

Doing the Math: Why State Regulation of AMC's Will Put Small AMC's Out of Business

By Jeff Schurman

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Finally, someone in media has reported what I've been trying to get across for the past month: That state registration and regulation of appraisal management companies (AMCs) will assure the survival of only the largest of the large AMCs.

Unintended Consequences

In a story, about a proposed AMC bill in Missouri in today's Valuation Review, I am quoted (correctly) as saying that, "... (T)his new legislation will have unintended consequences. Small or in-state AMCs won't be able to afford the initiation fee. The state is essentially forcing small or local AMCs out of business. They're taking jobs out of the state and putting them in other states with the large, national management companies."

The story also reported that "Schurman would prefer a federal regulatory solution: "We'd be happy to register AMCs, but not at a state level." But this is a story for another day. For now, I'll stick to my contention that the Missouri bill and others like it will put small and in-state AMCs out of business and drive appraisal management to the big competitors.

That I am an independent leadership and business development consultant is well known in the settlement services industry. Over the years, I've done time and motion studies on (4) of the title industry's best known transaction management systems. I've done income and expense pro formas on a variety of businesses including title agencies and appraisal management companies. I've collected and analyzed surveys from across the settlement services industry, and used these data to power complex Excel models. And so, as it regards building AMC financial models, I have some level of experience. Enough to know that small AMCs paying big-time registration fees -- like the \$5,000 registration fee and \$2,000 renewal fee proposed by Missouri -- are toast.

Math Time

I don't even need to show you my pro formas as proof. You can do the math yourself. Get out a piece of paper (or Excel worksheet) and jot down a few numbers.

1) Estimate the average appraisal fee charged by an AMC for a combination of URAR, drive-by, REO, field review, multi-family and FHA appraisals. For this hypothetical example, I'll suggest using \$315 as the average fee paid by a hypothetical client (remember, this is a blended fee for (mostly) URAR appraisals and a smattering of FHA, MF2-4 and lower-end valuation products).

2) Estimate the average fee paid to the appraiser by the AMC for the valuation product. Let's say the average fee to the appraiser is \$200 (again, hypothetically... I don't want objections to the fee to drown out the context of the point being made).

3) Subtract the \$200 appraiser fee from the \$315 client charge, which leaves the AMC with \$115 (36.5 percent gross margin).

The last step is where it becomes uncomfortable for the small business owner/operator.

4) From the \$115, subtract the following expenses: Personnel (appraisal ops., customer service, QC, sales and marketing, and executive), support services (IT, payroll and accounting, etc.), labor burden, quality control reviews, telecom, computer, travel and entertainment (someone has to find and cultivate clients... AMCs do that way better than appraisers), legal and professional fees, warranties/E&O insurance, facilities, office lease, data subscriptions, transaction management systems technology, etc.

Oh, and by the way, suppose every state adopts Missouri's \$5,000/\$2,000 AMC registration scheme. You'll need to break those fees down to a per-unit basis in the expense calculation above. If Missouri is the only state to nick a 250 order-per-month AMC add just 60 cents to each appraisal; if all 50 states and D.C. do, add \$30.60 per appraisal.

The bottom line is that there's a pretty thin net income in appraisal management. But as business schools teach, a small number times a big number is a big number. Which is why the nationwide AMCs have a distinct advantage over small in-state competitor. They do a lot of appraisals -- some upwards of 1,000 or 1,500... per... DAY!

So, if Missouri's aim is to wipe out AMCs, they'll be part way to their goal. They'll wipe out in-state AMCs and the local employee (tax and voter) base displaced by the AMC statute.

The math also lays bare the folly of the contention in the appraisal trades that an appraiser who's lost her or his license might morph into an AMC. The numbers say they simply don't have that great a chance even without usurious registration fees. Besides, an appraiser bad enough or unethical enough or lacking enough in the trust dimension to lose an appraiser credential has little chance of attracting enough lender-clients to lift an AMC off the ground. To do 1,000 or even 250 units a month requires a few huge or a lot of small clients. A defrocked appraiser without experience, contacts, or technology would surely wash out in the due diligence process.

The AMC Strikes Back!

The only recourse for the small time operator doing say, 250 orders per month, is to raise fees to the lender (costing consumers more by way of higher interest rates, points and fees), and/or lowering appraisal fees to appraisers (in this example to under \$100 per unit). Hardly what the legislators and state appraiser boards wanted when state regulation of AMCs was proposed.

This comes at a very critical time for mortgage brokers and appraisers seeking to service the broker community through local AMCs. Fannie and Freddie have been at odds over whether a mortgage broker can order an appraisal directly through an AMC. Freddie says yes, while

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Fannie, up until now has said no dice. If Fannie changes its stance (I've heard it is reconsidering) and allows brokers to order directly with a local AMC, guess what? There won't be a local AMC to funnel work to local appraisers. The Missouri bill will see to it that the only alternative will be to place orders with the 8-10 heavyweights in the AMC industry.

Much luck to appraisers not on the national AMCs fee panels.

What's a Lender to Do?

A recent email from a leader of the California Appraisal Institute suggested that the death of the AMC industry would be a good thing. So it's fair to ask, What if AMCs were wiped off the face of the earth and lenders forced to order appraisals on their own? Answer: For a mega-lender it would add \$100 per order to the cost of making a mortgage loan. In other words, if a big bank paid the appraiser's so-called "retail" fee (say \$325) and charged the borrower the same \$325, it would cost the lender another \$100 per order; much more if the lender was a small local bank unable to take advantage of the economies of scale.

But what if lenders decided that it appraisals weren't worth that much out-of-pocket cost? One alternative might be to find some displaced AMC owner/operator to hunt down alternative collateral assessment products like AVMs and BPOs.

After all, how valuable can appraisals be when appraisers and their trade associations testify to congress about how bad appraisals and appraisal oversight are? Or when well-known appraiser bloggers assert that 70 percent of residential mortgage appraisals aren't worth the paper they're printed on? Or when a person way-in-the-know at a GSE tells me that 25 percent of appraisals are lousy.

Time to stop talking down the brand, folks.