

GAO

Testimony

Before the Subcommittee on Housing and
Transportation, Committee on Banking,
Housing, and Urban Affairs, U.S. Senate

For Release on Delivery
Expected at 2:30 p.m. EST
Wednesday, March 24, 2004

REGULATORY PROGRAMS

Opportunities to Enhance Oversight of the Real Estate Appraisal Industry

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Highlights of [GAO-04-580T](#), a testimony before the Subcommittee on Housing and Transportation, Committee on Banking, Housing, and Urban Affairs, U.S. Senate

Why GAO Did This Study

The appraisal and mortgage lending industry has changed dramatically since the passage of Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. Some have concluded that the problems Title XI was intended to address—the risk to the federal deposit insurance funds and the lack of uniform standards and qualifications—no longer exist. This statement is based on GAO's May 14, 2003, report and discusses the roles of private, state, and federal entities that oversee the appraisal industry; the challenges that Title XI presented to these entities; and industry participants' concerns about the effectiveness of the Title XI regulatory structure.

What GAO Recommends

In its report, GAO suggested that, among other things, the Chairman of the Appraisal Subcommittee should:

- develop and apply consistent criteria for determining and reporting states' compliance levels with Title XI;
- explore potential options for assisting states in carrying out their Title XI activities, particularly for investigating appraiser complaints; and
- explore alternatives for providing future Title XI grant funding to the Appraisal Foundation and its two boards.

The Appraisal Subcommittee generally agreed with our recommendations and has taken actions to address them.

www.gao.gov/cgi-bin/getrpt?GAO-04-580T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact David G. Wood at 202-512-8678 or woodd@gao.gov.

REGULATORY PROGRAMS

Opportunities to Enhance Oversight of the Real Estate Appraisal Industry

What GAO Found

Title XI created a complex oversight structure for real estate appraisals and appraisers that involves private, state, and federal entities. Two private entities under the Appraisal Foundation establish uniform rules for real estate appraisals and set minimum criteria for certifying appraisers. State regulatory agencies certify appraisers based on these criteria. In addition, states (1) implement licensing of real estate appraisers and (2) monitor and supervise compliance with appraisal standards and requirements. The federal financial regulators oversee financial institutions' use of appraisals, and a federal agency, the Appraisal Subcommittee, monitors the functions of the entities. As part of its oversight activities, the Appraisal Subcommittee performs field reviews of the state appraiser regulatory agencies. GAO found that these reviews and their resulting reports could be more useful if based on clear and consistent criteria for assessing states' compliance with Title XI requirements.

All of these entities except the federal financial regulators identified potential impediments to carrying out their Title XI responsibilities. The two private entities stated that fund limitations could impede their ability to ensure that development of standards and qualifications evolve with changing conditions. State agencies said that funding shortfalls hindered their ability to enforce compliance. Appraisal Subcommittee staff reported that rule-making authority and additional enforcement sanctions could facilitate its oversight of state compliance with Title XI. The lack of funding and resources cited by state appraiser regulatory agencies and the two private entities, which establish appraisal standards and appraiser qualification criteria, could affect their future ability to fulfill their Title XI responsibilities. At the same time, the Appraisal Subcommittee has accumulated an operating surplus of almost \$4 million from fees levied and collected by the states on behalf of the federal government.

Industry participants raised concerns about aspects of the Title XI regulatory system for appraisers. They cited differences in state regulation that affect both lenders and appraisers, gaps in Title XI's coverage—for example, transactions of less than \$250,000 do not require an appraisal, high fees and burdensome processes for having appraiser education courses approved, and weak enforcement and complaints processing. Some industry participants felt that states, traditionally involved in regulating professions, should solely regulate the appraisal industry. Others felt that the current structure needed a significant overhaul to become effective. GAO found no clear consensus among the state regulatory agencies it surveyed or other industry participants regarding the need for or impact of possible changes to the Title XI regulatory structure.

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to be here today to discuss our report on federal oversight of the real estate appraisal industry.¹ In response to concerns that faulty and fraudulent appraisals played a major role in the savings and loans crisis of the 1980s, Congress enacted Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). Among other things, Title XI requires that real estate appraisals used in connection with federally related transactions be performed in writing, in accordance with uniform professional standards, and by individuals whose competency has been demonstrated and whose professional conduct is subject to effective supervision.²

My statement today, which is based on our May 2003 report, discusses (1) the specific responsibilities of the entities that comprise the Title XI oversight structure, (2) factors which these entities identified as potential impediments to carrying out their Title XI responsibilities; and (3) concerns expressed by the entities and industry participants about the effectiveness of the existing regulatory structure. In preparing our report, we reviewed FIRREA and its legislative history; interviewed officials from the entities involved in the Title XI regulatory structure; and surveyed appraiser regulatory agencies in the 50 states, the District of Columbia, and U.S. territories.³ Additionally, we met with officials and representatives of Fannie Mae and Freddie Mac, government sponsored enterprises (GSEs) that establish standards for appraisals associated with mortgages they purchase; the Department of Housing and Urban Development (HUD), which establishes appraisal requirements for its

¹U.S. General Accounting Office, *Regulatory Programs: Opportunities to Enhance Oversight of the Real Estate Appraisal Industry*, [GAO-03-404](#) (Washington, D.C.: May 14, 2003).

²As defined in Title XI, federally related transactions are real estate transactions involving financial institutions regulated by the federal government. These include banks, thrifts, and credit unions. Real estate transactions of mortgage bankers, brokers, pension funds, and insurance companies are not included.

³The territories included in our survey are Guam, Northern Mariana Islands, Puerto Rico, and the Virgin Islands. The only other U.S. territory—American Samoa—did not have a regulatory oversight structure for appraisers. We received responses from all but one survey recipient (U.S. Virgin Islands). In this testimony, the term “states and territories” refers to the 50 states, the District of Columbia, Guam, the Northern Mariana Islands, and Puerto Rico.

insured mortgages; trade groups representing appraisers and mortgage lenders; appraiser education providers; and academic experts.

In summary, we found the following:

Title XI created a complex regulatory system that relies upon the actions of private, state, and federal entities to help assure the quality of appraisals and the qualifications of appraisers used in federally related transactions.

- Two private entities—the Appraisal Standards Board and Appraiser Qualifications Board—respectively establish (1) uniform rules for preparing and reporting real estate appraisals and (2) minimum qualification criteria for certified real estate appraisers. Certified real estate appraisers are one of the two categories of appraisers listed in Title XI, the other being licensed real estate appraisers.
- States establish the minimum qualification criteria for licensed real estate appraisers. In addition, states (1) implement the certification and licensing of all real estate appraisers and (2) monitor and supervise compliance with appraisal standards and requirements. The states and territories have established structures typically consisting of a state regulatory agency coupled with a board or commission to establish education and experience requirements, license and certify appraisers, and monitor and enforce appraiser compliance.
- The Board of Governors of the Federal Reserve System (FRS), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), and National Credit Union Administration (NCUA)—hereinafter referred to as “the federal financial institution regulators”—are responsible for ensuring that real estate appraisals used by federally insured depository institutions comply with Title XI. The regulators have (1) adopted rules and policies specifying transactions for which regulated financial institutions are required to obtain an appraisal by a certified or licensed appraiser, (2) developed examination procedures to ensure that regulated financial institutions are in compliance with Title XI, and (3) appointed agency representatives to the Appraisal Subcommittee.
- The Appraisal Subcommittee, which was created by Title XI, is responsible for monitoring the implementation of Title XI by all parties—private, state, and federal. The subcommittee monitors the efforts of the federal financial institution regulators in developing and adopting appraisal-related regulations and policies, conducts periodic reviews of each state’s licensing and certification program, monitors and reviews the Appraisal

Foundation, and provides grants to the Foundation to support the Title XI-related activities of its two boards—Appraisal Standards Board and Appraiser Qualifications Board.

Entities involved in the Title XI regulatory structure described a number of factors that they believe constrain their ability to perform more effectively and efficiently. For example, officials of the Appraisal Standards Board and the Appraiser Qualifications Board told us that insufficient federal grant funding may impede their ability in the future to ensure that standards and qualifications evolve with changing conditions, such as how to appraise contaminated or polluted properties. State appraiser agencies—which are funded at the state level—reported resource limitations as the primary impediment in carrying out their oversight responsibilities. For example, of the 54 states and territories that responded to our survey, 26 reported that the current number of investigators was insufficient for meeting the states’ regulatory responsibilities, 37 cited a need for increasing the staff directed at investigations, and 22 cited a need for more resources to support litigation. The five federal financial institution regulators reported no major impediments to carrying out their Title XI responsibilities. The Appraisal Subcommittee reported that rule-making authority and additional authority to ensure state compliance with Title XI could facilitate its monitoring of state compliance with Title XI. Subcommittee officials stated that the only mechanism available under Title XI for effecting state compliance is to decertify a state, which would prohibit all licensed or certified appraisers from that state from performing appraisals in conjunction with federally related transactions and have a devastating effect on the real estate markets and financial institutions within that state. However, the Appraisal Subcommittee stated that it has always been able to achieve states’ compliance under the current enforcement and regulatory structure.

Officials of the regulatory agencies, appraiser trade groups, education providers, the mortgage industry, HUD, and the GSEs voiced concerns about Title XI’s regulatory structure. However, we noted no clear consensus on the need for or impact of possible changes. Some industry participants stated that a growing number of real estate transactions, such as those placed through mortgage brokers and those falling below a dollar threshold set by the federal financial institution regulators, are not universally subject to Title XI appraisal requirements. In addition, some industry participants cited concerns with the lack of a national qualification criteria for the licensed real estate appraiser category. Education providers and appraiser trade groups expressed concerns about

the Appraiser Qualifications Board's fees and requirements for instructor certification and course approval. Federal and state regulatory officials expressed concern about the apparent reluctance of lending institutions to make referrals or complaints regarding questionable appraisals they identify. HUD and GSE officials expressed concerns about a lack of consistent and effective enforcement actions by the states on referred cases and the adequacy of the Appraisal Subcommittee's oversight of state programs.

We made four recommendations to the Appraisal Subcommittee intended to enhance the effectiveness of the existing regulatory structure. As of March 17, 2004, the Appraisal Subcommittee reported that it has taken action on three of the recommendations: to (1) develop and apply consistent criteria for determining and reporting states' compliance with Title XI; (2) explore options, including drawing on its surplus, for addressing Appraisal Foundation grant shortfalls; and (3) provide non-financial assistance to aid the states in carrying out their Title XI responsibilities. The Appraisal Subcommittee reported that it attempted but has not been successful regarding our fourth recommendation, which was to coordinate with Fannie Mae, Freddie Mac, and HUD to improve the process of referring problem appraisals to state appraiser agencies for enforcement.

Background

An appraisal is an opinion of the value of a property as of a specific date. Appraisers generally consider a property's value from three points of view—cost, income, and comparable sales—and determine an estimated value based upon weighing the three valuation methods. The comparable sales approach, which compares and contrasts the property under appraisal with recent offerings and sales of similar property, is usually considered most appropriate for estimating the value of residential real estate.

The primary role of appraisals in the mortgage loan underwriting process is to provide evidence that the collateral value of property is sufficient to avoid losses on loans if the borrower is unable to repay the loan. Consumers often mistakenly assume that appraisals are intended to validate the purchase price of the property in question. Furthermore, appraisals are sometimes confused with home inspections, which are intended to warn consumers about serious defects in the home being purchased that should be repaired. In a loan transaction, the lender rather than the borrower engages the appraiser, and this usually occurs after the borrower has agreed to purchase the property.

The primary purpose of the appraisal reforms contained in Title XI was to assist in protecting the federal deposit insurance funds—and, by extension, mortgage lenders—from avoidable losses. Officials of the federal financial institution regulators noted that faulty and fraudulent real estate appraisals have been associated with losses incurred by federally insured financial institutions and have resulted in financial harm to individual consumers. However, all of the regulators stated that real estate appraisals have not been a major factor in the failure of depository institutions since the passage of Title XI.

Title XI Created a Complex Oversight Structure

Private, state, and federal entities have responsibilities under the Title XI regulatory structure. Private entities—the Appraisal Standards Board (ASB) and the Appraiser Qualifications Board (AQB)—establish minimum standards for the development and reporting of real estate appraisals and minimum qualification criteria for certified appraisers. States are responsible for certifying appraisers, using education and experience requirements that, at minimum, meet AQB criteria, and for enforcing compliance with appraisal standards. States may also license appraisers using state-established licensing criteria. (For those states that had both, experience and education requirements for certified real estate appraisers exceeded those for licensed real estate appraisers.) The federal financial institution regulators establish appraisal requirements for the insured depository institutions under their jurisdiction and monitor compliance with their regulations. Lastly, the Appraisal Subcommittee has primary responsibility for monitoring and reviewing the actions of the private, state, and federal entities as they relate to Title XI.

Appraisal Foundation's Boards Establish Appraisal Standards and Minimum Appraiser Certification Criteria

The Appraisal Foundation, a nonprofit educational organization composed of groups from the real estate industry, provides the organizational framework for the ASB and AQB to carry out their Title XI-related responsibilities.⁴ The ASB is responsible for setting standards for appraisals, which are contained in its Uniform Standards of Professional Appraisal Practice (USPAP). Under Title XI, these minimum standards apply to all federally related transactions for which an appraisal is required. The standards cover both the steps appraisers must take in

⁴The 2002 sponsors of the Appraisal Foundation consisted of eight appraisal organizations, four affiliate organizations (representing primarily the users of appraisal services), and one international appraisal organization. In addition, over 80 organizations, corporations, and government agencies are affiliated with the Appraisal Foundation.

developing appraisals and the information the appraisal report must contain.

The AQB establishes the minimum education, experience and examination requirements for real estate appraisers that are set out in Real Property Appraiser Qualification Criteria and Interpretations of the Criteria. The AQB's criteria cover four categories of appraisers—certified general, certified residential, licensed, and trainee—each with specific education, experience, examination, and continuing education requirements. Title XI does not require states to adhere to AQB criteria for licensed appraisers or for trainees.

The ASB and the AQB regularly evaluate USPAP and the appraiser qualification criteria to determine whether revisions are needed. According to the Appraisal Foundation, both boards solicit comments from appraisers, users of appraisal services, and the public before making final changes. Since the AQB set its original criteria in 1991, for example, it has issued numerous interpretations and approved two revisions of its criteria.

State Agencies Oversee the Licensing and Certification of Real Estate Appraisers

Under Title XI, states may establish agencies to certify and license appraisers. At the time of our survey, all 50 states, the District of Columbia, and 4 of the U.S. territories had established such agencies, which typically oversee the activities of appraisers for all types of transactions, including those that are federally related. All of the states and territories had established programs for certifying appraisers, and nearly 70 percent reported that they had introduced qualifications in addition to those established by the AQB.

At the time of our review, 6 states did not provide for licensed appraisers, according to the Appraisal Subcommittee. Those that did and responded to our survey reported a variety of licensing requirements. For example, some states did not require licenses unless appraisers planned to work with federally related transactions, while other states required appraisers to be either licensed or certified to perform real estate appraisals, even for transactions that are not federally related. The states' programs typically included temporary and reciprocal licensing provisions, though as discussed below, the provisions varied. (Title XI requires states to recognize on a temporary basis real estate appraisers who have been certified or licensed by another state if certain conditions are met, and encourages states to develop reciprocity agreements that readily authorize

appraisers who are licensed by and in good standing with their home state to perform appraisals in other states.)

In addition to conducting certification and licensing activities, states with certifying and licensing agencies are required under Title XI to provide the Appraisal Subcommittee with the names of those appraisers who become certified or licensed in accordance with Title XI, and to collect from them an annual registry fee that goes to the subcommittee. All of our survey respondents reported that they approve courses for appraisers' education or training, enforce state regulations concerning appraisals, and investigate complaints. Over half of the states reported that they had adopted appraisal standards in addition to those set by the ASB.

Although the states are responsible for the certification and licensing of appraisers, the Appraisal Subcommittee has a role in ensuring that state qualifications satisfy Title XI objectives. Under Title XI, the federal financial institution regulatory agencies are to accept a state's certifications and licenses unless the Appraisal Subcommittee issues a written finding that the state certifying and licensing agency has failed to recognize and enforce the standards, requirements, and procedures of Title XI; does not have enough authority to carry out its functions under Title XI; or does not make decisions on appraisal standards and qualifications or supervise appraiser practices in a way that carries out the purposes of Title XI.

Federal Regulators Determine Which Transactions Require Appraisals and Establish Compliance Standards for Depository Institutions

Title XI requires that the federal financial institution regulators prescribe the categories of federally related transactions that should utilize a state certified appraiser and those that should utilize a state licensed appraiser. The statute provides that certified appraisers must be used for federally related transactions having a value of \$1,000,000 or more. The federal financial institution regulators generally require the use of certified appraisers for commercial transactions of \$250,000 or more and "complex" residential transactions of \$250,000 or more. The regulators are responsible for determining whether other types of transactions warrant the use of a certified appraiser. All other federally related transactions,

unless subject to an exemption as authorized under Title XI, may utilize a state-licensed appraiser.⁵

Also, under Title XI the federal financial institution regulators may establish a threshold transaction amount at or below which neither a certified or licensed appraiser is required. As of March 15, 2004, each of the five regulatory agencies had regulations in place setting this threshold at \$250,000. Thus, for federally-related mortgage loan transactions of \$250,000 or less, financial institutions have the option of obtaining either an appraisal or some other form of an evaluation of the property's value.⁶ The regulators have issued guidelines to the institutions under their jurisdiction that specify the requirements for evaluating real estate collateral for those transactions that do not require an appraisal.

Title XI also requires the federal financial institution regulators to ensure that real estate appraisals used in connection with federally related transactions are performed in accordance with standards developed by the ASB. The regulators require that all appraisals for federally related transactions (1) conform, at a minimum, to USPAP, (2) be written, and (3) contain sufficient information and analysis to support the institution's decision to engage in the transaction.

The federal financial institution regulators may take informal and formal enforcement actions, including memorandums of understanding, removal, prohibition, and cease and desist orders and the imposition of civil money penalties, against institutions that violate their appraisal regulations. These actions can apply to contract (fee) appraisers as well as appraisers who are employees of the institutions and institution-affiliated parties. Moreover, pursuant to the FDIC Improvement Act of 1991, the federal financial institutions regulators can take action against institution-affiliated parties such as appraisers.

⁵Although the states are responsible for establishing and administering licensing qualifications, Title XI authorizes the federal financial institution regulators to establish additional qualification criteria.

⁶For more information on real estate evaluations, see U.S. General Accounting Office, *Bank and Thrift Regulation: Better Guidance Is Needed for Real Estate Evaluations*, GAO/GGD-94-144, (Washington, D.C.: May 23, 1994). In addition, the federal financial institution regulators issued Interagency Appraisal and Evaluation Guidelines on October 27, 1994.

Appraisal Subcommittee Monitors Title XI Regulatory Activities

Title XI created the Appraisal Subcommittee within the Federal Financial Institutions Examination Council and established it as the principal federal agency responsible for monitoring the activities of the other components of the real estate appraisal industry oversight structure.⁷ The subcommittee has six board members—designated by the five financial institution regulatory agencies that make up the Federal Financial Institutions Examination Council, and HUD—and seven staff members. The subcommittee funds its activities through a portion of the fees assessed by the states against individual appraisers for licensing and certification.⁸

Among other things, the subcommittee is responsible for:

- Monitoring and reviewing the practices, procedures, activities, and organizational structure of the Appraisal Foundation, including making grants in amounts that it deems appropriate to the Appraisal Foundation to help defray costs associated with its Title XI activities. According to subcommittee officials, the subcommittee monitors the Appraisal Foundation by attending all significant meetings and events associated with its Title XI activities and reviewing all proposed changes or additions to its appraiser qualifications criteria or USPAP-related documents. In addition, the subcommittee reviews the Appraisal Foundation's grant requests to ensure that the requested funds will only be used for activities related to Title XI.
- Monitoring the requirements established by the states, territories, and the District of Columbia and their appraiser regulatory agencies for the certification and licensing of appraisers. Accordingly, the subcommittee performs on-site field reviews of state agency programs and maintains communications with appraisers, state and federal agencies, and users of appraisal services. The reviews cover open and closed complaints, approved and disapproved education providers and courses, state statutes and regulations on certifying and licensing appraisers, minutes of board meetings, appraiser registries and fees, temporary practice and reciprocity, and topical issues such as predatory lending, fraud, and illegal

⁷The Federal Financial Institutions Examination Council is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the examination of financial institutions by the FRS, FDIC, OCC, OTS, and NCUA.

⁸Title XI authorizes the Appraisal Subcommittee to charge an annual registry fee of not more than \$25. However, the Federal Financial Institutions Examination Council may approve fees up to \$50 per year. As of March 15, 2004, the annual registry fee was \$25.

real estate flipping.⁹ The subcommittee issues the states letters at the conclusion of the reviews, identifying concerns, discussing whether the previous review's concerns have been resolved, and making general conclusions about the state's compliance with Title XI and Appraisal Subcommittee policy statements.

Our analysis of the Appraisal Subcommittee's state field review letters from 1992 to 2002 found that the letters provided some information to the state regulatory agencies but lacked evidence of transparent criteria for how the subcommittee determined and reported states' compliance levels. For example, state field review letters were sometimes inconclusive about whether the state regulatory program was in compliance. Further, when the letters contained determinations of compliance, the rationale for the decisions was not always given. For example, some states with identified concerns were deemed compliant, while others with identified concerns were deemed noncompliant. Accordingly, we recommended that the subcommittee develop and apply consistent criteria to assess states' compliance with Title XI requirements.

- Monitoring the requirements established by the federal financial institution regulators regarding appraisal standards for federally related transactions and determinations of which federally related transactions will require the services of state-licensed or state-certified appraisers. The subcommittee carries out this responsibility primarily through informal channels. For example, all six Appraisal Subcommittee board members are involved in the offices responsible for appraisal regulation in their individual agencies and provide input from the subcommittee informally to the agencies. The subcommittee also provides technical assistance on proposed regulations on appraisal issues.
- Maintaining a national registry of state-licensed and state-certified appraisers who may perform appraisals in connection with federally related transactions.

⁹Illegal real estate flipping is a scheme where a real estate speculator buys a house, usually in a poor neighborhood, and obtains an inflated appraisal and other fraudulent financial documents to trick a lender into making a loan that exceeds the fair market value. The house is sold again at an inflated price to a second buyer. The seller has then made a large profit on the inflated value of the property. If the second buyer defaults on the loan, the mortgage lender may not be able to recoup the amount of the loan and will therefore experience a loss.

Entities Cited Potential Impediments to Fulfilling Their Title XI Roles

The private, state, and federal entities involved in the oversight of the real estate appraisal industry identified a number of factors that they believe could constrain their ability to fulfill their Title XI responsibilities. ASB and AQB officials stated that an impediment that they may face in the future is inadequate federal funding, which would hinder their ability to ensure that appraisal standards and qualification criteria keep pace with changes in the mortgage industry and marketplace. State appraiser agencies reported that they often lack funding to revise their regulations with every USPAP update and to cover the increasing cost of administering the licensing and certification processes. The federal financial institution regulators did not identify any major impediments to fulfilling their Title XI responsibilities, but noted that reaching consensus on regulatory standards was difficult because of the number of entities involved in the appraisal industry. Appraisal Subcommittee officials reported that rule-making authority and additional enforcement sanctions could facilitate the subcommittee's oversight of state compliance.

The Appraisal Standards and Appraiser Qualifications Board Cited Concerns about Federal Funding

ASB and AQB officials told us that expected future funding shortfalls may limit the activities they believe enhance the quality, timeliness, and usefulness of standards and qualifications. For example, the AQB chair commented that funding is needed to update their "body of knowledge," which outlines the concepts, theories, and applications of the real property appraisal profession and delineates the skill necessary to practice. According to ASB and AQB officials, the ultimate impact of funding shortfalls could be a weakening in the protections intended by Title XI because appraisal standards and appraiser qualifications may not keep pace with changes in the marketplace.

Since 1991, the Appraisal Subcommittee has allocated the Appraisal Foundation a total of over \$9 million in grants to defray the costs of the two boards' Title XI-related activities. These grant allocations typically have been less than the amounts requested. For example, the ASB and AQB requested a total of over \$9 million in grant money between 1994 and 2003, but less than \$7 million was approved. However, the Appraisal Foundation has sources of revenue other than the Appraisal Subcommittee grants. For example, the largest source of revenue for the Appraisal Foundation in 2001 was \$1.1 million from publication sales; in comparison, the \$870,373 grant from the Appraisal Subcommittee represented approximately 36 percent of the Foundation's total revenue. Also, subcommittee officials noted that the ASB and AQB had not used the entire amounts of grant funds provided in past years.

The Appraisal Subcommittee told us that it did not have the current-year funds to fully meet the ASB's and AQB's grant requests over the past 3 years. However, the subcommittee had a \$3.9 million surplus as of December 2003. Subcommittee officials reported that the surplus built up in its early years when revenues exceeded its expenses and grants. They added that as its expenses have increased—primarily due to inflation and monitoring activity expenses—the amount of funds available for grants to the ASB and AQB from current-year funds has become limited. They further explained that it has not been Appraisal Subcommittee policy to use the surplus to provide grants to the ASB and AQB.

Appraisal Subcommittee officials also stated that they expect the boards' expenses to increase by up to 5 percent per year. Given that the number of appraisers has remained static for the last several years, subcommittee officials did not anticipate their revenues, which are based primarily on licensing and certification fees, to increase. As a consequence, future ASB and AQB grants are expected to fall unless the subcommittee uses its surplus, raises the \$25 fee that states collect from appraisers on the subcommittee's behalf, or both. Accordingly, we recommended that the Appraisal Subcommittee explore potential options for providing future grant funding, including drawing on its surplus if necessary, to the Appraisal Foundation and its two boards in support of their Title XI activities.

States Cited Funding Limitations and Frequent USPAP Updates as Impediments

In responding to our survey, most of the states identified funding and staffing deficiencies as the most serious challenges they faced in carrying out their Title XI duties. According to Appraisal Subcommittee officials, the subcommittee's general counsel analyzed whether the subcommittee could provide grants to the states to help provide funding for their Title XI activities, and determined that it lacked the necessary legal authority.

Based on survey data, the average state agency had about 3 staff members, who were responsible for overseeing almost 2,000 appraisers. Many of these state agencies reported that they needed to share resources—administrative staff, office space, investigators, or all three—with other state agencies in order to perform their Title XI duties. The survey results indicated that investigations of complaints about problem appraisers suffered most from these shortages. The majority of states sharing resources were sharing investigators, who often had no real estate appraisal experience. One state official explained that without adequate funding states could not effectively administer their appraiser certification programs or investigate and dispose of disciplinary cases in a timely

manner. Another state official noted that his agency knew that more enforcement and faster turnaround times in investigating complaints were needed but that limited resources hindered it. We recommended that the Appraisal Subcommittee explore potential options for funding or otherwise assisting the states in carrying out their Title XI activities, particularly the investigation of complaints against appraisers.

Seventy percent of the state appraiser regulatory agencies indicated that USPAP updates were too frequent. One state reported that frequent changes to USPAP have made processing complaints difficult because staff members have to determine what appraisal standards were in place at the time of the questionable appraisal. According to ASB officials, USPAP has been in place for only 15 years, and annual updates have been needed because so many changes have occurred in the appraisal industry. Moreover, they told us that many of the changes that have been incorporated into USPAP are a result of requests from state regulators. The officials explained that over the years the ASB has experimented with different formats for updating USPAP but has found that issuing an annual publication has been the best way to ensure that everyone is using the same standards. The ASB and the Foundation are working on developing a future publishing schedule of having USPAP issued biennially. In addition, ASB officials stated that they have recently started providing state regulators with newsletters that highlight any changes, modifications, or clarifications to USPAP or appraiser qualification criteria.

Appraisal Subcommittee Stated That Rule-Making Authority and Enforcement Options Could Facilitate Its Oversight of States

According to subcommittee officials, the lack of rule-making authority and limited enforcement powers make achieving the uniformity and standardization intended by Title XI more difficult. In addition, the officials noted that because the 55 state appraiser regulatory agencies took a variety of approaches to implementing Title XI, expanding the subcommittee's role to allow it to issue regulations would help ensure greater consistency among the states in credentialing appraisers and enforcing the most current version of USPAP. However, giving the Appraisal Subcommittee rule-making authority would also change the subcommittee's role under Title XI from a monitoring to a regulatory function.

Subcommittee officials stated that currently the only the only means for ensuring state compliance with Title XI is to decertify a state. Decertification would prohibit all licensed or certified appraisers from that state from performing appraisals in conjunction with federally related transactions. Because this action is so severe and could significantly affect

a state's real estate market, the subcommittee has never used it, and its impact has not been tested. (In addition, the decertification action can be taken only for the limited purposes specified in Title XI and is subject to proof requirements and judicial review.)

The Appraisal Subcommittee noted that its oversight of the states could be strengthened if it had more enforcement authority—for example, the authority to assess monetary penalties or to require that a state stop an activity or practice. However, in commenting on a draft of our report, the subcommittee stressed that it has always been able to ensure that states are complying with Title XI within the current supervisory and enforcement structure.

Industry Participants Raised Various Concerns about the Title XI Oversight Structure

Representatives of federal and state regulatory agencies, appraiser trade groups and education providers, and the mortgage industry expressed various concerns and conflicting viewpoints about the Title XI regulatory structure. However, there was no clear consensus regarding the need for or impact of possible changes.

Differences Among State Licensing Programs

According to many of the groups we contacted, Title XI's most significant shortcoming is the provision that leaves the criteria for licensed appraisers to each state, including decisions such as how often appraisers should be licensed and whether they should be licensed at all. According to an official from the Appraisal Subcommittee, Title XI's intent was to ensure that appraisers for federally related transactions met minimum requirements for experience and education and had been examined in order to ensure a minimum level of competency. But Title XI specifically provides that the Appraisal Subcommittee will not set requirements for licensing and that any subcommittee recommendations are nonbinding. Some groups believe that this provision has led to a lack of uniform qualifications in licensing across the country (for example, in education and experience) and may also have helped to create an environment conducive to mortgage fraud.

At the time of our review, officials from the Appraisal Subcommittee reported that most states have adopted provisions requiring that licensed appraisers meet AQB recommended criteria. However, six states did not have a state-licensed appraiser category, and six had licensing requirements that were less stringent than the AQB's. As a result,

subcommittee officials said, some licensed appraisers may not meet recommended qualifications criteria. For example, in 2002, one state passed legislation that eliminated the experience requirement for its licensed appraisers; and, in 2001, another state revised its licensing criteria to comply with AQB requirements but at the same time “grandfathered” in several hundred licensed appraisers.

According to two regulatory officials, problems related to the lack of uniformity in licensing appraisers are compounded by the fact that Title XI also makes licensing voluntary at the state level. Voluntary licensing means that the state does not have a legislative requirement that appraisers be licensed or certified. However, the volunteer states do provide the opportunity for an appraiser to become licensed or certified in order to perform federally related transactions. As of March 2003, 10 states were classified as being in the voluntary licensing category. Some regulators, as well as one appraiser trade group, view voluntary licensing as a serious flaw in the industry’s regulatory structure and a probable contributor to mortgage fraud. Moreover, voluntary licensing may indirectly place the onus on financial institutions to ensure that appraisers for federally related transactions have the appropriate qualifications. One federal financial institution regulator reported that most of the mortgage fraud problems it has encountered have occurred in states where licensing is voluntary. An earlier Federal Bureau of Investigation testimony at a special congressional hearing on predatory lending in March 2000 echoed this view. According to that testimony, the most egregious property flipping problems have occurred in states where licensing is voluntary for transactions that are not federally related.

Industry participants also cited a lack of uniformity in the way states grant temporary and reciprocal licenses. Because a state may not recognize the credentials from another state, appraisers often have to carry multiple state licenses. The Appraisal Subcommittee has issued policy statements on temporary practice and encouraging reciprocity. However, our survey indicated that state regulatory agencies continue to vary widely on these issues. For example, of the 53 states and territories that responded to this question, 40 issued temporary licenses for single assignments, 16 allowed an appraiser only one temporary license at a time, and 15 limited the number of temporary licenses an appraiser could receive annually. Six of the 54 respondents to our survey indicated that visiting appraisers are required to pass a state exam in order to receive a reciprocal license. This practice is inconsistent with the Appraisal Subcommittee’s guidance recommending that states accept licenses or certification from other states meeting AQB requirements.

Transactions Not Covered by Title XI

Industry participants also voiced concerns about the fact that Title XI does not cover all financial institutions and that mortgage brokers are not subject to federal regulation. When Title XI was enacted, federally regulated lending institutions (banks, thrifts, and credit unions) made most mortgage loans. Today, other financial institutions, such as mortgage bankers and finance companies, account for a substantial share of the mortgage marketplace. Many of these financial institutions that are not federally regulated, as well as an increasing portion of regulated financial institutions, use mortgage brokers to originate loans, so that these brokers now originate about 50 percent of all mortgage loans. These entities and individuals may have state licenses, but they are not monitored by federal or state entities through, for example, examinations or audits.¹⁰ Appraisers have anecdotally reported that these originators pressure them the most to appraise properties at or near the purchase price to assure that the mortgage transaction will occur.

Some industry participants have said that the \$250,000 real estate appraisal threshold established by the federal financial institution regulators undercuts efforts to protect consumers. These groups believe that oversight of real estate appraisals should be geared toward the interests of consumers, who should be able to expect an unbiased, objective third-party opinion of the value of real property offered as security for a loan. However, Title XI was enacted in response to the impact of appraisal problems on federally insured depository institutions, and federal financial institution regulators have identified few problems or risks to depository institutions associated with loans valued below the \$250,000 threshold.

Costs and Lack of Uniform Approval Processes for Appraiser Education Courses

Several state regulators and education providers expressed concerns about the expenses and lack of uniformity in the processes associated with approving instructors and courses for appraisers' continuing education. A representative of an appraisers' trade group noted that gaining approval for a course and an instructor in one state does not necessarily translate into approval in other states. As a result, the trade group spent around \$30,000 having courses for a July 2000 training conference approved in all jurisdictions. Some appraisal industry

¹⁰Fannie Mae officials noted that when an appraisal is required for a mortgage that will be delivered for sale to the GSE, mortgage brokers must use appraisers that are state-licensed or certified in accordance with Title XI.

participants believe that the added cost and procedures involved in acquiring approval in each state is overly burdensome.

AQB officials told us that the board has set up a voluntary national system for approving courses and that these concerns had influenced their project. According to the AQB, the course approval program was designed to be a convenience for both course providers and state regulators while helping to ensure quality appraisal courses. However, AQB's course and instructor approval programs have met opposition in some quarters. For example, some state officials and other industry participants stated that requiring AQB approval for all USPAP refresher courses and instructors and restricting course materials and examinations to AQB publications—for which AQB charges a royalty fee—represent a conflict of interest. In addition, some education providers have stated that the fees charged by the AQB for its course and instructor approval are excessive. On the other hand, some state and federal financial institution regulators believe that the Appraisal Foundation and its boards possess expertise and resources the states do not have and thus are needed to ensure that the quality of appraiser education and training is not compromised.

Similarly, some states and educators have expressed concern that the AQB and Appraisal Subcommittee have encroached upon state authority in setting certain appraisal standards and appraiser qualifications. For example, the regulatory agency and an education provider in one state objected to certain AQB education requirements for certified appraisers, in particular a requirement that education providers be certified through the AQB's instructor certification program. As part of its industry monitoring function, the Appraisal Subcommittee reviewed those standards and determined that the AQB had acted appropriately in adopting them. The Appraisal Subcommittee also requested a legal opinion from the Legal Advisory Group of the Federal Financial Institutions Examination Council on the scope of AQB's authority to adopt education-related standards for certified appraisers; the scope of the Appraisal Subcommittee's responsibility in monitoring the AQB; and the Appraisal Subcommittee's authority to oversee state regulators' implementation of AQB standards.¹¹ In a June 2002 opinion, the Legal Advisory Group concluded that the AQB's and Appraisal Subcommittee's actions appeared to be consistent with and authorized by Title XI.

¹¹The Legal Advisory Group consists of the general or chief counsels of the FDIC, FRS, OCC, OTS, and NCUA.

Variations in State Regulatory Agencies' Enforcement of Title XI Requirements

Some industry participants reported a lack of uniformity in processing complaints and taking disciplinary actions against those problem appraisers that were referred to state regulatory authorities. We analyzed data states submitted to the Appraisal Subcommittee and found that the number of disciplinary actions taken differed widely. For example, one state reported taking only a single disciplinary action, while two other states accounted for over 25 percent of the 4,360 disciplinary actions reported as of October 31, 2002.

Several entities reported that states' complaint filing requirements ranged from simple to onerous. For example, some states require simply that complainants submit information on an allegation, while others accept complaints only on a specific form, or require that complaint documents be notarized or that complainants provide witnesses and testify against appraisers. Other concerns included:

- The length of time needed to resolve complaints. For example, one state required 1 to 2 years, potentially allowing the appraiser to continue what might be fraudulent or questionable practices.
- Statutes of limitations that pose an obstacle in penalizing appraisal violators. For example, statutes in at least three states prohibit both investigations into and punitive actions for unlawful appraisal activities that allegedly took place more than 3 to 5 years earlier.

In addition to concerns about the complaint process, industry participants reported misgivings about outcomes, including disciplinary actions and feedback. For example, Fannie Mae officials commented that they had been dissatisfied with some state decisions on punitive actions and with the lack of feedback on actions that had actually been taken. The officials added that some states do not penalize appraisers for multiple violations if the appraisers have already been disciplined or do not tell complainants what action was taken. As an example, they noted that some states appeared to perform meaningful investigations and took appropriate actions while others appeared unwilling to investigate similar cases with comparable support and documentation. HUD officials echoed this view, saying that states typically do not take action when they are notified that an enforcement action has been taken against an appraiser. Another industry participant reported that there is little incentive to make referrals given the fact that there is no assurance that the state will take action.

According to Appraisal Subcommittee officials, a number of states have told them that the referral information that Fannie Mae and HUD have

provided to the states is frequently in a format or manner that they cannot readily absorb or use. For example, some of the states indicated that they received over a hundred referrals from Fannie Mae as one group, which overwhelmed the states' ability to review and investigate the referrals in a timely basis. Other states stated that the referrals were for real estate transactions for which the state's statute of limitations had already expired. To improve the process for referring problem appraisals by entities that oversee or use real estate appraisals to the state appraiser agencies for possible enforcement actions, we recommended that the Appraisal Subcommittee work with Fannie Mae, Freddie Mac, and HUD to ensure that the referral of problem appraisals (1) are provided in a format that is useful to the state appraiser agencies and (2) facilitate the subcommittee's efforts to monitor decisions made by the states regarding the supervision of appraiser practices.

No Clear Consensus Regarding the Need for Changes to the Title XI Regulatory Structure

Among the various representatives of trade groups, education providers, and other industry participants that we contacted, there were differing opinions as to what, if any, changes were necessary to Title XI. Likewise, the responses to the survey that we sent to the state appraiser agencies did not indicate a clear consensus regarding states' views of the impacts of eliminating some of the central aspects of the Title XI regulatory structure.

Some officials from state appraiser agencies have expressed strong viewpoints regarding the need for changes to Title XI. For example, an official from one of the state appraiser regulatory agencies stated that the states are now in a position to oversee the real estate appraisal industry without any federal involvement, much as they do other professions. He suggested that Congress eliminate the Appraisal Foundation and the AQB and make the ASB independent and self-supporting. An official from another state regulatory agency said that to correct the present system's problems, Congress would need to completely restructure the Title XI structure. He recommended eliminating the Appraisal Subcommittee and the Appraisal Foundation, replacing them with a new board at the federal level. The new board would represent the appraisal industry more broadly and have strong Congressional accountability. He also suggested that Congress clearly designate the states as having sole responsibility for administering and enforcing Title XI.

However, our survey of the state appraisal agencies showed a wide variety of views. For example, 22 states and territories (41 percent) said that eliminating the Appraisal Subcommittee would enhance their ability to regulate appraisers, while 17 (31 percent) responded that eliminating the

subcommittee would be a hindrance. The remaining states felt that not having the subcommittee would neither help nor hinder regulation. Similarly, 31 and 23 states, respectively, indicated that eliminating the ASB and AQB would hinder their efforts to regulate appraisers, while 10 and 21 states, respectively, indicated that eliminating the ASB and AQB would be helpful.

In conclusion, Title XI brought about significant changes in the real estate appraisal industry. According to federal financial institution regulators, real estate appraisals have not been a major factor in the failure of federally insured financial institutions since the passage of Title XI. However, opportunities exist to enhance the effectiveness of the current regulatory system to help ensure that federally related transactions are based on accurate assessments of the value of properties used as collateral for loans.

Mr. Chairman, this concludes my prepared statement. I would be happy to answer any questions at this time.

Contacts and Acknowledgments

For further information on this testimony, please contact David G. Wood at (202) 512-8678, or Harry Medina at (415) 904-2000. Individuals making key contributions to this testimony included Alexandra Martin-Arseneau and Paul Thompson.

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