

November 2004

# SINGLE-FAMILY HOUSING

## HUD's Risk-Based Oversight of Appraisers Could Be Enhanced



G A O

Accountability \* Integrity \* Reliability



Highlights of [GAO-05-14](#), a report to congressional addressees

## Why GAO Did This Study

Incomplete or inaccurate appraisals resulting in property overvaluations may expose the Department of Housing and Urban Development's (HUD) Single-Family Mortgage Insurance programs—which insured about 3.7 million single-family mortgage loans with a total value of about \$425 billion in fiscal years 2001 through 2003—to greater financial risks. In 1999, GAO reported on the need for improvements in HUD's oversight of appraisers, which has historically been a challenge for the department. Also, in the past, GAO reported that, due in part to poor oversight of appraisers, HUD's Single-Family Mortgage Insurance programs remained a high-risk area. GAO conducted this review as a follow up to the 1999 report. This report examines (1) how HUD ensures that appraisers it approves are qualified to perform FHA appraisals, (2) the extent to which HUD employs a risk-based monitoring approach, and (3) HUD's efforts to take enforcement action against noncompliant appraisers.

## What GAO Recommends

GAO is making four recommendations aimed at enhancing HUD's appraiser oversight processes. In responding to a draft of this report, HUD agreed with three of these recommendations, but disagreed with the presentation of its accomplishments as well as some of the findings.

[www.gao.gov/cgi-bin/getrpt?GAO-05-14](http://www.gao.gov/cgi-bin/getrpt?GAO-05-14).

To view the full product, including the scope and methodology, click on the link above. For more information, contact David G. Wood at (202) 512-6878 or [woodd@gao.gov](mailto:woodd@gao.gov).

## SINGLE-FAMILY HOUSING

### HUD's Risk-Based Oversight of Appraisers Could Be Enhanced

#### What GAO Found

Through new guidance and regulation, HUD has strengthened its criteria for placing appraisers on its appraiser roster—which establishes their eligibility to participate in HUD programs. Before 1999, HUD relied largely on the states' licensing processes to ensure that appraisers were qualified, but the states' minimum licensing standards did not specifically include proficiency in HUD's appraisal requirements. HUD's 1999 guidance requires appraisers to, among other things, pass an examination on HUD appraisal methods and reporting. Further, a 2003 regulation provides for, among other things, removing from the roster appraisers whose licenses have been suspended or revoked. However, HUD has limited quality control over the approval process, limiting the department's assurance that its criteria are being effectively implemented.

HUD has adopted an oversight approach that focuses on appraisers it believes pose risks to FHA's mortgage insurance fund, but certain weaknesses exist in its implementation. HUD's guidance calls for its homeownership centers (HOCs)—which are largely responsible for appraiser oversight—to develop quarterly targeting lists of appraisers for review based on certain criteria, or risk factors. The primary factor is the rate of defaults in certain loans associated with the appraiser; others include large numbers of appraisals as well as appraisals for loans made under one of HUD's programs known to be at higher risk of fraud and abuse. However, the HOCs do not maintain a permanent record of the data used to identify the targeted appraisers—even though HUD's automated system would enable them to—which limits HUD's ability to verify that those targeted were those that met the criteria and to determine the effectiveness of its targeting criteria in reducing risk to the mortgage insurance fund. GAO found that during fiscal year 2003 and the first half of fiscal year 2004 the HOCs generally reviewed the appraisers they identified as high risk and targeted for review. However, they reviewed fewer appraisals for each targeted appraiser than HUD's guidance prescribes: on average, about 5.6 appraisals instead of the 10 called for. GAO also found that HOC staff did not routinely visit appraised properties to verify the work of contractors who conduct field reviews of selected appraisers.

To facilitate enforcement actions against appraisers, HUD expanded the HOCs' authority to sanction appraisers and developed a new appraisal scoring system. According to HUD, the number of actions taken to remove appraisers from its roster has increased from 25 at a cost of over \$10 million in 1998 to 132 at a cost of under \$300,000 in 2003. HUD also developed a tool that scores each appraiser on several appraisals, weighting the scores to capture violations that pose the greatest risk to FHA's mortgage insurance fund. According to HUD, this tool allows the department to sanction appraisers more consistently.

---

# Contents

---

---

<b>Letter</b>		1
	Results in Brief	2
	Background	4
	HUD Has Strengthened Its Criteria for Placing Appraisers on Its Roster, but Has Limited Assurance that These Criteria Are Being Implemented	7
	HUD Focuses on Appraisers with Known Risks to FHA's Mortgage Insurance Fund, but Weaknesses Exist in Implementing These Efforts	10
	HUD Has Expanded the Authority of the HOCs and Developed an Appraisal Scoring System to Facilitate Enforcement Actions	15
	Conclusions	21
	Recommendations for Executive Action	22
	Agency Comments	22

---

<b>Appendixes</b>		
	<b>Appendix I: Scope and Methodology</b>	26
	<b>Appendix II: Comments from the Department of Housing and Urban Development</b>	28
	<b>Appendix III: GAO Contacts and Staff Acknowledgments</b>	39
	GAO Contacts	39
	Staff Acknowledgments	39

---

<b>Table</b>	Table 1: Number of Field Reviews Compared to Number of Removals, 1998–2003	18
--------------	--	----

---

<b>Figures</b>	Figure 1: Appraisals as Part of the Home-Buying Process	5
	Figure 2: Map of United States Showing HOC Regions and the Number of Appraisers in Each Region	6
	Figure 3: Number of Appraisers Targeted and Reviewed by HOC	13
	Figure 4: Average Number of Desk Reviews Performed on Each Appraiser Reviewed by HOC	14
	Figure 5: Number of Appraisers Field Reviewed Compared to Number and Types of Sanctions Imposed during Fiscal Year 2003 and the First Half of Fiscal Year 2004	17
	Figure 6: Appraisal Review Process Flow Chart	20

---

**Abbreviations**

FHA	Federal Housing Administration
GAO	Government Accountability Office
HOC	homeownership centers
HUD	Department of Housing and Urban Development

This is a work of the U.S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.



United States Government Accountability Office  
Washington, D.C. 20548

November 5, 2004

The Honorable Paul Sarbanes  
Ranking Minority Member  
Committee on Banking, Housing, and Urban Affairs  
United States Senate

The Honorable Michael Oxley  
Chairman  
The Honorable Barney Frank  
Ranking Minority Member  
Committee on Financial Services  
House of Representatives

Incomplete or inaccurate real estate appraisals resulting in property overvaluations could expose the Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA)—which insured about 3.7 million single-family mortgage loans with a total value of about \$425 billion in fiscal years 2001 to 2003—to greater financial risks.<sup>1</sup> Effectively overseeing the appraisers who prepare appraisals for its Single-Family Mortgage Insurance programs has historically been a challenge for HUD. In April 1999, we reported that weaknesses in HUD's appraiser approval, monitoring, and enforcement efforts pointed to the need for improvements.<sup>2</sup> We have also reported in the past that due in part to poor appraiser oversight, HUD's Single-Family Mortgage Insurance programs remained a high-risk area for the department.<sup>3</sup> Furthermore, HUD's Inspector General noted in its most recent semiannual report to Congress that its audits and investigations continue to reveal fraud and abuse in HUD's Single-Family Mortgage Insurance programs.<sup>4</sup>

---

<sup>1</sup>FHA is a part of HUD, and the Assistant Secretary for Housing is also the Federal Housing Commissioner.

<sup>2</sup>GAO, *Single-Family Housing: Weaknesses in HUD's Oversight of the FHA Appraisal Process*, [GAO/RCED-99-72](#) (Washington, D.C.: Apr. 16, 1999).

<sup>3</sup>GAO, *Major Management Challenges and Program Risks: Department of Housing and Urban Development*, [GAO-03-103](#) (Washington, D.C.: January 2003).

<sup>4</sup>U.S. Department of Housing and Urban Development, Office of Inspector General, *Semiannual Report to Congress, October 1, 2003 through March 31, 2004* (Washington, D.C.: Mar. 31, 2004).

---

We conducted this review at the initiative of the Comptroller General and as a follow up to our 1999 report. This report examines HUD's processes for listing appraisers on its roster—which establishes their eligibility to participate in the department's Single-Family Mortgage Insurance programs—and for overseeing the appraisers' work. Specifically, this report examines (1) how HUD ensures that appraisers it approves to perform appraisals under its Single-Family Mortgage Insurance programs are qualified to be placed on the appraiser roster; (2) the extent to which HUD uses a risk-based approach when monitoring the appraisers participating in its Single-Family Mortgage Insurance programs; and (3) HUD's efforts to take enforcement actions against appraisers it identifies as not complying with its requirements. We did not estimate the impact that HUD's appraiser oversight has on the financial health of FHA's mortgage insurance fund.

To address these objectives, we reviewed the activities of HUD's headquarters and its four homeownership centers (HOCs) in Atlanta, Georgia; Denver, Colorado; Philadelphia, Pennsylvania; and Santa Ana, California. Specifically, we reviewed HUD's process for approving appraisers to participate in its programs. Also, at each HOC, we obtained and analyzed data on the appraisers targeted for review by HUD during fiscal year 2003 and the first half of fiscal year 2004. In addition, we examined data on the types and number of enforcement actions HUD has taken against appraisers. We assessed the reliability of the HUD data we used by reviewing information about how the data were collected, and we performed electronic testing to detect obvious errors in completeness and reasonableness. We determined that the data were sufficiently reliable for the purposes of this report. We performed our work from December 2003 to August 2004 in accordance with generally accepted government auditing standards. Appendix I provides additional details on our scope and methodology.

---

## Results in Brief

Through new guidance and regulation, HUD has strengthened its criteria for placing appraisers on its appraiser roster, but control weaknesses limit assurance that these criteria are being implemented. Before 1999, HUD relied largely on the states' licensing processes to ensure that appraisers were qualified to perform appraisals, but the states' minimum licensing standards did not specifically include proficiency in HUD's appraisal requirements. In 1999, HUD issued guidance that required appraisers to (1) pass an examination on HUD appraisal methods and reporting; (2) meet either state licensing standards or certification standards based on criteria

---

issued by the private Appraisal Qualifications Board,<sup>5</sup> and (3) not be listed on various government and HUD excluded-party lists. Also, in 2003, HUD published a final rule making several changes to the licensing and certification requirements for the roster. Although HUD increased the requirements for placing appraisers on the roster, it has limited controls for assuring that only eligible appraisers are listed. Specifically, HUD does not routinely conduct quality control reviews of this process to ensure that it is being implemented appropriately.

HUD has focused its appraiser oversight efforts on appraisers that it has determined pose risks to FHA's mortgage insurance fund, but weaknesses exist in implementing these efforts. HUD's guidance calls for each HOC to target for review at least 30 appraisers each quarter, based on several risk factors. The primary risk factor is the "early default rate" of loans associated with the appraiser. (Early defaults are those that (1) occur within 12 months of loan origination and (2) represent a delinquency of 90 days or greater.) From this initial pool of appraisers associated with high early default rates, the HOCs identify those appraisers who during the preceding year performed 10 or more appraisals and who performed appraisals for five or more defaulted mortgages. The HOCs also target for review appraisers who performed appraisals in connection with loans insured under HUD programs known to be at higher risk of fraud and abuse. Although it is the primary factor behind HUD's targeting approach, the HOCs do not maintain a permanent record of the data used to identify the initial pool of appraisers for review each quarter. Because of this, we could not verify that the targeted appraisers were actually those that met HUD's criteria. The HOCs generally reviewed the appraisers that were targeted as high risk. Specifically, the HOCs reviewed about 78 percent of the 936 appraisers placed on the target lists during fiscal year 2003 and the first half of fiscal year 2004. However, the HOCs did not perform as many desk reviews—analyses of written appraisal reports for completeness, compliance, and reasonable and logical conclusions of property value—per appraiser reviewed as HUD's guidance calls for. Specifically, while the guidance instructs HOCs to perform desk reviews of at least 10 appraisals prepared by each appraiser reviewed, the HOCs performed, on average, about 5.6 desk reviews. Further, HUD staff did not routinely visit properties to verify the work of contractors responsible for conducting field

---

<sup>5</sup>The Appraiser Qualifications Board promulgates and maintains the Appraiser Qualifications Criteria, which all appraisers must meet in order to be certified by state appraiser regulatory agencies.

---

reviews—comprehensive inspections of appraised properties intended to assess the quality of written appraisals.

To facilitate enforcement actions against appraisers the department identifies as not complying with requirements and who pose a risk to FHA's mortgage insurance fund, HUD has, among other things, expanded the HOCs' authority to sanction appraisers and developed a new appraisal scoring system. A 2000 regulation authorized the HOCs to remove appraisers from the appraiser roster. This authority, in conjunction with the adoption of risk-based targeting of appraisers for review, has enabled HUD to increase sanctions while decreasing the number of field reviews. For example, according to HUD, the number of removal actions taken by the department has increased from 25 in 1998 to 132 in 2003, while the number of field reviews decreased from over 83,000 to 1,420. In 2002, HUD developed a Web-based tool, the Appraisal Review Process, which scores each appraiser on several appraisals, weighting the scores to capture violations that pose the greatest risk to FHA's mortgage insurance fund. According to HUD, this tool allows the department to sanction appraisers more consistently. HUD has also issued a final rule providing that lenders who submit appraisals that do not meet HUD requirements are subject to the imposition of sanctions.

This report makes recommendations designed to enhance HUD's processes for implementing its risk-based appraiser oversight. We provided a draft of this report to HUD for its review and comment. HUD agreed with three of our four recommendations, but disagreed with some of our findings and stated that our report does not recognize the significance of changes it has made to appraiser oversight. We clarified one of our findings in response to HUD's comments, but we believe the report appropriately recognizes the changes made to HUD's appraiser oversight.

---

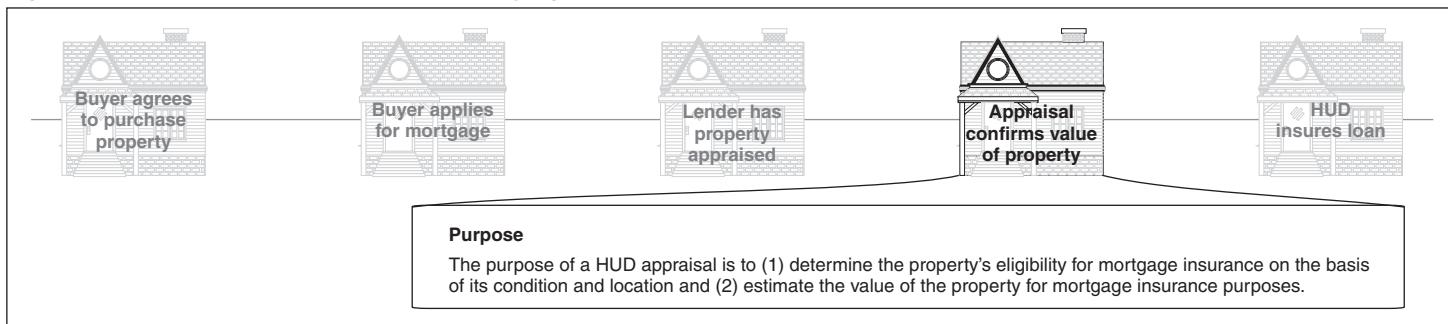
## Background

Each year, HUD helps hundreds of thousands of Americans finance home purchases by insuring their mortgage loans. HUD insures private lenders against losses on mortgages for single-family homes—which HUD defines as structures with one to four dwelling units—and plays a particularly large role in certain market segments, including low-income borrowers and first-time homebuyers. The loan amount that HUD can insure is based, in part, on the appraised value of the home. The primary role of appraisals in the loan underwriting process is to provide evidence that the collateral value of the property is sufficient to avoid losses on loans if the borrower is unable to repay the loan. If a borrower defaults and the lender



subsequently forecloses on the loan, the lender can file an insurance claim with HUD for nearly all of its losses, including the unpaid balance of the loan. After the claim is paid, the lender transfers the title of the home to HUD, which is responsible for managing and selling the property. Most of the mortgages are insured by FHA under its Mutual Mortgage Insurance Fund. To cover claims for lenders' losses, FHA deposits insurance premiums paid by borrowers into the fund, which, historically, has been self-sufficient. Figure 1 shows the role appraisals play as part of the home-buying process.

**Figure 1: Appraisals as Part of the Home-Buying Process**



Source: GAO.

As figure 1 indicates, the purpose of a HUD 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.<sup>6</sup> In performing these tasks, the appraiser is required to identify any readily observable deficiencies impairing the safety, sanitation, structural soundness, and continued marketability of the property and to assess the property's compliance with other minimum standards and requirements.

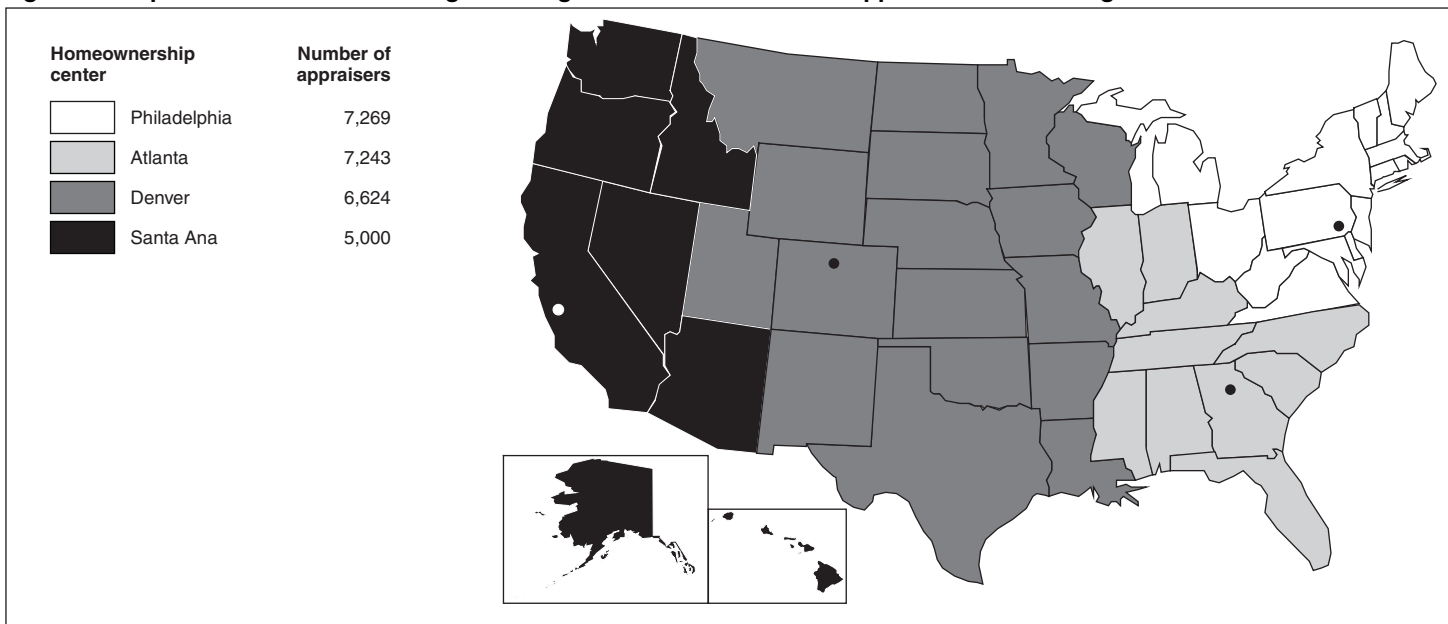
HUD maintains a roster of appraisers who have satisfied the requirements to be certified to perform HUD appraisals. Lenders underwriting mortgages to be insured by HUD must select one of the approximately 26,000 appraisers listed on the appraiser roster to prepare an appraisal of the

<sup>6</sup>Estimating the value of the property for mortgage insurance purposes protects the lender from loaning more than the home is worth and minimizes the losses to HUD if the property has to be sold due to foreclosure.

mortgaged property. In fiscal year 2003, appraisers listed on HUD’s roster performed 902,118 appraisals for the purposes of HUD mortgage insurance.

HUD’s oversight of appraisers who appraise properties with mortgages insured by HUD is the responsibility of the Processing and Underwriting Divisions at the four homeownership centers (HOCs). The HOCs are located in Atlanta, Georgia; Denver, Colorado; Philadelphia, Pennsylvania; and Santa Ana, California. Figure 2 below shows the distribution of appraisers throughout the HOCs, each of which is responsible for a multistate region. The HOCs report directly to HUD’s Office of Single-Family Housing, which is responsible for implementing HUD’s home mortgage insurance programs and maintaining the appraiser roster.

**Figure 2: Map of United States Showing HOC Regions and the Number of Appraisers in Each Region**



Source: GAO analysis of HUD data.

Since the creation of the HOCs in 1998, their role with respect to HUD’s appraiser monitoring strategy has evolved. From fiscal year 1998 through 2000, HUD instructed the HOCs to perform random field reviews for at least 10 percent of all loans insured by HUD. Starting in fiscal year 2000, HUD’s Real Estate Assessment Center assumed the responsibility of performing these field reviews for the HOCs and used an automated

---

system—the Single Family Appraiser Subsystem—to review the quality of appraisals and identify those that were poorly prepared. However, HUD discovered that the majority of the appraisals identified as poor simply had documentation errors, and the system had failed to identify poorly performing appraisers who contributed to losses to the FHA mortgage insurance fund.

In April 1999, we reported on HUD’s appraiser approval, monitoring, and enforcement efforts. We noted that HUD had limited assurance that the appraisers on its roster were knowledgeable about its appraisal requirements. We also reported that HUD was not doing a good job of monitoring the performance of appraisers and that HUD staff did not routinely visit appraised properties to determine the accuracy of field review contractors’ observations. In addition, we observed that HUD was not holding appraisers accountable for the quality of their appraisals and that HUD had not aggressively enforced its policy to hold lenders equally accountable with the appraisers they select for the accuracy and thoroughness of appraisals.

---

## **HUD Has Strengthened Its Criteria for Placing Appraisers on Its Roster, but Has Limited Assurance that These Criteria Are Being Implemented**

HUD issued guidance and regulations in order to help ensure that appraisers it approves to perform appraisals under its Single-Family Mortgage Insurance programs are qualified to be placed on the appraiser roster. In 1999, the department issued guidance that required appraisers to, among other things, pass an examination on HUD appraisal methods and reporting. In 2003, HUD also issued regulations making changes to the licensing and certification requirements for the appraiser roster. Although HUD has strengthened its criteria for approving appraisers to perform appraisals, quality control over the approval process is limited.

---

## **Guidance and Regulations Are Designed to Help Ensure Competency of Appraisers on FHA’s Roster**

In November 1999, HUD issued new guidance under its Homebuyer Protection Plan—which was implemented in an attempt to increase the accuracy and thoroughness of HUD appraisals performed as part of the home-buying process—for placement and retention on the appraiser roster. As noted previously, lenders underwriting HUD loans must select appraisers from those listed on the roster to perform appraisals in connection with FHA-insured mortgages. Before 1999, HUD relied largely on the states’ licensing processes to ensure that appraisers were qualified to perform appraisals. However, the states’ minimum licensing standards did not include proficiency in HUD appraisal requirements. According to

---

HUD's new guidance, in order to be eligible for placement on the roster, an appraiser must (1) pass an examination on HUD appraisal methods and reporting; (2) be state licensed or state certified, with credentials based on the minimum criteria issued by the Appraiser Qualifications Board of the Appraisal Foundation;<sup>7</sup> and (3) not be listed on the General Services Administration's Suspension and Debarment List, HUD's Limited Denial of Participation List, or HUD's Credit Alert Interactive Voice Response System.<sup>8</sup>

In May 2003, HUD published a final rule making several additional changes to the licensing and certification requirements for the roster.<sup>9</sup> Specifically:

- An appraiser who was included on the roster in June 2003, but did not meet the minimum Appraiser Qualifications Board licensing or certification criteria had 12 months to comply with these criteria and submit evidence of compliance to HUD. Failure to comply constituted cause for removal from the roster.
- An appraiser whose licensing or certification in a state has been revoked, suspended, or surrendered as a result of a state disciplinary action is automatically removed from the roster.
- An appraiser whose licensing or certification in a state has expired may not conduct HUD appraisals in that state.

---

<sup>7</sup>The Appraisal Foundation is a not-for-profit educational organization established in 1987. In 1989, the Financial Institutions Reform, Recovery, and Enforcement Act adopted the Appraiser Qualifications Board's qualification criteria for professional appraisers. All state-certified appraisers must meet the Appraisal Qualifications Criteria, as imposed by the state appraiser regulatory agencies. The minimum licensing criteria, which are imposed by each state's regulatory board, require that appraisers have 90 hours of classroom training in subjects relating to real estate appraisals, have 2,000 hours of appraisal experience, and pass its endorsed examination or an equivalent examination.

<sup>8</sup>The Suspension and Debarment List is a governmentwide compilation of individuals and firms ineligible to participate in federal programs. The Limited Denial of Participation List includes all individuals who have been issued a limited denial of participation, which is an action that excludes a party from further participation in a HUD program area for generally one year. The Credit Alert Voice Interactive Response System is a database of delinquent federal debtors that allows federal agencies to reduce the risk to federal loan and loan guarantee programs.

<sup>9</sup>See 68 *Fed. Reg.* 95 FR 26946 (May 16, 2003) Appraiser Qualifications for Placement on FHA Single Family Appraiser Roster; Final Rule.

---

HUD does not formally recertify appraisers whose licenses or certifications have expired or have been revoked. Instead, these functions are performed at the state level, and HUD is notified electronically, through an interface with state appraiser regulatory systems, to ensure that appraisers have passed the appropriate exams and that licenses have been renewed and through daily e-mails from the Appraisal Subcommittee to learn when licenses have been revoked.<sup>10</sup> HUD is seeking to establish an electronic connection to the Appraisal Subcommittee, which would enable automatic notification when appraisers are sanctioned by states and when appraisers' licenses or certifications need to be renewed.

---

### Quality Control for Placement of Appraisers on Roster Is Limited

While HUD strengthened the requirements for approving appraisers for placement on the appraiser roster, quality control over approval procedures is limited. According to HUD's guidance on placing new appraisers on the roster, HUD valuation staff are supposed to verify eligibility by checking (1) the Appraisal Subcommittee's National Registry to ensure that the applicant is listed, (2) the General Services Administration's Excluded Parties List System and HUD's Limited Denial of Participation List to ensure that the applicant is not listed, and (3) the Credit Alert Interactive Voice Response System to ensure that the applicant's social security number is not associated with any defaults or delinquencies in other federal loan programs.

We found that HUD's quality control for approving appraisers for placement on the roster is limited. According to HUD officials, the employees responsible for appraiser approval check to ensure the applications include all relevant information, verify that applicants are eligible to participate in HUD programs, and enter applicants' names into the Computerized Homes Underwriting Management System. They perform the eligibility verifications manually, checking the aforementioned registries and lists to ensure that the applicant is appropriately listed. HUD officials explained that they are developing a contract to establish a system

---

<sup>10</sup>The Appraisal Subcommittee was created as a federal entity and was charged with monitoring the implementation of Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. Title XI provides for national uniformity in appraisal standards and minimal national qualification requirements for appraisers. The Appraisal Subcommittee's mission is to ensure that real estate appraisers who perform appraisals in real estate transactions that could expose the United States government to financial loss are sufficiently trained and tested to assure competency and independent judgment according to uniform high professional standards and ethics.

---

that will track these verifications. In addition, while HUD officials indicated that they do perform quality control on the roster placement procedures, this quality control is limited. A HUD official conducts quality control reviews over a random sample of the approving employees' work, but not on a routine basis. HUD does not document these quality control reviews and could not provide evidence that they were performed. HUD officials indicated that they are planning to develop and implement a quality control plan for the appraiser approval process.

---

## HUD Focuses on Appraisers with Known Risks to FHA's Mortgage Insurance Fund, but Weaknesses Exist in Implementing These Efforts

HUD uses a risk-based targeting approach to identify appraisers for review. HUD has shifted its focus from targeting appraisals to targeting appraisers, modifying its approach in an attempt to more effectively identify and monitor appraisers most associated with known risks to FHA's mortgage insurance fund. The HOCs have generally reviewed the appraisers targeted during fiscal year 2003 and the first half of fiscal year 2004, but the reviews have not consistently met HUD's criteria for completeness. In addition, HUD has not performed adequate oversight of contractors who conduct field reviews of appraisals.

---

## HUD Uses a Risk-Based Approach to Target Appraisers for Review

HUD's process for monitoring appraisers is risk based. In 1999, we reported that HUD's guidance called for random reviews of 10 percent of all appraisals. HUD modified this approach and now targets for review appraisers who are associated with known risks to FHA's mortgage insurance fund, including those associated with a large number of defaulted loans, those who perform a large volume of appraisals, and those who appraise properties for loans with characteristics that are associated with high default and claim rates, including loans made under the 203(k) rehabilitation program, loans with nonprofit mortgagors, and loans for properties with multiple (three to four) units.<sup>11</sup> HUD's new approach is intended to identify poorly performing *appraisers* rather than poorly prepared *appraisals*. The goal of this approach is to remove from the appraiser roster appraisers who have not complied with HUD requirements and therefore pose a risk to FHA's mortgage insurance fund, disqualifying them from doing business with HUD.

---

<sup>11</sup>The section 203(k) program is the department's primary program for the rehabilitation and repair of single-family properties.

---

The “early default rate” is the primary factor that HUD uses to identify poorly performing appraisers. On a quarterly basis, each HOC first identifies appraisers with the highest percentage of early defaults over the last 12-month period. Early defaults are defined as those that occur within 12 months of loan origination and represent a delinquency—which occurs when the borrower is unable to honor the mortgage obligation—of 90 days or greater. Each HOC next identifies, from the pool of appraisers associated with high early default rates, those appraisers who performed 10 or more appraisals and who performed appraisals for five or more defaulted mortgages. To do this, HUD uses its Neighborhood Watch Early Warning System—a Web-based software application that displays loan performance data for lenders and appraisers by loan types and geographic areas using FHA-insured single-family loan information—which was enhanced to include summary and loan level appraiser data to enable the targeting of appraisers for review. The system not only helps HUD target appraisers associated with a high rate of early defaults but also provides HUD the ability to identify and analyze patterns—by appraiser, geographic area, or originating lender—in loans that go into early default.

According to HUD’s guidance, each HOC must develop a target list of appraisers to be reviewed based on the targeting criteria. They also must review at least 30 appraisers each quarter, but these do not necessarily need to be pulled from the target lists. In addition to selecting appraisers using the targeting criteria, the HOCs also may review appraisers for other reasons. For example, HOC officials informed us that they also include on the targeting lists appraisers who have recently been sanctioned and have completed their sanction period. The officials indicated that this helps them to ensure that recently sanctioned appraisers have corrected their relevant deficiencies and do not repeat past performance problems. However, because this targeting criterion is not required, there is no assurance that it will be used consistently. The HOCs may also review appraisers based on complaints from homebuyers and referrals from other HUD offices.

To help identify appraisers to be placed on the target lists, HUD has recently implemented a statistical risk-based appraiser-sampling algorithm. This algorithm helps to identify appraisers for desk and field reviews, focusing on those who are more likely to be associated with adverse outcomes, including (1) early default of an FHA insured loan, (2) large dollar amount of claims on the FHA mortgage insurance fund, or (3) severity of the net dollar loss on the FHA mortgage insurance fund. The algorithm also incorporates risk factors statistically related to these

---

adverse outcomes, including appraiser workload, performance in high-risk programs, and geographical area. According to HUD, this enhanced and automated targeting helps to ensure the efficient use of resources for field reviews.

Because the HOCs do not maintain a permanent record of the data used to identify appraisers for review each quarter, we could not verify that the appraisers they placed on their target lists were actually those that met HUD's criteria. The HOCs maintain general information about the reasons why appraisers are targeted for review, specifically labeling the reasons appraisers are targeted as "high default rate," "high volume," or high-risk loans or properties. However, they do not maintain specific early default rate information for the appraisers targeted, even though early default rate is the primary factor behind HUD's targeting approach. The Neighborhood Watch Early Warning system allows HUD officials to maintain this information. For example, HUD uses this system to target lenders participating in its Single-Family Mortgage Insurance programs for review and maintains targeted lenders' early default information. However, according to HOC officials, once the appraiser target lists are created, the HOCs do not maintain the targeted appraisers' early default information. Without the specific default rate information, we were unable to determine whether the HOCs reviewed those targeted appraisers who posed the greatest risk based on high default rate. More importantly, in the absence of this information, HUD is unable to monitor the HOCs to ensure that the appropriate appraisers were targeted and reviewed based on its criteria and may be unable to determine the effectiveness of its targeting criteria in reducing risk to the mortgage insurance fund.

---

### HUD Reviewed Most Targeted Appraisers, but Reviews Were Not Always Complete

Overall, the HOCs reviewed 730 (almost 78 percent) of the 936 appraisers who were placed on the target lists during fiscal year 2003 and the first half of fiscal year 2004.<sup>12</sup> However, as shown in figure 3, the percentage varied among the HOCs. Each HOC exceeded the goal of reviewing 30 appraisers per quarter. Specifically, they reviewed a total of 2,055 appraisers over this period, or an average of more than 85 appraisers per HOC per quarter. (In addition to the 730 appraisers who were reviewed because they were on the target lists, the HOCs reviewed 1,325 appraisers who were not on the target lists but were reviewed based on other reasons, including complaints

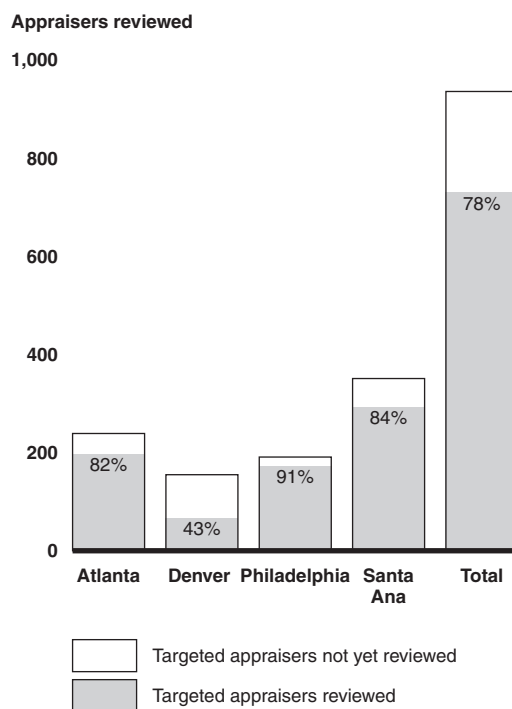
---

<sup>12</sup>The number of appraisers reviewed refers to the number of appraisers that were desk or field reviewed, unless specified otherwise.



from homebuyers and referrals from other HUD offices, for a total of 2,055 appraisers reviewed.) HOC officials explained that they are not always able to conduct reviews of the appraisers within the quarter targeted because of resource constraints, but indicated that they eventually perform reviews of all targeted appraisers.

**Figure 3: Number of Appraisers Targeted and Reviewed by HOC**



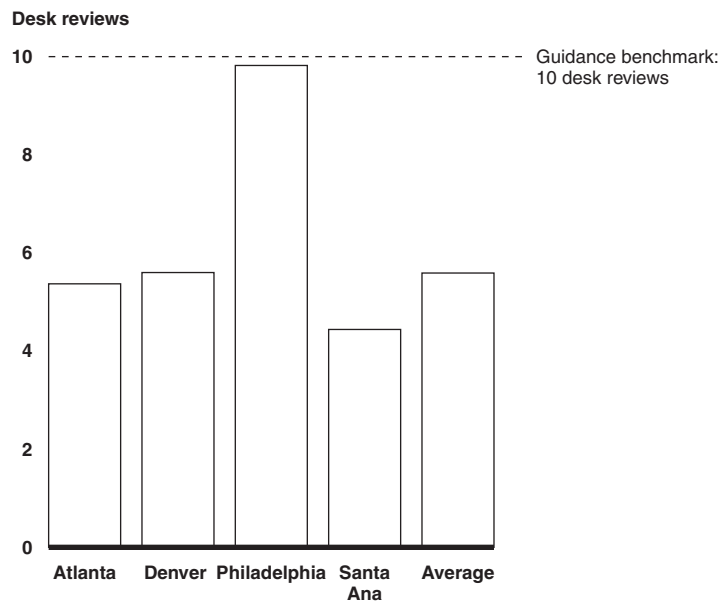
Source: GAO analysis of HUD data.

HUD's guidance calls for the HOCs to conduct desk reviews of 10 appraisals prepared by each appraiser identified for review through the targeting methodologies. The HOCs are to use a standard set of desk review criteria, the focus of which is to identify deficiencies in the content and format of the reported data. The appraisal report is to be analyzed for reasonable and logical conclusions of value to determine if the appraisal data are consistent with FHA requirements.

However, the HOCs did not review every appraiser to the extent called for in the guidance. The HOCs performed, on average, about 5.6 desk reviews

for each appraiser reviewed during fiscal year 2003 and the first half of 2004. As shown in figure 4, the Philadelphia HOC was the only HOC that conducted almost 10 desk reviews for each appraiser reviewed during this period. Officials from the other HOCs explained that an appraiser might have conducted fewer than 10 appraisals, and so the HOCs would be unable to perform the required number of desk reviews. However, as noted earlier, HUD's targeting criteria provide that from the pool of appraisers associated with high early default rates, those appraisers performing 10 or more appraisals and with five or more defaulted cases should be targeted.

**Figure 4: Average Number of Desk Reviews Performed on Each Appraiser Reviewed by HOC**



Source: GAO analysis of HUD data.

HOC officials also told us that they attempt to perform desk reviews of appraisals that were conducted no more than one year prior to the time of the review and that, if possible, they try to perform these reviews on the appraisers' 10 most recent appraisals. While this approach is not required, HOC officials explained that it helps them to ensure that an appraiser's most recent work is being reviewed and that appraisals are not outdated at the time of review.

---

---

## HUD Conducted Limited Oversight of Field Review Contractors

According to HUD guidance, if a desk review concludes that an appraisal is inconsistent or unacceptable, then a field review is warranted on up to five appraisals prepared by that appraiser. HUD uses contractors and HUD employees who are qualified as appraisers to conduct field reviews. The review consists of a comprehensive inspection of the subject property's interior and exterior, with the reviewer reporting any readily observable defective conditions (whereby the property does not meet minimum property standards as laid out in HUD's guidance). The reviewer also must perform an exterior inspection of the comparable properties—other recently sold properties with similar features used to help the appraiser estimate the value of the subject property—submitted in the original appraisal and must verify all data reported by the original appraiser for the subject property and comparables.

We found that HUD staff do not routinely visit appraised properties to verify the work of the field review contractors. According to HUD guidance, on-site monitoring reviews by HUD staff are essential for high-risk program participants to the extent practicable. HUD officials explained that they are constrained by limited travel resources and so are not able to make on-site visits to properties. HUD officials agreed contract oversight is important but indicated that it is often not cost efficient to send employees on site to review contractors' work because many of the department's contractors are responsible for reviewing only a few properties. However, HUD officials indicated that they are planning to develop a cost-efficient oversight mechanism.

---

## HUD Has Expanded the Authority of the HOCs and Developed an Appraisal Scoring System to Facilitate Enforcement Actions

Expanded authority giving HOCs the ability to sanction appraisers has provided the HOCs with additional enforcement options. According to HUD officials, by expanding their ability to sanction appraisers and by focusing oversight on appraisers instead of appraisals, they are able to effectively and efficiently impose sanctions on appraisers. HUD reviews and quantifies appraisers' work by using a Web-based tool, the Appraisal Review Process, a system that scores each appraiser on several appraisals, weighting the scores to capture violations that pose the greatest risk to FHA's mortgage insurance fund. According to HUD, the system helps to make the process of sanctioning appraisers more consistent. In addition, HUD has issued a final rule to hold lenders accountable for poor appraisals. Lenders who submit appraisals that do not meet HUD requirements are now subject to the imposition of sanctions by the department.

---

---

## Devolution of Authority and Risk-Based Targeting Assist HOCs in Sanctioning Appraisers

In 2000, a HUD regulation expanded its ability to sanction appraisers at the national level by giving the HOCs the authority to remove appraisers from the roster.<sup>13</sup> As figure 5 illustrates, for the 1,004 appraisers field reviewed by HUD in fiscal year 2003 and the first half of fiscal year 2004, 620 sanctions were imposed, with 180 appraisers having been removed from the appraiser roster.<sup>14</sup> Prior to receiving this expanded authority, the only enforcement tool at the HOCs' disposal was issuance of limited denials of participation.<sup>15</sup> However, the HOCs needed to refer limited denials of participation to headquarters, and the sanctions were only effective in the particular HOC's jurisdiction for a year. Currently, the sanctions available to the HOCs include removal from the roster for 6 to 12 months, removal from the roster in conjunction with education for 6 to 12 months, education for up to 90 days, notices of deficiency, and limited denials of participation.<sup>16</sup> Other sanctions available to HUD through headquarters include suspension—often used as a temporary measure to stop an appraiser from doing business with HUD until a more serious action can be taken—for up to 12 months or until the conclusion of legal or debarment proceedings; debarment, which removes an appraiser from the FHA roster, generally for up to 3 years; and civil and criminal penalties.<sup>17</sup> In fiscal year 2003 and first half of fiscal year 2004, HUD reports that it suspended 14 appraisers from the roster and did not debar or impose civil or criminal penalties on any appraisers. HUD officials stated that these sanctions are

---

<sup>13</sup>65 *Fed. Reg.* 49004 (Aug. 10, 2000); see 24 CFR part 200.204.

<sup>14</sup>Of the 2,055 appraisers who were desk or field reviewed during fiscal year 2003 and the first half of fiscal year 2004, 1,004 were field reviewed. Because, according to HOC officials, most sanctions are based on findings from field reviews, we used the number of field reviews in our analysis.

<sup>15</sup>A limited denial of participation is an action usually taken by a HUD field office or the Deputy Assistant Secretary for Single Family Housing that excludes a party from further participation in a HUD program area for generally one year.

<sup>16</sup>A notice of deficiency is a letter from the HOCs describing the deficiency and requires no further action by the appraiser. However, the notice is maintained by HUD in the appraiser's file.

<sup>17</sup>HUD pursues civil sanctions by initiating an investigation of the alleged noncompliant action. Any findings and conclusions are submitted to HUD's Office of the General Counsel or to the Enforcement Center. If either office determines that the investigation report supports an action, the office submits a written request to the Department of Justice for approval to pursue civil sanctions. If the noncompliant action is so egregious as to violate criminal law, the General Counsel or Inspector General refers the case to the Department of Justice to pursue criminal penalties.

harder to use and less timely so they focus their efforts on those sanctions they can use at the HOC level. Figure 5 illustrates the extent to which the department has made use of each type of enforcement action available, as reported by HUD.

**Figure 5: Number of Appraisers Field Reviewed Compared to Number and Types of Sanctions Imposed during Fiscal Year 2003 and the First Half of Fiscal Year 2004**

Home-ownership center	Number of appraisers		Sanctions					Total sanctions	
	Field reviewed		Available to HOCs			Available to HOCs through headquarters			
			Removed from roster	Sanctioned with education requirements	Issued a notice of deficiency	Issued a limited denial of participation	Suspended		
Atlanta		219	44	39	41	0	8		132
Denver		227	58	70	54	1	3		186
Philadelphia		230	54	52	97	0	0		203
Santa Ana		328	24	27	45	0	3		99
<b>Total</b>		<b>1,004</b>	<b>180</b>	<b>188</b>	<b>237</b>	<b>1</b>	<b>14</b>		<b>620</b>

Source: GAO analysis of HUD data.

In addition, HUD officials explained that by changing the oversight approach to focus targeting efforts on appraisers instead of appraisals they can now better focus oversight efforts on appraisers with known risks. Specifically, they reported that they can now review a smaller number of appraisers and use sanctions more effectively and efficiently. For example, HUD reports that since 1998, the number of removal actions taken by the department has increased, while the number of field reviews and the cost to the agency have decreased, as shown in table 1.

**Table 1: Number of Field Reviews Compared to Number of Removals, 1998–2003**

Fiscal Year	Number of field reviews	Number of appraisers removed	Total costs of field reviews
1998	83,084	25	\$10,773,605
1999 <sup>a</sup>	135,674	32	\$26,409,980
2000 <sup>b</sup>	10,000	11	\$15,378,082
2001	10,000	11	\$15,378,082
2002	1,868	97	\$300,000
2003	1,420	132	\$255,000

Source: HUD.

<sup>a</sup>HUD provided field review data from 1999 for HOC appraisal reviews and Real Estate Assessment Center appraisal reviews, because these centers each contributed to the costs and numbers of field reviews as well as the number of appraisers removed from the roster in 1999. However, the data from the Real Estate Assessment Center was provided as a total for fiscal year 1999 through December 2001, with 30,000 total field reviews performed, 33 appraisers removed from the roster, and \$46,134,248 in field review costs for this period. We took the average of this 3-year period and added this average to the 1999 Homeownership Center data in order to arrive at the data reported for 1999.

<sup>b</sup>For fiscal years 2000 and 2001, we used the average of the 3-year period that was reported from the Real Estate Assessment Center data discussed above.

## Risk-Based Appraisal Scoring System Is Designed to Help Ensure Consistency within and across HOCs

In 2002, HUD developed a monitoring and enforcement tool called the Appraisal Review Process, a risk-based appraisal scoring system that scores appraisers who are field reviewed. (Field-reviewed appraisers include those targeted and field reviewed by HUD on a quarterly basis as well as those who were not necessarily targeted but may have been field reviewed for a variety of reasons, including complaints from home buyers and referrals from other HUD offices.) In an attempt to ensure consistency within and across HOCs, HUD designed this tool to (1) weigh each field review question used to assess appraiser performance and (2) recommend actions to be taken against appraisers.<sup>18</sup> The tool provides the rater with a systematic way of thoroughly examining the written appraisal and carrying out the corresponding field review. Based on the desk and field review data, the system yields a recommendation of removal, education, or notice of deficiency. For example, questions associated with appraisal factors that are considered to be of greater risk to the fund—such as the accuracy of market value of the property and characterization of repair

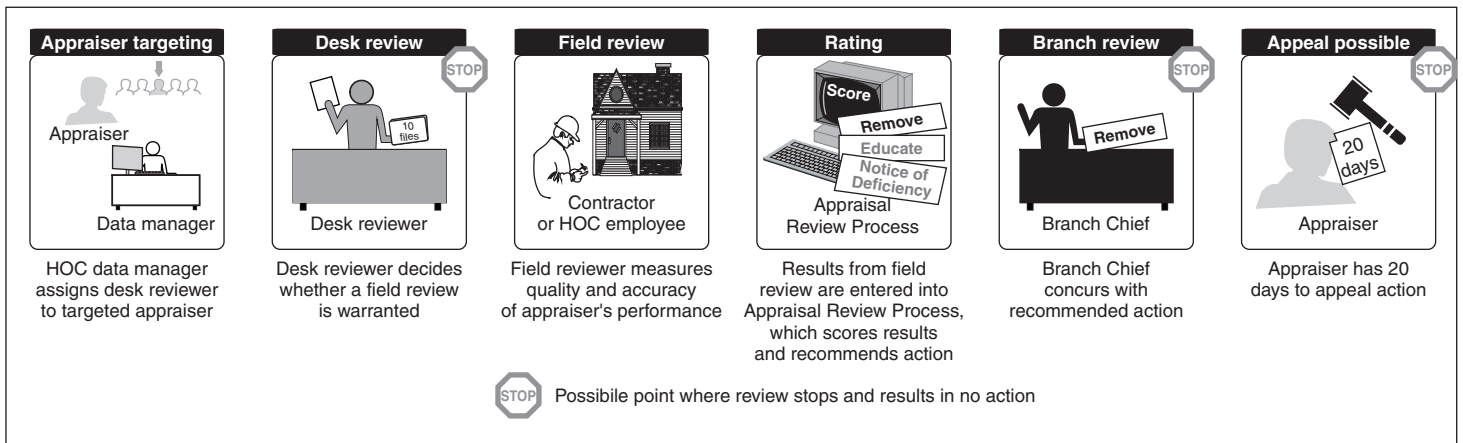
<sup>18</sup>The field review questions follow the Uniform Residential Appraisal Report and the new Valuation Conditions Form, both of which are used to conduct FHA appraisals.

---

conditions—receive a higher weight and automatically result in a removal recommendation if the appraisal exceeds the maximum allowable points.

The Appraisal Review Process tool allows HUD to review appraisers and impose sanctions on them in a systematic way. In 1999, we reported that HUD was not holding appraisers accountable for the quality of their appraisals and that the primary reason for HUD's inability to pursue enforcement actions against poorly performing appraisers was poor record keeping. According to HUD officials, the Appraisal Review Process's systematic approach to reviewing appraisers' work and maintaining electronic records of appraisers' performance has helped the HOCs maintain better documentation. The data manager at each HOC orders cases for each of the targeted appraisers and assigns them to a desk reviewer. Based on the results of the desk review, the desk reviewer can decide that a field review for a particular appraisal is warranted or that no further action is necessary. If a field review is warranted, the appraisal is assigned to a contractor or HUD employee, who measures the quality and accuracy of appraisers' performance in the completion of the desk-reviewed appraisal and up to four other appraisals prepared by the targeted appraiser and inputs the results electronically into the Appraisal Review Process. Based on the desk and field review data, the system yields a recommendation of removal, education, or notice of deficiency. A HUD rater then looks at the field review score generated by the system, factors in past performance and results from other appraisals, and recommends a proposed action. The branch chief must concur before the appraiser is notified of the action, at which point the appraiser has 20 days to appeal. Figure 6 portrays the major steps of the Appraisal Review Process.

**Figure 6: Appraisal Review Process Flow Chart**



Sources: GAO and Nova Development (images).

According to HUD's guidance, once a recommended action is affirmed, the appraiser roster is updated to reflect the change. If the appraiser is removed from the roster, lenders cannot assign cases to the appraiser until the appraiser is reinstated. Further, if the appraiser violated any of the laws in the state in which the appraiser is licensed, then the appropriate state regulatory agency is notified.

## Recent Rule Is Designed to Hold Lenders Accountable for Poor Appraisals

In 1999, we recommended that HUD determine its authority to hold lenders accountable for poor-quality HUD appraisals performed by the appraisers they select from the roster and issue policy guidance that sets forth the specific circumstances under which and actions by which HUD may exercise this authority. In July 2004, HUD issued a final rule clarifying lenders' accountability for the quality of appraisals on properties securing FHA-insured mortgages. Specifically, the rule provides that lenders who submit appraisals that do not meet HUD requirements are subject to the imposition of sanctions by the department. The rule applies to both sponsor lenders, who underwrite loans, and loan correspondents, who originate loans on behalf of sponsor lenders. HUD believes these changes will help ensure better compliance with appraisal standards and ensure that homebuyers receive an accurate statement of appraised value.



---

---

## Conclusions

The importance of accurate appraisals to HUD's Single-Family Mortgage Insurance programs underscores the need for effective appraiser oversight. HUD relies on appraisals to ensure that the billions of dollars in mortgage loans it insures annually accurately reflect the value of the homes being mortgaged. Since our April 1999 report, HUD has taken a number of steps designed to ensure the qualifications of appraisers on its roster; improve the efficiency and effectiveness of its oversight, specifically by revising its guidance to focus on appraisers (rather than appraisals) and incorporating a risk-based monitoring approach; and facilitate enforcement actions by empowering HOCs and developing a scoring system to promote consistency. However, certain weaknesses in implementing these initiatives limit their ability to (1) lower HUD's risk of insuring properties that are overvalued and (2) minimize potential losses to FHA's mortgage insurance fund. Thus, opportunities exist to enhance HUD's appraiser approval and monitoring efforts.

HUD's process for verifying that appraisers meet all relevant criteria when applying for placement on its roster lacks effective quality control. An effective control process is essential for HUD to systematically assure and demonstrate that all eligibility criteria are verified with respect to appraisers applying for placement on the roster so they can perform appraisals in connection with HUD's Single-Family Mortgage Insurance programs.

Further, while HUD's guidance specifies criteria for targeting appraisers based on a set of known risk factors, it does not require the HOCs to target for review appraisers who have been recently sanctioned, even though the HOCs sometimes do so in order to ensure that the problem for which the appraiser was sanctioned has been resolved. Requiring this criterion for targeting appraisers for review could help assure that sanctioned appraisers will not repeat past performance problems. Similarly, HUD does not require that the HOCs maintain historical information, particularly data on the associated default rates of loans, used to target and select appraisers for review. Without this information, HUD cannot demonstrate that the appropriate appraisers are being systematically targeted and reviewed based on its criteria and may be unable to determine the effectiveness of its targeting criteria in reducing risk to the mortgage insurance fund.

HUD rarely verifies the work of its field review contractors through on-site evaluations, weakening the department's ability to ensure that contracted work is actually performed and to accurately assess the quality of the

---

appraisals used to support the loans the department insures. While it entails costs, on-site monitoring is an essential part of any monitoring process and is an important way to verify that work is actually being conducted and to accurately assess the quality of appraisals.

---

## Recommendations for Executive Action

To reduce the financial risks assumed by HUD and to further enhance its oversight of appraisers participating in HUD's Single-Family Mortgage Insurance programs, we recommend that the Secretary of HUD direct the Assistant Secretary for Housing-Federal Housing Commissioner to

- institute reasonable controls on the process of placing appraisers on the appraiser roster to ensure that applicants' conformance to eligibility criteria is verified;
- consider a requirement to include, when targeting appraisers for review, those appraisers who have recently completed a sanction period in order to ensure that these appraisers have corrected their relevant deficiencies;
- maintain the historical information, particularly early loan default information, used to target appraisers for review in order to ensure that the HOCs target and review appraisers based on the criteria in HUD guidance; and
- implement a cost-effective field review contractor oversight process that includes on-site monitoring.

---

## Agency Comments

We provided a draft of this report to HUD for its review and comment. In written comments from HUD's Assistant Secretary for Housing-Federal Housing Commissioner, HUD agreed with three of our four recommendations, but disagreed with our presentation of its accomplishments as well as some of our findings. The full text of HUD's comments appears in appendix II.

HUD agreed with three of our recommendations. Specifically, it agreed to consider a requirement to include, when targeting appraisers for review, those appraisers who have recently completed a sanction period. Also, the department agreed to modify its system to archive quarterly reports in response to our recommendation that it maintain the historical information

---

used to target appraisers for review. Further, it agreed to consider implementing a cost-effective field review contractor oversight process that includes on-site monitoring.

However, HUD disagreed with our recommendation that it institute reasonable controls on the process of placing appraisers on the appraiser roster. HUD commented that our report inaccurately stated that HUD does not document all verifications of appraisers' eligibility for the roster and has limited quality control over the approval process, noting that the department has a paper record of the application review process whereby each applicant's eligibility is verified and documented. HUD also noted that we did not review its paper records of the application review process. We modified the report to clarify that our primary concern was quality control, in general, and not solely documentation. We did not review the paper files because it was not our objective to test whether or not specific verifications had been performed, but rather to examine the overall verification and documentation procedures HUD relies on to ensure that appraisers meet its criteria. In doing so we observed a control weakness and we modified the report to clarify this weakness. Specifically, a HUD official conducts quality control reviews over a random sample of the approving employees' work, but not on a routine basis. Also, HUD does not document these quality control reviews and could not provide evidence that they were performed. At a meeting to discuss the results of our review, HUD's acting Deputy Assistant Secretary for Single-Family Housing and the Director of the Office of Single-Family Program Development agreed that they do not systematically document that all of the verifications have been conducted and explained that they are developing a contract to establish a system that will track these verifications. They also indicated that they are planning to develop and implement a quality control plan for the appraiser approval process. We modified the recommendation to emphasize that HUD should institute reasonable quality controls on the process of placing appraisers on the appraiser roster.

HUD commented that while we acknowledged that it implemented policy and procedural changes, we did not recognize the significance of these changes, and that it is appropriate and necessary for our report to clearly present and highlight these significant achievements. While we agree that HUD has made significant improvements, our objectives concern HUD's appraiser oversight as it currently exists, regardless of past weaknesses. Nevertheless, we noted a number of specific improvements in the draft report. Specifically, we noted that the number of removal actions taken by the department has increased, while the number of field reviews and the

---

cost to the agency have decreased, as represented in table 1. With respect to HUD's adoption of a new risk-based approach for monitoring appraisers, we reported that HUD's process for monitoring appraisers is risk based and that HUD modified its approach to target for review appraisers who are associated with known risks to FHA's mortgage insurance fund. In addition, we reported that the department issued guidance that required appraisers to, among other things, pass an examination on HUD appraisal methods and reporting. We also noted that HUD issued several rules and mortgagee letters to strengthen its oversight and control of appraisers and improve appraisal quality.

HUD also disagreed with the accuracy of some of our findings. Specifically, HUD characterized as inaccurate our statement that in the absence of historical early default rate information, the department may be unable to determine the effectiveness of its appraiser targeting criteria in reducing risk to the mortgage insurance fund. HUD explained that its system directly targets the appraisers that pose the greatest risk to the fund. We concur that HUD's process is designed to so target, and our draft characterized the approach as risk based and described the specific criteria HUD's process calls for to target appraisers for review. However, because the HOCs do not maintain a permanent record of the data showing which appraisers met the criteria in each quarter, we could not verify that the appraisers the HOCs placed on their target lists were actually those that met HUD's criteria. Similarly, without these records, HUD is unable to determine whether the HOCs reviewed those appraisers who met the criteria. In turn, this limits HUD's ability to determine, over time, the effectiveness of its targeting criteria in reducing risk to the mortgage insurance fund. HUD went on to say that FHA would modify its system to archive quarterly reports in order to maintain the historical targeting records.

In addition, HUD disagreed that it conducted limited oversight of field review contractors and that such efforts are affected by limited travel resources. HUD explained that it conducts a 100 percent review of contractors' work and that the HOCs do not conduct on-site reviews (which may require travel resources) because the 100 percent review method serves as an appropriate and effective risk-control measure. As we noted in our report, HUD's guidance states that on-site monitoring reviews by HUD staff are essential for high-risk program participants to the extent practicable. Further, HOC officials told us that they are constrained by limited travel resources and so are not able to make on-site visits to properties. At a meeting to discuss the results of our review, HUD's acting Deputy Assistant Secretary for Single-Family Housing and the Director of

---

the Office of Single-Family Program Development agreed that contract oversight is important but indicated that it is often not cost efficient to send employees on site to review contractors' work because many of the department's contractors are responsible for reviewing only a few properties. However, as we reported in our draft, these officials indicated that they are planning to develop a cost-efficient oversight mechanism.

Finally, HUD disagreed with our conclusion that weaknesses in implementing its appraiser oversight initiatives limit the department's ability to (1) lower its risk of insuring properties that are overvalued and (2) minimize potential losses to FHA's mortgage insurance fund. HUD also stated that our recommendations would not affect FHA's risk. As we stated in the draft report, we did not attempt to estimate the impact that HUD's appraiser oversight has on the financial health of FHA's mortgage insurance fund. While we agree that HUD's new targeting methodology is intended to reduce risks to FHA, our concern is whether the methodology is operating as intended. Our recommendations relate to the implementation of processes that are directed at controlling and minimizing risk and we continue to believe that opportunities exist to enhance HUD's appraiser approval and monitoring.

---

We are sending copies of this report to the Secretary of HUD. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

Should you or your staff have questions or comments on matters discussed in this report, please contact me at (202) 512-6878 or [woodd@gao.gov](mailto:woodd@gao.gov), or Paul Schmidt, Assistant Director, at (312) 220-7681 or [schmidt@ga.gov](mailto:schmidt@ga.gov). Major contributors to this report are listed in appendix III.

*David G. Wood*

David G. Wood  
Director, Financial Markets  
and Community Investment

---

# Scope and Methodology

---

To examine how HUD ensures that appraisers it approves to perform appraisals under its Single-Family Mortgage Insurance programs are qualified to be placed on the appraiser roster, we reviewed pertinent HUD regulations and policy guidance and the minimum licensing criteria established by the Appraiser Qualifications Board of the Appraisal Foundation. In addition, we discussed this information with officials from HUD's Single-Family Housing Office of Program Development. Further, we met with the staff member responsible for maintaining the FHA appraiser roster and observed the process for adding approved appraisers to the roster.

To assess the extent to which HUD uses a risk-based approach when monitoring appraisers, we interviewed officials at the four HOCs and observed a demonstration of their quarterly targeting procedures. We reviewed HUD's risk-based targeting guidance and obtained data for fiscal year 2003 through the first half of fiscal year 2004 from each of the HOCs. We then compared each of the HOCs' appraiser target lists to their desk and field review lists to determine the number of targeted appraisers that were actually reviewed. Further, from each of the HOCs' desk review lists, we calculated the numbers of desk reviews performed by the HOCs on each appraiser reviewed in order to assess whether the HOCs have been following HUD's guidance.

To examine HUD's efforts to take enforcement actions against appraisers it identifies as not complying with its requirements, we reviewed HUD's guidance regarding enforcement actions taken against poorly performing appraisers. We also discussed enforcement issues with officials from HUD's Office of Single-Family Housing and the Departmental Enforcement Center. At the HOCs, we discussed the Appraisal Review Process and the HOCs' ability to sanction appraisers. We obtained data generated from the Appraisal Review Report on HUD's sanctions imposed between fiscal year 2003 and the first half of fiscal year 2004 and compared this data to the number of field reviews conducted during the same time period. We focused this analysis on removals because removals are the strongest type of action that can be taken at the HOC level.

We assessed the reliability of the HUD data we used by reviewing information about how the data were collected, and we interviewed HUD officials to determine the completeness and accuracy of the data provided. We performed electronic testing on the data elements used for our analysis to detect obvious errors in completeness and reasonableness. We

determined that these data were sufficiently reliable for the purposes of this report.

Finally, we discussed appraiser oversight issues with officials from the Appraisal Subcommittee, the Appraisal Foundation, the Appraisal Institute, the Federal Home Loan Mortgage Corporation, and the Federal National Mortgage Association.

We performed our work from December 2003 through August 2004 in accordance with generally accepted government auditing standards.

# Comments from the Department of Housing and Urban Development



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

Mr. David G. Wood  
Director  
Financial Markets Government  
Accountability Office  
441 G Street, NW  
Washington, DC 20548

OCT 21 2004

Dear Mr. Wood:

Thank you for permitting the Federal Housing Administration (FHA) to address the Draft Report, "HUD's Risk-Based Oversight of Appraisers Could Be Enhanced." While the report acknowledges that FHA implemented policy and procedural changes since GAO's last audit, performed in 1999, it does not recognize the significance of these changes. If GAO compared FHA's new methodology for identifying poorly performing appraisers with the procedures evaluated in the 1999 audit, the results are startling: FHA reduced annual operating costs by 98%; increased the efficiency of appraiser field reviews by 97.5%; and identified and removed nearly six times as many poorly performing appraisers each year.

FHA believes it is not only appropriate, but also necessary for the report to clearly present and highlight these significant achievements. From fiscal year 1998 through fiscal year 2001, FHA expended nearly \$17 million each year to remove on average 20 appraisers per year. In contrast, for fiscal years 2002 and 2003, FHA has spent *less than* \$300,000 each year to remove on average of 115 appraisers per year. FHA has reduced the cost to the government by \$16.7 million per year, a reduction of 98%. The cost per appraiser removed has been reduced from \$850,000 to \$2,600, a reduction of over 99%.

Under the old methodology, nearly 60,000 field reviews were performed each year, to achieve the relatively low level of 20 removals, on average. The current procedures require only 1,600 field reviews to achieve on average 115 removals. Previously, HUD conducted almost 3,000 field reviews per appraiser removed. Now, with risk-based targeting, HUD conducts fewer than 15 reviews to achieve a removal.

These extraordinary cost reductions and productivity improvements have occurred because HUD has completely revamped its appraiser review methodology. FHA now targets appraisers for review based on the risk they pose to the Mutual Mortgage Insurance (MMI) fund.

It should also be noted that while FHA instituted this more rigorous, risk-based appraiser oversight methodology, the agency has simultaneously improved FHA's reputation as a business partner. FHA's program changes have captured the attention of the industry. While FHA sanctions less than 1% of program participants, the appraisal and lending industries are alert to their role in assuring the quality of FHA appraisals. Both the Appraisal Institute and the Mortgage Bankers Association have applauded FHA's efforts to remove poorly performing appraisers without adversely affecting the administration of the FHA Single Family mortgage programs.

[www.hud.gov](http://www.hud.gov)      [espanol.hud.gov](http://espanol.hud.gov)



**Appendix II**  
**Comments from the Department of Housing**  
**and Urban Development**

FHA's response to the GAO report is organized into three sections: 1) Program Accomplishments; 2) Response to GAO Findings/Factual Errors; and 3) Response to Recommendations for Executive Action. While some information presented may be redundant, FHA feels that it is important to cover each of these objectives separately to ensure that the response is comprehensive and clear.

**Section 1: Program Accomplishments:**

A) Decrease in Program Operating Costs

The table below reflects the significant decrease in costs between the old methodology for identifying poorly prepared appraisals and the new methodology for identifying poorly performing appraisers. This change resulted in a 98% decrease in operating costs.

Fiscal Years	Average Costs of Field Reviews
Old Methodology: FYs 1998 – 2001	\$16,984,937
New Methodology: FYs 2002 –2003	\$277,500

B) Increase in Effectiveness at Identifying Appraisers that do not meet FHA Requirements

The table below reflects the significant increase in FHA's effectiveness between the old methodology for identifying poorly prepared appraisals and the new methodology for identifying poorly performing appraisers. The change resulted in a 475% increase in HUD's identification and removal of poorly performing appraisers.

Fiscal Years	Average Number of Removals
Old Methodology: FYs 1998 – 2001	20
New Methodology: FYs 2002 –2003	115

C) Increase in Efficiency at Performing Field Reviews

The table below reflects the significant increase in FHA's efficiency between the old methodology for identifying poorly prepared appraisals and the new methodology for identifying poorly performing appraisers. The change resulted in a 97.5% decrease in the number of field reviews necessary to identify far more poorly performing appraisers.

Fiscal Years	Average Number of Field Reviews
Old Methodology: FYs 1998 – 2001	59,690
New Methodology: FYs 2002 –2003	1,644

D) Risk Based Monitoring and Targeting of Appraisers

In FY2002, FHA adopted a new risk-based approach for monitoring appraisers, which resulted in the dramatic decrease in costs and increase in appraiser removals outlined above.

**Appraiser Watch** targets appraisers for review based upon traditional risk factors. Appraisers are identified by their association with loans that are experiencing early defaults, loans experiencing early defaults that are insured under FHA's higher-risk programs, and loans that are performing

---

**Appendix II**  
**Comments from the Department of Housing**  
**and Urban Development**

---

worse than loans associated with their appraiser peers. Based on these criteria, HOC staff generates a list of potentially high-risk appraisers and targets for review a *minimum* of 30 appraisers per quarter. The scope of this effort is comprehensive. Program staff analyzes the performance of all 27,000 appraisers on the FHA Roster each quarter to determine which appraisers present the greatest risk to FHA.

E) Testing of Appraisers

FHA worked in cooperation with the mortgage and appraisal industries to develop the FHA appraiser examination. This examination tests the competency of the individual appraisers, regarding both general appraisal requirements and FHA requirements. All licensed appraisers are required to pass the test to participate in FHA Single Family mortgage insurance programs. This test became mandatory February 1, 2000 and was updated October 1, 2004 to reflect current program changes. A reputable national testing company administers the test for FHA.

F) Final Rules

In response to GAO's last audit report, performed in 1999, FHA has promulgated four rules to strengthen its oversight and control of appraisers as well as improve appraisal quality. These rules expand FHA's authority to remove poorly performing appraisers; prohibit the "flipping" of properties; enhance FHA's appraiser qualifications requirements; and reinforce lenders' accountability for the quality of appraisals. These rules are listed below:

- Final Rule/FR-4572-D-19 (effective July 19, 2001), Redelegation of Authority To Remove Appraisers From FHA Roster provides notice of re-delegation of authority to remove appraisers from the FHA Roster pursuant to the HUD regulation at 24 CFR § 200.204. The Federal Housing Commissioner re-delegated to certain HUD officials in all four FHA Single Family Homeownership Centers (HOCs) the power and authority to issue notices of removal from the FHA Appraiser Roster to appraisers who have been found in violation of HUD's appraisal regulations.
- Final Rule FR-4615-F-02 (Effective June 2, 2003), Prohibition of Property Flipping in HUD's Single Family Mortgage Insurance Programs enacted 24 CFR § 203.37a and amended 203.255, and addresses property "flipping," the practice whereby a property recently acquired is resold for a considerable profit with an artificially inflated value, often abetted by a lender's collusion with the appraiser. Specifically, the final rule establishes certain new requirements regarding the eligibility of properties to be financed with FHA mortgage insurance. The new requirements prohibit flipped properties from FHA-insured mortgage financing, thus precluding FHA home purchasers from becoming victims of predatory flipping activity.
- Final Rule FR-4620-F-02 (Effective June 16, 2003), Appraiser Qualifications for Placement on FHA Single Family Appraiser Roster amended 24 CFR § 200.202 & 200.204 and makes several changes that strengthen the licensing and certification requirements for placement on the FHA Appraiser Roster. Appraisers on the FHA Appraiser Roster must have credentials that are based on the minimum licensing/certification standards issued by the Appraiser Qualifications Board of the Appraisal Foundation. The final rule also provides that an appraiser whose license or certification in any state has been revoked, suspended, or surrendered as a result of a state disciplinary action will be automatically suspended from the roster until HUD receives evidence that the state imposed sanction has been lifted.

---

**Appendix II**  
**Comments from the Department of Housing**  
**and Urban Development**

---

- Final Rule FR-4722-F-02 (Effective August 19, 2004), FHA Single Family Mortgage Insurance: Lender Accountability for Appraisals amended 24 CFR § 25 & 203 and clarifies that lenders are accountable for the quality of appraisals on properties securing FHA-insured mortgages. Specifically, lenders that submit appraisals to HUD that do not meet FHA requirements are subject to the imposition of sanctions by the HUD Mortgagee Review Board. The codification of these policies provides HUD additional enforcement authority, reminds lenders of their responsibilities with respect to appraisals, and ensures that homebuyers receive an accurate statement of the appraised value of their homes.

G) Mortgagee Letters

Since GAO's last report, FHA has issued 9 Mortgagee Letters to the 27,000 FHA Roster Appraisers and 10,000 FHA-Approved Mortgagees to strengthen FHA's oversight and control of appraisers and appraisal quality. These Mortgagee Letters are listed below:

- Mortgagee Letter 99-18, published June 28, 1999, as part of a process to increase the accuracy and thoroughness of FHA appraisals performed as part of the home-buying process, announced the issuance of Handbook 4150.2, the Comprehensive Valuation Package (CVP), and the updated "Importance of Home Inspections" form. Five attachments to the mortgagee letter were as follows: 1) Handbook 4150.2, 2) Uniform Residential Appraisal Report, 3) Part 2 of the CVP, Notice to Lender, 4) Part 3 of the CVP, Notice to the Homebuyer and 5) Four Your Protection: Get a Home Inspection.
- Mortgagee Letter 99-29, published September 10, 1999, provided clarification that the VC form does not constitute a home inspection and that appraisers are competent and adequately trained to properly fill out the VC sheet.
- Mortgagee Letter 99-32, published November 12, 1999, provided guidance and clarification regarding FHA appraisal guidelines and reporting standards as a result of the issuance of Handbook 4150.2, the Comprehensive Valuation Plan and the updated "Importance of Home Inspections". FAQs were included as an exhibit with the mortgagee letter.
- Mortgagee Letter 99-35, published November 24, 1999, announced new requirements for placement and retention on the FHA Appraiser Roster, including successfully passing an examination.
- Mortgagee Letter 00-30, published August 7, 2000, transmitted a revised (from that contained in HB 4150.2) copy of the FHA appraiser's performance and sanctions matrix, which outlines the type of sanction that may be imposed by the type of performance violation.
- Mortgagee Letter 2003-07, published May 22, 2003, provides a synopsis of the Final Rule FR-4615-F-02, which amended the mortgage insurance regulations to prevent the practice of flipping on properties that will be financed with FHA-insured mortgages. This mortgagee letter, with the effective date of June 2, 2003, also provides specific guidance to assist lenders in complying with the new requirements.
- Mortgagee Letter 2003-09, published June 20, 2003, announces the new appraiser qualifications for placement on the FHA Appraiser Roster, updating requirements contained in

---

**Appendix II**  
**Comments from the Department of Housing**  
**and Urban Development**

---

Mortgagee Letter 99-35 and HUD Handbook 4150.2 CHG1. The Mortgagee Letter provides specific guidance to assist mortgagees and appraisers in complying with the new requirements.

- Mortgagee Letter 2003-18, published October 16, 2003, informs Mortgagees that the Federal Housing Administration (FHA) has updated Form HUD-92564-VC, "Notice to the Lender" (Valuation Conditions/VC form) and Form HUD-92564-HS, "Notice to the Homebuyer" (Homebuyer Summary). Appraisers and Mortgagees are required to use the new forms for all cases submitted for case number assignments 30 days after the date of the Mortgagee Letter. In addition, FHA reduced the CHUMS data entry requirements outlined in Mortgagee Letter 00-06.
- Mortgagee Letter 2004-04, published January 22, 2004 announces the revision of Form HUD-92564-CN (For Your Protection: Get a Home Inspection) to clarify the importance of and differences between an appraisal and a home inspection.

H) FHA Handbook

Since GAO's last report, FHA has completed a comprehensive update of the Appraisal Handbook, HB 4150.2, CHG-1, "Valuation Analysis for Home Mortgage Insurance for Single Family One-to Four Unit Dwellings." Completed in July 1999, this update represents the first significant modification to this policy guide in 9 years: it incorporated policy guidance announced in 16 mortgagee letters published between 1990 and 1999, and provides detailed, step-by-step instructions on how to prepare an FHA appraisal.

I) FHA Appraisal-Related Forms

Since GAO's last report, FHA has revised or created additional forms to strengthen the FHA appraisal reporting process.

- Form HUD-92564-HS (Notice to Homebuyer), October 2003

The appraiser prepares the Homebuyer Summary to document any property conditions that are not in conformance with HUD's Minimum Property Standards or Requirements. The form is given to the homebuyer before loan closing.

- Form HUD-92564-CN (For Your Protection: Get a Home Inspection), January 2004

"For Your Protection: Get a Home Inspection," informs the homebuyer that FHA does not guarantee the value or condition of the property, an appraisal is not a home inspection, and the borrower has the right to have the house inspected by a professional home inspector.

- Form HUD-92564-VC (Valuation Condition Sheet), October 2003

The VC form has been revised to more clearly reflect the items under each of the current VC categories needed to meet the Department's Minimum Property Standards or Requirements. The lender must clear these items before loan closing.

---

**Appendix II**  
**Comments from the Department of Housing**  
**and Urban Development**

---

J) Staff Increases

FHA upgraded and increased staffing levels at Headquarters (HQ) to ensure better oversight, monitoring and control of real estate valuation issues with respect to FHA insured properties. Major changes are listed below:

- Creation of a Valuation Branch in FY 2003 to handle all valuation and appraisal related issues. Prior to its creation, there was no single team to address these issues and coordinate consistency in the application of valuation policy with the Homeownership Centers (HOC).
- Creation of full-time manager of Valuation Branch, appointed in FY2003. Prior to the creation of this position, there had been no one specific individual with a real estate valuation background to oversee and direct appraisal and real estate valuation related issues at the HQ level.
- Addition of three certified/licensed appraisers, all of whom have extensive experience in the private sector, to HQ staff in FY 2003. Prior to the addition of these certified /licensed appraisers, HQ had no staff member who was either a certified or licensed real estate appraiser.
- Addition of three staff persons to augment data verification and data entry tasks associated with the Appraiser Roster Management. As noted previously, there are approximately 27,000 appraisers on the FHA Appraiser Roster and the addition of this staff enabled HQ to ensure the timely processing of new applications for the Roster as well as provide thorough and accurate monitoring of appraisal state license/certification renewal.

K) Staff Training

FHA has provided training to its staff to ensure that personnel are adequately up to date on changes in the industry that affect appraisal policy. This training is offered to the certified/licensed appraisers and other staff. The staff training is listed below:

- Appraisal Principles, Appraisal Institute Course 110, provided an overview of the valuation process, emphasizing basic appraisal concepts and procedures.
- Appraisal Procedures, Appraisal Institute Course 120, provided problem solving using the three approaches to value (Cost, Sales Comparison and Income Approaches to Value) as well as appraisal report preparation techniques.
- Standards of Professional Practice, Part A of the Uniform Standards of Professional Practice (USPAP), Appraisal Institute Course 410, provided an overview of basic rules for ethical behavior and competent performance for appraisers and is designed to comply with USPAP requirements for state certified appraisers.
- Appraising Manufactured Housing, Appraisal Institute Seminar, provided a primer on how to identify and analyze various types of manufactured housing as well as an in-depth overview of manufactured housing requirements under HUD's Title II program.

---

**Appendix II**  
**Comments from the Department of Housing**  
**and Urban Development**

---

- The National Automobile Dealers Association (NADA) provided appraisal training with respect to the development and use of the NADA Manufactured Housing Appraisal Guide and manufactured housing valuation requirements under HUD's Title I program.

L) Training for Lenders and Appraisers

Changes and updates in the real estate industry are inevitable. As changes to FHA programs occur or when clarification on existing policies and practices are needed, FHA provides timely notification and comprehensive training to appraisers and lenders. In addition, guidance is provided on where and how to obtain information on FHA programs. The types of recent training are outlined below:

- **National Lender Training:** National training includes a segment on the FHA appraisal process, which highlights updates and changes to the requirements on how to appraise existing, proposed and new construction of one-to four-unit single family homes. The session, which includes a short question and answer forum for attendees, was presented in 4 locations during FY 2004. (Orlando, FL; Philadelphia, PA; Denver, CO and Atlanta, GA). Another national training session is scheduled for Santa Ana, CA in November 2004.
- **Localized Training:** Each fiscal year, the HOCs conduct a minimum of 200 training sessions for lenders and appraisers. The topics are quite similar to the national lender training, but provide more details and focus on topics unique to the area in which the training is conducted, such as common appraisal deficiencies indicative of a particular housing area. For example, the Atlanta HOC provides more guidance on manufactured housing, since it has the highest volume of loans involving manufactured homes.

M) Management Oversight and Control

FHA Headquarters and HOC managers and staff maintain continuous contact internally and externally with the lending and appraiser industries to ensure sufficient management oversight and control.

- Biweekly Conference Calls between Headquarters and HOCs to discuss appraisal oversight issues;
- Monthly meetings with the Appraisal Subcommittee (ASC), attended by both a Headquarters manager and licensed appraisers on staff (ASC is a federal entity created under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 to develop appraisal-related policies and monitor implementation of appraisal standards by private, state, and federal parties);
- Quarterly meetings of the Appraisal Foundation Advisory Council (TAFAC), where Headquarters manager represents HUD as a voting member of the council;
- Coordination with systems contractor (ATS) to constantly improve appraiser and appraisal data captured in CHUMS as well as implementation of the interface of CHUMS with National Registry of the Appraisal Subcommittee (ASC)

---

**Appendix II**  
**Comments from the Department of Housing**  
**and Urban Development**

---

**Section 2: Response to GAO Findings/Factual Errors**

FHA is concerned that the report contains several significant factual errors. A list of these errors, along with the appropriate correction is provided below:

- Page 1, Paragraph 1, second from last sentence, and repeated on page 23: “However, HUD does not document all verifications of appraisers’ eligibility for the roster and has limited quality control over the approval process.”

This statement is not accurate. FHA has a paper record for each application processed. A staff program analyst creates each of these records. The records are maintained in Headquarters and were available for review and inspection by the GAO auditors. However, the GAO auditors did not review these records. The program analyst’s verification and documentation procedures include:

1. Manually notating a new applicant’s file evidencing that he or she has been screened against HUD’s Limited Denial of Participation List; General Services Administration’s Excluded Parties List System; and the Credit Alert Interactive Voice Response System which indicates delinquency on federal debt;
  2. Verifying compliance with ASC National Registry/“AQB” Field, from the revised CHUMS Appraiser File (CHUMS file revised June 2004 when regulations for this requirement became effective);
  3. Manually notating the new applicant’s file regarding eligibility and verification from ASC National Registry
  4. Confirming the Prometric Certificate indicating FHA Appraiser test was completed with passing grade;
  5. Initialing and dating new applications with the date the FHA Appraiser was placed on the Roster, certifying completeness of the verification eligibility criteria; and
  6. Placing all source materials (documenting various eligibility checks) in an application file. All such files are stored in a locked cabinet in Headquarters.
- Page 1, Paragraph 2, second from last sentence and reiterated on pages 3 and 15: “However they (HUD) reviewed fewer appraisals for each targeted appraiser than HUD’s guidance prescribes: on average, about 5.6 appraisals, instead of the 10 called for.”

This statement is not accurate. The figures refer to the number of desk reviews conducted. In fact, HUD’s guidance, issued April 23, 2002, recognizes that 10 appraisals may not be available for review. The guidance states: “Desk review 10 cases per appraiser (**if possible as there may not be 10 cases**) and field review no more than 5”(emphasis added). Under many circumstances, 10 cases are not available for desk review. Also, during the course of the desk reviews, the analyst may determine from fewer than 10 cases that field reviews are warranted. Rather than expending government resources to perform additional desk reviews, HUD immediately proceeds to field review the cases identified.

- Page 13, Paragraph 2, and page 23 of the report states that GAO could not verify whether the appraisers identified for review met HUD’s criteria, nor that they represented greatest risk to FHA.

FHA generates its targeting lists from the Neighborhood Watch system and can regenerate these lists by inputting the same criteria used to create the original reports. Neighborhood Watch is a transactional system and its data changes on a daily basis, so the system may not reproduce exactly the

---

**Appendix II**  
**Comments from the Department of Housing**  
**and Urban Development**

---

same lists as were reported at a previous time. The variation from month to month is slight, however, because appraisers identified as poorly performing in one month remain on the list for succeeding months.

However, as will be discussed in the recommendations section, FHA will modify the Neighborhood Watch system to archive quarterly reports in order to maintain the historical targeting records.

- Page 14, Paragraph 1, last two lines read “More importantly, in the absence of this information, HUD . . . may be unable to determine the effectiveness of its targeting criteria in reducing risk to the mortgage insurance fund.”

This statement is not accurate. HUD’s Appraiser Watch system directly targets the appraisers that present the greatest risk to the MMI fund.

- Page 14, last sentence states “HOC officials explained that they are not always able to conduct reviews of the appraisers within the quarter targeted because of resource constraints, but indicated that they eventually perform reviews of all targeted appraisers.”

As noted by GAO, all four HOCs have completed more than the required minimum number of 30 field reviews per quarter. In fact, each HOC reviews every appraiser identified by Appraiser Watch whose volume exceeds a minimum threshold and whose claim and default rates exceed their peers’ rates by 200%. HOC managers then use their discretion to supplement this core list, identifying additional appraisers for review. FHA generates the Appraiser Watch targeting lists at the beginning of each fiscal quarter and completes the reviews of these targeted appraisers during that same quarter. However, the supplemental field reviews, which may be conducted as a result of consumer complaints or for other reasons, may be initiated at any point in a quarter and completed during another quarter. While contracting resources are limited, FHA has provided the funds necessary to perform all field reviews.

- Page 16, subhead states “HUD Conducted Limited Oversight of Field Review Contractors.”

This statement is not accurate. FHA conducts a 100 percent review of the contractor’s work. Initially, a program analyst performs a complete analysis, comparing the appraisal field review report with the original appraisal. Each field review appraisal is also verified using available data, such as public records, the Multiple Listing Service (MLS), and Automated Valuation Models (AVM), when applicable. A second review is conducted by HOC senior management for any action that is considered “sanctionable,” based on any discrepancy between appraisal prepared for the original mortgage and the contractor’s field review report. Finally, the original appraiser is allowed to dispute any findings and to submit evidence to counter any findings of the field review report.

- Page 17, 2<sup>nd</sup> paragraph 4<sup>th</sup> line reads: “HUD officials explained that they are constrained by limited travel resources and so are not able to make on-site property visits.”

The issue is not that travel resources are limited. The HOCs do not conduct on-site reviews because the 100% review method described above serves as an appropriate and effective risk-control measure.

- Page 23, Paragraph 1, 2<sup>nd</sup> to the last sentence reads “However, certain weaknesses in implementing these initiatives limit their ability to (1) lower HUD’s risk of insuring properties that are overvalued and (2) minimize potential losses to FHA’s mortgage insurance fund.”



---

**Appendix II**  
**Comments from the Department of Housing**  
**and Urban Development**

---

This concluding statement is based on the inaccurate information cited above. The main finding, that FHA does not verify and document the verification that all appraisers meet HUD's qualifications is not correct. The targeting methodology employed by FHA has proven to be vastly superior to the previous methodology at reducing risks to FHA. As stated throughout this response, FHA's new methodology is less costly, more effective, and more efficient. The issues noted by GAO and the attendant proposed recommendations do not and will not affect FHA's risk.

**Section 3: Response to Recommendations for Executive Action**

*GAO Recommendation:* Institute reasonable controls on the process of placing appraisers on the appraiser roster, including documenting that verifications of applicant eligibility for the roster are conducted.

*FHA Response:* As described above, FHA has a thorough application review process whereby each applicant's eligibility is verified and each of these verifications is documented. This process has been in place since January 2003. FHA staff creates a paper record for each application processed and these records include documentation that all eligibility criteria are verified for every applicant. All of these records are maintained in Headquarters and were available for review and inspection by the GAO auditors.

As described above, the program analyst verifies each applicant's compliance with the FHA eligibility criteria. Each file contains source material to document that each of these checks has been completed and each file is manually notated, whereby the analyst initials that each verification has been completed. In addition, each file contains the date when the FHA Appraiser was placed on the Roster.

*GAO Recommendation:* Consider a requirement to include, when targeting appraisers for review, those appraisers who have recently completed a sanction period in order to ensure that these appraisers have corrected their relevant deficiencies.

*FHA Response:* FHA will consider this recommendation. To implement such a change, FHA would need to evaluate, first, how to incorporate a non-risk-based approach into the current risk-based methodology; and second, whether the change would have any impact on the effectiveness of FHA's current risk-based approach. FHA would want to ensure that the interjection of a manual process (which is not readily automated) would not divert resources from the current automated targeting of appraisers based on predetermined risk factors, which has proven to be successful.

*GAO Recommendation:* Maintain the historical information, particularly early loan default information, used to target appraisers for review in order to ensure that the HOCs target and review appraisers based on the criteria in HUD guidance.

*FHA Response:* As noted above, the targeted appraiser lists change only slightly from month to month. However, FHA will modify the Neighborhood Watch system to archive quarterly reports to maintain this historical targeting records.

*GAO Recommendation:* Implement a cost-effective field review contractor oversight process that includes on-site monitoring.

---

**Appendix II**  
**Comments from the Department of Housing**  
**and Urban Development**

---

FHA Response: FHA currently has a cost-effective contract oversight process. FHA performs a 100 percent review of the contractors' work. As described above, the four Homeownership Centers follow a comprehensive quality control process that requires FHA staff and managers to review, verify, and ensure there are no discrepancies between the original appraisal, reports submitted by contractors, and relevant property documentation. The review covers all aspects of the property valuation process, including an evaluation of the computations of value, photographs, maps, public records, and MLS listings, to quickly identify any potential problems. FHA therefore doubts that on-site monitoring is necessary, but will consider this recommendation.

Sincerely,



John C. Weicher  
Assistant Secretary for Housing-  
Federal Housing Commissioner

# GAO Contacts and Staff Acknowledgments

---

---

## GAO Contacts

David G. Wood, (202) 512-6878  
Paul Schmidt, (312) 220-7681

---

## Staff Acknowledgments

Staff members who made key contributions to this report include Eric Diamant, Mark Egger, Harold Fulk, Nadine Garrick, Curtis Groves, John McGrail, Mark Molino, Josephine Perez, David Pittman, Terry Richardson, and Paige Smith.

---

## GAO's Mission

The Government Accountability Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

---

## Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site ([www.gao.gov](http://www.gao.gov)). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to [www.gao.gov](http://www.gao.gov) and select "Subscribe to Updates."

---

## Order by Mail or Phone

The first copy of each printed report is free. Additional copies are \$2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office  
441 G Street NW, Room LM  
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000  
TDD: (202) 512-2537  
Fax: (202) 512-6061

---

## To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: [www.gao.gov/fraudnet/fraudnet.htm](http://www.gao.gov/fraudnet/fraudnet.htm)

E-mail: [fraudnet@gao.gov](mailto:fraudnet@gao.gov)

Automated answering system: (800) 424-5454 or (202) 512-7470

---

## Congressional Relations

Gloria Jarmon, Managing Director, [JarmonG@gao.gov](mailto:JarmonG@gao.gov) (202) 512-4400  
U.S. Government Accountability Office, 441 G Street NW, Room 7125  
Washington, D.C. 20548

---

## Public Affairs

Susan Becker, Acting Manager, [BeckerS@gao.gov](mailto:BeckerS@gao.gov) (202) 512-4800  
U.S. Government Accountability Office, 441 G Street NW, Room 7149  
Washington, D.C. 20548