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# CUSTOMARY & REASONABLE FEES: **THE ELEPHANT IN THE ROOM**

Written by Ernie Durbin

Wikipedia describes the metaphor “the elephant in the room” as, “an obvious truth that is either being ignored or going unaddressed. The idiomatic expression also applies to an obvious problem or risk no one wants to discuss.”



## THE ELEPHANT IS BORN

As we all know, the debate over customary and reasonable fees (C&R) truly emerged after the proliferation of Appraisal Management Companies (AMCs) in mid-2009. The Home Valuation Code of Conduct (HVCC) was a real game changer. The agreement between the New York Attorney General and Fannie & Freddie's regulator established new policies regarding appraisal independence. As a result of HVCC, many lenders who had originally allowed their loan officers to order appraisals began to engage AMCs. AMCs created a firewall between loan production and the appraiser. Right or wrong, this decision sprouted hundreds of AMCs and the elephant was born.

Lenders quickly discovered the immediate benefits of outsourcing appraisal management. They could outsource risk (or so they thought), maintain a firewall for compliance and, the best part was this was all done without any expense to the lender. Profit, pure and simple. AMCs sold their services based on the premise of appraiser independence and cost savings. Let's face it; the real tension arose, of course, from the method by which the AMC was compensated. We all know that appraisers have been bearing the burden of the cost of outsourcing. From the lenders point of view it doesn't get any better than free.

As AMCs competed for business, lenders, being corporations, naturally sought the lowest cost alternative that was compliant with third-party risk. Ironically, fees increased to the consumer, which haven't

trickled down to the appraiser. AMC margins were exacted from appraisers' overall fees. AMCs were faced with the misaligned incentives of seeking the cheapest appraiser, allowing them to earn the best yield. The truth is, the rank-and-file appraiser began to pay for the lender's responsibility to manage the valuation process out of their own pockets. Suddenly, appraisers' fees were no longer customary or reasonable.

Somehow, recent events in the valuation space have deflected attention away from the elephant in the room, customary and reasonable fees. Real estate appraisers are resilient folks. They can adapt to change as well as any other professional. But like everyone else, they don't want to do more work for less pay. Most of the issues facing the valuation space today point to one simple problem- customary and reasonable fees. It's time to address this obvious problem and the risks that it poses to our industry.

## CUSTOMARY & REASONABLE FEES

Clamor erupted from the appraisal community over the change in process and the subsequent fee compression. To make matters worse, business contracted during and immediately following the housing finance crisis. Other advocates stood beside the appraisal industry and a clause regarding customary and reasonable fees was included in Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Appraisers were buoyed and thought this was the elephant gun. Unfortunately, the gun was not loaded. In October 2010, the Interim Final Rule was issued. The final rule essentially contradicted the law and allowed for avenues of compliance described as presumptions or loopholes, depending upon your point of view. These loopholes created enough confusion in the marketplace to maintain the status quo. It was a huge blow to the appraisal community.

### IGNORING THE ELEPHANT

Interest rates have remained low. Appraisers have enjoyed an increase in the volume of business, while

many still suffer from fee compression. The lack of enforcement of C&R remains one of the biggest disappointments to the appraisal community and is the source of the rancor between appraisers and AMCs and the lenders who use them.

First and foremost, below market fees are the primary argument appraisers have with AMCs. There may be other annoyances appraisers have with AMCs, but ultimately it boils down to subpar compensation. Appraisers view AMCs as a middleman in the transaction. They don't view AMCs as a source of business, and that is unfortunate. AMCs represent the largest portion of mortgage appraisal work out there right now. Good relations between AMC's and their appraisers is critical to providing good service to lenders, the client of both the AMC and the appraiser. Customary and reasonable fees would go a long way to improving the relationship between AMC's and their appraisers.

Second, the appraisal profession is facing a dearth of new entrants. There are many reasons behind the shortage, including the reluctance of lenders to allow trainees to inspect on their own and the high educational/experience requirements. These additional headwinds aside, bringing trainees into the business requires customary and reasonable fees to make the equation work. Fee compression does not allow supervisory appraisers to scale their business while paying trainees adequately for their time. Customary and reasonable fees are an economic necessity if new trainees are going to enter the business.

Finally, fee compression affects overall appraisal quality. Many will argue that appraisers are responsible for providing good quality reports regardless of the fee involved. After all, USPAP requires an appraiser to produce a credible report without discussion of the amount of the fee. This argument makes sense theoretically but not practically. The reality is, appraisers are required to produce more work product in the same amount of time in order to earn the same dollars as a result of fee compression. Even the best appraisers, under operational pressure, make mistakes. Paying customary reasonable fees will allow appraisers to spend more time in development of the valuation and make the same dollars they have been accustomed to previously. As a result, a growing number of appraisers are just refusing to do business with AMCs.

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## SHOWING THE ELEPHANT THE DOOR

Although not a reality now, there are many reasons to believe that appraisal fees will eventually align with what appraisers consider to be customary and reasonable. The free market alone will most likely have some impact as a result of the attrition of appraisers. The AMC Final Rule, enacted June 9, 2015, gives States the authority to enforce C&R. Some States have already begun enforcement actions. Georgia, Kentucky, Louisiana, Texas, Mississippi and Virginia have all commissioned independent appraisal fee studies. These states are clearly intending enforcement of customary and reasonable fees. The Consumer Financial Protection Bureau (CFPB) has not yet acted regarding C&R but there are indications that they are beginning the process of enforcement. This federal agency along with the States mentioned have noticed the elephant in the room; action on their part will draw the attention of other stakeholders (AMCs and lenders) that are currently ignoring the issue. The biggest elephant hunter by far though is the CFPB. This Federal agency alone can resolve the issue of customary and reasonable fees with one simple clarification of the rules.

According to their webpage, the CFPB "is a government agency built to protect consumers. We keep banks and other financial service providers you depend on every day operating fairly." When it comes to customary and reasonable fees, the CFPB could best live up to this mission statement by prohibiting lenders from passing on the cost of appraisal management to consumers. A simple clarification of the rules stating "a consumer may not pay for outsourced services required by the lender for the closing of the loan" would solve the whole problem. Lenders don't pass on other outsourced costs such as payroll management or janitorial fees on the HUD statement, why should appraisal management fees be any different?

Under this uncomplicated rule, "cost-plus" appraisal management would immediately take place. "Cost Plus" is defined as the "cost" of the fee to the appraiser and "plus" is the fee to the appraisal management company. Ideally, the "plus" would be determined by issuing RFPs (Requests for Proposal). Consumers would pay for the cost of the appraiser's services and lenders would pay for the cost of the appraisal management, traditionally

a cost they have born in the past. Immediately, there would be a level playing field for all stakeholders.

AMCs would compete for business, based upon their value add to the lender alone. Their margins would be based on their service, not on managing the cost of appraisals. Those who could perform compliant appraisal management at the lowest cost with the best service would win the business. Lenders would pay for services that they have traditionally paid for in-house and still enjoy the outsourcing benefits of elasticity during market change. Appraisers could charge their customary and reasonable fees and negotiate different fee levels based on the amount of work required by the assignment. And in the spirit of the mission of the CFPB, the consumer would be protected from paying for fees that should really be the lender's responsibility. Everyone wins.

If the CFPB were to implement this change, appraisers would receive higher fees, consumers would receive better quality appraisals, and AMCs would be motivated to contract with the best appraiser in the market. Appraiser relations with AMCs would improve and lenders would still maintain cost control through outsourcing. Finally, the CFPB would be doing its job, protecting the consumer and ensuring that lenders operate fairly.

**WE ALL SEE THE ELEPHANT... LET'S  
STOP PRETENDING IT'S NOT THERE.**

### ABOUT THE AUTHOR



#### ERNIE DURBIN

Ernest W. Durbin II, Chief Valuation Officer of Valuation Vision is a 2nd-generation appraiser with over 30 years experience. Ernie holds the SRA as well as the AI-RRS designations from the Appraisal Institute. At the national level, Ernie is currently on the Appraisal Practices Board (APB) of the Appraisal Foundation. He also serves on the Industry Advisory Council of the Appraisal Foundation, is a member of the Collateral Risk Network (CRN) and is an inaugural Board Member of the National Appraisal Congress.