Rising Home Prices Cast Appraisers in Harsh Light

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EAST STROUDSBURG, Pa. -- Hotel worker Danny Ruiz was living with his wife and four children in a cramped New York apartment when he saw a television ad promising the family a way out. "Why rent when you can own your own home?" a Pennsylvania builder asked.

The company even offered to pay his rent for a year, while he saved for a down payment. So the Ruizes fled the city for the Pocono mountains, where they bought a three-bedroom Cape Cod in 1999 for $171,000. But when they tried to refinance less than two years later, the home was valued at just $125,000. "I flipped," says Mr. Ruiz. His wife, he says, "went nuts."

In a time of rising real-estate prices, how could their home have lost so much of its value? The Pennsylvania attorney general has a theory: an inflated appraisal. State officials have sued an appraiser and builder, saying they colluded to sell inflated Poconos property to 170 homeowners including the Ruiz family. The state has also launched a criminal investigation.

The case is part of a widening assault on appraisers, with consumer advocates, mortgage companies -- and even many appraisers -- questioning the integrity of the real-estate-valuation process. Federal prosecutors are focusing on inflated-appraisal schemes as part of an effort to root out mortgage fraud, which has risen sharply in recent years. Congress is revisiting regulation of appraisers for the first time since the savings-and-loan debacle of the 1980s. And more appraisers are finding themselves defendants in lawsuits arising from home loans that went bad.

To many in the real-estate business, unreliable appraisals expose the shaky foundations of today's hot housing market. Spurred by low interest rates, mortgages and refinancings are expected to rise 19% to a record $2.4 trillion this year. But with the economy stuck in low gear and sales slowing, many experts fear home prices could soon drop. If so, substantial blame may fall on the nation's 40,000 residential appraisers -- much as Wall Street securities analysts are being criticized for hyping overpriced stocks before the Internet bubble burst.

Federal regulations require some form of appraisal for virtually every residential real-estate loan to protect lenders and homeowners against overextending themselves. Unlike loan brokers and real-estate agents, appraisers get paid whether the deal gets done or not, and the fee -- typically $250 to $500 -- isn't a percentage of the price. A good appraisal requires hours of legwork, visiting a property to check its condition, and coming up with at least three comparable sales.

The profession first organized in the 1930s, when plunging Depression prices made valuing property more difficult. In 1989, when appraisers came under fire for valuations that supported shaky S&L loans, Congress passed a law establishing state licensing requirements for appraisers, including coursework and continuing education.

But Congress hadn't reckoned on a major shift in the lending industry: Few of the people involved in making mortgage loans these days have a long-term interest in them. Traditionally, bankers had made loans directly and held them, giving the lenders a strong incentive to find fair appraisals to protect their interests. Today, many appraisers are picked by independent mortgage brokers, who are paid per transaction and have little stake in the long-term health of the loans. Many lenders also have lost a long-term interest in their loans, because they sell them off to investors.

Appraisers increasingly fear that if they don't go along with higher valuations sought by brokers, their business will dry up, says Don Kelly, spokesman for the Appraisal Institute, the profession's main association. More than 7,000 appraisers have signed a petition saying they have been subjected to customer pressure and calling on regulators to forbid the practice.

Cut Off

P.E. Turner Jr., who has worked for 30 years as an appraiser in Richmond, Va., says the message is often subtle. If he doesn't agree that a property is worth enough to support a loan, a broker will just never call back with new business.

But three to five times a week, he says brokers spell out what they want in black-and-white -- as one did in a recent fax: "Please let me know first if we can get this value before charging customer," it says. "Do not do appraisal if less."

"The truly sad part about this is they are going to find some whore appraiser to do this when I tell them no," says Mr. Turner, who declined to identify the faxing broker.

In a suit filed in October in state court in Atlanta, the mortgage units of National City Corp. and two other banks accused developer Phillip E. Hill Sr. and two appraisers of duping them in a scheme that exposed them and other lenders to tens of millions of dollars in losses on more than 600 properties. The lenders claim that Mr. Hill relied on inflated appraisals and the appraisers received hundreds of dollars above customary fees for valuing the properties. Mr. Hill couldn't be reached for comment, and his attorney didn't return calls; the appraisers named in the suit, Fred Farmer, of Roswell, Ga., and Julian Perez, of Winston, Ga., also didn't return calls seeking comment, but in court papers Mr. Perez denied the allegations and asked for the suit against him to be dismissed. An attorney for Mr. Farmer, John G. Haubenreich, says: "Mr. Farmer's position is he did not participate in any fraud. All his work was done in a professional manner using appropriate properties for comparing values."

The Department of Justice says it has made fighting mortgage fraud a priority. In October, federal prosecutors won a conviction against a Washington, D.C., appraiser, James E. Golden, Jr., who was sentenced to seven years in prison for performing inflated appraisals on 45 local properties so speculators could secure government-backed mortgages. Mr. Golden is appealing.

Prosecutors said Mr. Golden's co-conspirators bought distressed properties and then, using his inflated appraisals, sold them for a big profit. The arrangement could net as much as $130,000 per deal. Twenty of the overpriced and poorly maintained homes ended up in foreclosure, costing taxpayers $1.5 million in repayment of the mortgage loans. The scheme would have been impossible without a "dirty appraiser," prosecutor Virginia Cheatham told a federal judge. To perform the appraisals, the government said Mr. Golden got up to $1,500 from others involved in the fraud -- on top of his standard fee of $400.

The FBI says the amount of mortgage fraud reported by federally chartered banks and thrifts has nearly doubled over the last two years to $293 million. But John Gillies, chief of the FBI financial-institution fraud unit, says that vastly understates the total amount because half of all mortgage firms operate without a federal charter and don't report to the government.

The FBI doesn't track how much of the fraud involved appraisers. But the Mortgage Asset

Research Institute, which follows fraud for the industry, says 21% of the cases it tracked in 2000, the latest year for which data are available, involved bogus appraisals, quadruple the percentage five years before, making appraisal-related schemes the fastest-growing form of mortgage fraud.

Alarmed by the trend, the U.S. Senate Banking Committee earlier this year asked the General Accounting Office to determine whether state and federal authorities are adequately overseeing the appraisal process. U.S. Rep. Jan Schakowsky, an Illinois Democrat, has sponsored a bill that would prohibit brokers from coercing or intimidating appraisers or tying payment for an appraisal to a desired property value.

In suddenly hot real-estate markets, especially those with new construction, properties can be especially difficult for buyers to value. Such conditions developed in the 1990s in the Poconos, a longtime resort destination for New Yorkers that was being transformed into a commuter community. Ninety minutes by car from New York city, the area offered homes far cheaper than closer-in towns.

Gene Percudani, a 51-year-old native of Queens, New York, built a thriving home-building business in this market, running folksy television ads offering New Yorkers new homes in Pennsylvania for as little as $1,000 down and $685 a month. Atop winding mountain roads, the developments featured gates and guards, tennis courts and swimming pools. Appearing in shirt sleeves, the telegenic, square-jawed Mr. Percudani sold a vision of country living, free of crime and crowds. "Remember," he would say, "All you have to lose is your landlord."

If they joined Mr. Percudani's program, called Why Rent, homeowners would find financing through another of his companies, Chapel Creek Mortgage, which brokered loans from J.P. Morgan Chase & Co.'s Chase Manhattan Mortgage unit.

For years, the Why Rent program appealed to police officers, teachers and others with modest salaries who had trouble saving enough money for a down payment. Before he moved to the Poconos, Eberht Rios, a truck driver for United Parcel Service, his wife, Elizabeth, and four children lived in an apartment in Jamaica, Queens, paying $710 a month in rent. In 1997, the couple bought a three-bedroom colonial in a development called Pocono Country Place, in Tobyhanna, Pa., for $140,608, with a mortgage of $126,450. "It sounded great," says Mr. Rios, 38 years old. "We couldn't get a house in New York for $140,000."

But in 1998, Mr. Rios was laid up with a back injury and was out on disability for four months, making it difficult to meet his mortgage payments. This year, when he tried to refinance, he was told the home was only valued at $100,000. "We came here to have a good life," says Mr. Rios, who emigrated from Ecuador at age 13. "We're struggling."

In the 1990s, one local appraiser, Dominick Stranieri, signed off on most of the Why Rent deals that state officials now say were overpriced, including the Rioses'. As a result, Mr. Stranieri now faces the attorney general's suit, filed in state court in Harrisburg. In an unrelated case, Mr. Stranieri paid a $10,000 fine in 2001 to settle state regulatory charges of inflating appraisals of three Poconos properties. He neither admitted nor denied the accusations.

In another lawsuit, filed in U.S. District Court in Harrisburg, Pa., Poconos homeowners claim that Mr. Stranieri overappraised their properties by 35% to 45%. The lawsuit, seeking unspecified damages and class-action status, accuses Messrs. Stranieri and Percudani of fraud and conspiracy.

James Sysko, senior deputy attorney general, says Mr. Stranieri told investigators Mr. Percudani's firm picked him because of his quick work and low fee of $250, instead of the typical $300 to $400. In exchange for a steady stream of work, Mr. Sysko says, Mr. Stranieri accepted without question valuations from Mr. Percudani's company. The lawsuit claims Mr. Stranieri valued land at $20,000 to $27,000 per parcel that a Percudani family partnership had purchased for $1,250 to $12,000.

The homeowners and the attorney general in their separate suits argue that Mr. Percudani sought inflated appraisals to earn higher profits, and offset the cost of shouldering homeowners' rent payments -- the critical element of his Why Rent plan. Under the program, before buying a house, customers would pay a monthly fee for a year toward a down payment on a home while Mr. Percudani's company paid the homeowner's rent.

Homes They Can't Afford

The lawsuits also argue that Mr. Percudani misled homeowners into buying homes they couldn't afford. In addition, the attorney general argues that the program misled Chase Manhattan because it appeared that the borrowers had been able to save for a substantial down payment -- often 10% of the purchase price -- while making their rent payments. The state says Chase didn't know Mr. Percudani's company was actually paying homeowners' rent.

Freddie Mac, the government-sponsored buyer of mortgages, purchased many of the Why Rent loans from Chase. Worried about high default rates, Freddie Mac obtained new appraisals on 33 properties and found that, they were each valued at tens of thousands of dollars less than Mr. Stranieri had said in his evaluations, according to an exhibit in the attorney general's lawsuit.

Messrs. Stranieri and Percudani deny any wrongdoing and say they operated independently. They say that any home that declined in value did so because of a weaker economy. "Mr. Stranieri believed then and he believes now that his appraisals accurately reflect the fair market value of the properties being appraised," says his attorney, Philip Lauer of Easton, Pa.

"It's like buying a stock," Mr. Percudani says in an interview "The value goes up. The value goes down."

Mr. Percudani also says the rent payments reflected a legitimate sales concession common in the industry. He says the program was well known to Chase. Mr. Percudani has filed defamation suits against the local Pocono Record newspaper and its Web site, for articles it ran on his business and property values; the Record says it stands by the stories and is contesting the suit. Dow Jones & Co., which owns this newspaper, also owns the Record, through its Ottaway Newspapers subsidiary.

With many Why Rent homeowners falling behind on their payments, and some refusing to pay because of allegations of inflated appraisals, Chase Manhattan offered to forgive some of the principal amount owed on 258 loans valued at $35 million that it made through Mr. Percudani's Chapel Creek Mortgage. In all, 205 accepted the offer, reducing the amount outstanding by about $10 million. The Rios family's loan, originally $126,450, was reduced to $116,000. The mortgage held by the New York hotel worker, Mr. Ruiz, which was $153,900 to start, was cut to $105,000. Chase says it ended its relationship with Mr. Percudani's company in late 2000. Chase, which declined to comment on either suit, says it cut the amount owed on the mortgages so that homeowners could remain in their houses.

Mr. Sysko, the deputy attorney general, says the state is now pursuing half a dozen fraud cases against Poconos builders he wouldn't name. Most involve allegations of inflated property valuations. State officials are alarmed by rising numbers of foreclosures, and fear more homeowners and lenders may face heavy losses. "It's like the value of these homes is built on shifting sands," Mr. Sysko says.

For his part, Mr. Percudani says he isn't surprised that later appraisals, or even different appraisals made at the same time, could result in different values. "Appraisals are opinions," he says. "Value, like beauty, is in the eye of the beholder."