From the Desk of
Stewart Heller
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VIA e-MAIL

CC: Wally Young, FRB, San Francisco
Joan Trice, Collateral Risk Network

December 27, 2010
Kathleen C. Ryan
Senior Counsel
Federal Reserve
1709 New York Ave, NW
Washington, DC

Dear Ms. Ryan,

I received your contact information from Joan Trice and am thereby forwarding our comments submission to you with a copy to our other contact at the FRB, Wally Young in San Francisco. The following is the submission of our comments for the Dodd-Frank Appraisal Sections in response to the FRB request for comments to the interim rule; it also includes general comments on the Appraisal Sections 1471-1476.

These comments represent the consensus of group of high ranking bank officers, historically called chief appraisers, but this group is also inclusive of chief credit officers who perform the chief appraiser function in smaller banks, and is also inclusive of multiple chief appraisers at larger banks (ex: parallel residential and commercial chief appraisers) who perform separate functions in some institutions. These ranking officers in our group are responsible for the real estate property valuations for residential as well as commercial loans and other real estate transactions for fifty (50) federally insured banking institutions, primarily based in California, Arizona and Nevada; but this number also includes a few banks with regional offices in these states which are actually based elsewhere. We come from institutions that range in size from under $1 Billion to over $50 Billion in assets. Our gatherings are known as the Southern California Chief Appraisers Group and the Northern California Chief Appraisers Organizing Committee we have a website at www.chiefappraisergroup.com.

We do not represent the official positions of our banks, but rather the consensus of our own independent views based on the personal collective wisdom we have gathered through two thousand combined years of experiences in dealing with these appraisal issues on the front lines, with boots on the ground, frequently working hand in hand in concert with regulators through two major crises over the past 25 years.

As a group we are working to restore "the integrity of the appraisal process." In this endeavor, we represent many individuals who have dedicated their professional lives to this enterprise, and we know what we can do when we are allowed to do it. This is at the heart of our message to you.

We look forward to working with the FRB, or any other agency or Congressional body, to address this situation. We would greatly welcome the opportunity to speak with the FRB in greater depth about the comments we are presenting for your consideration.

Respectfully submitted,

Stewart Heller
Co-Founder
Southern California Chief Appraisers Group
Northern California Chief Appraisers Organizing Committee
Chief AppraiserGroup.com

December 26, 2010

COMMENTS TO INTERIM RULE REGARDING APPRAISALS
&
TO THE APPRAISAL SECTIONS 1471-1476 IN GENERAL
OF THE
DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

PURPOSE OF COMMENTS:

TO BETTER ACHIEVE THE STATED, CRITICALLY IMPORTANT GOALS
OF THE INTERIM RULE
AND THE
APPRAISAL SECTIONS 1471-1476 IN GENERAL
BY STRENGTHENING & ENHANCING CRITICAL AREAS OF
APPRAISAL ACTIVITIES IN THE LEGISLATION
WHICH WE HAVE CHARACTERIZED FOR THIS PURPOSE IN THREE AREAS
AS FOLLOWS:

A TRUE, REGULATORY, STRUCTURED APPRAISER INDEPENDENCE,

A REALISTIC, SYSTEMIC, COOPERATIVE SYSTEMIC SYSTEM OF ENFORCEMENT OF REGULATIONS,

AND

A SPECIFIC, EFFECTIVE, PRACTICAL SYSTEM OF PREVENTION

CONTENTS:

I. SOURCE OF THE COMMENTS

SOUTHERN CALIFORNIA CHIEF APPRAISERS GROUP
NORTHERN CALIFORNIA CHIEF APPRAISERS ORGANIZING COMMITTEE
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Contact Person: Stewart Heller, 510-816-2974. stewheller@aol.com

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Stewart Heller

II. MAIN FOCUS OF COMMENTS: ENHANCING THE APPRAISAL PROVISIONS OF DODD-FRANK IN AREAS CONSIDERED BY PROFESSIONAL EXPERTS TO NEED STRENGTHENING TO BE EFFECTIVE.

The main thrust of our efforts at the moment is to respond to the call for comments by the Dodd-Frank Reform transition team by offering our proposal for strengthening and enhancing what we see as the areas of the legislation as they relate to the safety and soundness of the property valuations. The appraisal of real estate represents the foundation underpinning our entire system of mortgage lending and real estate investment in this country.

The Dodd Frank Act itself, and the FIRREA Act which preceded it 20 years ago, have both sought to make the system of property valuations into an honest, independent, professionally based endeavor. As a group of valuation professionals with two thousand years of experience among us, we can assure you that the Dodd Frank Regulations as proposed, just as FIRREA before it, will not achieve these objectives, and will expose our financial system to another catastrophe, made worse by the mistaken belief that the holes in the dike have been plugged by the array of restriction contained therein. Its main weaknesses are found in its lack of real support for its goals and provisions in three most critical areas: enforcement, prevention and appraiser independence

#1 – Creating a Legally Commissioned Chief Valuation Officer (CVO) Position and a 500 member CVO Network to enhance the State-by-State Enforcement Efforts of Regulators and Congressional Oversight Committees, by dealing with <u>Correcting Appraiser Problems on a Systemic Basis</u> to enhance the state-by-state method of reporting misbehavior to the state agencies for corrective actions.

We propose a more comprehensive approach than reporting violations to an already overstretched system of state agencies, with our most experienced bank valuation officers participating on the ground level where loans are made, working with regulators and congressional oversight committees through a legally commissioned national network of "Chief Valuation Officers" (CVOs). This network will form the strong backbone of the Dodd-Frank Act's efforts to protect the American consumer, bank depositor and the bank fund by enhancing and strengthening the Law in terms of the systemic national enforcement of it's appraisal provisions both in response to violations that go far beyond the confines of state regulatory agencies, and in the all important prevention of law breaking through an Early Warning System, first proposed by Elizabeth Warren last Spring. This identification, collection and timely use of problematic valuation abuses would be based in a group of approximately 500 CVOs, embedded in banks where they already work, institutions with an assets size above $1.5 Billion (with special provisions made for smaller banks and for mega banks that have more than one chief appraisal officer).

The CVO network will enable emerging national problems to be caught sooner because just a few misdeeds will look like a crime wave if only 50 CVOs are reporting it. And locally, a CVO who is empowered by the regulators will be much more likely to take the step of reporting problems to the state because her role would be so defined, and the bank will be given credit for the CVO's positive contributions their work of keeping appraisal industry on its best behavior.

#2. Strengthen Dodd-Frank and the regulatory agencies' work in the Enforcement of Rules & Regs; and actually create new possibilities for them in the <u>Prevention Area of Enforcement;</u>

These are unquestionably the weakest links in the appraisal sections of the new law - and the same can be said as well of the inherent weaknesses in the current regulatory system, where agencies' staffing and use of resources are not positioned for prevention or enforcement of appraisal regulations to any meaningful degree.

The CVOs will be reporting on their bank's conformity to the regs and steps taken to improve self-regulation, enhancing the individual examiner's ability to work out enforcement strategies with the CVO. Wouldn't that be a great day? We don't expect perfect harmony just yet, but a closer working relationship between a more protected and independent CVO and an examiner supporting the CVO's efforts to continuously improve the bank's enforcement procedures would be transformative to overall enforcement and compliance. Example: Let's say the CVO takes strong corrective actions on her own to some stuff the bank shouldn't have been doing in the appraisal area, and the regulators decide that her actions will overall be a big plus in the bank's examination findings. The CEO takes a look at the regulator's glowing comments and says to herself, "Hey, these guys made us look good, and helped soften some other bad stuff we did. I like this CVO or whatever they call it."

#3. <u>Strengthen Bank Appraiser Independence and therefore fee appraiser independence</u> to the point where it really means something, by creating the CVO position and having its responsibilities include:

Fee Appraisers are appointed by the CVO and the ultimate decisions on decisions on which outsource appraisers to use become the decision of the CVO. A truly independent CVO is the best insurance of fee appraiser independence possible; complaints about interference from the fee appraiser to the CVO will be corrected without any concern that the appraiser will be thrown off the list; on the contrary;

A direct report to the Board of Directors as the **Subject Matter Expert (SME)** in real estate valuations including properties related to all RE loans, RE securities, direct investments, developments and developers, loan purchases, bank RE, et al; to include trends, cap rates, equity yield rates, the REO market, etc.;

Annual report to the Regulator on Compliance will mean that the CVO cannot easily be pressured by management when that pressure may affect the CVO's compliance report;

#4: <u>Provide Invaluable Support for the CFPB</u> through the CVO Early Warning Network

Working with new CFPB as resource provider – as part of CVO Network; this would make possible an extensive and responsive complaint mechanism for hot items relating to appraisal problems brought to the CFPB for resolution; this would allow for a rapid high level resolution of many complaints about appraisals in the system;

<u>III. THE SPECIFIC PROPOSALS</u>

THEREFORE, WE PROPOSE
Strengthening the Dodd-Frank Interim Rule &
The Appraisal Sections 1471-1476 in General
By the following specific comments &
Proposals for enhancements:

Even veteran investors, career real estate people and regular bank depositors are shocked and incredulous when they are told that there is no requirement for their banks to have a chief appraiser or a review appraiser or even a state certified or licensed appraiser on staff to monitor the appraisals used for mortgage loans. And moreover, the responsibilities of a chief appraiser are vague and subject to the whims of management even if they have one. The mischief that has resulted from these immense holes in the protective safety net can be seen in the losses from the disasters of the S&L crisis and the current real estate lending debacle that nearly destroyed our financial system; and for those who say the last one was a secondary market crisis, let's not forget that every one of those bad loans required an appraisal.

In its simplest terms, this proposal seeks to fill those immense holes once and for all in the following ways:

1. **Require finally that every federally insured institution that wishes to engage in mortgage lending must have a state certified chief valuation officer (CVO) - like a chief appraiser - on staff,** and not be out-sourced except under very special circumstances with approval of the regulators; with allowances made for very small and very large banks;
2. **Specify the responsibilities of the CVO to insure his/her independence from management's undue influence on the accurate reporting of their true professional opinions as follows:**
   a. **Annual Reports on the Bank's compliance (good and bad) to the supervisory regulator** – if corrective actions were taken, that's good for the bank's ratings
   b. **Direct Reports to the Board of Directors** – so that management cannot bury valuation problems and the Board can be assured it is getting the most reliable expert opinions from its qualified staff
   c. **Only if CVO's are truly independent can <u>the appraiser they chose to perform the bank's appraisals being truly independent as well</u>** – this fact is indisputable; the buck must stop with the CVO and the CVO must be independent!

3. **Participate in a National Network of CVO's for the following purposes**

   a. Early Warning System for Valuation Problems Arising from faulty Appraisal Practices and Property Valuations – CVOs like Chief Appraisers are privy to all manner of problems with valuations, whether it be market values falling, phony values being pushed by appraisers, brokers, developers, appraisal companies, and so on; and they see these as soon as they come in the lending door with loan approval requests; this data can be fed electronically from the desks of 500-600 chief valuation officers nationally with very little time lost and be collated in a Washington D.C. headquarters by a small CVO national staff with the **help of an agency like the FDIC, FRB or OCC;** and once confirmed, can be sent immediately out to the thousands of bank examiners in the field to be investigated; and if further confirmed in the field, these dangerous practices can be stopped before most of those bad loans are ever booked. That is the way to prevent a crisis from ever happening, and it can be done for a relatively minimal cost in people, technology & materials by partnering with an existing federal agency.

   b. Support the Consumer Financial Protection Bureau (CFPB) by directing complaints quickly and expertly regarding appraisal problems – there is no way on earth that consumers will ever get any satisfaction in the short run when they complain about appraisal problems because the new CFPB will never be able to hire enough appraisers to deal with the hundreds of complaints, especially on hot deals in process; here, the CVO network, by using little more than a fraction of each CVO's time in a given month, can help the Bureau either solve immediately or direct the bureau staffers to the best solutions, based on their senior experience in these areas.

IV. BACKGROUND

Background
Of the Valuation Problem that Dodd-Frank seeks to Fix:
Why does it exist?
Why do the regulators seem to ignore it?
Why does bank management minimize its significance?
How do these Comments fit into the Dodd-Frank
Enhancement Scenario?

As the FRB and the regulators who must enforce both the letter and the intent of the Dodd-Frank Appraisal provisions, you are the leaders now facing the enormous challenge of the greatest financial crisis to afflict this country since the Great Depression. Your predecessors and colleagues have already acted in the passage of "the most sweeping overhaul of the nation's financial regulatory system since the Great Depression." Now it is in your hands to take whatever steps you can in furtherance of our financial system's complete recovery.

As the FRB and the other regulators, many on Congress, and many others have said during the debates before and after passage of the Dodd-Frank Reform Act, substantial risks to our financial system and to our key financial institutions still remain. If unaddressed by your careful fine tuning now, these risks could result in crippling losses for our financial institutions once again, forcing taxpayers once again to pick up the tab or risk economic catastrophe.

Because we share these concerns with you, we are asking you and your committee to support for the first time in US Regulation History, the creation of a permanent position of Chief Valuation Officer (CVO), which is similar to the Chief Appraiser position. The lack of a regulation requiring a certified valuation control officer is the biggest major aspect of the safety and soundness net that everyone, perhaps you included, are almost always shocked to discover is not already a matter of regulation or law.

And along with that, there are some extremely important responsibilities that the CVO can and should perform to help stabilize and protect from abuse the entire valuation half of the mortgage loan half of the financial equation (remember no secured loan – including all those terrible ones from the boom years - can be made without an approved appraisal). A very important role is a cooperative one, that is working with the approbatory 500-600 other Coves across the US, to have for the first time in our history, and Early Warning Network that will alert regulators and the Congress when things are getting out of hand long before the loans are even closed, much less two or three years later when they finally go bad. This means the creation a permanent "Early Warning System by a Chief Valuation Officers Network for Appraisal Practices and Property Valuations." This is a system comprised primarily of a self regulatory body that works in close coordination with regulators and Congress to achieve a much better result that any government only regulator could achieve by itself without the full involvement and support of people within the industry empowered and dedicated to the common national goal of safety, soundness, and most of all, in preventing another financial catastrophe like the one we are now enduring.

Why are the CVO and the CVO Network needed? They are needed because the appraisal function, which is so critical to the integrity and reliability of mortgage lending, whether residential or commercial, has been seriously eroded in the last few decades, leading to great losses for our financial institutions, great costs for taxpayers, and enormous risks for our financial system. This is how it happened, slowly but surely over the past 40 years.

Through the 70s and up until the 1980's the vast majority of appraisal reports were generated by bank appraisers working alongside salaried loan officers making loans for their own bank's portfolios. They used their own appraisal forms and the system of valuation control was a built-in part of the process itself; the appraisers were supervised and trained in-house and were working to protect the interest of the bank. Chief appraisers in these banks had direct personal knowledge of the skills and limitations of the individual appraisers they supervised. They could ensure that appraisers had direct property and market knowledge in order to appraise specific properties. Financial institutions encouraged and in many cases required appraisers to attend continuing education seminars to maintain and upgrade their skills.

This system has largely broken down. The forms became standardized to suit the "secondary market" where banks began selling their loans, but the care they put into something they didn't own obviously slipped. And the appraisers changed, too. The vast numbers of in house staff appraisers have been replaced almost 100% - an amazing phenomenon on only 25 years - by a patchwork system of outsourced appraisal management firms, who in turn rely on a poorly organized network of sub-contractors, all of whom owe their livelihood to the local loan brokers and property owners who are the true source of their fees. The supervisors and in house reviewers are gone too. Today's appraisals are mostly about being the cheapest and the fastest and the results are frighteningly unpredictable. Most professional reviewers (a new category in the profession) will tell you that anyone thinking that the casually outsourced appraisal is somehow "objective" is in for a rude awakening as many regulators at closed banks are amazed as they uncover the "objective" appraisals used to support loans gone bad. For example, many key decisions about the appraisal process are made by individuals with little familiarity with local market conditions. The decision makers often live and work thousands of miles away from the properties for which they are responsible. This greatly limits their ability to make a wise selection of an appraiser for a particular assignment.

The consequences of this breakdown can be seen in the Material Loss Reports (MLRs) prepared by the FDIC's Office of Inspector General. For example, a review of a recent MLR on a California-based bank (MLR-10-047) noted:

> A significant weakness cited at this examination...was the practice of renewing or extending CRE credits in locations suffering considerable market deterioration without obtaining appropriate collateral evaluations or appraisals.

As of August 20, 2010 the estimated loss due to this bank's failure was $824.6 million.

While we wish this bank's experience were unusual, this is not the case. A review of 13 Material Loss Reports prepared between October 5, 2009 and January 6, 2010 found than in 10 of these cases there was a consistent pattern of poor appraisal practices. Among the common appraisal weaknesses identified in these reports were:

- Lack of independence of the appraisal function.
- Failure to obtain updated appraisals, especially as market conditions declined.
- Reliance on hypothetical appraised values, rather than on "as is" values when approving a loan.
- Failure to adequately review appraisals

Bank failures are costly. The 10 bank failures in which appraisal practices were a factor had total losses to the FDIC insurance fund of about $1.893 billion, or an average of $189 million for each failed financial institution. As this letter is being written, 126 banks have failed so far this year, and there are 829 banks on the FDIC's "problem" list. Job losses are also a factor. According to one consulting firm (FIG Partners) bank failures have directly cost 11,210 jobs since 2007 and many times that figure as the wage earner losses spread across communities.

Real-estate related risks are a major part of the problem, and the current patchwork system does a poor job of addressing this risk. According to SNL Financial LC, 94% of bank failures since 2008 had either residential or commercial real-estate as their largest category of delinquent loans.

It is urgent that we address the problem of poor appraisal practices because of the flood of loans that will be maturing. About $535 billion worth of loans collateralized by commercial real estate will mature in 2010 and 2011, but the current patchwork system of low-paid contractors and vendors with little knowledge of local market conditions is poorly equipped to accurately evaluate this risk. Reliance on vendors means that a contractor in Tampa may be trying to select a professional to appraise a property in Southern California or Upstate New York. The potential for poor selection is enormous, especially when financial considerations are the predominant factor in appraiser selection.

Unfortunately, even in the current crisis, there are signs that bank executives have a poor understanding of the importance of the appraisal process, and continue to search for ways to meet the letter of the law without understanding its purpose or its spirit. Not long ago one FDIC-insured financial institution fired its in-house appraisal staff and outsourced the entire appraisal function to a national, privately-owned appraisal company that is wholly owned by a national real estate sales company.

There is a clear need to establish integrity to the appraisal process in federally insured financial institutions. More failure is not acceptable, and the existing system, with its risky reliance on a network of outsourced vendors, only invites future failure. We urge you and your committee to consider the following steps:

First, we should require that every Federally-insured financial institution engaged in commercial or residential real-estate lending designate a Chief Valuation Officer (CVO), licensed to appraise real estate in the state where the financial institution does business. The CVO would be responsible for establishing and enforcing sound appraisal practices and annually certifying that the appraisal practices of the institution in question were sound and consistently enforced.

Second, the Coves, approximately 500 - 600 nationally, working together comprising an "early warning system," would periodically report to Congress and appropriate regulators concerning appraisal practices in their institutions and in the industry as a whole. They would be ideally positioned to put an early stop to shady practices, and to better be able to control the flow of self-serving, slated and misleading appraisals that are still being used every day to support thousands of unrealistic lending decisions.

Third, given the FDIC's nationwide presence and commitment to protect the fund, there is the possibility of having the FDIC (or the Fed, or the OCC) add value to the network of CVO's reports to Congress and to other agencies by validating data contained in these early warning system reports and providing technical support to the CVO Network.

Fourth, the national network of CVO's can serve as an active community resource for the Consumer Financial Protection Bureau (CFPB). The network can provide the highest expert level of resolution advice for bureau staff as they seek to help consumers with immediate appraisal complaints. The CVO network can also suggest solutions to systemic problems that bureau management decides are in need of correction to benefit consumers in general.

Fifth and finally, to provide the bank's board of directors with periodic credit risk analyses related to real estate values and accompanying appraisal issues that can affect the bank's overall risk profile, particularly with respect to its investment in real estate loans, development, mortgage-backed securities, real estate owned, potential acquisitions, etc. This responsibility refers to SR 95-51 in which the Federal Reserve emphasized the importance of sound risk management processes and strong internal controls when evaluating the activities of the institutions it supervises. A direct reporting relationship between the CVO and the Board will demonstrate active board oversight without the filter of management, leading to a higher level of technical knowledge and policy making by directors in the key area of real estate valuations.

The losses our nation has sustained are substantial, but unfortunately we have not implemented some of the urgently needed reforms that would help restore integrity and soundness to valuation side of our financial system. Until we do so, we remain at risk of repeating this same experience again (1985, 2008 and perhaps another cycle repeating in 2031).