WEDNESDAY, FEBRUARY 13, 1985

THE WALL STREET JOUR

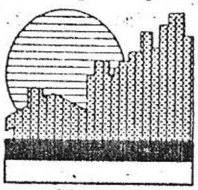
REAL ESTATE

Appraisers Face More Scrutiny As Property Values Stagnate

By Robert Guenther
Staff Reporter of The Wall Street Journal

AMONG REAL ESTATE APPRAISERS, M.A.I. is a designation of professional competence. It stands for Member of the Appraisal Institute. Some wags in the real estate trade offer another meaning for M.A.I.: "Made As Instructed."

Appraisers, sensitive to criticism that they bend valuations to clients' wishes, never have found much humor in the shopworn joke. Lately, mortgage insurers haven't either as they worry that more appraisals on homes are being overstated.



Faulty appraisals are suspected to have played a role in BankAmerica Corp.'s recent $95 million write-off in connection with mortgage-backed securities. But even before that, concern about valuations had reached the point where the Federal National Mortgage Association, a big mortgage investor, invited housing industry groups to two "summit" meetings to air the problem. The meetings in recent months were closed to the press, and participants weren't allowed to tape record the proceedings. A Fannie Mae spokesman describes them only as "not a hot discussion. No one pointed fingers."

One mortgage insurer's experience offers some insight into why many in the industry are bothered, however. A California savings and loan association last May applied for insurance on a $159,700 home mortgage and submitted a $177,500 appraisal to back it up. As part of its spot checks on home appraisals, the insurer ordered its own appraisal. When its report came back, the insurer found that the builder had paid $45,000 for the lot six months before the sale. However, the lender's appraiser valued the lot at $85,000.

MOREOVER, THE INSURER learned that the house originally had been listed for sale at $157,500—$20,000 less than the lender's appraiser said the house was worth. Not surprisingly, the insurer refused coverage.

The mortgage insurer theorizes that the builder was under pressure to sell the home and had a buyer who lacked the money for a downpayment. So the builder and buyer agreed to inflate the stated selling price to make it appear that the buyer was making a downpayment. The lender knowingly or unknowingly went along with it because the mortgage would be insured and he would get the loan fees. Pressure was then applied on the appraiser to put a value on the house that would satisfy the insurer.

It's hard to gauge the extent of the problem, because few are eager to talk about inflated appraisals. However, Fannie Mae has checked its home foreclosures and, according to one source, found about 5% had faulty appraisals.

Robert Hastings, president of Foremost Guaranty Co., a mortgage insurer, says, "While there are a number of cases of out-and-out fraud, it's not a major problem. What's more common is 'fudging.' Lenders often have no problem calling an appraiser and saying, 'We'd like to make this loan. Could you raise this appraisal a little?' There's usually no problem getting it changed."

Insurers also say that appraisers may rely too heavily on prices paid for comparable properties when preparing an appraisal. But various financing gimmicks offered by sellers, such as below-market interest rates on mortgages, often are built into home prices and distort them. Many appraisers fail to adjust their values downward to reflect the cost of the financing, insurers say.

MR. HASTINGS SAYS, "Too many appraisers are confusing price with value." Adds Leon Kendall, chairman of Mortgage Guaranty Insurance Corp., the largest private mortgage insurer: "An appraisal isn't supposed to be a validation of the selling price but the price the second time a property is sold. In other words, what am I going to get for a house if I have to repossess it? Using comparable sales was a conservative approach when inflation was the order of the day. But today, using comparables that are three, six or nine months out of date is an invitation to disaster."

In the 1970s, it didn't matter as much if an appraisal was off the mark because home prices were rising faster than inflation. But with today's home values barely keeping up with inflation, quality appraisals are more crucial to good lending.

In addition to soft home prices, changes in lending and appraising practices have contributed to the problem. Under financial pressures, many lenders no longer have their own appraisers and have turned to independent appraisers who often compete on price rather than quality of work. And as the number of appraisers has grown, fewer of them are getting certified by one of several professional appraisal organizations.

Mr. Hastings of Foremost Guaranty says, "The problem is with the appraiser who has no professional designation." James Aylward, president of Investors Mortgage Insurance, says, "Only a small number have any professional credentials. The majority are people who know how to fill out Fannie Mae and Freddie Mac forms."

FEE CUTTING by appraisers hungry for business is also being blamed for some faulty appraisals. Mr. Aylward says, "We're not used to paying appraisers enough. They should get more than $150 for an appraisal."

David Craig, president of the 5,700-member American Institute of Real Estate Appraisers, agrees there is a problem. But he says much of the difficulty is caused by market conditions, pressure from lenders and inadequate instructions on appraisals. "There are all kinds of definitions of market value," Mr. Craig says. "The question is, what is the appraiser being asked?"