

APPRAISERS AND REALTORS®

A common complaint among REALTORS® in virtually all of Michigan is that many residential deals are failing because the home will not appraise at a value that permits the buyers to finance the purchase and close on the home. Many REALTORS® take the position that many of these properties do not appraise because the appraiser is not “geographically competent.” In other words, the appraiser is from out-of-town, unacquainted with the area in which the appraised property is located; thus, fails to learn or uncover various factors that would substantially change the valuation of the property. The question is then posed why are we in this situation and how can we change it.

The situation is at least in part attributable to actions taken by Congress “to provide the financial stability of the United States by improving accountability and transparency in the financial system . . .” and “to protect consumers from abusive financial services practices . . .” This quoted language is from the preface of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). It should be noted that Dodd-Frank is a mere 848 pages in length, not including the regulations that were promulgated pursuant to Dodd-Frank. In looking at this legislation, it would appear that Congress has determined that inflated appraisals played a substantial role in the real estate collapse, as a significant portion of Dodd-Frank focuses on appraisals. A stated goal of Dodd-Frank is to make certain that the appraiser involved in a home loan is truly independent. To accomplish this goal, the law provides that various persons involved in a residential transaction can have no role in the selection of the appraiser. A presumably unintended consequence of this law is

that sometimes the appraiser that is selected is not at all familiar with the community in which the home is located.

Can REALTORS® Block The Out-Of-Area Appraiser From Making An Appraisal?

Section 129(E) of Dodd-Frank prohibits “any act or practice that violates appraisal independence. . .” In order to combat inflated appraisals, Congress sought to make certain that anyone who would have a motive to try to cause an appraiser to provide an inflated appraisal has no hand in the selection of the appraiser. Thus, the regulations prohibit any person whose compensation depends on the transaction closing from participating in “valuation management functions.” § 226.42(d)(1)(ii). The definition of “valuation management functions” includes “recruiting, selecting or retaining a person to prepare a valuation.” A hypothetical helps demonstrate how this restriction limits REALTORS® in their efforts to prevent appraisals by persons who they believe are geographically incompetent appraisers.

Assume that the buyers for 123 Elm Street in Lansing, Michigan, apply for a loan from Acme Bank. The appraisal management company for Acme Bank assigns Mary Green, an appraiser from Harbor Springs, to prepare the valuation. Listing REALTOR® Smith and buyers’ agent Jones both oppose the choice of Ms. Green based on their belief that she is geographically incompetent. Can REALTORS® Smith and Jones make a demand on Acme Bank that it replace Ms. Green with a local appraiser? The answer is “no.” Because REALTORS® Smith and Jones have a financial stake in the transaction, *i.e.*, they will only be paid if it closes, they are prohibited from engaging in “valuation management functions” which include the selection of the person to prepare a valuation. They cannot make a

demand on Acme Bank to have Ms. Green be replaced by a local appraiser based upon Ms. Green's alleged geographic incompetence.

Assume Ms. Green proceeds forward with her appraisal of 123 Elm Street. Assume further that when Ms. Green arrives at the property to perform part of her valuation, REALTORS® Smith and Jones are on hand to deny her access to the property. Is it lawful for REALTORS® Smith and Jones to obstruct Ms. Green from completing her valuation? While there is no case yet on point, it does not require an in-depth analysis to connect the dots and conclude that the obstruction of Ms. Green is designed to cause Acme Bank to remove her and replace her with a different appraiser. Again, because their compensation is dependent on the transaction closing, REALTORS® Smith and Jones cannot be involved in the process of selecting of an appraiser.

Can REALTORS® Smith and Jones approach Acme Bank to express their displeasure with appraisal management companies who assign geographically incompetent appraisers? Assuming the complaint is general in nature and does not involve a specific transaction in which REALTORS® Smith and Jones have a financial interest, it would appear that Dodd-Frank and its regulations do not prohibit this discussion.

Can A Listing REALTOR® Or Buyer's Agent Interact With An Appraiser?

Assume in our hypothetical that Ms. Green, the appraiser from Harbor Springs, proceeds with her valuation of 123 Elm Street in Lansing, Michigan. Can REALTORS® Smith and Jones interact with Ms. Green during the course of her valuation to try and offset her geographical incompetence? The answer is "yes," but REALTORS® Smith and Jones must be very careful, as their efforts to enlighten Ms. Green are restricted under Dodd-Frank.

In regard to the valuation of a consumer's principal dwelling, the regulations provide:

Coercion. In connection with a covered transaction, no covered person [in our example, REALTORS® Smith and Jones] shall or shall attempt to directly or indirectly cause the value assigned to the consumer's principal dwelling to be based on any factor other than the independent judgment of a person that prepares valuations, through coercion, extortion, inducement, bribery, or intimidation of, compensation or **instruction to**, or collusion with a person that prepares valuations or performs valuation management functions. § 226.42(c)(1).

In other words, REALTORS® Smith and Jones can interact with Ms. Green, but they can do nothing that would fall within the definition of "coercion" as set forth in the quoted regulation. It seems fairly certain that REALTORS® Smith and Jones would be acquainted with the concepts of "coercion, extortion, inducement, bribery, or intimidation." A much grayer area is the notion of coercion through "instruction." While many would argue that the reference to "instruction" in the regulation simply refers to someone trying to instruct an appraiser to provide a specific value, there are perhaps others who would attribute the more common definition of "instruction" as meaning "to educate." The latter definition would essentially prohibit any meaningful interaction between the REALTORS® and Ms. Green.

Fortunately, the regulation also contains examples of activities REALTORS® Smith and Jones can engage in with Ms. Green with respect to her valuation of 123 Elm Street. "Permitted actions" by REALTORS® Smith and Jones include the following:

1. Asking Ms. Green to consider additional, appropriate property information, including information about comparable properties that may support a valuation, including a copy of the purchase agreement;

2. Requesting that Ms. Green provide further detail, substantiation or an explanation of her conclusion about the value of 123 Elm Street; and
3. Asking Ms. Green to correct any errors in her valuation.

It is clear the REALTORS® Smith and Jones can provide Ms. Green with additional comparables. The regulations provide no guidance as to what additional “appropriate property information” can be provided to Ms. Green. Presumably, “appropriate property information” may include truthful information with respect to the physical condition of 123 Elm Street and prior or current sales activity with respect to 123 Elm Street.

After an appraisal is completed, the Uniform Standards of Professional Appraisal Practice (“USPAP”), which governs appraisers, prevents the appraiser from discussing the results of the appraisal with anyone other than their client (*i.e.*, the lender) or parties designated by their client. Thus, if REALTORS® wish to submit additional comparables or data to attempt to correct what they believe are errors in a completed appraisal, they will need to submit such data through the lender.

As already indicated above, the law on these issues is relatively new and there is no reported case law which puts flesh on the bones of Dodd-Frank and its regulations. While passions can run quite high when properties fail to appraise after months spent putting a deal together, REALTORS® should be aware that violations of this law can be as high as \$20,000 for each day a violation continues. Please tread carefully.