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Resources, Community, and
Economic Development Division

B-279604

May 6, 1998

The Honorable Rick A. Lazio
Chairman, Subcommittee on Housing
and Community Opportunity
Committee on Banking
and Financial Services
House of Representatives

Subject: Appraisals for FHA Single-Family Loans: Information on Selected Properties in New Jersey and Ohio

Dear Mr. Chairman:

Property appraisals are an important part of the underwriting process for mortgages insured through the Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA) because they influence the amount of the loans and FHA's corresponding financial exposure. Since December 1994, private mortgage lenders making FHA-insured loans for single-family housing have been able to select any licensed or certified appraiser listed on FHA's roster. Before that time, appraisals for FHA-insured loans were conducted almost exclusively by a panel of fee appraisers whom FHA assigned to the lenders on a rotational basis. HUD estimates that in fiscal year 1997, over 1 million appraisals were conducted for the purposes of FHA mortgage insurance.

Some former fee panel appraisers are opposed to the change in FHA's selection process for appraisers because they believe that some lenders are selecting appraisers who are not accurately reporting the value and physical condition of the homes they appraise. They believe that if left uncorrected, this situation will increase the financial risks to FHA if borrowers default on their mortgage loans. They also contend that inaccurate reporting on the physical condition of

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homes results in borrowers' not knowing the extent and cost of needed home repairs.[1]

Because of these allegations, you asked us in an October 28, 1997, letter to review claims made by some former fee panel appraisers who had raised concerns regarding the quality of the appraisals for several properties in New Jersey and Ohio. Specifically, you requested that we determine the extent to which these appraisals completely and accurately described the condition of the properties. This report provides information on the nine properties--six in New Jersey and three in Ohio--that we visited in November 1997 and January 1998, respectively. As agreed with your office, the properties we visited were selected by the former fee panel appraisers to illustrate their concerns. As a result, the properties were not representative of all properties appraised for FHA mortgage insurance. This report also discusses issues regarding HUD's oversight of the appraisal process that came to our attention during the course of our work.

In brief, we found the following:

- The appraisal reports for eight of the nine properties did not reflect conditions we observed that could adversely affect the structural soundness and continued marketability of the houses and the health and safety of the occupants. Examples of conditions we observed that were not reflected in the reports included termite damage, masonry and foundation damage, makeshift structural supports, rotted siding, and deteriorated roofing shingles.[2] As of February 1998, five of these eight properties had been purchased with FHA-insured mortgages. The ninth property we visited did not have any significant visible defects, and the appraisal report accurately reflected the conditions we observed at the home.

- HUD's field offices in Camden, New Jersey, and Cleveland, Ohio, did not adequately monitor the performance of the appraisers for the properties we visited. A HUD contractor who performed field reviews of the appraisals for

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[1]We discussed these concerns in our report <u>Homeownership: Information on Changes in FHA's New Single-Family Appraisal Process</u> (GAO/RCED-97-176, July 25, 1997).

[2]Because the appraisals for the nine properties were conducted anywhere from 3 to 35 months prior to our visits, we could not be certain whether all the conditions we observed were present at the time of the appraisals. However, to the extent possible, we corroborated our observations with photographs taken by the appraisers, field evaluations of the appraisals, and statements from the homeowners.

three of the New Jersey homes concluded that the appraisers overlooked serious deficiencies and should have rejected the properties. The Camden office could locate only one of the three field review reports in its files. The appraiser for two of the Ohio properties had received four "unacceptable" ratings in field reviews conducted in fiscal year 1997–grounds for possible removal from FHA's roster of appraisers–but the Cleveland office had not taken any disciplinary action against the appraiser.

BACKGROUND

The National Housing Act (12 U.S.C. 1709) authorizes FHA to insure mortgage loans made by private lending institutions to buyers of single-family homes. The amount that FHA can insure is based, in part, on the appraised value of the home. If a borrower defaults and the loan is subsequently foreclosed, the lender can recover losses from FHA, including the unpaid principal balance of the loan.

The purpose of an FHA appraisal is to (1) determine the property's eligibility for mortgage insurance on the basis of its condition and location and (2) estimate the value of the property for mortgage insurance purposes. In performing these tasks, the appraiser is to identify any visible deficiencies impairing the safety, sanitation, structural soundness, and continued marketability of the property and assess the property's compliance with FHA's other minimum property standards.

According to HUD's guidance, if an appraiser finds noncompliance with these standards, the appraiser should include in the appraisal report an appropriate and specific action to correct the deficiency. It further states that the appraiser should reject a property for purposes of FHA mortgage insurance when compliance with FHA's minimum standards is not feasible or would require major repairs or alterations. HUD's guidance specifically refers to termite damage, leaking or worn-out roofs, and masonry and foundation damage as examples of typical conditions requiring repairs. To be listed on FHA's roster, appraisers are required to sign a document stipulating that they have read the pertinent HUD guidance.

Prior to December 1994, most appraisals for FHA-insured home loans were conducted by approximately 6,000 fee panel appraisers whom FHA assigned to lenders on a rotational basis.[3] In 1990, legislation was enacted allowing lenders

[3]FHA's policy at that time also allowed lenders' in-house appraisers to conduct appraisals.

to choose the appraisers.[4] This was done to (1) improve the efficiency of lenders, who would no longer have to rely on HUD's field office staff to assign appraisers, and (2) improve the quality and reliability of appraisal services for HUD's mortgage assistance and other housing programs by promoting uniform eligibility standards for those performing federal appraisals. HUD implemented the legislation in December 1994 and began to develop a roster of appraisers from which lenders could select. In January 1996, FHA informed its lenders that effective March 1, 1996, they had to select appraisers from FHA's roster of about 31,000 state-licensed or -certified appraisers.

APPRAISALS MIGHT HAVE OMITTED SIGNIFICANT DEFICIENCIES

Appraisal reports for eight of the nine properties we visited in New Jersey and Ohio did not reflect conditions we observed that could adversely affect the structural soundness and continued marketability of the houses and the health and safety of the occupants. According to HUD's guidance, the appraiser should note such conditions in the appraisal report and either call for repairs or reject the property for FHA mortgage insurance, as appropriate.

All six of the New Jersey properties had significant defects that were not reflected in the appraisal reports. For example, a load-bearing beam in the basement of one home was supported by seven screwjacks–a type of temporary support–which were not secured to the beam or the floor. In addition, the beam showed evidence of termite damage and had a notch approximately 4 inches deep and 30 inches long cut out of it. The appraisal report did not require the repair or inspection of these conditions or even mention them. A second property had large holes in the basement wall and floor as well as nine unsecured screwjacks and loosely stacked concrete blocks serving as structural supports. Another property had an uncovered, pull-cord light fixture above a bathtub and shower, a missing handrail on the open side of a basement stairwell, and a damaged foundation. However, none of these conditions were identified in the appraisal reports. Examples of deficiencies omitted from the other appraisal reports included deteriorated roofing shingles, rotted wood siding, and fire damage. Additional details about each of the New Jersey properties appear in table I.1 in enclosure I.

Two of the three properties we visited in Ohio had deficiencies that were not identified in the appraisal reports. For example, one home had a doorway that led from a second-floor bedroom onto a sloped section of the roof that had no

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[4]Section 322 of the Cranston-Gonzalez National Affordable Housing Act of 1990, amended section 202(e) of the National Housing Act, allowing lenders to choose the appraisers for mortgages to be insured by FHA.

safety railing. The other home had cracks in the foundation and a damaged masonry support column in the basement. In addition, the owners of both of these properties told us that their roofs had leaked after they moved in and had to be replaced. The appraiser for one of the homes had required a roofing inspection and certification, but the other appraiser had not. The remaining Ohio property had no significant visible defects, and the appraisal accurately reflected the conditions we observed during our visit. Additional details about each of the Ohio properties appear in table I.2 in enclosure I.

As of February 1998, five of the eight properties that had significant defects had been purchased with FHA-insured mortgages. For the remaining three properties, the mortgage lender had either not approved the mortgage for credit reasons or had not submitted the case to HUD for its approval of mortgage insurance.

During the course of our work, we discussed with HUD officials our observations on the nine properties. As a result of these discussions, HUD has begun to take follow-up actions on some properties.

HUD'S OVERSIGHT OF SOME APPRAISERS WAS LIMITED

Our work at HUD's Camden, New Jersey, and Cleveland, Ohio, field offices indicated that they did not adequately monitor the performance of the appraisers for some of the properties we visited. Field reviews of completed appraisals are an important tool for identifying poorly performing appraisers and for determining whether appraisals comply with statutory, regulatory, and administrative requirements. A HUD contractor who in September 1997 performed field reviews of the appraisals for three of the six New Jersey homes concluded that the appraisers overlooked serious deficiencies and should have rejected the properties.[5] However, HUD's Camden office could locate only one of the three field review reports in its files. Moreover, HUD's Philadelphia Homeownership Center subsequently approved FHA mortgage insurance for one of these three properties, even though the center's staff had information about problems with the appraisal and the condition of the home. After we brought this situation to the attention of the homeownership center's director, he acknowledged that the property should not have been insured and removed the appraiser from FHA's roster. The homeownership center also instructed the mortgage lender to pay for the repairs that were necessary to bring the property into compliance with FHA's standards.

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[5]According to HUD, the remaining three appraisals did not undergo field reviews.

At HUD's Cleveland office, we found that the appraiser for two of the three Ohio properties had received four "unacceptable" ratings in field reviews conducted in fiscal year 1997, grounds for possible removal from FHA's roster of appraisers. However, a single-family housing specialist from that office told us that because of staffing constraints, none of the four field review reports had been reviewed by HUD's technical staff and that no disciplinary action had been taken against the appraiser. In addition, although HUD requires its field offices to review 10 percent of the appraisals conducted within their jurisdictions, HUD's Cleveland office conducted no field reviews from October 1997 until February 1998 because of delays in renewing the field reviewers' contracts.

AGENCY COMMENTS

HUD provided us with comments on a draft of this report. (See enc. II.) HUD stated that it agreed with our findings and would conduct its own investigation of the properties identified in the report. HUD also indicated that it would evaluate what changes could be made to the appraisal process to prevent the recurrence of similar problems.

SCOPE AND METHODOLOGY

The nine properties we visited–six in New Jersey and three in Ohio–were selected by five former fee panel appraisers to illustrate their concerns about FHA's current selection process for appraisers. We visited the six New Jersey properties in November 1997 and the three Ohio properties in January 1998. Because the appraisals for these properties were conducted prior to our visits, we could not be certain whether all the conditions we observed were present at the time of the appraisals.[6] To the extent possible, we corroborated our observations with photographs taken by the appraisers, appraisal field review reports, and statements from the homeowners. All of the appraisals were conducted after HUD had implemented the system allowing lenders to select appraisers. The manner in which these properties were selected prevents us from generalizing the results for these properties to all properties appraised for FHA mortgage insurance.

In conducting our work, we reviewed the pertinent HUD guidance on appraisals as well as appraisal reports, field review reports, and data from HUD's Computerized Homes Underwriting Management System for each property. We also interviewed homeowners, former fee panel appraisers, representatives from

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[6]For the six New Jersey properties, the approximate time between the appraisals and our visits ranged from 3 to 5 months for four of the homes and 17 months and 35 months for the remaining two homes. For the three Ohio properties, the approximate time that elapsed was 8, 11, and 18 months.

appraisers' groups, and officials dealing with single-family housing matters from HUD's headquarters, Camden and Cleveland field offices, and Philadelphia Homeownership Center.

We performed this review from November 1997 through March 1998 in accordance with generally accepted government auditing standards.

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As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 15 days from the issue date. At that time, we will send copies of this report to the appropriate Senate and House committees; the Secretary of HUD; and the Director, Office of Management and Budget. We will also make copies available to others on request.

Please call me at (202) 512-7631 if you or your staff have any questions. Major contributors to this report were Paul Schmidt, Stan Ritchick, and Steve Westley.

Sincerely yours,

Judy England-Joseph

Judy A. England-Joseph
Director, Housing and Community
Development Issues

Enclosures - 2

ENCLOSURE I

INFORMATION ON THE NEW JERSEY AND OHIO PROPERTIES VISITED BY GAO

Table I.1: Information on the Six New Jersey Properties

	Date of appraisal	Date FHA approved mortgage insurance	Amount insured by FHA	Examples of conditions that GAO observed in November 1997 that were not reflected in the appraisal report
Property 1	12/22/94	3/22/95	$94,800	The home had no gutters or downspouts, and algae and water stains covered large portions of the exterior walls.
Property 2	6/11/96	5/9/97	$84,900	Seven screwjacks and two 6-by-6-inch wood posts supported a load-bearing beam in the basement. The screwjacks were not secured to the floor or the beam, and the beam had termite damage. In addition, a notch approximately 4 inches deep and 30 inches long had been cut out of the beam.
Property 3	6/9/97	Mortgage not approved by lender	$0	The first-floor bathroom had an uncovered, pull-cord light fixture above the bathtub and shower. The open side of the basement stairway had no handrail.
Property 4	7/1/97	1/23/98	$72,403	Nine screwjacks supported beams and floor joists in the basement. Stacked concrete blocks and small screwjacks supported floor joists in the basement crawl space.
Property 5	7/30/97	Mortgage not insured by FHA as of 2/98	$0	Portions of the exterior wood siding were rotten, and the garage ceiling had extensive fire damage. A broken clothes dryer duct vented into the basement crawl space.
Property 6	8/22/97	Mortgage not insured by FHA as of 2/98	$0	The kitchen ceiling sagged. Stacked bricks and concrete blocks supported floor joists in the basement crawl space.

ENCLOSURE I

Table I.2: Information on the Three Ohio Properties

	Date of appraisal	Date FHA approved mortgage insurance	Amount insured	Examples of conditions that GAO observed in January 1998 that were not reflected in the appraisal report
Property 1	7/11/96	10/30/96	$58,844	The foundation was cracked, and a masonry support column in the basement was crumbling.
Property 2	1/31/97	5/6/97	$54,039	None.
Property 3	5/23/97	7/17/97	$50,409	A doorway in the second-floor bedroom led out onto a sloped section of the roof that had no safety railing.

ENCLOSURE II

COMMENTS FROM THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-8000

APR 23 1998

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

Ms. Judy England-Joseph
Director
Housing and Community
Development Issues
General Accounting Office
441 G Street, NW, Room 2056
Washington, DC 20548

Dear Ms. England-Joseph:

Thank you for the opportunity to comment on the proposed audit report Appraisals for FHA Single-Family Loans: Information on Selected Properties in New Jersey and Ohio (GAO/RCED-98-145R, Code 385706). The Department is supportive of the review and the observations identified by the General Accounting Office (GAO). The issues raised regarding the appraisals are of great concern to us. As with the observations identified in Information on Changes in FHA's New Single-Family Appraisal Process (GAO/RECD-97-176), we will use this information to continue to improve the quality of appraisals prepared for FHA insured mortgages.

FINDINGS BY THE GAO

GAO reviewed nine properties and concluded that the appraisals for eight of the nine properties did not reflect all of the adverse conditions existing in the properties at the time of the appraisals. GAO also found that certain field offices did not adequately monitor the performance of the appraisers for the properties visited. The observations were not limited to one particular lender or appraiser. GAO stated that the nine properties, brought to the attention of GAO by former FHA fee panel appraisers, were not representative of all properties appraised for FHA mortgage insurance.

THE DEPARTMENT'S RESPONSE

After a file review, the Department agrees with the findings and GAO's conclusion that the eight selected properties are not representative of all properties appraised for FHA mortgage insurance annually. The Department's goal is that every appraisal be correct and accurate. In this regard the Department believes the following changes will improve the appraisal process:

Organizational Changes

Under the Department's 2020 reorganization plan, FHA has reengineered its mortgage insurance operations and has streamlined its operations to improve customer service. This was accomplished by consolidating its 81 field offices into four homeownership centers (HOCs). Each HOC has five divisions, which include a Quality Assurance Division as well as a Customer Assistance staff. The benefit of this structure is that it creates a more responsive organization for mortgagors and mortgagees. This consolidated approach will improve the monitoring, consistency and enforcement in the single family programs. Moreover, the assurance of appraisal quality has been established as a major priority under the new HOCs.

Actions To Improve Appraisal Quality

The Department continues to take actions to improve its monitoring, control and oversight of the appraisal process. Since GAO issued its last report, FHA has taken four separate actions to improve quality in the appraisal process. These actions were:

- Two sets of instructions were issued to the HOCs. One set provided additional guidelines on removing a poor performing appraiser from the FHA Appraiser Roster. The other instructions provided additional guidance for monitoring the quality of appraisals and enforcement actions and sanctions against appraisers and lenders.

- Through a Mortgagee Letter, the Department emphasized to mortgagees the importance of the appraisal and that appropriate administrative action will be taken against any mortgagee that engages in unacceptable appraisal practices.

- The Department established a national management plan goal to perform field reviews and desk reviews on no less than 10 percent of the appraisals conducted within each HOC's jurisdiction.

The Department's future efforts to improve the quality of appraisals include the implementation of a testing process in FY 99 for all appraisers who wish to perform FHA appraisals to ensure that an appraiser has a basic level of understanding of FHA processes and requirements. Also, the Department is considering recommending legislation authorizing FHA to withdraw a lender's authority to select from the FHA Appraiser Roster for just cause.

In addition to our efforts to improve the quality of appraisals, we have taken steps to ensure affirmative selection of female and minority appraisers.

Selection of Female and Minority Appraisers

When mortgagees were granted the authority to select appraisers, there was considerable concern that mortgagees would not select female and minority appraisers in proportion to their availability on the roster. In addition to the actions FHA has taken prior to GAO's last review, we have taken the following actions:

- The Department posted on its webpage lender's selection of female and minority appraisers in relationship to the total number of appraisals prepared on their behalf. This information is available to the lenders now and will be available to the general public in May 1998.

- The Department has issued a mortgagee letter stating that female and minority appraisers should be affirmatively selected for a fair share of appraisal assignments.

Follow up on Appraisals Identified in GAO's Report

The Department will conduct its own complete investigation of the properties noted in the report, including a visitation to each property by HUD staff. The information on the properties has been forwarded to the Philadelphia HOC which will perform the field work. Once its investigation is complete, appropriate action will take place, including an evaluation to determine what changes in the appraisal process might be made to preclude situations such as these from recurring.

CONCLUSION

Let me again assure you that the findings of GAO are of great concern to us. It is our intent to continue our efforts to ensure accurate appraisals in FHA's Single Family Mortgage Insurance Program. If you or your staff should need additional information, please feel free to call me on (202) 708-3600.

Sincerely,

Art Agnos
Acting General Deputy Assistant
Secretary for Housing-Federal
Housing Commissioner

(385706)

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