



United States Department of Agriculture

Single Family Housing Guaranteed Loan Program Appraisals



Audit 04601-0001-41

June 2020

OFFICE OF INSPECTOR GENERAL

IMPORTANT NOTICE

This audit report contains sensitive information that has been redacted for public release, due to privacy concerns.

Single Family Housing Guaranteed Loan Program Appraisals

Audit Report 04601-0001-41

OIG reviewed RHS' SFHGLP controls to determine whether it adequately ensured lenders' and appraisers' compliance with agency and USPAP requirements.

OBJECTIVE

Our objective was to determine whether RHS had adequate and effective controls in place to ensure lenders and appraisers complied with agency and USPAP requirements prior to guaranteeing a loan.

REVIEWED

We reviewed relevant laws, regulations, policies, and procedures; interviewed key personnel from the national and State offices and approved lenders; and selected and reviewed a non-statistical sample of appraisals and appraisal review documents for completeness and compliance with USPAP, RHS policy, and Federal regulations.

RECOMMENDS

We recommend that RHS develop and implement:

- (1) an oversight function for administrative appraisal reviews;
- (2) additional controls for pre-closing technical appraisal reviews;
- (3) a formal process to identify common deficiencies found during technical appraisal reviews; and
- (4) processes to communicate deficiencies found during technical appraisal reviews.

WHAT OIG FOUND

The Department of Agriculture's (USDA) Single Family Housing Guaranteed Loan Program (SFHGLP) guarantees loans made by approved lenders to eligible applicants. SFHGLP provides low- and moderate-income households with an opportunity to own decent, safe, and sanitary dwellings in eligible rural areas by guaranteeing loans issued to eligible applicants through private sector lenders. USDA's Rural Housing Service (RHS), an agency within Rural Development, administers SFHGLP through national, State, and local area offices. SFHGLP loans require no down payment and have low up-front costs. In fiscal years 2016–2018, SFHGLP provided 366,619 loan guarantees valued at over \$52.5 billion.

RHS had controls in place to assess whether appraisals met agency and Uniform Standards of Professional Appraisal Practice (USPAP) requirements prior to guaranteeing a SFHGLP loan. However, we determined that additional controls were needed to enhance the quality of appraisals the agency receives. We assessed 44 administrative appraisal reviews and found 22 (50 percent) reviews in which administrative reviewers selected inaccurate or questionable responses for appraisal reviews and/or did not complete the appropriate version of the form. Additionally, we found that RHS issued four conditional commitments for over \$814,000 in SFHGLP loan guarantees for properties that did not have SFHGLP-compliant appraisals. We also found that RHS did not effectively communicate the results of its pre-closing technical appraisal reviews and quality control reviews (QCRs) to help ensure RHS receives SFHGLP-compliant appraisal reports. As a result, RHS may continue to risk accepting appraisals that may not be suitable for the agency's use and issuing conditional commitments for those properties.

We accepted management decision on 3 of the 5 recommendations. Further action from the agency is needed before management decision can be reached on the remaining recommendations.



United States Department of Agriculture
Office of Inspector General
Washington, D.C. 20250



DATE: June 24, 2020

AUDIT
NUMBER: 04601-0001-41

TO: Bruce W. Lammers
Administrator
Rural Housing Service

ATTN: Gary Bojes
Acting Chief Risk Officer
Rural Development

FROM: Gil H. Harden
Assistant Inspector General for Audit

SUBJECT: RHS' Single Family Housing Guaranteed Loan Program Appraisals

This report presents the results of the subject review. Your written response to the official draft is included in its entirety at the end of the report. We have incorporated excerpts from your response, and the Office of Inspector General's (OIG) position, into the relevant sections of the report. Based on your written response, we are accepting management decision on Recommendations 3, 4, and 5. Please follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer (OCFO).

Based on your written response, management decision has not been reached on Recommendations 1 and 2. The information needed to reach management decision on the recommendations is set forth in the OIG Position section following the recommendations. In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective action taken or planned, and the timeframe for implementing the recommendations for which management decision has not been reached. Please note that the regulation requires management decision to be reached on all recommendations within 6 months from report issuance, and final action to be taken within 1 year of each management decision to prevent being listed in the Department's annual Agency Financial Report. For agencies other than the Office of the Chief Financial Officer (OCFO), please follow your internal agency procedures in forwarding final action correspondence to OCFO.

We appreciate the courtesies and cooperation extended to us by members of your staff during our audit fieldwork and subsequent discussions. This report contains publicly available information and will be posted in its entirety to our website (<http://www.usda.gov/oig>) in the near future.

Table of Contents

Background and Objectives.....	1
Section 1: SFHGLP—Administrative Appraisal Reviews	5
Finding 1: RHS Needs an Oversight Function Over its Administrative Appraisal Review Process.....	5
Recommendation 1.....	7
Section 2: SFHGLP—Technical Appraisal Reviews	8
Finding 2: RHS Needs to Strengthen Controls Over its Pre-Closing Technical Appraisal Review Process.....	8
Recommendation 2.....	10
Finding 3: RHS Needs to Effectively Communicate its Technical Appraisal Review Results.....	11
Recommendation 3.....	13
Recommendation 4.....	13
Recommendation 5.....	14
Scope and Methodology.....	15
Abbreviations	18
Exhibit A: Summary of Monetary Results.....	19
Exhibit B: Audit Sites Visited.....	20
Agency’s Response.....	21

Background and Objectives

Background

The Department of Agriculture's (USDA) Rural Development helps improve the economy and quality of life in rural America by providing various financial programs. The Housing Act of 1949, as amended, authorizes USDA to guarantee loans made by approved lenders to eligible applicants through the Single Family Housing Guaranteed Loan Program (SFHGLP).¹ SFHGLP provides low- and moderate-income households with an opportunity to own decent, safe, and sanitary dwellings in eligible rural areas by guaranteeing loans issued to eligible applicants by agency-approved private sector lenders. These loans require no down payment and have low up-front costs. The program provides a 90 percent loan note guarantee to approved lenders in order to reduce the risk to lenders of extending 100 percent loans to eligible rural homebuyers. SFHGLP loan guarantees are available for new loans and refinancing existing loans. Eligible applicants may build, rehabilitate, improve, or relocate a dwelling in an eligible rural area.

SFHGLP has grown from a commitment authority of approximately \$3 billion in 2007 to \$24 billion in 2018. SFHGLP provided 366,619 loan guarantees valued at over \$52.5 billion in fiscal years (FYs) 2016–2018. The Rural Housing Service (RHS), an agency within Rural Development, administers SFHGLP through its national office in Washington, D.C., and its network of State and area offices. To qualify for a loan guarantee, approved lenders must ensure that each borrower is income-eligible and has the ability to repay the loan.² Lenders are also responsible for acquiring property appraisals as well as originating, underwriting, servicing, and liquidating the loans. RHS staff are responsible for reviewing loan applications, including property appraisals, to verify that the proposed loan guarantees made to lenders for eligible borrowers meet agency requirements.

Approved lenders must ensure appraisals are completed by a qualified and competent appraiser that is independent, objective, and licensed or certified, as appropriate, in the State in which the property is located.³ In addition, lenders are responsible for examining all appraisals for integrity, accuracy, and thoroughness, prior to submission of a complete loan application package to RHS.⁴ A high quality appraisal that is completed by a qualified, independent, and objective appraiser is key to ensuring adequate security for the proposed loan. The appraiser must complete appraisals that comply with the current edition of the Uniform Standards of Professional Appraisal Practice (USPAP), including its reporting requirements, to the agency.⁵

¹ Section 502(h) of Housing Act of 1949, Pub. L. No. 81-171, 63 Stat., as amended by the Cranston-Gonzalez National Affordable Housing Act, Pub. L. No. 101-625, 104 Stat. 4085.

² At the time of loan approval, the household's adjusted income must not exceed the applicable moderate income limit, which is the greater of: (1) 115 percent of the U.S median family income; (2) the average of the State-wide and State non-metro median family income; or (3) 115/80ths of the area low-income limit adjusted for household size for the county or Metropolitan Statistical Area (MSA) where the property is, or will be, located.

³ USDA-Rural Development, *HB-1-3555 SFH Guaranteed Loan Program Technical Handbook*, § 12.5, "Residential Appraisal Reports" (March 2016).

⁴ USDA-Rural Development, *HB-1-3555 SFH Guaranteed Loan Program Technical Handbook*, § 12.5, "Residential Appraisal Reports" (March 2016).

⁵ *Ibid.*

The purpose of USPAP is to promote and maintain a high level of public trust in appraisal practices by establishing requirements for appraisers to follow. USPAP contains a set of standards related to appraisal development, reporting, and review.⁶

To assess whether RHS receives acceptable appraisals from approved lenders, the agency conducts administrative appraisal reviews and, if warranted, technical appraisal reviews. These internal control methods assist RHS with verifying the acceptability and credibility of the property's appraisal.

Administrative Appraisal Reviews

RHS performs an administrative appraisal review on all submitted appraisals prior to the issuance of a conditional commitment to the lender.⁷ RHS administrative appraisal reviews are conducted by in-house RHS staff ("administrative reviewers"). Administrative reviewers document their opinions and conclusions for each submitted appraisal via Rural Development 1922-15 form entitled *Administrative Appraisal Review*. An administrative reviewer determines if there are inconsistencies in the appraisal report that need to be addressed or if a technical appraisal review should be completed. If there is a deficiency with regard to an appraisal, the administrative reviewer is required to communicate the deficiency to the lender. These deficiencies should include any item that may affect loan security, value conclusions, or unacceptable property conditions.⁸

Technical Appraisal Reviews

RHS conducts two types of technical appraisal reviews: pre-closing technical appraisal reviews and technical appraisal quality control reviews (QCRs).⁹ Both types of reviews are conducted by regional agency appraisers who are required to follow current USPAP standards. These appraisers are licensed appraisers employed by Rural Development who have met the required qualifications in education, training, and experience to estimate the value of property.¹⁰

⁶ Appraisal Standards Board, *Uniform Standards of Professional Appraisal Practice* (2016-2017 edition and 2018–2019 edition).

⁷ A SFHGLP conditional commitment is an agreement that a proposed loan will be guaranteed if all conditions and requirements established by Rural Development are met.

⁸ Loan security is the collateral, such as the subject property, that can be used as payment to the lender if the borrower does not pay back the loan. The value conclusion is the appraiser's opinion of the value of the subject property. Unacceptable property conditions include those conditions that do not meet agency guidelines, including ensuring the property is in a properly designated rural area and that the property does not include buildings that are designed principally to be income-producing.

⁹ For the purposes of this report, a pre-closing technical appraisal review is a technical appraisal review conducted by RHS prior to the agency issuance of a conditional commitment to guarantee the property being appraised.

¹⁰ USDA-Rural Development, *HB-1-3555 SFH Guaranteed Loan Program Technical Handbook*, § 12.5, "Residential Appraisal Reports" (March 2016).

Pre-closing Technical Appraisal Reviews

At the request of an administrative reviewer or other RHS staff, RHS performs a pre-closing technical appraisal review for either of the following reasons: (1) when the administrative reviewer identifies an appraisal-related concern or issue during the administrative appraisal review process, or (2) when any deficiency identified in the administrative appraisal review cannot or will not be addressed by the submitting lender. Technical appraisal reviews are in-depth reviews of whether an appraisal report is complete, the methods and techniques used were appropriate, and the conclusions in the appraisal were supported and credible.

In each pre-closing technical review, a regional agency appraiser determines if there is any deficiency in the appraisal report that may affect the appraisal's compliance with USPAP and/or agency requirements. Additionally, a regional agency appraiser is to determine whether this deficiency might affect the appraisal's stated property value. Regional agency appraisers document their conclusions in an *Appraisal Review Report*.¹¹ If a regional agency appraiser determines an appraisal is not adequate, the lender is informed of needed corrections prior to RHS' issuance of the conditional commitment for loan guarantee. Once informed, the lender is required to correct or complete any appraisal returned by the agency for corrective action. The lender is responsible for communicating and initiating corrective action with the appraiser hired by the lender.

Technical Appraisal Quality Control Reviews

In addition to pre-closing technical appraisal reviews, RHS routinely conducts quality control reviews (QCR) of selected appraisals. QCRs are technical appraisal reviews completed by regional agency appraisers and these reviews occur after loans have been closed and subsequently guaranteed by the agency. Specifically, similar to a pre-closing technical appraisal review, a QCR determines whether:

- (1) the appraisal was complete based on agency requirements;
- (2) the content, analysis, and conclusions in the report were in compliance with USPAP and agency requirements;
- (3) the methods and techniques used in the appraisal were appropriate;
- (4) the opinions and conclusions in the appraisal were supported, credible, and clearly reasoned; and
- (5) the appraisal was acceptable for use by the agency.

Appraisals chosen for QCRs are randomly selected from RHS' approved obligated loans from the prior month. During our scope period, the applicable

¹¹ The *Appraisal Review Report* was developed by RHS in August 2015 to document the results of its technical appraisal reviews.

version of the RHS handbook required the agency to conduct QCRs on a minimum of 5 percent of its approved obligated loans.¹² This 5 percent threshold was selected to achieve a representative sample of lenders and appraisers. QCRs provide a method of internal control to ensure RHS receives appraisals that are in compliance with USPAP and agency requirements.

Objective

Our objective was to determine whether RHS had adequate and effective controls in place to ensure lenders and appraisers complied with agency and USPAP requirements prior to guaranteeing a loan.

¹² USDA-Rural Development, *HB-1-3555 SFH Guaranteed Loan Program Technical Handbook*, § 12.5, “Residential Appraisal Reports” (March 2016).

Section 1: SFHGLP—Administrative Appraisal Reviews

Finding 1: RHS Needs an Oversight Function Over its Administrative Appraisal Review Process

We found that RHS did not monitor the quality of its administrative appraisal reviews to detect inconsistencies. Specifically, 22 of the 44¹³ (50 percent) administrative appraisal reviews we assessed had instances where administrative reviewers selected inaccurate or questionable responses on the administrative appraisal review form and/or did not complete the appropriate version of the form.¹⁴ These discrepancies were not identified because RHS did not have an oversight function to review the quality and accuracy of its administrative appraisal reviews. As a result, the agency risks accepting SFHGLP appraisals that are not in compliance with agency requirements. Implementing an oversight function could reduce this risk and ensure RHS monitors the effectiveness of its administrative appraisal review process.

RHS guidance requires the agency to complete an administrative appraisal review form for all appraisals submitted to SFHGLP.¹⁵ According to USDA’s regulation on internal controls for all programs, all managers directing or controlling resources are responsible for establishing, maintaining, evaluating, improving, and reporting on controls for their assigned areas.¹⁶

To determine the acceptability of an appraisal for SFHGLP and ensure compliance with agency requirements, administrative reviewers conduct administrative appraisal reviews on all appraisals associated with SFHGLP applications. Administrative reviewers document their analysis of each appraisal report by selecting corresponding responses on the administrative appraisal review form. The review form consists of appraisal related questions, such as the following:

- *Does the appraisal report correctly identify and describe the subject property?*¹⁷
- *Was the sales history of the subject property reported?*
- *Did the appraisal include three comparable properties that sold within the last 12 months?*
- *Do the comparable properties appear to be similar to the property being appraised and are from the same or like market?*

In our review of 44 SFHGLP administrative appraisal reviews conducted by [REDACTED] State offices, we found instances where administrative reviewers provided responses that were inaccurate, questionable, and/or incomplete as a result of using the wrong administrative appraisal review form. For example, we found the following:

¹³ The applicable State office visited could not locate the administrative appraisal review completed for 1 of the 45 sample appraisals we selected. Therefore, we did not assess the responses associated with that administrative appraisal review.

¹⁴ The administrative reviewers completed the 2010 version (revised May 2010) of the form instead of the required 2017 version (effective August 2017).

¹⁵ USDA-Rural Development, *HB-1-3555 SFH Guaranteed Loan Program Technical Handbook*, § 12.5, “Residential Appraisal Reports” (March 2016).

¹⁶ USDA Departmental Regulation 1110-002, *Management’s Responsibility for Internal Control* (June 2013).

¹⁷ “Subject property” refers to the property being appraised.

- (1) For almost 32 percent of the administrative appraisal reviews,¹⁸ administrative reviewers did not use the most current version of the administrative appraisal review form.¹⁹ Consequently, these administrative reviewers did not provide additional appraisal-related information that was required in the updated form, such as whether certain adjustments²⁰ in the appraisal report were documented, supported, and explained. Adjustment explanations and support assist the reviewer in understanding the rationale for the adjustment and method used to calculate the adjustment amount.



- (2) Approximately 67 percent of applicable²¹ administrative appraisal review forms contained inaccurate and/or questionable responses related to (1) whether comparable sales concession²² adjustments, or lack of adjustments, were supported by analysis within the appraisal report; or (2) if adjustments were made when the appraiser indicated that concessions were not common.

For example, in two appraisal reviews, the administrative reviewer selected “not applicable” regarding sales concession adjustments; however, we found evidence that the appraisal reports included comparable sales concessions with associated explanations for adjustments or lack of adjustments. Sales concession adjustments can impact the sales price of comparable properties, ultimately impacting the appraised subject property value.

A lack of oversight for RHS’ administrative appraisal review process affected the agency’s ability to identify the issues we found in our review. During our scope period, the agency relied on periodic administrative appraisal review training to ensure the accuracy and quality of its

¹⁸ We identified this issue with approximately 32 percent (14 of the 44) administrative appraisal reviews we assessed for this audit.

¹⁹ During our scope period, FYs 2016–2018, RHS updated its administrative appraisal review form in June 2017, effective August 2017.

²⁰ An appraiser develops a value indication for a property by comparing the subject property with similar properties, called comparable sales. The sale prices of the comparable properties indicate a range in which the subject property value indication will fall. The appraiser applies dollar adjustments to the sale price of each comparable property for price-influencing dissimilarities between the comparable and the subject property to derive the range. Through this procedure, the appraiser arrives at an opinion of value.

²¹ Based on information in the associated appraisals, the sales’ concession question was applicable to 12 of the 44 administrative appraisal review forms we assessed. We determined that 8 of these 12 administrative appraisal review forms contained inaccurate and/or questionable responses.

²² A sales concession is a cash or noncash contribution that is provided by the seller, or other third party, to the transaction and subsequently reduces the purchaser’s cost to acquire the property. In developing an opinion of value for a property, an appraiser must take into consideration the effect of any sales concessions on the value of that property.

administrative appraisal reviews. However, the agency agreed to implement oversight over its administrative appraisal review process. In October 2019, agency officials informed us that, as part of the agency's restructuring, a quality assurance group will be established to include a review of administrative appraisal reviews. An oversight function could increase RHS' assurance that administrative reviewers accurately assess SFHGLP appraisals and accept appraisals that comply with agency requirements. Therefore, we recommend that RHS develop and implement an oversight function to periodically assess the quality and accuracy of its administrative appraisal reviews and establish the frequency of its oversight activities.

Recommendation 1

Develop and implement an oversight function to assess the quality and accuracy of RHS' administrative appraisal reviews and establish the frequency of its oversight activities.

Agency Response

In its April 24, 2020, response, RHS stated:

The QA branch will assess the quality and accuracy of administrative appraisal reviews in its ongoing evaluations. The QA branch will accomplish its aim by developing an administrative appraisal review guide that will be used as a training tool for decision makers in the OPD. A SharePoint page will also be developed to track the reviews and gather data.

OIG Position

We do not accept management decision for this recommendation. To achieve management decision, RHS needs to specify the frequency in which the agency plans on conducting assessments of administrative appraisal reviews.

Section 2: SFHGLP—Technical Appraisal Reviews

Finding 2: RHS Needs to Strengthen Controls Over its Pre-Closing Technical Appraisal Review Process

We found that RHS issued conditional commitments for SFHGLP loan guarantees on properties that did not have appraisals that met applicable regulations and program requirements.²³ Specifically, we found that RHS issued four conditional commitments, totaling over \$814,000, for SFHGLP loan guarantees on properties without acceptable appraisals. For appraisals that underwent pre-closing technical reviews, this issue occurred because RHS did not have sufficient controls to prevent the issuance of conditional commitments for loan guarantees with unresolved appraisal deficiencies.²⁴ As a result, the agency may continue to issue conditional commitments for loan guarantees on properties for which appraisals are not acceptable for the agency’s use. Furthermore, RHS may be vulnerable to potential loss claims due to appraisals that are not credible, supported, or clearly reasoned.

The SFHGLP regulations require program appraisals to be conducted in accordance with USPAP.²⁵ The SFHGLP Technical Handbook requires the lender to correct or complete any appraisal found deficient prior to the issuance of a conditional commitment for loan guarantee by the agency.²⁶ The SFHGLP Technical Handbook also states, “[e]xceptions to any requirement of this handbook, or 7 C.F.R. Part 3555, can be approved in individual cases by the Administrator.”²⁷

In our evaluation of appraisal reviews at the RHS State offices, we found instances where pre-closing technical appraisal reviews noted deficiencies with the appraisal, but administrative reviewers had not followed agency policy and procedures to ensure noted deficiencies were resolved prior to issuing the conditional commitment.

During our appraisal and loan file review, we found the following:

- (1) In [REDACTED], we found two examples [REDACTED]
[REDACTED]

²³ The conditional commitment is issued prior to the loan note guarantee. The loan note guarantee constitutes an obligation supported by the full faith and credit of the United States. Ultimately, loan note guarantees were issued for all four conditional commitments discussed in this finding.

²⁴ Our audit sample included completing analysis on 12 pre-closing technical appraisal reviews [REDACTED]
[REDACTED]

²⁵ 7 Code Federal of Regulations (C.F.R.) § 3555.107 (d)(1).

²⁶ USDA Rural Development, *HB-1-3555 SFH Guaranteed Loan Program Technical Handbook*, § 12.5, “Agency Review” (March 2016).

²⁷ USDA Rural Development, *HB-1-3555 SFH Guaranteed Loan Program Technical Handbook*, § 1.9, “Exception Authority” (March 2016).

[REDACTED]

In the second example, an administrative reviewer similarly [REDACTED]

[REDACTED]

(2) In [REDACTED], we found two examples [REDACTED]

[REDACTED]

In the second example, the [REDACTED]

[REDACTED]

During our review of loan guarantee files and appraisals at this State, we did not find any documentation for these two cases indicating that an exception to program requirements was requested by RHS staff, or granted by the Administrator.

²⁸ In one of these examples, [REDACTED]

Pre-closing technical appraisal reviews are critical to preserving the quality of the SFHGLP portfolio and any reported deficiencies should be resolved prior to the agency issuing a conditional commitment for loan guarantee. The agency's completion of pre-closing technical appraisal reviews prior to issuance of conditional commitments for loan guarantees helps ensure that RHS identifies unsound appraisals prior to the extension of any financial commitment; and supports the reduction of agency exposure regarding higher risk loans. In conclusion, for appraisals that undergo pre-closing technical appraisal reviews, we recommend that RHS develop and implement controls to prevent the issuance of conditional commitments for loan guarantees prior to regional agency appraisers' determinations that appraisals are acceptable.

Recommendation 2

Develop and implement controls for pre-closing technical appraisal reviews to prevent the issuance of conditional commitments for loan guarantees prior to regional agency appraisers' determinations that appraisals are acceptable.

Agency Response

In its April 24, 2020, response, RHS stated:

Controls were implemented by removing loan making authority from 47 different State Offices and establishing the OSFHGLP. The OPD developed desk procedures designed to ensure that all agency guidelines are being followed when issuing conditional commitments and loan note guarantees. The OPD will amend its origination desk procedures by adding language that prohibits the issuance of conditional commitments prior to the resolution of an appraisal technical desk review conducted by a regional staff appraiser.

OIG Position

We do not accept management decision for this recommendation. Language that prohibited the issuance of a conditional commitment prior to the resolution of a pre-closing technical appraisal review was included in the USDA-Rural Development, *HB-1-3555 SFH Guaranteed Loan Program Technical Handbook* during our scope period. However, we identified four examples of conditional commitments that were issued by RHS despite this language. To achieve management decision, RHS needs to develop and implement controls that would prevent the issuance of conditional commitments, such as the examples we cited in the finding, prior to regional agency appraisers' determinations that appraisals are acceptable.

Finding 3: RHS Needs to Effectively Communicate its Technical Appraisal Review Results

RHS did not effectively communicate the results of its pre-closing technical appraisal reviews and QCRs to help ensure RHS receives SFHGLP appraisal reports that comply with agency and USPAP requirements. This occurred because the agency had not established a formal process to: (1) effectively identify and communicate common deficiencies found during its pre-closing technical appraisal reviews and QCRs to all lenders and administrative reviewers; and (2) share specific QCR results with the responsible lenders and administrative reviewers. As a result, appraisers hired by lenders may continue to submit appraisals not acceptable for RHS' use, thereby potentially impacting property value determinations.^{29, 30}

RHS program guidance states that technical appraisal reviewers “provide a method of internal control by the appraisal review staff and ensure that appraisals received are in compliance with USPAP and agency requirements.”^{31, 32}

Identification and Communication of Trends and Common Deficiencies Noted During Pre-closing Technical Appraisal Reviews and QCRs

We found that RHS used an informal mechanism to compile deficiencies found during its QCRs, but did not similarly compile deficiencies identified during its pre-closing technical appraisal reviews. For example, in FY 2017, the agency developed a spreadsheet to document QCR results and identify common appraisal deficiencies. However, the agency had not established a formal process to: (1) analyze and compile the results of pre-closing technical appraisal reviews and QCRs; and (2) communicate identified trends and common deficiencies to all approved lenders and administrative reviewers.

Pre-closing technical appraisal reviews and QCRs are intended to ensure that RHS receives appraisals that comply with USPAP and agency requirements. The compiled results of pre-closing technical appraisal reviews and QCRs could help the agency identify common deficiencies and implement actions to improve the overall quality of appraisals, identify deficiencies that impact property value determinations, and reduce the number of appraisals submitted with similar deficiencies. Agency actions could include periodically sharing these deficiencies with all approved lenders and administrative reviewers to educate them and provide an opportunity to implement corrective actions to prevent similar deficiencies. Therefore, we recommend that RHS develop a formal

²⁹ A regional agency appraiser may deem an appraisal not acceptable due to a lack of detail, explanation, or completeness. For example, an appraisal could be deemed not acceptable for lack of support for adjustments to a subject property value.

³⁰ For the purpose of this audit, the term “acceptable” appraisal means that the appraisal complied with agency requirements, including USPAP and other agency-specific SFHGLP regulations and policies. The term “not acceptable” indicates an appraisal did not comply with agency requirements.

³¹ 7 C.F.R. § 3555.107 (d)(1).

³² USDA Rural Development, *HB-1-3555 SFH Guaranteed Loan Program Technical Handbook*, § 12.5, “Agency Review” (March 2016).

process to (1) identify and communicate common deficiencies found during its technical appraisal reviews and (2) establish the frequency of communicating identified common deficiencies to all approved lenders and administrative reviewers.

Communication of Specific QCR Results to the Responsible Lender and Administrative Reviewer

RHS policy requires communicating specific pre-closing technical appraisal review concerns to the applicable lenders. However, we found that the agency had not established a process to share specific QCR results with responsible lenders and administrative reviewers.

As part of a QCR, the regional agency appraisers must document, in an *Appraisal Review Report*, the deficiencies found and their reason(s) for determining that an appraisal was not acceptable.³³ In our review of QCR results,³⁴ we found that regional agency appraisers concluded that nearly 26 percent of appraisals were not acceptable for use by the agency.³⁵ Regional agency appraisers deemed these appraisals not acceptable for various reasons, such as lack of support for large variances between actual and effective age for the subject property and inadequate explanations for comparable sales adjustments. Although deficiencies were documented during these QCRs, we found that RHS did not communicate specific QCR results to the responsible lenders and administrative reviewers following the completion of its monthly QCRs.

In addition to sharing common deficiencies with all lenders and administrative reviewers, communicating specific deficiencies identified through QCRs to responsible lenders and administrative reviewers could be an important and beneficial mechanism for the agency. This information could provide lenders an opportunity to mitigate similar appraisal deficiencies in the future by sharing results with its hired appraisers. Additionally, communicating QCR results to the responsible administrative reviewers could assist them with identifying potential appraisal issues or concerns during their administrative appraisal review that warrant a referral to a regional agency appraiser for a pre-closing technical appraisal review.

RHS officials acknowledged that QCR results were not communicated to lenders and/or administrative reviewers. To maximize the impact and utility of the QCR results, RHS should communicate the individual review results to the responsible lenders and administrative reviewers as part of the regional agency appraisers' QCR process. To ensure success in this action, we recommend that (1) RHS develop and implement a process to share all "not acceptable" QCR results with the responsible lender and

³³ Standard Operating Procedure, "Single Family Housing Guaranteed Loan Program (SFHGLP) Quality Control Appraisal Review Assignment" Revision July 2017.

³⁴ During our scope period (FY 2016–FY 2018), there were 12,826 QCR results that noted a determination of either acceptable or not acceptable appraisals. Of the 12,826 QCRs, 3,311 were deemed not acceptable.

³⁵ An appraisal may be found not acceptable by a regional agency appraiser for many different reasons, which may not impact the appraised value of the subject property. However, all appraisals are required to comply with agency requirements, regardless of whether the property's appraised value was affected.

administrative reviewer and (2) establish the frequency of communicating all “not acceptable” QCR results to the responsible lender and administrative reviewer.

Technical appraisal reviews are a key internal control to ensure RHS receives the highest quality appraisals. RHS can further strengthen its technical appraisal review processes and the quality of appraisals it receives in the future by (1) identifying and communicating common deficiencies found during technical appraisal reviews, and (2) communicating all “not acceptable” QCR results to responsible lenders and administrative reviewers. In October 2019, agency officials stated that they planned to initiate actions related to the issues noted in this finding.

Recommendation 3

Develop and implement a formal process to identify common deficiencies found during pre-closing technical appraisal reviews and QCRs.

Agency Response

In its April 24, 2020, response, RHS stated:

The RD Program Support Staff Appraisal team will formalize a process to identify common deficiencies found during the review process for both pre-closing technical appraisal reviews and Quality Control Reviews. The Appraisal team will formally develop methods for collection of data on common deficiencies for both pre-closing and quality control reviews. The data collection will be shared with the QA Division and posted on the SharePoint page referenced in the agency’s response to recommendation 1.

RHS provided an estimated completion date of September 30, 2020, for this action.

OIG Position

We accept management decision for this recommendation.

Recommendation 4

Develop and implement a process, including the frequency of communication, to share common deficiencies found during pre-closing technical appraisal reviews and QCRs with all approved lenders and administrative reviewers.

Agency Response

In its April 24, 2020, response, RHS stated:

The RD Appraisal team will report quarterly the common deficiencies found during pre-closing and QCR technical appraisal reviews to program leadership, supervisors of administrative reviewers, and all approved lenders. Report will be generated from the data collected in Recommendation 3.

RHS provided an estimated completion date of September 30, 2020, for this action.

OIG Position

We accept management decision for this recommendation.

Recommendation 5

Develop and implement a process, including the frequency of communication, to share all “not acceptable” QCR results with the responsible lender and administrative reviewer.

Agency Response

In its April 24, 2020, response, RHS stated:

The RD Appraisal team will report the deficiencies found during QCR technical appraisal reviews of all appraisals, found to be “Not Acceptable,” to supervisors of administrative reviewers and the individual approved lenders. Reporting will be completed on at least a monthly basis.

RHS provided an estimated completion date of September 30, 2020, for this action.

OIG Position

We accept management decision for this recommendation.

Scope and Methodology

We conducted a nationwide audit of RHS' controls over its SFHGLP appraisal and appraisal review process. The scope of our audit work covered all appraisals and appraisal reviews completed during FYs 2016–2018 for RHS' SFHGLP. To accomplish our objectives, we performed fieldwork at the RHS national office, located in Washington, D.C., [REDACTED] State offices, and [REDACTED] approved lender sites. For specific locations we visited, see Exhibit B. We performed our audit fieldwork from December 2018 through February 2020.

We non-statistically selected [REDACTED] States and [REDACTED] approved lenders for review.³⁶ Our selection of the [REDACTED]

[REDACTED] We selected one lender from each visited State primarily based on its high issuance of loan guarantees during the scope period. We used loan guarantee and technical appraisal information provided by RHS to non-statistically select appraisal reviews to review for each State.³⁷ Specifically, we sampled 76 appraisal reviews primarily based on the following:^{38, 39}

- highest appraised subject property values;
- whether a regional agency appraiser deemed the appraisal acceptable during his/her QCR;
- whether a regional agency appraiser deemed the appraisal not acceptable during his/her QCR;
- appraisals that were administratively reviewed and referred to a regional agency appraiser for a pre-closing technical appraisal review; and
- technical appraisal reviews, both pre-closing and QCR, completed by the regional agency appraiser assigned to the State visited.

The conditional commitments associated with these 76 appraisal reviews totaled approximately \$11.6 million.

To assess the selected appraisals and appraisal reviews, we used the USPAP and the SFHGLP Technical Handbooks. Specifically, we used the versions of the USPAP and the SFHGLP

³⁶ Rural Development has 47 State offices. The [REDACTED] States selected for review completed [REDACTED] percent of the RHS SFHGLP appraisals for FY2016–FY2018.

³⁷ RHS obtained this information from its SharePoint® site and the Guaranteed Loan System (GLS). RHS' SharePoint® site contains information related to the agency's technical appraisal reviews and includes pre-closing technical appraisal review requests by SFHGLP staff as well as post-closing appraisal technical review results. The Guaranteed Loan System is the agency's automated loan accounting system for RHS guaranteed rural housing loans.

³⁸ We sampled 45 administrative appraisal reviews and 31 technical appraisal reviews. We analyzed 44 of the administrative appraisal reviews and all 31 technical appraisal reviews, including their corresponding documentation. Of the 45 administrative appraisal reviews selected in our sample, one of the completed administrative appraisal review forms could not be located. For this administrative appraisal review, we completed our analysis by using supporting documentation provided by RHS.

³⁹ The [REDACTED] State offices we visited, [REDACTED], had a total of [REDACTED] appraisals completed during FYs 2016–2018. Those [REDACTED] State offices had a total of [REDACTED] technical appraisal reviews, including pre-closing technical appraisal reviews and QCRs, completed during FYs 2016–2018.

Technical Handbooks that were in effect during FYs 2016–2018, the time covered by the our scope period.

In developing the findings for this report, we performed the following steps and procedures:

At RHS' national office, we:

- reviewed the pertinent laws, regulations, policies, and procedures related to appraisals and appraisal reviews;
- interviewed key personnel, including the SFH Guaranteed Loan Division director and senior staff appraiser, to gain an understanding of their roles and responsibilities related to appraisals and appraisal reviews; and
- ascertained the adequacy and effectiveness of RHS' reviews, oversight, and monitoring related to appraisals and appraisal reviews.

At RHS' State offices, we:

- interviewed key personnel at the State office, including the SFH program director and regional appraiser, to determine their roles and responsibilities related to appraisals and appraisal reviews;
- ascertained the adequacy and effectiveness of RHS' reviews, oversight, and monitoring related to appraisals and appraisal reviews; and
- selected and reviewed a non-statistical sample of appraisals and appraisal review documents for completeness and compliance with the USPAP and RHS policy and regulations.

At selected approved lenders, we:

- reviewed policies and procedures developed by the lender to obtain appraisals and appraisal reviews for an SFHGLP loan guarantee; and
- interviewed key personnel, including the chief operating officers and compliance staff, to understand the process for a lender to obtain an appraisal review for an SFHGLP loan guarantee.

During the course of our audit, we did not solely rely on information from any agency information systems. While we conducted limited verification of information generated by the agency's Guaranteed Loan System and SharePoint® site data, we make no representation regarding the adequacy of these systems as a whole or the information generated from them because evaluating the effectiveness of the information systems (or information technology controls) was not one of the audit objectives. We used data from these systems to non-statistically select appraisals and appraisal reviews for review. However, we solely relied on documentation, not system-generated information, to support the conclusions in this report.

We conducted this performance audit 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Abbreviations

C.F.R.	Code of Federal Regulations
FY	fiscal year
OIG	Office of Inspector General
OMB	Office of Management and Budget
QCR	quality control review
RHS	Rural Housing Service
SFH	single family housing
SFHGLP	Single Family Housing Guaranteed Loan Program
USDA	U.S. Department of Agriculture
USPAP	Uniform Standards of Professional Appraisal Practice

Exhibit A: Summary of Monetary Results

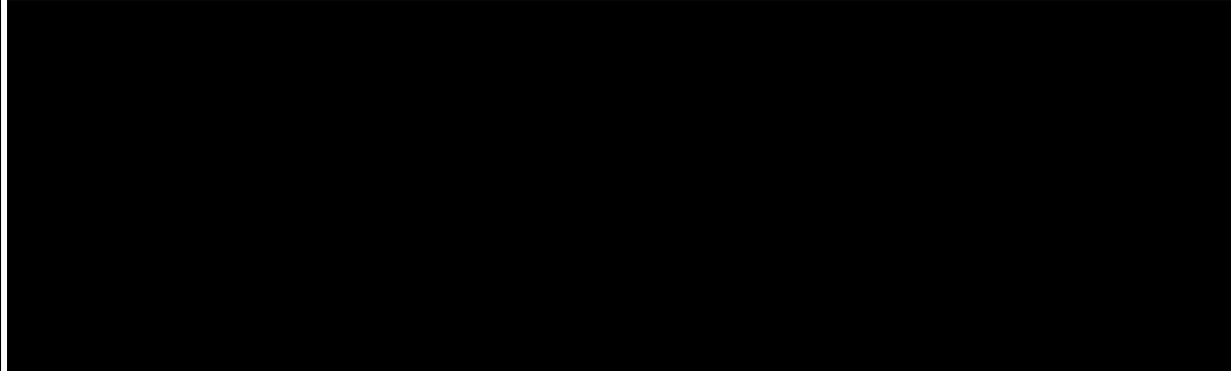
Exhibit A summarizes the monetary results for our audit report by finding and recommendation number.

Finding	Recommendation	Description	Amount	Category
2	2	Value of RHS guaranteed SFHGLP loans issued without ensuring appraisals met applicable regulations and program requirements. ⁴⁰	\$814,604	Questioned Costs/Loans, No Recovery
Total Monetary Results			\$814,604	

⁴⁰ Loan note guarantees, which constitute an obligation supported by the full faith and credit of the United States, were issued for all four conditional commitments discussed in Finding 2.

Exhibit B: Audit Sites Visited

This exhibit shows the name and location of all visited RHS offices and lender sites.

SITE NAME	LOCATION
RHS National Office	Washington, D.C.
	

**AGENCY'S
RESPONSE TO AUDIT REPORT**



Rural Development

Bruce W. Lammers
Administrator

Rural Housing Service
1400 Independence Ave, SW
Room 5014-S
Washington, D.C. 20250

Telephone: (202) 692-0268

TO: Gil H. Harden
Assistant Inspector General for Audit
Office of Inspector General

FROM: Bruce W. Lammers
Administrator
Rural Housing Service

SUBJECT: OIG Audit: Official Draft Response – RHS Single Family Housing
Guaranteed Loan Program Appraisals - Audit# 04601-0001-41

Rural Development appreciates the opportunity to submit our responses to the recommendations in the subject Official Draft report dated April 14, 2020.

The agency recently completed a reorganization which created the Office of the Single Family Housing Guaranteed Loan Program (OSFHGLP). One of the primary objectives driving the creation of the OSFHGLP is to execute program operations in a uniform and consistent fashion. The loan making activities, including administrative appraisal reviews, were previously performed by the State Offices. They are now consolidated into two Origination Processing Divisions (OPD).

The OSFHGLP includes an independent Quality Assurance branch (QA) which reviews the production of loan originations in an ongoing sampling basis. The purpose is to ensure that the decision makers in the OPD are consistently following agency guidelines.

Recommendation 1

Develop and implement an oversight function to assess the quality and accuracy of RHS' administrative appraisal reviews and establish the frequency of its oversight activities.

Agency Response:

The QA branch will assess the quality and accuracy of administrative appraisal reviews in its ongoing evaluations. The QA branch will accomplish its aim by developing an administrative appraisal review guide that will be used as a training tool for decision makers in the OPD. A SharePoint page will also be developed to track the reviews and gather data.

Estimated Completion Date:

August 30, 2020

Recommendation 2

Develop and implement controls for pre-closing technical appraisal reviews to prevent the issuance of conditional commitments for loan guarantees prior to regional agency appraisers' determinations that appraisals are acceptable.

Agency Response:

Controls were implemented by removing loan making authority from 47 different State Offices and establishing the OSFHGLP. The OPD developed desk procedures designed to ensure that all agency guidelines are being followed when issuing conditional commitments and loan note guarantees. The OPD will amend its origination desk procedures by adding language that prohibits the issuance of conditional commitments prior to the resolution of an appraisal technical desk review conducted by a regional staff appraiser.

Estimated Completion Date:

September 30, 2020

Recommendation 3

Develop and implement a formal process to identify common deficiencies found during pre-closing technical appraisal reviews and Quality Control Reviews (QCR).

Agency Response:

The RD Program Support Staff Appraisal team will formalize a process to identify common deficiencies found during the review process for both pre-closing technical appraisal reviews and Quality Control Reviews. The Appraisal team will formally develop methods for collection of data on common deficiencies for both pre-closing and quality control reviews. The data collection will be shared with the QA Division and posted on the SharePoint page referenced in the agency's response to recommendation 1.

Estimated Completion Date:

September 30, 2020

Recommendation 4

Develop and implement a process, including the frequency of communication, to share common deficiencies found during pre-closing technical appraisal reviews and QCRs with all approved lenders and administrative reviewers.

Agency Response:

The RD Appraisal team will report quarterly the common deficiencies found during pre-closing and QCR technical appraisal reviews to program leadership, supervisors of administrative reviewers, and all approved lenders. Report will be generated from the data collected in Recommendation 3.

Estimated Completion Date:

September 30, 2020

Recommendation 5

Develop and implement a process, including the frequency of communication, to share all “not acceptable” QCR results with the responsible lender and administrative reviewer.

Agency Response:

The RD Appraisal team will report the deficiencies found during QCR technical appraisal reviews of all appraisals, found to be “Not Acceptable”, to supervisors of administrative reviewers and the individual approved lenders. Reporting will be completed on at least a monthly basis.

Estimated Completion Date:

September 30, 2020

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