AMERICAN BANKER®
THE FINANCIAL SERVICES DAILY
Monday, May 5, 2008

COVER STORY

Appraisal Issues – Beyond Independence

■ BY LAWRENCE RICHTER QUINN

For bankers like Dean Hackemer, the president and chief executive of Access National Mortgage Corp., ensuring the accuracy of appraisals has become a bigger focus these days.

His lender, a unit of the $621 million-asset Access National Corp. of Reston, Va., has begun asking "far more questions than before and wanting more information" from appraisers, Mr. Hackemer said.

For the last several years property values in northern Virginia rose an average of 20% to 25% a year, making the accuracy of an appraisal relatively unimportant — until now.

"Until this mortgage meltdown, generally it hasn't been a problem finding another house in the same subdivision that has sold relatively recently," Mr. Hackemer said. "To me, that has represented a really good comp" — a comparable sale, the basis of many appraisals.

"Now, though, you want that same good comp, but it's becoming increasingly difficult to get, even in northern Virginia," he said. "Today appraisers are having to go outside subdivisions for something that has sold in 60 days or less, because now even that's a long period of time in this housing market. And on top of that, you're finding situations where the closest comp might be a foreclosure, where a bank's just trying to unload a property, so the question is whether that value really is representative of what a property is worth."

But appraisers are telling him, "'If there were more comps, we'd give them to you. If there were properties sold within a mile and 90 days, we'd tell you.' So you can bet lenders are asking, 'How good is that appraisal and the person doing it?' " Mr. Hackemer said. "All these questions are on the table as never before."

The appraisal profession is receiving the kind of scrutiny not seen since the savings and loan crisis of the 1980s, when poor performance and fraud by appraisers received much of the blame.

The current scrutiny is coming from both inside and outside the real estate finance industry. Most famously, New York Attorney General Andrew Cuomo unveiled an agreement in March in which Fannie Mae and Freddie Mac pledged not to buy mortgages from lenders that use in-house staff members, or a company they own or control, for appraisals. The deal also prohibited mortgage brokers from selecting appraisers.

Other Concerns

Appraisal problems not addressed by the Cuomo-GSE deal or by the "independence" debate

Builder concessions:
Inducements to buy home (like free trips) not disclosed to appraisers, lead to inflated loan amounts

Qualifications:
Barriers to entering profession said to be low

ID Theft:
Appraisers said to impersonate other appraisers

Timeliness:
Tepid market makes it hard to find recent comparable sales

The idea is to ensure appraiser "independence" and eliminate pressure from lenders and brokers to inflate valuations, something appraisers have complained about for years.

The Home Valuation Code of Conduct, the backbone of the deal, stemmed from an investigation Mr. Cuomo began in November of First American Corp. of Santa Ana., Calif., and its eAppraiseIT LLC, which he accused of inflating the value of home loans under pressure from Washington Mutual Inc. All three companies have denied the accusations.

As part of the investigation, Mr. Cuomo subpoenaed Fannie and Freddie and asked them to supply details about Wamu's loans and their due diligence practices related to appraisals.

The deal has aroused controversy. In comment letters sent to Fannie and Freddie last week, bankers, industry and real estate groups, and others warned the agreement would have significant unintended consequences.

But even those who support the deal — or at least the goal of protecting appraiser independence — say the agreement and the debate about client pressure do not address a number of problems. These include the buyer "concessions" (like furniture, trips, or automobiles) that builders and homeowners are using to clinch the sale of a property, the use of inexperienced and untrained appraisers, and the impersonation of appraisers by other appraisers.

"Appraiser independence by itself is important, but it's just a first step along the way to building a profession where there is absolutely no doubt about the quality and integrity of its work," said Kathy Coon, the chief appraiser and director of appraisal quality control at FNC Inc. in Oxford, Miss., and a national instructor at the Appraisal Institute, a trade group in Washington.

BUILDER CONCESSIONS

Ms. Coon, a member of a task force the Mortgage Bankers Association convened last year to examine ways to reduce fraud and increase professionalism in appraisals, identified concession-related fraud as an issue that urgently needs to be addressed.

“Home builders can do a lot of creative stuff regarding concessions, but appraisers aren't necessarily privy to that information, and it has become an enormous problem,” she said.

“We need total and full disclosure from the home builders and the real estate industry regarding concessions, but they have no legal obligations currently to make those,” Ms. Coon said. “It's a rapidly increasing problem now with such an enormous stock of unsold new homes and pre-owned ones, and that means builders are really pushing concessions — free trips, vehicles, motorcycles, other inducements such as houses loaded with free furniture — as a means of selling their housing stock. Unfortunately, these ‘free’ concessions really aren't free. Appraisals can be inflated to include those costs, so that the ultimate amount of a loan is much greater than it would be otherwise.”

Comparable sales have become harder for appraisers to find, says Hackemer.

Coon calls homebuilder concessions “a rapidly increasing problem.”

She acknowledged that “there's no law saying that home builders or real estate agents have to disclose this information to appraisers.” Nevertheless, “appraisers are only as good as the quality of data they receive.”

The situation shows why it is unfortunate the agreement between Mr. Cuomo and the government-sponsored enterprises “focuses only on brokers and lenders, not on these other crucial groups,” Ms. Coon said.

Mr. Hackemer agreed that concessions have become a big problem. “Now you're seeing those concessions flowing over into the existing-home market,” he said. “You have to ask yourself, ‘If you're giving away almost 10% of a property's sale price as a concession, is the house really worth what you're selling it for?’ If you're giving away a $35,000 car, does the house's appraised value stay at $165,000 or go up to $200,000?”

Home builders deny that they are trying to do an end run around appraisers by inflating home values (and loan amounts) to pay for concessions. They argue that if anything, appraisers are exaggerating the importance of “free” gifts such as automobiles or trips.

Gopal Ahluwlia, staff vice president of research at the National Association of Home Builders, said only 2% of home builders offer cars or trips as concessions.

“It can't be done, offering concessions ‘free’ with the idea that they'll be financed by increasing the value of an appraisal and therefore the total amount of a loan involved,” Mr. Ahluwlia said. “Instead, when builders offer to install a free hardware floor or enlarge a garage for a third car, whatever it is, they're paying for it out of their own profit.”

Appraisal values should come down if major concessions like a car are involved, he said. “If you're giving away a $30,000 car and the value of the house is $300,000, then the appraised value should be reduced 10%.”

HUMAN RESOURCES

Mike Freeman, an executive vice president and the consumer risk executive at First Horizon National Corp. of Memphis, said he welcomes increased scrutiny of individual appraisers and their qualifications.

Too much attention has been focused on trying to determine the quality of automated valuation techniques, he said. “Until now I haven't known of anyone who has focused on quality in terms of the human element — the individuals involved.”

Terry Franzen, a partner with Franzen & Salzano PC, an Atlanta law firm specializing in financial services and mortgage fraud, and a spokeswoman for the Georgia Real Estate Fraud Prevention and Awareness Coalition, said: “There's a real need to tighten up on licensing so that you have to be a licensed appraiser to sign off on appraisal. Right now supervising appraisers are supposed to go out and look at properties before the appraisal is signed, but in reality that rarely happens.”

Merle Sharick, the manager of business development for the Mortgage Asset Research Institute, a Reston antifraud tool vendor owned by Choicepoint Inc., said even seemingly small problems with appraiser accuracy — say, underestimating a property's square footage — can cause enormous difficulties.

"Let's say a loan closes and at some point the borrower's not able to pay," Mr. Sharick said. "At some point a post-closing appraisal review is done, and you find out that instead of dealing with a property that was 2,500 square feet, as the appraisal indicates, it's only 2,100 square feet. By no means is that an inconsiderable difference — it's 15%." The lender ends up "swallowing" the difference, "because the proper appraisal work wasn't done up front."

John Bredemeyer, the president of the Omaha appraisal company Realcorp Inc. and the vice chairman of the Appraisal Foundation, the organization authorized by Congress to set appraisal standards and qualifications, blamed problems with credentialing on early uncertainties about whether there would be enough appraisers to meet demand when the credentialing process began in the early 1990s.

"The whole process began after the S&L debacle," Mr. Bredemeyer said. "Until then there was no licensing, and the profession looked to professional associations like the Appraisal Institute, rather than regulatory bodies like we have now, to establish who was qualified. So the Appraisal Institute had all kinds of designations, just as the American Institute of Certified Public Accountants has its CPA designation."

Worried about meeting demand, "we brought people into the profession who were minimally qualified, who were more susceptible to being pressured," he said. "The good thing is that we've recognized that now, and we think we'll see some real benefits down the road."

In January the foundation made substantial changes in the qualifications for credentialing. It substantially increased the educational and experience requirements, and it established a national examination for credentials.

"This was an absolutely crucial development in terms of pushing quality along," Ms. Coon said. "In the past there had been a mishmash of requirements that had to be required by individual states, and those weren't even up to date."

However, those already credentialed cannot be kicked out of the system, even if they have minimal talent, unless they perform unprofessionally or unethically. Mr. Bredemeyer said enhanced quality will be achieved only through time and attrition.

"That's why we think it's so important for appraisers to be involved with a professional association, whether it's the institute or others," he said. "At least that way they're in a group of people who value experience and education, so we're really doing a lot of outreach to bring more people into the institute."

The institute says that will probably be an uphill battle; there are about 100,000 certified appraisers nationwide, but only 20,000 belong to the trade group, and about a third of the 100,000 may not be practicing.

"Beyond that, some are probably leaving the industry," Mr. Bredemeyer said. "Meanwhile, we understand that in younger generations of appraisers, there may simply be fewer joiners."

OTHER FACTORS

Even appraisers who are licensed, credentialed, and well trained will have to worry about being impersonated by those who are not.

"The theft of an appraiser's identity is really becoming a significant problem," Mr. Sharick said. "I talked with an appraiser the other day who had been contacted by a bank that had three appraisals theoretically signed by him, and he hadn't been involved in any of them. Their ability to work has been severely challenged by this threat, and for the last year I've been telling lenders they need to call the appraisal company to make sure the appraiser actually did the work that has his or her name on it."

Mr. Freeman identified another thorny issue: the timeliness of valuations.

"If you're talking about accuracy, are you talking about accuracy at this very moment in time, or are you talking about accuracy in terms of where values were headed 18 months ago, for example?" he said. "These are all issues that we need to address as long as we're focusing on improving the professionalism of the appraisal profession and confidence in the work done by individual appraisers."

Still, "I think it's extremely healthy for the credit industry overall and the [mortgage] industry in particular that people are zeroing in on the quality of individual appraisers and appraisals," Mr. Freeman said.

Until the subprime meltdown, the industry had lost track of the importance of accurate appraisals, he said. "Collateral value — the value of the property — had become a secondary issue, viewed as a secondary source of repayment, with everyone focused on the credit scores of the individuals first and foremost," he said.

"Now we're understanding that the more opaque credit risk is, the more important … the accuracy of that valuation. So there's an extremely important rebalancing now of what ultimately is important to consider before a loan is made. Getting to quality in appraisal valuing is finally getting the attention it needs."

Mr. Quinn is a freelance writer in Atlanta.