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Highlights

Highlights of GAO-11-653, a report to congressional committees

July 2011

RESIDENTIAL APPRAISALS

Opportunities to Enhance Oversight of an Evolving Industry

Why GAO Did This Study

Real estate valuations, which encompass appraisals and other estimation methods, have come under increased scrutiny in the wake of the recent mortgage crisis. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act) mandated that GAO study the various valuation methods and the options available for selecting appraisers, as well as the Home Valuation Code of Conduct (HVCC), which established appraiser independence requirements for mortgages sold to Fannie Mae and Freddie Mac (the enterprises). GAO examined (1) the use of different valuation methods, (2) factors affecting consumer costs for appraisals and appraisal disclosure requirements, and (3) conflict-of-interest and appraiser selection policies and views on their impact. To address these objectives, GAO analyzed government and industry data; reviewed academic and industry literature; examined federal policies and regulations, professional standards, and internal policies and procedures of lenders and appraisal management companies (AMC); and interviewed a broad range of industry participants and observers.

What GAO Recommends

GAO recommends that federal banking regulators, the Federal Housing Finance Agency (FHFA), and the Bureau of Consumer Financial Protection consider addressing several key areas, including criteria for selecting appraisers, as part of their joint rulemaking under the Act to set minimum standards for states to apply in registering AMCs. The federal banking regulators and FHFA agreed with or indicated they would consider the recommendation.

View GAO-11-653 or key components.
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What GAO Found

Data GAO obtained from the enterprises and five of the largest mortgage lenders indicate that appraisals—which provide an estimate of market value at a point in time—are the most commonly used valuation method for first-lien residential mortgage originations, reflecting their perceived advantages relative to other methods. Other methods, such as broker price opinions and automated valuation models, are quicker and less costly but are viewed as less reliable and therefore generally are not used for most purchase and refinance mortgage originations. Although the enterprises and lenders GAO spoke with do not capture data on the prevalence of approaches used to perform appraisals, the sales comparison approach—in which the value is based on recent sales of similar properties—is required by the enterprises and the Federal Housing Administration and is reportedly used in nearly all appraisals.

Recent policy changes may affect consumer costs for appraisals, while other policy changes have enhanced disclosures to consumers. Consumer costs for appraisals vary by geographic location, appraisal type, and complexity. However, the impact of recent policy changes on these costs is uncertain. Some appraisers are concerned that the fees they receive from AMCs—firms that manage the appraisal process on behalf of lenders—are too low. A new requirement to pay appraisers a customary and reasonable fee could affect consumer costs and appraisal quality, depending on how new rules are implemented. Other recent policy changes aim to provide lenders with a greater incentive to estimate costs accurately and require lenders to provide consumers with a copy of the valuation report prior to closing.

Conflict-of-interest policies, including HVCC, have changed appraiser selection processes and the appraisal industry more broadly, which has raised concerns among some industry participants about the oversight of AMCs. Recently issued policies that reinforce prior requirements and guidance restrict who can select appraisers and prohibit coercing appraisers. In response to market changes and these requirements, some lenders turned to AMCs to select appraisers. Greater use of AMCs has raised questions about oversight of these firms and their impact on appraisal quality. Federal regulators and the enterprises said they hold lenders responsible for ensuring that AMCs' policies and practices meet their requirements for appraiser selection, appraisal review, and reviewer qualifications but that they generally do not directly examine AMCs' operations. Some industry participants said they are concerned that some AMCs may prioritize low costs and speed over quality and competence. The Act places the supervision of AMCs with state appraiser licensing boards and requires the federal banking regulators, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection to establish minimum standards for states to apply in registering AMCs. A number of states began regulating AMCs in 2009, but the regulatory requirements vary. Setting minimum standards that address key functions AMCs perform on behalf of lenders would enhance oversight of appraisal services and provide greater assurance to lenders, the enterprises, and others of the credibility and quality of the appraisals provided by AMCs.