The Age of AMCs - How Long Will it last?

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When we look back to 2009 I believe we will mark this year as the beginning of "the age of the AMCs." That's not to say appraisal management companies (AMCs) did not exist before 2009, they have been around for three decades. Appraisal management companies were born out of a bundling of closing requirements such as title, credit and appraisal. Originally designed as an efficiency play, these companies soon caught the eye of national lenders who had a problem managing appraisal panels on such a large geographic basis. The national AMC was very attractive to national lenders, it made sense to outsource to them. But things changed in 2009.

In May of 2009 something else popped up besides spring flowers, the Home Valuation Code of Conduct (HVCC). This private agreement between the New York Attorney General's Office and the two largest GSEs, Fannie Mae and Freddie Mac, was a real game changer. The result of a lawsuit, this agreement required Fannie and Freddie to institute new policies regarding appraisal independence. No longer were any parties whose compensation was dependent upon the closing of the loan to be involved in the selection of the appraiser. Many lenders who had originally managed appraisers in-house made a decision to outsource the process. National lenders may have already been doing this, but regional and local lenders, saddled with the new requirements, decided AMCs were the way to go. Suddenly, there was great demand for outsourcing of the appraisal management process.

In response to this demand, many entered the AMC space who have never been involved with this scale of management. Regional appraisal firms, reacting to the sudden migration of business, formed their own appraisal management companies. Others who had no history in valuation at all, created management companies to fill the growing demand for this outsourcing service. As a result, numerous new AMCs sprung to life, most without the necessary capitalization, knowledge, and resources to meet the task. Some of the startup organizations, provided poor and unprofessional service subsequently giving the whole AMC industry a black eye. With the rapid proliferation of AMCs became a whirlwind of controversy, real estate agents, appraisers, mortgage brokers and local lenders began to complain about the appraisal management process. Most of the grievances can probably be traced to the startup organizations.

The complaints still echo, and new ones are frequently sounded. From the lending and real estate community they center around competency. Frequently stories are told of appraisers traveling "150 miles" to perform an assignment; there's no way they can be geographically competent. We also hear that AMCs are hiring from the bottom of the barrel; only those appraisers that are willing to work for their "slave labor" rates. This incompetency results in a low appraisal and subsequently a lost transaction. Clearly from their perspective, a low appraisal indicates incompetent appraiser. As a 28 year appraiser, I have problems with this, but I digress.

A large portion of the appraisal community began to speak up as well. Many small appraisal companies were very disheartened by the proliferation of AMCs. Not all relationships with their clients involved pressure. They had good relationships with honest lenders, which developed over many years, but now AMCs are the middle man causing a separation. When their longtime clients utilized AMCs the process now prohibited directing business to them. To make matters worse, this AMC-middleman effect reduced their fee while bombarding them with requests for changes and additional information. May 1, 2009 was supposed to be Appraiser Independence Day but for many appraisers it marked a large downturn in business volume and income.

The complaining parties joined together to promote state legislation regulating appraisal management companies. To date, 11 states have passed statutes in some way supervising appraisal management companies, 19 others are pending or in process. The requirements of these legislative acts vary widely, with some reflecting a more punitive than regulatory tone. Compliance with these dissimilar regulations is a burden to all but the largest AMCs. The smaller Johnny-come-lately organizations may not be able to address the complexities of multi-state legislation.

The Home Valuation Code of Conduct, the genesis of this AMC era, is set to expire in November of 2010. With the sunset of the code and increasing legislation, will the age of the AMC be short-lived? To answer this question we need to unpack the appraisal management business model from the perspective of both the client and the appraiser. Understanding the benefits and consequences of working with an AMC for both of these parties will shed light on the future of the appraisal management enterprise as a whole.

The Lender.

Benefits

As noted, AMCs have provided a valuable service to the lending sector for decades. The appraisal management model was not invented in response to HVCC. For years, appraisal management companies have been retained by lenders to provide a host of services. Both national and regional lenders selected AMCs to manage their whole appraisal panel or sometimes a portion of their business. Let’s look at the reasons why lenders elect to use an appraisal management company.

First, nationwide coverage. In recent history, we have seen merger after merger of regional lenders creating large nationwide organizations trading in all 50 states. As these companies combined, despite their girth, they were unprepared to source appraisal services on the national level. The logistics of managing a nationwide panel without substantial volume in any particular market became unwieldy. Their solution was to outsource their appraisals to AMCs. They decided to let someone else find a competent appraiser in rural Montana as well as in downtown Los Angeles.

Seasoned and properly managed AMCs spend considerable resources developing and maintaining a nationwide panel of valuation experts. There is a lot of work that goes on behind the scenes in this process. License information has to be kept up-to-date on an annual basis. Errors and omissions insurance is required and the policies also have to be annually audited. Appraisers are scrubbed against lender blacklists to ensure only those approved are utilized. Quality audits are performed and appraisers are ranked by their competency to perform differing assignment types. These tasks are done on a very large scale to provide the best nationwide panel. AMCs are able to source appraisers in urban areas as well as in Western counties where livestock outnumber people thousands to one.

Another benefit of using an AMC is the ability to “right size” according to business volume. The volume of lending transactions has always been somewhat volatile, but the past several years it has been extreme. When a lending institution has an internal appraisal department, staffing for these fluctuations can be nerve-racking. If they are not prepared for a rapid increase in the marketplace they can find themselves falling behind quickly and not able to close loans in a timely manner. The natural result is a loss of business. The alternative is to remain staffed at high volume levels all the time. Clearly when things slow down this is a detriment to the bottom line. Upper level management hates watching people update their Facebook rather than do something productive. Outsourcing all or a portion of the appraisal management process is a good fiscal decision.

“Appraiser independence” has been a real buzz word over the last several years. As another benefit, appraisal management companies provide a natural level of autonomy for the real estate appraiser. Outsourcing appraisal management completely from a lending institution creates a distinct firewall between the appraiser and commission compensated staff. Not to say this cannot be done internally, I have worked with lenders who handle this task very well. Often it creates tension within their own departments and frequently, despite their best efforts, appraisers are contacted by interested parties and pressured to reconsider their values without warrant. AMCs do not have a dog in the value fight; they are compensated for their service, not the closing of a loan. Mature AMCs have whole departments to resolve value disputes factually and professionally, satisfying the questions of the lender and at the same time not pressuring the appraiser.

Consequences

Conversely, lenders can experience unintended consequences when working with an AMC. By nature, outsourcing any business activity results in a certain loss of control. Internal staff usually have a certain protocol for how the process is handled. Procedures are developed over time with a comfort level based on knowledge of process.

Relationships are developed between processors and appraisers providing confidence to the lending staff the job will be done right and on time. When these tasks are outsourced, a certain level of confidence in the process is lost. Giving up control is not easy and can be disconcerting. To re-instill confidence in the process, professional AMCs assign teams to individual accounts, developing new relationships between the client and vendor. Lenders can gained confidence in their AMC teams knowing they will be able deliver valuation services done right and on time.

The structure of AMCs can cause confusing and complex communications. The "firewall" created between the lender and the appraiser adds layers of discourse. Lenders always have questions. When will the appraisal appointment be scheduled? When will we receive the appraisal back? Why was it necessary to leave the neighborhood for comparable sales? All of these inquiries now have to pass through the AMC. The question that once could have been answered with one quick call between the processor and appraiser now requires four. The processor calls the AMC, the AMC calls the appraiser, the appraiser responds to the AMC, and AMC responds to the processor. Even if this doesn't add much time to the process, sometimes things get lost in the communication. Technologically competent AMCs add portals that log and transmit this information over the Internet. Nonetheless, isn't it easier just to pick up the phone and call the appraiser?

The Appraiser

Benefits

When it comes to AMCs we mostly hear of the negative impact on appraisers. In fact appraisers do benefit from working with appraisal management companies, some actually embrace them. Receiving orders from an AMC allows the appraiser to focus on what they do best, valuing property. Appraisal firms are traditionally small, with the owner of the company wearing many hats. Marketing appraisal services was a challenging endeavor before HVCC, now even more. A lot of effort goes into promoting appraisal services on the local level. The time and money spent on this activity does not immediately add to the bottom line. Time away from the desk is time not billed for appraisal services. If you spend several hours a week attracting new business, those are hours that you cannot spend fulfilling those orders.

Another time thief is billing and collections. Appraisal companies must always be on top of this activity. As funny as it seems, those people with the most money (to lend) seemed to take the longest to pay you. Sometimes appraisers receive orders from out of town lenders and never receive payment. This frustrating aspect of small business, billing and collections, is relieved when the appraiser works with a reputable AMC. AMCs may pay less, but they do pay on time and do not have to be nagged about it. Knowing when you can expect a check and exactly how much it will be removes a lot of pressure from being a small business person. AMCs understand without appraisers they are out of business. Most pay as expected.

Appraisers are workaholics. Most of them take very little time for holiday. Why is that? Possibly because they fear losing good clients when they can not service them 52 weeks a year. Some appraisers are concerned if they take two weeks off for vacation, some other appraiser will capture their client given the opportunity. And what happens when your best client orders twice the number of appraisals they usually do in a week? In an effort to not let them down, most small appraisal companies will burn the midnight oil cranking this volume out. Sure there's money to be made but there is also little league games and dance recitals to attend. AMCs can help appraisers scale their business volume. Management companies encourage appraisers to turn down work when they cannot handle it. Strong AMCs have large panels and respect appraisers who turn down work if they cannot return it in a timely manner. There's no love lost, when they're ready for orders again they just have to say so. Appraisers who work with AMCs can take a little time off.

Appraiser independence is the last and most obvious benefit of working with an appraisal management company. Pressure on the appraiser is minimized by the effective firewall created by the AMC. Seldom are stories told of AMCs pressuring appraisers related to value. It may occur, but when it does the appraiser should not work with that company.

Consequences

There has been much voice given to the consequences of appraisers working with AMCs. The primary concern is of course lower fees. Let's be honest, the AMCs margin is taken directly from the appraiser's pocket. While some lenders are willing to pay for management services separately, most expect the service without cost. The result is compressed fees for the appraiser. Appraisers should decline orders from appraisal management companies that gouge to increase their margins. These less reputable AMCs will have a hard time soliciting business if they do not have an appraisal panel to service it.

Another consequence for appraisers is loss of connectivity with their clients. Honest relationships with clients forged over many years suddenly disappear. There are lenders who did not pressure appraisers and appraisers who did not succumb to pressure. Appraiser independence is about integrity. Decades of marketing and good service evaporated when these valued clients no longer worked directly with the appraiser. Of all the unintended consequences of appraiser independence, I believe this loss of connectivity is the most significant.

Finally, working with AMCs creates time compression on the appraiser. Appraisal management companies are required to provide standard turn times to their clients.

Built into this process is a certain amount of time to account for the additional layers of communication discussed earlier. As a result, appraisers are asked to schedule appointments quickly and return written reports expediently. This allows for quality control and additional communication necessary to satisfy client requirements. These turn time requirements can make working with an AMC uncomfortable. Appraisers still have to complete their due diligence and research irrespective of mandatory turn times. Appraisers should not accept orders if the return time is unreasonable. When delays are not a result of the appraiser, the AMC should be informed immediately. This will stop the clock.

AMCs, The Future

After looking at the pros and cons of AMCs from a lender and appraiser perspective, we returned to the question, “How long will the age of AMCs last?” Not much longer as we know it. Don’t misinterpret this statement, AMCs will be around for a long time, their services are validated in the market. Although HVCC will expire soon, the emphasis on appraiser independence will not. Given the conditions of the current real estate market, an appropriate demand for accurate unbiased valuation has been stamped into our psyche. In addition, most of the HVCC themes have been institutionalized within the selling guides of the GSEs. HUD followed suit in September of 2009 adopting an appraiser independence protocol of similar flavor. The structural firewall appraisal management companies provide will remain in demand.

The major points of HVCC have also been incorporated into the new Dodd-Frank Wall Street Reform and Consumer Protection Act, signed by President Obama on July 21, 2010. According to the Bill, Dodd-Frank will take affect no later than October 19, 2010. After this date the law also states that HVCC will have “no force or effect,” ending the code two weeks prior to its sunset. Dodd-Frank amends several federal laws including the Truth in Lending Act (TILA) and the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA). Within these amendments are sections that directly speak to the practices and regulation of AMCs.

The TILA changes require appraisers to be paid “customary and reasonable” fees. It instructs that customary and reasonable fee schedules may be established by third-party surveys which exclude assignments ordered by known appraisal management companies. Violations draw a heavy penalty, they equate to fines up to $10,000 for each day any violation occurs. The implication is clear, “customary and reasonable” fees are something different than the typical amount received by the appraiser from a management company. AMCs are going to have to address customary and reasonable fees almost immediately.

FiRREA has been modified to require AMC registration with the Appraisal Subcommittee (ASC). The ASC will be required to maintain a national registry of AMCs that are subject to state regulation and/or operating as subsidiaries of federally regulated financial institutions. AMCs will be required to register within 36 months after the minimum standards are set by the ASC. The Appraisal Subcommittee will have the authority to remove AMCs from the national registry on an interim basis, pending outcome of disciplinary proceedings. In addition, there will be a national registration fee from $25-$40 per appraiser per year levied on the AMCs. Appraisal management companies are now facing additional regulation and fees at the federal as well as the state level.

Given the growing regulatory requirements and additional fees, I don't think the future is bright for all appraisal management companies. Those that sprung up as a result of sudden market demand will most likely wither under regulation, higher costs and market reaction to substandard service. As with national lenders, expect there to be a consolidation in the AMC arena as well. The cost of providing a national service is daunting. Smaller appraisal management companies will most likely need to specialize on the regional level in order to compete. The era of AMC proliferation is over.

All AMCs will have to face one major problem in the future. A scarcity of appraisers. From an industry perspective, the fees that are "customary" in the marketplace now cannot "reasonably" sustain a future for real estate appraisers. Customarily low fees are preventing the entrance of new appraisers into the business while at the same time causing the exit of our most seasoned professionals.   AMCs need to focus more on what is reasonable while developing a new customary fee schedule.

If AMCs want to have a panel to manage in the future they must solve the fee problem regardless of regulatory requirement. Margins now consumed by appraisal management companies once were paid to senior appraisers who trained new valuers. Without that margin, small appraisal firms are perishing.   The dilemma is under the current fee structure appraisers cannot scale their business beyond themselves. Without appraisers to manage, what is the value add of an appraisal management company? Solving this quintessential problem could mark the beginning of a new age for AMCs.