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Preventing mortgage fraud: How competent appraisers can help

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By Ken Chitester and staff of the Appraisal Institute

As mortgage fraud continues to adversely impact the New England real estate market, those of us in the industry should be particularly aware of how the appraisal component of a real estate transaction works ... and what each of us can do to promote competency and ethics in the valuation process.

The easiest and most reliable way to safeguard clients' financial interests (and perhaps your own) may be simply to request that lenders hire only ethical, competent appraisers. While the Home Valuation Code of Conduct has created a barrier between brokers and lenders, brokers are within their boundaries to request that lenders and appraisal management companies use only the highest qualified appraisers to perform valuation assignments. Still, cases of mortgage fraud have been on the rise.

According to the 12th Periodic Mortgage Fraud Case Report by the Mortgage Asset Research Institute - which was issued earlier this year at the Mortgage Bankers Association's annual National Fraud Issues Conference in Chicago - cases of mortgage fraud in the United States increased 7% from 2008 to 2009. (See the report at http://solutions.lexisnexis.com/forms/MortgageFraudCaseReport12?source=RD_fraudreport.)

The role of the appraiser in the mortgage lending transaction has always been to act as an impartial third party, working in the best interests of both the consumer and the lender. Appraisers are required to adhere to the Uniform Standards of Professional Appraisal Practice and are regulated at the state level by federally mandated state appraisal boards.

So if appraisers are heavily regulated and required by law to be impartial, why are instances of fraud, whether due to intent or incompetence, involving appraisers rising? According to the latest MARI report, the most prevalent types of appraisal fraud involve incorrect (or fabricated) comparables, omitted information from the appraisal report and value inflation. In fact, the MARI report shows that 33% of cases involving appraisal fraud contain a material omission of relevant information that would have affected the value. These cases include incorrectly listed property condition, room count, square footage and zoning information.

These types of omissions show a clear lack of competence on the part of the appraiser, which, on a broader level, indicates a lack of ethics and professional practice training.

The Appraisal Institute's research has found that disciplinary actions against appraisers have been on the rise each year since 2005. Using information shared by the Appraisal Subcommittee, the Appraisal Institute discovered there were 2.6 times as many disciplinary actions from Jan. 1, 2005 to April 1, 2010, as in the previous five-year period.

The Appraisal Subcommittee - which was created by Congress in 1989 to oversee the real estate appraisal process as it relates to federally related transactions - reported 162 disciplinary actions in 2005, 198 in 2006, 280 in 2007, 337 in 2008 and 413 in 2009. From a statistical standpoint, that's a 22.2% increase in 2006 from the previous year; a 41.4% increase in 2007 over 2006; a 20.4% increase in 2008 over 2007; and a 22.6% increase in 2009 over 2008. In the first quarter of 2010, 78 disciplinary actions were reported.

These disciplinary actions are due to a variety of reasons, but it's worth noting that professionally associated appraisers, such as members of the Appraisal Institute, are required - by their organization - to adhere to a higher level of ethics and principles of practice than non-affiliated appraisers. Those who have earned a designation - such as the MAI or SRA designation from the Appraisal Institute - display a particular level of commitment to excellence.

Those in the real estate industry who suspect a faulty appraisal has been delivered shouldn't hesitate to request a second appraisal report from the lender. If further discrepancies continue, or no second appraisal is performed, use the regulatory system in place in your state to report the issue. Helping eradicate mortgage fraud is not exclusively the responsibility of state and federal regulators. It's also the responsibility of all real estate professionals who care about the future of our industry.

John Gavin, MAI, is president of the Connecticut Chapter of the Appraisal Institute, the nation's largest professional organization of real estate appraisers. Learn more at www.appraisalinstitute.org.