Home Insecurity

How Widespread Appraisal Fraud Puts Homeowners at Risk

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While many U.S. households have benefited from the recent rise in real estate prices, homeowners who have bought at record high prices are vulnerable to a fall in property values that could leave them owing more on their mortgage than their home is worth. This risk is aggravated by the fact that many Americans have reduced the equity in their home to pay off credit card debts and cover day-to-day expenses. More troubling still is evidence that many appraisers fraudulently inflate property values during the buying or refinancing of homes. This paper explores the implications of appraisal fraud.

Key Findings

- Serious conflicts of interest pervade the mortgage industry. Lenders, brokers, and real estate agents often have an incentive to inflate the value of residential properties. The process of appraising a property — among the most important steps in either the purchase or refinancing of a home — is sometimes done dishonestly as appraisers go along with requests to overstate the value of a home.
- Appraisal fraud can lead homeowners to borrow more money than their homes are worth, putting themselves at risk of being "upside down" in a home — e.g., not being able to sell for a high enough price to pay off their mortgage — even if there is no downturn in the real estate market.
- Appraisal fraud is not a new problem, but the refinancing boom — in which homeowners have cashed out over $450 billion in home equity since 2001 — has created fresh incentives for self-interested parties to collude in the overstatement of property values.
- Up to half of all appraisers have reported feeling pressures from lenders or brokers to overstate property values. Many appraisers go along with these pressures out of fear of losing future work. Appraisers who have not complied with such pressures report not being paid for work and being blacklisted by lenders and brokers.
- The inflation of home prices through appraisal fraud may be helping to push real estate prices up to unsustainable levels and contributing to a housing "bubble." Some observers believe that appraisal fraud helps explain high foreclosure rates in certain parts of the nation.
- Predatory lending targeting minority and sub-prime borrowers often involves appraisal fraud. Low-income aspiring homeowners are also targeted by developers who collude with dishonest appraisers in the aggressive marketing of new homes offered at inflated prices.
- Government oversight of the appraisal process is inadequate. Key participants in the mortgage industry, such as mortgage brokers, are unregulated in many states and oversight of lending institutions is often very weak. State boards that license appraisers and investigate reports of fraud often lack enough resources. New reform steps are urgently needed.

Assets at Risk

The real estate boom has delivered rising property values to millions of homeowners over the past five years — as well as soaring mortgage burdens for Americans buying homes at record high prices. While the boom has greatly strengthened the financial position of some households, many others face growing financial insecurity. Homeowners are spending a higher percentage of their income on mortgages than ever before and also carry unprecedented levels of credit card debt. The ratio of household debt to income has risen steeply in the past five years to an all-time high, while savings have declined. Average credit card debt among all families increased by 53 percent between 1989 and 2001, with lower income households experiencing even higher increases. In the past few years, larger debt burdens have been aggravated by stagnant or falling wages and rising healthcare costs.[1]

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In the face of rising financial pressures, many homeowners have tapped the growing equity in their home to meet current living expenses. American households pulled out a record $458 billion worth of equity from their homes between 2001 and 2004, according to data from Freddie Mac.[2] This trend is expected to continue in 2005. As reported in an earlier Demos briefing paper, “House of Cards,” a majority of refinancing loans have been used to repay other loans, such as credit card debts, or to cover consumer expenditures. Adjustable rate mortgages accounted for 34 percent of these new loans in 2004, leaving borrowers vulnerable to a rise in interest rates. Today, the homeownership rate stands at a record 69 percent, but Americans actually own less of their homes than they did thirty years ago. Homeowner equity fell to 55 percent in 2004, down from 68 percent in the early 1970s.[3]

Homeowners who refinanced their homes based on current high real estate values face major risks if prices should fall. Also at risk are the millions of homeowners who have purchased their homes in the past few years. Overall, the net effect of the surging real estate market and the accompanying refinancing craze is that the financial well-being of American households hinges as rarely before on the continued strength of property values. And, in an ominous development for both the economy and individuals, many Americans have taken on mortgages that exceed the true market value of their homes thanks to appraisal fraud.

What Is Appraisal Fraud?

The real estate boom in recent years has meant record levels of business — and profits — for banks, mortgage brokers, and others who originate mortgage loans. But this boom has had a dark side. Evidence suggests that property appraisals, perhaps the most critical step in the mortgage process, are not always conducted honestly. Indeed, the financial incentives of those involved in this process often work against securing an honest appraisal of a home’s value.

Appraisal fraud can take different forms. When a home is being purchased or refinanced, the lender or broker — as well as the consumer — may seek to have it appraised for more than its actual value. Lenders may look for an appraiser who will appraise the home for the desired value, and even request that an appraiser not appraise a property unless they will confirm that price. In other cases, lenders or brokers may commission several appraisals and use the one that confirms the price they want. Or they may pressure an appraiser to adjust their appraisal upward. They may withhold payment for an appraisal unless this demand is met. The goal of lenders or brokers — who are generally paid on commission based on the value of the mortgage — is to ensure that the loan will close without any problems. An appraisal that comes in below the value of the desired loan amount could jeopardize a completed transaction. Real estate agents have the same interest, and are also known to exert pressures for dishonest appraisals. Developers who directly market new homes may also exert such pressure.

The refinancing boom has aggravated the problem of appraisal fraud by increasing the incentives for dishonesty. Take the example of a homeowner with a house whose true value is $150,000 and who has $140,000 in outstanding mortgage debt, as well as $20,000 in credit card debt. If the homeowner wants to refinance in order to pay off credit card debt, he or she will need a new mortgage loan that is based upon an appraisal of the home that is above its true value. (*See Table 1.*) A lender or broker may encourage the homeowner to believe that the home is worth this money, and find an appraiser who will appraise the property for this value. Without the dishonest appraisal, there will be no basis for refinancing the loan at all.

Table 1. How Appraisal Fraud Puts Homeowners at Risk

	Market Value	*Appraised Value*	*Mortgage Outstanding*	*Loan to Value*
Old Loan	$150,000	$150,000	$140,000	93%
	Market Value	*Fraudulent Appraisal*	*Mortgage Outstanding*	*Loan to Value*
Refinanced Loan With Inflated Appraisal	$150,000	$170,000	$160,000	107%

Another incentive for dishonesty is that, today, those parties who originate mortgage loans are less likely to pay a price if the borrower defaults. In a big change from the past, third-party mortgage brokers play a growing role in originating loans — by some estimates up to 70 percent of all mortgages.[4] Likewise, lenders used to have a greater interest in ensuring that the appraisals were accurate, since they held the mortgage debt extended to borrowers. Now, many mortgages are quickly sold to a large secondary market of debt holders such as quasi-government sponsored entities like Freddie Mac and Fannie Mae. In principle, these secondary holders of mortgage-backed securities can force lenders to buy back loans where property values have been overstated, and many larger lenders have rigorous systems in place to ensure that appraisals are accurate so that this doesn't happen. In practice, the risk of such forced buybacks can seem low and lenders may worry less than they used to about being stuck with a foreclosed property that is worth less than its appraised value.

The financial incentives of those involved in the mortgage process often work against an honest appraisal of a home's value.

Appraisers also have a financial interest in providing appraisals that may not be accurate. Their livelihoods are dependent on a steady stream of work from lenders and mortgage brokers. An appraiser who fails to deliver the desired appraisal, thus torpedoing a loan deal, may find that he or she does not receive future work from that particular lender or broker.

In some jurisdictions, weak government oversight (see below) means there is little risk that a dishonest appraiser will be punished for overstating the price of a property.

Consumers may accentuate the problem of appraisal fraud by not looking out for their long-term interests. Typically, they just want to complete the mortgage or refinancing process as quickly as possible, and may exert pressure on brokers or lenders to get the deal closed without any hitches. When purchasing a home, buyers are likely to assume that the price they are paying reflects "where the market is at" and insomuch as they pay attention to the appraisal process it is with an eye toward having it done quickly and without problems. They may look more critically at this step when refinancing, but their keen desire to pull out low-cost cash from their home — and their hopeful views about the direction of real estate prices — may override any caution about ending up with a mortgage worth more than the home.

Consumers are also prey to aggressive brokers or lenders who have an interest in closing a refinancing deal at the highest loan amount possible. Bombarded by solicitations for refinancing, many of which contain misleading information, consumers are easy targets for manipulation. Unwittingly, consumers put their financial well-being in the hands of two parties — the lender or broker, and a handpicked appraiser — who bring conflicts of interest to the job of assessing the value of their home. Most consumers never consider hiring an independent appraiser.

Evidence of Appraisal Fraud

There is no comprehensive data on the incidence of appraisal fraud, and by its nature this type of fraud can be difficult to prove since real estate prices are often subjective. A large variety of factors determine the price of a home, from trends in a fast-changing market to the condition and location of a property. In cases where an appraisal seems inflated, it can be hard to say whether an appraiser knowingly overstated value. All that said, available evidence suggests that the deliberate manipulation of property values is pervasive.

In 2003, October Research, a private firm, conducted the National Appraisal Survey, which polled 500 appraisers in 44 states about their professional experiences. The findings were startling. The survey found that 55 percent of appraisers reported that they had felt pressures to overstate property values. A quarter of the appraisers surveyed reported feeling such pressures in half of all appraisals that they handled.[5]

Fifty-five percent of appraisers reported that they had felt pressures to overstate property values.

In March 2004, the National Association of Realtors — representing over one million realtors — stated to a Senate subcommittee that the problem of lender pressure and appraisal fraud seemed to have worsened: "Increasingly there is evidence that the use of such pressure is widespread in the appraisal field. These pressures are beginning to erode the independent judgment of appraisers, and are contributing to the ability of unscrupulous individuals to engage in improper loan practices, including property flipping and predatory lending schemes."[6]

Perhaps the most persuasive evidence of the problem is that over 8,000 appraisers have signed a petition to the federal government complaining that the lending industry has "individuals within their ranks, who, as a normal course of business, apply pressure on appraisers to hit or exceed a predetermined value. This pressure comes in many forms and includes the following: the withholding of business if we refuse to inflate values; the withholding of business if we refuse to guarantee a predetermined value; the withholding of business if we refuse to ignore deficiencies in the property; refusing to pay for an appraisal that does not give them what they want; and black listing honest appraisers in order to use 'rubber stamp' appraisers, etc." In signing the petition, many appraisers have posted comments underscoring the severity of the situation. "This is a HUGE problem," reads a typical comment, by Teri Hoke of Mount Holly, North Carolina.

Data collected by the Mortgage Asset Research Institute (MARI) also sheds light on the extent of appraisal fraud. Over the past decade, mortgage lenders, insurers, and other participants in the mortgage industry have reported information to MARI about the problem of mortgage fraud. An April 2004 analysis of data from 2000 through 2003 indicated that while appraisal fraud was not the most common form of mortgage fraud — dishonesty on applications and financial statements topped the list — it was clearly a problem, ranging from a low of 10 percent of fraud cases in 2003 to a high of 38 percent in 2000. However, the authors of the report noted that the actual incidence of appraisal fraud was likely higher than the data indicated.[8]

Appraisers Face Intense Pressures

Testimonials by individual appraisers provide yet more evidence of the endemic nature of appraisal fraud. While the general public remains in the dark about the profound conflicts of interest that surround the mortgage business, this problem is an open topic of discussion among appraisers. The view of many appraisers is that the appraisal process is rife with lender or broker pressures and fraudulent appraisals. For this policy brief, Demos gathered appraiser testimonials from industry newsletters, Internet discussion forums, and direct correspondence with appraisers.

Bob Burnitt is a Texas appraiser who recently quit the profession because of the pervasiveness of fraud. Burnitt commented to the *Realty Times* that "without a shadow of a doubt, real estate appraisal is the most corrupt 'profession' I have ever seen. ... I have lost every single 'good' client I have ever had for the same 'reason.' Sooner or later, I do an appraisal that doesn't 'make value' and that is it, I'm fired. Time and time again. During the so-called 're-fi boom' loan officers absolutely demanded that I either lie or inflate an appraisal for them. When I tell them I can't do that, it is unethical and illegal, they just hang up the phone and call my competition."[9]

Ray Miller, an appraiser from Wisconsin, summed up the problem this way in a recent correspondence with Demos: "You have no clue how the mortgage brokers refuse to pay for appraisals if you don't get the value they need. How they shop around until they find an appraiser who will hit the numbers. How they tell the home owners that if the appraiser does not hit the numbers they are bad appraisers. How they try and force an appraiser to violate USPAP [Uniform Standards of Professional Appraisal Practice] state and federal rules and regs. I would be willing to say that 33 percent of appraisals have been fudged upwards." Miller says lenders or brokers owe him $30,000 for appraisals that did not meet

Destroying Dreams
Appraisal Fraud and Foreclosures in the Poconos

Appraisal fraud is linked to heartbreaking stories of mortgage foreclosure across the nation. Some of the worst abuses have occurred in the Poconos area of Pennsylvania, two hours from New York City, where one in five mortgaged homes has been foreclosed since 1995. Over the past decade, homebuilders have heavily developed the region and have advertised new homes to residents of New York City. Many of the first-time homebuyers in the Poconos have been African-American and Latino families from the Bronx and Brooklyn in search of affordable homes and a better life. What they have found instead is a nightmare.[7]

Unfamiliar with the local real estate market, and subjected to high-pressure and dishonest sales tactics, buyers from the city bought homes at prices that seemed great by New York standards but were far above market value. Many of the homes were shoddy in their construction, at least to a trained eye. But dishonest appraisers, handpicked by developers, signed off on the mortgage loans — mortgages that often consumed more than half of the buyers' monthly incomes. Homeowners who later tried to sell or refinance their homes found that the difference between the price they had paid and market value was as high as $80,000. There have been nearly 6,000 foreclosures in the Poconos county of Monroe since 1995, with many families losing all the down payment equity that they had put into their home purchase.

An independent appraisal process would have prevented many of the Poconos loans from ever being made. But as documented by the *Pocono Record*, appraisers were directly asked by the developers to overstate property values in exchange for high fees. Some went along. Those who didn't were threatened and told they wouldn't get future work. Revelations about the housing scams in the Poconos have resulted in criminal charges for at least one appraiser, as well as for developers. But the conditions under this fraud occurred remain unchanged. Like most states, Pennsylvania does not have any laws that bar lenders or brokers from colluding with appraisers to overstate property values. In addition, as outlined later in this report, Pennsylvania does not always do an effective job of responding to complaints from appraisers about lender pressures. The state is said to be considering tougher laws in this area.

the desired value. An Internet forum that lists "deadbeats" who haven't paid appraisers features a running tally of unpaid bills. As of mid-February 2005, over 1,000 "deadbeats" were listed and owed appraisers nearly $1 million.

Lee Lansford, an appraiser from Illinois, commented in a correspondence with Demos, "I've been appraising residential properties since 1983 and I've seen a significant — major — increase in blatant fraudulent-type behavior in the lending and appraisal arenas. ... There are too many times when either individuals, or entities, with a direct financial stake in seeing to it that a loan transaction closes also has responsibility for the selection and retention of the appraiser who performs the appraisal. This is not a good situation."

In another correspondence with Demos, Pamela Crowley, an appraiser from Florida, commented that mortgage appraisal orders often demand, even in writing, that appraisers ensure that they will meet certain numbers or they will not be sent the appraisal order. Loan originators, mortgage brokers, and real estate agents that demand the use of specific appraisers that will do whatever they're told, she says, "are running the honest and competent appraisers out of business."

Only a few states have laws that prohibit lenders or brokers from pressuring appraisers to overstate values.

In an Internet forum, an appraiser from Denver echoed some of these points, saying that "finding a mortgage broker client who wants a fair market value on one of their deals is like finding a needle in a haystack these days. They'll do anything and everything they can to get a commitment from the appraiser that guarantees the needed value before they'll send an appraisal order. Sadly, plenty of appraisers have their own bills to pay and families to feed, so they play ball." This appraiser goes on to comment on the pressures put upon honest appraisers and how such appraisers are often blackballed from further work. She suggests that the real estate market in Denver was artificially propped up by dishonest appraisal practices following the tech bust and the economic downturn of 2001, with homeowners now paying the price. "Appraisers continued to push values for a solid year after that, using increasingly older comparable sales to justify higher values, in spite of a growing number of homes being put on the market for sale, a clear indicator that the market was stabilizing. ... What we have left now is many homeowners who are upside-down, or close to it, on their mortgages. They can't sell for what they currently owe, so they're left with few choices."

Some of the most vivid evidence of appraiser fraud is found in documents from lenders or brokers that blatantly pressure or threaten appraisers. Several such documents have been collected by appraisers and posted on an Internet site, http://appraisersforum.com. An email from one lender to an appraiser reads: "Unless you can change the appraised value to what I requested, I am going to instruct payroll not to pay for that appraisal." Another email from a lender reads: "Thanks for the appraisal. But dude we ordered this thing at 92K. ... This loan is dead unless we get to 92K."

Weak Laws, Silent Watchdogs

Given how critical an honest appraisal is to the mortgage process, one might think the growing frequency of appraisal fraud would have triggered new regulatory steps in recent years. One would be wrong. Appraisal fraud remains a common problem because, even as evidence of misconduct has mounted, neither the federal government nor most states have taken decisive steps to fix an obviously broken system.

The federal government is the chief watchdog that regulates the banking industry. But federal efforts to prevent appraisal fraud have been ineffective. Recent federal standards issued by the U.S. Treasury clearly call on lenders to respect the independent judgment of appraisers — echoing previous federal statements — but these guidelines do not have the force of regulatory law. Moreover, many loan originators in the mortgage process — such as brokers — are not regulated at all under federal banking statutes. So even if there were a clear federal law preventing pressure on appraisers, such a law would not cover some of the worst offenders. To the extent that federal law enforcement agencies such as the FBI can go after perpetrators of appraisal fraud, it by using other laws (e.g., mail fraud laws) to build a case that illegal activity has occurred.

States have also done a poor job in this area. Only a few states have laws that prohibit lenders or brokers from applying inappropriate pressure on appraisers. Many states do not regulate mortgage brokers or mortgage originators through a licensing process. This means that, in much of the nation, neither the federal nor state government has leverage over those actors who play the biggest role in today's mortgage industry — and who are responsible for most of the pressure on appraisers.

Regulators lack the resources to investigate and punish illegal behavior.

In contrast, the appraisal profession is governed by various federal and state regulations, most of which focus on standards for conducting appraisals and ensuring that appraisers are qualified to do their jobs. Appraisers complain that this regulatory apparatus is cumbersome and overreaching (a "bureaucratic nightmare," according one appraiser) even as the biggest problem around appraisals — lender pressure to overstate values — goes unaddressed. Appraisers also complain that appraisers are most exposed to possible punitive action in cases of appraisal fraud — such as losing their license — while lenders face few possible consequences. Meanwhile, appraisers who are subjected to pressure from lenders or brokers often don't know where to file a complaint. Because pressures on appraisers can come from various actors — banks, mortgage brokers, real estate agents — and each of these actors is regulated by a different agency, or not regulated at all, it can be hard for an appraiser to determine where to seek redress. As the Appraisal Institute notes, "This difficulty in deciphering the proper reporting mechanism allows many instances to go unreported."

Disciplinary action for those involved in appraisal fraud can vary widely across jurisdictions. In some states, such as Florida, state appraisal licensing and certification boards regularly take action against dishonest appraisers. Penalties include fines, suspensions, and license revocations. The FBI and Justice Department have also been active in investigating appraisal fraud in various states. According to an article in *Realty Times*, appraisers increasingly turn to the Bureau for redress in cases of lender pressure.[10]

Appraisers who are subjected to pressure often don't know where to file a complaint.

One big reason for an absence of aggressive enforcement is that regulators lack adequate resources for investigating and disciplining illegal behavior. According to a 2003 study by the General Accounting Office on oversight of the real estate appraisal industry, state agencies overseeing appraisers only have an average of three staff members. The report, which surveyed all states, found that "about two-thirds of the states said that they needed additional funding to conduct investigations, and over three quarters said they needed additional staff."[11]

Why aren't there more resources available to government watchdogs? Good question. Key policymakers and legislators are clearly aware of the pervasive nature of appraisal fraud, thanks to efforts by appraisers to raise awareness about the problem and press for reform. For example, the Appraisers Petition (http://appraiserspetition.com) mentioned earlier calls for more ethical practices in the mortgage industry. The petition, begun in 1999, is a plea to the Appraisal Subcommittee of the Federal Financial Institutions Examination Council, a federal agency, for stronger accountability in the mortgage industry around appraisal matters. The 8,100 signatures gathered so far are testament

Complaints Go Ignored

Many appraisers report frustration with state regulators. When complaints are filed, action may not be taken by regulators, even when action would seem to be clearly called for. David Wilson (not his real name), an appraiser in Pennsylvania, recounted such an episode in a message to an Internet forum. "I was told I was not getting paid [for an appraisal] after I submitted my report which was below the value they needed to make the loan. An office assistant called and told me they were not paying me for my report because they found another appraiser 24 miles out of town who could come up with the value they needed."

The other appraiser's value was $45,000 over what Wilson had estimated. Wilson also learned that the appraiser had not even made an inspection of the property and was able to ensure the value the lender wanted, sight unseen.

Wilson complained to the Consumer Services Division of the Pennsylvania Department of Banking about the incident. The lender responded by claiming that Wilson had undertaken the appraisal without being asked to, and even though Wilson had an appraisal order from the lender, this excuse was accepted by the Department of Banking. Wilson was told that if he wanted to make a complaint against the lender, he should hire legal counsel.

After the incident, Wilson commented, "I hear many complaints like mine against lenders and I want to know who enforces this type of behavior by these lenders who walk all over us. ... I ask, again, who do we report these illegal acts to?"

to the strong desire among appraisers for reform in the industry.

Beyond this initiative, individual appraisers have pushed for reform. Bob Burnitt, the Texas appraiser, tells of his efforts to make change happen. "I have met face-to-face with my Congressman and supplied him with plenty of documentation that loan fraud and inflated, fraudulent appraisal practices are rampant, and his reply was, 'Oh, that's just human nature, I can't do anything about that.'"

"My State Representative ... is equally aware of this situation. Same reaction, 'can't do anything about it.' My State Senator ... has also been advised of the situation as well." Burnitt comments further about the failure of key agencies and associations in Texas, including the Texas Appraiser Licensing and Certification Board, the Texas Real Estate Commission, the Texas Savings and Loan Department, and the Texas Association of Realtors. "All these agencies and associations are aware of the situation and are simply looking the other way."[12]

While some legislators do take the problem of appraisal fraud seriously, so far they are a small minority. At the federal level, proposed congressional legislation to address this problem — introduced on several occasions in recent years by Representative Jan Schakowsky of Illinois — has failed to garner much support. Likewise, there has been little action at the state level.

Fixing the Problem

The conflicts of interest around real estate appraisal practices pose serious risks to homeowners and new homebuyers. In most parts of the country, these risks have been masked by continually rising real estate prices. However, if there is a leveling off or decline in property values, the consequences of appraisal fraud could be devastating for millions of Americans. The experience of trapped homeowners in Denver, as discussed earlier, may provide a glimpse of the heartache that lies ahead in other parts of the United States. It is imperative to reform the mortgage industry now, while real estate prices remain strong.

Given the considerable body of regulation that already surrounds the appraisal profession, new reform efforts must be developed carefully. *The principal recommendation of this policy report is that there should be an independent and thorough investigation of the scope and causes of appraisal fraud by an appropriate federal agency. Such an investigation should be mounted in collaboration with state regulators, with input from a range of actors in the mortgage industry. A set of reform proposals should be developed from this process.*

It is clear that several kinds of reforms will be needed to reduce appraisal fraud: New rules to ensure the independence of appraisers, stronger sanctions on appraisers who overstate property values, tougher punishment of lenders or brokers who pressure appraisers, streamlined processes for filing complaints in cases of lender or broker pressure, additional government enforcement capacity, and new efforts to educate consumers. These and other reforms should be achieved through a combination of industry self-regulation and more effective government oversight. Each approach is discussed below.

- *Ensure Appraiser Independence.* New rules are needed to ensure that appraisers can act with independence. Currently, lenders and brokers have wide latitude in choosing who to ask to appraise a property. This creates an obvious potential for abuse, allowing lenders or brokers to choose appraisers known to be dishonest or "shop" for an appraiser who will hit their number. The remedy for this problem is to greatly reduce or eliminate contact between appraisers and lenders or brokers. Echoing the sentiments of many in her profession, appraiser Pamela Crowley commented in correspondence with Demos that appraisal fraud wouldn't stop "until/unless the people pushing the appraisers to inflate the values are no longer able to have anything to do with ordering or paying for the appraisal." Exactly how such a critical reform might be enacted and enforced is a question that must be studied carefully.

- *Punish Lenders, Brokers, and Real Estate Agents Who Pressure Appraisers.* Loan originators and others, like real estate agents, who pressure appraisers to overstate property values should face stiffer punishment. There needs to be greater deterrence of wrongdoing across the range of entities involved in originating mortgage loans. At least two steps are needed to accomplish this goal: First, both the federal government and all states should expressly prohibit the pressuring of appraisers. Second, all actors in the mortgage process should be accountable to a regulatory authority — and, in particular, all states should require the licensing of mortgage brokers and other loan originators.

Those who pressure appraisers should face stiffer punishment.

- *Sanction Dishonest Appraisers.* Even as appraisers agree that most of the burden for changed behavior lies with lenders and brokers, there is also some agreement that there should be tougher sanctions of those appraisers who go along with requests to inflate property values. Currently, honest appraisers may find themselves at a competitive disadvantage in their profession because of lax punishment of dishonest appraisers. This must change. If dishonest appraisers truly feared losing their licenses, they would be more reluctant to give in to lender pressures. In turn, lenders or brokers would have a harder time finding dishonest appraisers. The implicit threat that lenders or brokers can now invoke — "If you don't hit the number I want, another appraiser will" — would carry less weight as more appraisers refuse these requests on the grounds that "I might lose my license if I do that." Exactly how tougher sanctions of appraisers might work should be determined by the study recommended above.

- *Streamline the Complaint Processes.* Appraisers who are subjected to lender or broker pressures — or denied payment for an appraisal that comes in too low — often find it difficult to file a complaint about such behavior because different agencies regulate different kinds of loan originators. There should be more formalized and effective means for filing complaints. In 2003, the Appraisal Institute and several other groups called on federal financial institution regulators to formulate an appraiser complaint policy. Such a policy would provide a point of contact in each agency for appraisers to submit complaints, explain how such complaints should be submitted, and clarify how complaints would be investigated. This recommendation should be acted upon.

- *Increase Enforcement Capacity*. Regardless of what new regulations are enacted, there must be more capacity to enforce the law. As noted earlier, most state licensing boards lack the resources to fulfill their responsibilities. Some federal agencies engaged in oversight of various actors involved in the mortgage process also lack enough capacity. New investments in oversight are urgently needed.
- *Educate Consumers*. A further solution is to better educate consumers about the problem of appraisal fraud and, more generally, about the potential downsides of home buying and refinancing. As the real estate market has boomed in recent years, lenders, brokers, and developers have invested heavily in selling a one-sided story about how Americans can improve their financial future. Consumers have been urged to buy into new housing developments while the new homes last, to treat their home equity like a bottomless ATM, and to exchange high-interest credit card debt for low-interest mortgage debt. In an atmosphere of what some experts have called "panic" home buying and refinancing, many Americans have unwittingly encouraged appraisal fraud by pressuring lenders to wrap up deals quickly, by paying no attention to the appraisal step, and by readily accepting higher levels of financial risk than is prudent.

  The real estate boom has granted windfalls to millions of Americans. But many Americans, also, have made rash and uninformed decisions in this area that will haunt them financially for the rest of their lives. Major lenders can play a leading role in consumer education by better explaining what an appraisal is and how it is done. Consumers should be told, for example, that they have the right to see the appraisal, along with the data that it was based upon. The option of an independent appraisal, and the benefits of such a step, should be explained. Government agencies can play an important role here. In the best case, state agencies would compel lenders and brokers to engage in more extensive and honest efforts to educate consumers about the mortgage process. Agencies at all levels of government that work with first-time home buyers should also take direct steps to educate them about the role that the appraisal plays in getting a mortgage and the potential for unethical conduct. At the very least, some agencies can play an active role in education by publicizing the problem of appraisal fraud and drawing attention to major incidents of such fraud. The media can play a constructive role in the same fashion.

There must be more capacity to enforce the law.

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Notes

1. For a full analysis of recent trends in credit card debt, and the causes of these trends, see: Tamara Draut and Javier Silva, "Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the '90s," Demos, 2004.
2. Freddie Mac, Office of the Chief Economist, Cash Out Refi Report, 4th Quarter 2004.
3. Javier Silva, "House of Cards: Refinancing the American Dream," Demos, January 2005, pp. 4-5.
4. Erick Bergquist, "A View of Refi Boom Pressures From the Appraisal Trenches," *American Banker*, February 5, 2004.
5. National Appraisal Survey 2004: Technology and Business Practices, October Research (2004).
6. Statement of the National Association of Realtors Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on Housing and Transportation, Regarding the Real Estate Appraisal Industry and Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, March 24, 2004, p. 5.
7. This account is based on news reports, including a three-part series by the *Pocono Record* and several articles by *The New York Times*. See: Matthew Birkbeck, "I'm Going to Lose Everything," *Pocono Record*, April 8, 2001; and Michael Moss and Andrew Jacobs, "Blue Skies and Green Yards, All Lost to Red Ink," *The New York Times*, April 11, 2004, p. 1.
8. In those cases where one kind of fraud is present, such as false financial statements, the lender has no incentive to investigate further to see if other forms of fraud, such as appraisal fraud, were also involved. William Matthews, et. al., "Annual Case Report to National Home Equity Mortgage Association," Mortgage Asset Research Institute, Inc., April 2004.
9. Blanche Evans, "Sickened by Fraud, a Real Estate Appraiser Turns In His Pencil," *Realty Times*, January 17, 2005.
10. Blanche Evans, "The Appraisal Crisis and the FBI," *Realty Times*, February 2, 2005.
11. *Opportunities to Enhance Oversight of the Real Estate Appraisal Industry* (General Accounting Office, May 2003), p. 20.
12. Blanche Evans, "Sickened by Fraud, a Real Estate Appraiser Turns In His Pencil," *Realty Times*, January 17, 2005.

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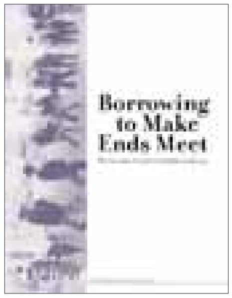

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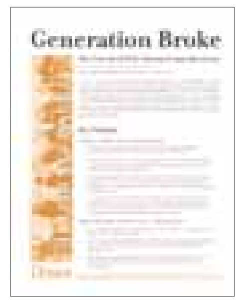

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For more information about Dēmos' work on debt and assets, please contact:
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