Federal Housing Finance Agency
Office of Inspector General

FHFA's Oversight of the Enterprises' Use of Appraisal Data Before They Buy Single-Family Mortgages

Audit Report • AUD–2014–008 • February 6, 2014

Synopsis

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Why OIG Did This Audit

Assessing the value of collateral securing mortgage loans is one of the pillars in making sound underwriting decisions. Since September 2008, the Federal Housing Finance Agency (FHFA) has operated Freddie Mac and Fannie Mae (the Enterprises) in conservatorship, due to poor business decisions and risk management that led to enormous losses. While in conservatorship, the Enterprises have relied on Treasury's financial support to operate in the secondary mortgage market, buying loans in order to provide needed liquidity to lenders. In 2010, FHFA directed the Enterprises to improve single-family residential loan quality and risk management through, among other things, developing a uniform collateral data portal (portal).

Before the associated loans are presented for the relevant Enterprise to buy, appraisal and appraiser information is collected through the portal system. If its checks find signs that the appraisals violate the Enterprises' requirements, it alerts them and the lenders to the problem(s). By using the portal, the Enterprises are striving to improve data quality, ensure compliance with their loan eligibility guidelines, enhance loan reviews, and lower the number of loans that must be bought back by sellers (i.e., repurchased) for not meeting their standards.

As of March 2012, the portal must analyze all appraisals for single-family loans before the Enterprises buy the loans. This is a significant undertaking since, in 2012 alone, the Enterprises collectively purchased and guaranteed approximately 6 million single-family residential mortgages, valued at $1.3 trillion. This joint Enterprise effort to create a portal for submitting and analyzing appraisal data represents a significant change in how they and the mortgage industry have processed appraisal information.

The objective of the audit was to assess FHFA's oversight of the Enterprises' use of appraisal data to minimize the risk of loss on single-family mortgages.

What OIG Found

While the Enterprises have progressed in establishing the portal and collecting appraisal data, more remains to be done to use the portal's data to minimize the risk of loss. OIG concludes that increased FHFA oversight can enhance Enterprise use of the portal's appraisal data before they buy single-family mortgages and can reduce collateral risk.

Specifically:

- From January 2013 through June 2013, Fannie Mae spent $13 billion buying over 56,000 loans even though the portal's analysis of the

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associated appraisals warned the Enterprise that the appraisals were potentially in violation of its underwriting requirements.

- From June 2013 through September 2013, Freddie Mac spent $6.7 billion buying over 29,000 loans despite the portal warning the Enterprise that either no property value could be provided or the value of the property was in question.

The Enterprises had set such warning messages as automatic overrides allowing lenders to disregard the problems signalled by the portal before selling the associated loans to the Enterprises. The Enterprises established the messages as automatic overrides for various reasons, to include their concern that they needed more time to fine tune the portal messages before requiring lenders to address the messages. Both Enterprises also expressed concern that they did not want to burden lenders with having to respond to messages. Further, as of November 2013, the Enterprises have had an extensive (nearly four year) development, testing, and implementation phase to reach the level of readiness such that the Enterprises should be able to require lenders to respond to warning messages. This work is being performed under a joint five-year contract valued at $52 million. The portal is a vital tool to minimizing the risk of loss and should be fully used to improve loan quality.

In addition, the Enterprises bought nearly $88 billion in loans when system logic errors in the portal did not allow them to determine if the appraiser was properly licensed to assess the value of the properties, which served as collateral for the loans. Specifically, the portal alerted the Enterprises and lenders that some appraisers were suspended; however, the Enterprises set the portal to automatically override the messages and accepted the submitted appraisals. Based on OIG's work and the Enterprises' responsive actions, 23 loans valued at $3.4 million may be repurchased based on the "suspended" status of the appraiser, which is a violation of requirements.

By improved use of the portal's appraisal data, the Enterprises will be better able to assess the value of the property securing the loans they buy to ensure underwriting decisions are sound and are well supported and related risk is properly managed. In turn, this will help protect the Enterprises' and the taxpayers' investment in them.

What OIG Recommends

Overall, OIG made 14 recommendations to help the Enterprises use appraisal data to improve loan quality and to reduce the risk of loss. In general, the recommendations are geared to improve FHFA's oversight of how the Enterprises use the portal according to the Agency's directive. OIG also recommends that the Enterprises require lenders to resolve key warning messages

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generated by the portal's analyses of their submitted appraisal data before buying the associated loans.

FHFA provided comments agreeing with the recommendations in this report. FHFA will continue to work with the Enterprises as they develop and implement the portal. Planned actions include ensuring that the Enterprises determine which proprietary messages should be changed to manual override or fatal, which will require lenders to address the appraisal-related messages.

FHFA will continue to work with the Appraisal Subcommitte in pursuit of enhancements to the National Registry of Appraisers to include retention of historical records and real-time reporting of appraiser license status. FHFA agrees that, once the National Registry achieves retention of historial license status information and real-time reporting, the Enterprises will pursue modifying the portal to address system logic errors.

FHFA also agreed to ensure that both Enterprises seek appropriate remedies for the loans delivered by the two suspended appraisers.

FHFA estimated the completion date for these actions, to include providing a status report on activities related to implementation of the portal as intended by its directive, to be January 31, 2015.

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ABBREVIATIONS .....

Enterprises	Fannie Mae and Freddie Mac
Fannie Mae	Federal National Mortgage Association
FHFA or Agency	Federal Housing Finance Agency
Freddie Mac	Federal Home Loan Mortgage Corporation
HVE	Home Value Explorer
LTV	Loan-to-Value
OIG	Office of the Inspector General
Portal	Uniform Collateral Data Portal

PREFACE

A series of reports by OIG has assessed FHFA's oversight of the Enterprises and their related loan quality and risk management. For example, OIG has identified that FHFA can strengthen its oversight of Fannie Mae's underwriting standards for single-family mortgage loans.[1]

This report continues OIG's work by assessing FHFA's oversight of the Enterprises' use of appraisal data to improve loan quality and to reduce the risk of loss associated with single-family mortgages they buy. Specifically, OIG reviewed the Enterprises' use of appraisal data generated by the uniform collateral data portal. OIG determined that, through better FHFA supervision, the Enterprises can improve their use of appraisal data before they buy mortgages, which will help reduce the risk of loss and improve loan quality.

OIG is authorized to conduct audits, evaluations, investigations, and other law enforcement activities pertaining to FHFA's programs and operations. As a result of OIG's work, it may recommend policies that promote economy and efficiency in administering FHFA's programs and operations, or that prevent and detect fraud and abuse in them. OIG believes that the recommendations contained in this report, along with those in prior reports, will increase FHFA's assurance that the Enterprises are operating safely and soundly, and that their assets are preserved and conserved.

OIG appreciates the cooperation of all those who contributed to this audit, which was led by Tara Lewis, Audit Director, who was assisted by Andrew W. Smith, Audit Manager, Terese Blanchard, Auditor-in-Charge, and Katie Hollings, Auditor.

This report has been distributed to Congress, the Office of Management and Budget, and others, and will be posted on OIG's website at www.fhfaoig.gov

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Deputy Inspector General for Audits

[1] OIG, *FHFA's Oversight of Fannie Mae's Single-Family Underwriting Standards* (AUD-2012-003, March 22, 2012). Accessed November 20, 2013, at http://fhfaoig.gov/Content/Files/AUD-2012-003_0.pdf.

BACKGROUND

Property Appraisals' Role in Mortgage Loan Transactions

A residential appraisal reports on the property offered as collateral for a mortgage loan, including its condition, neighborhood, market, and value. As noted by Freddie Mac (and echoed by Fannie Mae),[2] this appraisal is critical to underwriting mortgage loans:

> The appraisal report is one of the most important documents in a loan file because it supports the underwriter's determination of whether there is sufficient and appropriate collateral to back the mortgage transaction.[3]

Underwriting assesses a borrower's ability to repay a loan and the collateral's value that may be used to offset losses if the borrower defaults. Critical to this assessment, appraisals estimate the value of collateral. In addition, appraisals help lenders meet underwriting requirements such as those related to **loan-to-value (LTV)**.

What is Loan-to-Value (LTV)?
LTV is how much you owe on a property compared to its worth. For example, if you owe $150,000 on a home worth $300,000, your LTV is 50%.

The Enterprises' selling guides contain requirements for lenders to follow when contracting with appraisers. The lenders are responsible for ordering the appraisal, selecting the appraiser, and reviewing the appraisal to determine if the property is adequate collateral for the mortgage loan. In addition, the Enterprises have several requirements for appraisers such as being licensed or certified in the state where the property is located and following the Enterprises' requirements and standards.

However, before 2012, there was no uniform system for gathering, analyzing, and responding to standardized appraisal data to ensure loans sold to the Enterprises met their requirements before purchase.

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[2] Source: *Fannie Mae's Single-Family webpage on Appraisers*, accessed November 22, 2013, at https://www.fanniemae.com/singlefamily/appraisers?from=hp.

[3] Source: *Freddie Mac Publication Number 83: Reviewing Appraisals in Today's Mortgage Market*, accessed November 22, 2013, at: http://www.freddiemac.com/singlefamily/uw/docs/PLNAQ_series_Reviewing_Appraisals_in_Todays_Mtg_Mkt_Fact_Sheet_838.pdf.

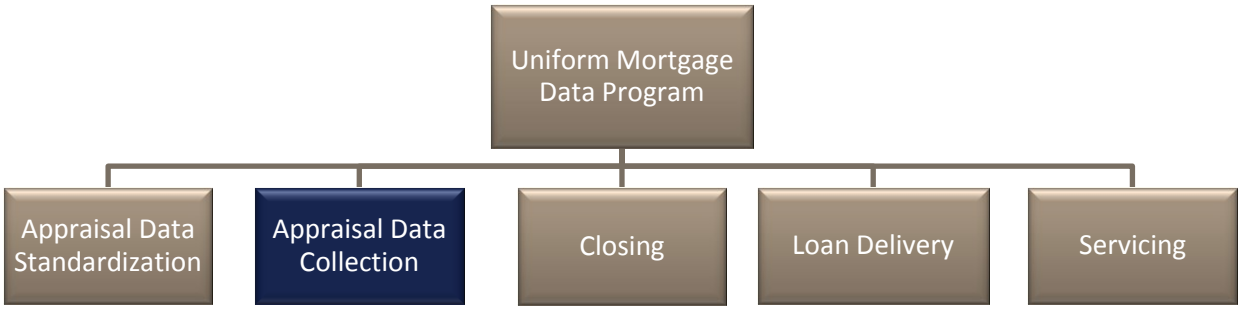
The Uniform Mortgage Data Program

After being appointed as the Enterprises' conservator following 2008's housing crisis, FHFA introduced initiatives to enhance oversight of them and help them better manage their risk. Among the Agency's efforts, the uniform mortgage data program focused on developing consistent and useful data related to mortgage finance.

In February 2010, FHFA announced the program's goals, which included improving the Enterprises' risk management and data quality. To achieve these goals, FHFA directed the Enterprises to work together while operating as separate businesses and exercising independent business judgment on their use of loan data.

As of April 2013, FHFA's uniform mortgage data program initiative had five components that correspond to key parts of the mortgage loan-making (appraisal data standardization, appraisal data collection, and closing) and loan-selling (loan delivery, servicing) business. This audit focused on one area, the uniform collateral data portal, which included appraisal data collection.

FIGURE 1. THE UNIFORM MORTGAGE DATA PROGRAM[4]



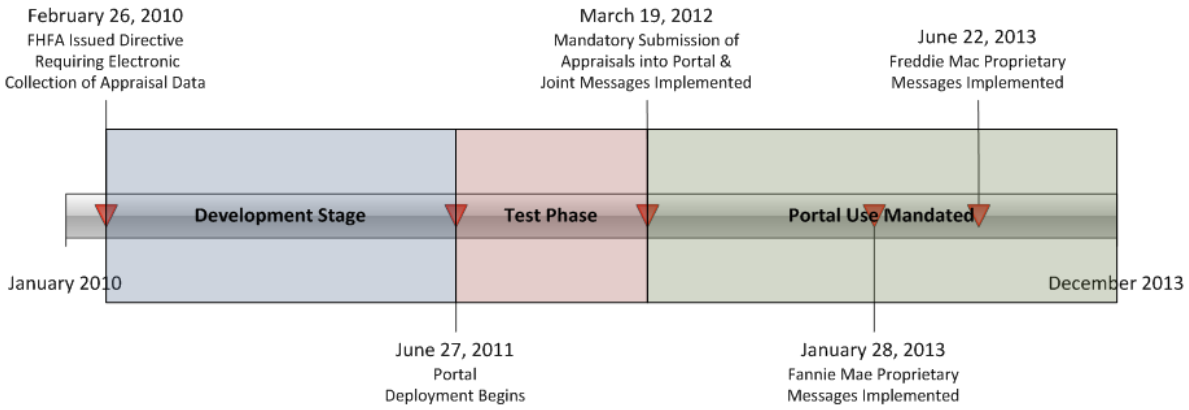
Developing the Uniform Collateral Data Portal

Under the uniform mortgage data program, the Enterprises began to develop consistent data definitions and formats for appraisals, and a uniform collateral data portal for lenders to submit the information.

[4] Source: OIG analysis of FHFA Uniform Mortgage Data Program Directives in conjunction with Fannie Mae and Freddie Mac's Uniform Mortgage Data Program Overview**,** accessed February 4, 2014: https://www.fanniemae.com/singlefamily/uniform-mortgage-data-program and http://www.freddiemac.com/learn/umdp/.

As shown below, the Enterprises developed and tested the portal for over two years (February 2010 through March 2012) before requiring all lenders to submit the data for their appraisals according to standardized data definitions and formats. During the three years following FHFA's directive to develop the portal, the Enterprises implemented the electronic checks and analyses of the data that will allow them to make both common and individual use of the information relative to their underwriting requirements and business models.

FIGURE 2. DEVELOPMENT AND IMPLEMENTATION OF THE UNIFORM COLLATERAL DATA PORTAL[5]



As they developed the portal, the Enterprises also defined and standardized the appraisal data that feeds into it in order to:

- Manage and mitigate valuation risk by resolving inconsistencies with appraisal data, including formatting, terminology, and use of specific descriptions;
- Provide lenders and the Enterprises with greater confidence in loan quality by offering better data quality; and,
- Create efficiency and consistency in appraisal reviews by offering appraisers and lenders an improved view and understanding of Enterprise appraisal data requirements.

Meanwhile, the Enterprises also worked from 2010 to develop checks and analyses that could sift through appraisal data submitted to the portal and alert them of potential problems, such as incorrectly entered data and appraisals that may contain incorrect valuations of the collateral properties.

The Enterprises had agreed upon a set of joint messages that the portal would send about appraisals—these common alerts dealt mainly with data entry format issues, such as using

[5] Source: OIG analysis of Uniform Collateral Data Portal information provided by FHFA, Fannie Mae and Freddie Mac.

whole dollars, but some warned about more serious issues such as an appraiser's license status. By 2013 (January for Fannie Mae and June for Freddie Mac), each enterprise developed proprietary messages that warned about potential problems specific to its particular business model. Fannie Mae, for example, designed a message to alert if fewer than three comparable sales were used when appraising a property's value.

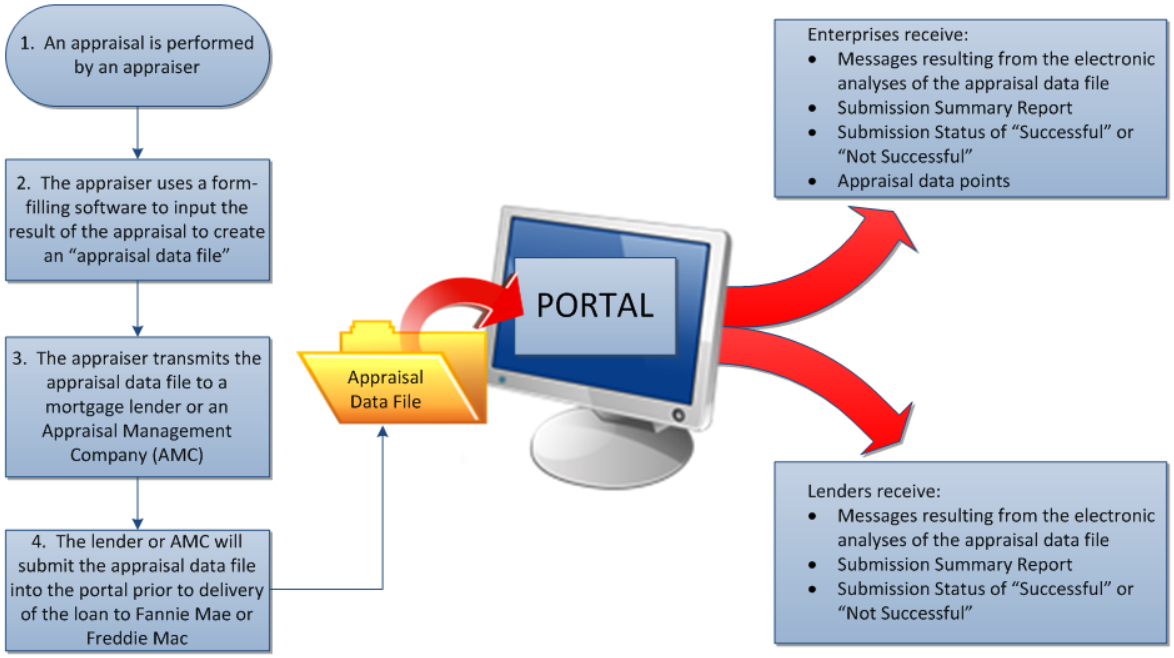
After an extensive, nearly four-year development, testing, and implementation phase, the major elements of the Enterprises' uniform collateral data portal—data standardization, submission, and analysis—are currently online and receiving appraisals from lenders who wish to sell their mortgage loans to Fannie Mae and Freddie Mac.

Submitting Appraisals into the Enterprises' Uniform Collateral Data Portal

As shown in Figure 3 below, appraisers fill out electronic forms with appraisal information and send the resulting data file to a lender or an appraisal management company acting on the lender's behalf. The lender or appraisal management company then uploads the appraisal into the uniform collateral data portal. The submission can go to one or both Enterprises, but in either case they recommend that the appraisal be submitted early so lenders can address any messages the portal generates.

Once submitted, the portal automatically analyzes and checks the data, which can result in various types of messages. Appraisals that do not receive messages requiring additional action by the lender are identified as successful, which allows the associated loan to be delivered for purchase by one of the Enterprises. However, it is important to note that appraisals that are deemed successful do not relieve lenders of their obligations to adhere to the Enterprises' selling guide requirements.

FIGURE 3. APPRAISAL DATA FILE FLOW[6]



OIG analyzed loans delivered to the Enterprises between June 15, 2012 and June 15, 2013, to illustrate the use of the portal. OIG found there were 4.1 million appraisals submitted into the portal that were associated with loans delivered to the Enterprises, valued at $940.2 billion.

For Fannie Mae, OIG analyzed loans delivered between January 28, 2013 (when Fannie Mae's proprietary warning messages went into effect) and June 15, 2013, where the associated appraisal was also submitted during this time-frame. OIG found that lenders submitted data for over 747,000 appraisals performed by nearly 52,000 appraisers, which resulted in Fannie Mae's purchase of about $167 billion in single-family loans.[7]

For Freddie Mac, OIG analyzed loans delivered between June 22, 2013 (when Freddie Mac's proprietary warning messages went into effect) and September 30, 2013, where the associated appraisal was also submitted during this time-frame. OIG found lenders submitted data for

[6] Source: OIG analyses of appraisal data file flow beginning with the appraisal and ending with information generated by the uniform collateral data portal.

[7] The number of appraisers was determined by counting the appraisal license numbers contained in the uniform collateral data portal for loans purchased by Fannie Mae for the applicable time period. Appraisers may be licensed in multiple states and therefore could be counted more than once. Blank appraiser license fields were not included in the count.

almost 135,000 appraisals performed by 34,000 appraisers, which resulted in Freddie Mac buying over $29 billion in single-family loans.[8,9]

Joint and Proprietary Warning Messages About Submitted Appraisals

As of June 2013, the uniform collateral data portal analyzes submitted appraisal data and, when appropriate, can send any of 366 messages developed jointly by the Enterprises and 166 proprietary messages (total) developed by each. Both categories communicate potential red flags about submitted appraisals.

Joint Warning Messages

Almost all of the joint messages, 345 of 366 (94%), address formatting issues; therefore, OIG did not analyze these messages. For example, some of the appraisal fields must be presented in whole dollars and date fields have prescribed formats. However, the remaining 21 joint messages address topics such as the status of the appraiser's license, the appraised value of the property, etc. If, for example, the appraiser's license number shows up as suspended when the portal checks it against data maintained in the National Registry of Appraisers, then the portal will send a warning message to the lender and the Enterprise(s) indicating the apparent suspension.[10]

Proprietary Warning Messages

Of the 166 proprietary messages, 157 are Fannie Mae's while the other 9 are Freddie Mac's. Each Enterprise developed its messages in consideration of its own business needs and requirements. For example, 25 of Fannie Mae's proprietary messages tie to its selling guide

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[8] Freddie Mac officials informed OIG in November 2013 that they identified an error related to the electronic transmission of appraisal data from its contractor. The error occurred when a lender initially selected Fannie Mae as the investor of the subject loan, but subsequently selected Freddie Mac as the investor of the loan. In these isolated instances, some of the appraisal data was not transmitted to Freddie Mac. This error impacted 47 appraisals, representing less than 1% of the loans delivered during the three-month period. This error also occurred for the appraisal data submitted during the June 15, 2012 to June 15, 2013 period; however, officials did not have an estimate of the number of appraisals that may have been omitted. Further, in November 2013, OIG determined that three appraisals were not included in the initial portal information provided by Freddie Mac, covering June 15, 2012 to June 15, 2013. Freddie Mac responded that additional analyses would be required to determine the cause of the omission and that assembling portal information was challenging because they had not completed data analysis yet and there were limited controls around some of the data.

[9] The number of appraisers was determined by counting the appraisal license numbers contained in the uniform collateral data portal for loans purchased by Freddie Mac for the applicable time-period. Appraisers may be licensed in multiple states and therefore could be counted more than once. Blank appraiser license fields were not included in the count.

[10] The National Registry of Appraisers is maintained by the Appraisal Subcommittee, see https://www.asc.gov for a complete description of its mission.

requirements for underwriting property, such as one noting if the appraiser did not comment on market trends (which can identify declining property values) even though there were indications of negative market trends. (See Appendix D for a listing of Fannie Mae's 25 messages related to underwriting requirements.) In contrast, four of Freddie Mac's proprietary messages tie to one aspect of its property underwriting requirements, the property's value. Specifically, Freddie Mac's proprietary messages relate directly to its automated model for valuing properties. For example, the portal will send a message if the automated model cannot estimate a value based on the information uploaded for an appraisal. (See Appendix E for a listing of Freddie Mac's nine messages related to its automated valuation model).

Officials informed OIG that beginning in January 2014, Freddie Mac's proprietary messages will be suspended. Specifically, the Consumer Financial Protection Bureau announced new disclosure requirements for property valuation information effective January 18, 2014. To address these new requirements, Freddie Mac will revise its proprietary messages and will resume proprietary analyses of appraisals during the summer of 2014.

Resolving Warning Messages To Successfully Submit Appraisals

For their appraisal submission to be successful, lenders do not have to do anything to resolve most warning messages they receive about the appraisals they submit. Specifically, as of June 2013, the Enterprises have set the portal to automatically override all of the Enterprises' proprietary messages (166) and most of their joint messages (334 of 366). For two other joint messages, the lender may manually override the warning by selecting a reason for the problem from a dropdown menu. The remaining 30 joint messages are "fatal," which require the lender to take action to resolve the issue identified by the message. For example, the lender may have to fill in missing information, reformat data, or convert the file and will then resubmit the appraisal before receiving a successful status, thus allowing delivery of the loan.

FINDINGS AND RECOMMENDATIONS

Finding 1: Fannie Mae Bought Loans Despite Warnings of Them Potentially Not Conforming to Its Appraisal Requirements

> Fannie Mae purchased over 56,000 loans, valued at $13 billion, which may have contained potential violations of underwriting requirements.

During a five-month period of time, from the end of January 2013 through June 2013, over 56,000 appraisals uploaded into the portal generated at least one of the 25 warning messages about potential violations of Fannie Mae's underwriting requirements. Over 4,500 of these appraisals generated more than one warning message (up to 9 messages per appraisal). Despite these alerts, Fannie Mae purchased all of the loans for over $13 billion.

The triggering issue varied from technical appraisal documentation requirements (e.g., confirming that the lender had obtained a certification of completion of repairs) to unauthorized use of single-family loan funds (e.g., buying hotels/motels, or properties that were over 20% commercial). The warning messages shared with lenders were coded as "automatic overrides" in the uniform collateral data portal. That is, Fannie Mae did not require lenders to explain or resolve potential problems ranging from formatting issues to violations of its underwriting requirements.

Instead, Fannie Mae focused its efforts on reviewing the loans for conformance with its requirements after it bought them. Enterprise officials informed OIG that their plan was to determine how effective the warning messages were by analyzing some of the actual appraisals to see if they should have triggered the alert; that is, to determine the rate of false positives generated by the portal's automated analyses and checks of appraisal data. With that information, the Enterprise plans to fine tune the warning messages; for example, determining if some automatic overrides should require lender action before resubmitting the appraisal (i.e., be "fatal" to the submission).

OIG acknowledges Fannie Mae's plans for testing as a positive step, but the concern is that the Enterprise should already have a level of readiness to require lender action in response to warning messages. Specifically, prior to deploying its messages to all lenders in 2013, Fannie Mae performed over 23,500 tests to determine if rules were acting as intended. In addition to this testing, in June 2012, Fannie Mae conducted a pilot for six months before deployment, where the Enterprise internally analyzed messages that would have been sent to three lenders. Finally, in January 2013, these messages reached a certain level of readiness and were

released to all lenders. Therefore, since June 2012, Fannie Mae has had over 18 months to test the warning messages that indicate appraisals may not meet its underwriting requirements.

In addition, Fannie Mae's plan to review the appraisals after purchase will test only a subset of the alerts. Specifically, the portal's messages feed into Fannie Mae's tool to select post-purchase review samples, which is also guided by specific points of data (e.g. loan-to-value) rather than pulling from the entire universe. Prior to 2013, Fannie Mae reviewed a small fraction of the loans it purchased each year. Officials informed OIG that in 2013, Fannie Mae redesigned its post-purchase review process to electronically screen loans purchased and to perform a manual review of approximately 3% to 5% of these purchases. With the portal, however, the Enterprise has the entire universe of data at its disposal. Finally, Fannie Mae's selection of warning messages is limited to high-risk messages, which may restrict its view to the breadth of a problem for low-risk but pervasive problems.

Overall, Fannie Mae's approach to manage such risks after buying the loans is also contrary to the goals of its own loan quality initiative, which works to enhance loan quality and lower valuation risk by ensuring loans meet standards before, not after, purchase.

As of November 2013, FHFA had not performed any supervisory review or conducted any examination work related to Fannie Mae's use of proprietary messages to reduce the risk of loss. While per FHFA's overall uniform mortgage data program, the Enterprise should continue to exercise its independent business judgment to evaluate, adopt, and maintain its separate business terms, credit policies, and analytics, the program also states that FHFA will oversee this work.

As a result of Fannie Mae not fully using the information provided by the portal related to some of its key warning messages, valuation risk was not fully minimized as intended by the uniform mortgage data program and the Enterprise's own loan quality initiative. Ultimately, FHFA created the uniform mortgage data program to improve data quality and risk management. However, Fannie Mae has yet to fulfill an important aspect of its plans to implement the program: specifically, use of loan data pre-purchase to better the loan quality and reduce representation and warranty risk. Fannie Mae officials believed, however, that they have made progress in the loan quality initiative and informed OIG that they have worked with lenders throughout 2013 relating to loans receiving proprietary messages. As a result, Fannie Mae reported to OIG that there has been a slight decrease in loans receiving proprietary messages they deemed as critical from January to July 2013.

Recommendation for Finding 1:

To improve Fannie Mae's use of appraisal information generated by the uniform collateral data portal related to the 25 proprietary messages, FHFA should perform supervisory review and follow-up to ensure that Fannie Mae takes action to:

1. Change the portal message type from automatic override to manual override or fatal for the 25 proprietary messages related to underwriting requirements, which will require lenders to take action to address the appraisal-related messages warning of potential underwriting violations prior to delivering the loans.

Finding 2: Freddie Mac Bought Loans Despite Questions about Their Appraised Value

During a three-month period of time, from June 22, 2013 through September 30, 2013, over 29,000 out of 135,000 appraisals uploaded into the portal generated one of Freddie Mac's proprietary warning messages alerting that either no property value could be provided or the value of the property was in question. Despite these alerts, Freddie Mac purchased all of the loans for approximately $6.7 billion.

> Freddie Mac purchased over 4,000 loans, valued at approximately $1.1 billion, despite indications that the appraised values may be excessive for the local market.

Unlike Fannie Mae, Freddie Mac's proprietary messages were limited to only one aspect of its property underwriting requirements, the property's value. Specifically, Freddie Mac accomplished this by feeding the portal's appraisal data through the Enterprise's model for estimating property value (Home Value Explorer). However, the model could not estimate a value for around 25,000 appraisals totaling $5.6 billion for reasons ranging from the system not being available at the time to not being able to verify that the address existed. For over 4,000 other appraisals, valued at $1.1 billion, the model warned that the appraisals should be reviewed for accuracy because the estimated value may be excessive for the local market.

Indeed, Freddie Mac does not require lenders to address any of its proprietary messages before buying their loans. Instead, the warning messages were coded as automatic overrides, so the portal accepted the appraisal, giving it a successful status, without lenders explaining or resolving the questionable or absent property values.

Like Fannie Mae, rather than requiring the warning messages to be addressed beforehand, Freddie Mac relies on post-purchase review to catch problems. However, the Enterprise's review does not begin with the appraisals that generated the alerts, but instead selects files to review based on data points (e.g., an appraised value exceeds the market value by at least 10%), which may or may not include problematic appraisals. In addition, Freddie Mac's

reviews generally only look at a small sample of the loans bought by the Enterprise—in 2012 Freddie Mac purchased approximately 2 million loans; however, it only selected about 254,000 loans for review that year. Therefore, requiring lenders to address messages generated by the portal, prior to purchase of the loans, will provide more thorough identification of problems with loans rather than reviewing a portion of them as part of the post-purchase review.

In December 2013, Freddie Mac officials informed OIG that post-purchase review sampling will leverage appraisal data by February 2014. Specifically, Freddie Mac informed OIG that it has built capacity to perform a full underwrite on 500 loans targeted by its appraisal samples each month.

OIG noted that Freddie Mac could expand its proprietary messages to tie to additional property requirements in its selling guide, and the Enterprise could further develop its use of the data available in the uniform collateral data portal to help it manage risk. The Enterprise agreed that these were important elements in its use of the portal, and assured OIG that plans to do both were underway—primarily through a contract awarded in September 2013.

In general, the contract's goals are to:

- Evaluate appraisal data received through the portal,
- Provide pre-funding feedback to Freddie Mac lenders regarding the quality of the appraisal data, the valuation assessment, and appraiser compliance to standards; and,
- Make timely and appropriate funding decisions based on high quality appraisal reports that have been scored and validated based on the best information available.

The results of the contractor's validation service will be returned through the portal messages to the user submitting the appraisal and will be available for Freddie Mac inquiry and download. Further, Freddie Mac officials stated the contract will also include a review of the collateral's value, condition, and marketability, which are part of the lender's responsibilities.

As it proceeds to develop its use of the portal, Freddie Mac should ensure that it minimizes valuation risk—a key goal of FHFA's overall uniform mortgage data program—by further developing proprietary warning messages related to additional underwriting requirements, and using these warnings to manage risk upfront.

Recommendations for Finding 2:

To improve Freddie Mac's risk management related to the use of proprietary messages, FHFA should perform supervisory review and follow-up to ensure that Freddie Mac takes action to:

2. Develop and implement additional proprietary messages related to its property underwriting requirements.
3. Establish the additional proprietary messages related to property underwriting requirements as manual override or fatal, which will require the lenders to take action to address the messages prior to delivering the loans.
4. Review the type of message related to the existing nine proprietary messages for consideration of converting the type of message from automatic override to manual override or fatal, which will require the lenders to take action to address the messages prior to delivering the loans.

Finding 3: The Uniform Collateral Data Portal Can Better Identify Appraisers' License Status

From June 2012 to June 2013, there were 414,000 appraisals that received messages from the portal for loans totaling nearly $88 billion warning that the appraiser's license was unverified.[11,12] Over the same period, the portal alerted that 25 appraisers (associated with 805 appraisals) were suspended, and so, according to both Enterprises' guidelines, could not be used by lenders for mortgages sold to the Enterprises.

The Enterprises' purchased loans valued at almost $88 billion when, contrary to their own requirements, they could not determine if the appraiser was licensed to perform the work.

In both cases of the portal alerting of the appraisers' licenses being unverified or suspended, OIG's analysis showed that the warning messages were either indeterminate or inaccurate. Specifically, the "unverified" message was comprised of either (1) the appraisers' licenses were inactive and so their appraisals could not be used for property sold to the Enterprises, or (2) the portal simply could not find the appraisers' license numbers in the National Registry of Appraisers it searched through. In this second case, the appraisers' licenses may well have been valid, but the Enterprises did not know. Of the 25 appraisers identified as suspended, OIG found that only two appraisers were indeed suspended at the time the appraisal was completed.

[11] In total, this represents about 10% of appraisals uploaded into the portal during this period (414,000 of 4.1 million), and about 9% of their total value ($88 billion of $940 billion). Specifically, for Fannie Mae, the portal generated this message approximately 280,000 times for which Fannie Mae purchased loans valued at over $59 billion. Likewise, for Freddie Mac, the portal generated this message about 134,000 times when loans were purchased for nearly $29 billion.

[12] See footnote 8 regarding a qualification relating to the appraisal data.

However, since the Enterprises set the portal to automatically override both messages and accept the submitted appraisal, they lost opportunities to ensure that appraisals were being performed by appraisers who met their qualifications. For example, the two appraisers who were accurately identified by OIG as suspended had 13 appraisals supporting nearly $2 million in loans that the Enterprises bought. In reviewing the reasons for their suspensions, OIG found that one of the appraisers had completed misleading appraisals and the other appraiser engaged in gross misconduct.

OIG alerted Enterprise officials of the findings, who swiftly reviewed the portal for additional appraisals performed by the two appraisers and found an additional 10 loans valued at approximately $1.4 million. The Enterprises' acted aggressively to refer the 23 total loans, valued at $3.4 million, to their respective post-purchase review groups and fraud departments. OIG's Office of Investigations has also been advised of these findings.

Based on OIG's work and the Enterprises' responsive actions, 23 loans valued at $3.4 million may be repurchased due to violations of underwriting standards.

The portal identified appraisers' suspension status inaccurately because it compared the appraisers' status when the appraisals were uploaded (irrelevant to their eligibility to appraise for the Enterprises), not when the appraisals were performed (required to have an active, unsuspended license when the work was done). Since an appraisal may be uploaded more than four months after the appraiser does the work, this leaves a lot of room for misidentifying their status at the time of the appraisal. That is, the appraiser could have been active at the time but suspended since; or, suspended at the time, but off suspension since. Either way, the Enterprises do not have assurance that the portal has correctly identified the appraisers' status on the effective date of the appraisals.

The problem of determining appraisers' status when they performed their appraisals is made worse by the fact that historical records were not maintained in the National Registry of Appraisers (the record of those who are licensed and certified by each state). However, since the status can be updated and the registry does not keep a record of their historical status (e.g., if they were suspended at a given time), it does not provide any certainty that appraisers were, in fact, allowed to perform their appraisals when they did. They may have, for example, been suspended then, but active now without the portal knowing.

Further, the registry does not necessarily reflect the appraisers' current status since update submissions vary by state – some states and U.S. territories (states) update in real-time and some do not. In 2010, the registry was updated to allow states to submit data directly from their tracking applications – thereby facilitating "real-time" updates to the registry. However, states are only required to update the registry related to licensing information on a monthly

basis. As of August 2013, 25% of the states are reporting appraiser data in real-time. If states convert to a real-time update, it can reduce costs, increase efficiency, and allow states the opportunity to provide almost immediate updates to the registry, making it a more effective tool for users. As a result of all states not fully utilizing the real-time submission capability, the Enterprises are not fully able to use the registry to identify the status of appraisers' licenses.

Until August 2013, the Enterprises did not have internal control policies or procedures in place to address portal messages related to the status of an appraiser's license. Freddie Mac officials informed OIG that they did not have any policies or procedures in place to follow up and take action when the portal generated messages related to an appraiser's license status. To their credit, as previously discussed, Freddie Mac officials took immediate action to address the instances identified by OIG's audit where loans were purchased when the appraisals were performed by a suspended appraiser.

For their part, Fannie Mae officials informed OIG that they developed new suspended appraiser procedures, with an effective date of September 2013. The new procedures include various tests designed to minimize Fannie Mae's risk involving loans delivered with an appraisal completed by an appraiser whose license or certification has been suspended, revoked, or surrendered. Results of this new procedure will assist, using the portal's information, in referring loans to Fannie Mae's fraud department and post-purchase review group.

As of November 2013, FHFA has not performed any examination work associated with the Enterprises' compliance with the Agency's uniform mortgage data program directive, related implementation, and the Enterprises' use of the portal to minimize the risk of loss. However, FHFA officials stated that, over time, it would be scoped into the ongoing monitoring program as the Agency becomes more knowledgeable about various program operations at the Enterprises.

Without better oversight, the Enterprises may not fully use the portal to minimize the risk of buying loans supported by inactive or unlicensed appraisers. FHFA developed the uniform mortgage data program as part of an effort to enhance risk management and to reduce representation and warranty risk through up-front monitoring of loan quality. To facilitate these goals, a reliable uniform collateral data portal is necessary for the Enterprises to have access to electronic appraisal data prior to purchasing the loans.

Recommendations for Finding 3:

To enhance both Enterprises' use of joint messages related to the status of an appraiser's license, FHFA should perform supervisory review of both Enterprises to:

5. Ensure the portal warning messages distinguish between inactive appraisers and unverified appraisers, as of the date the appraisal is performed.
6. Ensure that the portal tests whether appraisers are licensed and active at the time the appraisal is performed.
7. Change the message type, for messages relating to appraiser license status, from automatic override to manual override or fatal, which will require lenders to take action to address the message prior to delivering the loan. This action can be taken once the system logic is fixed and the historical records are available to determine the status of an appraiser's license at the time the appraisal work is performed, and the states are updating in real- time.[13]
8. Seek remedy for the 23 loans, valued at $3.4 million, delivered to the Enterprises by the two suspended appraisers in violation of underwriting requirements.

To improve Freddie Mac's use of joint messages related to the status of an appraiser's license, FHFA should perform supervisory review and follow-up to ensure that Freddie Mac takes action to:

9. Implement an internal control policy and related procedures to follow up on appraisal license status messages generated by the portal.
10. Review loans purchased since the portal's inception that generated messages related to the appraiser's license status.
11. Use the results of the review to repurchase the loans that contained appraisals that were performed by unlicensed appraisers, as appropriate.

To improve its oversight, FHFA should:

12. Pursue retention of historical records of the status of appraisers' licenses in the National Registry of Appraisers sufficient to determine the status of appraisers' licenses at the time the appraisal work is performed.
13. Pursue having the National Registry of Appraisers updated to reflect the status of state certified and licensed appraisers on a real-time basis.
14. Perform supervisory review and follow-up to ensure that the Enterprises develop and implement the portal as intended by FHFA's uniform mortgage data program directive.

[13] Recommendations 5, 6, and 7 are dependent on the implementation of recommendation 12.

CONCLUSION

FHFA directed the uniform mortgage data program initiative to enhance oversight, reform and rebuild aspects of the mortgage industry, and improve risk management. The related uniform collateral data portal is intended to improve appraisal data quality and risk management for the Enterprises by collecting appraisal data to help them make informed decisions about the loans they buy. Further, the uniform mortgage data program and the uniform collateral data portal are essential tools for the Enterprises to use to continue making progress toward reducing loan defects because they provide a means whereby the Enterprises can identify potential "red flags" on loans they may purchase. However, as demonstrated by the results of this audit, these goals are at risk of not being achieved.

As a result of this audit, 23 loans valued at $3.4 million are being considered for repurchase by the Enterprises because the appraisers were suspended at the time the appraisals were performed, which is a violation of underwriting requirements.

While the Enterprises have made great strides by standardizing appraisal data and establishing a single system to capture it, more remains to be done to ensure that the Enterprises fully use their portal to improve loan quality and reduce the risk of loss.

OBJECTIVE, SCOPE, AND METHODOLOGY .....

The objective of this performance audit was to assess FHFA's oversight of the Enterprises' use of appraisal data to reduce the risk of loss on single-family mortgages. The scope of this audit included a review of joint and proprietary messages and related appraisal data generated from the uniform collateral data portal. Specifically, OIG reviewed:

- Joint messages and related appraisal data related to loans delivered to the Enterprises from June 15, 2012 to June 15, 2013;
- Fannie Mae's proprietary messages and related appraisal data related to loans and appraisals delivered from January 28, 2013 to June 15, 2013; and,
- Freddie Mac's proprietary messages and related appraisal data related to loans and appraisals delivered from June 22, 2013 to September 30, 2013.

OIG performed this audit from April 2013 through December 2013. OIG conducted this audit at FHFA's and Fannie Mae's offices in Washington, D.C., and Freddie Mac's office in McLean, Virginia. OIG interviewed FHFA, Fannie Mae, and Freddie Mac personnel, the Enterprises' portal's third-party contractor, members of the Appraisal Subcommittee, and officials from selected states responsible for appraisers' licensing. The scope of the audit related specifically to the Enterprises' use of appraisal data contained in the portal.

OIG relied on computer-processed and hardcopy data from Fannie Mae and Freddie Mac to accomplish the audit objective. The computer-processed data included electronic appraisal data generated by the portal that was transmitted to Fannie Mae and Freddie Mac's separate internal central repositories by a contractor responsible for the development of the portal. OIG assessed the reliability of the data by performing electronic/manual logic testing for missing and accurate data. OIG relied on Enterprise officials to provide data generated by the portal, which was analyzed to support the conclusions. As described in finding 3 of this report, the portal can better identify appraisers' license status. Specifically, the portal alerted of appraisers' licenses being unverified or suspended, but OIG's analyses showed that the warning messages were either indeterminate or inaccurate. Accordingly, OIG determined that the computer-generated data, specific to unverified and suspended appraisers, was not sufficiently reliable since it was not always complete and accurate. OIG made recommendations designed to enhance the reliability of the portal generated data related to unverified and suspended appraisers. Also, as described in footnote 8, Freddie Mac had not performed full data analysis and there were limited controls around some of the data, which resulted in some omissions of data provided to OIG. Officials were working to understand and address the omissions of data during the audit.

To achieve the audit objective, OIG:

- Judgmentally selected and tested the joint and proprietary messages generated by the portal;
- Interviewed Fannie Mae's and Freddie Mac's business unit personnel on the development, implementation, and future plans for the portal as well as how the Enterprises are using the data generated from the portal;
- Interviewed FHFA officials on policies and examination work related to the implementation of the uniform mortgage data program directive and the portal;
- Interviewed the third-party contractor who hosts the portal used by Fannie Mae and Freddie Mac to gain an understanding of how the portal was developed and how it operates; and,
- Interviewed officials from selected states responsible for appraiser licensing for determining the status of appraisers' licenses for selected points in time.

OIG also assessed the internal controls related to the audit objective. Internal controls are an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting; and,
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives, and include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance. Based on the work completed on this performance audit, OIG considers weaknesses in FHFA's supervisory oversight of Fannie Mae's and Freddie Mac's controls over use of appraisal data to be significant in the context of the audit's objective.

OIG performed fieldwork for this audit from April 2013 through December 2013 in accordance with generally accepted government auditing standards. Those standards require that audits be planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objective. OIG believes that the evidence obtained provides a reasonable basis for the findings and conclusions included herein, based on the audit objective.

APPENDIX A .....

FHFA's Comments on OIG's Findings and Recommendations

Federal Housing Finance Agency

MEMORANDUM

DATE: January 27, 2014

TO: Russell A. Rau, Deputy Inspector General for Audits
FHFA Office of Inspector General

FROM: Sandra Thompson, Deputy Director
Division of Housing Mission and Goals

SUBJECT: FHFA Comments on FHFA-OIG Audit Report: *FHFA's Oversight of the Enterprises' Use of Appraisal Data Before they Buy Single-Family Mortgages*, AUD-2013-012

This memorandum transmits the Federal Housing Finance Agency's (FHFA) management response to the findings and recommendations contained in the above referenced audit report (Report). We appreciate the opportunity to provide a response and value the feedback on FHFA programs we receive from the Office of Inspector General (OIG) through its audits and evaluations.

Report Recommendations and FHFA Responses

Recommendation 1: To improve Fannie Mae's use of appraisal information generated by the uniform collateral data portal related to the 25 proprietary messages, FHFA should perform supervisory review and follow-up to ensure that Fannie Mae takes action to change the portal message type from automatic override to manual override or fatal for the 25 proprietary messages related to underwriting requirements, which will require lenders to take action to address the appraisal-related messages warning of potential underwriting violations prior to delivering the loans.

FHFA Response: FHFA agrees with this recommendation and will ensure that Fannie Mae takes action to determine which of the 25 proprietary messages should be changed to manual override or fatal and implement the changes. Fannie Mae has already begun to identify the messages that are clearly tied to underwriting and eligibility requirements that do not yield a significant number of false positives, with plans to change the messaging to manual override. Evidence to close this recommendation will consist of documentation of message changes in the portal, along with the logic for selection of the messages. Estimated date of completion is January 31, 2015.

Recommendations 2, 3 and 4: To improve Freddie Mac's risk management related to the use of proprietary messages, FHFA should perform supervisory review and follow-up to ensure that Freddie Mac takes action to:

2. Develop and implement additional proprietary messages related to its property underwriting requirements.

3. Establish the additional proprietary messages related to property underwriting requirements as manual override or fatal, which will require the lenders to take action to address the messages prior to delivering the loans.

4. Review the type of message related to the existing 9 proprietary messages for consideration of converting the type of message from automatic override to manual override or fatal, which will require the lenders to take action to address the messages prior to delivering the loans.

FHFA Response: FHFA agrees with these recommendations and will follow up with Freddie Mac to assure they complete and implement their Appraisal Data Validation Service (ADVS) Plan which includes development and implementation of proprietary messages related to property underwriting requirements. As OIG notes in the Report, Freddie Mac has temporarily suspended the existing 9 proprietary messages and will revise and reactivate them later in 2014. Freddie Mac suspended the messages in response to customer feedback regarding the new compliance requirements under the Consumer Financial Protection Bureau's final rule on the Equal Credit Opportunity Act amendment under Regulation B. They, along with other potential messages, will be considered as part of the ADVS Plan. Evidence to close this recommendation will consist of documentation of implementation of messages developed and selected for manual override or fatal. Estimated date of completion is January 31, 2015.

Recommendation 8: To enhance both Enterprises' use of joint messages related to the status of an appraiser's license, FHFA should perform supervisory review to ensure that both Enterprises seek remedy for the 23 loans, valued at $3.4 million, delivered to the Enterprises by the 2 suspended appraisers in violation of underwriting requirements.

FHFA Response: FHFA agrees with this recommendation and will ensure that both Enterprises seek appropriate remedies for the loans delivered by the two suspended appraisers. Evidence to close this recommendation will be documentation of Enterprise actions and outcomes related to the loans. Estimated date of completion is January 31, 2015.

Recommendations 9, 10 and 11: To improve Freddie Mac's use of joint messages related to the status of an appraiser's license, FHFA should perform supervisory review and follow-up to ensure that Freddie Mac takes action to:

9. Implement an internal control policy and related procedures to follow-up on appraisal license status messages generated by the portal.

10. Review loans purchased since the portal's inception that generated messages related to the appraiser's license status.

11. Use the results of the review to repurchase the loans that contained appraisals that were performed by unlicensed appraisers, as appropriate.

FHFA Response: FHFA agrees with these recommendations and will require Freddie Mac to provide a copy of internal control policy and related procedures regarding follow-up on license

status messages, review loans that generated messages related to the appraiser's license status and use the results of the review to seek remedies for loans containing appraisals performed by unlicensed appraisers, as appropriate. Evidence to close this recommendation will consist of a copy of Freddie Mac's internal control procedures, evidence of loan reviews and any resulting actions. Estimated date of completion is January 31, 2015.

Recommendations 12, 13, 5, 6 and 7: To improve its oversight, FHFA should:

12. Pursue retention of historical records of the status of appraisers' licenses in the National Registry of Appraisers sufficient to determine the status of an appraiser's license at the time the appraisal work is performed.

13. Pursue having the National Registry of Appraisers updated to reflect the status of state certified and licensed appraisers on a real-time basis.

To enhance both Enterprises' use of joint messages related to the status of an appraiser's license, FHFA should perform supervisory review of both Enterprises to:

5. Ensure the portal warning messages distinguish between inactive appraisers and unverified appraisers, as of the date the appraisal is performed.

6. Ensure that the portal tests whether appraisers are licensed and active at the time the appraisal is performed.

7. Change the message type, for messages relating to appraiser license status, from automatic override to manual override or fatal, which will require lenders to take action to address the message prior to delivering the loan, once the system logic is fixed and the historical records are available to determine the status of an appraiser's license at the time the appraisal work is performed, and the states are updating in real- time.

FHFA Response: FHFA agrees with recommendations 12 and 13, and will continue to work with the Appraisal Subcommittee in pursuit of enhancements to the National Registry of Appraisers to include retention of historical status records and real-time reporting of appraiser license status. While some progress has been made toward real-time reporting, there is not yet sufficient reliable information for the Enterprises to modify the portal to perform recommendations 5, 6 and 7. FHFA agrees that, once the National Registry achieves retention of historical license status information and real-time reporting, the Enterprises will pursue modifying the portal to address these issues. FHFA will continue the dialogue in support of these changes with the ASC. Evidence to close these recommendations will be a written communication to the Appraisal Subcommittee encouraging them to pursue retention of historical appraiser status records and updating the National Registry on a real-time basis. Estimated date of completion is January 31, 2015.

Recommendation 14: To improve its oversight, FHFA should perform supervisory review and follow-up to ensure that the Enterprises develop and implement the portal as intended by FHFA's uniform mortgage data program directive.

FHFA Response: FHFA agrees with this recommendation and will continue to work with the Enterprises as they develop and implement the portal. Because this is a multiyear project,

FHFA will provide a status report on activities related to implementation as evidence to close this recommendation by January 31, 2015.

APPENDIX B.....

OIG's Response to FHFA's Comments

On January 27, 2014, FHFA provided comments to a draft of this report, agreeing with the recommendations and identifying FHFA actions to address them.

Specifically, for recommendations 1 through 4, FHFA agreed to ensure that Fannie Mae takes action to determine which of the 25 proprietary messages should be changed to manual override or fatal and implement the changes in the portal. In addition, FHFA will ensure that Freddie Mac develops and implements proprietary messages related to property underwriting requirements. Freddie Mac will also select messages for conversion to manual override or fatal, which will require lenders to take action to address the messages prior to delivering the loans.

For recommendations 8 through 11, FHFA will ensure that both Enterprises seek appropriate remedies for the loans delivered by the two suspended appraisers. In addition, FHFA will require Freddie Mac to develop internal control policy and related procedures regarding follow-up on license status messages, review loans that generate messages related to the appraisers' licenses status, and use the results of the review to seek remedies for loans that contain appraisals performed by unlicensed appraisers.

With respect to recommendations 5 through 7, 12, and 13, FHFA stated it will continue to work with the Appraisal Subcommittee in pursuit of enhancements to the National Registry of Appraisers to include retention of historical status records and real-time reporting of appraiser license status. Further, FHFA stated that once the National Registry of Appraisers achieves retention of historical license status information and real-time reporting, the Enterprises will pursue modifying the portal to perform recommendations 5, 6, and 7. FHFA will continue the dialogue in support of these changes with the Appraisal Subcommittee.

OIG considers FHFA's planned actions to recommendations 5 through 7, 12, and 13 to be potentially responsive to the recommendations. Specifically, depending on the response from the Appraisal Subcommittee, FHFA may need to pursue additional actions to address the recommendations. As communicated during OIG's audit, one such option is for the Enterprises to retain the Appraisal Subcommittee's daily file. Currently, the Enterprises, through the portal contractor, download a daily file from the Appraisal Subcommittee that includes among other fields, the appraiser's name, license number, and license status. By retaining this file daily, the Enterprises could begin building a historical database of the status of appraisers' licenses. Retaining this historical data along with states fully utilizing real-time submission capability would allow the Enterprises to determine whether an appraiser was

licensed at the time the appraisal was performed, resulting in the successful implementation of recommendations 12 and 13, which would allow the Enterprises to implement recommendations 5, 6, and 7. While the real-time updates will further enhance the information contained in the National Registry of Appraisers (recommendation 13), retention of historical records (recommendation 12) in and of itself would be a significant step towards improving the accuracy of the warning messages generated by the portal (recommendations 5, 6, and 7).

Regarding recommendation 14, FHFA stated it plans to continue working with the Enterprises as they develop and implement the portal, and will provide a status report on activities related to implementation of the portal in accordance with the directive.

OIG considers FHFA's response to be sufficient to resolve the recommendations, which will remain open until OIG determines that the agreed upon corrective actions are completed and responsive to the recommendations.

OIG has attached FHFA's full response (see Appendix A), which was considered in finalizing this report. Appendix C provides a summary of management's comments on the recommendations and the status of agreed-to corrective actions.

APPENDIX C.....

Summary of FHFA's Comments on the Recommendations

This table presents management's response to the recommendations in OIG's report and the status of the recommendations as of when the report was issued.

Rec. No.	Corrective Action: Taken or Planned	Expected Completion Date	Monetary Benefits	Resolved[a] Yes or No	Open or Closed[b]
1	FHFA agrees with this recommendation and will ensure that Fannie Mae takes action to determine which of the 25 proprietary messages should be changed to manual override or fatal and implement the changes. Fannie Mae has already begun to identify the messages that are clearly tied to underwriting and eligibility requirements that do not yield a significant number of false positives, with plans to change the messaging to manual override. Evidence to close this recommendation will consist of documentation of message changes in the portal, along with the logic for selection of the messages.	1/31/15	$0	Yes	Open
2 through 4	FHFA agrees with these recommendations and will follow up with Freddie Mac to assure it completes and implements its Appraisal Data Validation Service (ADVS) Plan, which includes development and implementation of proprietary messages related to property underwriting requirements. As OIG notes in the report, the existing nine proprietary messages will be revised and reactivated later in 2014. They, along with other potential	1/31/15	$0	Yes	Open

Rec. No.	Corrective Action: Taken or Planned	Expected Completion Date	Monetary Benefits	Resolved[a] Yes or No	Open or Closed[b]
	messages, will be considered as part of the ADVS Plan. Evidence to close this recommendation will consist of documentation of implementation of messages developed and selected for manual override or fatal.				
8	FHFA agrees with this recommendation and will ensure that both Enterprises seek appropriate remedies for the loans delivered by the two suspended appraisers. Evidence to close this recommendation will be documentation of Enterprise actions and outcomes related to the loans.	1/31/15	$0	Yes	Open
9 through 11	FHFA agrees with these recommendations and will require Freddie Mac to provide a copy of internal control policy and related procedures regarding follow-up on license status messages, review loans that generated messages related to the appraiser's license status, and use the results of the review to seek remedies for loans containing appraisals performed by unlicensed appraisers, as appropriate. Evidence to close this recommendation will consist of a copy of Freddie Mac's internal control procedures, evidence of loan reviews, and any resulting actions.	1/31/15	$0	Yes	Open
5 through 7, 12, and 13	FHFA agrees with recommendations 12 and 13, and will continue to work with the Appraisal Subcommittee in pursuit of enhancements to the National Registry of Appraisers to include retention of historical status	1/31/15	$0	Yes	Open

Rec. No.	Corrective Action: Taken or Planned	Expected Completion Date	Monetary Benefits	Resolved[a] Yes or No	Open or Closed[b]
	records and real-time reporting of appraiser license status. While some progress has been made toward real-time reporting, there is not yet sufficient reliable information for the Enterprises to modify the portal to perform recommendations 5, 6, and 7. FHFA agrees that once the National Registry achieves retention of historical license status information and real-time reporting, the Enterprises will pursue modifying the portal to address these issues. FHFA will continue the dialogue in support of these changes with the ASC. Evidence to close these recommendations will be a written communication to the Appraisal Subcommittee encouraging them to pursue retention of historical appraiser status records and updating the National Registry on a real-time basis.				
14	FHFA agrees with this recommendation and will continue to work with the Enterprises as they develop and implement the portal. Because this is a multiyear project, FHFA will provide a status report on activities related to implementation as evidence to close this recommendation.	1/31/15	$0	Yes	Open

[a] Resolved means: (1) Management concurs with the recommendation, and the planned, ongoing, and completed corrective action is consistent with the recommendation; (2) Management does not concur with the recommendation, but alternative action meets the intent of the recommendation; or (3) Management agrees to the OIG monetary benefits, a different amount, or no amount ($0). Monetary benefits are considered resolved as long as management provides an amount.

[b] Once OIG determines that the agreed upon corrective actions have been completed and are responsive, the recommendations can be closed.

APPENDIX D .....

Fannie Mae's 25 Proprietary Messages Related to Underwriting Requirements[14]

Message	Description of the Underwriting Requirement
The sales contract was not analyzed.	Unacceptable Appraisal Practices: Failure to adequately analyze and report any current contract of sale, option, offering, or listing of the subject property and the prior sales of the subject property and the comparable sales.
There was no comment on market conditions, even though one or more negative housing trends were indicated (declining, over supply, over six months).	The appraiser must provide his/her conclusions for the reasons a market is experiencing declining property values, an over-supply of properties, or marketing times over six months.
Less than three settled sales were used as comparables.	A minimum of three comparable sales must be reported as part of the sales comparison approach to value.
Residential Property: Research of prior sale was not performed.	The Uniform Standards of Professional Appraisal Practice (USPAP) requires appraisers to report a minimum three-year prior sales history for the subject property. The appraiser must comply with the minimum requirements of USPAP.
Condominium Unit: Research of prior sale was not performed.	The USPAP requires appraisers to report a minimum three-year prior sales history for the subject property. The appraiser must comply with the minimum requirements of USPAP.
Concession adjustment for comparable property is greater than zero. Fannie Mae policy does not permit positive sales or financing concession adjustments.	Positive adjustments for sales or financing concessions are not acceptable.
Indicated value by sales comparison approach is not contained within the range of adjusted comparable property values.	The lender is responsible for ensuring that the appraiser uses sound reasoning and provides evidence to support the methodology used for developing the value opinion.
Residential Property: Final estimated value is outside the bounds of the approaches to value used in the appraisal.	In the final reconciliation, appraisers must reconcile the reasonableness and reliability of each applicable approach to value.
Condominium Unit: Final estimated value is outside the bounds of the approaches to value used in the appraisal.	In the final reconciliation, appraisers must reconcile the reasonableness and reliability of each applicable approach to value.

[14] *Uniform Collateral Data Portal User Guide for Fannie Mae Messaging*, accessed publicly on November 27, 2013, at https://www.google.com/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&ved=0CCkQFjAA&url=https%3A%2F%2Fwww.fanniemae.com%2Fcontent%2Fuser_guide%2Fucdp-user-guide-fannie-mae-messaging.pdf&ei=A1yWUt-GHdPQkQeQ54CoBQ&usg=AFQjCNFalldaHLOkKwvLtEfBBZW8grWKjg&bvm=bv.57155469,d.eW0.

Message	Description of the Underwriting Requirement
State certification is not provided on transaction amount over $1 million.	Lenders must use appraisers who: are state-licensed or state-certified in accordance with the provisions of Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).
Appraiser license state does not match subject property state.	Lenders must use appraisers who: are state-licensed or state-certified in accordance with the provisions of Title XI of FIRREA.
Supervisor license state does not match subject property state.	Lenders must use appraisers who: are state-licensed or state-certified in accordance with the provisions of Title XI of FIRREA.
Seller is not indicated as owner of public record.	Lenders must confirm and document in the mortgage file that the property seller in a purchase money transaction or the borrower in a refinance transaction is the owner of the subject property when a new appraisal is required.
Residential Property: Illegal zoning compliance has been indicated in appraisal. Review description to verify if the property may be eligible per the selling guide.	Fannie Mae does not purchase or securitize mortgage loans on properties if the improvements do not constitute a legally permissible use of the land.
Condominium Unit: Illegal zoning compliance has been indicated in appraisal. Review description to verify if the property may be eligible per the selling guide.	Fannie Mae does not purchase or securitize mortgage loans on properties if the improvements do not constitute a legally permissible use of the land.
Residential Property: Present use is indicated as not highest and best use.	If the current improvements clearly do not represent the highest and best use of the site as an improved site, the appraiser must so indicate on the appraisal report. Fannie Mae will not purchase or securitize a mortgage that does not represent the highest and best use of the site.
Condominium Unit: Present use is indicated as not highest and best use.	If the current improvements clearly do not represent the highest and best use of the site as an improved site, the appraiser must so indicate on the appraisal report. Fannie Mae will not purchase or securitize a mortgage that does not represent the highest and best use of the site.
At least one of the “subject to” boxes is checked. The lender must obtain a certificate of completion, stating the nature of the “subject to” issue has been resolved before loan delivery.	A certification of completion must be obtained to verify the work was completed and must: • be completed by the appraiser, • state that the improvements were completed in accordance with the requirements and conditions in the original appraisal report, and • be accompanied by photographs of the completed improvements.
The subject property may be a hotel/motel or condotel.	Ineligible Project Types: Projects that are managed and operated as a hotel or motel, even though the units are individually owned.

Message	Description of the Underwriting Requirement
The subject property is in a condominium project that may be ineligible for delivery to Fannie Mae.	Ineligible Project Types: Fannie Mae will not purchase or securitize mortgages that are secured by units in certain types of planned unit development (PUD), condos, or co-op projects, regardless of the characteristics of the unit mortgage.
The developer/builder is in control of the HOA. Determine the project review type. Fannie Mae eligibility requires a full project review on properties that are not established, except for detached subject properties on which a limited project review is permitted.	New project: • fewer than 90% of the total units in the project have been conveyed to the unit purchasers; • the project is not fully completed, such as proposed construction, new construction, or the proposed or incomplete conversion of an existing building to a condo; • the project is newly converted; or • the project is subject to additional phasing or annexation.
A single entity owns more than 10% of the project units. Projects where a single entity (other than the developer during the initial marketing period) owns more than 10% of the total units are ineligible under Fannie Mae policy.	Ineligible Project Types: Projects where a single entity (the same individual, investor group, partnership, or corporation) owns more than 10% of the total units in the project.
Some part of the condominium project has not been completed (including planned rehabilitation). Confirm that the project, or subject legal phase, meets the applicable completion standard as described in the Fannie Mae Selling Guide.	The project, or the subject legal phase, must be “substantially complete.” This means that: • a certificate of occupancy or other substantially similar document has been issued by the applicable governmental agency for the project or subject phase; and, • all the units in the building in which the unit securing the mortgage is located are complete, subject to the installation of buyer selection items, such as appliances.
More than 20% of the overall space in the project is commercial use. Property is ineligible for delivery per the selling guide.	No more than 20% of the total square footage of the project can be used for commercial purposes.
Comparable property may be a hotel/motel or condotel.	The following are examples of unacceptable appraisal practice: selection and use of inappropriate comparable sales.

APPENDIX E

Freddie Mac's Nine Proprietary Messages Related to its Automated Valuation Model[15]

As part of these analyses, OIG classified Freddie Mac's proprietary messages related to its automated valuation model, Home Value Explorer (HVE), into two categories:

1. Unable to Provide HVE Feedback – five of the nine messages indicate Freddie Mac's HVE tool cannot provide an estimated value of the property that can be used to determine the accuracy of the appraisal. Specifically, these five messages and descriptions are:

    - **HVE is currently unavailable**. This message indicates "the HVE model cannot be accessed at this time." The lender should try resubmitting the appraisal at a later time.
    - **HVE value not available.** This message indicates an appraisal form, other than one of the acceptable uniform appraisal dataset forms, was submitted. **The message states "this appraisal form cannot be submitted to HVE**."
    - **HVE value not available. An invalid appraised value cannot be submitted to HVE.** This message indicates that the market value of the subject property from the reconciliation section of the appraisal report is not a valid number. For example, the value is less than or equal to zero or was not included.
    - **Unable to return the HVE point value for property address.** This message indicates that HVE is unable to provide a valuation for the submitted property address. For example, the property may be a newly constructed home and information on the property is not yet available to HVE, or the property may be located in an area where HVE does not have enough data to generate a value.
    - **HVE value not available. The subject address cannot be validated in HVE.** This message indicates that the submitted property address could not be verified by HVE.

2. HVE Feedback Provided – The remaining four messages relate to Freddie Mac's estimated value of the property to determine the accuracy of the appraisal. The

[15] Freddie Mac's *Uniform Collateral Data Portal Proprietary Valuation Messages*, accessed publicly on November 27, 2013, at http://www.google.com/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=2&cad=rja&ved=0CC8QFjAB&url=http%3A%2F%2Fwww.freddiemac.com%2Flearn%2Fpdfs%2Fuw%2FUCDP_Prop_Results.pdf&ei=2l2WUom6OsyNkAf43IEw&usg=AFQjCNFBCBdHHD5xIB5JGs-K7MNH0tFD7w.

first message, which indicates if the estimated value of the property may be excessive, is generated based on the results of the remaining three messages. Specifically, these four messages are:

- **Review for Accuracy: The estimated value of property for this transaction may be excessive for the local market. The appraisal should be carefully reviewed for this transaction.** The message is referred to as the "Excessive Value Message" and indicates an increased probability that the appraised value may be inflated. Depending on the results of the following three messages, the excessive value message will be generated:
    - **HVE point value estimate for property address. The HVE point value estimate returned does not indicate Freddie Mac's acceptance of the appraised value entered for the subject property. The lender will continue to be responsible for the property appraisal, as well as representation and warranties of the appraisal, regardless of the HVE market value.** This message indicates an estimate of value based on a Freddie Mac statistical model that assumes average marketability and condition for the property.
    - **The percentage difference between the estimated/appraised value and the HVE point value estimate of the subject property.** This message indicates the calculation result of the percentage difference between the appraised value and the HVE Point Value Estimate.
    - **The HVE confidence level of the HVE point value estimate of the subject property the HVE forecast standard deviation of the HVE point value estimate of the subject property.** This message indicates the confidence level which is summarized within High, Medium, and Low value ranges.

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