

EDITORIAL

Coming Back

AS THE MORTGAGE BANKERS ASSOCIATION'S National Secondary Market Conference meets this week in New York, there are the first signs that a nonconforming secondary market might be showing some signs of life.

For the past two years, the only secondary game in town basically has been Fannie Mae, Freddie Mac and the Federal Housing Administration/Government National Mortgage Association. The subprime securitization market was vaporized by the market crash in 2008, and all other nonconforming products, such as jumbo mortgages, were tarred with the same brush and became highly illiquid.

For jumbo mortgages in particular it was a bum deal, since often these higher-end loans are to people with plenty of cash flow

and higher-end credit (although not always).

That's why it has been encouraging to see Redwood Trust Inc. of Mill Valley, Calif., come to market with a jumbo MBS and now reportedly is working on another jumbo mortgage-backed security. Redwood's \$238 million jumbo MBS was the first nongovernment jumbo bond in almost two years. Redwood has also announced that it is starting to buy loans on a flow basis.

Another area that is starting to show some signs of life is the distressed asset market. There is no doubt that this area is getting bigger and bigger all the time. But a secondary market has been slow to develop, as banks, propped up by TARP money, have been hanging on to their distressed product in hopes of getting a better price than current markets offered.

Back in the days of the savings and loan crisis, it was the government that took the lead in the disposition of distressed assets,

through the Resolution Trust Corp. However, this time, there's no immediate government plan to sell mortgages. Instead, the government is putting a lot of energy into loss mitigation techniques like modifications designed to keep loans current.

That means there will be a big opportunity for a private market to dispose of distressed loans, either through securitizations or as whole loans. And this market has begun to roll out.

We've reported recently that there are plenty of nonperforming loans and "scratch and dent" products available as whole loans in the first quarter, and there have been some sales. However, many of them retain a big disparity between bid and ask prices, meaning sellers are overpricing and buyers low-balling their bids.

Once this unnatural coyness has been overcome and true market values set (this was one thing that the RTC did very well, establishing values, even if they were skewed), this market should develop like gangbusters. ♦

OPEN FORUM

Items to Look for When Reviewing Appraisals

By Jennifer Schnell

FRAUD IS AN INTENTIONAL ACT WHEREBY the perpetrator uses some form of deception for unfair or unlawful gain. A reporting error does not constitute fraud.

An individual, acting alone (or in partnership with other parties to a transaction) commits mortgage fraud when they intentionally misrepresent a property, which is being used as collateral for a mortgage transaction. The appraiser in a fraudulent mortgage appraisal is most commonly a partner to a crime.

How is it then that we can be proactive in fraud detection? How can we cut our exposure to fraud, and that of our business partners? What are the most common "red flags" for detecting fraudulent residential appraisals?

The following are the top 10 items we at Lincoln Appraisal & Settlement Services look for when reviewing an appraisal report for intentional misrepresentation.

1. Adequate identification of the real estate and the impact on value

The simplest method of misrepresenting a property to the reader of an appraisal report is to improperly identify the real property. By intentionally misidentifying the subject's bundle of rights, a value can be altered.

Example: A condominium unit identified as a single-family dwelling.

2. Identification of the parties and analysis of the transaction

An appraiser can purposefully mislead the reader by failing to report the full names of

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the parties, by failing to detail the listing and sales history with analysis of the offerings, including offering dates, prices and methods, or by failing to identify all relationships among the parties to the transaction and the signature dates on the contract.

Example: A sales price which is above the listing price in a declining market may include excessive and unidentified seller concessions.

3. Misrepresentation of the neighborhood and/or the market

The appraiser can manipulate the facts and present a property as being something which it is not.

The appraiser can mislead the reader by mischaracterizing the neighborhood's high and low values, predominant values, market conditions, absorption rates, marketing times, external influences and/or makeup of the neighborhood.

Example: A new construction home priced well above predominant values in an area with an oversupply of new construction homes and vacant land.

4. Misrepresentation of the site

The appraiser reports that the site is larger than it is. Or, they report that it is legal as to zoning. Or, they report that it is residential in nature when the surrounding area is impacted by commercial activities.

Example: The subject sits on a side street

proximate to a strip mall. The parking area for the strip mall is directly across the street from the front of the subject lot. The home is compared to homes on quiet residential streets, away from the commercial activity.

5. Misrepresentation of GLA, condition and amenities

Appraisers can mislead the reader by describing the subject as larger than it actually is (i.e., the reported gross living area can improperly include enclosed porches or unfinished basements) or they might present it as in "good" condition or as "remodeled" without any explanation.

Example: An older home which sold just months earlier is described as being in "good" condition, with a significant reduction in effective age, although it has had nothing more than new paint and carpets.

6. Number of neighborhood listings and sales is mischaracterized

By reporting a larger or smaller number of sales and offerings, appraiser can mischaracterize the subject market. They report sales well above the actual sales prices of comparable properties in an effort to inflate the appraised value for the subject. Or, they report a smaller number of sales and offerings in an effort to support their use of inappropriate comparables.

Example: The appraiser reported that there were four sales of similar homes between \$100,000 and \$150,000. However, there were actually 20 sales of comparable homes between \$80,000 and \$125,000.

7. Comparison to homes which are all superior in substantive areas

An appraiser can misrepresent the subject by presenting homes for comparison, which are significantly superior as to condition, size, lot size, bedroom or bath counts, foundation or parking. The appraiser knows that these may not be similar properties in the eyes of the market. The appraiser "boosts" the value of the subject by applying inadequate adjustments.

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Items to Look for When Reviewing Appraisal Reports

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Example: Three-bedroom homes are presented for comparison to the subject two-bedroom home. Or, a two-bath home is presented as a comparable to the subject, which is a one bath home.

8. Improperly reporting attributes of the comparables

The appraiser can underreport improvements at the comparables or fail to disclose superior condition or locations.

Example: A comparable is described as 1,000 square feet on a slab foundation. However, public records show that the home is actually 1,250 square feet on a full basement foundation.

9. Misreporting the prior sale or transfer of the subject and the comparables

By not reporting prior sales and transfers of the subject and the comparables, the appraiser can mislead the reader as to the parties involved and the condition of the properties presented. Homes which had sold recently and which might have been improved can be presented as in "average" condition. Transfers, which are the result of foreclosure, or transactions which were not arms length, can be improperly presented as comparables.

Example: A property is presented as a comparable. The transfer that is reported was a deed-in-lieu of foreclosure, and the value reported is the balance of the owners' mortgage, not a sales price.

10. Appraiser's credentials are not verifiable
An individual who is not qualified to perform a valuation assignment signs a report with the intent to defraud.

Example: A trainee appraiser signs a report without a supervisor's signature.

Clearly, as many ways as there are to report data there are ways to misrepresent the data. The appraiser can manipulate the facts and present a property as being something which it is not.

In order to detect fraud the reader of the appraisal must pay attention to the details. Look for consistency and adequate explanation. The appraiser's goal should be your understanding. The reader of the report is the customer. The appraiser should be able to satisfy any outstanding questions or concerns.

The use of reviews in fraud detection is a growing trend. Desk reviews can be useful. Field reviews are the gold standard in fraud detection. In a field review an independent appraiser is engaged to analyze and verify the data presented in an appraisal. The field review appraiser is a local professional. They will compare and contrast the information presented and provide their client with a summary report prepared under Standard 3 of the Uniform Standards of Appraisal Practice.

Nothing is as helpful as a fresh set of professional eyes to view and report to the client on what was reported in the appraisal under review in consideration of what they observe on site and interpret with their lo-

cal market knowledge. Whether you need additional examination by trained personnel or whether you can help detect fraud in your daily review of appraisals is something that

each of us must determine in the course of our business.

Attention to detail and careful review of the information in the appraisal is the first

step to fraud detection. If something doesn't make sense to you ask questions and seek information. If it seems too good to be true it probably isn't. ♦



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