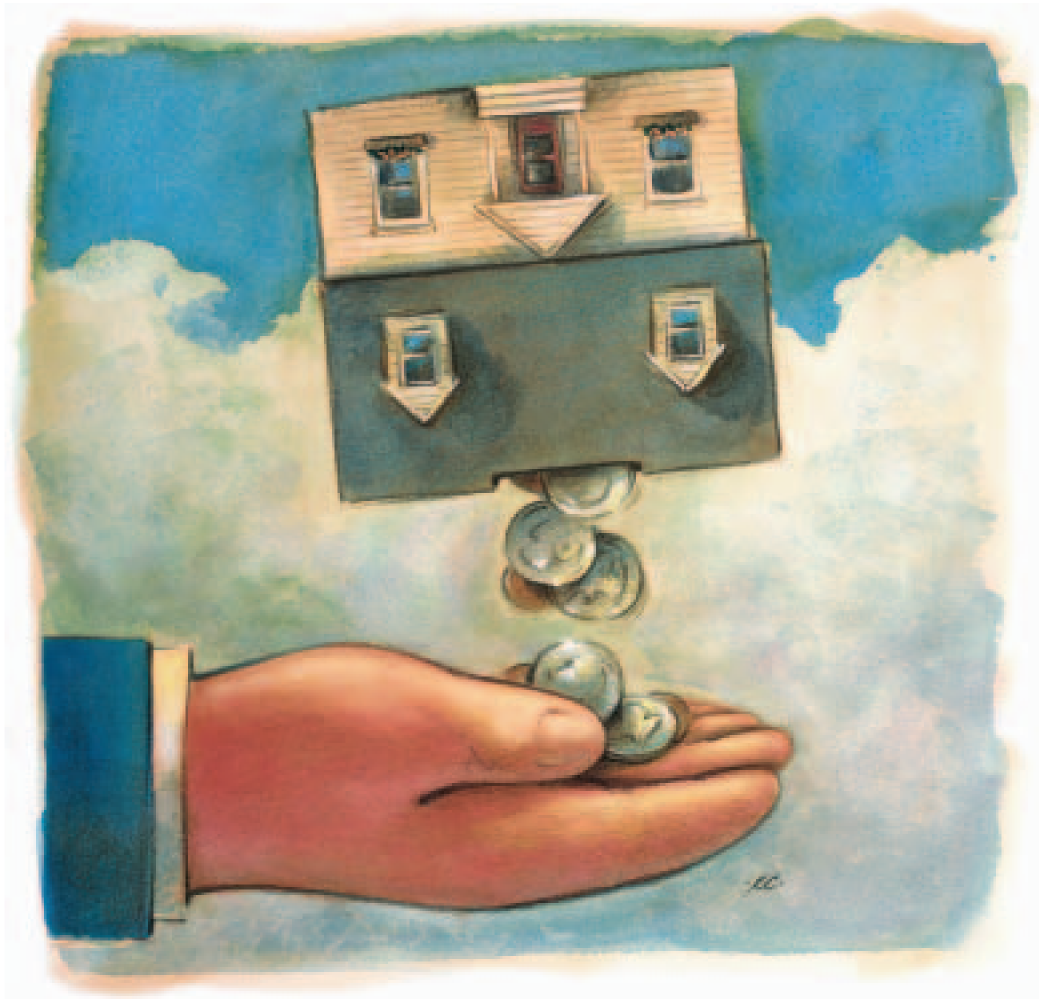
NATIONAL COMMUNITY REINVESTMENT COALITION NCRC



Predatory Appraisals: $tealing the American Dream

The National Community Reinvestment Coalition

The National Community Reinvestment Coalition (NCRC) is the nation's trade association for economic justice whose members consist of local community based organizations. Since its inception in 1990, NCRC has spearheaded the economic justice movement. NCRC's mission is to build wealth in traditionally underserved communities and bring low- and moderate-income populations across the country into the financial mainstream. NCRC members have constituents in every state in America, in both rural and urban areas.

The Board of Directors would like to express their appreciation to the NCRC professional staff who contributed to this publication and serve as a resource to all of us in the public and private sector who are committed to responsible lending.
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June 2005

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Introduction:

During the past year, the National Community Reinvestment Coalition (NCRC) has closely examined the prevalence of predatory practices in the appraisal of residential real estate. This research was initially prompted by referrals of consumers to the NCRC National Anti-Predatory Lending Consumer Rescue Fund (CRF) by our members across the country.

In our experience counseling consumers, lenders and other industry insiders pressure appraisers to inflate home values. In return many consumers find themselves struggling with a higher mortgage than home equity and even the possibility of foreclosure. The prevalence of "upside down" mortgages is a serious issue, however, the impact and complexity of predatory appraisal practices does not stop there. Abusive practices manifest themselves in many ways and are documented in great detail in this report in the form of consumer "vignettes" which place a human face to the issue.

Predatory appraisers and appraisal practices, combined with consumer protection loopholes and the absence of meaningful industry standards, is facilitating the theft of equity from homeowners nationwide and, in the process, threatening the safety and soundness of the market. Further, predatory appraisals destroy entire communities, leave the secondary market in extreme risk and endanger the market place as a whole. These abuses must end before the American Dream of homeownership is stolen from the entire nation.

This significant increase in referrals to the CRF comes at a time when Federal regulators are also beginning to express concern about mortgage valuation and appraisal issues. The link between safety and soundness, predatory lending and responsible lending practices is becoming clearer – and NCRC is sounding the alarm for action and oversight on each level of the issue.

On May 16th, 2005, Federal banking regulators warned banks and other lenders to be more selective about who can get home equity loans and lines of credit because rising interest rates may make it harder for people to repay their loans. The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corp., the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision, identified several "risk factors" in the guidance including:

- Interest-only features that require no amortization of principal for a protracted period;
- Limited or no documentation of a borrower's assets, employment and income;
- Higher loan-to-value (LTV) and debt-to-income ratios;
- Lower credit risk scores for underwriting home equity loans;
- Greater use of automated valuation models and other collateral evaluation tools for the development of appraisals and evaluations; and
- An increased number of transactions generated through a loan broker or other third party.

All of these factors are pertinent to the discussion of responsible lending and appraisal practices. Frankly, it has been NCRC's experience that when one risk factor is present, in almost every case, so is the issue of appraisal fraud.

The problem has become so pervasive, that the number of appraisal complaints that NCRC is receiving mirrors the level of complaints that we received regarding predatory servicing practices just two years ago. NCRC's exposure of that issue prompted Congressional inquiry, regulatory intervention and significant civil litigation. Significantly, NCRC then collaborated with responsible lenders, servicers and securtizers to produce national servicing best practices as a component of the regulatory solution. It is our hope that, once again, by similarly exposing this issue to sunshine, we can collectively and holistically work towards a solution to eliminate the abusive appraisal issue.

Through critical literature review, individual case analysis, and outreach to public and private sector leaders, we researched this report which is designed to provoke critical discussion. **The core finding of the report is that problematic appraisal practices exist as a serious impediment to responsible lending, impede fair housing and equal access to credit, and place the American dream of homeownership and the safety and soundness of the mortgage marketplace at risk.**

The problem has become so severe, that many agree the time has come for both new voluntary, statutory and regulatory industry wide standards relating to the valuation of residential real property that acts as collateral for mortgage lending transactions. These new standards should supplement and in fact be more stringent than existing Federal, state and local statutes and regulations.

The time to act in partnership with community and industry is now. The issue is manifesting itself and is being documented by the surge in the number of problematic or predatory loans referred the NCRC National Anti-Predatory Lending Consumer Rescue Fund and to programs operated by NCRC members in our nations communities that involve appraisal fraud and valuation issues. This recent focus stems from the realization that the valuation of property lies at the heart of fair lending practices in the real estate, mortgage lending, and insurance industries.

Ultimately, it is the value of real property and its value as collateral that are the cornerstones of the real estate and mortgage lending industry. Appraisers play a key role in ensuring a healthy mortgage marketplace. Responsible appraisers protect the interests of each of the parties to the mortgage transaction through application of appropriate home valuation protocols that serve to inform and insure a robust housing market where securitizers play an active role in providing access to capital and credit.

In a market with double digit appreciation and increased risk oversight, professional real estate appraisers have come under more scrutiny with regard to their compliance with laws and regulations

about fair lending & responsible lending practices. It is very clear that today's professionals need to elevate their awareness of the proper presentation of factual information that has been collected in the market. No longer is the adage valid that, "…what I don't know can't hurt me……"

Today, equity and intergenerational wealth is being stolen through appraisal fraud. This is not only placing consumers at risk, but neighborhoods and investors from Main Street to Wall Street. New national best practices and statutory and/or regulatory protections are required. That said, it is also the responsibility of the consumer to understand the role of the professional real estate appraiser in estimation of the market value of a property. As consumers and appraisers alike become more educated, the process becomes more balanced, streamlined and unbiased.

It is abundantly clear to us that "advocates" and "industry" alike agree about both the importance of an independent appraisal that serves as a component of mortgage compliance rather then that of mortgage production. We have also learned that there is need for expanded attention to appraisal best practices and home valuation standards. It is our hope that this report will prompt a serious policy and best practice discussion on the subject and serve as a call to action. Frankly, if we fail to act, the risk to our mortgage system and to our communities is real, and the human cost and impact upon access to credit is incalculable.

Fear of Foreclosure After Almost Forty Years

Mr. and Mrs. M, 71 and 62, have lived in their home for over 37 years and recently celebrated their 40th wedding anniversary. However, a few years after being convinced to refinance their mortgage in 1998, the couple discovered the appraisal had been falsely inflated by over $37,000 and they were facing foreclosure as a result.

The mortgage lender had used high-pressure sales tactics to convince the Ms to refinance and hired a predatory appraiser who valued their home at $95,000. Despite his being retired, Mr. M was forced to go back to work to help make ends meet after their monthly payments rose significantly. When they fell into arrears, the elderly couple sought help and had a retroactive appraisal* done, which showed the true value of the house to be only $58,000.

After the fact, the Ms also learned that the predatory appraiser had falsely documented the square footage of their home, claiming that it was larger than it really was.

* See glossary at the end for definition

What the Ms experienced was demonstrative of the growing scam known as appraisal fraud, which is leaving many homeowners with more mortgage than equity and threatening the safety of the entire market. The current rise in appraisal fraud occurs at a time when consumers must already keep an eye out for high fees, steering, flipping and many other abusive features. Lenders are increasingly targeting consumers with high cost loans, the percentage of which has doubled from 1994 to 2004. [1]

[1] Liz Pulliam Weston, "Are There Too Many Homeowners", *MSN Money*, December 6, 2004.

Fair lending studies released by NCRC in March and April revealed that minority, low- and moderate-income, and women borrowers were disproportionately more likely to receive high cost loans than their white, middle- and upper-income and male counterparts, thus increasing the pricetag of homeownership for these vulnerable populations. Even when controlling for credit risk, as demonstrated in NCRC's Broken Credit System Report, significant fair lending disparities stubbornly persist.

Ultimately, as lenders and brokers continue to apply pressure and appraisers continue to succumb to it, consumers are forced to struggle against yet another predator in the lending industry that threatens to diminish their equity and destabilize the market as a whole.

What is an Appraisal?

To understand the larger impacts of predatory appraisers, you must understand the true role of an appraiser and recognize the composition of a proper appraisal. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which calls for the safety and soundness of lenders, stipulates that "providers of valuations [to] have no financial interest or otherwise in the property or the transaction".[2] The Appraisal Institute, an international association of over 18,000 appraisers, describes an appraiser as "provid[ing] objective, impartial and unbiased opinions about the value of real property". [3]

To do this, an appraisal must provide a description of the property and the condition of its surroundings and an analysis of the sales of comparable properties as close to the property being appraised as possible. Together, these factors are weighed by an appraiser to determine the value of a property, which later impact the amount of the mortgage.

Fraud Led to Bankruptcy

Ms. T, a 54-year-old nurse, was forced to file for bankruptcy after she purchased a home that was overvalued by over $84,000. The house was originally appraised at $192,500 by an appraiser selected by the seller, who was in business with Ms. T's mortgage company. However, she was unable to make the high mortgage payments while trying to make the home livable, with its basement floods and ceiling leaks. Eventually, Ms. T had to file for bankruptcy. It was then that she discovered her home was only worth $107,700 at the time she purchased it. Ms. T is now attempting to refinance through NCRC's Consumer Rescue Fund (CRF).

What is a Predatory Appraisal?

A predatory appraisal occurs when the value of a property is falsely overstated during a new purchase or during the home equity or refinancing process. Yet, while appraisers are the ones inflating the figures, lenders, brokers and other members of the industry are the ones pressuring appraisers to provide their desired valuation and to close the deal. In fact, criminal investigations by the FBI have revealed that "industry insiders" were involved in 80% of reported fraud cases.[4] This should not be surprising as lenders and other industry players have an

[2] As stated in Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA).

[3] Appraisal Institute, "Some Commonly Asked Questions About Real Estate Appraisers & Appraisals" brochure, 2005. http://www.appraisalinstitute.org/resources/downloads/brochures/FAQs_Web.pdf

[4] Statement of Chris Swecker, Federal Bureau of Investigation before the House Financial Services Subcommittee on Housing & Community Opportunity, October 7, 2004.

incentive to inflate property values. While appraisers are only paid on a per appraisal basis, lenders and brokers are paid commissions based on the value of the loans they secure. Likewise, real estate developers and agents are paid profits and commissions based on the sales price. For example, just in 2003, lenders made over $832 billion in conventional and government-insured loans and over $2.2 trillion in refinance loans.[5]

In fact, many lending institutions violate federal laws on independence by having their loan production offices in charge of hiring appraisers and reviewing the appraisal process.[6] These arrangements make it too easy for a loan officer to pressure appraisers into providing the valuations they need.
This conflicting role of a loan officer has become a mounting concern for regulators as evidenced by their re-occurring need for policing.

In October 2003, the federal regulators jointly issued guidelines stating that "an institution's lending functions should not have undue influence that might compromise the [appraisal] program's independence," and even specified that "individuals independent from the loan production area should oversee the selection of appraisers." [7] However, this was not clear enough for lenders. In March 2005, the regulators had to release a supplemental statement to address this issue and again reiterated that loan production staff is not to select appraisers. [8]

Predatory Appraisal Tactics

In order to get an inflated valuation, lenders and brokers use a number of tactics. Some apply pressure by withholding their payment, threatening to not do business with the appraiser, or even blacklisting him or her altogether unless the appraiser meets the lender's requested value. They may demand that appraisers guarantee a predetermined value, ignore deficiencies in the property or simply increase the appraisal if the lender is unsatisfied with it. Lenders also "shop around" (also known as "value shopping") by contracting several appraisers to evaluate one property and then use the highest valuation they find.

Struggling to Make Ends Meet

Mr. and Mrs. C responded to a newspaper advertisement from a local homebuilder. They put their faith in a smooth-talking salesman, and closed on their new home in February 1997, at a price of $164,500. The couple soon realized that they were in over their heads. Faced with a high-cost loan, Mr. C struggled to hold a third job in order to make ends meet for his family. It was not until later though that the Cs discovered that the real value of their home at the time of their purchase was only $130,000 and that they could not refinance due to the lack of equity. In 2004, after their home had appreciated in value, the Cs refinanced through NCRC's CRF.

Many also argue that bank- or title-owned appraisal management companies (AMCs) and staff appraisers are another form of leverage used by lenders. In these cases, lenders commission the AMC

[5] According to 2003 Home Mortgage Disclosure Act data available through the Federal Financial Institutions Examination Council. See www.ffiec.gov.

[6] Erick Bergquist, "A View of Refi Boom Pressures From the Appraisal Trenches," *American Banker*, February 7, 2004; Brad Finkelstein, "Expert: Appraisers Still Subject to Lender Pressure," *American Banker*, December 1, 2004; Rob Garver, "Bracing for a Crackdown on Appraisals," *American Banker*, July 20, 2004

[7] "Independent Appraisal and Evaluation Functions," Office of the Comptroller, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration. October 27, 2003.

[8] "Frequently Asked Questions on the Appraisal Regulations and the Interagency Statement of Independent Appraisal and Evaluation Functions," Office of the Comptroller, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration. March 22, 2005.

that is owned by their own holding company. Bank- and title-holding companies purchase AMCs in order to create “bundled” services, which are cheaper for and more attractive to lenders and ultimately lead to more profits for the holding company. This also lowers the cost as “in-house” appraisers are less expensive than independent fee appraisers.

Regardless of their methods, unscrupulous lenders and appraisers are ultimately capitalizing on trusting consumers by selling them inflated equity and afalse sense of security. This growing trend of overvaluation occurs at a critical time when American consumers using home equity loans to pay off short term debt and are being bombarded by abusive predatory lenders.

Why is there a Surge in Predatory Appraisals Now?

While appraisal fraud is not a new predatory practice, the refinance boom of the past five years has helped it to flourish into a more common one. A recent study showed that the average household credit card debt has increased by 53% from 1989 to 2001, while credit card debt for lower income households has increased by even more.[9] Given these growing figures of personal debt and the low interest rates of the past few years, it is no wonder that consumers are turning to home equity loans to help make ends meet. However, with millions of homeowners looking to trade high interest rate for lower interest rate home equity loans, more and more lenders are willing to pressure appraisers to inflate the property value and fabricate equity when it is not really there.

Further, as individual debt increases, the credit card industry has determined that to continue their growth and returns it is imperative that they expand into new realms. Home equity and first mortgage loans are part of this expansion. Soon an individual who has high credit card debt will be offered an opportunity to use their home as collateral to alleviate the higher interest rate. To achieve this deal, there will be tremendous pressure to reach a predetermined appraisal value that will enable the transaction to take place. Debt consideration, in addition to loan-to-value (LTV), must be taken into consideration as credit card companies move down this path. Since lower-income borrowers will feel the most pain from this, complete independence within the process must be achieved. In their recently released May 2005 guidelines, the federal regulators jointly addressed these concerns, highlighting the numerous risk factors involved in the increased level of home equity lending.[10] Consumer protection advocates see this as a convergence of market factors that place consumers and their homes at risk, while also increasing risk to the secondary market.

Another reason for the recent surge in appraisal fraud is the lowered risk that loan originators are experiencing. In earlier years, the majority of lenders bore the responsibility of holding the outstanding mortgage until the loan was fully repaid and thus risked the possibility of the borrower defaulting on his/her loan during that time. However, mortgages are now routinely and quickly resold to financial institutions in the secondary market, such as Fannie Mae and Freddie Mac. Between 1999 and 2001, the government-sponsored entities (GSEs) purchased 57% of the conforming conventional

[9] Tamara Draut and Javier Silva, “Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the ‘90s,” *Demos.* 2004.

[10] “Credit Risk Management Guidance for Home Equity Lending,” Office of the Comptroller, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration. May 16, 2005.

[11] HUD’s Housing Goals for Fannie Mae and Freddie Mac for the Years 2005-2008, Final Rule, Federal Register, Vol. 69, No. 211, Tuesday, November 2, 2004, p. 63588.

home loans in the nation.[11] With this transfer of risk and responsibility of a potentially defaulted loan, loan originators are relieved of the risk burden and can free up resources to start the process over and originate another loan.

Predatory Appraisals Lead to Major Risks and Serious Losses

Overstating the value of a property might seem insignificant at first, especially if you are the homeowner who is receiving a needed home equity loan. However, appraisal fraud, like many other types of predatory lending, is most harmful to consumers as it quietly strips the equity and wealth of consumers.

"Value shopping" is just as onerous as appraisal abuse. Each inflated value sets a precedent within a community that becomes the precedent for future sales. Lenders must implement policies and controls to preclude value shopping. The use of several valuation tools may return different values for the same property. These differences can then result in systematically inflated properties if the valuation choice becomes driven by the highest property value. If several different valuation tools are used for the same property, the institution should adhere to a policy for selecting the most reliable method, rather than the highest value.

Resolving predatory appraisals can become very complicated as they are often not discovered until years after the transaction. Many times consumers do not realize they have been the victim of this crime until after they have attempted to refinance or sell their home. For consumers located in booming markets experiencing today's swelling rise in property values, appraisal fraud can easily be masked and go unnoticed. However, consumers in towns with slow or gradual increases in real estate might not be able to sell his or her home for many years to come, literally imprisoned in their own home due to a predatory appraisal.

Consumers Feel Shockwaves:

Equity. Consumers lose the difference between the fraudulent appraised value and the true appraised value of their home. For example, Mr. and Mrs. M, the elderly homeowners discussed earlier, lost $37,000 of their equity: the difference between the overvaluation ($95,000) and the true valuation ($58,000).

Mortgage Insurance. If a consumer had enough for a 20% down-payment, but now takes out a larger loan due to an inflated appraisal, the consumer will have to pay for mortgage insurance, thus increasing the housing costs.

99% of appraisers say that their peers give in to pressure to inflate housing values...
October Research Corp. 2003

Higher Monthly Mortgage Payments. As the loan balance has been artificially inflated, monthly interest costs increase.

Higher Interest Rates. Again, an inflated valuation on a property may lead the lender to charge a higher interest rate on the mortgage, due to a higher debt to equity ratio, leading to additional costs for the consumer.

Excess Closing Costs. As closing costs are a percentage of the mortgage, an overvalued property would lead consumers to pay additional closing costs to the originators of the mortgage.

Closed Out of the Market. With inflated appraisals, many lower-income borrowers are completely closed out of the market. By offering purchasing options that are beyond their means, lenders end the dream of homeownership and wealth for lower-income borrowers.

Foreclosure. While equity serves as a buffer for consumers in cases of financial hardships, a fraudulently overvalued property can lead to foreclosure. After losing his job, a Monroe County, Pennsylvania consumer discovered that the home he purchased a year earlier for $183,000 was only worth $80,000. Without an income to make mortgage payments on his overvalued home and unable to resell his house to sufficiently pay his debt, foreclosure was one of the few choices he had available.[12] In addition, borrowers with subprime loans must be particularly cautious of appraisal fraud, as these types of loans, compared to prime loans, are already ten times more likely to be in serious delinquency or in foreclosure, according to William Apgar, former commissioner of the Federal Housing Administration. [13]

Consumers Pressured As Well

Mr. M and Ms. F were supposed to close on their home in April 1999. But their developer gave them an ultimatum in December 1998: either close within the next 10 days or pay $100 per day for the delay, which would total over $8,000. With little savings, the couple was pressured into closing on their home right away for the appraised value of $168,000 so that they could meet the low-down-payment program.

But the parents of three never received their promised subsidies, incentives, or rebates. The property was chock-full of problems: leaky bathroom windows, loose kitchen floor tiles, cracks in the walls, nails coming off the floors, flooding from the kitchen sink, a damaged boiler pump, and kitchen cabinets coming off the walls--blatantly obvious defects that should have been caught by the appraiser.

When all is said and done, consumers pay for a large chunk of the scam. This prompts many in fact to abandon their homes and be forced into foreclosure. Despite the large burden homeowners must bear while regulators and the industry attempt to get mortgage fraud under control, they are not the only stakeholders threatened by appraisal fraud. Entire communities, government-sponsored entities (GSEs) and the market as a whole are at risk by these unsafe and unsound practices.

[12] Matt Birkbeck, "A Price Too High: Unreal Deals," *Pocono Record*, April 8, 2001.
[13] Matthew Royse, "AMCO's Board Draws Big Names", *Mortgage Banking*, December 2004.

Consumers Not the Only Victims:

Communities. Appraisal fraud can lead to an epidemic of foreclosure, plummeting home values, and ultimately a depressed community when entire neighborhoods are overvalued. Coolbaugh Township, which is located in Monroe County, Pennsylvania where the foreclosure rate more than quadrupled between 1990 and 1999, is a prime example.[14] Relying on inflated appraisals, two local home builders in Coolbaugh sold 35 homes ranging from $140,000 to $230,000 even though the median home price in the county was $113,499 in 1999.The overvaluations ultimately lead to 120 foreclosures in the township and by 2001 the median home price in Coolbaugh had dropped to $66,019. The crisis has still not been resolved. A recent study commissioned by the Monroe County Task Force confirmed that the number of filed foreclosures has increased by 34% between 2000 and 2003 and that these loans "more likely involved an inflated sale price than those not in foreclosure".[15]

Market Damage. Falsely inflated home prices are adding to the already soaring cost of real estate. Over the past five years, prices have jumped 95% in California, while New York and Washington, DC prices have gone up 70% and 97%.[16] However, some estimated that over appraisal rates range from 15-30% of all homes being overvalued by 15%.[17] With so many regions heavily invested in real estate, this creates a serious potential for disaster as millions of homeowners have much less equity than they believe they have.

Secondary Market Risks. Lenders who sell to the secondary market generally must warrant and represent that appraisals are compliant with law and industry standards. The GSE's will point to this liability as their "feedback" if there is appraisal fraud. The problem, however, is that:

a) Many lenders will be out of business as the result of a recession, rendering the warranties meaningless.
b) The larger lenders selling to the secondary market are customers of the buyers and have the clout to force the GSEs to not fully enforce their remedies.
c) Enforcement of warranties would lead to the questioning of the value and integrity of the securities sold by the GSEs.

Price risk:

Pricing of mortgage loans is directly related to the risk. Lower loan to values, the result of purposeful over valuation, artificially decreases the assumed risk, leading to pricing that is not truly reflective of the risk. Thus, if there are higher foreclosures, the secondary market buyer does not have the "risk premium" in pricing to pay for that increased cost.

[14] Matthew Royse, "AMCO's Board Draws Big Names", *Mortgage Banking*, December 2004.
[15] The Reinvestment Fund, "A Study of Mortgage Foreclosures in Monroe County and the Commonwealth's Response", Monroe County Task Force, August 3, 2004. www.banking.state.pa.us/banking/lib/banking/Final_Monroe_Report_Complete_condensed.pdf
[16] Jennifer Harmon, "Homebuyers Borrowing More to Get in Homes, Saving Less," *National Mortgage News*, February 21, 2005.
[17] Erick Bergquist, "A View of Refi Boom Pressures From the Appraisal Trenches," *American Banker*, February 5, 2004 quoting Greg Hansen, president of Fidelity Hansen Quality, Inc., which reviews appraisals for secondary loan buyers.

Sarbanes Oxley:

Publicly held lenders and secondary market buyers, particularly the GSEs, artificially decrease their necessary loss reserves when they artificially increase the assumed value of the collateral for loans. This can amount to many billions of dollars of inflated profits that taint the financial statements of larger institutions.

Securities Law Violations:

When loans, with over valued collateral, are sold as securities into the secondary mortgage market, there is purposeful or grossly negligent misstatements of materials facts that are violations of federal and state securities laws.

FHA-insured loans. Federal Housing Administration (FHA)-insured loans seem to be more vulnerable to appraisal fraud as they are guaranteed loans, which lenders will not be stuck with it if the loans default. Because of this reduced risk for lenders, they might be more likely to pressure appraisers when dealing with FHA-insured loans.

Impotent Regulators

Despite the soaring number of homeowners that have been cheated because of appraisal fraud, regulations to curb this practice have remained weak and ineffective. FIRREA, as discussed earlier, was originally developed in response to the 1980s Savings and Loan crisis but also enforces the safety and soundness of lenders by requiring appraisers to remain independent from the loan production process. The federal regulators jointly issued additional guidelines over the past two years defining "independent" and clarifying that appraisers should not have "a direct, nor indirect, interest, financial or otherwise, in the property or transaction".[18] As discussed earlier, the guidance also clearly stated that loan production officers should not be permitted to order appraisals or review the appraisal process. However, regardless of their repeated statements, regulators face several obstacles that limit their power to implement and enforce appraiser accountability.

State regulatory agencies, which certify and license appraisers and monitor and supervise their compliance to appraisal standards and requirements, have repeatedly cited funding limitations as reason for their inability to enforce compliance. According to a 2004 report by the General Accounting Office (GAO), 69% of states needed more staff to respond to appraisal investigations while 40% needed more resources to support litigation.[19]

The Appraisal Subcommittee of the Federal Financial Institution Examination Council (FFIEC) is the federal oversight agency which monitors the functions of the appraisal regulatory entities and

[18] "Independent Appraisal and Evaluation Functions," Office of the Comptroller, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration. October 27, 2003.

[19] Testimony Before the Subcommittee on Housing and Transportation, Committee on Banking, Housing and Urban Affairs, U.S. Senate. "Opportunities to Enhance Oversight of the Real Estate Appraisal Industry." *General Accounting Office.* March 24, 2004.

performs field reviews of the state appraiser regulatory agencies. In the GAO report, the Subcommittee stated that it did not have the rule-making authority or the ability to enforce sanctions to ensure state compliance. Subcommittee officials note that they only have one unrealistic enforcement power, which is to decertify an entire state, thus having the devastating impact of prohibiting all appraisers from performing appraisals and bringing the entire state's lending industry to a halt.[20]

Gaining Ground in Ending Appraisal Fraud

Despite the obstacles regulators face with enforcing their regulations, several other federal agencies and legal enforcement offices, including HUD and the Federal Bureau of Investigations (FBI) have had some great successes in stopping predatory appraisers from preying on unknowing homeowners.

- In Spokane, Washington, a U.S. District judge recently convicted five people operating an appraisal fraud scheme from 1997 to 2000, which robbed homeowners of an estimated $1 million. The group sold homes to first-time and disadvantaged consumers for up to 100% more than market value and left them to struggle with high interest rates, balloon payments, foreclosure and even bankruptcy. Sentenced with a total of 31 counts in March 2005, the appraiser, real estate agent, closing agent and two mortgage company co-owners received a total of over 12 years in prison and must repay their victims over $1.5 million in restitution.[21]

- Through an enduring initiative known as *Operative Continued Action*, the FBI has drastically increased its efforts to stop appraisal fraud as it is investigating 533 mortgage fraud cases as of September 2004.[22] This is up from the 102 open cases in 2001. For example, a two-year joint investigation ended in August 2004 when four business associates were charged with securing predatory appraisals and flipping properties approximately 300 times, resulting in losses of over $15 million.[23]

Targeting the Elderly

Mrs. D, a 65-year-old retiree, who was living on a fixed income, sought to refinance her home in order to save money to help defray the nursing home costs, where her husband (now deceased) resided. During her refinancing she received a fraudulent mortgage valuing her home at $105,000. Due to this fraudulent appraisal, her costs were higher and she soon faced difficulties making her monthly payments Mrs. D attempted another refinance through a different broker and received a different appraisal. This time her home was valued at $93,500. When asking if she could use the higher appraisal, the second broker discovered discrepancies in the square footage and number of bathroom scausing the inflated fraudulent appraisal. He recommended Mrs. D seek legal help, and the case was eventually resolved through mediation by NCRC's CRF staff with her lender.

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[20] Ibid, pg. 13.

[21] "Appraiser Sentenced in Real-Estate Fraud", *Associated Press*, March 29, 2005; Rachel Dollar, "Sentences in Washington Mortgage Fraud," www.mortgage-fraudblog.com, March 8, 2005.

[22] Michele Derus, "Mortgage Fraud Scams Costs Millions of Dollars Each Year", *Milwaukee Journal Sentinel*, April 17, 2005.

[23] Statement of Chris Swecker, Assistant Director, Criminal Investigative Division, Federal Bureau of Investigation Before the House Financial Services Subcommittee on Housing and Community Opportunity, October 7, 2004.

- The Federal Housing Administration (FHA) has implemented a new and effective monitoring tool, known as "Appraiser Watch", which uses risk factors to identify predatory appraisers who inflate values and put home-owners at risk for foreclosure. Compared to its former system which spent $46 million to identify and remove only 33 appraisers from the 30,000 appraisals it reviewed from 1999 to 2001, Appraiser Watch has been a significant improvement. With the program, the FHA was able to remove 132 appraisers from the 1420 appraisals reviewed in 2003 at only a cost of $311,000. [24]

- The Pennsylvania Attorney General's Office has two civil suits pending involving predatory appraisals in the Poconos, Pennsylvania. One complaint seeking $10 million and filed in 2002 includes 170 homeowners who allege that they were defrauded when a developer and his companies sold them homes with inflated appraisals. The appraiser in the suit was already suspended from practicing. Complainants in the second lawsuit, filed in 2003, have the same claim against another developer and his companies and are seeking $8.5 million.[25]

Research & Case Studies

Most practitioners in the lending industry would agree that property appraisal is more of an art than a science. As the process depends on several factors, as described earlier, it often becomes hard to prove intentional fraud. One appraiser might weigh some factors slightly different than another appraiser evaluating the same property, resulting in two different appraised values. However, despite the difficulties of proving appraisal fraud, consumers, appraisers, advocates, law enforcers, and even brokers are speaking up and acknowledging it as a growing abuse in the lending industry that needs to be controlled.

Factors in Appraisals include:

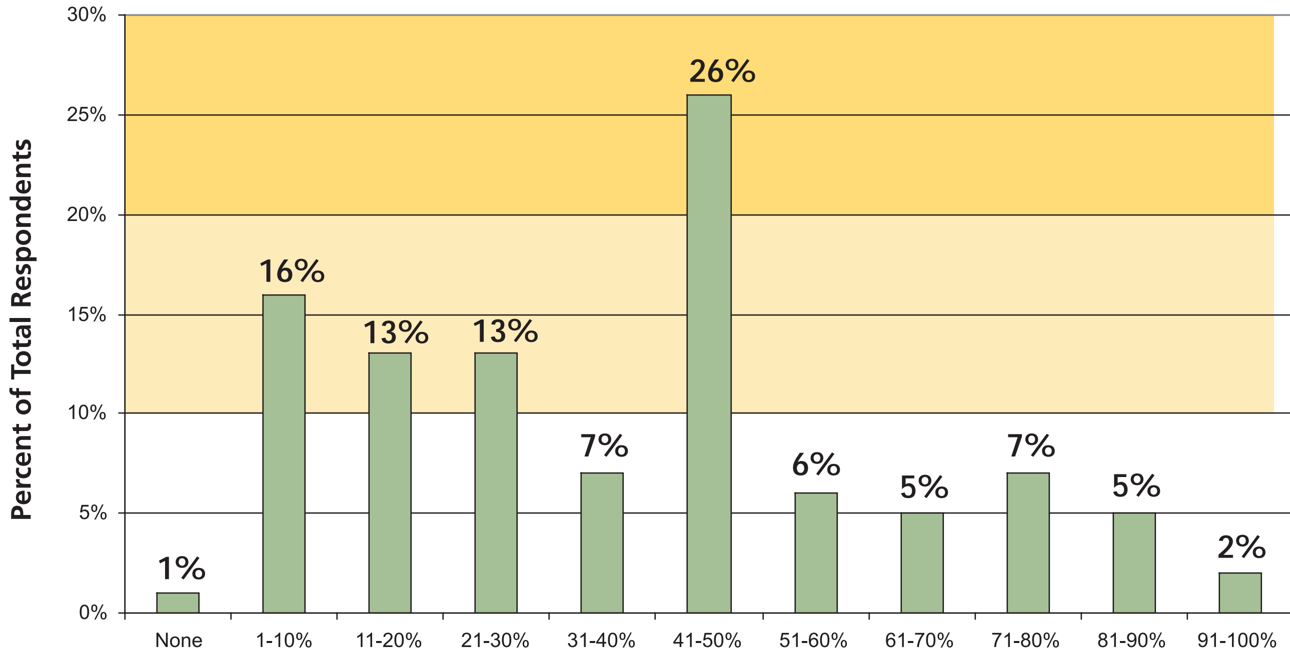
- description of the property;
- condition of its surroundings;
- analysis of comparable properties as close to the property being appraised

In 2003, a study conducted by October Research Corporation reported that appraisers were feeling pressure by lenders to mark up property values.[26] Of the 500 appraisers surveyed nationwide, an alarming figure of 55% said they felt pressure to overstate values of the properties they appraised. Table 1 illustrates how 99% of the appraisers interviewed believed that their peers give in to lender demands at some point. According to October's findings, "everybody does it some of the time."[27] In fact, the largest group (26%) said appraisers succumb to pressure 41-50% of the time.

Pressured appraisers reported that 51% of the time they were asked to inflate the values by up to 10%, while 41% of the time they were asked to inflate values by 11-20%. October reported that 8% of the time appraisers were pushed to increase property values by more than 20%.

[24] Statement of John C. Weicher, Assistant Secretary for Housing—Federal Housing Commissioner, U.S. Department of Housing and Urban Development Before the House Financial Services Subcommittee on Housing and Community Opportunity, October 7, 2004.
[25] Rachel Dollar, "Joint Mediator Appointed for Poconos Real Estate Lawsuits," www.mortgagefraudblog.com, November 2, 2004.
[26] "Final Survey Results Now In: Ninety-Nine Percent of Real Estate Appraisers Say Their Peers Go Along With Pressure To Inflate Values…" pres release, *October Research Corporation*. February 3, 2004.
[27] Ibid.

Table 1: How Often Appraisers Give into Pressure to Overstate Value



Percent of appraisers who "sometimes go along" with pressure to overstate value

October Research Corporation 2003

> **"We're appraisers, not value confirmers."**
> -Signer of the Appraisal Petitiion

Appraisers themselves are speaking out on the issue too. Through an ongoing online petition that currently holds over 8300 signatures, appraisers nationwide are urging the Appraisal Subcommittee to stop lenders and brokers from pressuring them to hit a predetermined number by inflating property values.[28] The petition acknowledges the serious financial loss to consumers and the greater potential impacts resulting from appraisal fraud. To stop these abusive practices, they request that lenders be held responsible for these actions and penalized.

Consumer Rescue Fund Research

NCRC first became concerned with predatory appraisals as its National Anti-Predatory Lending Consumer Rescue Fund (CRF) witnessed a significant increase in the number of cases involving appraisal fraud. Through CRF, NCRC works to mediate troubled loans of consumers who feel that they have been victimized by a predatory loan. CRF assists and educates consumers in addition to

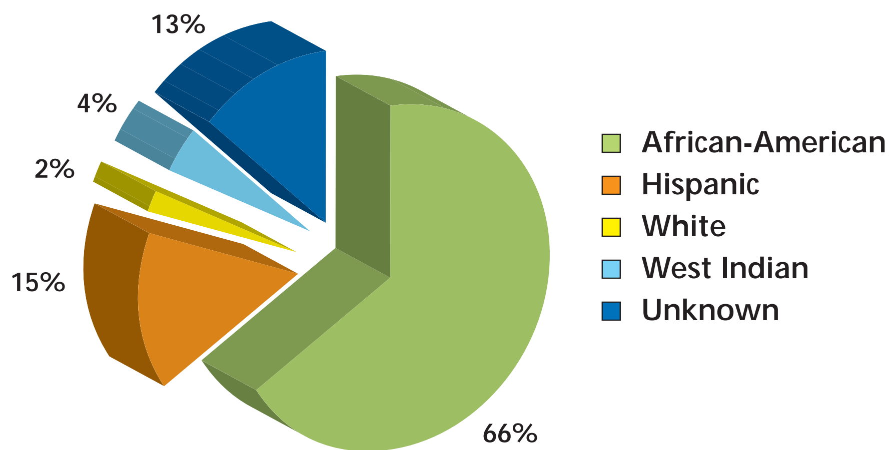
[28] Appraisers Petition, www.appraiserspetition.com, as of May 9, 2005.

evaluating the terms and circumstances of consumers' loans to determine whether they are predatory in nature or not.[29]

In an effort to review the impacts and trends of appraisal fraud, NCRC sampled 54 loans from consumer cases filed with CRF which involved suspected predatory appraisals. By reviewing consumers' demographic data and financial records, including original appraisals, retroactive appraisals, and the monthly mortgage payments increases, NCRC was able to distinguish several trends in the appraisal fraud cases.

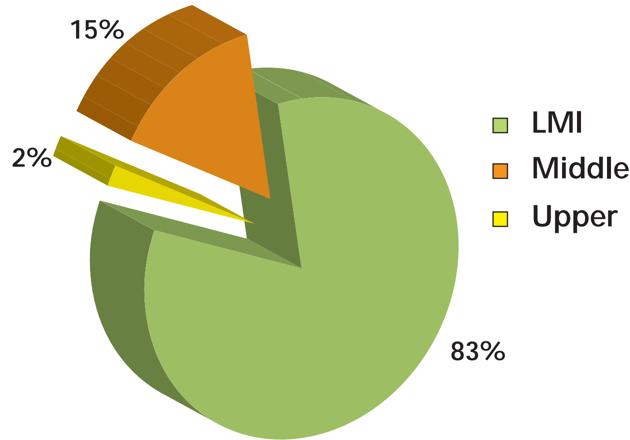
Chart 1 illustrates that two-thirds of the suspected appraisal fraud victims were African-American. Comparatively, 14.8% of the victims were Hispanic, 3.7% were West Indian, and only 1.8% were white. The race of the remaining consumers was unknown.

Chart 1: Distribution of the applicants by race and ethnicity



[29] For more information, see www.fairlending.com.

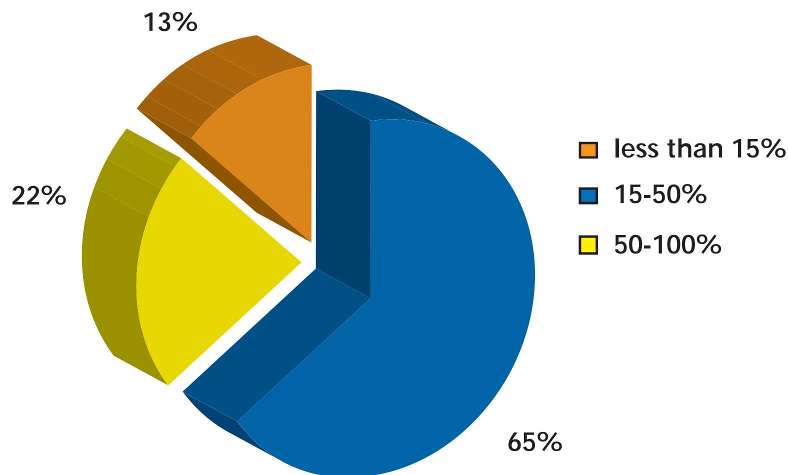
Chart 2: Distribution of the cases by census tract type



The data analysis also indicated that 83.3% of the sampled consumers experiencing appraisal fraud live in low- and moderate-income (LMI) census tracts (see **Chart 2**). These findings are quite alarming, given that minority and low-income consumers have already been identified as vulnerable targets for other forms of predatory lending, as illustrated in earlier NCRC studies.

Chart 3 lays out the amount by which the properties of sampled consumers were overvalued. To calculate this overvaluation, NCRC subtracted the retroactive appraisal[30] value from the original appraisal value, and then divided that figure by the retroactive appraisal value. In other words, the percentage shows how much the price of the property has been overestimated.

Chart 3: Distribution of the cases by "appraisal fraud"



[30] See glossary for definition of retroactive/retrospective appraisal.

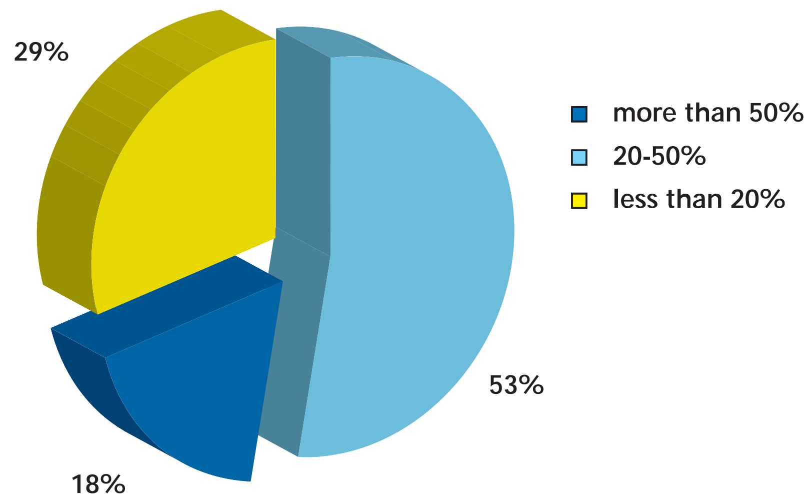
$$\text{Overvaluation} = \frac{\text{Original Appraisal — Retroactive Appraisal}}{\text{Retroactive Appraisal}}$$

As all 54 cases indicated a lower retroactive appraisal value than the original appraisal value, we concluded that all of our cases represent appraisal fraud. Chart 3 below illustrates that 22.2% of the homes were overvalued by more than 50% of their true value, 65% of the homes were overvalued by 15-50% more than their true value, and 13% of the homes were overvalued by up to 15% of the true value. In addition, almost all the cases with over 50% overvaluation occurred in low-income census tracts. This could, again, imply that this already vulnerable population is specifically targeted for appraisal fraud. Since we do not claim that our sample is random or statistically representative, additional comprehensive research should be conducted to further analyze this relationship.

NCRC also observed that after these fraudulent appraisals for home purchases or refinances occurred, homeowners' monthly mortgage payments increased substantially over time. While many factors are at work, it is clear that the predatory appraisals played a significant role in leading to these increased mortgage payments.

NCRC analyzed mortgage data in 28 of the original 54 cases as not all provided the amounts of the varying payments. However, a majority of the 28 cases reviewed had dramatic increases in the monthly payments following the fraudulent home purchase or refinance. Chart 4 shows that approximately 18% of the borrowers experienced a 50% and higher increase on monthly payments, 53% experienced an increase by 20-50%, and approximately 29% of the homeowners experienced mortgage increases by up to 20%.

Chart 4: Distribution of the cases by increase in monthly mortgage payments



Faces of Fraud

• In 2001, Mr. C and Ms. P contacted a developer about the possibility of purchasing a newly built suburban home for their three children to grow up in. They were impressed when the developer showed them model homes with high quality construction, vanities, full basements, landscaping, and alarm systems. However, for the $170,000 price, C and P received faulty plumbing and a cracked foundation. They contacted the developer, who never responded to their concerns. C and P, who are both Hispanic, believe that they were targeted on basis of race. They later discovered through a retrospective appraisal that their home was only valued at $140,000, and that they were stuck in the property due to a mortgage of more than $164,000. Fortunately, the home appreciated in value enough for C and P to refinance through NCRC's CRF.

• Mr. and Mrs. C purchased a home for $142,000—a price provided by their mortgage company's chosen appraiser. After the papers were signed in January 1997, the Cs' were troubled to find the actual home they purchased was in poor condition--which was not represented on their appraisal. A retrospective appraisal later found that the home was actually only worth $120,000 at the time that they purchased it. After years of struggling with repairs, Mr. and Mrs. C received a refinance through NCRC's CRF.

• In July 2003, NCRC received a letter from the H family explaining how they lost $30,000 in home equity they thought they had, and that they were about to lose their home. Mr. H, 41, writes, "In 1995 my wife and I decided to go after our dreams and buy a home. We saved every cent we could." He and his wife, 43, contacted a mortgage company to purchase an "affordable home." However, after purchasing the home for the appraised value of $153,000, they never received the safe and solid home they expected nor did they get any of the incentives they were promised. After seeking help and having a retroactive appraisal, the family learned that their home was only worth $120,000 and had been falsely inflated in value. The couple later refinanced through NCRC's CRF. Due to their extreme financial need, the Hs were given a 30-year fixed mortgage at 4.04%.

• When a seller showed Mr. and Mrs. H homes in 2000, he knew that the property was only worth $145,000. However, he was still willing to find an appraiser to inflate its value by more than 30% so that he could sell it to the Hs for $190,000. He left Mr. H, a 52-year-old custodian, and Mrs. H, a 41-year-old medical assistant, trapped by $45,000 of lost equity. The case is currently being reviewed by NCRC's CRF.

• Mr. M, an emergency room administrator, and Mrs. M, a nursing assistant, are currently in bankruptcy due to a deceptive and fraudulent appraisal facilitated by a residential builder in 1996. While making promises of a beautiful high-quality home complete with a full basement, landscaping, alarm system and several financial incentives to go along, the builder knowingly sold the African-American couple a shoddy house for $42,000 more than its true appraised value. Unable to make payments complete and on time while still trying to support their two children, the Ms were finally

served with foreclosure papers in August 2001 and later filed for bankruptcy. The Ms are currently in litigation against the builder and the mortgage company, who they allege acted in collusion to defraud them.

• Mr. T, an elderly man in a metropolitan area, tapped into his savings in 2000 to make a down payment of $13,200 on the $190,000 home he purchased through a local homebuilder. The builder, who supplied the appraiser and lender for the transaction, promised T that in exchange he would have low monthly payments, no closing costs, eight years of tax reductions, his first month free, and additional mortgage subsidies and several amenities added. However, the builder denied T all of the subsidies and incentives that were promised to him. Instead, he was forced to manage with a myriad of dangerous housing problems, such as a defective oil tank, faulty wiring and a faulty furnace. The home also had cracks in the foundation and walls, easily seen flaws that the appraiser somehow missed. A retroactive appraisal later illustrated that T's home was only valued at $147,000, a difference of $43,000. Now aged 77, Mr. T has refinanced through NCRC's CRF program with the help of his daughter.

• Mr. and Mrs. T contacted a developer after reading a newspaper advertisement in 1999. After a salesperson drove them around showing the African-American couple homes near golf courses, country clubs and schools, they soon agreed to purchase a new home for $190,000--a price which they thought was a great bargain. Unfamiliar with the process, the Ts did not have an inspection done prior to closing, and they allowed the builder to select an attorney for them. When they finally entered their home, the Ts saw a broken living room window, no landscaping, loose bathroom tiles, an incomplete driveway and cracked walls. The Ts complained to the attorney who represented them at closing, but the problems were not resolved. The couple then had a retrospective appraisal done, which revealed the home was worth $40,000 less than what it was purchased for.

• In 1998, Mr. and Mrs. V, a West Indian couple, purchased their newly-built home for $147,000. They completed a walk-through inspection prior to settlement, and did not notice any problems, although workers were still there. However, after their closing, they found multiple problems, including basement flooding, cracked walls, doors that did not close, and unsteady railings and stairs. In litigation, the couple discovered that their home's purchase price should have been around $130,000. After a long struggle, the Vs were able to refinance through NCRC's CRF, receiving a 30 year fixed mortgage at 5.64%.

• In 1997, Mr. and Mrs. W, a New York City police officer and manager, respectively, believed they were getting a great value for the $146,000 purchase price of the home they were buying for them and their four children. However, the Ws received a poorly constructed home with problems that include: a cracked foundation, faulty plumbing, an inaccessible attic, grading problems, a faulty boiler, rusted siding, no landscaping and warped stairs. One of Ms. W's new neighbors told her that she had paid too much for the home. The home was then re-appraised at $125,000. The Ws are working with NCRC's CRF in an attempt to refinance.

• A single mom of two, Ms. W-W works two jobs to maintain her mortgage payment. In 1998 she purchased a home for $174,000. The developer told her that she would receive an appliance package, mortgage subsidies, first year's taxes free and a rebate at the end of the year. However, she was never given any of the promised incentives. When W-W's mortgage payments shot up by 30% after the first year, she had difficulty paying completely and on time. A retroactive appraisal later revealed that her home had only been worth $150,000 at the time she purchased it and that she had been the victim of an appraisal scam. Ms. Wright-Watson received a loan from NCRC's CRF in 2004.

• Mr. and Mrs. B are both African American and are retired factory workers who lost wealth that they thought they would pass on to their children when they did a cash-out refinance in 2001 through a local broker. The Bs received a $167,000 mortgage based on an inflated value of $192,000. The couple was notified in 2003 that their mortgage company was trying force the broker to buy back a group of loans on the basis of appraisal inflation. The mortgage company is now litigating. Per the lawsuit, the Bs discovered their home was worth only $130,000. Fifty-three other homeowners living in the same area as Mr. and Mrs. Bs are also involved in the lawsuit for the same reason of appraisal fraud. Since their predatory appraisal, the couple's neighborhood has become economically depressed and they estimate that their home would now only be worth about $70,000. NCRC's CRF was unable to resolve the Bs' issues.

• Mr. and Mrs. W purchased a home in 1995 for $140,000. After experiencing problems with the home, they contacted a local legal aid organization. In litigation against the seller and mortgage broker, they discovered that their home had been sold six months prior to their purchase for only $65,000. Properties used as comparables in their appraisal had also been sold and resold at higher prices in 1995, and by the same parties. The strain of the situation broke up the marriage, and Mr. and Mrs. W divorced in 1998, leaving Ms. W alone to deal with the mortgage payment. Foreclosure was prevented by a refinance through NCRC's Consumer Rescue Fund program. With Ms. W's financial need, a 4.144%, 30 year fixed mortgage was required to remedy the situation.

• Mr. and Mrs. R, who live in a rural area, refinanced their mortgage in 2002 after their home had been appraised at $252,000. However, two years later when they tried to refinance again, the appraisal only came back at only $215,000 and the transaction could not be completed. The R case is currently under investigation.

Call to Action

Develop Best Practices & Voluntary Code of Conduct: A standard set of Best Practices outlining a fair and responsible appraisal process and clearly defining the appropriate roles of all the parties involved must be developed to ensure accountability. In addition, a voluntary code of conduct, with a simple dispute resolution process for all members of the industry, would allow aggrieved consumers and appraisers to stand up to the lenders.

Empower Appraisal Regulators: The state regulatory agencies and the federal Appraisal Subcommittee must be strengthened so they can effectively enforce and oversee regulations that are already in place. As illustrated by the 2004 GAO report, state agencies are not able to investigate a significant portion of reported appraisal abuse primarily because of a lack of funds and staff. Resources must be reallocated to these regulatory agencies if we are to stop the stripping of consumer equity that occurs because of appraisal fraud. Similarly, Congress must strengthen the Appraisal Subcommittee by granting them rule-making and enforcement authority so they can ensure state compliance with current regulations. Without these powers, the Appraisal Subcommittee is not able to properly perform its role in the appraisal process.

Create Whistleblower Procedures with Federal Oversight: Appraisers currently do not have one central agency that they can file a complaint with if they feel pressure from a lender, broker or real estate agent. Because of this, many concerns of appraisal abuse go unreported and unheard. However, if specific reporting procedures were developed and publicized and complaints were directed to one central agency, appraisal fraud would be detected more quickly and effectively and state agencies would be able to better investigate these claims.

Regulate Mortgage Brokers: While last year the U.S. Department of Housing and Urban Development (HUD) released a rule making lenders accountable on mortgages insured by the FHA, no broader regulations currently exist that truly hold lenders accountable for all types of mortgages. Furthermore, mortgage brokers, who according to the National Association of Mortgage Brokers originate nearly 70% of the nation's mortgages, are not federally regulated at all.[31] Without regulations to hold lenders and brokers responsible for their actions, appraisers will continue to succumb to the pressure and homebuyers will continue to be defrauded of their equity.

Prohibit Appraisal Fraud through Comprehensive Anti-Predatory Lending Legislation: Research illustrates that appraisal fraud and overvaluation has become a pressing issue for consumers, communities, and the market as a whole. Congress must enact strong anti-predatory lending legislation that prohibits lenders, mortgage brokers, and other interested parties from pressuring appraisers into inflating property values. Comprehensive legislation, such as the bill introduced by Representatives Watt, Miller, and Frank, would eliminate the profitability of exploitative practices by making them illegal. However, simply prohibiting appraisal fraud, as the bill introduced by Representatives Ney and Kanjorski does, will not fully tackle the issue. For example, federal anti-predatory lending bills should include stringent penalties applied to appraisers, lenders, and brokers for appraisal fraud. Lenders, brokers, and AMCs should also be penalized for not having processes that prohibit the practice of inflating, while appraisers that violate USPAP/FIRREA regulations should face the possibility of a private right of action by aggrieved borrowers. In addition, federal bills need to strengthen the Appraisal Subcommittee and state agencies along the lines suggested above.

[31] Erick Bergquist, "A View of Refi Boom Pressures From the Appraisal Trenches," American Banker, February 5, 2004.

GSEs Must Abide by Anti-Predatory Safeguards: The Government-Sponsored Entities (GSEs), including Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, purchase more than half of the home loans made on an annual basis in this country. It is vitally important, therefore, that the GSEs adopt adequate protections against purchasing loans with inflated values or other types of predatory loans. Fannie Mae and Freddie Mac have already voluntarily adopted significant protections that would stop them from purchasing loans with some abusive features such as single premium credit insurance. The GSEs must have independent third-party audits of, at a minimum, 10% of their portfolios and enforce warranties against all lenders who have violated them due to overvalued appraisals.

HUD has ruled that Fannie Mae and Freddie Mac will not receive credit towards their Affordable Housing Goals for any loans that contain certain abusive features. While HUD's ruling is an important first step, it needs to be enhanced to include loans with inflated values.[32] Furthermore, the Federal Housing Finance Board, as the regulator for the Federal Home Loan Banks, has not formally applied protections against abusive loans to the Home Loan Banks. Congress has an opportunity to further bolster the anti-predatory protections applied to GSE loan purchasing activity as Congress considers GSE regulatory reform this year.

[32] HUD has the authority to disqualify loans from counting towards the affordable housing goals in either the current year or previous years. Hence if a GSE purchased a significant number of loans with appraisal fraud from previous years and HUD discovered this, the GSEs could still be penalized.

Glossary

Definitions derived from www.fanniemae.com, www.freddiemac.com, www.bankrate.com and NCRC.

Appraisal – An appraisal is a written analysis of the estimated value of a property prepared by a qualified appraiser.

Appraisal fraud – The intentional misrepresentation of the value of a property

Appraiser – An appraiser is a person who is qualified by education, training, and experience to estimate the value of real and personal property. Appraisers usually charge one fee for a single-family home and slightly higher fees for a two-family, three-family, or four-family home.

Appreciation – An increase in the value of an item (e.g., the increase in the market value of real estate).

Assessed Value – Typically the value placed on property for the purpose of taxation.

Assessor – A public official who establishes the value of a property for taxation purposes.

Collateral – An asset that is pledged as security for a loan. The borrower risks losing the asset if the loan is not repaid according to the terms of the loan agreement.

Comparables, or Comps – An abbreviation for “comparable properties,” which are used as a comparison in determining the current value of a property that is being appraised.

Easement – A right to the use of, or access to, land owned by another.

Encroachment – The intrusion onto another’s property without right or permission.

Encumbrance – Any claim on a property, such as a lien, mortgage or easement.

Equity – The owner’s interest in a property, calculated as the current fair market value of the property less the amount of existing liens.

Fair market value – The price at which property would be transferred between a willing buyer and willing seller, each of whom has a reasonable knowledge of all pertinent facts and is not under any compulsion to buy or sell.

Flipping – The practice of repeated loan refinancings with little or no benefit to the borrower. NCRC defines "flipping" as the making of a home loan to a borrower which refinances an existing consumer home loan when the new loan does not have a tangible benefit to the borrower considering all of the circumstances, including the terms of both the new and refinanced loans, the cost of the new loan, and the borrower's circumstances. Home loan refinancings are presumed to be flippings if the primary tangible benefit to the borrower is an interest rate lower than the interest rate on debts satisfied or refinanced in connection with the home loan, and it will take more than four years for the borrower to recoup the costs of the points and fees and other closing costs through savings resulting from the lower interest rate. Flipping can also refer to the purchase of real estate at a low price and the subsequent resale to an unsuspecting consumer at a much higher price.

Foreclosure – The legal process by which a property that is mortgaged as security for a loan may be sold and the proceeds of the sale applied to the mortgage debt. A foreclosure occurs when the loan becomes delinquent because payments have not been made or when the borrower is in default for a reason other than the failure to make timely mortgage payments.

Home equity loan – A loan based on the amount of equity a homeowner has in the property. The interest paid on a home equity loan is usually deductible. Unlike a home equity line of credit (HELOC), the home equity loan features a fixed rate, payment and term, usually five to 15 years.

Home Inspection – An examination of the construction, condition and internal systems of a home prior to purchase; satisfactory home inspection may be a condition of purchase.

Loan-To-Value (LTV) Ratio – The relationship between the loan amount and the value of the property (the lower of appraised value or sales price), expressed as a percentage of the property's value. For example, a $100,000 home with an $80,000 mortgage has an LTV of 80 percent.

Low-income – 50 percent and under of median income; can be used in reference to the income level of a borrower or a census tract. The income definitions here are from the Community Reinvestment Act (CRA) regulation.

Middle-income – 81 to 120 percent of median income; can be used in reference to the income level of a borrower or a census tract. The income definitions here are from the Community Reinvestment Act (CRA) regulation.

Moderate-income – 51 to 80 percent of median income; can be used in reference to the income level of a borrower or a census tract. The income definitions here are from the Community Reinvestment Act (CRA) regulation.

Predatory loan – A predatory loan is an unsuitable loan designed to exploit vulnerable and unsophisticated borrowers. Predatory loans are a subset of sub-prime loans. A predatory loan has one or more of the following features:

1. Charges more in interest and fees than is required to cover the added risk of lending to borrowers with credit imperfections
2. Contains abusive terms and conditions that trap borrowers and lead to increased indebtedness,
3. Does not take into account the borrower's ability to repay the loan, or
4. Violates fair lending laws by targeting women, minorities and communities of color.

Prepayment penalty – A fee that a borrower may be required to pay to the lender, in the early years of a mortgage loan, for repaying the loan in full or prepaying a substantial amount to reduce the unpaid principle balance.

Quality Control – A system of safeguards to ensure that loans are originated, underwritten and serviced according to the lender's standards and, if applicable, the standards of the investor, governmental agency, or mortgage insurer.

Real property – Land and anything permanently affixed thereto — including buildings, fences, trees, and minerals.

Retroactive or Retrospective Appraisal – A valuation of real property as of a date that has passed. Retrospective appraisers determine the value of a home by comparing sales of nearby properties of similar quality as the subject property, much like regular appraisers do. As this technique can be more complex since retrospective appraisers must "look back" to previous sales data, the retrospective appraiser should be intimately familiar with the home's neighborhood and should be a senior or supervisory appraiser.

Sale-Leaseback – A transaction in which the buyer leases the property back to the seller for a specified period of time.

Steering – An illegal procedure in which a prospective buyer is shown properties in specific neighborhoods where the residents share the buyer's ethnicity.

Straw buyer – A form of fraud where one person purchases property or takes out a mortgage for another to conceal the identity of the real borrower. Usually the real borrower would not qualify for the mortgage.

Underwriting – In mortgage lending, the process of evaluating a loan application to determine the risk involved for the lender. Underwriting involves an analysis of the borrower's creditworthiness, ability to repay the loan, and the value of the property securing the loan.
Unsecured Loan – A loan that is not backed by collateral

Upper-income – 121 percent or greater of median income; can be used in reference to the income level of a borrower or a census tract. The income definitions here are from the Community Reinvestment Act (CRA) regulation.

NOTES

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