CRN STANDARDS COMMITTEE – NEW UAD DISCUSSION BRIEF

TOPIC: *Impact of Conditional Information on Appraisal Review*

BACKGROUND/SUMMARY:

This viewpoint is guided by the four component parts of the "CRN Standards Committee": conditional information; new reporting topics; operational readiness; and unintended consequences.

The appraisal review is an essential part of the due diligence process that is typically performed at multiple stages and by multiple parties; pre-delivery to the intended user, after delivery to the intended user (pre-funding), and as a post-funding quality control measure.

The appraisal review scope of work can vary greatly. These scope of work variances may also take on different naming conventions, but primarily there are three levels of review. A completeness check, a compliance screen, and a technical (USPAP Standard 3-4) review.

The level of review required is generally determined by the procuring lending institution (*intended user*) based on a multitude of collateral and loan risk criteria.

As part of this discussion, it is important to recognize the responsibility of the lending institution's requirement to comply with the Interagency Appraisal and Evaluation Guidelines.

Per the Interagency Appraisal and Evaluation Guidelines:

> "The Agencies' appraisal regulations specify that appraisals for federally related transactions must contain sufficient information and analysis to support an institution's decision to engage in the credit transaction.
>
> As part of the credit approval process and prior to a final credit decision, an institution should review appraisals and evaluations to ensure that they comply with the Agencies' appraisal regulations and are consistent with supervisory guidance and its own internal policies. This review also should ensure that an appraisal or evaluation contains sufficient information and analysis to support the decision to engage in the transaction. Through the review process, the institution should be able to assess the reasonableness of the appraisal or evaluation, including whether the valuation methods, assumptions, and data sources are appropriate and well-supported."

In understanding the lending institutions responsibility to ensure the appraisal is meeting the guidelines noted above, a robust quality assurance and control process is required and essential.

Whether the lending institution utilizes a third-party vendor, proprietary automated rule system, or in-house staff to execute the appraisal review, the action of reviewing the appraisal and subsequent review result has been thoroughly integrated into existing processes and systems of record.

New UAD 3.6 Conditional Information. The review of the appraisal, depending on scope, may be performed initially by the appraisal software and then further review may be completed by an automated rules engine reading the XML file, or a third-party vendor, analyst, underwriter, appraiser, and/or credit administrator reading the report itself.

Today, when reviewing an appraisal, all fields of data entered by the appraiser are available and viewable to the reviewer and end intended user. There are no "hidden" data elements. Both the PDF and the XML versions contain the same data elements in the current environment.

However, the new UAD 3.6 changes this environment. Although basic property types will remain the primary conditional driver of the appraisal software we are aware that specific data fields when selected as "none or not applicable" will not be visible in the final developed appraisal report.

An example of a conditional data field is as follows:

> **Question:** Does the subject property have disaster mitigation features?
>
> **Answer:** None

Although the GSE 3.6 XML dataset will transmit the information above as "none", the final signed appraisal report delivered to the reviewer and end-user will <u>not</u> contain the question or the answer "none" noted above. The "missing" information is due to the appraiser answering "None" to the question.

When these data fields are non-existent within the delivered appraisal, the reviewer and end-user of the appraisal, are then to assume that the appraiser answered "None" to the data element appraisal question. Currently, there is no "requirement" for the appraiser to provide support or rationale for responses to the conditional data fields, nor is there an output of conditional data fields <u>not utilized</u> that are made available to the reviewer for consideration of completeness or compliance. However, checks could be introduced to the automated review process that reads the XML to bubble out those "none/not applicable" items but that would only serve as a list from which a verification with the appraiser would be needed to confirm its validity.

Unintended consequences

As with many new products that are brought to market, the positive or negative long-term impacts take time to fully visualize. The discussion of unintended consequences is a proactive effort to provide awareness, anticipate challenges for those who develop software, create automated rules, provide review services, and stimulate a more broad-based discussion of impact to the intended end-users of the GSE appraisal report format.

Although the GSEs creation of the new URAR has been very detailed, there appears to be a lack of attention to the moving parts and processes that surround the review process, cost of retooling the review (automated and manual) and the training ramp-up period that will be required for all stakeholders.

<u>Multiple Versions of the URAR</u>

When reviewing the new URAR, a previous appraisal may be brought into the reviewer's scope as a tool for comparison and/or to reconcile between the multiple dates of value. The comparison between the new URAR and the current version of the GSE form reports may prove to be challenging due the increase in data points, revised data labeling and overall format changes of the new URAR vs. the original format of the current GSE forms.

Another factor to be considered is whether over time, stakeholders will identify an adverse or positive impact to the concluded values between the development of the valuation on the current set of GSE forms vs. the new single URAR. It should also be noted that many lending institutions utilize the current GSE forms for both portfolio loans (not sold to GSE) and GSE loans.

For that matter, the current GSE forms are utilized for most appraisals developed within the industry regardless of whether the loan is targeted for sale to the GSE. The reach of use and review of the new URAR is much broader than just the GSE focus. For those who are not working directly with the GSE, the future changes may not be known and therefore will not be prepared for the impact to review or system ingestion.

One of the primary focus points of the new URAR was to vastly reduce the volume of narrative within the current versions of the appraisal forms and walk the appraiser thru a series of valuation development data entry steps that would assist in reducing or eliminating the need for extended narrative. The reason for this was multi-faceted but primarily, the narrative sections of the appraisal report are difficult to scrub for specific data points.

When it comes to non-complex vs complex property types, there are considerations that need to be pondered. For the non-complex residential property types, the structure of the new URAR may provide a format that will work well for low-risk collateral, such as a conforming track home . However, where the property type becomes more complex, such as a custom-built residence with a waterfront location, the reviewer and end-user may require more feedback from the appraiser than a form filled with collected data points. The desire for extended narrative feedback from the subject matter expert will be necessary or the quality of appraisal development and resulting credit decision may be at risk.

The future best practices of reviewing the new URAR may vary from lending institution, AMC, and/or intended user. This moving review target will prove to be frustrating for the appraiser and challenging for the reviewer. Initially this may cause increased turnaround times and ultimately increased fees. Because of this, pro-active operational readiness is needed to better serve the valuation industry and ultimately the consumer.

Recommendations for Operational Readiness

Our recommendations start with the proactive development of appraisal review policies and procedures that have a focus on the new URAR and its use in the credit lending decision by the lend. Take the time to consider the potential impacts that may trigger changes to current workflows, polices, operations procedures, standard, and guidelines. Proactively identify control points within the quality assurance and control processes that may need revision to accommodate the new URAR. Plan for revision to these documents, update associated training, and provide exposure of these changes to specific stakeholders.

Appraisal fulfillment and loan operating systems will likely require minor to major modifications to address the fact that future state, the appraisal naming convention will no longer be property type specific and therefore the appraisal review must also follow a similar protocol.

Anticipating the solution of maintaining the previous versions of the appraisal and review as well as the new URAR and the associated challenge with reconciling reports with vastly different data sets and formats will need to be resolved with policy, procedures, and training.

From the initial valuation procurement, the enhancement of the engagement letter should identify the appraisal review and appraiser response expectations. Providing full transparency to the appraiser regarding the review process and the multiple review scopes of work the appraisal assignment maybe subject to will better prepare the appraiser to respond effectively and efficiently.

Preparing the reviewer with the tools necessary for success is also essential. The reviewer must have the knowledge of what conditional data fields will or will not be visible to the reviewer. Updating current review templates will provide review consistency and will assist in efficiency and effectiveness of the review process. This will almost certainly require new or improved automated review tools to be deployed as well. Consideration of the impact to completeness and compliance administrative reviews versus standard 3 reviews is also in order.

Correction rates may increase initially, as well as the potential for an increase in borrower requests for a reconsideration of value. Making sure the appraiser and reviewer are hyper focused on swiftly resolving such completeness or quality concerns with sound analysis and support will better serve the lender and consumer.

If utilizing AMC services, understand the awareness level and business continuity strategy of the third-party AMC. Fully review the AMC's future plans and procedures for quality assurance including but not limited to test plans, test scripts, and correction and reconsideration of value workflows.

If you do not have in-house staff that can identify the strengths and weaknesses of your third-party AMC quality assurance routines, consider hiring such subject matter expertise to assure compliance with regulatory requirements.

For internal front line unit quality assurance teams, communicate future changes early on and deliver training and exposure to the new URAR to the reviewers, underwriters, and lending teams.

Continue that collaboration with your frontline unit subject matter experts to design and develop quality assurance and control review templates. The appraisal review templates, and varied scopes of work for standard 3 reviews should clearly demonstrate all fields that are available to the appraiser during the development of the appraisal regardless of what is visible to the end-user. .

Converse early and often with borrower facing credit teams to prepare them for the possibility of increased turn-times and fees for the service of the AMC, the development of the appraisal, and the associated review.

Lastly, all stakeholders should consider the impact of a ramp up period for transitioning vendors and reviewers to the new URAR, the potential for error during this period, and the resulting increased risk to the representations and warranty requirements that exist between the GSE and the Lender.

The quality assurance appraisal review must sufficiently align with the representations and warranties to which the lending institutions are held accountable for. The reviewer's role in establishing strong quality assurance and control oversight is essential to ensuring the specific rep and warrants are satisfied, thereby avoiding the potential for repurchase claims due to breach of these requirements.

In addition, all stakeholders must be cognizant of all changes to the assumptions and limiting conditions that may impact the legal use of the data within the new URAR.

For example, it is known that the intended use and intended user of the new URAR has been modified. The assumptions and limiting conditions that defined such use will be available within the PDF version of the new URAR but will not be present in the XML version of the appraisal data. And unlike today, the PDF of the corresponding appraisal report will not be embedded in the XML file.

It is important that all stakeholders understand how this change may legally impact the use and rep and warrant of the of the XML appraisal data when the intended use/user is non-existent.