

Legislative Analysis



PREDATORY LENDING: INFLUENCING APPRAISERS

Mitchell Bean, Director
Phone: (517) 373-8080
<http://www.house.mi.gov/hfa>

House Bill 4054 (Substitute H-1)
Sponsor: Rep. Jeff Mayes

Senate Bill 343 (Substitute H-1)
Sponsor: Sen. John Pappageorge

House Bill 6148 as introduced
Sponsor: Rep. Barbara Farrah

Senate Bill 356 (Substitute H-2)
Sponsor: Sen. Randy Richardville

House Committee: Banking and Financial Services
Senate Committee: Banking and Financial Institutions

First Analysis (6-3-08)

BRIEF SUMMARY: The bills would amend various acts to prohibit the practice of coercing an appraiser in order to receive a predetermined appraisal, prohibit an appraiser from developing and communicating an appraisal set by a client in order to receive a predetermined appraised value, and revise criminal penalties and civil fines for violations of acts regulating mortgages and brokers, lenders, and servicers of mortgages.

FISCAL IMPACT: The bills would have an indeterminate fiscal impact on state and local units of government. A more detailed discussion follows later in the analysis.

THE APPARENT PROBLEM:

By September of 2007, Michigan ranked fourth in the nation for number of homes in foreclosure. The fallout from the foreclosure crisis, which affects more than just the homeowner who loses a house, has brought intense scrutiny by the media, lawmakers, and regulatory agencies to identify the factors at play and devise remedies to help those homeowners in danger of losing their homes and to prevent similar large-scale recurrences in the future.

Generally speaking, a foreclosure proceeding is triggered when a homeowner falls behind in making scheduled mortgage payments. For some, job loss or mounting medical bills due to an illness causes a person to miss several mortgage payments. For others, predatory lending practices (such as inflating or failing to verify a mortgage applicant's salary and steering an applicant to a more expensive adjustable loan even when a fixed rate loan was available), resulted in some people being in homes that they could not afford in the long term when teaser rates ended and adjustable rate payments reset to a higher monthly amount.

Legislation addressing some aspects of predatory lending has already been enacted this year; bipartisan legislative packages have recently been signed into law that will increase oversight of loan officers and allow the Michigan State Housing Development Authority (MSHDA) to offer low interest fixed rate loans to qualifying individuals in danger of

entering foreclosure. Attention has also been focused on appraisal fraud, which has also been identified as an aspect of predatory lending practices that has significantly contributed to the foreclosure crisis.

When a person applies for a mortgage, the mortgage broker or lender hires an appraiser to appraise the value of the property. The appraiser then makes an independent assessment of the property's value based on market analysis as of the date of the appraisal. That figure indicates to the lender whether the property is a good investment. For instance, an appraisal that comes in below the seller's asking price may not be a good investment, and the lender may then decline to offer a loan for the full amount. However, if the appraisal comes in higher than the true market value, and the loan originator agrees to loan that amount, the new homeowner ends up unwittingly paying too much for the home.

When a house is bought at an inflated price, the house has less true equity. Coupled with the recent fall in home values, some homeowners are losing up to 40 percent of what they thought was the value of their homes. A homeowner in this situation with an adjustable rate loan about to reset at a higher rate may find he or she can't qualify to refinance with a more affordable fixed rate loan. If the homeowner tries to sell the house to avoid foreclosure, the true market value may be less than the amount owed on the original loan. This affects more than just the homeowner. As the number of foreclosures in a neighborhood rises, property values for adjacent homes drop. As property values drop, so do property tax assessments. Reduced property tax collections mean less revenue to support local governmental services, such as infrastructure improvements, law enforcement, and fire suppression.

For several years, appraisers have complained that some mortgage brokers and loan originators have pressured them to inflate the value of properties to a predetermined amount—referred to as "hitting the number"—which allows the mortgage broker or lender to collect more money in commissions and fees. At least half of appraisers report this type of pressure. If appraisers don't comply, according to some accounts, they don't get paid for appraisals, or worse, they get blacklisted and stop getting appointments for future jobs. Some say they yield to this pressure because even if they say no, the lender or broker will just give the appointment to another appraiser, and also because if they don't, they will be put out of business.

Some feel that stopping appraisal fraud is an important piece of any solution to the foreclosure crisis. Legislation has been offered to specifically criminalize the practice of deliberately inflating the value of a home in an appraisal.

THE CONTENT OF THE BILLS:

The bills would amend various acts to prohibit coercing an appraiser in order to receive a predetermined appraisal, prohibit an appraiser from developing and communicating an appraisal set by a client in order to receive a predetermined appraised value, and revise criminal penalties and civil fines for violations of acts regulating mortgages and brokers,

lenders, and servicers of mortgages. House Bill 4054 and Senate Bills 343 and 356 are tie-barred to each other. House Bill 6148 is tie-barred to the two Senate bills.

House Bill 4054 would amend Article 26 (Real Estate Appraisers) of the Occupational Code (MCL 339.2635) to address instances when an appraisal was used as an investment or as collateral for a loan in a real estate-related financial transaction. The bill would establish a misdemeanor penalty for a licensed appraiser who, in violation of standards adopted under Article 26, developed and communicated such an appraisal as a result of the client's or intended user's doing either or both of the following:

- Setting preconditions on the outcome of the appraisal as a prerequisite for being selected to develop and communicate an appraisal or for obtaining future appraisal work.
- Representing or implying that payment for the development and communication of the appraisal was predicated upon attaining a desired minimum appraised value.

A licensee who violated this prohibition would be guilty of a misdemeanor punishable by a maximum fine of \$15,000 and/or imprisonment for up to one year.

Senate Bill 343 would amend the Secondary Mortgage Loan Act (MCL 493.77) to revise the criminal penalty for certain violations of the act. Currently, it is a misdemeanor, punishable by a maximum fine of \$5,000 or imprisonment for up to three years, or both, for a person to willfully or intentionally engage in the business of making secondary mortgage loans without a license. (This applies to a person, association, nonprofit corporation, common law trust, joint stock company, limited liability company, or any other group of individuals, or any owner, partner, member, officer, director, trustee, employee, agent, broker, or representative of the person or entity.)

Under the bill, the maximum fine would be \$15,000 and the maximum term of imprisonment would be one year. The penalty would also apply to a person who willfully or intentionally coerced or induced a real estate appraiser to inflate the value of real property used as collateral for a secondary mortgage loan, including doing either of the following:

- Representing or implying that a real estate appraiser would not be selected to conduct an appraisal of the real property or selected for future appraisal work unless the appraiser agreed in advance to a value, range of values, or minimum value for the real property.
- Representing or implying that a real estate appraiser would not be paid for an appraisal unless the appraiser agreed in advance to a value, range of values, or minimum value for the real property.

Currently, a person who violates the act or counsels, aids, or abets in a violation is liable for a maximum civil fine of \$1,000 for each offense, in addition to other penalties imposed by the act. Under the bill, the person would be liable for a maximum civil fine

of \$3,000 per violation, but not more than \$30,000 for a transaction resulting in more than one violation, plus the costs of investigation.

Senate Bill 356 would amend the Mortgage Brokers, Lenders, and Servicers Licensing Act (MCL 445.1679) to make it a misdemeanor for a person, or any owner, partner, member, officer, director, trustee, employee, agent, broker, or their representative acting on the authority of that person, willfully or intentionally to coerce or induce a real estate appraiser to inflate the value of real property used as collateral for a mortgage loan, including by doing either of the following:

- Representing or implying that a real estate appraiser would not be selected to conduct an appraisal of the real property or selected for future appraisal work unless the appraiser agreed in advance to a value, range of values, or minimum value for the real property.
- Representing or implying that a real estate appraiser would not be paid for an appraisal unless the appraiser agreed in advance to a value, range of values, or minimum value for the real property.

A violation would be punishable by a maximum fine of \$15,000 or imprisonment for up to one year, or both. This is the current penalty in the act that applies to a person who willfully or intentionally violates existing provisions of the act by engaging in the business of a mortgage broker, lender, or servicer without a license or registration; or by transferring or assigning a mortgage loan or a security in violation of the act.

Currently, the commissioner of the Office of Financial and Insurance Regulation may assess a maximum civil fine of \$1,000 for each violation or \$10,000 for a transaction resulting in more than one violation, plus the costs of investigation, against a licensee or registrant who violates the act. The bill would increase those amounts to \$3,000 and \$30,000, and would extend this and other administrative sanctions to someone who directly or indirectly counseled, aided, or abetted in a violation.

House Bill 6148 would amend the sentencing guidelines portion of the Code of Criminal Procedure (MCL 777.19p) to reflect the changes to the maximum term of imprisonment for certain violations of the Secondary Mortgage Loan Act.

BACKGROUND INFORMATION:

Homeowners at risk of missing a mortgage payment are always encouraged to contact their lenders before the payment is due; most, if not all, lenders have policies in place to prevent a loan default, such as spreading out a missed payment over several months. Homeowners facing a crisis may also benefit from the services of a mortgage counselor. A list of reputable mortgage counseling services can be obtained from both the Michigan State Housing Development Authority (MSHDA) and the U.S. Department of Housing and Urban Development (HUD).

Recently, New York state Attorney General Andrew Cuomo crafted an agreement with the mortgage financing companies Fannie Mae and Freddie Mac to address appraisal fraud by promoting appraiser independence and objectivity. Beginning January 1, 2009, the agreement would, according to news reports, prohibit lenders nationwide who wish to sell loans to Fannie Mae and Freddie Mac from using appraisers on their own staffs or appraisers employed by companies owned by the lender. The agreement would also prohibit mortgage brokers from selecting appraisers.

More information on appraisal fraud can be found on the Web and in the report *Home Insecurity: How Widespread Appraisal Fraud Puts Homeowners at Risk* released in March, 2005, by Demos, a nonpartisan public policy research and advocacy organization. The report can be viewed online at www.demos-usa.org/demos/publications.

FISCAL INFORMATION:

House Bill 4054 (H-1) would have an indeterminate fiscal impact on the Department of Labor and Economic Growth, relative to aiding in the prosecutions of criminal violations of the Occupational Code (Article 26), as provided in the bill. The Occupational Code (Article 26) currently imposes penalties for a violation of any of the standards for the development and communication of appraisals and, in Article 6, imposes penalties where an appraiser practices fraud, deceit, or dishonesty, or demonstrates a lack of good moral character, among other violations. The penalties imposed under Article 6 include, among other things, license suspension or revocation and an administrative fine of up to \$10,000. The bill adds that in the specific instance where an appraiser makes an appraisal based on obtaining future work or securing payment, such an action would be punishable by a fine up to \$15,000 and/or imprisonment of up to one year. Apparently, there is no data to indicate how many criminal violations would occur. However, in Fiscal Year 2006-07, the department issued 44 fines totaling \$189,600 against appraisers for various violations, although the exact reason is not known. The department collected \$43,250 in revenue from fines assessed in FY 2006-07. The department opened 248 new investigations during the year.

Senate Bills 343 and 356 would have an indeterminate impact on the Office of Financial and Insurance Regulation, relative to aiding in prosecutions of criminal violations of Secondary Mortgage Loan Act or the Mortgage Brokers, Lenders, and Servicers Licensing Act. The Consumer Mortgage Protection Act (2002 PA 660, MCL 445.1631 et seq.) already provides (1) a person, appraiser, or real estate agent shall not make, directly or indirectly, any false, deceptive or misleading statement or representation in connection with a mortgage loan, including the borrower's ability to qualify for a mortgage loan or the value of the dwelling used to secure repayment of the mortgage loan; (2) a lender shall not condition the payment of an appraisal based upon a predetermined value or the closing of a mortgage loan; and (3) a person shall not directly or indirectly compensate, coerce, or intimidate an appraiser for the purpose of influencing the independent judgment of the appraiser with respect to the value of the dwelling used to secure repayment of the mortgage loan.

The bills would, however, increase revenue (consumer finance fees) for the Office of Financial and Insurance Regulation. In general the bill increases the maximum amount of the fine that may be imposed for violations of the Secondary Mortgage Loan Act and the MBLSL Act. The exact breakdown of the fines under the two acts is not known. However, if tripling the maximum amount of the fine, increases fines of a lesser amount by the same rate, administrative fine revenue under the two mortgage licensing acts could potentially triple. In FY 2006-07, secondary mortgage fines were \$37,725 and fines under the MBLSL Act were \$609,315. The average revenues for each of the previous five years (FYs 2003-2007) were \$72,421 and \$380,317, respectively. Under the two acts, the OFIR commissioner has the authority to set a schedule of fees necessary to defray the costs of administering the two acts. The fees are driven, in part, by the appropriation made to OFIR any carry forward revenue. A significant increase in fine revenue would exert a downward pressure on the fee schedule established by the commissioner.

In regards to the criminal penalties, the fiscal impact of House Bill 4054 and Senate Bill 343 and 356 would depend on how they affected the numbers and severity of misdemeanor sentences, which generally are a local responsibility. There are no data to indicate how many offenders might be affected by the bills. To the extent that more offenders were convicted of misdemeanors and sentenced to local sanctions, local units of government could incur increased costs of misdemeanor probation supervision and jail incarceration, both of which vary by jurisdiction. If elimination of the three-year misdemeanor penalty affected the numbers of offenders who otherwise would be sentenced to prison or state probation supervision, the state could experience avoided costs of prison incarceration or probation supervision. Any increase in penal fine revenues could benefit local libraries, which are the constitutionally-designated recipients of those revenues.

ARGUMENTS:

For:

Many factors have contributed to the rising numbers of foreclosures in the state and around the country. Historically, loss of employment, divorce, illness, disability, substance abuse or gambling addictions, and poor money management skills have been the main forces driving a family into foreclosure. More recently, many would agree that predatory lending practices, coupled with the use of adjustable rate mortgage products and declining levels of equity in homes have set many homeowners on the path to foreclosure. By 2004, 34 percent of home loans were adjustable rate mortgages and the average homeowner equity was 55 percent—down from 68 percent from the early 1970s (*Home Insecurity: How Widespread Appraisal Fraud Puts Homeowners At Risk*, Demos, March 2005). Many of these adjustable rate mortgages were subprime loans (meaning loans made to people with lower credit scores and therefore a higher risk of defaulting). Though subprime loans may be appropriate in some situations, the recent real estate boom and increased use of subprime loans opened the door to homeownership for people who previously did not qualify for mortgage loans.

Many would also agree that a piece of the foreclosure puzzle is the widespread problem of appraisal fraud. According to the Demos report, appraisal fraud "encourages homeowners to borrow more money than their homes are worth, putting them at risk of not being able to sell for a high enough price to pay off their mortgage." Reportedly, at least half of appraisers report being pressured by loan originators and brokers to inflate a home's value to a predetermined amount—an amount that would give the broker or lender a higher commission—rather than base the value on an analysis of the current market. Though an inflated appraisal nets a larger commission for the mortgage broker and/or lender, the appraiser typically gets his or her usual pay, about \$350-\$450 per appraisal. Appraisers maintain that resisting such pressure is futile because the mortgage broker or lender will just give the appointment to an appraiser who will "hit the number," (as the practice is called). The appraiser may then find himself or herself blacklisted from getting future jobs. Some even report being denied payment for appraisals they've completed if they didn't report the home's value at the amount requested by the lender or broker.

The practice has become so widespread that many believe one way to curtail abuses is to it a crime to pressure an appraiser to inflate a home's value. The bill package would do that and more. Under the bills, it would be a misdemeanor offense with a hefty maximum fine for a person or entity to coerce an appraiser to inflate the value of real property. Similarly, it would also be a misdemeanor for an appraiser to collude with anyone else to inflate a home's value. Since the bills apply only to intentional conduct, the bills are not expected to inhibit the flow of communication between lenders or mortgage brokers and appraisers that is typical in the normal course of business. Further, the bills would increase civil fines for certain violations of the Secondary Mortgage Loan Act and Mortgage Brokers, Lenders, and Servicers Licensing Act and apply the civil fines and other administrative sanctions to persons who aided and abetted another in violating the acts.

If enacted, the bills should encourage appraisers to say NO to requests to inflate appraisals. Moreover, lenders and brokers should be deterred from coercing appraisers with threats and withholding of payments since the appraiser could report them to the police. The benefit to future homeowners is that they will not be tricked into paying more than their homes are worth. Having a smaller mortgage, and one that more closely reflects true market value, will go a long way in decreasing an individual homeowner's risk for foreclosure.

Against:

Michigan already prohibits coercing an appraiser from making a fraudulent appraisal, and was one of the first states to do so. The problem, therefore, may be more of a lack of enforcement of existing laws rather than a need to create new ones. State enforcement agencies have seen their staff levels slashed due to the poor state economy. Statewide, local governments have almost two thousand fewer law enforcement officers. Jails are overcrowded and courts are overburdened. Simply creating yet another new crime category will not in and of itself correct the problem of appraisal fraud.

Instead, adequate staffing of regulatory agencies is needed to investigate complaints and levy administrative sanctions. Recent legislation increasing the regulation of mortgage loan officers should also go a long way to screen out those likely to engage in appraisal fraud. Other steps that could be taken to reduce the problem of appraisal fraud would be to adopt regulations encouraging more independence from brokers and lenders on the part of appraisers to minimize conflicts of interest, and to streamline the complaint process (often, multiple agencies regulate various players and it isn't clear to whom to report a violation or suspected violation). Further, more resources need to be allocated to educating the public on the pitfalls, scams, and predatory lending practices involved in homeownership before going to that first open house.

Response:

The bills are not presented as a "cure" for the foreclosure crisis or appraisal fraud. However, making appraisal fraud a criminal offense provides one more tool for prosecutors to shut down those profiting at the expense of innocent homebuyers.

POSITIONS:

A representative of the Michigan Mortgage Lenders Association testified in support of the bills. (5-27-08)

A representative of Michigan ACORN testified in support of the bills. (5-27-08)

The Michigan Association of Realtors indicated support for the bills. (5-27-08)

The Michigan Bankers Association indicated support for the bills. (5-27-08)

The Michigan Mortgage Brokers Association indicated support for the bills. (5-27-08)

AARP indicated support for the bills. (5-27-08)

The Office of Attorney General indicated support for Senate Bills 343 and 356. (5-27-08)

Legislative Analyst: Susan Stutzky
Fiscal Analyst: Mark Wolf
Marilyn Peterson

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.