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### Real-estate appraiser regulation is a failure

By MITCH WEISS  
Associated Press Writer

CHARLOTTE, N.C. — As soaring home prices set the stage for America's great housing meltdown, a critical step in making sure those home sales were a fair deal — the real estate appraisal — was undermined from within.

After the nation's last major banking disaster, Congress set up a system to catch rogue appraisers. Their game: inflating the value of homes at the direction of equally unscrupulous real estate agents and mortgage brokers, whose commissions are determined by the size of the deals.

But a six-month Associated Press investigation found that the system is crippled by both the bumbling of its policemen and their inability to effectively punish those caught committing fraud.

And despite ample evidence appraisers are pressured into inflating home values — sometimes to prices in support of loans that are more than buyers can afford — the federal regulators charged with protecting consumers have thus far made a conscious choice not to act.

"The system is completely broken," Marc Weinberg, the former acting director at the federal agency charged with monitoring the appraisal industry, told the AP before he retired earlier this year. "It's amazing that the system ever worked at all."

The AP conducted dozens of interviews and reviewed thousands of state and federal documents, and found:

\_\_ Since 2005, at the height of the housing boom, more than two dozen states and U.S. territories have violated federal rules by failing to investigate and resolve complaints about appraisers within a year. Some complaints sat uninvestigated for as long as four years. As a result, hundreds of appraisers accused of wrongdoing remained in business.

\_\_ The only tool federal regulators have to force states into compliance is so draconian — it would effectively halt all mortgage lending in a state — that it has never been used.

\_\_ Both state appraisal boards and the federal agency charged with overseeing them are chronically understaffed, many with only one full-time investigator to handle the hundreds of complaints that arrive each year. Some don't even have an investigator.

"The appraisal reforms of the late 1980s were good reforms," said Susan Wachter, a real estate professor at the University of Pennsylvania's Wharton School of Business. "But they were not sufficient to prevent what we have seen ... because regulation without teeth is not regulation."

To be sure, there are many causes of the housing crisis — lenders who allowed people with spotty credit to buy homes with little or no money down, mortgage brokers who focused on selling loans without regard to the borrowers' ability to repay, investment bankers who bought and sold risky mortgage-backed securities. A few of the worst offenders — appraisers included — have been put behind bars.

But experts and industry insiders, including appraisers who feel betrayed by colleagues who don't follow the rules, believe the failure to effectively monitor the real estate appraisal industry contributed to housing's collapse.

There is no doubt, Wachter said, "that fraud has increased and appraisal fraud has increased in a way to exacerbate the problems."

This is the way the system is supposed to work:

Typically, an appraiser receives an order from a real estate agent, lender or mortgage broker to inspect a property. Based on a physical inspection of the home and comparable sales in the area, they develop an estimated value for the property. That figure is used by banks to set the home's value as collateral for the mortgage loan.

Appraisers are supposed to come up with a value free of any outside pressure. But more than three dozen appraisers nationwide interviewed by the AP said they often felt pushed by a real estate agent or mortgage broker to fraudulently inflate a property's value. They supplied the AP with documents from lenders asking them to "hit a number."

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"The higher the loan amount, the more money brokers and lenders make in the deal," said Ray Haynes, an appraiser from Cherryville, N.C. "And they threaten you. They say, 'If you don't play ball with us, we'll go somewhere else.' And they do. I've seen my business shrink. They're all doing it. It's hard to stay honest."

Documents obtained by the AP also show that hundreds of appraisers complained to federal and state agencies about such fraudulent inflation of property values.

The appraisal system has broken down before. In 1989, Congress concluded that "faulty and fraudulent appraisals were an important contributor to the losses that the federal government suffered during the saving and loan crisis." And it passed the Financial Institutions Reform, Recovery and Enforcement Act.

Under the law's reforms, a private group known as the Appraisal Foundation wrote the rules governing appraisers. The law also recommended that states begin licensing appraisers and disciplining those who break the rules.

A federal agency called the Appraisal Subcommittee, an independent federal agency that answers to Congress, would conduct field reviews and audits, and maintain a national registry of appraisers — including dossiers on those who break the rules.

But problems plagued the system from the start. It took years for some states to set up the independent review boards to supervise appraisers or hire personnel to investigate complaints. Even today, eight states still do not require appraisers to obtain a license or certification.

"We got to this point by a lack of enforcement. ... The public has the right to expect the appraisal boards are taking care of that problem," said Bob Ipock, an appraiser from Gastonia, N.C., who is a critic of the current system. "And they are not. They're looking the other way."

The Appraisal Subcommittee is supposed to help states remove from the system those appraisers who agree to "hit a number." But it has only four employees to conduct field reviews and audits of 50 states and four U.S. territories, and hasn't even had a permanent director since the agency's former chief retired at the end of last year.

Following Weinberg's subsequent departure in February as acting director, none of the agency's current employees — including interim director Vicki Ledbetter — returned more than a dozen messages left by the AP over a period of several months seeking comment.

When the agency does find a state failing to follow the law, the only tool available to force compliance is a death sentence known as "non-recognition" — a penalty that would ban all appraisers in that state from handling deals involving a federal agency.

"Do you know what that would have meant? The net effect is it would have effectively shut down mortgage lending in that state," former subcommittee director Ben Henson, who retired in December, told the AP. "To take that action would have been an unbelievable disruption to the economy. I wasn't going to do that."

When field reviews began in the 1990s, states were repeatedly warned they were failing to comply with the law — warnings that continue to this day. But without the ability to issue fines or impose a less destructive punishment, the Appraisal Subcommittee is powerless. It has never taken any action against a state for not obeying the law.

"Either you shut it off completely in a state, or you just send letters," said Gary Taylor, an appraiser from New York who sits on the Appraisal Foundation board that writes qualification guidelines. "The threat of the atomic bomb is the only thing."

And so, the violations stack up year after year, largely without consequence.

In the last three years alone, as the nation's housing market went from boom to bust, 27 states or territories failed to investigate and resolve complaints within a year. In Washington, D.C., the agency found last August that 32 of the district's 35 pending cases were older than two years. In Florida, almost 50 percent of 169 cases older than a year concerned appraisers involved in "fraud and flipping."

Faced with such backlogs, some states just give up. In New Hampshire, the state appraisal board decided in July 2006 to close all outstanding files dating to 2002 — some of which included allegation of fraud — because they "were too old to investigate."

In Ohio, the Appraisal Subcommittee found in 2005 that 40 percent of the state's 199 outstanding cases were older than a year, many older than two. To help clear the backlog, Ohio began allowing appraisers to sign consent orders — a deal similar to a plea bargain in which an appraiser agrees to the facts of a case in exchange for a reduced punishment. That could be a short-term suspension, for example, instead of a license revocation.

In 2006, 11 appraisers signed such consent orders in Ohio. That figure swelled to 148 the following year.

"They know they can keep doing what they're doing because they can get away with it," said Carl Schneider, an appraiser who serves on the Oklahoma appraisal board's disciplinary procedures committee. "They're not getting punished. And states aren't doing more because they know regulators won't do a thing."

By law, the Appraisal Subcommittee must maintain a registry of appraisers that includes a disciplinary history. But a disciplinary action stays on the Web site only as long as it's current — once the suspension is over, the action is removed, making it appear as if the appraiser has never been in trouble.

The flaws in the system also allow appraisers to stay in business while complaints against them are under investigation. North Carolina appraiser Jerry Gooden had eight complaints filed against him between 2001 and 2003, all related to a trainee who performed dozens of appraisals under his supervision and later pleaded guilty to mortgage fraud.

All the while, Gooden remained listed in good standing on the Appraisal Subcommittee's Web registry of appraisers. His license was suspended in 2005 for nine months because of the complaints. But even today, his entry shows he's never been disciplined. When contacted recently by telephone, Gooden said he was busy and didn't have time to talk.

When Illinois appraiser Donald Martin wrote to the Appraisal Subcommittee in December 2000, he told of how lenders, mortgage brokers and real estate agents withheld business from appraisers who refused to inflate values, guarantee a predetermined value or ignore deficiencies in a property.

Honest appraisers, he wrote, were blacklisted in favor of those with a "rubber stamp." He begged the agency to take action.

But as it would say in response to nearly a dozen such letters, the subcommittee answered that it didn't have the statutory authority to investigate such complaints. It promised to forward the complaint to the appropriate federal agencies, such as the Federal Reserve, which could have acted out of concerns for the health of the appraisal industry.

There is no evidence that ever happened.

"They just blew me off," Martin said. "I wasn't alone. We had appraisers from all over the nation writing in and urging them to take action."

That same month, subcommittee board member Thomas Watson Jr. — then the national bank examiner at the federal Office of the Comptroller of the Currency — did propose action. In a letter to appraiser groups and banking regulators, he called a meeting to discuss concerns "resulting from inappropriate pressure being placed on real estate property appraisers to 'hit a certain value.'"

Henson, the subcommittee's director at the time, attended the meeting and remembers hearing story after story about appraisers being pressured. But he called the information "mostly anecdotal," never forwarded the information to the full board and never followed up to see if any federal regulator looked into the complaints.

"People who say we should have done more don't understand how the system works," Henson said. "Agencies just don't lobby to change things. We had no interest in doing anything like that. It just wasn't our area."

The American Society of Appraisers formally asked the Appraisal Subcommittee to act in January 2001, noting the agency was in a "good position to work with bank regulators and others on the problem." Again, the agency responded by saying it did not have the authority to examine the issue.

"It didn't surprise me they didn't do anything," said Richard Amoling, the society's former president. "Everything related to the issue went into a black hole. Why, I just don't know."

Weinberg, who worked at the Securities and Exchange Commission before he was hired as the Appraisal Subcommittee's attorney in 1991, said the agency could have pushed more.

"I tried to push, but nobody wanted to hear what I was saying," he said.

That included Congress. When serving as president of a national appraisers trade association in June 2004, Taylor — the Appraisal Foundation committee member — told a House subcommittee field hearing that "problem appraisals are being allowed, and in some ways even encouraged, by a regulatory structure that promotes lax enforcement and ineffective oversight."

Taylor, president of Rogers & Taylor Appraisers Inc. in Hauppauge, N.Y., pleaded for help: "We are here to alert Congress that the licensing system it created for appraisers is broken ... and needs to be fixed." It wasn't.

Records obtained by the AP also show that complaints about individual appraisers filed at the state level are left unresolved for months — and often for years — but for a different reason: Many states have only one full-time inspector. Some appraisal boards also are rolled into bigger regulatory agencies, where inspectors with little or no experience are assigned to investigate complaints.

"I think the design of the system is excellent," said Philip Humphries, the current director of the North Carolina Appraisal Board. "But states don't have the money to hire personnel to carry out what the system was designed to do."

Henson said most of the complaints are frivolous, involving consumers upset because an appraiser "may have been rude or said my house wasn't worth as much as I thought." He said few of the complaints have anything to do with inflated appraisals. "That was just not a problem," he said.

Filed complaints are considered private and are not open to public inspection. But consent orders are public, and the AP's investigation found that Henson's assessment that most complaints are frivolous is simply wrong. In North Carolina, for example, of the more than 300 consent orders filed since 1994, 65 percent involved mistakes that inflated a home's value.

Even when states do investigate and find problems, rogue appraisers are rarely disciplined. Since 1994, only 13 appraisers — there are currently about 3,500 licensed appraisers in the state — have had their licenses taken away by North Carolina's appraisal board. During the same period, California, the nation's most populous state, revoked 89 licenses; Tennessee, West Virginia and Wyoming did not revoke any, according to Appraisal Subcommittee records.

Violators are usually only reprimanded or, if their licenses are suspended, the suspension often is reduced if they agree to take remedial education classes.

Since 1994, consumers have filed 23 complaints against Richard Chapman, an appraiser from Emerald Isle, N.C. His license was suspended for five years in a case in which he was accused of submitting appraisals with "misleading information" and "inaccurate data." Since his license was reinstated in 2000, 11 new complaints

have arrived.

"Just because you're disciplined, that doesn't make you a bad appraiser," said Chapman, who estimated he's been involved in 80,000 appraisals since 1980 and trained about 60 appraisers. "I may have done some technical things wrong, but I've done a good job. I'm proud of my work."

The North Carolina board dismissed two of the 11 recent complaints outright, while two others were dismissed with warnings to be more careful. Six were dismissed on the condition that Chapman complete appraiser education classes, and he was reprimanded for one complaint.

"There no habitual felon law for appraisers," said board attorney Roberta Ouellette, defending the agency's action. "Why should he get super-zapped for doing a lot of little things that a lot of other appraisers are doing every day but haven't had complaints turned in on them?"

The failings of the appraisal regulatory system and its impact on the nation's housing market led Andrew Cuomo, the New York attorney general, to reach a deal in March with Fannie Mae and Freddie Mac, which purchase mortgages from other financial institutions.

Cuomo's deal requires Fannie Mae and Freddie Mac to buy mortgages only from lenders who use independent appraisers. The new rules also prevent lenders who want to sell loans to Fannie Mae or Freddie Mac from using in-house appraisers to do the first evaluation.

The agreement, which will take effect in 2009, will create a watchdog to monitor the appraisal business: Fannie Mae and Freddie Mac will spend \$24 million to create the Independent Valuation Protection Institute, which will accept complaints from consumers and appraisers. It will also monitor the enforcement and report to Cuomo's office.

But such a system duplicates the regulations already in place, including the same lack of enforcement tools that led the existing system to failure. And it's already under fire. John Dugan, the U.S. comptroller of the currency, wants the deal scrapped, arguing it would increase the cost of home loans for borrowers without strengthening consumer protections.

Cuomo didn't return repeated requests for comment. But Taylor, the Appraiser Foundation board member who asked Congress for action in 2004, doesn't see much hope for his success.

"There has to be effective enforcement of some sort. There has to be reality to it," Taylor said. "What are you going to do if there is pressure on appraisers? How are you going to penalize someone who puts that pressure on appraisers? Who's going to do it? Who's going to enforce it? They need to have that or it won't work."

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