Long and Short of It

WAS IT POSSIBLE TO PREDICT THE BURSTING of the subprime mortgage bubble before it happened, and thus maybe to prevent it or make its effects less drastic?

By the reporting in Michael Lewis’s entertaining book “The Big Short” (W. W. Norton), a few capital markets types saw what was coming and took decisive action.

Did they lobby for restraint among the big packagers of mortgages and the ratings agencies that blithely rated them AAA, or for action by lawmakers or regulators? Of course not. They shorted the market and made tens of millions of dollars before the market collapsed and took the planet’s economies to the edge of a worldwide depression into a recession which lingered to this day and could relapse into a double-dip hit against housing and mortgages.

Lewis, author of “Liar’s Poker,” the story of a previous round of irrational exuberance on Wall Street, has a lively style and an admirable way of explaining what a tranche or a collateralized debt obligation is to a general reader.

He uses the metaphor of a tower to describe how subprime mortgages packaged into asset-backed securities got repackaged into CDOs, with tranches filled by pieces of securities that towered up from lowest rated to best-rated.

He is good at getting across the head-scratching imponderables of the mortgage bust, such as how CDOs filled with crappy mortgages could somehow be rated AAA. He is level-headed and clear about the irresponsibility of the ratings agencies, who were paid by the issuers and hence were prone to pleasing the issuer with the highest ratings. Perhaps part of the current market’s hesitancy to loan money is a natural lack of confidence in ratings. Why hasn’t there been a move for a new ratings agency, paid for by investors, rather than issuers, to challenge the tarnished legacy of Moe, Larry and Curly?

What the book lacks, though, is a memorable playbook. The guys Lewis tracks through their big short are not memorable or even likable. Colorful is the nicest way to describe them. The only difference between the players going long on subprime mortgages (which was almost all of the market) and those going short is that the shorts were better analysts of the market and could see the flaws in the CDO structures.

There are no Lew Raniers (hero of “Liar’s Poker”) in this story, which is too bad for the book and for our economy. ♦

OPENN FORUM

Geographic Competency: Does It Really Matter?

By Jennifer Schnell & George Demopolus

IN THIS DAY OF THE HOME VALUATION CODE of Conduct and FHA appraiser independence standards many users of appraisal products find themselves dealing with new vendors. The industrywide response to the HVCC and FHA appraiser independence standards has been the increasing use of appraisal management companies. AMC’s streamline the appraisal ordering and quality assurance process for their clients thereby ensuring a high-quality appraisal which meets stringent appraiser independence guidelines.

Increasingly, the industry is wondering if appraisals ordered by an AMC are as reliable as those which brokers and local personnel used to previously order on from their approved appraisal vendor list. The answer is yes. In fact, if they use a high-quality AMC which has implemented a comprehensive process of vetting appraisers and conducting routine performance reviews on its appraisal panel, which any high-quality AMC does, then many times those appraisers selected to conduct the appraisal report are more competent.

However, the biggest question, of course, is about value.

The huge downturn in real estate values throughout the country over the past two to three years has many loan applications dead in their tracks. A recent study by Fannie Mae revealed that three years has many loan applications dead in their tracks.

High-quality appraisal management companies do not want to use the cheapest and fastest appraiser.

Know the local market and are able to analyze and communicate the most important aspects of value associated with the subject property?

To answer these questions first we look at the 2010-2011 edition of the Uniform Standards of Professional Appraisal Practice rule, section 300. Prior to accepting an assignment or entering into an agreement to perform any assignment, an appraiser must properly identify the problem to be addressed and have the knowledge and experience to complete the assignment competently…” USPAP further states, “In an assignment where geographic competency is necessary, an appraiser preparing an appraisal in an unfamiliar location must spend sufficient time to understand the nuances of the local market and the supply and demand factors relating to the specific property type and the location involved. Such understanding will not be imparted solely from a consideration of specific data such as demographics, costs, sales, and rentals. The necessary understanding of local market conditions provides the bridge between a sale and a comparable sale or a rental and a comparable rental. If an appraiser is not in a position to spend the necessary amount of time in a market area to obtain this understanding, affiliation with a qualified local appraiser may be the appropriate response to ensure development of credible assignment results.”

So the appraiser must have geographic competency before and during the appraisal process. Any appraiser who does not have this competency must decline the order. Do appraisers decline orders due to lack of knowledge in a certain market area? Yes, it happens. Do appraisers accept work in area where they sparsely or never appraise? Yes, and they become competent during the assignment. Do appraisers accept work in area in which they are not familiar and fail to deliver a quality report? Yes. This does happen. Just as in any business, and justifiably, the paying client can be concerned and upset if the product they paid for is not of superior quality.

You may ask how we can ensure that the appraiser is “geographic competent” or not? Here are some key items to look for:

1. The appraiser should actually describe the market in the appraisal report.

Geographic boundaries should be clear and informative. The report should inform the reader about the subject’s location on a broad scale before it moves down to an individual depiction.

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Jennifer Schnell is the senior quality review appraiser and George Demopolus is president and chief corporate appraiser for LienTech Appraisal & Settlement Services, Providence, R.I.
Does Geographic Competency Really Matter Much?

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2. Users of appraisals should take the time to read through the descriptions provided and ask themselves if they have enough information to understand the community the subject property is located in, such as the value influences, the proximity to jobs and schools, the housing mix, etc. If the appraiser doesn’t do their job here they are not demonstrating “geographic competency.”

3. The comparables presented should be truly comparable in the eyes of the local market. Their proximity may matter. Their similarity of style, design and age may matter. Whatever their differences or their similarities the appraiser must explain to the reader why these properties demonstrate the local market response to the subject property. If the sales approach to value does not inform the reader about the subject property then the appraiser is not demonstrating their competence.

4. The appraiser must have access to enough data sources and enough types of data to analyze the market. Their report should take steps to inform the reader so that the reader gains an understanding of the subject’s market.

5. Look for the appraiser’s explanations in their report. If the explanations do not answer your questions ask the appraiser to add more commentary to their report which explains their research and development process. Their scope of work must be adequately defined. Where did they search? What did they analyze? What couldn’t they find? These pieces of information should inform the reader, too.

AMCs are waist-deep in this issue. It is a serious concern for all high-quality AMCs and this area is where a huge amount of financial resources are directed. High-quality AMCs do not want to use the cheapest and fastest appraiser. They want to work with quality people and quality appraisers who want to have an independent appraisal relationship while providing superior appraisal reports. High-quality AMCs work diligently in maintaining and improving their appraisal panels throughout their coverage areas on a weekly and monthly basis.

No AMC wants to open their company up to client criticism by using appraisers who lack geographic competency. However, just because an appraiser lives in one town, has an office based in another town, does not mean they cannot provide a quality appraisal report in a third town 30 miles away. Conversely, just because an appraiser lives, works and appraises in one town and one town only does not mean they are the best appraiser in that market area. They may, in fact, be the only appraiser who lives in the town, but it does not make them the “best.”

Many AMCs are hearing the concerns from lenders and brokers and are even advertising that “their appraisers are guaranteed to be within a certain distance any property they appraise.” This is a bold claim which makes many lenders and brokers very interested in these companies.

However, we must remember any appraiser who wants to make a decent living, grow and gain experience in their targeted coverage area and gain knowledge of issues that affect real estate values cannot limit themselves to an arbitrary distance parameter. Indeed, in order for them to make themselves more marketable they must continue to grow in their profession and learn what is going on in their coverage area and beyond. Again, just because the appraiser lives in the area does not make him the best appraiser for the assignment.