APPRAISAL TODAY

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Will another profession replace appraisers?

By George Dell, MAI, SRA, ASA, CDEI

Some have said that soon appraisers will not be needed. Replaced by electronic intelligence? What if some human intervention is still needed?

Let's compare the **Appraiser** to a new profession – let's call them an "**Asset Prophet**".

WHAT HAS CHANGED?

The appraisal function was invented mostly in this country in the 1930's. The data was owned mostly by real estate brokers, who usually were the default 'experts'. They had the advantage of **data**. They could look at similar properties in an area, and compare them. Two or three sales seemed enough.

Then data happened. MLS and Commercial data came in printed form, then electronically. In most areas, complete or near complete data sets became available, instantly. The appraisal process stayed with the traditional model: 1) pick a few comps; 2) compare them; 3) give your opinion.

What would a new, different profession do instead? What has changed? We can make a short list of what has changed since the 1930s:

- The **properties**: more homogeneous/similar, more value in the land;
- The **data**: complete, instantly available, more numerical than words;
- The **analytics**: instant computation, visual interfaces (stats, graphs, maps).

The key difference is in modeling fundamentals:

- **Appraiser**:
  - Focus on verifying/confirming your "best" **four or five comparables**.
  - Form an exact **point-value opinion**, support that opinion.
  - Avoid any mention of the **confidence** or reliability level.
- **Asset Prophet**:
  - Focus on the outliers, using the ***complete market segment*.**©
  - Document your **replicable analysis**.
  - Provide a "transaction range" and **reliability score**

WHAT WOULD A REPLACEMENT PROFESSION DO?

Asset Prophets, of course, would do things differently. **The difference is in the modeling**. The data, the computer power, are the same for asset prophets and for appraisers. So what would asset prophets do differently?

First, there is no discarding useful information. According to the Fisher Information Function, more information is always better. Up to a point. Beyond that point, however, more data results in more noise. Asset prophets immediately figure out exactly the best data set. Data (sales) which compete directly with the subject are good data, those that do not compete are noise. This then is Asset prophet rule #1: Use the “complete competitive market segment©.”

Next, an asset prophet knows exactly where a computer can help, by applying quick algorithms. These formulas are easy to understand, but need computer calculation. The asset prophet knows exactly where the human brain is required: 1) where practical on-the-ground experience is needed; and, 2) where human superior ability is needed to make modeling decisions.

Data cannot build models. It requires human direction.

Finally, the Asset Prophet will fit the communication to the client. Just as today we have a “scope of work” requirement, there will be a new “scope of reporting” requirement. The way the prophet’s results are communicated depend on the client. Some will understand basic data science concepts and modeling decisions, others will not. Some clients will require a “modified data stream” – electronically transmitted, and flowing directly into their decision dashboard, fully integrated with proprietary risk and forecast algorithms, while allowing human modeling of that decision tree also.

Most importantly, no subjective “review” will be required. In fact, it will likely atrophy, or even be outlawed. As the Asset Prophet’s work is reproducible, a “believability review” becomes obsolete. “Credible” = “worthy of belief” per USPAP definition is no longer necessary. Testability replaces believability. Only assumptions and modeling decisions can be logically challenged.

In summary, Asset Prophets: 1) objectively identify the analytical data frame – the competitive market segment©; 2) apply simple data science tools of classification and association; 3) provide a documented, replicable analysis and result; 4) communicate the results to the *client’s* level of competence.

HOW WOULD THE TWO PROFESSIONS COMPETE?

First, let’s look at the (practical reality) **advantages and disadvantages of the traditional appraisal**.

Traditional appraisal -- *advantages* for the client:

- **Price** is easier to pressure downward. The controlling factor is not quality, but price. Price pressure varies a lot depending on the demand for loan and other valuations.

- It is possible to subtly, directly, or indirectly **influence** the appraiser. Government regulation appears to have simply added to the layers of bureaucracy and direct cost of ordering an appraisal.
- The existence of AMCs (Appraisal Management Companies) enables lenders to push off some of the responsibility of **compliance**. (However, a new level of AMC regulation oversight is added).
- Clients, especially lender/bank clients can push off some **administrative expenses** of directly ordering appraisals, using the “middle man” to send off email blasts to the lowest priced, speediest appraiser bidder. They can also more easily show real or feigned independence of the production and appraisal-ordering functions.

Traditional appraisal – *disadvantages* for the client:

- The appraisal solution is a **point value**. The actual need is a reliability/risk measure.
- There is an analytical/mathematical disconnect between the point value, and the needed risk inputs to **portfolio management** analytics.
- The lack of a **reliability measure** inhibits comparison to alternative valuation products (such as AVMs (Automated Valuation Models), which can provide a fsd (forecast standard deviation).
- **The result is an opinion**. It is always defensible as a personal opinion, not a mathematical, tractable result.

Now let’s look at the **advantages and disadvantages of the Asset Prophecy profession**.

Asset Prophecy -- *advantages* for the client:

- **Price**/**cost** of a ‘Prophesy’ is much easier to estimate. The same algorithms which generate a risk/reliability function can generate an estimate of the work needed, including the needed levels of property identification, description, market segmentation, and analytics.
- The opportunity to influence the Prophesier is dramatically reduced. While this may appear as a disadvantage to the commissioned loan salesperson, it is a major advantage to the ethical profit-motivated lender in the long term. Top management which may not desire this would be suspect.
- The availability of **reliability scoring** (risk rating) integrates fully with portfolio management and speedy dashboard underwriting decision-making.
- The subjectivity of the *appraisal review* disappears. **No judgment of ‘credibility’ is needed** nor even appropriate. It becomes obsolete. Any

remaining judgment centers on the reproducibility of the evidence-based valuation©. Any desired field observation is also reduced to validation, or when necessary, specific disagreement of factual inputs or modeling decisions.

- **Speed** of value Prophesies is quicker. Consistent analytical algorithms are easily re-used by Prophesiers.
- **Asset risk, market risk, and borrower risk can be algorithmically integrated** at the dashboard level.

Asset Prophecy -- *disadvantages* for the client:

- While many appraisers are acquainted with the evidence based valuation© methods, only a handful are fully **competent with the process** from beginning to end. However, my experience in training in this topic tells me that the learning curve is fast, and would respond quickly once the demand-side (lenders primarily) desire qualified Asset Prophesies.
- There may be **resistance** amongst current underwriters, AMCs, review appraisers, and middle management – if they are unfamiliar with the new paradigm.
- Some **investment will be required** to integrate the direct input of the valuation function into the loan processing or other decision-making analytics, as well as some training of the reformed underwriting function.

WHAT NEEDS TO BE DONE?

- **USPAP requires only credibility** (believability). The tests of work scope are: 1) client expectations; and, 2) conformity to peers' practices. USPAP or acceptable professional standards, such as the Appraisal Institute's SVP (Standards of Valuation Practice) – would need to allow for the measure of reproducibility, and analytical **trueness and sureness** (accuracy and variation).
- Asset Prophesiers would need to be trained in reproducible work product. Current AQB (Appraiser Qualifications Board – Appraisal Foundation) requirements would require a major paradigm shift to Evidence Based Appraisal© practices. This set of requirements, once changed, would have the force of the Appraisal Foundation, as "*Authorized by Congress as the Source of Appraisal Standards and Appraiser Qualifications*."
- The Appraisal Foundation has a superior market position, with the power to tax (fees from appraisers and others). As such, other organizations which might otherwise attempt to support a superior public service, standards,

practices, and education toward ethical behavior – would stand little chance against this well-funded quasi-governmental group.

- Education for the new profession requires other recognitions:
  - Inferential statistics are of little or no valid use in valuation. Statistical tests such as *p*-values and confidence intervals relate only to how well a random sample represents a population. It has nothing to do with the correctness of the model applied.
  - "Predictive models are predominant in most valuation settings." (ARE, p.736) Predictive methods impel data science, not outdated inferential statistics. Thus "advanced" appraiser education, emphasizing inferential statistics is of little use toward the future in the Asset Prophesy profession.

WHAT CAN AN INDIVIDUAL APPRAISER DO?

- Some appraisers can qualify to become Asset Prophesiers.
- Market knowledge and much appraisal theory is useful
- Some *unlearning* is necessary. (Jack Uldrich, keynote speaker, AI National Conference, 2016)
- Basic education in data science and software tools is needed.
- Specific training in classification and association methods is necessary. (Primarily the *proper* use of simple regression, contrasting, and control).

About the Author

George Dell, MAI, SRA, ASA, CDEI provides a basic course, approved in most states for appraiser CE: *Stats, Graphs, and Data Science*[1]. For further information visit georgedell.com. Access is free to class information, a link to the voluntary support group of the National Appraisers Forum, as well as useful analytical tools in the files section there. It is our intent to provide tools, insight, and a professional community to share information on preparing for the near-future shift to Evidence Based Valuation Practice.©

I believe that appraisers can survive and prosper.

What's up with Fannie's CU? Risk Scores, public records, comps source, peer discrepancies, new forms, etc.

Primary Source: Fannie Mae Webinar: Appraisal Observations and Insights
March 1, 2018
Presenter: Julie Jones

Editor's note: there was an excellent live demo on what underwriters see when they use CU, including how they can change subject appraisal data in CU to "test" if it makes a difference. I ran out of room to include info and screenshots on it. The demo included changes to "test" the appraisal GLA data to see if it affected value, for example, because a message was generated by CU. The original appraisal data was not changed. Unfortunately, no recording was available. If it is offered again, I will let you know.

Of course, the Q&A with appraisers had the "hottest" issues, extra comp requests, data discrepancies, etc.

About Julie Jones, the presenter

Per LinkedIn, she has been a Credit Risk Analyst III at Fannie Mae since November, 2016. She is the editor of Fannie Appraiser Mae Update and "leads broader communication and outreach strategy to external stakeholders including lenders, field appraisers, industry trade groups, AMCs, investors, and mortgage insurers."

Previously she was a National Review Appraiser at Fannie starting in October 2010. Prior to that she reviewed residential sales and transactions for up 10 real estate brokers for a year. She started appraising in 2001. In 2004-2008 she was a real estate broker.

Julie’s experience in appraising and reviewing made her a good presenter, with examples from her practical experience. Her recent Fannie experience allows her to see the "inside".

Who reviews your appraisals?

- Pre-funding QC by AMC and/or lender
- Post-closing QC by lender on sample of loans
- Loan guarantor (some appraisals) FHA, VA, Mortgage Insurer
- Loan purchaser - Fannie Mae, Freddie Mac or Ginnie Mae
- Loans packaged to Credit Risk Transfer and MBS (mortgage backed securities) Investors (who may engage a third party to review a sample of appraisals in loan pool)

Notes: This does not include correspondent lenders. Depending on the corresponder and the aggregator, either or both may review appraisal.

On 1004 certification you agree to item 21-23 you are agreeing that these entities may use your appraisal.

Appraisal Data Evolution

The old days: typewriters and carbon paper, 35mm camera and glue sticks, MLS books. Very little or no oversight. Maybe a loan officer said you did not hit the value.

UAD (Uniform Appraisal Dataset) standardizing data captured the critical parts of the appraisal. Then data analytics could be used to do messaging back to the appraiser where there are true problems, not just "did not hit value". As of now there are almost 29 million appraisal records. Lenders get real time feedback.

CU timeline

CU started being developed around 2011. In 2013, Fannie started testing it for post-acquisition review. In January 2015 it was rolled out to lenders, who were given messages about problems.

Correspondent lenders and aggregators were given access to CU in 2016. Mortgage insurers were given CU access in late 2017. They are given a minimal amount of data and input certain fields from the lender.

Fannie's FHFA 2017 scorecard recommendations - appraisal modernization - UAD and forms

FHFA is the GSEs' regulator.

Among other scorecard goals, the research and planning for appraisal process modernization was included as a key objective...which could include revised appraisal forms and data requirements.

Assess and, as appropriate, begin implementation of strategies to redesign the Uniform Appraisal Dataset.

"While we are only in the early planning stages of this multi-year initiative ..."

I forecast significant additions to UAD fields and new forms.

Audience question: When will CU be available to appraisers?

"The objective of CU is to assist lenders with assessing property eligibility and appraisal quality. It does not provide approvals or denials, nor may it be used as a basis for a credit decision."

CU was intended for Fannie's customers, the lenders so they could address appraisal quality issues in advance. It has not been a priority to share with appraisers, who are not Fannie's customers.

There is potential value in some of the CU data to appraisers, but is not on the radar now. But, possible is a conversation for the future. In the CU demo you can see what would be useful to appraisers.

There is a very fine line. Fannie wants to maintain appraiser independence. They do not want any of the data provided to the appraiser to influence what they know to be 100% correct.

Audience question: Are appraisers graded?

No. Fannie evaluates the risk on the appraisal report itself.

Appraiser contact initially starts when there is a pattern of issues with an appraiser's body of work that may have an influence on values. The next step is an initial training letter is sent to make the appraiser aware, and a list of the appraisals is included. Fannie contact information is also included in the letter.

See more info below on AQM.

The purpose is to create a dialog, not a "gotcha" moment as there could be very good reasons for the apparent pattern.

CU data

Today, over 3,000 lenders are registered to use CU, with over 23,000 registered users and 28 million appraisal submissions.

What is CU and what CU can actually do?

CU is an appraisal valuation application that Fannie developed internally. It was tested internally before being rolled out to the lenders.

It is designed to help lenders address risks before the appraisal is submitted to Fannie.

It leverages standardized appraisal data and leverages it against market data and analytics. It can highlight appraisals with higher risk, for example where there are appliance violations, over valuation or quality issues.

Lenders get the findings through UCDP (Uniform Collateral Data Portal) and DU (Desktop Underwriter). It is an early check and Fannie encourages them to go into the CU application and learn how to use it.

Fannie has done a lot of lender training.

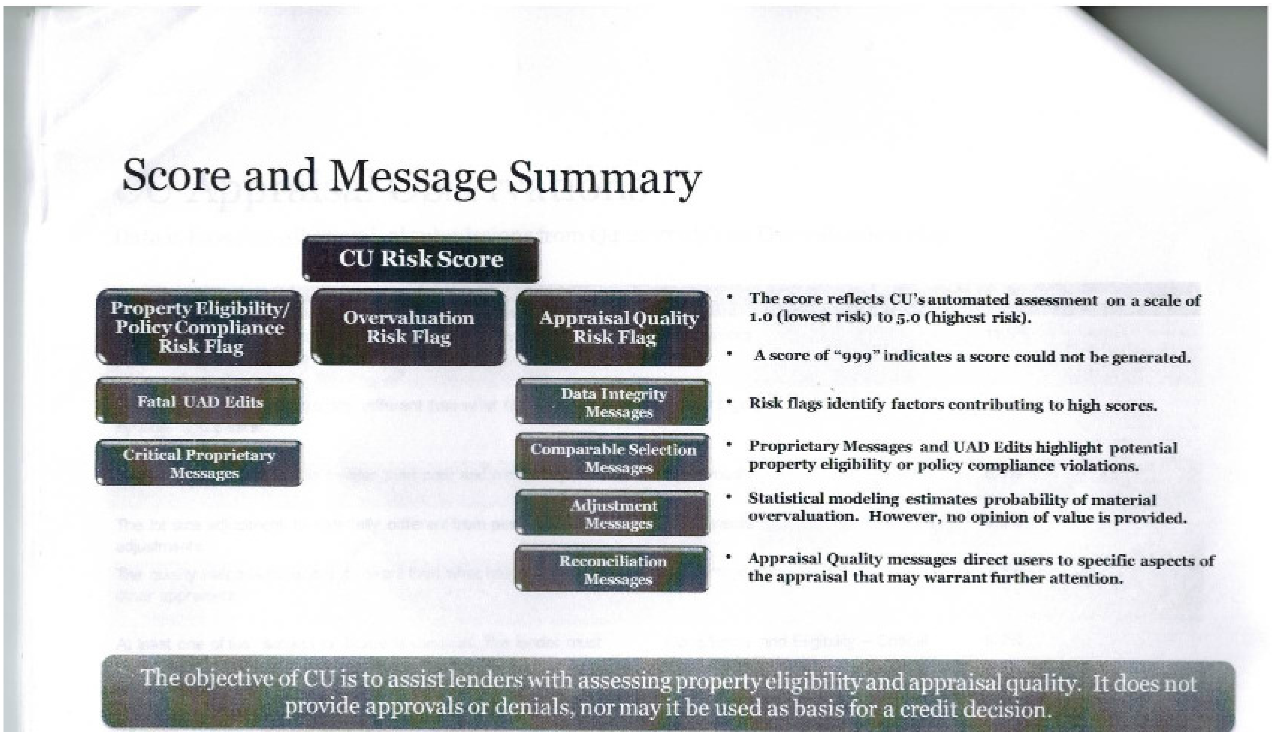
CU Risk Scores

Risk Scores are from 1 (lowest risk) to 5 (highest risk). It does not mean the appraisal is "bad". Thumbs up or thumbs down. It is designed to mitigate risk.

The reason an appraisal would have a higher risk score is that it has potential risk issues and the lender needs to spend more time on that appraisal.

Higher scores are found, for example, on new construction in a new community and CU can't find the new address. If CU can't find the subject, it can't find the comps or market information, then the appraisal would receive a "999" score (could not be generated). The lender is encouraged to use other third party tools to evaluate the appraisal.

In Quarter 4, 2017, around 64% of appraisals were 2.5 or lower. Lenders hope to see fewer revision requests coming.



Risk Flags

Note: these are to notify the lender to look closer at the appraisal, not that there is necessarily a "problem". The lender needs to resolve the issue.

The three risk flag Categories:

• Property eligibility/property compliance risk flags

• Fatal UAD edits - think about Appendix D. If fields are not filled out correctly, it may have a higher score

• Critical proprietary messages - 22 messages now. Something in the appraisal may make it not eligible for delivery. Additional followup is needed. A good example is marking the appraisal "subject to". This is not a quality issue with

your appraisal. It indicates to the lender to get a 1004D.
• Overvaluation risk flag. Fannie's model suggests there may be some overvaluation issues with this appraisal. Lenders do not get an estimated value from CU. Lenders use their own judgment.
• Appraisal Quality Risk Flag
    • Data Integrity Messages
    • Comparable Selection Messages
    • Adjustment Messages
    • Reconciliation Messages

Presenter additional comments on Appraisal Quality Risk Flag messages:

Data integrity messages. Different from other appraisers. For example, you say it is 1,500 sq.ft. and your peers say 1,200 sq.ft. Fannie says inconsistency is worse: changing the data from a previous report that you have completed. In the appraisal you say the subject is a C2, but every other report you say it is a C4. Of course, there could be a good reason such as remodeling. Condition and Quality are frequent messages.

Comparable selection messages - Speaker was surprised this was low because when you are a field appraiser you hear about comp selection.

Adjustment messages are populated - if the appraiser's adjustments are outside of both 75% of peers and model. Example: Net adjustments for comps are materially different from the model net adjustments.

Reconciliation messages - fairly straightt forward. For example your value is $250,000, but all adjusted comps are $150,000 to $200,000.

Most frequent messages in Overvaluation Risk Flag in Quarter 4, 2017

Read this list to see what Messages are most probable
• 11.8% The appraiser's net adjustments for the comparable sales are materially different from the model net adjustments.
Adjustment Category
• 11.0% The condition rating is materially different than what has been reported by other appraisers.
Data Integrity Category
• 8.9% The condition adjustment is smaller than peer and model adjustments.
Adjustment Category
• 9.3% The lot size adjustment is materially different from peer and model adjustments. *Adjustment Category*
• 7.3 The quality rating is materially different than what has been reported by other appraisers. *Data Integrity Category*

• 5.7% At least one of the "subject to" boxes is checked. The lender must obtain a certificate of completion, stating the nature of the "subject to" issue has been resolved before loan delivery.
Compliance and Eligibility - Critical Proprietary Message.
• 4.7% The GLA adjustment is smaller than peer and model adjustments.
Adjustment Category

How many messages are sent?

Almost 83% of appraisals have less than 3 messages.

No. of messages	% of appraisals
0	32.5%
1	31.5%
2	18.9%
3	9.5%
4	4.3%
>=5	3.3%

Most frequent messages

Data integrity (42.5%) and adjustment (40.6%) messages are the most frequent messages.

Reconciliation (1.2%) is low. Comp selection is also low (9.8%).

What were the most frequent attendee questions?

Data integrity had the most questions.

Appraiser Quality Management and Do Not Use list

The next step is AQM. Very few appraisers have been added to the do not use list. Fannie has "fewer than 10" appraisers on the list.

For egregious issues, such as this implausible work standards example: one small appraisal shop with two appraisers that is turning out 100 appraisals a month. Licensing problems are also an issue. It is a very intensive manual process and not a grading process.

Every month about 40,000 appraisers have reports submitted to Fannie.

When persistent deficiencies are identified within an appraiser's body of work, the Appraiser Quality Monitoring (AQM) team sends training letters detailing the issues along with a list of associated appraisals. Feedback and responses are not only welcomed, but are encouraged.

After a six-month period, if the appraiser's body of work has not improved, a follow-up training letter is sent to that appraiser.

In 2017, a total of 965 initial training letters were sent and only 45 follow-up training letters were sent. That's a 95 percent improvement in appraisal quality.

Audience question: peer discrepancies

If Q or C, your photos should prove your ratings. Be sure your rating fits the UAD definitions. You cannot control what your peers do. You can only control the quality of work that you do. How you reply is a business decision. But, the speaker recommended educating the lender and supporting your opinion. Your peers may be wrong. When the speaker worked in Fannie QC, she had instances where the appraiser was the only one who was correct.

CU is not a standalone. It is a starting point. It is a manual review process that CU assists. Fannie is not looking for conformity.

The messages call out an inconsistency and a need for lender attention.

Audience question: A number of appraisers getting requests to address multiple comps (10-15) generated by CU. Is this something Fannie is expecting from lenders?

No. Sending the full list of 20-30 comps is not what they want. Fannie tasks the lenders to read through the information provided in CU. Read the appraisal report to see if the appraisal said why they did not use the comp or used another. Due diligence should be done by the lender. Not just copy and paste.

Audience question: Does CU leverage public record data in data discrepancy analysis?

Fannie does not model on public records: uses peer data.

Audience question: When the appraiser is asked to comment on data discrepancy, but is not provided with any data by the lender what do you do?

This is a business decision on how to handle this. When the speaker was a field appraiser, she used to get "whacky" requests from lenders. If you cannot respond and can't defend yourself, you are perfectly within your rights to request the data from the lender. As a former appraisal business owner, the speaker recommends being very thoughtful in her response just to maintain positive relations with the lender.

Audience question: Where are the CU comps sourced? Where do they come from?

All of Fannie's comps come from their appraisal database, provided by appraisers.

Audience question: When will the Fannie forms change? They have not been updated since 2005.

The forms are "under review". Changes are coming, working with Freddie and soliciting feedback from industry stakeholders. Under the umbrella of "appraisal modernization"

On their plans is revisiting UAD fields.

Editor comments: the current forms were not designed for data. Some of the fields have standardized data, but many do not. Other data is not on the current forms. I can definitely see web-based appraisal "forms". Data analysis, software and apps have changed dramatically. Also, FHFA, the GSE regulator, has been pushing for modernization.

Fannie's recommendations for appraisers

• Be Nimble. Your ability to embrace change, adapt, and learn new technologies is essential for an informed dialogue.
• Keep Yourself Informed. Use resources like the Appraiser page and the Selling Guide to stay current on the most recent policy changes.
Make Your Voice Heard. Provide constructive feedback through appraiser trade groups or directly to Fannie Mae.
• Accurate and consistent data is the key. Double-check sales prices and property attributes with MLS data, public records, and other available resources. If you use comparable sales in multiple reports, be sure data is accurate and consistent with prior reports.
• Make market based adjustments for time, location and property attributes. ... Statistical analysis techniques such as regression can be effective tools for discovering market reaction.
• Provide your clients with thoughtful commentary and responses to lenders' questions. ...This can reduce further requests for correction and clarification.
• Keep yourself informed. Staying current on the most recent policy changes is the best defense against unnecessary appraisal revision requests.
• Be nimble. Your ability to embrace change, be adaptable, and to learn new technologies may increase the transparency of your appraisal results and improve process efficiencies.
• Know that reliance on arbitrary guidelines may have unintended consequences.

What does this mean for you?

George Dell's article in this newsletter has a good analysis of the effects of

data on appraisals.
CU is only used for Fannie loans. How to avoid CU:
• Jumbo loans: - Specialize in high value properties in your area. there are not many appraisers who do this.
• Do non-conventional loans not sold to Fannie, such as private money loans
• Don't work for AMCs, who do not assign work by loan amount.

When will it change? Fannie is very conservative and changes slowly. It is definitely coming. The relatively recent 2008 crash is holding it back. But, markets (and regulations, etc.) are cyclical. Collateral requirements will loosen up.

Where to get more information

Send questions and comments using the new
www.fanniemae.com/singlefamily/appraiser-contact-form
www.fanniemae.com/singlefamily/collateral-underwriter - main CU page
www.fanniemae.com/singlefamily/appraisers - appraiser page

Collateral Underwriter or Collateral Underminer: Risk Score Manipulation?

By Brian Musto

Editor's note: Brian called me a few weeks ago and left a message about a problem he was having. I get a lot of these calls, but they are almost always just complaints that many appraisers have: low pay, stupid requests for changes, etc. But, Brian had something I had never heard about and I asked him to write an article about his experiences. Below is his well written article about his problem with a client manipulating risk scores by asking him to change his appraisal. Many thanks to Brian. He attended the same Fannie Mae webinar I wrote about in this newsletter. The webinar included a live demo of tests can be done to see how changes in data from the appraisal could affect other factors such as value. The original appraisal cannot be changed. The lender has to ask the appraiser to change it.

I have been engaged in the practice of real estate appraising since 1985 and over the last several years have completed thousands of residential appraisals for the mortgage industry (for many, if not most, of the larger institutions in the industry).

With the advent of FNMA's Collateral Underwriter, from time to time I would get a request from a lender to review data/sales and comment as to why they were not used, or to add them if applicable. On average I estimate that this occurred a total of 5 times a year (versus the hundreds of assignments completed).

I recently was recruited (and added) to be on a panel for a lender that was expanding into my market/coverage area. I began receiving assignments on a weekly basis, and after completing a number of reports I noticed a trend that was uncommon to all of my other clients. Routinely this new client would send me a report critique/revision request based on the fact that FNMA's Collateral Underwriter had indicated a risk score of 2.5 or higher (FNMA Collateral Underwriter risk scores range from 1 to 5, with 1 being the least risk and 5 being the highest risk). I would review the request and provide a detailed written response.

As time progressed I realized that I was regularly receiving these requests from this one lender (on a weekly, or at the very least a couple of times a month), while I was completing similar assignments in the same market areas with the same/similar data and methodology for many other lenders and not getting any requests. It gave me reason to wonder if I am doing similar work in the same market areas for many different lenders/clients, why am I only getting these requests from one lender?

In the case of this particular lender there was consistency to the requests in that they were related to FNMA's Collateral Underwriter and when a risk score was greater than 2.5. In my discussions with the lender's reviewer it was revealed that if a risk score is 2.5 or less the value of the collateral is guaranteed and there is no risk of loan buyback by the lender. My question to the lender was then "is it your expectation that every score (report) will be less 2.5 or less?", to which the response was "wouldn't you".

With this experience I began to closely look at my reports for this lender, their feedback and "CU" risk scores.

In most instances the risk score had nothing to do with the quality of the appraisal presented, but that the report did not align with data collected and regurgitated by "CU". Routinely, on reports where a risk score was more than 2.5, this lender would recite "peer model adjustments", "peer model comps", and "over valuation" as being factors indicated by "CU". My response would be "what if the CU information is inaccurate or not relevant?". In some of these instances "CU" was not in line with the most sound/routine of appraisals.

For example, in appraising a 2 bedroom 2 bath condominium that was under contract for sale for $325,000 (and reflective of an arms length transaction), the appraisal submitted contained all 2 bedroom 2 bath sales that were recent with a price range of $315,000 to $335,000. "CU" rated the appraisal a 5, and here is where it gets interesting. The 5 rating was as a result of the appraiser not using a sale of a larger higher priced ($400,000) unit in the subject building (that would not be market recognized as competitive). By adding said sale to the appraisal the risk score dropped to 2.5 or less.

In another example a property was being appraised for a construction loan. A total of four sales were used from the immediate neighborhood and ranged in price from $1.4M to $1.45M. These were custom high end (for the market) dwellings that offered minor differences in bedroom count, bath count and GLA, but clearly the market demonstrated little if any recognition for said differences. The appraiser made no adjustments. "CU" gave a high risk rating as "peer model adjustments" were different than the appraisal.

In a third example, a 4 bedroom 2 bath property was selling for $625,000 and the comps provided in the appraisal were all on the subject street, in close proximity and ranged in price from $615,000 to $645,000. "CU" gave a high risk rating and suggested a comp that sold on a different street at $735,000 and another comp at $540,000!!

In these examples it seemed to be common sense to me that reports with limited price range variances and few adjustments are reflective of appraisals that represent the most relevant/similar data in comparison to the subject property (versus data that offers a greater price variance and more adjustments, i.e., less similar and generally reflecting a wider margin for error in valuation).

In each of these cases the lender requested the appraiser address these differences rather than review and correlate the reasonableness/accuracy of "CU" findings. It was further suggested by the lender to use data by "CU" in an effort to influence the risk score to be less, hence reducing the risk of the lender and manipulating "CU".

As a result I decided to conduct some additional research as it related to "CU" and lenders' practices. I reached out to underwriting departments of a number lenders, fellow appraisers, loan officers and attorneys.

My concern(s) included the fact that I felt I was being unduly influenced to change reports or add data that was less comparable, which in turn could be construed as being misleading or misrepresenting, as well as adding data to the "CU" data base that could be construed as credible, when in fact it appears that there are certainly some flaws to its reporting and use.

In speaking to other lenders and underwriters I found that the typical routine for higher risk score is to review the appraisal versus the "CU" findings and correlate the data, prior to going back to the appraiser. Essentially, the lender has the ability to reconcile whether "CU" findings are relevant or not without going back to the appraiser, and/or trying to manipulate the risk score.

When I discussed this with other appraisers I was surprised by many that suggested adding the data and then explaining that no weight was given to said data and why. My response to that is simple, when did appraising become adding data to a report that is not relevant to the methodology and reasoning used? In the "litigation era" and in an era where reports are reviewed multiple times, in my opinion you expose yourself to liability with such a practice. I have been an expert witness in court throughout my career, I can't imagine being on a witness stand and explaining why I added a comp that has no relevance because the client wanted it in the report?

(Editor's note: I did this when I worked for lenders. For example, all three approaches were required on a commercial appraisal. For owner user properties in my market, the Income Approach was typically much lower than the Sales Comparison. I included it and said it was a client request and given no weight. I would never do this now if it was a lender appraisal that was going to be risk scored.)

Each attorney I spoke with agreed that the process is flawed and that there seems to be legal issues with the process. But, the reality is the appraising community is the "little guy" with no leverage/voice.

My next step was to gain more knowledge of "CU" and be as informed as possible. I reviewed data on FNMA's website and attended a webinar, which was helpful, but I am not sure that it provided any clarity. Did you know that 60% of appraisals receive a risk score of 2.5 or better on initial submission, which means 40% don't! So does that mean appraisers are only good 60% of the time, or "CU" fails to recognize a quality appraisal 40% of the time?? FNMA has over 29 million appraisals in its "CU" data base. I'd like to know what the score ratio is for the entire database!

What I gathered from the website and webinar is that "CU" is collecting a great deal of data, but there was no clear explanation as to how it is weighted or used in creating a risk score. Certainly the standard "time and distance" are factors as well as UAD classifications, but it does not distinguish location versus proximity. (I had an appraisal whereby 2 properties were on the same street with one backing to residential and the other to commercial, and "CU" did not recognize a distinction).

Terms like "model peer adjustments" and "model comps" are also an issue as "CU" is making the general assumption that said data is accurate, wherein it may not be accurate or relevant to the property being appraised. Finally, and perhaps the most disturbing aspect of "CU" is that you can manipulate a risk score by merely adding or using data that "CU" suggests!! Does that not seem like being unduly influenced to misrepresent and use misleading information!

About the author

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What really happens with State Regulator USPAP Enforcement?

By Barry Bates, former Senior Property Appraiser/Investigator

Please see the last page of this newsletter for flow chart of enforcement.

Editor's comment: Barry has a long, varied career in his 42 years appraising, from trainee to lender management, to self employed appraiser, back to management and finished his career a Senior Property Appraiser/Investigator worked for the California Bureau of Real Estate Appraisers (BREA). I have known him for over 30 years. He can be a bit "off the wall", is always humorous, an entertaining speaker and a writer with lots of "insider" info. He is in failing health. I will miss him. I plan on publishing his articles on at www.appraisaltoday.com.

Barry's comment: I was going to make this article a theory piece about the validity of the market approach, but by the time I got to the end of the thought, I was asleep.

Purpose and Background

As my career as an appraiser/article writer draws to a close (June, probably), I decided I hadn't delivered what every other writer has tried to do: give appraisers in general some helpful hints about avenues to avoid in order to maintain your peaceful and quiet relationship with your state appraiser board, bureau, board or department, which has blessed you with a license and really doesn't want to take it away.

The goal of USPAP enforcement is compliance, not punishment. So the wishy-washy book of rules was designed to be loose enough so as not to destroy anyone's livelihood.

The bottom line is that serious errors are only that: the perpetrator may need to pay for it or get more education, usually both as a way to improve COMPETENCE without throwing the baby out.

On the other hand, if the appraiser's CONDUCT shows A DELIBERATE ATTEMPT TO DECEIVE, the general view is that the perpetrator should suffer some limitation to his/her license in order to protect the public. Revocation is sometimes the only answer, but even that bad actor can ask for the license back in

5 years.

Keep in mind that state appraisal agencies are children of FIRREA, and in most states operate as the appraiser licensing entity. Enforcement in California, because of the relatively high population of appraisers, operates separately from licensing.

Most agencies seem to do a good job of improving the competency of appraisers (a hot topic these days) by calling them on the carpet to explain their questionable reports, and by offering a hearing at which the appraiser may present his or her side of the story.

Advice to appraisers on dealing with state boards

I recommend "lawyering up" once you've received a letter demanding your report(s) and work file(s). At this point, it's wise to engage an attorney to provide support for a lenient outcome at hearing, even when you truly believe in the quality of your reports.

As long as the federal government is interested in licensing and enforcement, appraisers should adopt a humble attitude when dealing directly with their assigned investigator. Don't come out of your trench as the Incredible Hulk. It will not help you or your case.

I've cited and interviewed several appraisers who told me, during the phone interview, that I was not competent to review his or her work, the appraisal practice is super-specialized ("I only do oil rig appraisals using the profit approach".)

The Hulk usually doesn't fare well if s/he claims the investigator was biased or incompetent. In interview, such claims would irritate me to the point where I would not extend a helping hand, being convinced it will be bitten off. Should you decide to lawyer up, you can address your anger problem up front and bring him/her into the interview, or have him/her take care of all interface between you and the bureau's investigator.

Because I think I'm pretty sure of my intelligence, I am offended by the bull in the china shop and become indisposed to cutting slack. Such behavior leads me to turn over every stone on the Respondent's appraisal path.

I mean, I was not the sharpest knife in the BREA drawer, by a long shot. Tina (not her real name) was an encyclopedia of regulatory information. The rest of us trusted her over the actual laws and regulations. Gerhardt (not his real name) and Heilig were unmistakable geniuses.

One of them was always given the tough investigations because we all knew that s/he never lost a case at a hearing. Like many other appraisers, s/he truly had a legal mind and an astonishing talent for critical thinking (outside the box). SO, don't try to bully them, or lie to them Even a newbie with a residential license is not hired at BREA without displaying notable intelligence.

My last job - state investigator

In December of 2014, I went to work as a Senior Property Appraiser/Investigator for California's Bureau of Real Estate Appraisers.

At 69, I was still running on all six mental cylinders, and I thought I could bring my "real world" experience to bear in investigating complaints, filing a comprehensive report and, if necessary, appear at any hearing or court process related to the complaint, and win my case.

I had no preconceptions or bias with respect to the Bureau's functions or effectiveness as a licensing bureau or enforcement structure.

I had never had a complaint on my license (not bad for 25 years, partly perhaps because of management jobs inside lending institutions and securities advisors. I'm certainly no angel.

It's hard to be disciplined as an appraiser when not doing appraisals. I started in 1972 and entered the management suites just when licensing came into being in the early 1990s. If I had ever received a complaint, it would have been for inadequate comp selection. I remember stretching a few at the Money Store, before I became its Chief Appraiser. I was doing commercial fee assignments for their commercial lending activities.

To my memory, I never was guilty of bad CONDUCT while appraising real property, but I had that gut feeling appraisers get that Comp 1 wasn't really the best. I'm not emotionally mature, so I still have a sense of justice and fairness.

Appraiser issues

One tendency I observed in the cases I handled as an investigator (most ended up as citations with fines) involved appraisers who didn't know how they got into trouble in the first place, sometimes even after a comprehensive verbal explanation.

Another sizeable contingent knew better, but were just hoping the shortcut wouldn't come up.

The most frequent reason for citation was a lack of understanding how complaints come up and how enforcement works.

The vast majority of cases I worked involved employing "creative" valuation methodology; in nearly every case, if the appraiser had honestly picked the most recent, proximate, and similar sales and listings, there might still be a complaint, but there wouldn't be a prosecution.

Gerrymandering appraiser geographic areas

Few appraisers have an idea of the enormous amount of complaints that are closed while still in the Bureau's inbox.

These are often complaints by appraisers trying to gerrymander their appraisal territories. At BREA, my fellow investigators would greet such cases with murder in their eyes, though they studiously maintained reserve so as not to let their desire for execution affect their decision. Trying to get another appraiser blacklisted is not a crime, though it should be.

Where to find out about your state's disciplinary guidelines

In California, the BREA's (website refers you to the Business and Professions Code, Sections 14400 and following. When you're uncertain about any aspect of discipline, this is a good place to start.

To find information on what your state regulator does, drill into your state agency website. There are disciplinary actions with complete backstories that will amaze and entertain.

Conduct vs. Competence

The bottom line is that violations of conduct result in license restrictions like suspension or revocation, where technical errors are usually treated as failures in competency.

The thought is that competence can be improved if the spirit is willing (fines and courses), while bad conduct is too often an incurable dysfunction of character (license denial or revocation, suspension, abridged, etc.).

If you fail to make child support payments, could that be a conduct violation? Yes, because USPAP requires compliance with all local (state, county, city) laws and regulations (technically). Claiming you paid, then having an investigator find out you didn't, results in a conduct violation.

Is not making those payments a slimy thing to do (conduct)? My tendency to say "yes" is interrupted by remembering how broke I was after my first divorce, when a $400 monthly child support payment seemed so, so unfair.

Can my license be restricted to appraising detached single family homes just because I missed a few? Yes, because it might be shown that the Respondent DELIBERATELY LIED during the interview.

Citations (in California)

SO, if you get a CITATION (at least in California), you'll know the state is only claiming incompetence on your part which can be fixed by a moderate fine and a few specified real estate courses (which may NOT be used for continuing education credit).

Failure to drive by comps investigation

Some appraisers, who know what they're doing amounts to bad conduct, think they can hide the conduct aspect of the penalty because although they used Google Street Views on five drive-bys, they could still claim that they physically inspected the properties. That has a good chance of escaping notice.

But, if somebody complains that the properties were not inspected, a highly trained investigator will take the report apart pixel by pixel.

The complainant (a bank) suspected non-location, but the investigator discovered that every single subject and comp photo were Google Street Views. The drive by form requires physical presence when taking subject and comp photos.

When I searched the properties that I could collect from the bank's order log to compare order with delivery. I was ecstatic that on at least 3 reports, order vs. delivery was impossible. On the first one, he would have to have driven the 784 miles from Escondido to 265 mph up I-5 to get there.

Then my hopes were dashed when he claimed to have used his airplane. Fortunately, on Google, the photos were so recent as to have been identical (shadows, angles, distance, etc.).

I'm especially grateful for our Sun, because I've caught many a bad actor by proving the time of day was incorrect or the evening shot was really 8am. I remember being very disappointed when I realized that I still had no concrete proof that the dude did not inspect because all I could PROVE was that the pictures were not taken on site.

Then I realized I was finally able to prove non-inspection by two of his unrelated appraisals in San Diego County from the bank's log, done the same day he did 3 of the drive-bys that were 784 miles from his office. This proved he had lied to an investigator; that's CONDUCT because he concealed a crime (there's a state law).

Bad conduct in the context of Consumer fraud

In USPAP, the restriction of licenses presumes bad conduct in the context of consumer fraud.

Fraud is "intentional perversion of truth in order to induce another to part with something of value or to surrender a legal right (Merriam-Webster), or, alternatively, [an] intentional perversion of truth in order to induce another to part with something of value or to surrender a legal right."

Appraisal fraud usually involves the fabrication of data to support a value conclusion higher than local market data would support.

Fannie's most important red flags: Conduct or Competence?

Here's what Fannie thinks are the most important red flags in a biased appraisal report (they should not surprise anyone, and they mirror the opinion of most state agencies.

Ask yourself in each case whether bad CONDUCT had to have been involved; or what would have made it just a COMPETENCE issue):

1. Appraisal ordered by a party to the transaction (you'd have to prove you didn't know; the investigator would have to prove you did)
2. Occupant shown to be tenant or unknown (may indicate buyer is already in occupancy or identity of seller is not known or is being concealed, or the property is vacant)
3. Owner is someone other than seller shown on sales contract (the classic indicator of appraisal fraud [deliberate misinformation, named seller is not in title, appraiser has not read sales contract)]
4. Appraisal indicates transaction is a refinance, but other documentation reflects a purchase (indicates a a buyer, seller or borrower in trouble, needing cash immediately)
5. Purchase price is substantially higher than predominant market value (by far the most frequent violation of USPAP, including the Ethics Rule. The object is to put soft dollars into a borrower's hands (sometimes it's the lender's fraud, sometimes the appraiser's, sometimes the buyer, but the appraiser is always the sitting duck)
6. Purchase price is substantially lower than predominant market value (rare, but if dishonest, usually means a buyer or borrower is attempting to acquire property at fire sale price)
7. Subject property obsolescence is minimized. Another very frequent competence or conduct violation. Property is presented as better located or in better condition than is actually the case. This is usually done to convince reader that the distant, dated and/or dissimilar property is really the opposite. The most costly frauds are in this category when it's not disclosed that the house abuts a sewer treatment plant. This is another reason not to falsify pictures.
8. Large positive adjustments made to comparable properties (see #5 above)
9. Comparables' sales prices do not bracket the subject's adjusted value (well, duh; see #5 above)
10. Comparable sales are not similar in style, size, and amenity (see #5 above)
11. Dated sales used as comparable sales (usually a ploy to overvalue in a declining market)
12. Significant appreciation in short period of time (applied to comps to make them

look worse)
13. Prior sales are listed for subject and/or comparables without adequate explanation

Note that nearly all of the above could be avoided by care in selecting the most recent, proximate and similar comps.

Reasons for appraisal fraud over-valuation

Investopedia defines "appraisal fraud" as "A form of mortgage fraud, whereby the value of a home is deliberately appraised above its market value.

The overstated value obtained through Appraisal Fraud is commonly used to:

" Help a seller get a better price than the market would warrant
" Help a buyer get financing because the mortgage amount could be much less than the appraised value of the home
" Help a homeowner get a preferable refinance, or home equity loan

Appraisal fraud can occur when an appraiser is in on the scam, and dishonestly overstates the value of the property. It can also occur when the homeowner, seller or purchaser physically alters an "honest" appraisal using methods such as digital editing, as well as the old tricks noted above.

Remember, you can be accused of appraisal fraud (and "possible jail time") if you deliberately misrepresented the subject or comparable properties in order to inflate or deflate the conclusion. Just ask yourself, "Could what I'm doing potentially harm anyone, financially or otherwise?"

It would be easy to write down an appraiser's ten commandments, but that risks the use of them by ignorant or crooked appraisers.

To me, pushing values just to keep the work flowing in takes all of the fun out of appraisal because although you may still work confident of earnings, you will confront an ever-growing ball of fear in your gut that you may be "outed" at any time.

I can remember how proud I would be when I could argue down a loan officer in the presence of his boss, noting what he/she did to falsify info before giving it to me.

1004 most abused fields - See next page

In closing, let me walk through the 1004 with a list of fields and stating whether they are most commonly the result of incompetency (rampant in the world of AMCs) or conduct.

I have avoided the least abused fields in order to give you a useful commentary on how susceptible appraisers are to the issue of conduct, sometimes being completely unaware of their wrongdoing. It doesn't happen a lot, but it happens.

And your public reproval probably means an end to your appraisal career.

I haven't even gotten to half the 1004 front page. More to come.

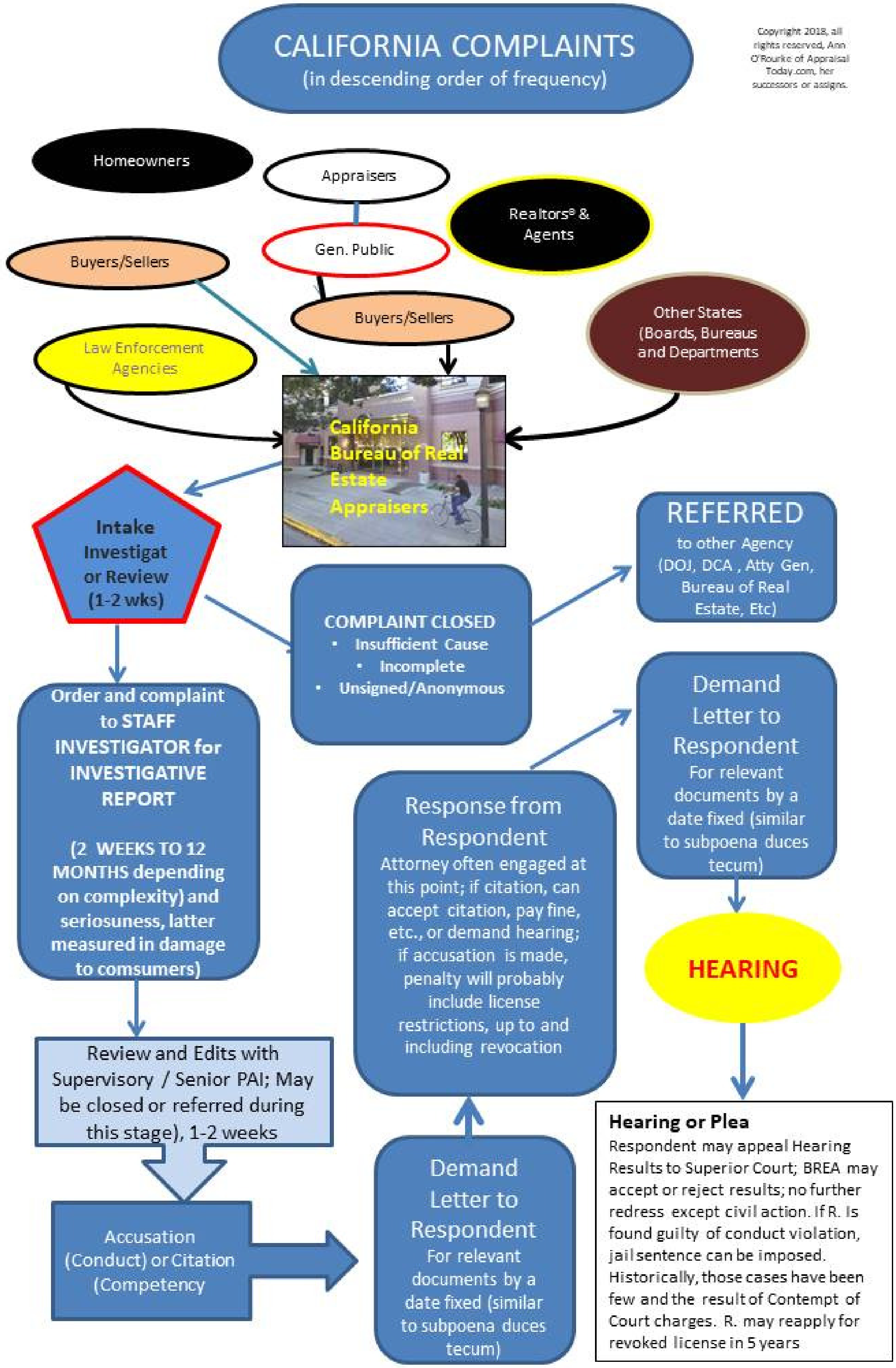
About the author

At 72, Barry has had wide-ranging experience and a technological perspective in a fast-paced career that serves as a testament to the fact that he has never been able to hold down a steady job.

He is now "retired" and lives in Pittsburgh, Pennsylvania with his wife, Kathleen and their two dogs. He writes for real estate publications and, in his own words, tries to get into more trouble.

In 2008, he filed whistleblower suits against MERS (on behalf of county recorders) in 12 states, all of which failed miserably.

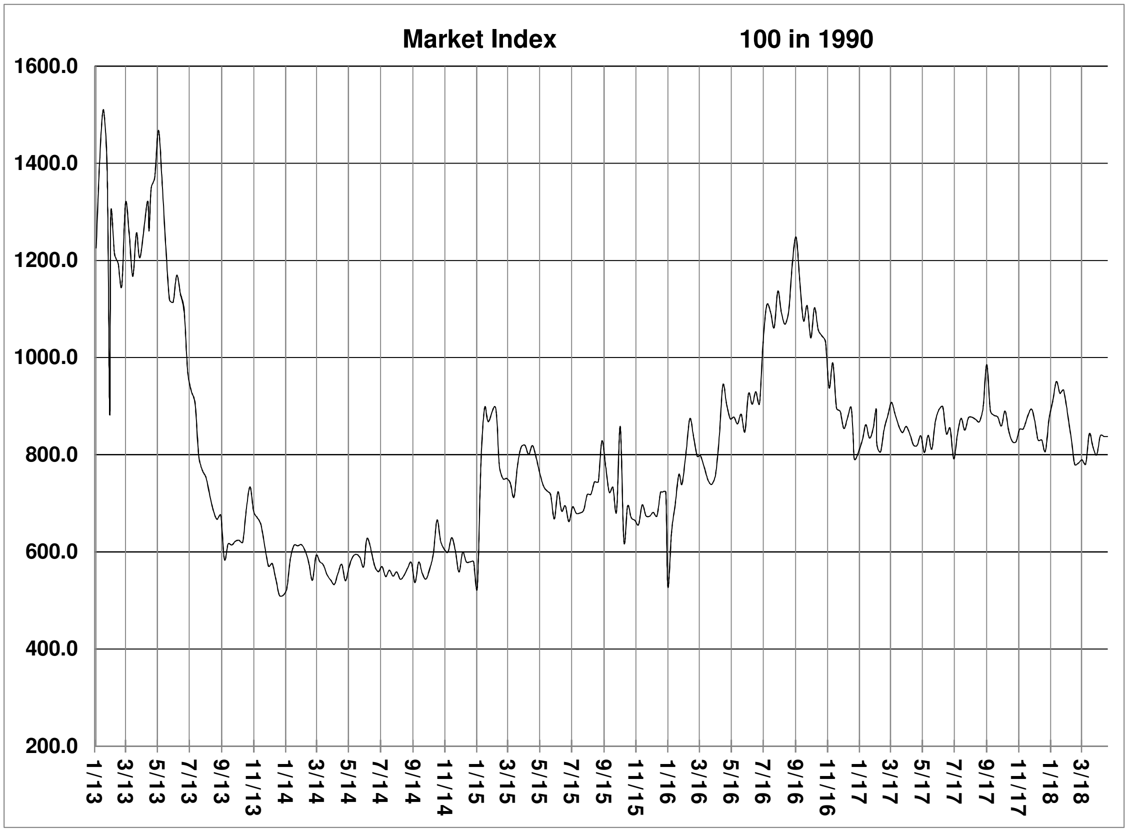
Barry Bates wants to hear from you! Send your comments and criticisms by email. He can be reached at barrettbates@gmail.com.


CALIFORNIA COMPLAINTS
(in descending order of frequency)
Homeowners
Appraisers
Realtors® & Agents
Gen. Public
Buyers/Sellers
Buyers/Sellers
Other States (Boards, Bureaus and Departments
Law Enforcement Agencies
California Bureau of Real Estate Appraisers
Intake Investigat or Review (1-2 wks)
REFERRED to other Agency (DOJ, DCA , Atty Gen, Bureau of Real Estate, Etc)
COMPLAINT CLOSED
• Insufficient Cause
• Incomplete
• Unsigned/Anonymous
Order and complaint to STAFF INVESTIGATOR for INVESTIGATIVE REPORT
(2 WEEKS TO 12 MONTHS depending on complexity) and seriosuness, latter measured in damage to comsumers)
Demand Letter to Respondent
For relevant documents by a date fixed (similar to subpoena duces tecum)
Response from Respondent
Attorney often engaged at this point; if citation, can accept citation, pay fine, etc., or demand hearing; if accusation is made, penalty will probably include license restrictions, up to and including revocation
HEARING
Review and Edits with Supervisory / Senior PAI; May be closed or referred during this stage), 1-2 weeks
Accusation (Conduct) or Citation (Competency)
Demand Letter to Respondent
For relevant documents by a date fixed (similar to subpoena duces tecum)
Hearing or Plea
Respondent may appeal Hearing Results to Superior Court; BREA may accept or reject results; no further redress except civil action. If R. Is found guilty of conduct violation, jail sentence can be imposed. Historically, those cases have been few and the result of Contempt of Court charges. R. may reapply for revoked license in 5 years

Temptations in the 1004 (by field name).

Field Name	Error or Ethics? Competence or Conduct? Most often? Which?	
Address	Missing/wrong	Error
City	Missing/wrong	Could be either or both. Good way to avoid disclosure of zoning or lawsuit issues.
State	Missing	Error
County	Missing/wrong	Error, sometimes used to conceal zoning issues
Legal description	Missing/wrong	This field is a playground for appraisers too dumb to know why it's important. Those folk just take it from a secondhand data source like DataQuick without verification. This is the kind of field that makes an appraiser the object of a civil suit, claiming that the appraiser's negligence in relying on secondhand sources resulted in serious financial damage to a buyer who did not want a house on an oil pipeline, which the appraiser could have discovered by calling the city planning department when she saw the funny dashed lines running across the assessor's plat. Making sure of the subject's zoning and legal status is essential. While you're on county websites, dig down to the subject and you'll also find out stuff like delinquent taxes, etc.
Occupant	Wrong	Essential to avoid prosecution; if wrong, often an intent to deceive as to nature of transaction
Property type	Missing/wrong	Usually a conduct issue, trying to hide monthly dues, condo ownership
Assignment type	Wrong	Misrepresentations are rampant between refinance and purchase. Underwriting is more lenient in refi's, but there are many other reasons to misrepresent.
Data sources	Error or Misrepresentation	My pet peeve: please don't say you reviewed the sales contract if you did not, and don't call it a contract if it is not signed and dated by buyer and seller. Usually this is just sheer laziness. Be aggressive when transaction parties won't send you a copy You may never otherwise know about the race car included in the sale price.
Seller owner of record?	Error or Misrep	NEVER fail to verify occupancy or ownership. It's the nexus around which frauds are perpetrated. NEVER fail to ask for a title report. You don't have to get it, but if they say no, ask why.
Urban, Suburban, Rural	Error or Misrep	98.6% of appraisers have issues with this. An old underwriting rule said that you had to reduce the loan-to=value ratio by 500 basis points if the property is in a rura area. Result = pressure on appraiser to never state rural. Remember, an authoritativ source takes the heat off you! I invented RUSTI, a determiner of status by zip code It's free, use it. Coming soon hopefully (technical issues).
Neighborhood Section	Error or a chronic conduct issue by assuming property location	Many appraisers don't think this section is important, but when it's wrong, it can be both a competence and conduct issue. Market condition is the one thing left that appraisal clients need and assume that the appraiser's word is golden. When too many practitioners "make it up" or fail to disclose that some or all opinions may be from secondhand data sources. If you're not going to do it, disclose it.

MBA Loan Volume Application Index 1/13 to 4/18



As you can see above, between 2013 and today, volume peaked in early 2013, declined, then peaked again in 8/16. The most recent peak was in early 2018. Today, it has declined and then came up a little. For many appraisers, volume started dropping in early 2017 and has been going up and down since then. The forecast is fewer loans in 2018 due to increasing interest rates. This is a good demonstration of the ups and downs of mortgage lending.

The survey covers approximately 75 percent of all U.S. retail residential mortgage applications, and has been conducted weekly since 1990. Respondents include mortgage bankers, commercial banks and thrifts. Base period and value for all indexes is March 16, 1990=100.

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