

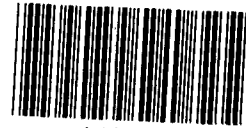
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Report to the Chairman, Commerce,
Consumer, and Monetary Affairs
Subcommittee, Committee on
Government Operations, House of
Representatives

October 1992

APPRAISAL REFORM

Implementation Status
and Unresolved Issues



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B-251051

October 30, 1992

The Honorable Doug Barnard, Jr.
Chairman, Commerce, Consumer, and
Monetary Affairs Subcommittee
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

This report responds to your request that we review the implementation of Title XI (Appraisal Reform) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). Specifically, you were interested in our comments on appraiser availability and appraisal cost under Title XI and the de minimis threshold, which is the transactional value of a real estate loan that determines whether appraisers who complete appraisals for federally related transactions are required to be state-licensed or -certified.

Results in Brief

Overall, positive strides have been made at the federal and state levels to implement Title XI by the December 31, 1992, deadline. For example, all 50 states, the District of Columbia, and most U.S. territories have developed and implemented programs for licensing and certifying appraisers involved in federally related transactions. Moreover, as of September 1992 over 59,000 appraisers nationwide had been state-licensed or -certified.

Similarly, each of the federal financial institutions regulatory agencies¹ and the Resolution Trust Corporation (RTC) have issued appraisal regulations. However, reaching this point has been controversial and has resulted in several unresolved issues. These unresolved issues include appraiser availability and appraisal cost, the appropriate de minimis threshold, standards for evaluating real estate-related financial transactions under the de minimis threshold, and state enforcement of appraisal standards.

**Objectives, Scope,
and Methodology**

Our objectives were to review (1) federal and state efforts to implement Title XI, (2) appraiser availability and appraisal cost, and (3) the de minimis threshold. We were also asked to summarize our prior reports and

¹The federal financial institutions regulatory agencies include the Office of Thrift Supervision (OTS), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (FRB), and National Credit Union Administration (NCUA).

testimonies related to appraisals. The focus of this report is residential real estate transactions.

The fact that the effective date of the requirements for licensing and certifying appraisers is not until December 31, 1992, coupled with incomplete information, limited our ability to do an in-depth review of the impact of Title XI at this time. Therefore, we relied heavily on interviews with officials responsible for developing real estate appraisal regulations and implementing the legislation as well as those who are affected by Title XI. Specifically, we interviewed officials at selected federal and state levels who are responsible for implementing Title XI to determine the status of implementation efforts. Additionally, we interviewed officials from the professional appraisal organizations, professional banking associations, individual bankers, and the secondary residential real estate mortgage market to obtain data on their perspectives and experiences with Title XI. Finally, we also collected and analyzed available data on residential real estate lending activity from the Federal Home Loan Mortgage Corporation (Freddie Mac), Federal National Mortgage Association (Fannie Mae), Federal Housing Administration (FHA), and Department of Veterans Affairs (VA) to determine the number of loans that would be appraised by a Title XI appraiser. We did not independently verify the information we received from the various officials.

We did our review from May through September 1992 in accordance with generally accepted government auditing standards.

Background

In August 1989, Congress passed Title XI of FIRREA in response to concerns that faulty or fraudulent real estate appraisals were significantly affecting the safety and soundness of the nation's insured financial institutions. Title XI was designed to protect federal financial and public policy interests in real estate-related transactions by imposing specific requirements for real estate appraisals. Title XI requires that real estate appraisals for federally related transactions² be written reports that conform to uniform standards and be completed by individuals whose competency has been demonstrated and whose professional conduct will be subject to supervision.

Federal and state entities are jointly responsible for carrying out Title XI. For example, states are required to develop and implement programs for

²A federally related transaction is any real estate-related financial transaction that the federal financial institutions regulatory agencies or RTC engages in, contracts for, or regulates and requires the services of an appraiser.

licensing and certifying appraisers. The primary distinctions between state-licensed appraisers and state-certified appraisers are the written examinations, education, and experience requirements. For example, a state-licensed appraiser typically must successfully complete a minimum of 75 hours of real estate appraisal courses, a state-certified residential appraiser is required to complete 105 hours, and a state-certified general appraiser must complete 165 hours. Additionally, Congress created the Appraisal Subcommittee (ASC) of the Federal Financial Institutions Examination Council to oversee the overall implementation efforts by federal and state entities to ensure that they are consistent with the intent of the legislation.

Federal Implementation Efforts

The federal financial institutions regulatory agencies and RTC were required under Title XI to issue in August 1990 real estate appraisal standards for federally related transactions under their respective jurisdictions and determine which of these transactions requires the services of a state-licensed or -certified appraiser. In the summer of 1990, the regulatory agencies and RTC developed their appraisal regulations, which included a \$50,000 de minimis threshold, with the exception of FRB, which set its threshold at \$100,000. In the spring of 1992, FDIC, OCC, and OTS revised the regulations and changed their thresholds for requiring a state-licensed or -certified appraiser to \$100,000. NCUA's de minimis threshold remains at \$50,000. RTC is in the process of increasing its threshold to \$100,000. Thus, real estate transactions below these respective thresholds do not have to be appraised by a state-licensed or -certified appraiser.

The federal financial institutions regulatory agencies' decision to establish de minimis thresholds at the current amount was based on information received from bank reports, experience gained from bank examinations, and comments from bankers that included information on loan losses. For example, bankers commented that their institutions experienced low levels of loan losses on real estate loans of less than \$100,000. Moreover, they commented that while the majority of their loan losses were from real estate loans greater than \$100,000, these losses were not caused by faulty or fraudulent appraisers but were more a function of economic changes. Data from 575 banks presented to FDIC showed that losses for loans of less than \$100,000 were less than 1 percent (.79 percent) while losses for loans greater than \$100,000 were averaging about 1 percent (1.37 percent) of the dollar amount held.

Although the data provided by the bankers were not based on a scientific sample, FDIC compared this data with its Call Reports, which contained similar information on real estate lending but in aggregate form. FDIC was able to show some similarities between the bankers' data and the Call Reports. Specifically, the Call Reports for the fourth quarter of 1991 and the first quarter of 1992, which are similar to the time frames that the bankers based their comments on, demonstrated that loan losses for 1- to 4-family residential and home equity lines of credit were significantly lower than other real estate-secured loans. For example, during the first quarter of 1992, 1- to 4-family residential loan loss was less than 1 percent compared to 3 percent for construction and development and 1 percent for commercial real estate. Thus, FDIC concluded that the aggregate losses of about .79 percent experienced by bankers on residential real estate transactions below the \$100,000 de minimis threshold did not hamper federal or public policy interests.

Opposing the regulatory agencies' decisions over which federally related transactions require a state-licensed or -certified appraiser are appraisal organizations and private mortgage insurance companies. Appraisal organizations argue that the establishment of a de minimis threshold is inconsistent with Title XI's objectives, which are to ensure the stability of residential mortgage markets and prevent the repeat of widespread financial institution failures. Equally important, consumers, particularly those of low to moderate income, are disadvantaged by a de minimis threshold, according to appraisal organizations. For example, they state that under a \$100,000 de minimis threshold, more than 53 percent of homes in the country could be appraised by individuals who may not meet a state's minimum requirements for a licensed appraiser. Specifically, the Appraisal Institute³ stated that low to moderate income homebuyers are often less knowledgeable about the real estate market and could benefit from an independent assessment of the property's value.

Additionally, these groups note that the risk is even more noticeable when reviewed on a regional level. In the Midwest, where the average home price is \$73,600, 73 percent of the homes in the area would be exempt from being appraised by a licensed or certified appraiser. Moreover, 62 percent of home sales in the South, where the average sales price is about \$82,200, would also be exempt from appraisal by a state-licensed or -certified appraiser. Thus, appraisal organizations believe that the large amount of risk on an individual bank basis and the high number of transactions that

³The Appraisal Institute is a professional appraisal organization resulting from the unification of 2 appraisal organizations in 1991. It has more than 32,000 members and affiliates nationwide.

are not included under a \$100,000 de minimis threshold demonstrate the need for a lower de minimis threshold.

Similarly, private mortgage insurance companies disagree with raising the de minimis threshold to \$100,000 because they see their residential loan losses as significant and risk associated with fraudulent or incompetent appraisals as high. In a March 1992 letter to NCUA, the Mortgage Insurance Companies of America stated that they paid claims totaling \$873 million in 1989, which they believe, in large part, could have been prevented if appraisers had been adequately trained and competent.

Fannie Mae, Freddie Mac, FHA, and VA require an appraisal by a state-licensed or -certified appraiser for real estate transactions of any amount. In its August 1992 report to Congress titled De Minimis Levels For Commercial Real Estate Appraisals, the Office of Management and Budget (OMB) stated that over 80 percent of all 1- to 4-family residential loans will be appraised by a licensed appraiser because of the high level of participation by Fannie Mae, Freddie Mac, FHA, and VA in the residential lending market. Thus, they concluded that about 17 percent of the real estate-secured loans under \$100,000 in the country would not be subject to appraisal by a state-licensed or -certified appraiser.

State Implementation Efforts

Title XI requires the states and U.S. territories to develop programs by December 31, 1992, for licensing and certifying appraisers who will complete appraisals in connection with federally related transactions. As the deadline approaches, programs have been developed in each of the states, the District of Columbia, and most U.S. territories. Thirty-four states and Guam have provided ASC with the names and fees of licensed or certified appraisers, which have been entered into the national registry. (See app. I for the number of certified and licensed appraisers by state.)

However, work still remains to be done by some states. Sixteen states, the District of Columbia, and 3 territories have not submitted a roster and fees of certified and licensed appraisers to ASC. According to ASC, the states are licensing and certifying appraisers but have not submitted the names and fees because the deadline for doing so has not occurred. ASC is optimistic that these states will report their information by the December 31, 1992, deadline.

Additionally, ASC staff are concerned whether some state licensing programs fully carry out the objectives of appraisal reform. The Appraisal

Institute and the Appraisal Foundation⁴ believe that a real estate appraisal license should not be issued to any individual who does not have a minimum of 2,000 hours of experience. However, Title XI did not dictate the requirements for state licensing, and in 1991 the act was amended to specify that ASC should not set qualifications or experience requirements for state-licensed appraisers. Each state has established its own licensing requirements. This has resulted in inconsistent licensing criteria among the states.

The following examples illustrate the types of variances that have developed. To ensure minimum competency, Virginia does not license appraisers unless they have successfully completed 75 hours of real estate appraisal courses, a written examination, and a minimum of 2,000 hours of experience over 2 years. In contrast, Oklahoma will license appraisers who successfully complete 75 hours of classroom training and passed the real estate appraisal exam but have zero hours of experience. Similarly, although Illinois requires applicants for an appraisal license to complete 75 classroom hours as a prerequisite before taking the exam, it reduced its hours of experience from 2,000 to 500 for licensed appraisers. Consequently, according to ASC staff, individuals who may not be competent to appraise could be licensed to appraise properties in some states.

Unresolved Issues

As the December 31, 1992, deadline approaches for requiring appraisals in connection with federally related transactions to be completed by state-licensed or -certified appraisers, several unresolved issues exist. These unresolved issues are discussed next.

Appraiser Availability and Appraisal Cost

During our review, we found differing views regarding appraiser availability and appraisal cost. Some bank officials, particularly in rural areas, contend that they are experiencing a shortage of licensed or certified appraisers. They report that this has increased the cost of appraisals and the time it takes to obtain them. For example, officials from Virginia and Montana banks stated that appraisals now cost about \$400 compared to \$200 before Title XI, and it now takes approximately 2 weeks to a month to obtain an appraisal compared to 10 days before. However, they stated that the refinancing boom has also affected the time it takes to obtain an appraisal. The Appraisal Institute attributes the increased cost

⁴The Appraisal Foundation is a private, nonprofit organization established in 1987 and was recognized in Title XI to develop uniform standards and qualifications for the appraisal profession.

for appraisals perceived by some bank officials to the additional regulatory requirements and detailed data that financial institutions and the secondary residential real estate mortgage market require. Therefore, they believe that it is not practical to compare the current cost of appraisals to the prior cost because the product is not the same.

A survey completed by the Council of Appraisal and Property Professional Societies (CAPPS)⁶ showed that most respondents did not believe there was a shortage of appraisers or an increase in appraisal cost. CAPPS surveyed about 100 of its members nationwide about appraiser availability as well as appraisal cost and completion time. According to CAPPS, 91 percent of the 100 respondents stated that there was not a shortage of appraisers in their areas, 71 percent stated that the cost of appraisals had not increased because of licensing and certification requirements, and 76 percent stated that the processing time for completing appraisals had not increased as a result of the enactment of Title XI. Additionally, ASC, which has the statutory authority to grant a temporary waiver, has not received any requests for waivers because of appraiser shortages from states that are currently licensing and certifying appraisers.

We believe that at this point it is premature to determine whether there is a nationwide shortage of state-licensed or -certified appraisers or an increase in the cost of obtaining an appraisal. Further, options exist for addressing geographic-specific concerns regarding the scarcity of state-licensed or -certified appraisers. For example, Title XI provides for the implementation of temporary practice procedures whereby an appraiser who has been licensed or certified by one state is permitted to practice for a limited time in another state upon registering. According to ASC, however, some states have established high fees, which makes it difficult for an appraiser who is licensed or certified by another state to practice in that state. For example, Maine charges \$425 for a temporary appraisal license while Georgia, Nebraska, and Oklahoma require a \$200 temporary practice fee.

Although not required by Title XI, another option, which ASC has encouraged the states to pursue, is reciprocity provisions under which the licensing and certification qualifications of one state are permanently recognized and accepted by another state in its regulations. However, 14 states have not adopted reciprocal agreements or endorsement provisions, according to the Appraisal Institute.

⁶CAPPS is a nonprofit organization established in 1991 by four appraisal organizations with over 25,000 members nationwide.

Appropriate de Minimis Threshold

The primary argument raised by appraisal organizations against a \$100,000 de minimis threshold is their contention that it would exempt more than half of the homes in the country from the requirement that they be appraised by a state-licensed or -certified appraiser. Consequently, they believe that low to moderate income homebuyers would not have the opportunity to have their single largest investments appraised by individuals who have successfully demonstrated their competency and whose performance is subject to supervision. On the other hand, supporters of a \$100,000 de minimis threshold contend that the cost of complying with the regulations for transactions below the de minimis threshold would outweigh any likely reductions in loan losses. However, since neither side has presented sufficient data to support their concerns, the federal financial institutions regulatory agencies and RTC would have to analyze residential real estate lending data to determine the impact of the de minimis threshold on homebuyers as well as on the safety and soundness of financial institutions.

Standards for Transactions Under the de Minimis Threshold

Another area requiring attention is ensuring that each of the federal financial institutions regulatory agencies and RTC have sufficient standards for evaluating real estate-related transactions that are under the de minimis threshold. Guidelines for evaluating these transactions are essential given that, according to OMB, 17 percent of appraisals for residential real estate loans in the country could be completed by individuals who are not state-licensed or -certified. An interagency group was established by the federal financial institutions regulatory agencies to revise the 1987 guidelines for determining the value of real estate-related transactions that are below the de minimis threshold. During the fall of 1992, FDIC, OTS, OCC, and FRB issued separate guidelines for real estate appraisals below the \$100,000 de minimis threshold. RTC has not amended its regulations to include guidance for real estate appraisals below its de minimis threshold. NCUA included guidance for real estate transactions below its \$50,000 de minimis threshold in its appraisal regulations. We believe that the actions taken by the federal financial institutions regulatory agencies are a step in the right direction.

Enforcement of Standards by States

Equally important will be the enforcement of the appraisal standards by the states once Title XI is fully implemented. Under Title XI, appraisers are required to prepare written appraisals in accordance with the uniform standards. This has been implemented by issuance of the Uniform Standards of Professional Appraisal Practice by the Appraisal Foundation.

According to the Appraisal Institute, many of the states' programs include only limited guidance for processing complaints against appraisers who have acted unprofessionally or unethically. We recognize that the states were initially concentrating on licensing and certifying appraisers. However, as states move forward, enforcement of the regulations will become a significant factor in achieving the objectives of Title XI.

Summary of Past GAO Reports on Appraisals

Since 1987, we have issued 16 products in which appraisals were discussed. (See "Related GAO Products" for a list of recently issued GAO reports on this issue.) In general, we have found some problems with the accuracy and completeness of appraisals. Specifically, problems with appraisal accuracy were discussed in 12 of the 16 products. For example, in our 1991 review of Freddie Mac's multifamily program,⁶ we concluded that inaccurate and incomplete appraisal information contributed to Freddie Mac overfinancing several properties by about 20 percent, or \$5.4 million of its total investment in them. Similarly, in 1989 we testified before the Subcommittee on Criminal Justice, House Committee on the Judiciary, that bank examiners found that appraisal reports accepted by 23 of the 26 thrifts we reviewed were not adequately or accurately substantiated as required, and in some cases thrifts did not obtain appraisals or obtained them after the loan was granted.⁷

Additionally, appraiser ethics and qualifications were discussed in four reports. In April 1992, we reported that some of RTC's review appraisers appeared to be unqualified for their positions because they did not have sufficient appraisal experience.⁸

Conclusions

Although there are some unresolved issues, we believe that when fully implemented, Title XI will be an important vehicle in helping to ensure that federal financial and public policy interests in real estate-related financial transactions are protected by requiring that appraisals be completed in accordance with uniform standards by individuals whose competency has been demonstrated and whose performance will be subject to supervision. Title XI can help alleviate concerns that faulty or

⁶Federal Home Loan Mortgage Corporation: Abuses in Multifamily Program Increase Exposure to Financial Losses (GAO/RCED-92-6, Oct. 7, 1991).

⁷Failed Thrifts: Internal Control Weaknesses Create an Environment Conducive to Fraud, Insider Abuse, and Related Unsafe Practices (GAO/T-AFMD-89-4, Mar. 22, 1989).

⁸Resolution Trust Corporation: Better Qualified Review Appraisers Needed (GAO/GGD-92-40BR, Apr. 23, 1992).

fraudulent real estate appraisals have increased and affected the safety and soundness of the nation's insured financial institutions. Additionally, it should help ensure that appraisers have the expertise needed to complete accurate appraisals.

Agency Comments

We discussed the issues presented in this report with responsible officials at the Appraisal Subcommittee, federal financial institutions regulatory agencies, RTC, and the Appraisal Institute. These officials generally agreed with the information presented in our report and suggested some technical changes, which we have incorporated as appropriate.

As arranged with the Subcommittee, unless you publicly announce its contents earlier we plan no further distribution of the report until 30 days from the date of this letter. At that time, we will send copies to interested parties. We will also make copies available to others upon request.

The major contributors to this report are listed in appendix II. If you or your staff have any questions concerning this report, please contact me at (202) 736-0479.

Sincerely yours,



Gaston L. Gianni, Jr.
Associate Director,
Federal Management Issues

Number of Licensed and Certified Appraisers by State, as of September 1992

State	Total number of licensed or certified appraisers
Alabama	803
Alaska	140
Arizona	1,226
Arkansas	583
California	7,703
Colorado	1,520
Connecticut	1,929
Delaware	236
District of Columbia	356
Florida	3,098
Georgia	2,359
Guam	6
Hawaii	343
Idaho	249
Illinois	882
Indiana	1,466
Iowa	623
Kansas	692
Kentucky	601
Louisiana	553
Maine	747
Maryland	1,678
Massachusetts	220
Michigan	2070
Minnesota	1,374
Mississippi	759
Missouri	1,099
Montana	171
Nebraska	384
Nevada	513
New Hampshire	370
New Jersey	2,100
New Mexico	300
New York	1,984
North Carolina	2,855
North Dakota	146
Ohio	1,794

(continued)

**Appendix I
Number of Licensed and Certified
Appraisers by State, as of September 1992**

State	Total number of licensed or certified appraisers
Oklahoma	578
Oregon	877
Pennsylvania	1,857
Puerto Rico	746
Rhode Island	156
South Carolina	1,192
South Dakota	170
Tennessee	1,119
Texas	3,110
Utah	439
Vermont	333
Virginia	1,531
Washington	1,477
West Virginia	462
Wisconsin	954
Wyoming	149
Total	59,082

Source: Appraisal Subcommittee of the Federal Financial Institutions Examination Council.

Major Contributors to This Report

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Related GAO Products

Resolution Trust Corporation: Better Qualified Review Appraisers Needed
(GAO/GGD-92-40BR, Apr. 23, 1992).

Land Exchange: Phoenix and Collier Reach Agreement on Indian School Property
(GAO/GGD-92-42, Feb. 10, 1992).

Federal Home Loan Mortgage Corporation: Abuses in Multifamily Program Increase Exposure to Financial Losses
(GAO/RCED-92-6, Oct. 7, 1991).

Land Exchange: Phoenix Indian School Development Plan Adversely Affects Property Value
(GAO/GGD-91-111, July 25, 1991).

Property Disposition: Information on Federal Single-Family Properties
(GAO/RCED-91-69, Mar. 29, 1991).

Navy Office Space: Cost Estimate for Consolidating the Naval Systems Commands May be High
(GAO/GGD-91-61, Mar. 8, 1991).

Facilities Location Policy: GSA Should Propose a More Consistent and Businesslike Approach
(GAO/GGD-90-109, Sept. 28, 1990).

Conflicting Values for Land Near the Columbia Hospital for Women
(GAO/T-GGD-90-39, May 23, 1990).

Federal Timber Sales: Process for Appraising Timber Offered for Sale Needs to Be Improved
(GAO/RCED-90-135, May 2, 1990).

Federal Real Property: Conflicting Appraisals of Land Near Columbia Hospital for Women
(GAO/GGD-90-15, Dec. 11, 1989).

Failed Thrifts: Internal Control Weaknesses Create an Environment Conducive to Fraud, Insider Abuse, and Related Unsafe Practices
(GAO/T-AFMD-89-4, Mar. 22, 1989).

Federal Real Property: Appraisal of Land to Be Sold to Columbia Hospital for Women
(GAO/GGD-89-46, Mar. 10, 1989).

Land Exchange: New Appraisals of Interior's Collier Proposal Would Not Resolve Issues
(GAO/GGD-88-85, May 11, 1988).

Denver Post Office: Estimate of Fair Market Value
(GAO/GGD-88-51, Mar. 11, 1988).

Internal Controls: Weaknesses in HUD's Single Family Housing Appraisal Program (GAO/RCED-87-165, Sept. 30, 1987).

Federal Land Acquisition: Land Exchange Process Working But Can Be Improved (GAO/RCED-87-9, Feb. 5, 1987).

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