

Federal Housing Finance Agency
Office of Inspector General



FHFA Did Not Document Reviews of Desktop Appraisal Reports

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Executive Summary

The Federal Housing Finance Agency (FHFA) continues to modernize its appraisal-related policies, practices, and processes to ensure the safe and sound operations of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (together, the Enterprises). As part of this effort, FHFA explored various property valuation solutions, including desktop appraisals where appraisers assess properties without physically inspecting the property. According to FHFA, the purpose of desktop appraisals is to support appraisal modernization, promote the health and safety of appraisers and borrowers, reduce potential costs for borrowers, and address appraiser capacity concerns. FHFA reported that modernizing the appraisal process can create a more streamlined and accurate property valuation process.

Between March 2020 and May 2021, FHFA directed the Enterprises to introduce temporary appraisal flexibilities, including desktop appraisals, to help minimize market disruptions and ensure access to credit in response to the challenges presented by the Coronavirus Disease 2019 public health emergency. On October 18, 2021, FHFA announced plans to restore desktop appraisal flexibility for certain new purchase loans, thereby aiming to overcome barriers to affordable and sustainable homeownership and to reduce inefficiencies in the mortgage process. In December 2021, FHFA approved the Enterprises' use of desktop appraisals, and in March 2022, Fannie Mae included desktop appraisal requirements in its Selling Guide while Freddie Mac included similar requirements in its Seller/Servicer Guide. The Enterprises' Selling and Seller/Servicer Guides specify the underwriting standards, eligibility guidelines, and policies and procedures related to sales of mortgages to the Enterprises. Starting in July 2022, FHFA required the Enterprises to submit quarterly desktop appraisal reports.

FHFA's Office of Housing and Regulatory Policy (OHRP), within the Division of Housing Mission and Goals (DHMG), oversees the Enterprises' policies and certain policy development and implementation activities, such as desktop appraisals. The OHRP Review Process is a document that outlines specific procedures for its oversight of certain Enterprise reports.

We performed this audit to assess FHFA's oversight of the Enterprises' use of desktop appraisals from October 18, 2021, through March 31, 2023.

We found that OHRP did not document reviews of the desktop appraisal reports in accordance with internal control standards. According to OHRP officials, Policy Analysts review quarterly desktop appraisal reports to assess for immediate concerns or need for policy changes, but results are not



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documented. An OHRP official further explained that a formal review process for desktop appraisal reports has not been implemented and documented in part due to low volume. According to the Enterprises' data, desktop appraisals represent less than one percent of the Enterprises' total loan volume. Additionally, OHRP is developing a dashboard that will include desktop appraisal reports. Once implemented, OHRP's reviews of the dashboard – including review of the desktop appraisal reports reflected therein – will be documented in accordance with an updated version of the OHRP Review Process document. Until the dashboard is deployed, OHRP does not have an interim plan to document results of all the desktop appraisal report reviews. Without such documentation, OHRP management may be challenged in identifying trends, concerns, or emerging issues related to desktop appraisals that could affect the Enterprises' safety and soundness.

We made two recommendations in this report to address our finding. In a written management response, FHFA agreed with our recommendations.

This report was prepared by Andrea Smith, Audit Director; Pamela L. Williams, Audit Manager; Christopher Mattocks, Auditor-in-Charge; Eleanor Kang, Auditor; and Michael Schumann, Auditor; with assistance from Abdil Salah, Assistant Inspector General for Audits. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.

This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfaog.gov, and www.oversight.gov.

James Hodge, Deputy Inspector General for Audits /s/

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ABBREVIATIONS

DHMG	Division of Housing Mission and Goals
Enterprises	Fannie Mae and Freddie Mac
Fannie Mae	Federal National Mortgage Association
FHFA	Federal Housing Finance Agency
Freddie Mac	Federal Home Loan Mortgage Corporation
OHRP	Office of Housing and Regulatory Policy

BACKGROUND.....

FHFA Made Appraisal Modernization a Priority for the Enterprises

FHFA continues to modernize its appraisal-related policies, practices, and processes to ensure the safe and sound operation of the Enterprises. FHFA reported that modernizing the appraisal process can create a more streamlined and accurate property valuation process.

FHFA’s appraisal modernization involves exploring the risks and benefits of a range of property valuation solutions, including desktop appraisals. This exploration includes seeking opportunities to improve the tools available to appraisers, as well as the appraisal process itself.

The appraisal modernization initiative is comprised of five property valuation solutions:

- Traditional appraisal – An appraiser inspects the property to estimate the market value based on observation, research, and market analysis.
- Desktop appraisal – An appraiser performs an appraisal without physically inspecting the property, using data from various sources, including tax records and multiple listing service information.
- Hybrid appraisal – An appraiser performs a desktop appraisal using key data points collected during a property inspection completed by a third-party, such as a home inspector, real estate agent, or appraiser trainee.
- Appraisal waiver plus property inspection – A lender is allowed to sell a loan to the Enterprises without an appraisal, contingent on the lender delivering property data collected by a trained and vetted third-party, such as a real estate agent or appraiser.
- Appraisal waiver – The lender and borrower forgo the requirement of an appraisal. Instead, the Enterprises assess the value of the house using automated processes.

FHFA issues annual Scorecards to the Enterprises communicating its priorities and expectations for the Enterprises and to provide transparency to the public.¹ In its 2018 Scorecard, FHFA requested that the Enterprises research, assess, and begin planning for modernizing the appraisal process. FHFA’s 2022 Scorecard directed the Enterprises to modernize the appraisal process, thereby fostering efficiency in the mortgage markets and addressing barriers to equitable valuation. Similarly, FHFA’s 2023 Scorecard instructs the

¹ Scorecards are on a calendar year basis.

Enterprises to “Promote Equitable Access to Affordable and Sustainable Housing” by implementing strategies that improve the efficiency of single-family home² appraisal processes and practices.

Desktop Appraisals Became Permanent in the Enterprises’ Selling and Seller/Servicer Guides

In addition to supporting FHFA’s appraisal modernization, officials reported that the incorporation of desktop appraisals promotes the health and safety of appraisers and borrowers, reduces potential costs for borrowers, and addresses appraiser capacity concerns. In March 2020, FHFA directed the Enterprises to introduce temporary appraisal flexibilities to help minimize market disruptions and ensure access to credit in response to the challenges presented by the Coronavirus Disease 2019 public health emergency. One flexibility was the use of desktop appraisals to accommodate social distancing guidelines. In May 2021, FHFA discontinued the use of desktop appraisals.

Between March 2020 and May 2021, when desktop appraisals were utilized, the Enterprises gained valuable insights for events that restrict property access. As a result, FHFA collaborated with the Enterprises to permanently integrate desktop appraisals into their policies. In October 2021, FHFA announced that the Enterprises would permanently incorporate desktop appraisals into their Selling and Seller/Servicer Guides, which specify the underwriting standards, eligibility guidelines, and policies and procedures related to sales of mortgages to the Enterprises.

In December 2021, FHFA approved the Enterprises’ incorporation of desktop appraisals into their Selling and Seller/Servicer Guides. In March 2022, Fannie Mae updated its Selling Guide while Freddie Mac updated its Seller/Servicer Guide to include desktop appraisals for one-unit properties with a loan-to-value ratio³ of 90 percent or lower, with exceptions.⁴ To comply with FHFA’s requirements, the Enterprises began submitting quarterly desktop appraisal reports from July 2022 onwards. Reports contain key performance metrics, such

² According to Fannie Mae, a single-family home is a property that provides one to four residential units.

³ The loan-to-value ratio is the relationship between the original loan amount of the first mortgage and the property’s appraised value (or sales price if it is lower). Freddie Mac calculates the loan-to-value ratio for desktop appraisals only using the sale price. Fannie Mae calculates the loan-to-value ratio for desktop appraisals using the lower of the appraised value or sales price.

⁴ Freddie Mac will accept mortgages originated with a desktop appraisal with a loan-to-value ratio higher than 90 percent as calculated using the value obtained from the desktop appraisal if the loan amount does not increase and all other eligibility requirements continue to be met. Loan-to-value ratios greater than 90 percent that occur as a result of loan amount increases require an upgrade to an interior and exterior inspection appraisal.

as loan volume and results of quality control reviews, and are used by FHFA to evaluate the effectiveness of the Enterprises’ policies and to make adjustments, as necessary.

The OHRP Review Process Document Governs OHRP’s Report Reviews

OHRP oversees the Enterprises’ policies, including certain policy development and implementation activities, such as those related to desktop appraisals. This oversight includes reviewing certain Enterprise reports. The guidance that governs certain reviews is set out in the OHRP Review Process, and includes the following:

- The Policy Analyst reviews the Enterprises’ reports periodically. The Policy Analyst prepares a summary analysis highlighting trends and any concerns. They may request additional information, discuss observations with the Enterprises, or raise emerging or risk issues to management. The OHRP Team Manager, or designee, reviews the summary analysis for concurrence or returns the document to the Policy Analyst for additional analysis or revision. Once the OHRP Team Manager concurs, the summary analysis is presented to OHRP management for discussion.
- The Policy Analyst presents the summary analysis to the OHRP Senior Associate Director, or designee, during an OHRP management discussion, typically within 45 days of receipt of complete information or resolution of open questions or requests. The OHRP Senior Associate Director, or designee, may share the summary analysis with the Deputy Director, DHMG. The OHRP Senior Associate Director, or designee, reviews and concurs on resolution and then it is ready to close.

The OHRP Monitoring and Surveillance List identifies reports for review. The list includes key details such as report name, description, and submission frequency. Although desktop appraisals are not part of the list, as a matter of practice, the OHRP Policy Analysts review desktop appraisal reports.

FACTS AND ANALYSIS

OHRP Did Not Document Reviews of Desktop Appraisal Reports

Since July 2022, the Enterprises have been submitting quarterly desktop appraisal reports. We reviewed the July 2022 through March 2023 quarterly reports and relevant documentation to assess FHFA’s oversight of desktop appraisals.

We found that OHRP Policy Analysts did not document their reviews in accordance with internal control standards. According to the Government Accountability Office’s *Standards*

for Internal Control in the Federal Government, management should implement control activities through policies, and documentation is a necessary part of an effective internal control system.⁵

OHRP officials informed us that Policy Analysts review the quarterly reports to assess for immediate concerns or need for policy changes and results of these reviews are discussed with the Enterprises. When we requested records of reviews and discussions with the Enterprises to support compliance with the OHRP Review Process, an OHRP official told us there was no documentation.

OHRP officials stated that desktop appraisal reports do not appear on the OHRP Monitoring and Surveillance List in part due to desktop appraisals representing less than one percent of the Enterprises' total loan volume; therefore, the OHRP Review Process document does not currently apply. Officials stated that they intend to include desktop appraisal reports on the Monitoring and Surveillance List in the future.

We were also told that OHRP is developing a property valuation dashboard using FHFA's Mortgage Loan Integrated System and supplemental Enterprise data, which will consolidate property valuation data, including desktop appraisals. Once implemented, OHRP plans to document reviews of the dashboard in accordance with the updated version of the OHRP Review Process document. OHRP anticipates that the dashboard will be available by September 30, 2023. When we inquired about the project management plan, including a timeline for deployment of the dashboard,⁶ an OHRP official informed us that one was not developed due to the limited scope of the effort.

OHRP officials acknowledged the importance of documenting the results of desktop appraisal reports as part of future dashboard reviews. While they intend to include the reports on the OHRP Monitoring and Surveillance List, there is no interim plan to document all review results. Without documenting its reviews of the quarterly desktop appraisal reports, OHRP management may face challenges in assessing the effectiveness of policy objectives, and may not identify trends, concerns, or emerging issues related to desktop appraisals that could affect the Enterprises' safety and soundness.

⁵ Government Accountability Office, *Standards for Internal Control in the Federal Government*, GAO-14-704G (September 10, 2014).

⁶ According to the Project Management Institute's *A Guide to the Project Management Body of Knowledge*, an industry standard, the key benefit of a project management plan is it defines how the project will be planned, executed, monitored, controlled, and closed.

FINDING

OHRP did not document reviews of desktop appraisal reports.

CONCLUSIONS

The Enterprises incorporated desktop appraisals into their Selling and Seller/Service Guides and submitted the required quarterly reports to FHFA containing key performance metrics. We found that OHRP did not document reviews of desktop appraisal reports in accordance with internal control standards. OHRP officials stated that reviews will be documented as part of the reviews of the property valuation dashboard, once implemented, but they do not have an interim plan to document all desktop appraisal reviews. While we acknowledge the current *de minimis* volume of desktop appraisals, OHRP management may nevertheless be challenged in assessing the effectiveness of desktop appraisals without documenting its reviews.

RECOMMENDATIONS

We recommend that the Senior Associate Director, OHRP:

1. Require OHRP staff to document reviews of quarterly desktop appraisal reports in accordance with internal control standards and OHRP internal guidance.
2. Immediately place desktop appraisal report reviews on the OHRP Monitoring and Surveillance List.

FHFA COMMENTS AND OIG RESPONSE.....

We provided FHFA management an opportunity to respond to a draft of this audit report. FHFA management provided technical comments on the draft report and those comments were considered in finalizing this report. FHFA management also provided a written response, which we included as an Appendix to this report. In its management response, FHFA agreed with our recommendations and included the following planned corrective actions:

1. FHFA will augment its existing review of the Enterprises' management reports on desktop appraisals by documenting the Agency's review, including any findings, in the quarterly monitoring and surveillance reporting cycle by June 30, 2024.
2. FHFA has added desktop appraisal reports to OHRP's Monitoring and Surveillance List.

We consider FHFA's planned corrective actions responsive to our recommendations.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our audit objective was to assess FHFA’s oversight of the Enterprises’ use of desktop appraisals. The scope of this audit covered OHRP’s oversight activities related to the Enterprises’ use of desktop appraisals and relevant internal controls from October 18, 2021, through March 31, 2023.

To accomplish our objective, we performed the following procedures:

- Reviewed the following documentation related to FHFA’s actions, objectives, and plans to expand the use of desktop appraisals:
 - FHFA, News Release: FHFA Announces Two Measures Advancing Housing Sustainability and Affordability (October 18, 2021);
 - FHFA, 2018 Scorecard for Fannie Mae, Freddie Mac, and Common Securitization Solutions (December 21, 2017); 2022 Scorecard for Fannie Mae, Freddie Mac, and Common Securitization Solutions (November 17, 2021); and 2023 Scorecard for Fannie Mae, Freddie Mac, and Common Securitization Solutions (January 4, 2023);
 - Interagency Task Force on Property Appraisal and Valuation Equity, Action Plan to Advance Property Appraisal and Valuation Equity: Closing the Racial Wealth Gap by Addressing Mis-valuations for Families and Communities of Color (March 23, 2022); and
 - FHFA, Strategic Plan Fiscal Years 2022-2026 (April 14, 2022).
- Reviewed the Government Accountability Office’s *Standards for Internal Control in the Federal Government* (GAO-14-704G; September 10, 2014), and determined that the control activities component was significant to our objective, focusing on the underlying principles that management should: (1) design control activities to achieve objectives and respond to risks and (2) implement control activities through policies.
- Reviewed the Project Management Institute’s *A Guide to the Project Management Body of Knowledge*, sixth edition, for project management industry standards.
- Interviewed FHFA officials, including the Senior Associate Director, DHMG OHRP; Associate Director, Single-Family Origination Branch, DHMG OHRP; Associate Director, Office of Fair Lending Oversight; then-Deputy Director, Division of Enterprise Regulation; Supervisory Conservatorship Specialist, Division of

Conservatorship Oversight and Readiness; and other FHFA personnel to gain an understanding of the following:

- FHFA’s oversight activities, including the OHRP reviews, related to the Enterprises’ use of desktop appraisals; and
- Whether FHFA developed performance measures or implemented a tracking mechanism for its stated objectives for the Enterprises’ use of desktop appraisals.
- Interviewed Enterprise officials to gain an understanding of the use of desktop appraisals in the home buying process and their oversight activities. The Enterprise officials interviewed are responsible for risk management and included the following:
 - Fannie Mae: Senior Director Risk Management, Single-Family Collateral Risk; Director, Loan Quality Compliance, Single-Family Risk; Director, Risk Management, Enterprise Single-Family Risk; Director, Internal Audit, Single-Family; and other risk management personnel; and
 - Freddie Mac: Senior Director, Collateral Risk Policy; Director, Collateral Risk Policy; Senior Director, Information Technology Internal Audit; and other risk management personnel.
- Reviewed the following FHFA and Enterprise policies, procedures, and guidance relevant to desktop appraisals:
 - FHFA, OHRP Review Process (November 18, 2021);
 - Fannie Mae, Selling Guide (versions dated February 2, 2022; April 6, 2022; December 14, 2022; and March 1, 2023); and
 - Freddie Mac, Single-Family Seller/Servicer Guide (versions dated December 15, 2021; March 17, 2022; June 24, 2022; September 21, 2022; December 14, 2022; and March 29, 2023).
- Assessed the OHRP Review Process document to determine whether it was consistent with the Government Accountability Office’s *Standards for Internal Control in the Federal Government* (GAO-14-704G; September 10, 2014).
- Reviewed documentation related to FHFA’s approval to permanently add desktop appraisals in the Enterprises’ Selling and Seller/Servicer Guides, including:

- Conservatorship Committee meeting materials related to the Enterprises' submissions for approval of their desktop appraisal policies (December 13, 2021); and
- Email communications to the Enterprises documenting the conservator decision to approve the use of desktop appraisals for certain loans up to 90 percent loan-to-value (December 17, 2021, and January 25, 2022).
- Reviewed the Enterprises' quarterly desktop appraisal reports submitted from July 2022 through March 2023.

We conducted this performance audit in Washington, D.C., from February 2023 to October 2023 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX: FHFA MANAGEMENT RESPONSE.....

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Federal Housing Finance Agency

MEMORANDUM

TO: James Hodge, Deputy Inspector General for Audits

FROM: Naa Awaa Tagoe, Deputy Director, Division of Housing Mission and Goals

SUBJECT: Draft Audit Report: *FHFA Did Not Document Reviews of Desktop Appraisal Reports*

DATE: October 5, 2023

NAA AWAA TAGOE
Digitally signed by
NAA AWAA TAGOE
Date: 2023.10.05
12:16:41 -0400

Thank you for the opportunity to respond to the Office of Inspector General's (OIG) draft report. The objective of OIG's audit review was to assess FHFA's oversight of the Enterprises' use of desktop appraisals. The audit found that the Enterprises incorporated desktop appraisals into their Selling and Seller/Service Guides and submitted the required quarterly reports. OIG identified weakness in the Agency's documentation of the review of reports, which are addressed in the following recommendations.

The OIG report acknowledges that there is only a *de minimis* volume of current desktop appraisals and that desktop appraisals are not currently on the Office of Housing and Regulatory Policy's (OHRP) Monitoring and Surveillance List. As FHFA's appraisal modernization efforts remain an important priority, OHRP is working towards a more comprehensive appraisal modernization monitoring and surveillance report, encompassing all collateral solutions, instead of the current report that is focused on appraisal waivers. In the interim, OHRP will begin documenting its reviews of the Enterprises' management reports of desktop appraisals.

Recommendation 1: *Require OHRP staff to document reviews of quarterly desktop appraisal reports in accordance with internal control standards and OHRP internal guidance.*

Management Response for Recommendation 1: FHFA agrees with the recommendation. Because desktop appraisals were not on OHRP's Monitoring and Surveillance List, OHRP was operating consistent with established processes. However, FHFA will augment its existing review of the Enterprises' management reports on desktop appraisals by documenting the Agency's review, including any findings, in the quarterly monitoring and surveillance reporting cycle by June 30, 2024.

Recommendation 2: *Immediately place desktop appraisal report reviews on the OHRP Monitoring and Surveillance List.*

Management Response for Recommendation 2: FHFA agrees with the recommendation. FHFA has added desktop appraisal reports to OHRP's Monitoring and Surveillance List.

cc: Maria Fernandez
Edom Aweke
John Major

ADDITIONAL INFORMATION AND COPIES.....

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