

**Comments of**  
**The American Society of Home Inspectors**  
**Regarding**  
**[Docket No. OCC-2012-0013]**  
**RIN 1557-AD62**  
**[Docket No. R-1443]**  
**RIN 7100-AD90**  
**RIN 3133-AE04**  
**[Docket No. CFPB-2012-0031]**  
**RIN 3170-AA11**  
**RIN 2590-AA58**

**Appraisals for Higher-Risk Mortgage Loans**

**Part III**

**77 FR 54722**

**October 11, 2012**

I am writing on behalf of the American Society of Home Inspectors (ASHI) to offer comments regarding this proposed regulation addressing higher-risk mortgage loans.

ASHI is the largest professional association for home inspectors in North America, with 6,000+ members and 80+ chapters.

ASHI has a goal of building consumer awareness and enhancing the professionalism of its field. ASHI's Standards of Practice—covering all of a home's major systems—are now part of many pieces of state legislation and are recognized by consumers as the authoritative standard for professional home inspection. The mission of ASHI is to meet the needs of its membership and promote excellence and exemplary practice within the profession.

ASHI serves as the voice of the home inspection profession in America, a thought leader in proposing legislation and federal policy enhancements designed to help homebuyers make knowledgeable decisions in buying homes.

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## **SUMMARY**

**While ASHI supports the underlying policy giving rise to the proposed rule, ASHI cites several important impacts on consumers that have not been addressed and require further clarification, particularly with respect to the role of home inspection in the homebuying process, and with particular sensitivity to widespread consumer confusion regarding the difference between appraisals and home inspections.**

**Without changes, the proposed rule's general requirements for an appraisal to include a "physical inspection" could exacerbate consumer confusion regarding the nature of "physical inspections" conducted by appraisers, causing prospective homebuyers not to consider obtaining home inspections based on the premise that some manner of "physical inspection" has been performed during the appraisal. This would be a calamitous unintended consequence of the proposed rule. It would deter many homebuyers from making timely considerations to obtain a comprehensive professional home inspection, which could be severely detrimental to the interests of homebuyers, lenders, HUD and the GSEs.**

**There are reasonable solutions to this problem -- solutions that make use of existing federal precedent.**

**In short, ASHI recommends that CFPB et.al. endorse/adopt the federal policies, precedents, documents and messages created by HUD, and supported by Congress in DFA Sec. 1451, to educate homebuyers on the differences between appraisals and home inspections, and to encourage homebuyers to make the voluntary choice to obtain a home inspection.**

**In terms of specifics, ASHI recommends that the proposed rule be improved to --**

- 1) Clarify the quite limited nature of any "physical inspection" to be conducted as part of the appraisal; that the appraisal is not a home inspection; that the appraisal is performed to protect the interest of the lender and mortgage insurer, whereas the home inspection is performed to protect the interest of the homebuyers, lenders, HUD and the GSEs;**
- 2) Clarify that the "physical inspection" for appraisals will be quite limited in scope and detail, and is not performed by an individual fully trained and state licensed to conduct professional home inspections.**
- 3) Require mortgage lenders to provide a copy of HUD Form 92564-CN "For Your Protection, Get a Home Inspection" at first contact with prospective mortgagors.**

- 4) **The proposed rule seeks to address property flipping risks. But the solution proposed in the rule – providing for an additional appraisal in certain circumstances to protect the interest of the lender – is incomplete. The increased risks under property flipping accrue to the homebuyer as well as the lender, and are particularly acute in cases where the home is the security for the loan. In many cases, such homes will have been exposed to periods of inadequate maintenance, abandonment or vandalism. There is federal precedent to address this problem in a more complete manner, and to address the property flipping risk to the homebuyer, by including a home inspection as a required criterion for allowing an exception to limitations on property flipping. SEE HUD Waiver of Requirements of 24 CFR 203.37a(b)(2). ASHI recommends that the rule include home inspection as an additional quality control criterion to facilitate property flipping.**
- 5) **To expand on the recommendation in the prior paragraph, ASHI recommends that any home inspection performed to address property flipping concerns be provided to the appraiser. More broadly, ASHI recommends that CFPB et. al. consider a general requirement to provide relevant home inspection reports to appraisers.**
- 6) **Whereas the proposed rule makes reference to the *Uniform Residential Appraisal Report*: ASHI cautions against adopting the *Uniform Residential Appraisal Report* and the *Uniform Appraisal Dataset* (UAD) as a template in describing the physical inspections required for appraisals. While there is wide GSE use of the UAD at this time, there is controversy in its description of physical inspections and what the UAD means ultimately in terms of appraiser responsibility, liability, code compliance responsibilities, and whether the inspections required might exceed the professional training and capability of appraisers. ASHI is concerned that, as realty professionals encounter consumer confusion and problems with the UAD, the UAD will likely need to be amended. The UAD is a relatively new creation, does not have a lengthy track of success or unfettered acceptance in the marketplace, and is controversial. ASHI anticipates that that controversy will increase as practical concerns arise through use over time. ASHI recommends that CFPB et al. avoid relying upon the appraiser to determine comprehensive property condition by casual observation in high risk loans and instead rely upon an appropriate and thorough home inspection to evaluate property condition, and consider the inspection report in determining value.**

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## **BACKGROUND**

A home inspection is an in-depth objective visual examination of the physical structure and systems of a house, from the foundation to the roof. As required by law in most states, home inspection is performed by a state licensed professional home inspector who is trained and licensed to do home inspections. In 30 states, the home inspector is subject to state licensing requirements.

The standard home inspector's report will cover the condition of the home's heating system; central air conditioning system (temperature permitting); interior plumbing and electrical systems; the roof, attic and visible insulation; walls, ceilings, floors, windows and doors; the foundation, basement and structural components.

To provide some relative perspective between the type of inspection required for an appraisal versus a home inspection: for an appraisal, the physical inspection may be conducted in minutes, whereas a home inspection requires hours. The home inspector enters into crawl spaces and attics, is equipped with a ladder and climbs on roofs.

The American Society of Home Inspectors (ASHI) publishes a Standards of Practice and Code of Ethics that outlines what should be covered in a home inspection report.

To minimize unpleasant surprises and unexpected difficulties, it is in a homebuyer's/homeowner's interest to learn as much as possible about the condition of a home prior to making a commitment to purchase or refinance. A home inspection may identify the need for major repairs or builder oversights, as well as the need for maintenance. A home inspection allows a homebuyer to make a purchase with confidence and peace of mind regarding the comprehensive physical condition of the home. An appraisal does not.

Even the most experienced homeowners lack the knowledge and expertise of a professional home inspector. A home inspector is familiar with the elements of home construction, proper installation, maintenance and home safety.

Most homebuyers find it difficult to remain objective about the houses they are considering for purchase, which may affect their judgment. For accurate information, it is best to obtain an impartial, third-party opinion by a professional state licensed home inspector trained in the field of home inspection. On their websites, HUD and the GSE's recommend obtaining a home inspection prior to purchase.

In the United States, the decision to obtain a home inspection is a voluntary decision, typically made by most buyer(s) of a home. (See GAO report 04-462)

Because buying a home is not only a complex process filled with confusing details, but also an infrequent occurrence for most Americans, it is often the case that homebuyers who would like to, or should, obtain a home inspection fail to do so in a timely manner out of ignorance, lack of understanding, confusion or distraction.

Because home inspections are voluntary rather than mandatory, this fact places a special emphasis on the need for ongoing, effective communications to the homebuyers of the U.S. so that they may exercise their voluntary prerogatives to seek home inspections in a timely fashion should they choose to do so.

Homebuyer confusion has been well documented by a leading independent investigative authority in GAO. We cite GAO Report 04-462, which documents multiple reasons how homebuyers fail to

understand key details concerning home inspections. (See greater detail on GAO Report 04-462 later in this comment).

One of the most prevalent misunderstandings is that appraisals, which are required in realty transactions, are home inspections or the equivalent of home inspections. Appraisals do not supply the critical information that homebuyers need about the physical structure and the systems of a house, from the roof to the foundation and the grounds and the grading. An appraiser spends minutes in the home versus hours for the professional state licensed and/or certified home inspector.

The confusion evinced by GAO Report 04-462 is even more remarkable given the fact that the study surveyed individuals who had recently purchased a home – and presumably should have had greater understanding the need for a home inspection than the general population, or individuals who have yet to purchase a home.

While the GAO study focused on FHA homebuyers, it is reasonable to assume that the results are indicative of general confusion among homebuyers about home inspections. Congress has dealt with the generality of this confusion, which is not restricted only to the FHA-insured homebuyer audience, in the Dodd-Frank Act, to be discussed later in this comment.

The key findings of GAO Report -4-462 are as follows:

- A. Only 36% of FHA homebuyers clearly understood the distinctions between home inspections and appraisals. While GAO equivocated on the level of understanding of the remaining 64%, only 36% did affirmatively understand the difference.
- B. The rate of correct understanding is greater (42%) among buyers who actually got inspections. But this rate is still poor.
- C. A very high percentage of homebuyers using FHA mortgages – 86% -- reported that they had voluntarily sought and obtained home inspections. This is an unrealistically high figure that is starkly inconsistent with the earlier findings. This figure further confirms that confusion with other elements of the homebuying process – the appraisal or some other limited inspection – or the misunderstanding that some other entity had required a home inspection without homebuyer involvement, had likely resulted in a large number of homebuyers making purchases without obtaining the home inspection they assumed errantly had taken place.

Clearly, the report demonstrates widespread material confusion among homebuyers.

In attempting to focus on the experiences of those homebuyers who did have a good understanding of home inspections, GAO found mostly very positive reviews to verify that homebuyers do benefit substantially from obtaining a home inspection:

- A. 94% of buyers who got inspections would do so again on future purchases.

- B. 85% said inspections were worth as much or more than the buyers paid for them.
- C. 80% said the inspections increased their confidence in the purchase.
- D. 74% said the inspections gave buyers peace of mind that homes had no major problems.
- E. 73% said the experience was either somewhat or very positive.
- F. 67% of inspections identified problems to be addressed.
- G. 29% of identified problems were major (incurring costs greater than \$500 to fix).
- H. 30% of the time, buyers were able to renegotiate some part of the contract based on the inspection.
- I. The key reasons homeowners obtained home inspections were to ensure there were no serious problems with the homes, or they thought FHA required them to obtain home inspections, which of course is not the case. They also wanted confidence and peace of mind.
- J. Homebuyers believed they benefited from the inspections by identifying problems to be fixed by sellers, by allowing them to renegotiate a more favorable price, and by learning about home maintenance.

In conclusion, the record is clear that there is widespread material confusion about home inspections, particularly in distinguishing home inspections from appraisals, and that this confusion is preventing homebuyers from making homebuying decisions based on all the information they would like to have. Furthermore, homebuyers do benefit when they make the voluntary decision to obtain a home inspection. It is critical that appraisers, lenders and GSE's have the same information most buyers obtain (a professional home inspection by a state licensed home inspector) for greater transparency and to enhance their risk analysis prior to approval.

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## QUESTIONS AND ANSWERS REGARDING HOME INSPECTION

### How is home inspection different from the appraisal?

- An appraisal is a required element of a home purchase. However, a home inspection is a voluntary choice of a party to the transaction – usually the buyer. No home inspection will be performed unless a party to the transaction – usually the consumer/homebuyer -- asks for it and makes the arrangements.

- The appraisal examines the market value of the house. The home inspection examines the physical condition of the home using a comprehensive physical and technical examination.
- The appraisal involves a relatively cursory physical review that can be completed in minutes. A home inspection involves a very detailed physical and technical examination pursuant to ASHI's Standards of Practice, (or equivalent) or state licensing requirements, and requires hours to complete.
- The appraisal is to protect the interest of the lender. The home inspection is to protect the interest of the consumer/homebuyer, but should be required reading for the lender & GSE's.
- The appraiser's duty is to the lender. The home inspector's duty is to the consumer/buyer.

*Is a home inspection a form of consumer protection for the homebuyer? If so, how?*

Houses are expensive, extraordinarily complicated structures and systems. Many potential defects are latent. Repairs can be expensive. There may even be defects that affect habitability. Yet, nearly all consumers lack the technical knowledge and training required to fully inspect and understand the physical condition of the house, even though they will become solely responsible for any defects, patent or latent, that may be present in the house.

The home inspection can help the consumer/homebuyer make an informed decision whether to buy the house by knowing the condition of the house. This can be particularly advantageous if the buyer includes the home inspection as a contingency in the sales contract. The homebuyer can renegotiate the terms of the sale commensurate with the condition of the house. Even in cases in which there are no identified defects that might affect the transaction, the inspection provides valuable information and peace of mind.

*Can appraisers conduct home inspections, or is the appraisal a de facto home inspection?*

No. The training and experience required for home inspectors is utterly distinct and different from appraisers. Training, certifications, licenses are neither equivalent nor interchangeable. Furthermore, in most states, a home inspector requires separate licensing and qualifications.

*Do consumers understand that appraisals and home inspectors are not the same thing?*

By and large, no. There is great confusion on this point in the consuming public. Even buyers who have recently purchased a home are routinely confused. SEE the discussion of GAO Report 04-462 supra.

*Why do homebuyers fail to obtain a home inspection, or are otherwise deterred from getting one?*

There are several factors, but the leading factor indicated by GAO is consumer confusion regarding the difference between appraisals and home inspections.

Consumers are confused that –

- the appraisal is a home inspection or is a substitute for a home inspection;
- the appraisal provides the same information and services as a home inspection;
- a home inspection is assumed to be performed automatically by someone else, usually FHA;
- other inspections, like a radon inspection, constitute a home inspection.

Of course, all of these assumptions are incorrect.

There are other factors, such as homebuyers neglecting to add a home inspection contingency to the contract, or not realizing it is their sole responsibility to make arrangements for a home inspection.

But by and large, it is consumer confusion about appraisal and home inspection, and lack of education and understanding about these features in the realty transaction.

*What can federal agencies do to reduce consumer confusion, and avoid inadvertently contributing to consumer confusion between appraisals and home inspections, and make for greater transparency for lenders and the GSE's?*

HUD has set useful precedents. HUD has adopted a clear and consistent policy urging consumers to obtain voluntary home inspections. Further, HUD has produced disclosure and education documents to educate consumers regarding the benefits of obtaining a home inspection.

ASHI recommends that federal agencies such as CFPB be cognizant of the consumer confusion problem -- and avoid contributing to this phenomenon -- by maintaining the clear distinctions between appraisals and home inspections in regulatory policy.

The most prevalent regulatory drafting problem is any reference in appraisal policy to “physical inspections”, and how such references to physical inspections confuse consumers into thinking the appraisal constitutes a home inspection.

ASHI recommends that any appraisal regulations clearly distinguish a home inspection from any manner of physical inspection associated with the appraisal. Regulations should clarify that any such physical inspections to support the appraisal are very limited compared to a home inspection and do not constitute nor replace a home inspection, and are not compliant with most states’ home inspector licensing laws. Such regulations should recommend that consumers obtain a professional home inspection. In short, such regulations should reflect the core messages of HUD Form 92564-CN, “For Your Protection, Get a Home Inspection.”

*What is the federal policy toward voluntary home inspections?*



To date, the federal policy relating to home inspection has been promulgated by HUD.

HUD has a well-settled, long-standing policy of advocating that homebuyers obtain voluntary home inspections. See HUD Form 92564-CN “For Your Protection, Get a Home Inspection.” HUD has taken an active role in advising consumers to obtain voluntary home inspections.

HUD expands on its support and education commitment with a document entitled “Ten Questions to Ask Your Home Inspector”. Both “For Your Protection, Get a Home Inspection” and “Ten Questions to Ask Your Home Inspector” are available on the HUD website.

[“For Your Protection...” has been modified and improved several times, so there are multiple versions. ASHI is currently working with HUD staff on yet another improvement and update.]

Of course, there is important congressional support for voluntary home inspections (see below).

*Is there congressional support for federal policy advocating voluntary home inspections?*

Yes. Congress included the core of the Consumer Protection Home Inspection Act in the Dodd-Frank Act (see Sec. 1451 of DFA). DFA amends all HUD housing counseling programs to include comprehensive counseling on home inspection and how to obtain a home inspector. The purpose of Sec. 1451 is to use the resources of HUD’s housing counseling programs to advise buyers to make an informed choice whether to obtain a home inspection. HUD is in the process of implementing Sec. 1451 of DFA. Sec. 1451 lists in detail the actions to be taken by the Secretary of HUD to integrate home inspections into housing counseling programs.

Further, DFA requires FHA mortgage lenders to provide prospective homebuyers, at first contact, whether upon pre-qualification, pre-approval, or initial application, the home inspection materials mentioned supra. ASHI expects HUD to issue a new Mortgagee Letter to comply with the law.

*What are the core federal policy documents with respect to voluntary home inspections?*

- GAO Report 04-462;
- HUD form 92564-CN “For Your Protection, Get a Home Inspection” currently under revision and improvement;
- HUD Mortgagee Letter 2004-04, revision of “For Your Protection Get a Home Inspection”;
- HUD’s “Ten Important Questions to Ask Your Home Inspector”;
- Dodd –Frank Act, Section 1451;
- HUD Waiver of Requirements of 24 CFR 203.37a(b)(2).

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## **THE PROPOSED RULE**

The proposed rule refers to a “physical inspections” requirement but is vague regarding the scope and depth of the physical inspection.

In the absence of more, the passage mentions the *Uniform Residential Appraisal Report* in such a way that observers might regard it as incorporation by reference, or at least that the *Uniform Residential Appraisal Report* may be used as a guidance:

“The proposed NPR's requirement to conduct a physical visit of the interior of the mortgaged property potentially adds an additional burden to the appraiser. The USPAP and title XI of FIRREA and the regulations prescribed thereunder do not require appraisers to perform on-site visits. Instead, USPAP requires appraisers to include a certification which clearly states whether the appraiser has or has not personally inspected the subject property. During informal outreach conducted by the Agencies, outreach participants indicated that many creditors require appraisers to perform a physical inspection of the mortgaged property. This requirement is documented in the *Uniform Residential Appraisal Report* form used as a matter of practice in the industry, which includes a certification that the appraiser performed a complete visual inspection of the interior and exterior areas of the subject property. Outreach participants indicated that requiring a physical visit of the interior of the mortgaged property added on average an additional cost of about \$ 50 to the appraisal fee, which is paid by the applicant.”

ASHI is concerned that this minimal description of the physical inspection requirement, without more, will inadvertently exacerbate the prevalent consumer confusion regarding the distinctions between appraisals and home inspections, causing homebuyers to rely too much on appraisal casual findings and deter them from obtaining true professional home inspections. In addition, ASHI suggests that this minimal appraisal treatment also negatively impacts the lender by including only readily observable dwelling elements when determining value and not identifying possible latent structural or system defects that could impact the borrower's ability to maintain the home and make payments when due. The appraisal report may indicate that the house is in good structural and mechanical condition, whereas a state licensed home inspection report often will note structural or mechanical problems or violations of code not cited in the appraisal, a possible boon to future litigation.

Most importantly, ASHI urges CFPB et. al. to add language to the proposed rule stating explicitly that the physical inspection required for appraisals is not a home inspection, is in no way related to a home inspection or a substitute for the same, and that the lender continues to be obligated to provide HUD Form 92564-CN “For Your Protection, Get a Home Inspection” to the prospective borrower at first contact.

Note: ASHI has been informed that under HUD precedent, lenders have been required to provide HUD Form 92563-CN to loan applicants. However, there is widespread concern over compliance with this requirement. DFA Section 1451 includes a provision to ensure codification of this requirement:

*(b) Requirement for FHA-approved Lenders- Each mortgagee approved for participation in the mortgage insurance programs under title II of the National Housing Act shall provide prospective homebuyers, at first contact, whether upon pre-qualification, pre-approval, or initial application, the materials specified in subparagraphs (A), (B), and (D) of subsection (a)(1).*

To reinforce the effort to avoid unintended consequences such as deterring homebuyers from considering obtaining a home inspection, ASHI suggests that the rule include the latest home inspection messaging developed for inclusion in HR4219, The Consumer Protection Home Inspection Counseling Act of 2012:

Those messages appear below:

(A) That a home inspection in connection with purchase of a home is voluntary, but not mandatory, which means that the homebuyer must make a personal choice whether to obtain a home inspection.

(B) That the Department of Housing and Urban Development recommends that homebuyers obtain a voluntary home inspection.

(C) That a home inspection is an in-depth technical and objective examination of the physical structure and internal systems of the home, from the foundation to the roof, and should be performed by a trained and experienced professional home inspector.

(D) That a home inspection is not required in the case of an FHA loan insured under title II of the National Housing Act (12 U.S.C. 1707 et seq.) and that a home inspection is not performed by FHA.

(E) That in most cases, no home inspection will be performed unless the homebuyer requests one.

(F) That it is the burden of the homebuyer to arrange for a home inspection if one is requested.

(G) That an appraisal is not equivalent to a home inspection.

(H) That if the homebuyer chooses to obtain a home inspection, it is generally to the homebuyer's benefit to do so as early as possible.

(I) That the homebuyer may ask to make the transaction contingent on the outcome of the home inspection and that the homebuyer may realize substantial financial benefits from the home inspection, including from identifying possible repairs that could be performed and paid for by the seller prior to the closing.

(J) That the homebuyer should consider requesting a voluntary home inspection.

### **PROPERTY FLIPPING AND THE USE OF HOME INSPECTION AS A MEANS TO REDUCE THE RISKS TO THE CONSUMER IN BUYING A FLIPPED PROPERTY**

The proposed rule allows for an additional appraisal, not to be paid for by the buyer, to reduce risks to the lender in property flipping circumstances where the seller of a given property has purchased the property for less than the current sales price within the last six months.

Of course, the extra appraisal is to protect the interest of the lender. It may or may not protect the interest of the homebuyer, particularly in property flipping circumstances in which there may have been factors such as lack of routine maintenance, abandonment and foreclosure, and vandalism and theft. It is worth noting that frequently such sellers focus on making cosmetic repairs and do not address structural, mechanical, environmental or system issues. All such factors may affect the interest of the consumer as well as the lender. Inasmuch as the house is the security for the loan, and the consumer will be responsible for any defects that may be in the home to be used as security for the loan, the consumer has a strong interest in knowing the technical condition of the home. Providing the consumer with a copy of the appraisal report at least three days before closing (as required) cannot enable the purchaser to reasonably initiate any corrective action with the property seller without significantly risking the initial deposit and having the seller enforce the sales contract for specific performance.

The Secretary of HUD has included “property inspections” as a criterion in justifying an exception to the HUD property flipping ineligibility period for FHA insurance.

In brief, HUD does not allow FHA insurance on properties being sold by a seller who acquired the property less than 90 days previously – property flipping.

HUD allows some exceptions to this rule in the current realty environment. One of the exceptions includes obtaining a property inspection, which appears to be the equivalent of a home inspection. See HUD Waiver of Requirements of 24 CFR 203.37a(b)(2). Such an inspection is deemed to ensure that the physical improvements to a home that would be commensurate with a legitimate property improvement have indeed been made and the home is in good condition.

ASHI urges CFPB to consider techniques that draw upon the precedent set by HUD in using home inspection as a “carrot” or safe harbor incentive that would allow for faster sale of distressed properties, while concurrently protecting consumers from possible consequences of distressed sale situations. ASHI strongly supports the emerging use of home inspection as a consumer protection device to accelerate distressed property sales to advance the needs of consumers, taxpayers, and realty professionals, and promote transparency for lenders, GSE’s and all parties to the real estate transaction.

Further, ASHI recommends that any home inspection performed to address property flipping concerns be provided to the appraiser and the lender. ASHI suggests that CFPB et. al. consider a general requirement to provide relevant home inspection reports to appraisers and lenders.

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### **USE OF THE UNIFORM RESIDENTIAL APPRAISAL REPORT AND THE UNIFORM APPRAISAL DATASET AS A TEMPLATE TO DESCRIBE PHYSICAL INSPECTIONS**

ASHI has expressed strong concerns with regard to the Uniform Residential Appraisal Report and the Uniform Appraisal Dataset. Those concerns have been addressed to representatives of Fannie Mae, Freddie Mac, the Appraisal Foundation, and the Appraisal Standards Board.

To date, ASHI is unaware that substantive changes have been made in the UAD to address the concerns raised by ASHI. ASHI is concerned that as various parties develop a track record with these documents, that problems will arise relating to the obligations, expectations, possible liability and possible code enforcement issues raised by the UAD's incomplete description of physical inspection requirements. This track record is yet being developed. Given the fact that the UAD is controversial among some interested groups and may become more so, ASHI recommends omitting any references to the Uniform Residential Appraisal Report and the Uniform Appraisal Dataset, or at the least, making it clear that the UAD is not offered as a template, safe harbor exemption from state home inspector licensing requirements, or other manner of guidance document in interpreting the meaning of "physical inspection" in the proposed rule.

The condition of the property has been a long established factor in determining value, but was broadly minimized during the prior residential real estate period of hyper price inflation. During that period, property condition was generally overlooked as the underlying land value often drove the valuation where property condition was poor. When values plummeted, many homeowners and investors simply neglected or deferred property maintenance. This was particularly true when the property was under water and the homeowner found it hard to invest additional or even spend moderate amounts on upkeep that would not generate a return on investment. At the depth of the current housing crisis, 11 million homes were estimated to be under water. Consequently, a significant portion of the housing stock has deferred maintenance at varying levels.

The issue of property condition in value is further impacted by a large number of individuals and institutional investors acquiring property with defaulted mortgage loans in short sales or foreclosure. For the most part, the interest of these investors is to generate rental income as quickly as possible. Further, a large number of individuals who have gone through a short sale, foreclosure or deed-in-lieu cannot purchase another home, except perhaps for cash, without a 2-4 year period of rehabilitating their credit. As a result, these investors focus their investment dollars on property cosmetics and not on system and structural issues that may not be apparent in a typical appraisal physical inspection but would affect valuation if known.

In a managed effort to achieve better information about property condition and to drive the appraiser to be more cognizant of property condition in determining market value, under a directive from FHFA the GSEs promulgated new scoring requirements regarding property value in the appraisal form and required appraisers to comment on property condition. ASHI refers to these scoring requirements collectively as the UAD problem. Unfortunately, this approach makes the review and consideration of property condition totally and solely by appraiser observation. Appraisers do not conduct “property inspections” in the full technical sense as do home inspectors. In general, they review room sizes, make observations regarding any obvious property issues to make certain the description of the property provided to them is correct so that they may properly perform a market analysis of comparable properties. Appraisers do not carry ladders, climb to the roof, perform thorough systems checks, and carefully review for structural and other issues. Appraisers are not trained, licensed or certified as professional home inspectors. Such an in-depth review of property condition will not occur unless a party to the transaction retains a state licensed or certified inspector (or equivalent) home inspector.

Regrettably, the wording in the appraisal form regarding property condition implies that the appraiser “inspected” the property, and reviewed the property condition, but is silent or ambiguous as to the depth and detail of the review, or the limitations on how it should be used. Most home purchasers, particularly those buying a property for the first time, do not readily understand the difference between appraiser and a state licensed home inspector. Consequently, many purchasers of homes who dutifully receive a copy of the appraisal from their lender likely will interpret the wording in the appraisal as full and complete statements regarding property condition and code compliance.

The existing GSE requirements regarding property condition have skirted the home inspection industry and were developed without any input from the industry, at least through the leading industry professional association, ASHI. While the industry currently has no standardized inspection form or data standards, it has recognized these shortcomings and is in the process of developing a specialized guidelines for mortgage financing inspection that would provide appropriate data standards and possibly serve as a more complete guide for appraisers and lenders.

We understand the CFPB et. al. mission is to develop and enforce appropriate rules and regulations regarding finance so that the consumer makes an intelligent and informed decision about financing, and that lenders and GSE’s receive information in a transparent manner. Yet, without a complete and thorough inspection of the dwelling there is no mechanism by which any lender, the lender’s appraiser or the homeowner can make an intelligent informed decision. For example, if one of the core systems (plumbing, heating, electric, structural or environmental) in the home is faulty, in need of early replacement or repair, should not that condition be considered by the homeowner, lender & GSE’s before the borrower incurs substantial mortgage debt? Is it not true that early unforeseen major repairs could impact the value of the home as security for the loan, as well as materially affect the ability of the homeowner to make timely payments on the mortgage? Under these circumstances, should not the lender insist that either the needed core system repairs be made prior to closing, or require adequate funds be provided by the seller, be available to the buyer, or built into the loan amount?

It is worthwhile to note that while many home purchasers obtain property inspections prior to applying for a mortgage loan or certainly prior to making the loan, there is nothing in the current regulated lending process that requires the prospective borrower to disclose that inspection to the lender or to the lender's appraiser. Some lenders typically will ask for the inspection if it is a condition in the sales agreement, but based on anecdotal information, lenders typically do not provide the inspection to the appraiser for use to ascertain its impact on value or consider the results into the underwriting decision. It has been little more than a document that the lender seeks assurance the borrower obtained.

If one were designing the home financing process from inception to assure that all parties to the financing transaction were transparently informed about all aspects of the property posted as collateral and fully recognizing the roles, responsibilities and capabilities of the parties to the transaction, a home inspection would be the first required step towards determining value with the appraiser required to review and consider the home inspection in making the determination of market value. This process would be applicable for all mortgage financing transactions, including refinancing.

The appraiser's review of a professional inspection report performed by a state licensed and professional home inspector would enable the borrower and the lender to make materially better judgments on the elements that drive statements about property condition. Furthermore, an inspection report would inform the borrower about the quality of construction and the existence of defects that may impact value or create possible future losses. Such an approach would also enable the homeowner to explore appropriate insurance coverage to mitigate the financial impact of likely losses from natural and other disasters.

On a limited basis, this revised process could begin immediately with the requirement that any home inspection report made on the subject property within six months prior to making the loan be provided to the lender and the appraiser. We suggest that it is in the interest of the prospective borrower, the lender, the banking and housing agencies, the mortgage insurers and all other direct and indirect parties to the home financing transaction to make their individual decisions on a complete and thorough report on property condition.

Looking forward, ASHI would be pleased to work with the regulatory community to evolve appropriate data and report standards for a mortgage financing inspection report, including a scoring methodology.

Sincerely,

Mr. Marvin Goldstein – ACI  
President 2012  
American Society of Home Inspectors

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