Appraisal Institute®
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Home Valuation Code of Conduct

Myths vs. Realities

The Home Valuation Code of Conduct is scheduled to be implemented by Fannie Mae and Freddie Mac on May 1, 2009. After that date, all loans sold to either government sponsored enterprise must represent and warrant that appraisals obtained by mortgage lenders 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)
- Freddie Mac (HVCC and Frequently Asked Questions)

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 in the process of reviewing their internal appraisal operations, and some must retool or restructure their operations to achieve compliance.

The Appraisal Institute has observed a great deal of misinformation in the marketplace regarding HVCC compliance, particularly as it relates to use of third party vendor management firms. To help bring clarity to several concerns, we provide the information below to correct several myths that we have identified in recent weeks. For further information, please contact insidethebeltway@appraisalinstitute.org.

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

Myth: Financial institutions cannot achieve compliance without outsourcing the appraisal function
Reality: Institutions can achieve compliance by establishing long-standing and meaningful risk management practices, including separation between risk management (appraisal) and loan production.

Myth: Financial institutions cannot maintain the appraisal function internally, out of the reach of loan production.

Reality: There are several ways in which financial institutions can staff appraisal functions internally without outsourcing the function to a third party, while maintaining separation between risk management and loan production. To achieve compliance the appraisal function should simply report to an individual or department outside of loan production. Some examples of eligible individuals or entities within institutions includes:

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

Whether the appraisal function is a fully staffed appraisal department, or an individual assigned with the appraisal responsibility, the function can be maintained internally but the reporting line must be to someone other than loan production (e.g. any of the entities listed above).

Myth: Outsourcing appraisal functions means reduced costs for financial institutions
Reality: With many appraisal management companies taking as much as 50 percent of normal appraisal fees, lenders are incurring costs that could be used to establish and run fully functioning appraisal departments.

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 they can significantly increase a bank's risk profile, notably its strategic, reputation, compliance, and transaction risks[1]. 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: Third party appraisal management companies insure the lender will receive credible and competent appraisals
Reality: Lenders have always been responsible for insuring the competency 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.

Myth: Licensing assures the competency of the appraiser

[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

Reality: Licensing does not necessarily constitute 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."[2]

Myth: Professional appraisal designations cannot be used when evaluating the qualifications, education and experience of an appraiser

The Fannie Mae Selling Guides state that designations can 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."[3]

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 a "skin in the game." They are allowed to order appraisals on loans sold to Fannie Mae and Freddie Mac like other financial institutions under the HVCC.

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

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