

Genie Back in the Bottle - The Appraisal Industry

Is it already too late to put the “genie” back in the bottle? Like much of the real estate industry, “it depends” is part of any answer. First, let’s look at how this magic lamp was opened and the *genie* was released; and the possible impact on the future of the real estate and mortgage industries. In the last year the appraisal industry has been turned upside down and inside out. Veteran appraisers across the country have been forced into new circumstances and many into other professions. Many have also been politely asked to work faster and for half their fee. Imagine going in to work tomorrow and finding out your pay has just been cut in half, and you have no say in the matter. And, to add insult to injury, they want you to work under their rules and on their (often unrealistic) schedule. You have worked for the last ten years setting your own schedule and controlling your own business. That was yesterday. Today, you are no longer your own boss. You have no options and no one ever asked your opinion about this new business plan. Today you work for a new company (many of which know little or nothing about your business). Somebody flipped a switch and a new powerful industry emerged; an industry now in charge of the real estate valuation process. An industry with an enormous power and one which has states scrambling to impose some kind of restrictions over. However, at the time the switch was made, most of these companies were totally unregulated. If you look back over the events of the last year, this could have never happened to any other industry. Just imagine telling the bar association or the insurance industry they will now work for half fees, under new rules, and on someone else’s schedule. Is any industry with problems now subject to restructure by a state official? It’s hard to believe it really happened, but it is a reality of this new real estate market.



The national real estate market collapsed. Whenever there is a problem of this magnitude, someone has to take the blame; changes must be made. In the recent real estate crisis, the appraisal industry was selected as the most likely candidate for changes and regardless of what happens in the next year, many experienced, highly educated, dedicated, and well qualified appraisers have been lost forever. No way to turn back the clock. A politician (who knew little about the appraisal business) decided to take out his magic lamp and use his all powerful *genie* to change an industry. A highly respected (highly regulated) industry, barely over twenty years old, was dismantled and a brand new (non-regulated) industry was created to take their place.



Let's look at the collapse of the real estate market and the specific reason so many homeowners walked away (some willingly and some angry at the *system*) from their loans and their homes. The current *powers that be* are set in their efforts to control the appraisal industry and see this one division of the housing industry as the "problem" that needs to be fixed. The total real estate problem was overwhelming and changes had to be made; big changes. And they were, quickly. Perhaps a little too quickly, before they had time to really examine the big picture. One state official started the ball rolling and this movement has been building, with many different points of view, until it may turn into a new appraisal revolution. No matter what else happens, eventually, consumers will pay for the price of change.

Picking one division of an industry to single out (in hopes it will solve all of real estate's problems) is where this started to go wrong. Completely re-inventing one department or segment of the home buying process is NOT going to solve the problem. Appraisers certainly were not the sole cause of this current crisis. But, they have turned out to be one of the many *victims* of this real estate meltdown. Let's talk just a little about real estate values - how they escalated - and what finally led to the bubble bursting. There's no way around this answer, even though it may be unpopular among some groups. However, let's look at some of the facts.

Real estate prices are in direct correlation with the availability of mortgage funds. The more people that have access to home loans, the more buyers, and the better chance the seller has of getting a higher price. It's nothing more than the law of supply and demand. Let's face it; over a three year period (during the real estate boom), money was easy to get. 100% loans, no doc loans, low doc loans, stated income loans, first time buyer programs over 100%, variable or adjustable rate mortgages which often offered an unrealistic payment for a short initial term - they would worry about tomorrow - tomorrow; loans and the name of some of the loan programs was a creative wonder to watch. Lenders and mortgage brokers flourished across the country. There was money to lend and everyone in the real estate industry was making money. For a few years, life was good. Money was flowing, homes were selling, prices rising, and it appeared there was no end in sight; just part of the American dream. But, unlike the fairy tales and happily ever afters, eventually "tomorrow" had to come.



Have you heard of "The Golden Rule?" **He who has the gold makes the rules!** There's no gentle way to say this, but the fact is; the greed of lenders is one of the main sources of the problem and always has been. They are the ones with the money to lend. The ones with the money, making the rules. They are the ones that established the lending guidelines that had to be followed by everyone else in the lending chain. They are the ones who wanted to keep the "loan pipeline" full and flowing. When they ran out of borrowers with the traditional twenty percent down payment, they reduced the requirements to encourage borrowers with only ten percent down to get loans. Got to keep that pipeline full! When they ran out of borrowers with the ten percent down, they once again reduced the lending and credit requirements to encourage borrowers with five percent down, then three percent, zero down, then "low doc" and "no doc loans."

Think about the meeting where they came up with these genius ideas. “Hey, let’s loan money to everybody! It doesn’t really matter if they can afford the home. If we can make it easy for them to qualify for a loan, we are going to get paid. There’s no way we can lose. We make a profit on loan fees up front, the interest rate on our adjustable rate mortgages can only go one way, up. And, we sell most of our loans anyway for a nice profit in the secondary market. Let them worry about if the people can actually keep up with the mortgage payments. We’ve made our money and moved on. What about the increased risk? Well, the lenders just pack the loans up and sell them off to someone else in a mortgage backed security that is so far removed from the valuation process no one can figure out the value any more...not even the most sophisticated investors. At that time, nobody really thought to ask the appraiser’s opinions. The appraiser was just a step in the process. The local lender wasn’t worried about the true value of the property. All the local lender knows is that they need this appraisal to come in at the right price so they can close this loan (and get paid). No appraisal, no loan, and no one is getting paid. Anything beyond that is not their problem.



Just think about that executive who said “let’s give loans to people who don’t look so good on paper, but they can come up with three percent down and pay the loan fees. Let’s create a “low doc, stated income,” and “no doc” loan. We’ll let the applicants write down whatever they want on the loan application and if they sign it, we’ve got no liability. Borrowers can walk in and say they make \$60,000 a year, but over half is in cash. We’ll smile and say “*no problem*, we’ve got a loan for you.” It’s not very logical, but it turned out to be very profitable; at least for a little while. You have to admit those executives were right. Profits soared and anyone that wanted a loan got a loan. Easy credit put many people in homes they really could not afford. And, instead of saving more money and getting a traditional mortgage, they sank whatever money they had in a loan (or in fixing up the house) which left them *house poor*. In the end, they lost it all. Now they have to start all over. Many American dreams have been shattered during this boom and bust time.



It was inevitable there was going to be a problem. People were getting loans they could not afford, and getting them easily. There was no concern for the true financial outlook for consumers and every lender was pushing loans through just as fast as they could. **It was easy money gone crazy.** Many people in the appraisal industry were screaming to slow down this craze. The end was in sight long before the bottom fell out. But no one listened. So, even as many appraisers saw the inevitable outcome and tried their best to reverse it, they are now suffering the consequences for the market gone bad. Guess they didn't scream loud enough??



Most of the real estate industry's problems stem from financial motivation. Getting paid is a strong motivator. There have been some fraud cases involving appraisers. They made big news. How many stories have you seen written about the lenders that pushed the appraiser to get that value so they could continue to feed their family? Any stories about lender fraud? You hear about a few fraud cases, but more about the lending industry getting tax bailout money and paying out executive bonuses. After all, they came up with some great ideas so they deserve these bonuses, right? **Remember that appraisers can't work alone. They have to be motivated by a lender.**

There was never really any question of "if" this was going to happen, just a question of "when." And then, what could be done to correct it. Who gets to decide the future? The lending industry created this monster and is interestingly being left out of the solution. Now we are arguing over AMC's and the HVCC, and everybody thinks they have the best idea to "fix" the appraisal industry. Industry leaders have been saying for months that, no matter what the fate of the HVCC, the shotgun marriage between appraisers and AMC's is sealed forever. If appraisers want to do business now, they have to do business with AMC's, and on the terms dictated by these "middlemen" and the newcomers to the industry.

According to the Working RE/OREP Appraiser Talkback Survey, with over 4,500 appraisers responding, 92% of appraisers are not in favor of the HVCC. 82% do not consider AMC's to be a legitimate business model. 53% report they experience pressure for value from AMCs (what they are supposed to eliminate), and over 55% say that they are asked to re-examine reports with the intention of trying to "make the deal work." **Even under the new system meant to fix the old, within the first six months of existence, they are experiencing the same issues they were designed to eliminate.** It makes it look like most lenders really don't want the appraiser to provide a true opinion of value; they just want the *deal* to work so they can get paid. Um, sound familiar?

Most appraisers support evidence that appraisal quality has diminished since the HVCC started. Many AMC's look for the lowest bidder who returns the report the fastest. Most surveys indicate that low fees and quick turnaround times are hurting the quality of the appraisal. Quality is not the main focus. "Quality" in their eyes (remembering they are untrained in appraisal and no nothing about the real estate industry, and especially local markets) quality is deemed only by the percentage of adjustments on the report. As long as the comps are within a short distance from the subject property and there are no "red flags" on the report, they love it. In a market with perfect comparables, the system works great. The problem is that in America, perfect comparables exist in about 10% of the total market. Leaving 90% of appraisers who may be considered as providing low quality work when they are simply trying to protect the investor and providing fair opinions of value. Appraisers try to do what they were hired to do (at least what they believe they were hired to do), provide an unbiased opinion of value. Until the lending industry decides what they want from appraisers, this problem will not go away. Appraisers solve valuation problems. The problem is with what the lenders are asking the appraiser to do. Do you really want to know the property value or do you just want to make the deal work? The old saying "the buck stops here" needs to be directed towards the lending industry. Until the system that orders and pays for appraisal services changes, the industry cannot change. The only way to fix this problem is to start where the problem begins. Like too many things, it comes down to making deals work and getting paid. It's all about the money.

Follow the Money



There are too many stories like the one below.

Getting Out: Why I'm Leaving Residential Appraisal

By appraiser Mike Read.

I used to love appraising. Long before there was any appraiser regulation, my clients came to me for valuation opinions because of my years of experience in real estate and their recognition of my accurate and reliable reports. Then came the HVCC. Now my clients of 24 years are not allowed to contact me. They have to order appraisals through a third party appraisal management company (AMC) which takes up to 60 percent of my fee for their trouble.

I have signed up with about a half dozen AMCs. One went out of business owing me over \$7,000. Three asked for all my exhibits (resume, license, E&O policy, application forms, etc.) and I've never heard from them again. One expected me to complete a URAR full appraisal report for \$90. My most recent AMC has not sent me an assignment in months due to their lack of volume.

I recently testified before my state legislature in support of a bill to regulate AMCs. My first suggestion was to support the repeal HVCC at the federal level. Secondly to ensure that a certified appraiser is on staff at the AMC to do review work, and third to require the AMC to have a surety bond of \$500,000 to \$1 million so payment to appraisers is assured if the AMC defaults. Others recommended that AMCs become regulated by the State Appraiser Licensing Board.

I have 24 years of appraising experience, am licensed in two states as a General Certified Real Estate Appraiser, have been HUD approved for the whole 24 years, without any complaints and have completed hundreds of hours of special education. What good has that done for me now?

What is driving this patchwork quilt of ineffective appraiser regulation? Have you heard of "The Golden Rule?" He who has the gold makes the rules! The greed of lenders is the source of the problem and always has been. They are the ones with the money to lend. They are the ones that establish the lending guidelines that have to be followed by everyone else in the lending chain. They are the ones with the "pipeline" to keep full and flowing. When they run out of borrowers with 20 percent down they reduce the requirements to encourage borrowers with 10 percent down. Keep that pipeline full. When they run out of borrowers with 10 percent down they reduce the requirements again to encourage borrowers with five percent down, then zero down, then "no doc loans." Keep that pipeline full.

What about the increased risk? Well, they just pack the loans up and sell them off to someone else in a mortgage backed security that is so far removed from the valuation process no one can figure out the value any more...not even the sophisticated investors. (Nobody thought to ask the appraisers!)

Now it's time for me to say goodbye to my clients and friends in the residential real estate and financial service fields. You've heard of the theory of "trickle down" economics? Well here is how my exit from the business will trickle down to you all.

Dear MLS provider, I will be canceling my subscription for data services at the end of my current period (\$150/Q).

Dear title company, I will be canceling my subscription for data services at the end of my current period (\$85/mo).

Dear software company, I will not be renewing my annual software maintenance agreement at the end of my current period (\$799/yr).

Dear Board of Realtors, I will not be renewing my annual dues this year (\$525/yr).

Dear Appraisal Institute, I will not be renewing my annual dues this year (\$395/yr).

Dear E&O insurance company, I will not be renewing my policy at the renewal (\$700/yr).

Dear state of Washington, I will not be renewing my appraiser license at the end of the biennium (\$500).

Dear state of Oregon, I will not be renewing my appraiser license at the end of the biennium (\$500).

Dear education provider, I will not be needing any more CE credits so will not need any more expensive classes (\$500/yr).

All together (apx. \$6,000 a year).

Dear AMCs, goodbye.

Dear Consumer, you are the only one I feel sorry for. I will no longer be in a position to provide you with an independent valuation for your largest lifetime investment. Your lender does not want you to know who I am, how to contact me, how much I charge, what value opinion I reach. They just want you to pay for some conforming paperwork. If they receive any bad news they just shoot the messenger.

It's time for appraisers to take an active role in change. Contact your senators and let your opinions be known. Stay updated from the Appraisal Institute. Read what's happening in the industry and speak your mind. If we don't stand up and speak out, the real estate appraisal industry may become the next dinosaur. Change is already upon us. It is up to us to help determine which path that change will take. Participate in your future!



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