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1999-SE-121-0802  
Audit-related Memorandum

June 18, 1999

MEMORANDUM FOR: Lily Lee, Director, Santa Ana Home Ownership Center

FROM: Frank E. Baca, District Inspector General for Audit, OAGA

SUBJECT: Confidential Complaint  
Appraiser Selection for FHA-Insured Single Family Properties  
Anchorage, Alaska

In response to a confidential complaint, we performed a limited review of lender activities specific to FHA insurance for single family Alaskan home buyers. The complainant alleged that a large group of real estate agents in the Anchorage, Alaska area were exerting pressure on single family direct endorsement lenders to select certain appraisers.<sup>1</sup> The complainant further alleged that real estate agents would not give their business to lenders that refused to allow them to select the appraisers, putting those lenders at a competitive disadvantage.

We found that the complainant's allegation was credible in that lenders were selecting appraisers recommended by real estate agents. While HUD regulations require lenders to select and be responsible for the work of single family property appraisers, the regulations do not prohibit lenders from selecting appraisers recommended by real estate agents. However, the results of our limited review of loan files were inconclusive and did not disclose definite patterns or relationships between real estate agents, appraisers, underwriters, or loan processors. Also, we could not determine whether or not lenders were losing business if they chose an appraiser other than the one a real estate agent recommended.

In our opinion, lenders acquiescing to influence from real estate agents in the selection of appraisers calls into question the appraiser selection process. HUD requires lenders to exercise due diligence in choosing only the best qualified and knowledgeable appraisers. However, HUD has little assurance that lenders are exercising due diligence in the selection of appraisers if lenders are being pressured to select certain appraisers. Appendix A contains the results of this limited review.

We recommend that you remind direct endorsement lenders that they are responsible and accountable for selecting appraisers and ordering the appraisal report on single family properties. This responsibility must be taken seriously and not be given to anyone else. Also, if a lender can demonstrate that undue pressure from any individual or entity involved in the FHA insurance program caused the lender's business to suffer by following FHA rules, HUD should consider appropriate disciplinary action against the responsible individuals or entities.

If you have any questions, please contact Bill Taylor or myself at (206) 220-5360.

<sup>1</sup> The complainant did not specifically name any lender or real estate agent in the complaint.

## Objectives, Scope, and Methodology

Our objective was to determine if lenders doing business in Alaska were selecting appraisers for single family housing direct endorsement loans in accordance with HUD requirements. We reviewed loan activity for the period January 1997 through October 1998.

To accomplish our objective, we:

- Interviewed appropriate HUD officials to: (1) identify HUD requirements relevant to lender selection of appraisers, (2) obtain and review any recent monitoring reviews of Alaska lenders, and (3) understand HUD's process to identify potential violations in processing single family mortgages.
- Reviewed single family loan processing information contained in HUD's single family data base, Computerized Homes Underwriting Management System (CHUMS), to obtain appropriate information about lenders and appraisers in Alaska.
- Selected two of the largest lenders providing single family mortgages in the Anchorage area, based on the volume of FHA-insured single family loans.
- Reviewed the two lenders' most recent annual audited financial statements and contacted each lender's Independent Public Accountant (IPA) to review appropriate audit work papers to build on and not duplicate previous work performed by the IPA.
- Reviewed both lenders' controls over their loan origination and underwriting process; focusing on who made the decisions to select appraisers, and how the decisions were made and documented.
- Interviewed the complainant, 4 appraisers, and 25 people involved in the Alaska single family real estate industry, including management and/or loan underwriting staff from Alaska USA Federal Credit Union, City Mortgage Corporation, Premier Mortgage, National Bank of Alaska, and Vista Mortgage.
- Developed an Access database to summarize and compare information contained in lender loan files and reviewed 19 files of defaulted loans submitted for claim and 120 loan case files.
- Gained an understanding of lender management controls that were relevant to our objective.

## Criteria

Prior to December 5, 1994, HUD assigned appraisers from a fee panel on a rotating basis to perform single family property appraisals. Effective December 5, 1994, direct endorsement (DE) lenders were permitted to select appraisers from the Lender Selection Roster to perform appraisals of single family properties receiving FHA mortgage insurance.

Section 322 of the National Affordable Housing Act allows direct endorsement lenders to select their own appraisers in addition to the current options of using a staff appraiser employed by the direct endorsement lender itself or a fee appraiser assigned by HUD from one of its fee panels. Section I, Lender Responsibility and Accountability, of Mortgagee Letter 94-54, dated November 7, 1994, states:

“As is the case with a DE staff appraiser, a DE lender that selects its own appraiser must accept responsibility, equally with the appraiser, for the integrity, accuracy and thoroughness of the appraisal and will be held accountable by HUD for the quality of the appraisal....For this reason, lenders must exercise due diligence in choosing only the best qualified and knowledgeable appraisers and have in place a quality control system to assure good quality appraisals.”

Further, Section III, Pressure on Appraiser and Conflicts of Interest, of Mortgagee Letter 94-54 states:

“The Department requires that appraisers chosen under this new procedure not be supervised or directed by any loan officers or loan production personnel. Chosen appraisers should be supervised by the lender’s underwriting or management personnel. Instances of undue pressure or influence on an appraiser reported to HUD will result in appropriate disciplinary actions against the lender involved.

The lender and appraiser must also avoid conflicts of interest which affect, either in reality or in appearance, the credibility of the appraisal.”

## **Results and Conclusion**

In response to a confidential complaint, we performed a limited review of lender activities specific to FHA insurance for single family Alaskan home buyers. The complainant alleged that a large group of real estate agents in the Anchorage, Alaska area were exerting pressure on single family direct endorsement lenders to select certain appraisers. The complainant further alleged that his company was unable to maintain a competitive posture in the Alaska single family housing market because his company would not acquiesce to this pressure from real estate agents.

Specifically, the complainant alleged that a large group of real estate agents in the Anchorage area steered mortgage applicants to lenders that would accommodate them by allowing the agents to select the appraisers. The complainant stated that real estate agents would refuse to bring business to his company unless his company chose the appraisers recommended by the agents.

The complainant stated in his letter that on at least 50 occasions during the past 2 years, he had heated discussions with real estate agents over the issue of appraiser selection. To support his position, the complainant provided documents which showed that two real estate agents involved in single family property sales had already selected appraisers prior to forwarding the sales information to the lender.

Based on information contained in Computerized Homes Underwriting Management System (CHUMS), we selected the two highest volume lenders<sup>2</sup> in Alaska to review. City Mortgage Corporation and Alaska USA Federal Credit Union were selected based solely on their volume of business during the time period. We also identified the top five appraisers who performed the most appraisals of FHA-insured single family properties for each lender during the period. We then reviewed a sample of loan files to see if any patterns or relationships between appraisers, real estate agents, loan processors, and underwriters could be identified:

September 2, 1997 to November 2, 1998	City Mortgage Corporation	Alaska USA Federal Credit Union	Totals
Number of FHA Loans	1211	875	2086
Number of Loans involving the top 5 appraisers	382	283	665
Number of Loan Files reviewed	77	62	139*

\* The 139 loans reviewed include 19 defaulted loans submitted for claim.

The results of our limited review of loan files were inconclusive and did not disclose definite patterns or relationships between real estate agents, appraisers, underwriters, or loan processors<sup>3</sup>. Out of the 139 loan files reviewed, we found only 14 instances in which a real estate agent's name appeared more than once. Although it is beyond the scope of this review, we believe a more complete data base that contained the necessary information for all Alaska lenders and real estate agents and a larger sample of loan files would be needed to conclusively determine if such patterns or relationships exist.

However, according to lender management and staff, loan processors routinely selected the appraisers recommended by real estate agents rather than making independent and arbitrary selections. We were told by lender management that the mortgage business in Alaska is extremely competitive and going along with real estate agents' recommendations helped develop positive relationships which would increase the lender's business. Also, lender management emphasized that their underwriting was a quality control check on the quality of an appraisal.

Similarly, the loan origination and processing staff at both the lenders confirmed that real estate agents recommended particular appraisers they wanted the lenders to use. While the loan processors make the actual appraiser selection, the loan processors told us that they usually accommodated the real estate agents' requests for particular appraisers as long as: (1) the appraiser was on HUD's Approved Appraiser Roster; (2) the appraiser could complete the appraisal within the desired time frame; and (3) the loan processor had no previous problems with the appraiser. The loan processors' primary consideration was a quick turn-around time for the appraisal.

While there may be a potential effect, lender management told us they were not aware of losing any business if they did not follow a real estate agent's recommendation and selected a different appraiser. However, we were not provided with any examples where lenders did not follow a real

<sup>2</sup> Includes affiliates of the two lenders.

<sup>3</sup> In this report, loan processors include loan originators and loan processors involved in the loan origination process.

estate agent's recommendation. The complainant also did not provide evidence that he was losing business if his loan processors selected an appraiser other than the one a real estate agent recommended. One lender executive did comment that real estate agents in Anchorage were aggressive and "carry a big stick" compared to the real estate agents in other parts of the country.

Two factors make the potential effect of any appraiser-selection problems difficult to determine:

- Different factors can cause defaults on FHA-insured loans and Alaska's default rate is far lower than the national average. According to HUD's information system on originations defaulting within the first two years, Alaska's default rate on FHA-insured single family loans for the period January 1996 to March 1999 was one-third of the national average (1.52 percent compared to the national average of 4.56 percent), and
- According to lender management and the complainant, Alaska's economy and the housing market was booming at the time of our review due in part to low interest rates, and all lenders and appraisers were busy. If there is any negative effect from the real estate agents' pressure for lenders to select certain appraisers, that effect would probably not be evident or determinable until the Alaskan economy slows down and default rates rise.

Nevertheless, in our opinion, lenders acquiescing to influence from real estate agents in the selection of appraisers calls into question the appraiser selection process. HUD requires lenders to exercise due diligence in choosing only the best qualified and knowledgeable appraisers. HUD has little assurance that lenders are exercising due diligence in the selection of appraisers if lenders are being pressured to select certain appraisers.

We are recommending that you remind direct endorsement lenders that they are responsible and accountable for selecting appraisers and ordering the appraisal report on single family properties. This responsibility must be taken seriously and not be given to anyone else. Also, if a lender can demonstrate that undue pressure from any individual or entity involved in the FHA insurance program caused the lender's business to suffer by following FHA rules, HUD should consider appropriate disciplinary action against the responsible individuals or entities. This recommendation will be closed upon issuance of this report.

## **RECOMMENDATION**

We recommend that your office:

1. Remind direct endorsement lenders that they are responsible and accountable for selecting appraisers and ordering the appraisal report on single family properties.

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