why are these policy changes important? Directly speaking, although the majority of brokers and lending institutions are conscientious and conduct themselves honorably, too great a percentage are only interested in closing loans and generating commissions. Those with unscrupulous business practices continued to seek out those appraisers whom they could influence to “push” values with the promise of more work if the appraiser “worked with them” on value. Many in the mortgage industry used their on-going appraisal work as leverage with these appraisers to get the valuations they needed to close their loans.

Simply put, with the adoption of FHA’s new policy of Appraiser Independence, mortgage brokers can no longer directly order the appraisal for any FHA transaction. Many lenders will continue to rely on AMC’s to provide appraisals on a regional or nation-wide level as they have with the HVCC.

The consequences of the HVCC and FHA policies are, in some instances, frustrating. Many independent appraisers have lost long-time local broker relationships and have had to work on a fee-split basis with national AMC’s. And, mortgage brokers can no longer work with and have direct influence over appraisers. The broker has lost “control” over the appraisal process.

However, even with the challenges the new FHA and HVCC appraiser independence policies will help provide stability and eliminate fraud and collusion in a real estate market which was completely out of control.

All FHA Mortgagee Letters can be found at
<http://www.hud.gov/offices/adm/hudclips/letters/mortgagee>