Appraisal Tampering
Some quantitative measures...

Scope

As with any other good piece of work, I would like to start by telling you the scope of my topic. It is real estate lending. There may be appraisal tampering in equipment leasing, but the Appraisal Subcommittee doesn't want to give the Foundation money to develop personal property standards, so it must not be a problem. Right? And there is talk about phonied estate valuations, but these seem mostly to involve business appraisals, family limited partnerships and so on. Once again, no funds from the AS for standards, must not be a problem. So I'm comfortable limiting this piece to something that I actually know something about.

Who phonies up appraisals?

After too many years in the business I have always known that there are the "good guys" who do appraisals right, and the "bad guys" who don't. In all of those years I haven't met many of the latter. I must not get around in the wrong circles. Ann O'Rourke recently opined much the same sort of sentiment about who would constitute a good appraiser. I think that many, if not most appraisers want to do the job "right". Some don't know how. Some don't care. And some deliberately want to milk the system for as much money as possible hoping not to get caught. As few are caught, that is not an unrealistic expectation.

Who wants phony appraisals?

I would like to believe that many if not most lenders would like accurate and honest appraisals. Certainly if you go to the top, most senior managment expresses the desire. There are exceptions. The corporate counsel of a mortgage company one time told me that the company had been founded to avoid the excessive regulation associated with savings and loans. This came in what amounted to a termination interview in which I was introduced to my replacement, a nice young lady with one year of appraisal experience who was taking over as statewide appraisal review manager. So I have definitely met at least one client for phony or at least marginal appraisal work. I am excluding institutions which are no longer in business, even though I think some of my suspicions are justified.

How to tell the difference

It follows that those who want bad appraisals have to find appraisers who will accomodate them. There are a couple of ways to do that. One is to hire and train them. The difficulty is that there is some start up expense, and the staff forms an ongoing non-interest expense as well as headcount. Tough on the value of the business. The next is to shop among the large number of independents. Look hard enough and you are likely to find someone either ignorant or venal enough to fill your needs. At one point in the 1980's one of the dead savings and loans regularly hired an FHA appraiser to do their commercial appraisals. His work was awful. They would accept it in draft, rewrite it and give it back to him for signature. Worked like a charm, except the poor schlepp gave one of his drafts to the institution a week or so after the feds took it over... Now the difficulty is that all of this shopping around is going to cause some churn on the list of fee appraisers. Heretofore this has been explained away by saying that of course appraisers are dropped from the list. Just amazing how many appraisers are out there who either don't understand their jobs or can't meet deadlines.

This leads to the first proposed numeric checks. It should be possible to develop a normal turnover for a fee appraisal panel. More turnover is a flag. The second check is related. If appraisers are eliminated for in some fashion "saying no", then two corollaries appear. First, those with less experience are less likely to say no, because they have less experience and confidence on which to base their judgement. Second, even if all else is equal, then the longer an appraiser is around, the more likely it is that he or she would have said no and been eliminated. Thus, if the staff or fee panel has less than the average amount of experience associated with their license levels, that is suspect.

How can appraisal tampering be hidden?

It has been hypothesized, by HUD, that appraisers appraise at price too often to the detriment of buyers and lenders. Well, this is hard to test. If a multiple regression model of a market can explain 95% of value, how do we sort out the difference? If appraisers hit 97% of sales in the same market, is that because they are influenced by the sellers and agents, or because they are better than statistics? There is a more productive line of inquiry. Reckless lending can be disguised by undervaluing sales, and getting wild on the other stuff, for which there is no direct measure of value. So, if the values reached in the sold property loans are modeled, and that model applied to the refinances and construction loans, there might be a difference. There was in the mid-'70's when I took over the Tahoe Regional Appraisal Office for Wells Fargo. It seemed that one of the branch managers was trying to do a loan points pyramid, hoping to jump off the top to a promotion and leave somebody else to pick up the pieces. Possibly in part because of my uncooperative attitude it didn't work. The collapse, however, coincided with an overall recession, which would have been the excuse if it had. So, if sales are valued differently, lower, than similar properties appraised for other functions, that is an indicator.

Who dunnit?

The other day I sat at an industry lunch and did a double take. At the head table was a man whom I believe had been chief appraiser of Bell Savings in the 1980's. His standard was succinct, with an MAI appraisal, a pro-forma and title report he would turn in-state multi-million dollar deals around in a week. Out of state would take a week and a half. Bell failed with a 98% default ratio. Subsequently I know that he was chief appraiser of another institution which is no more. And he was at the head table! What have I done wrong in my career?? So, this is a possible non-numeric test. For those who are associated with an institution and have average or more experience, or who have senior positions, check the cv's. If the experience is mostly with failed or merged institutions, is that a good sign? There was recently an examination of Chaucer's "perfect gentle knight". Literary critics had accepted him as the exception to the humorous depictions of other characters. Turns out that Sir Knight was equivalent to a modern officer and gentleman whose campaign ribbons were Algeria, Katanga, Biafra, Namibia, Angola, with time off for Laos and Myanmar. How about a cv that started with Litton Savings, home of the 48 foot tape measure delineated in 50 increments?

Conclusion

It seems that, first, the next debacle in real estate is only waiting for the next recession. In its cold light the effects of past abuses will be apparent. If past experience is any guide, retribution will be slow, ineffective, and highly selective. These suggestions if effected might allow regulators, if not to get ahead of the problem, at least to have a program and know the players. I suppose it comes down to one of those questions sometimes termed "retirement issues". Will the problem eventuate before I retire? For some at the Federal Home Loan Bank Board which shared with appraisers the ignominy of the last debacle, the answer was probably yes. I suppose if the present regulators calculate the odds as against them, they may modify their examination techniques to integrate some or all of these proposals.

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