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Bankers and Appraisals: Where is the Disconnect?

Richard L. Borges II, MAI, SRA
President, Appraisal Institute

Federal Reserve Bank of Atlanta – Banking Industry Outlook
February 28, 2013

About the Appraisal Institute



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*Professionals Providing
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- Nation's largest professional association of real estate appraisers
 - 23,000 professionals in 60 countries
 - Confers MAI, SRA designations
 - Largest publisher of appraisal texts; one of world's largest education providers
 - 5-10% of AI professionals work for financial institutions

Recent Headlines



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Former Bank of Clark County executive pleads guilty to concealing appraisals from regulators

By [Jeff Manning](#), [The Oregonian](#)

February 19, 2010, 10:00PM

The wave of bank failures in the Pacific Northwest took an ugly twist Friday when a former high-ranking executive of the defunct [Bank of Clark County](#) pleaded guilty to concealing material facts from bank regulators.



Daily Newsbytes



American
Bankers
Association.

REGULATORS

Duke to Community Banks: Voice Concerns About Onerous Regs

Community banks should continue to identify new regulations that are most onerous to their business models, Federal Reserve Governor Elizabeth Duke said yesterday at the Southeastern Bank Management and Directors Conference at the University of Georgia in Duluth.



ABA RESOURCES

Chart your compliance

Recent Headlines



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SEC Charges Three Former Bank Executives in Virginia for Understating Loan Losses During Financial Crisis

FOR IMMEDIATE RELEASE
2013-4

Washington, D.C., Jan. 9, 2013 — The SEC today charged three former executives of a Virginia Commonwealth bank for understating the true health of the bank's loan portfolio

SEC Claims KPMG Auditors Failed to Scrutinize Nebraska Bank

By Dave Michaels - Jan 9, 2013 7:30 PM ET



0 COMMENTS

QUEUE



Two KPMG LLP auditors are facing U.S. Securities and Exchange Commission claims that they failed to properly scrutinize a Nebraska bank that hid millions of dollars in loan losses from investors during the credit crisis.

John J. Aesoph, a partner, and Darren M. Bennett, a senior manager, didn't get evidence to back up TierOne Bank's allowance for loan and lease losses when issuing opinions on the bank's 2008 financial statements, the SEC said in an administrative release today. Instead of independently testing TierOne's value for collateral, the auditors accepted the bank's "biased and inconsistent" estimates, the SEC said.

Recent Investigations



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- Senate Government Affairs Committee
Permanent Subcommittee on
Investigations
- *Wall Street & the Financial Crisis –
Anatomy of a Financial Collapse, 4/13/11*
 - *“During the five-year period reviewed by the
Subcommittee, from 2004 through 2008, OTS
examiners identified over 500 serious deficiencies in
Washington Mutual’s lending, risk management, and
appraisal practices.”*

Recent Investigations



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- *“Still another area in which OTS failed to take appropriate enforcement action involves WaMu’s appraisal practices.”*
- *“WaMu’s decision to outsource the appraisal function received minimal attention from OTS.”*
- *“Problems began almost immediately after WaMu outsourced the appraisal function.”*

Recent Investigations



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- *“In its 2007 ROE, OTS identified serious issues with IndyMac’s appraisals.*
- *OTS found that the borrowers, rather than the mortgage originator, were paying the appraisers directly, which did not ensure appraiser independence.*
- *Despite these serious weaknesses, OTS did not require action be taken.”*

Recent Investigations



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- Material Loss Reports – What We’ve Learned
 - 2011 review of MLRs
 - 75% of now-failed banks had been previously cited for various appraisal violations
 - Citations include often failing to obtain appraisals where required, or having insufficient resources within the bank to manage and oversee the appraisal function.

Problems Identified After the Crisis



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- Greed was pervasive; fraud was rampant
- You can't lend on credit alone –
Collateral matters
- Loan production staff (within institutions)
were dominant
- Appraisal departments were often
marginalized within banks

Problems Identified After the Crisis



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- Examiners
 - Too little expertise on appraisal matters
 - May have been ill-equipped, unprepared to deal with technical appraisal issues
- Appraiser population
 - Marginally qualified
- Enforcement
 - Spotty at best in mortgage, real estate

Where the Disconnect Begins



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- Perception of the appraisal function
 - Often seen as “onerous” or to be avoided
 - Expressed by bankers on both sides of market
 - Becomes a “compliance obligation” rather than integral part of risk management

Where the Disconnect Begins



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- Examiner enforcement concerns
 - Big bank vs. small bank
 - Disparities, inconsistencies
 - Inconsistent Interagency Appraisal Guideline interpretations

Where the Disconnect Begins



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- Failing to learn from past mistakes
 - Rating agencies have not altered methodologies for evaluating CMBS
 - cursory audit and review of appraisals
- Understanding of appraisal theory, methods and practice
 - Appraisal is an applied science
 - It has a strong foundation in law and economics

Common Banker Criticisms



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- Complaint 1
 - “It costs too much”
- Complaint 2
 - “Why can’t they get it right?”
- Complaint 3
 - “Why can’t I use a BPO instead?”

Where Can We Work Together?



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- Evaluations
 - AI has fought for flexible appraisal standards
 - Starting in 2008, Scope of Work rules allow appraisers to tailor service to client needs
 - In 2012, AI published a Guide Note on preparation of Evaluations by Appraisers

Where Can We Work Together?



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- Broker Price Opinions
 - Rush to use represents a failure to communicate on the part of appraisers and bankers
 - Creativity with the Scope of Work can
 - Provide a cost-competitive service
 - Maintain independence and competency in valuation process

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- Broker Price Opinions
 - Brokers do not have sufficient training in real estate valuation
 - Brokers are paid little or nothing (\$0-\$300)
 - Brokers are under no obligation for independence and impartiality
 - Experience shows that there is wide variation in BPOs

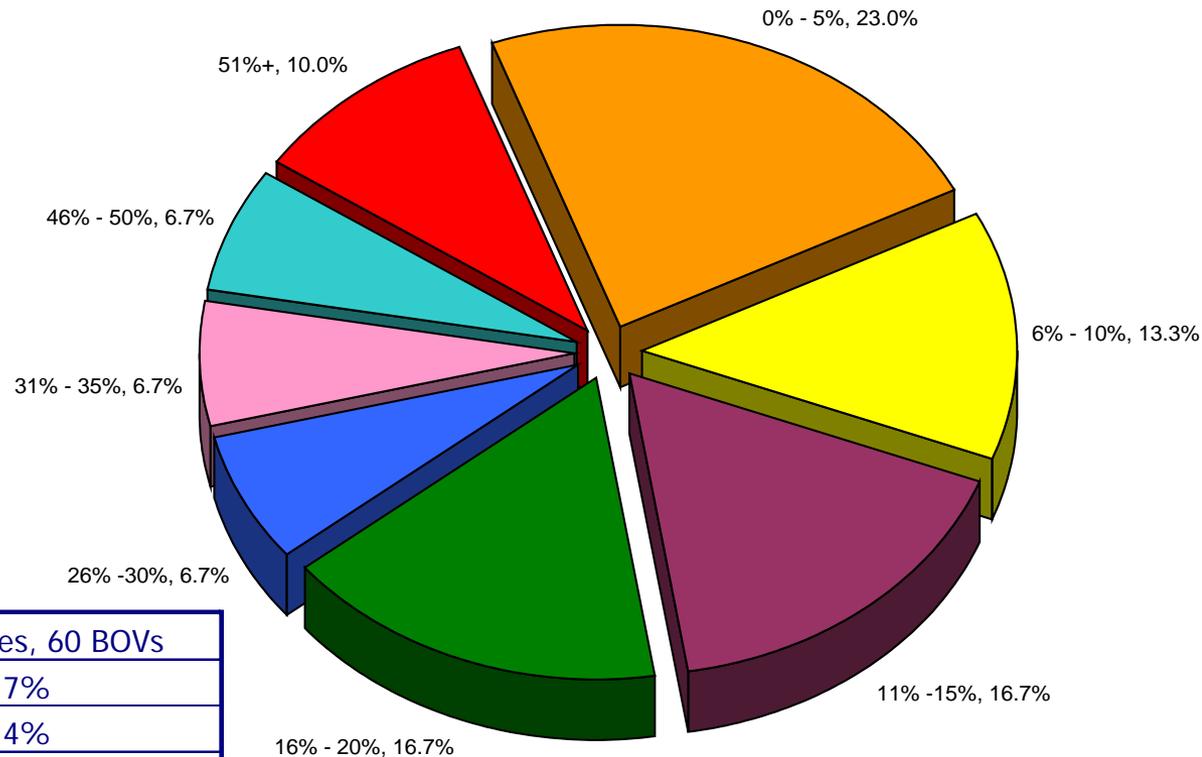
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Variation in Broker Opinions of Value



Sample	30 Properties, 60 BOVs
Median Variance	14.7%
Mean Variance	21.4%
Percentage with 15% or Less	53.0%
Percentage over 15%	47.0%

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Variation in BOVs: Actual case comparison

Sale Price, Appraised Value, BOVS

Broker #7	\$5.678 million
Broker #5	\$4.920 million
Broker #6	\$3.00 million
Broker #1	\$2.996 million
Sale Price	\$2.90 million
Appraisal	\$2.84 million
Broker #2	\$2.258 million
Broker #4	\$2.072 million
Broker #3	\$1.129 million

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- Enforcement
 - Strong self-police program
 - Peer Review Process recently streamlined and improved
 - Results show an increase in efficiency and effectiveness of the investigations

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- Guidance from AI
 - *Appraisal of Real Estate, 14th Edition* (to be published summer 2013)
 - Guide Notes from the AI Appraisal Standards and Guidance Committee

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- Legislation
 - Financial Institutions Examination Fairness and Reform Act
 - Likely to be reintroduced in 2013
 - Would tie hands of bank examiners
 - Bank examiners must have tools

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- Education
 - Examiner
 - Bank staff
 - Cutting edge issues



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Thank you!

Questions?

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