Finding the Value in Appraisal Management Companies

How these companies add value to the mortgage industry.

By Jeff Schurman and Rick Grant

National lenders have always worked with third party service providers to complete tasks that depended upon workers or information tied to a specific geographic area. Title underwriters, which base their policies on public record information, title examiners and abstractors, and appraisers, who specialize in certain communities or neighborhoods, have long been hired through vendor management companies (VMCs).

Traditionally, these firms haven't garnered much attention from the general public. They work largely behind the scenes to facilitate transactions that benefit both lenders and home loan borrowers. Lately however, in an attempt to stop some practices that have led to mortgage fraud, New York State Attorney General Andrew Cuomo advanced the Home Valuation Code of Conduct (HVCC), in association with Fannie Mae and Freddie Mac.

The HVCC has had many consequences; some positive, and others, not so much. One of the consequences of HVCC is that it thrust certain of these VMCs, specifically appraisal management companies (AMCs), into the spotlight. In the process, some people have raised questions about why these companies are even in the process and question their value to the transaction. It is reasonable for us to provide some answers.

We can look at the way AMCs serve mortgage lenders and appraisers in a number of ways. They can be compared to a wholesaler selling collateral valuation products to lenders, they can be compared to any other provider offering a lender a fee for service or they can be compared to a marketing contractor working for individual real estate appraisers. In all cases, AMCs work to get a collateral valuation product from the appraiser to the lender while keeping the appraiser and the lender's sales organization at arm's length from each other, a requirement of HVCC.

An AMC's core competency is managing workflow and contracts - with clients and appraisers.

The AMC as wholesaler

Merriam-Webster's dictionary defines the term "retail" to mean "to sell in small quantities directly to the ultimate consumer." In the appraisal world, one envisions an appraiser or appraisal firm selling appraisals individually or in small quantities directly to end-users. The big box retail trade, say Home Depot or Lowes, sells hammers and nails and lumber at or slightly below retail to the do-it-yourself crowd. In the mortgage banking industry, lenders charge borrowers retail fees for various loan products. In each of these examples, the product or service is sold in small quantities directly to the consumer.

The same dictionary defines wholesale as "the sale of commodities in quantity usually for resale (as by a retail merchant)." If in the real estate transaction we view the end-user as the mortgage lender, who relies upon the appraisal to assess the risk inherent in a prospective loan transaction, this model applies well to the modern AMC. In other words, AMCs do not operate in a retail environment but rather as a "reseller" of large numbers of appraisals to the end-user.

Just like wholesalers in other industries, the AMC packages up collateral valuation reports for the lender, adding value by handling the relationship with the appraiser, providing a layer of quality control on the reports and simplifying the lender's transaction coordination and billing processes. We would never expect a grocer to write a check to every brand owner that is represented on his shelves. They'd much prefer dealing with a distributor of many brands. So too a national lender, which could manage relationships with appraisers across the country, but if given the option will usually outsource supplier and pipeline management to a third-party whose core competency is managing supplier contracts and workflow.

Appraisers often criticize AMCs for accruing benefits to only the lender. However, upon closer look, benefits also accrue to the appraisal provider. Like the brand owners in the grocery store example, or tool and lumber wholesalers in the big box retail trades, appraisers would have a difficult time forging relationships with the nation's largest lenders and servicers, unless they control companies that provide valuations for a large geographic area. But that would require them to hire and manage large numbers of local appraisers, which is how the nation's largest and most successful AMCs were formed.

Just like the brand owner-wholesaler relationship in other industries, appraisers also get an important risk mitigation benefit by working with an AMC, according to T. Michael Ousley, executive vice president of appraisal services for ClearCapital.com, Inc.

"One appraiser told me, he works with AMCs because he always gets paid," Ousley said. "They may not get the "full fee" on every file, but they get paid on every file."

He pointed out that many appraisers who worked directly with the nation's largest subprime lenders received a rude shock when the lights suddenly went off in those companies. Some appraisers lost tens of thousands of dollars. That probably would not have happened if they had been working with reputable AMCs. In fact, I recall only two instances of large-volume AMCs that folded in the past 5 years. One was an independent VMC that, in my understanding, went under due to title-side matters; the other was a lender-captive that ceased operations when the parent company failed. Thus stability and payment of appraisers' invoices are additional benefits for appraisers working with AMCs.

The fee for services model

It is perhaps even simpler to think of the relationship between the appraiser, AMC and mortgage lender in terms of the lender trying to minimize its fees for certain products and services

without sacrificing quality. Likewise, the professional appraiser is in need of certain services and is willing to discount their fee to get them. With these facts in mind, the fee for services model seems an appropriate consideration as well.

When a local lender does business in a major U.S. market, the institution may have up to 20 licensed or certified appraisers who specialize in that geographical area to choose from. Of those appraisers, perhaps half have relationships with local lenders that keep them fully engaged and thus out of relationships with AMCs. Left with 10 possible partners and only a few loans to originate in that particular MSA, even a large lender doesn't have much bargaining power and is left paying the fee the appraiser asks, and passing that on to the borrower.

An AMC working in the same MSA is likely to have many more loans in process from the many lenders it serves and can therefore negotiates from a better leverage position. Plus they typically have the technology to track and report things like fees, turnaround times and service levels, something most local lenders cannot do with such precision. An AMC's core competency is managing workflow and contracts – with clients and appraisers. Which presents appraisers with a choice: compete for say 1 in ten full fee appraisal orders from local clients, or offer the best combination of quality, service, and price to compete for 3-4 in ten appraisal orders from one or more AMC?

On the other side of the table, the professional appraiser is working hard to complete reports and return them to customers to collect a fee. There are many tasks that must be completed in order to run a successful appraisal business beyond the development and reporting of an appraisal. In addition to the appraisal production cost, every entrepreneur, including an appraisal business owner, expects to incur costs for business development, sales and marketing, accounting, public record or other data, facilities, technology, and billing.

Some of those expenses are paid to administrative staff workers, information technology professionals, and Web service providers, among others. Increasingly, appraisers are contracting with AMCs to provide some or many of these services, reflecting the work of the AMC in their pricing schedule.

I can hear howls that 'AMCs add no value to the appraiser!' right now. So let's talk about a few value-adds for appraisers who work with AMCs. One area where AMCs benefit appraisers is information technology and connectivity. Computer hardware and software are very expensive. Likewise, software development is beyond the reach of many small business owners. AMCs assume responsibility for getting appraisal reports from the appraiser to the client's desktop; the appraiser doesn't have to. There's value in this.

One area where AMCs benefit appraisers is information technology and connectivity.

Another area relates to the property information locked within databases that can help appraisers do a better job of evaluating properties. Data, even when it's in the public record, can be expensive. AMCs can help with that.

"We have sources of data that are more affordable for local appraisers," says ClearCapital's Ousley. "We do aerial imagery and historical sales information and listing information and even have a home data index that can help an appraiser identify where a market is going. We might do 100 files in their zip code over a month or two where they may do 15, so this is a real benefit to them."

Another added benefit to appraisers under this model revolves around risk. Every business runs the risk that work will be completed, and accounts billed, but payment is never received. The AMC mitigates this risk for the professional appraiser by agreeing to pay for every job, whether the lender accepts the work, closes the loan or goes out of business. Very often, the appraiser is paid before the AMC is. Fewer accounts receivable, collections, and charge-offs add value to the appraisal shop and protects cash flow, the life's blood of any small business enterprise.

The AMC as marketing contractor

A specialized case of the fee for services model as it pertains specifically to the appraiser is the case where the valuation provider contracts with the AMC to provide all of the tasks required to get new business in the door.

In 2008, a national survey of appraisers discovered that over 60% of residential appraisers rely on referrals and networking as their primary means for business development. Less than 10% of the respondents indicated telephone and internet marketing are primary sales vehicles. Although referrals and networking are terrific ways to market to local audiences, the marked increase in centralized loan production has made these methods somewhat obsolete in the residential mortgage industry. So appraisers increasingly rely on AMCs that employ national business development and client relations managers, inside and outside salespeople, advertising and public relations firms, and complex Web-interfaces to engage and serve the national sector of the mortgage industry.

Business development, marketing and sales are areas of particular expertise for the AMC. I can tell you from experience fielding calls from AMC business owners that highly connected national sales representatives are in great demand. And they're not inexpensive. Companies rely on sales and client relations teams to cultivate and maintain relationships with national lenders. This takes the sales burden off the appraisers who work with AMCs, so they can focus on being in the field and doing appraisals. And there's value in that too.

Meanwhile, the industry downturn has put even more of the nation's origination volume in the hands of fewer national lenders who cannot maintain relationships with individual appraisers across the country. Just look at the quarterly rankings of mortgage lender size by loan originations and you'll see that the top 10 retail lenders control over 73 percent of all loan originations.

"The number of lenders has decreased from what it was a number of years ago," said Jeff Dickstein, chief appraiser for Pro-Teck Valuation Services. "Those that are still operating are doing so on a national level. They need AMCs to outsource that business to so they can get the quality that meets their expectations."

It makes sense for appraisers, too, according to Dickstein. "An appraiser that is a local expert in an area doesn't always have easy access to a large national lender or servicer. The AMC takes over being their sales department, their account manager, their resolution department, and their billing department. We pay all of our appraisers whether a deal closes or not. They don't spend time chasing past due invoices. They don't have to deal with the minutia that comes through from the lender."

One of the biggest challenges that the small business owner has is erratic sales performance. It's often "feast or famine" for these operators, and over the past few years as the real estate market has suffered, appraisers have shared in this unfortunate circumstance.

Lenders have a related problem. Financial institutions have learned to resist the urge to staff up when business increases because they know they will only have to lay workers off when the business returns to normal levels. This involves reputational and other risks to the lender.

Even as the appraiser wants consistency of work, lenders want consistency of workflow. National lenders need to know that the appraisal will be delivered within the agreed-upon time, in the proper format to be used by its technology and at the proper quality level. AMCs are in a perfect position to give appraisers and lenders what they both want.

The AMC as adversary

Regardless of which business model we use to explore the business benefits the AMCs deliver to both appraisers and lenders, there will always be some lenders who do not outsource to AMCs and some appraisers who won't work for them. That is their choice.

The idea that any lender or appraiser is forced to do business with an AMC by HVCC or any other market force is not true. They enter into contracts with AMCs (or not) at their own volition. Offer, acceptance, and consideration are generally considered the hallmarks of enforceable contracts. An appraiser say, who chooses not to work with an AMC, does not have to; nor must an AMC work with an appraiser if it chooses not to. And that is fine. It is what makes our free enterprise system great. But the majority of residential appraisers do work with AMCs. My concern is that bashing AMCs undermines the appraisal profession.

There are success stories in our industry among both individual appraisers working directly for lenders and those that have made a success out of working with AMCs. Others work with both.

I often suggest to appraisers that they compare the net income of a professional appraiser who hires and pays staff to handle all business development, technology-related and accounting duties with what the same appraiser could earn working for one or a few prominent AMCs. A sole proprietor communicating candidly about these costs will tell you that, at the end of the year, they are netting somewhere between 60% and 70% of the retail fees that they earn directly from the lender.

Doesn't that make sense? Aren't there marketing costs in securing and serving out-of-area lenders? Technology costs? Accounts receivable and charge-off costs? Administrative costs? While we can argue about "how much" of a gap there is between gross and net income. However, we must agree that a do-it-all-yourself appraiser or small shop appraisal firm has some expense that can be avoided working with an AMC.

It is true that AMCs work on behalf of the lender and will always work to get the best price for each collateral valuation product they order. In the same way, mortgage lenders will always look for ways to reduce costs associated with loan production and to improve productivity.

In the end, characterizing the AMC-appraiser relationship as adversarial is unfair both to the parties as well as to the lender and ultimately the consumer. It behooves the industry to determine where AMCs make sense and to make it easy for them to operate there, servicing both lenders and appraisers in the process. But yelling at each other will only push down the perceived value of appraisal in the mind of the client and consumer. Which is counterproductive to us all. ❍