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HUD's Certification of Appraisers and its Effect on Worldwide ERC® Appraisals

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When choosing an appraiser, one needs to be aware of the prevalence of Federal Housing Authority (FHA) financing in the desired market. In those markets where FHA-insured mortgages are prevalent, not choosing an FHA-certified appraiser could be a costly mistake. The requirements for FHA-insured mortgages are significantly different from those for other types of loans. Martin makes sense of the confusing world of FHA appraisals and explains the ins and outs of the certification process.

By Donald J. Martin, SCRP, RAA, GAA

As of January 31, 2000, all appraisers performing Federal Housing Authority (FHA) appraisals were required to be certified by the Department of Housing and Urban Development (HUD). Certification requires knowledge of the HUD 4150.2 Handbook, which was issued May 20, 1999. The 4150.2 Handbook is the valuation analysis for home mortgage insurance for single-family and one-to-four unit dwellings. It can be found on HUD's client information and policy system Web site.

The certification process includes a mandatory examination on appraisal methods and reporting, consisting of 50 questions chosen from a pool of 200. In the summer of 1999, roughly 39 percent of appraisers—about 33,000—performed FHA appraisals. According to Lemar C. Wooley of the FHA, "the Appraisal Sub-Committee's [ASC] national registry shows 98,413 active appraisers as of December 6, 2004. Of that number, 26,228—or about 27 percent—are on the FHA appraiser roster." While the number of certified real estate appraisers has increased by at least 15 percent since 1999, the number of appraisers certified by HUD to perform FHA appraisals has dropped by 20 percent—or roughly 7,000—in that same period.

This indicates an alarming trend. Many older appraisers who have retired in recent years may have been doing FHA appraisals prior to their retirement, and others simply may have lost interest due to low fees available for this work. FHA appraisals are considered by most appraisers to be, if not more difficult, certainly more time-consuming than standard appraisals. While some clients pay a reasonable fee to perform FHA appraisals, many do not. Fees for FHA appraisals actually appear to have decreased, rather than increased, in the last five years. At the time the new 4150.2 manual and certification requirements that followed during 1999 and early 2000, fees for FHA appraisals typically ran about 50 percent higher than conventional appraisals. Today, they are typically only about 25 percent to 30 percent higher than what they were in 1999, preceding the changes. Thus, a net drop has occurred since late 1999 and early 2000.

As appraisers become more experienced, they may elect to refuse such low-paying work and opt for work that pays better and can be completed faster. This follows what appears to be a general trend: the "dumbing down" of the appraisal industry. While more and more appraisals for conventional and non-conforming loans are being done on simpler forms like the 2055 and the 2065, as well as the forms now in the test market for Fannie Mae, the appraisals currently done for both FHA and Worldwide ERC® have become increasingly detailed. The fear is that in some portions of the market there are not enough well-qualified appraisers. The newer appraisal forms are less-probing, with fewer questions about repairs, condition, and features of the home. Although appraisers may be becoming more experienced by seeing more properties, they may lack certain analytic skills that many of the forms and clients do not push them to use.

The Appraisal Standards Board (ASB) has made changes that will dramatically increase the requirements of future state licensing and certification of appraisers, by increasing licensing requirements for appraisals in which the appraiser must be at least state-certified. The number of course hours—including exams—required for each of the three licensing categories ("Licensed," "Certified Residential," and "Certified General") will increase by 67 percent, and both of the certified levels will require either an Associates or Bachelor's degree or comparable college credit. These changes will not, however, have any impact on the educational requirements for appraisers who wish to maintain their current license level as of January 1, 2008.

Embracing Change

The certification process by HUD should be embraced by as many appraisers as possible. Even for appraisers who may choose to do few FHA appraisals, this avenue provides an opportunity to expand their knowledge. In considering an appraiser's qualifications, clients should check whether the appraiser is certified by HUD to perform FHA appraisals. This is—or should be—of great importance to those requiring Worldwide ERC® appraisals, because of the potential of a transferee's home being sold to an FHA buyer. The FHA appraisal report and the "comprehensive valuation package valuation conditions," which must be attached, describe what repairs are mandatory for an FHA-insured mortgage. If these repairs are incomplete at the time the transferee's home comes under contract and is inspected by an FHA appraiser, the closing could be delayed.

Not all markets may be impacted significantly by HUD's requirements, but certainly there are those that are. Several weeks may pass between when a property comes under contract and when the HUD-certified FHA appraiser has inspected the transferee's home and reported the results back to the lender. Many repairs may be major, and may be impeded by poor weather conditions. If the transferee's company knows this at the time of the Worldwide ERC® appraisal, the repairs could be completed before the home is even placed on the market, thus assuring a greater likelihood of a smooth closing at an earlier date.

Oversight

According to Wooley, "although there have not been any formal HUD studies on the impact of the Handbook 4150.2 and the certification process of appraisers, there has been ongoing monitoring and oversight of both the appraisal process and appraisers. Reviews of appraisals and appraisers' activities show a general improvement in the overall quality of the product. Setting a minimum standard for appraiser qualifications for placement on the FHA Single Family Appraiser Roster has had a positive impact. Appraisers now are required to have credentials based on the minimum qualifications for licensure established by the Appraiser Qualifications Board (AQB). In some cases this may be higher than what is required by a state for licensure."

While this may give cause for some celebration, this positive impact is only on the FHA appraisals and not all appraisals or appraisers as a whole. There is also cause for concern because there are far fewer appraisers able to do FHA appraisals than there were before, thus the application of skills learned from doing FHA appraisals is being applied in fewer and fewer other types of appraisals, including Worldwide ERC® appraisals.

Some clients may elect not to offer the home to potential buyers seeking FHA financing, but this may have a negative impact on both the "anticipated sales price" and the "forecasting" made on a Worldwide ERC® appraisal. If the number of buyers seeking financing in a particular market is less than 5 percent, this will have no impact; but if the home is in a market where 20 percent, 30 percent, 50 percent, or even more, typically elect for an FHA-insured mortgage, this becomes of dire importance. As the percentage of FHA buyers who would potentially buy the transferee's home in a given market increases and FHA financing is not allowed, the home could be exposed to fewer potential buyers. The fewer potential buyers, the longer it will take to market the property. A typical property offered for sale to qualifying buyers of only conventional loans or cash may take significantly longer, causing the home to exceed a 120-day marketing time. This may cause the appraiser to consider a negative forecasting adjustment.

As the frequency of FHA financing increases and more clients require that the home is sold only if the mortgage is FHA-insured, the appraiser must consider possible negative outcomes. A thorough analysis must be performed; in some cases a forecasting adjustment may be more cost-efficient and yield a greater net sales price on the transferee's residence than making repairs, such as when the repairs normally would not be needed for a conventional loan or cash transaction, or when the cost of the repairs necessary for an FHA-insured mortgage would exceed the forecasting adjustment for a non-FHA-insured mortgage.

Of particular note to FHA appraisers and clients requesting appraisals in markets in which transferees' homes may be sold with FHA financing is that, according to Wooley, the "HUD Handbook 4150.2 will be under revision in the next 18 months to two years to include mortgage letters published since the issuance of the handbook in June 1999, and industry feedback on those areas needing better clarification."

Appraisers who are not certified by FHA but work in markets that have portions financed by FHA-insured mortgages should at the least read and be familiar with the 4150.2 manual, accompanying mortgage letters and, once it is available, the revised 4150.2 manual.

On October 1, 2004, HUD updated the exam for appraisers seeking FHA certification. The new exam reflects changes occurring in the last five years, which were published in mortgage letters and FAQs posted on the HUD Web site. Periodically, listed mortgage letters supplement the 4150.2 manual, and will be included in the manual now under revision.

Appraisers, or anyone interested in a sample of FHA appraiser exam questions, can visit the HUD site at www.hud.gov/offices/hsg/sfh/appr/appraisal_200question.pdf. Those interested in the mortgage letters can visit HUD at www.hud.gov/offices/hsg/mltrmenu.cfm.

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