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TO: Members of the House Committee on Business and Labor

FROM: Appraisal Institute
Contact: Scott DiBiasio

RE: HB No. 3419 – Relating to Broker Price Opinions

POSITION: **Support**

The Appraisal Institute appreciates the opportunity to offer this testimony in support of HB 3419 regarding placing limitations on the use of broker price opinions by financial institutions. We have submitted a package of amendments and would appreciate their favorable consideration by the committee.

The Appraisal Institute is a global professional association of real estate appraisers, with nearly 21,000 professionals in almost 60 countries throughout the world. Its mission is to advance professionalism and ethics, global standards, methodologies, and practices through the professional development of property economics worldwide. Individuals of the Appraisal Institute benefit from an array of professional education and advocacy programs, and may hold the prestigious MAI, SRPA, SRA, AI-GRS, and AI-RRS designations.

Our position has long been that financial institutions should be precluded from using BPOs for all residential and commercial mortgage loan origination, in foreclosure situations, and for purposes of short sales. This is primarily due to the potential for a broker or salesperson to be biased in favor of their client – the financial institution – when performing these services. State licensed and certified real estate appraisers are required by law to be independent, impartial, and objective when performing real estate valuation services and are prohibited from being biased towards any one party in a real estate transaction. These same protections do not exist for real estate brokers and salespersons.

In mortgage loan origination transactions, for example, there is nothing to prevent a financial institution from attempting to inappropriately influence a broker or salesperson to report a pre-determined result in a BPO. Financial institutions are in the business of making residential and commercial mortgage loans. In most cases, they will do whatever is necessary to make those loans close. Unfortunately, obtaining an accurate and reliable valuation of the real estate collateralizing a loan is often seen as merely a regulatory requirement and an impediment to the closing of deals. Financial institutions will often obtain valuations from the party that is able to provide the valuation in the shortest amount of time at the lowest possible price. We saw during the real estate run-up that financial institutions had a disregard for the safety and soundness of their institutions in favor of making deals go through. In the case of a residential mortgage loan transaction where an appraisal by a competent and qualified appraiser is not required by federal law, an improperly performed BPO could result in a borrower agreeing to pay too much for a property, and obtaining a mortgage loan on a property for more than the property is realistically worth. This negatively impacts both the borrower and the safety and soundness of the financial institution. The importance of accurate and reliable real estate valuations prepared by individuals who are competent and qualified to apply appropriate valuation methodologies and techniques should not be underestimated. BPOs do not fulfill this need on the part of financial institutions.

Similarly, we believe that financial institutions should be required to obtain an accurate and reliable opinion of the value of a parcel of property as part of their pre-foreclosure due diligence. Lenders have a fiduciary responsibility to obtain the highest value possible on the property to retain whatever equity is left in the property and to reduce whatever amount is owed by the consumer to the lender. In addition, financial institutions have a responsibility to minimize the financial impact of a foreclosure on their institution.

Unfortunately, in an effort to get rid their balance sheets of distressed assets as quickly as possible, financial institutions often sell properties at foreclosure sales at prices that are far below market value and that are set as the result of inaccurate and unreliable BPOs. Importantly, we do not believe that BPOs are sufficient for a financial institution to accurately and reliably determine the condition of properties, the market appeal, and the marketing timeframes for a property. This is particularly true in commercial properties where there may be environmental or other issues associated with the property that may not be evident from a “drive-by” inspection and a review of publicly available data. These are all very important things for a financial institution to consider when making a decision whether or not to foreclose on a property. In addition, an inaccurate and unreliable BPO could result in a financial institution making a decision to foreclose on a property when the more prudent and financially advisable course of action would be a loan modification, workout or restructuring. There are also income tax implications for foreclosed property owners that could result in them underpaying or overpaying income taxes based upon the sales price of the property by the financial institution.

The cost involved should not be the primary consideration when a financial institution contracts with a third-party to provide an estimate of the value of a property subject to a foreclosure proceeding. Instead, the only goal of the institution should be to obtain an accurate and reliable opinion of the value of a subject property that will minimize the impact of the foreclosure proceeding on both the consumer and the financial institution. We do not believe that BPOs provide these assurances to financial institutions. All too often financial institutions obtain valuations in relation to foreclosures merely to satisfy regulatory requirements, rather than to attempt to mitigate the damage to both the consumer and the financial institution.

We also do not believe that BPOs are appropriate for use by financial institutions for short sales. This is particularly due to the potential for short sale fraud. "Short sale flopping" occurs when a short sale is approved based on a misrepresentation of the value of the property by a broker or salesperson. In these cases, a broker or salesperson retained by a financial institution to perform a BPO on a property in relation to a short sale will recruit a “straw purchaser”. The broker or salesperson will then report an artificially low value of the property to the financial institution. The unknowing financial institution believes the value of the property to be reasonable and agrees to the short sale to the “straw purchaser” that was recruited by the broker or salesperson. The straw purchaser takes title to the property and immediately resells it to a third-party buyer at the true market value and pockets the difference between the short sale purchase price and the sale at the true market value. The broker or the salesperson makes a commission on both the short sale and the sale at true market value, and may receive a portion of the difference between the two sale prices.

Estimates are that short sale fraud involving real estate brokers and agents occurs in more than 1 percent of short sale transactions, and results in $50 million in lost revenue to financial institutions annually. There have been several instances where real estate brokers and salespersons have gone to prison for supplying fraudulent broker price opinions in relation to short sale transactions.

In summary, we do not believe that the risks associated with financial institutions using BPOs for mortgage loan origination transactions, foreclosures, and short sales are worth the difference in price between a BPO and an accurate and reliable appraisal performed by a competent and qualified real estate appraiser that is acting independently from any party with a financial, or other, interest in the transaction.

We strongly support the intent of HB 3419 to preclude financial institutions in Oregon from using BPOs for purposes of mortgage loan originations, foreclosures and short sales.