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Vickie L. Gill, SRA
Chief Appraiser- Interthinx

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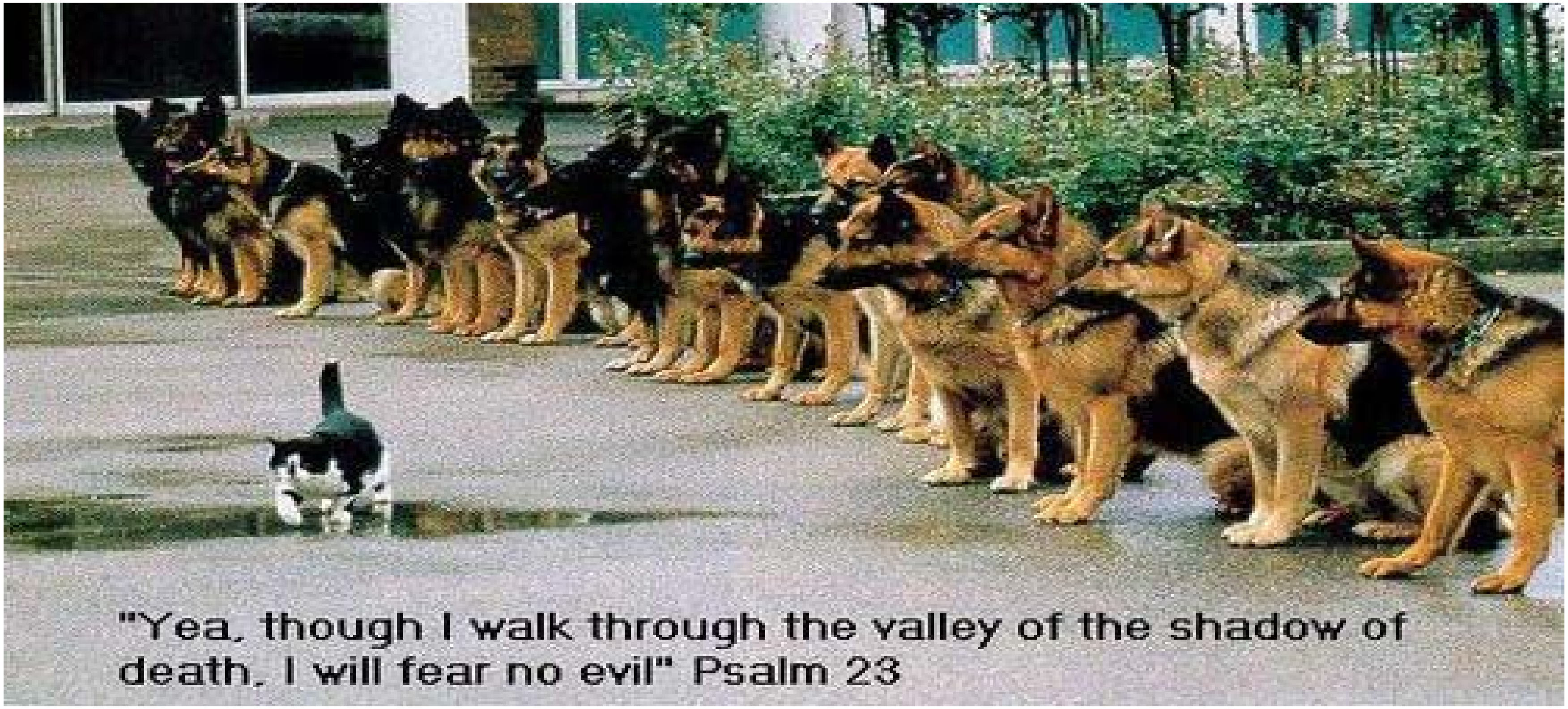
Avoiding Reponses to lenders in today's volatile marketplace

Vickie L. Gill, SRA-Chief Appraiser- Interthinx

In the beginning technology acts as a lever and credit replaces collateral as the primary component of security…

- "Innovation has brought about a multitude of new products, such as subprime loans and niche credit programs for immigrants. Such developments are representative of the market responses that have driven the financial services industry throughout the history of our country… With these advances in technology, lenders have taken advantage of credit-scoring models and other techniques for efficiently extending credit to a broader spectrum of consumers… Where once more-marginal applicants would simply have been denied credit, lenders are now able to quite efficiently judge the risk posed by individual applicants and to price that risk appropriately… Unquestionably, innovation and deregulation have vastly expanded credit availability to virtually all income classes. Access to credit has enabled families to purchase homes, deal with emergencies, and obtain goods and services. Home ownership is at a record high, and the number of home mortgage loans to low- and moderate-income and minority families has risen rapidly over the past five years."
  – *Alan Greenspan 2005*

Confidence abounds utilizing this new lever along with a favorable marketplace however…



…we eventually begin to realize that all is not as it seems…

…and many get stung or crash outright from over reliance on credit as a single evaluator of security.

So the pendulum swings back balancing the lending model with a renewed reliance on collateral as the other half of the equation again.

The finger of blame for the issues of the current age has been pointed aptly in many directions. One however is pointed at the lack of coordination & innovation on the part of the collateral valuation and underwriting communities in communication, procedures, and reporting techniques

BOOM ERA VALUATION

Traditional "old school" methods of evaluating collateral fell behind quickly changing housing, borrower, and market profiles.

- ✓ 'Three comparables and the truth' didn't encompass or forecast for complexities in the marketplace.
- ✓ Appraisal forms and delivery technologies were too rigid missing pertinent issues.
- ✓ Appraiser & underwriter competency was at times questionable.
- ✓ Segregated approaches to risk [re: credit, valuation, fraud] allowed for loopholes.

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Atypical is typically typical in valuation

The uniqueness of property and current market conditions places a new level of responsibility on the appraiser.

Today's appraisers are faced with challenges on many fronts that require skills well beyond the ability to analyze 3 comparable sales.

From the Interthinx fraud investigation desk…

Tips to avoid in so, you are not to provide a response to <u>the client</u> :

- Analysis
- ✓ <u>Subject property</u> –
  - ✓ Physical condition.
  - ✓ Compatibility with area / neighborhood.
  - ✓ Appeal against competition.
  - ✓ Offsite influences on marketability.
- ✓ <u>Neighborhood / area</u> -
  - ✓ Ratio of:
    - ✓ Arms length to "other" transactions.
    - ✓ Owner to tenant.
    - ✓ Occupied to vacant homes.
  - ✓ Overall number of listings, their respective exposure times, and trends in both areas.
    - ✓ Identification of submarkets within an overall neighborhood area – positive & negative.
  - ✓ Area influences both positive and negative.
  - ✓ Community influences both positive and negative {jobs, overall economy, etc.}

Reporting

✓ Dealing with the rigidity and limitation of forms.

✓ It isn't OK to simply fill out the form to address today's complex market issues.

✓ *While the definition of "FMV" hasn't changed it certainly has become more complex*.

✓ Exercise care in comments:

✓ For instance – Its nice to know that the subject is located in a neighborhood close to schools, shopping, and freeways but nicer to know that the onramp to that freeway is next door. ☺

✓*Remember – each property in this market is struggling to maintain its position.*

✓.... And while overt fraud is down we do see schemes in these valuation practices:

✓ The utilization of sales of less statistical similarity and / or more distance from the subject in lieu of the converse to falsely enhance the "look" of the valuation:

✓ Ignoring high or increasing exposure times.

✓ Ignoring offsite conditions that influence value and marketability.

✓ Hiding behind unverifiable "private financing".

Misrepresentation- Appraiser Error

"The subject property is located in an established neighborhood of predominantly ranch style homes close to all expected amenities in this housing class". –
"no adverse neighborhood or site related issues noted at inspection".

The subject is the property at the left of the image. Review of file due to payment delinquency.

- ✓The OA shot the street scene from right to left.
- ✓The field reviewer shot this photo {we duplicated it using Go(
- ✓All of the comparable sales utilized in the report were statistically similar but .25 to .5 mile west of the subject.
- ✓Two sales were located within .01 mile of the subject. These sales although similarly renovated brought 19-28% less than the other sales utilized in the OA.
- ✓The retro field review considered all of the sales available at the time of the OA however, for obvious reasons weighted the most proximate sales. After balancing all other factors the final estimate of value was reduced by 25%. The lender was placed in an indefensible position and was required to repurchase the loan.
- ✓ The borrower is still in the home.

OA Photo

Misrepresentation is the #1 reason for repurchase.

Fraud

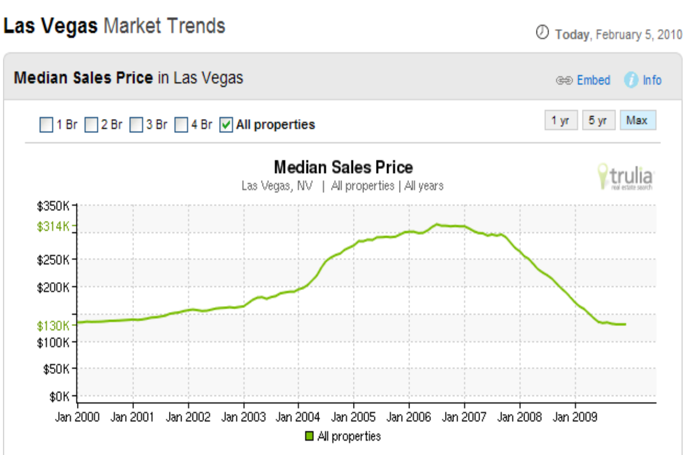
"The subject is located in a diverse neighborhood of varying housing styles ranging from single family to multi-family. The neighborhood is close to shopping, schools, and area traffic arteries".

- ✓ Review of file due to foreclosure.
- ✓ OA exhibits –
  - ✓ Close in photos shot to south.
  - ✓ Map shows large vacant area to north {does show FWY}.
- ✓ No mention of the many deviants to residential market value.
- ✓ All comparable sales located well south of subject location.
- ✓ 50% REO rate in subject area at time of OA not mentioned in OA comments.
- ✓ Subject <u>is</u> in good condition and is a conforming home style for area.
- ✓ Issues discovered in desk review then elevated to field review. Retro field review and following BPO 45-70% under OA FMV. Origination lender loss on sale 80% of loan amount after repurchase.

How does this differ from misrepresentation?

incomplete analysis

- ✓ Review of file due to foreclosure.
- ✓ Conforming home, good condition, nice neighborhood.
- ✓ 12/07 OA / Property values = “stable”. FMV = $255k top FMV due to remodeling.
- ✓ OA 5 sales at or above $200k however listing DOM is steadily increasing and list prices are falling. At time of OA 14 proximate and statistically similar homes listed at or below $200k – all same neighborhood and similar condition.
- ✓ Most respected market reports noting declines in value and increases in exposure time.



- ✓ REO 12/08. BPO $185k however listed at $212k. Exposed with two realtors for 16 months sold $145k – move in condition.
- ✓ Repurchase due to appraiser not advising of declining market and ignoring comparable listings of same to similar homes at lesser asking prices – plenty of data cited by review appraiser from time of OA.
- ✓ Exponential loss to lender = loan amount plus associated costs.

Technology linked with the honed skills of qualified appraisers produces the most credible results in our constantly moving marketplace.

Many tools exist that allow the appraiser and lender to match solution with level of risk in the analysis of a scenario and better define purpose from a myriad of angles.

Better tools include:

- ✓Borrower and property reference data.
- ✓Multi-approach automated valuation models.
- ✓Risk scoring models.
- ✓Neighborhood valuation and marketability statistics.
- ✓Neighborhood sales data, active MLS data, and data showing NOD information to assess "shadow".
- ✓Statistical forecasting.
- ✓Transaction history data.
- ✓Images.
- ✓User configurable search tools.

Bottom line ~ data IS available / more than ever before.

Best Practices

- ✓ Work through each case scenario with the diligence this market deserves.
- ✓ Over explain any item pertinent to value and marketability.
- ✓ Support value from the standpoint of both history and competition.
- ✓ Consider all neighborhood and surrounding area influences – positive & negative.
- ✓ Detail adjustments – especially subjective and intangible.
- ✓ Be realistic - Sure, we all want the growth we saw in ’03 ~ ’06 and, knowing the durability of our markets and way of life I feel we will see it again, but for the present use ample amounts of pragmatism when assessing your deal utilizing an approach that most of our folks taught us – ‘if it appears too good to be true - it probably is’. None of us wants to be the poster child for “what not to do”.

From the case scenarios its easy to see that a repurchase isn’t just caused by fraud but by the simple omission of data that can radically change the outcome of the appraisal report.

US housing markets will eventually recover. The time it will take is anyone's guess. Now is the time for all to retool their enterprises to serve today's volatile marketplace while developing sound practices that will protect the marketplace of tomorrow.