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REAL ESTATE

Guess What's Holding Back Housing

SEPT 25, 2014 9:03 AM EDT

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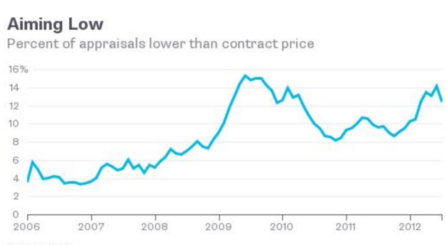
During the U.S. housing boom, real-estate appraisers acted like deal-enablers rather than valuation experts. Indeed, inflated appraisals were a key ingredient in the erosion of mortgage-lending standards that led to the housing bust. Now we are seeing the opposite -- low appraisals -- with unwelcome consequences for the housing market.

After the bust, Andrew Cuomo, then New York attorney general, looked to resolve a conflict of interest long-enjoyed by mortgage brokers: They were allowed to select the real-estate appraiser needed for loan approval. Because brokers only are paid when a loan closes, and the bigger the loan the bigger the payday, appraisers had an incentive to provide exaggerated valuations. Many mortgages approved under this arrangement were eventually sold to Fannie Mae and Freddie Mac.

Cuomo, along with Fannie and Freddie, reached an agreement in 2008 to end this practice and as well as others related to appraisals. Called the Home Valuation Code of Conduct (HVCC), this agreement became effective on May 1, 2009. Although HVCC (pronounced "havoc") was replaced the next year by the Dodd-Frank Act, the rules remained and they were embedded into government policy.

A recent working paper by the Federal Reserve Bank of Philadelphia looked at the impact of the HVCC rules on the outcome of appraisals and mortgages, touted as the first empirical analysis undertaken since the agreement was enacted.

The study looked at the frequency of low appraisals, in which the appraised value was less than the contract price. A low appraisal doesn't necessarily equate to low quality but it could be a concern. The highest percentage of low appraisals occurred around May 2009. This was not only the peak of the housing-market collapse, but also when the agreement first went into effect, easing the pressure on appraisers by mortgage brokers and banks to "hit the number."



The quality of appraisal reports wasn't analyzed, but the paper suggests that it may have declined.

Although the study indicates that inflated appraisals are less common today, the impact of low appraisals may be problematic in its own right -- higher levels of loan rejections that put a damper on the housing market. With the recent rise in housing prices, we are again seeing more low appraisals. This may mean that the rules have left appraisers slower to respond to sudden changes in housing-price trends.

It seems as if appraisers just can't get out of the way.

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