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# In Appraisal Shift, Lenders Gain Power and Critics

Kevin Moloney for The New York Times

Andrea and Terry Hartlieb are real estate appraisers in Fort Collins, Colo. They laid off four appraisers who used to work for them.

By DAVID STREITFELD
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Mike Kennedy, a real estate appraiser in Monroe, N.Y., was examining a suburban house a few years ago when he discovered five feet of water in the basement. The mortgage broker arranging the owner's refinancing asked him to pretend it was not there.

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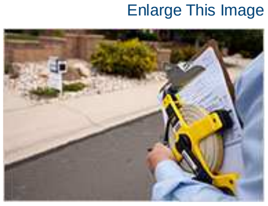

Kevin Moloney for The New York Times

Terry Hartlieb on his way to a home appraisal in Fort Collins, Colo. This year, lenders began controlling the appraisal process.

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Brokers, real estate agents and banks asked appraisers to do a lot of pretending during the housing boom, pumping up values while ignoring defects. While Mr. Kennedy says he never complied, many appraisers did, some of them thinking they had no choice if they wanted work. A profession that should have been a brake on the spiral in home prices instead became a big contributor.

On May 1, a sweeping change took effect that was meant to reduce the conflicts of interest in home appraisals while safeguarding the independence of the people who do them.

Brokers and real estate agents can no longer order appraisals. Lenders now control the entire process.

The Home Valuation Code of Conduct is setting off a bitter battle. Mortgage brokers, lenders, real estate agents, regulators and appraisers are all arguing over whether an effort to fix one problem has created many new ones.

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The agents, maintaining that the changes are effectively blocking home sales by encouraging the use of inexperienced appraisers, are asking Washington to suspend the code until 2011. For their part, appraisers acknowledge that the change may have been well intentioned but contend that it has no teeth and is undermining the economics of their profession.

"We've been begging for years for enforcement of existing state and federal laws regulating appraising," said Mr. Kennedy, a leader in the appraisal community. "We thought we were finally going to get that. But the code is doing nothing except putting ethical appraisers out of business."

Financial change is one of the most contentious issues in Washington, and efforts to fix even widely acknowledged problems seem stalled. The attempt to change the appraisal system is an example of how difficult it can be to adopt changes that are good in theory and also work in practice — while simultaneously winning support from warring interest groups.

"The real estate industry is incredibly complex," said Josh Denney, a lobbyist with the Mortgage Bankers Association. "If you take one piece and tinker with it, it causes friction throughout the process."

The Home Valuation Code of Conduct had an unusual origin. It was developed by the New York attorney general, Andrew M. Cuomo, who persuaded the big federal mortgage agencies, Fannie Mae and Freddie Mac, to adopt it. That has effectively made it national policy.

Putting appraisals completely in the hands of lenders may sound like a good idea in principle, because it is supposed to be lenders who are putting their money at risk in a home loan.

But the reality is that many companies that write home loans these days do not have much incentive to worry about the accuracy of appraisals. That is because the companies do not keep the loans on their own books, instead selling them to Fannie Mae or Freddie Mac.

"The code is a formula for continued problems with fraud," said David Callahan, a senior fellow with the public policy group Demos who has studied appraisals. "Appraisers have been asking for a long time for a reliable firewall between themselves and lenders, and are further from it than ever."

**Appraisers Pressured**

Before real estate prices went out of control, appraisal work was straightforward. The appraiser examined a property inside and out, judging it against the prices that similar properties in the neighborhood were fetching. If the appraisal value matched the sales price, the lender financed the loan.

As lending standards collapsed during the housing boom, appraisers were pressured from all sides. When the appraiser did not deliver a satisfactory price, the deal did not get done, and the broker, agent and lender did not get their fees. Homeowners also loved inflated appraisals, using them to take out as much as possible when they refinanced.

"I got daily calls from lenders and brokers saying, 'Here's the address. Can you get me $400,000?' " said Mr. Kennedy, who has been in the business since 1993.

When he responded that it was illegal for him to supply an unsupported value — or when he noted in his report defects that the client hoped he would ignore, like a flooded basement — the broker or lender dropped him for a more compliant appraiser.

**Petition Notes Abuses**

The honest appraisers saw that the situation was helping to drive housing prices beyond reason. A petition they started a decade ago, just as the long boom was getting under way, warned of "the potential for great financial loss" to the economy if the penalties for pressuring appraisers were not enforced. The petition also complained that honest appraisers were being blacklisted. It drew 11,000 signatures.

Regulators and lawmakers did nothing. A rising market covered all sins. Then the market turned, and the lawsuits began.

In late 2007, Mr. Cuomo filed suit in New York Supreme Court against the data company First American and its subsidiary eAppraiseIT for fraud.

EAppraiseIT is an appraisal management company, which means lenders hire it to hire appraisers. This method, First American stressed in its annual report, produced "unbiased valuations" that benefited "not only the homeowner and lender, but our nation's economy."

Washington Mutual, based in Seattle, was the biggest client of eAppraiseIT. (Mr. Cuomo could not sue Washington Mutual for jurisdictional reasons.) The suit, still in court, charges that eAppraiseIT let itself be pressured by Washington Mutual to revise appraisals upward to match the value of deals.

Washington Mutual collapsed last fall, the largest bank failure in the nation's history.

Mr. Cuomo, convinced that the troubles with appraisals went far beyond a single case, began an inquiry into Fannie and Freddie's role in the buying of fraudulent mortgages. Before that investigation could be concluded, the two finance companies agreed they would buy mortgages only from lenders that abided by a new code of conduct.

In its original draft, the code froze out brokers and agents and placed severe restrictions on lenders. They were forbidden from using their staff appraisers or an appraisal management company in which they had more than a 20 percent interest.

The American Bankers Association and the Mortgage Bankers Association fought the restrictions, saying they would increase costs to consumers. The lenders also argued that Mr. Cuomo had no jurisdiction over their federally chartered operations. Banking regulators, who saw their authority being usurped, agreed.

The final version of the code gives much greater leeway to lenders. For instance, lenders can hire their own appraisers if they "recognize" that complaints will be forwarded to regulators.

The appraisal world was stunned. Dave Biggers, the chief executive of A La Mode, a maker of software for appraisers, said, "It's like telling me I can steal as long as I 'recognize' that complaints will be directed to the police."

Benjamin Lawsky, a special assistant to Mr. Cuomo, defended the revised version. "Our goal was always for the code to eliminate the causes of appraisal inflation while minimizing any disruptive impact on the industry," he said. "We believe we accomplished this."

Since national lenders cannot maintain lists of appraisers in every community, they long ago began outsourcing the process to the management companies, who had claimed about 30 percent of the market before the code took effect. Now that the lenders are the ones ordering all the appraisals, the management companies are expanding their share.

Real estate groups say the management companies, with the competition from brokers and agents eliminated, are now trying to fatten their profit margins by hiring appraisers as cheaply as possible.

These inexperienced appraisers, often traveling many miles to a market they do not know well, are scuttling legitimate deals, the agents claim. This argument has resonated in Congress, where 55 legislators have sponsored a bill calling for an 18-month moratorium on the code.

Appraisal management companies and lenders say the agents' charges are not true.

"We're an easy scapegoat," said Donald Blanchard, chief compliance officer of Lender Processing Services Inc., which works with 20,000 appraisers. "We've yet to see any quantifiable proof as to the problems that management companies are supposedly causing."

The real source of trouble for independent appraisers, he suggested, is not the code but a changing economy.

"Appraisers want to go back to the way it used to be," Mr. Blanchard said. "But it's good business for us to demand more for less."

**Fees Decline**

Terry and Andrea Hartlieb, longtime appraisers in Fort Collins, Colo., miss the old days.

Instead of developing relationships with brokers and agents, the Hartliebs must wait for a lender or appraisal management company to call. A year ago, they would make $350 for an appraisal that would take about five hours. Now the management companies offer as little as half that. The couple has laid off four appraisers who used to work for them.

One recent call was about a complex property that would take additional time. Mr. Hartlieb asked for a bigger fee. The response: "We can get it done faster and for less elsewhere."

Mrs. Hartlieb said, "Buying a house is the largest expense of your life. Don't you want the best professional advice about its value, not the cheapest?"

Appraisers might be earning less, but consumers are being asked to pay more. The cost of an appraisal is now about $500, up from $400, appraisers say, because of the management companies' share.

Moreover, if the goal of the code is to lessen pressure on appraisers, it is not clear that is happening.

A memo from U.S. Bancorp, which is based in Minneapolis, was posted recently on Appraisers' Forum, an online discussion group. The memo bluntly urged the lender's appraisers to "try and get the value we need the first time." (A U.S. Bancorp spokeswoman said the memo was "not an official document.")

In an online poll of 2,250 appraisers by Working RE magazine, half the respondents said they sometimes felt that management companies were ordering them to come up with a value that would make the deal work.

Banks and appraisal management companies say appraisers can be hypersensitive. "To some appraisers, the fact that we call you and ask a question is pressure," said Mr. Blanchard of Lender Processing Services.

Under the code, the role of deciding what is pressure is assigned to a new entity called the Independent Valuation Protection Institute. If appraiser complaints are deemed valid, the institute is supposed to forward them to regulators.

Seventeen months after it was announced, the institute has no staff and no appraiser complaint hotline. All that exists is a single Web page.

Mr. Callahan, who wrote about the trouble with appraisals during the boom, is dismayed that the problem cannot be fixed even during the bust.

"Appraisers play a key role in keeping real estate transactions honest," he said. "But we as a society have done very little to support them and ensure their independence."

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