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*Announcement 02-02*

*January 29, 2002*

*Amends These Guides: Selling*

*Appraisal-Related Issues*

We have received a number of inquiries from lenders and appraisers asking for clarification on several of our property valuation policies and practices. This Announcement not only addresses those questions, but also includes some revisions to other appraisal-related policies. Specifically, this Announcement addresses issues related to

- referring unacceptable appraisal reports to state appraiser licensing or regulatory boards,
- managing the property valuation and appraisal review process,
- performing appraisals on properties in market areas experiencing significant fluctuations in property values,
- appraising factory-built housing (including manufactured homes, modular homes, and other types of prefabricated housing),
- updating an appraisal report, and
- adding, modifying, or deleting limiting conditions on an appraisal report.

### **Referring Unacceptable Appraisal Reports to State Appraiser Licensing or Regulatory Boards**

As part of our quality assurance efforts, we have started referring unacceptable appraisal reports to state appraiser licensing or regulatory boards for any investigation and action they consider appropriate based on our examination of independent appraisal field review reports. Our objectives in referring appraisal reports to state appraiser licensing or regulatory boards are to (1) emphasize our continuing efforts to

maintain the quality of appraisals, (2) protect our interests and improve the quality of mortgages delivered to us by identifying appraisers who have performed appraisals of a sufficiently poor quality to impair our security interests, and (3) help the industry enhance the quality of appraisals by identifying and referring individual appraisers who appear to be unethical and/or incompetent to the state appraiser licensing or regulatory boards for review and, if appropriate, enforcement under their professional standards.

Our decision to refer appraisal reports to state appraiser licensing or regulatory boards does not affect the lender's traditional responsibility for managing the property valuation and appraisal review process. The lender remains responsible for (1) assuring that the appraisers it uses provide objective appraisal reports that accurately describe the property, reflect overall market conditions, adequately support the opinion of value for each property, and take into consideration all factors that affect the value of the property; (2) monitoring market conditions in those areas in which it originates mortgages (or otherwise acquires mortgages for delivery to us); and (3) ensuring that its origination procedures (or the origination procedures of any third-party originator it uses) result in mortgages that meet our requirements.

We believe that this heightened effort to improve the quality of the property valuation and property underwriting process is warranted based on concerns expressed by lenders and observations we have made about a number of recurring property appraisal deficiencies. To assist lenders in identifying potential appraisal problems, we are providing the following summary of the most common appraisal deficiencies that have been identified through our on-going appraisal quality assurance efforts:

- **Unsupported opinions of market value** -- the appraiser's opinion of value is not appropriately supported by the market data;
- **Improper selection (or creation) of comparable sales** -- appropriate comparable sales are available, but the appraiser selects comparable sales that are not comparable to the subject property; are located in superior, non-competing neighborhoods; or have superior characteristics to the subject property; or creates comparable sales by combining vacant land sales with the contract purchase price of the home that has been built or will be built on the land;
- **Unsupported adjustments in the sales comparison approach** -- the appraiser uses adjustments in the appraisal report that are not supported by the market data;
- **Inadequate reporting of the sales history for the subject property and comparable sales** -- the appraiser does not analyze and/or report the sales history for the subject property and comparable sales;
- **Lack of analysis of, and reporting on, the listing, offering, or contract of sale for the subject property** -- the appraiser does not comment on how the subject property transaction relates to the market; and
- **Misrepresentation of the physical characteristics of the subject property, improvements, and comparable sales** -- the appraiser does not accurately report both the positive and negative features

that affect the value of the subject property and comparable sales (for example, by incorrectly reporting the property condition or failing to report any physical, functional and external inadequacies).

## **Managing the Property Valuation and Appraisal Review Process**

Before a lender (or any third-party originator it uses) engages an appraiser's services, it must be satisfied that the appraiser has the knowledge and experience that is required to perform quality appraisals for the specific geographic location and the particular property type for which the lender intends to use the appraiser's services. A lender must not assume -- simply based on the fact that an appraiser is state-licensed or -certified -- that the appraiser is qualified and knowledgeable about a market area or is aware of the appropriate market data sources for the area and will be able to obtain access to them. A lender must also make sure that its appraisers are aware of our appraisal standards and correctly address them in the appraisals they perform.

A lender must not attempt to unduly influence an appraiser's valuation analysis, determination of the opinion of value for the property, description of the property, or reporting of market conditions. From time to time, appraisers report that they are told (directly or indirectly) that future assignments might not be forthcoming unless they report a predetermined value (or direction in value that favors the cause of the client or any related party) or remove or change information in the appraisal report that might be considered detrimental to a specific property. Such attempts to influence the appraiser are clearly unacceptable. However, this does not mean that a lender cannot question the appraiser's findings or provide factual information (such as comparable market data) to the appraiser in support of a proposed mortgage transaction.

When a lender delivers a mortgage to us, it warrants that it knows of nothing involving the mortgage that reasonably can be expected to cause the mortgage to become delinquent or to adversely affect the reported value of the security property. The lender must take appropriate measures to assure that no actions -- such as pressuring appraisers to arrive at predetermined values and/or indicators of market condition -- taken by its employees, agents, or third-party originators compromise the warranties it makes to us. To assure that it can make our required warranties, a lender must take appropriate measures to assure that its quality assurance procedures adequately address our mortgage eligibility, underwriting, and property appraisal standards.

## **Performing Appraisals on Properties in Market Areas Experiencing Significant Fluctuations in Property Values**

A lender must take appropriate steps to assure that the appraisers it uses accurately report the primary indicators of market condition: trend of property values, supply and demand, and average marketing time, as well as the prevalence of sales and financing concessions in the subject market area. To assist the appraiser, the lender must disclose all financing data and sales concessions for the property that will be, or have been, granted by the property seller. Generally, this can be accomplished by providing the appraiser a copy of the complete, ratified sales contract for the property that is to be appraised. The lender should also inform the appraiser if it is aware of other pertinent information that is not included

in the sales contract.

The appraiser's analysis of a property must take into consideration all factors that have an effect on value. To assure that this is done in the development of the sales comparison approach to value, we require the appraiser to analyze closed or settled sales, contract sales, as well as current and expired listings of properties that are the most comparable to the subject property (although we generally require the appraiser to report only the comparable sales in the appraisal report). The appraiser should also include in the appraisal report (or in an addendum) any other information that the lender will need to make a prudent underwriting decision and establish appropriate mortgage terms.

Because we purchase mortgages in all markets, it is particularly important for the appraiser to analyze current listings, expired listings, and contract sales in market areas that are experiencing significant fluctuations in property values (including sub-markets for particular types of housing within the market area), in addition to analyzing closed or settled sales. The competing current listings, expired listings, and contract sales typically represent the upper end of value for the subject property as of the effective date of the appraisal. The appraiser's analysis and reconciliation must be reflected in the appraisal report (or in an addendum).

In arriving at the sales comparison approach to value, the appraiser must make appropriate adjustments for location, date of sale, and the physical characteristics of the properties. "Time" adjustments (both negative and positive) are acceptable, as long as they reflect the time elapsed between the contract date for the comparable sales and the effective date of the appraisal. These adjustments must be representative of the subject market and supported by market data that is reported in the appraisal report. Our definition of market value is intended to assure that an appraisal reflects an opinion of market value after adjustments have been made for any special or creative financing or sales concessions paid by the property seller (although no adjustments are necessary for any of those costs that are normally paid by sellers as a result of tradition or law in a market area). Not only must the appraiser make appropriate adjustments in the analysis of the property's value, but the lender also must make a negative adjustment to the property's sales price to reflect the amount of any contributions that exceed the maximum we allow and then calculate the loan-to-value ratio using the lesser of the reduced sales price or appraised value. This approach assures that the effect of sales and financing concessions is properly acknowledged in the underwriting process.

## **Appraising Factory-Built Housing**

We are modifying our property valuation policies for mortgages secured by factory-built housing (which includes manufactured homes, modular homes, and other types of prefabricated housing). The following guidelines are effective for appraisal reports related to factory-built housing that are developed on or after April 30, 2002:

- The appraiser must identify the type of factory-built housing -- as either a manufactured home, a modular home, or another type of prefabricated housing -- in the appraisal report. This is an important step in defining the appropriate market area and in selecting comparable properties. For manufactured and modular homes, the appraiser must also include in the appraisal report the

manufacturer's name, the model name, the year of manufacture, and the serial number for the subject property. This information can be verified by reviewing the Data Plate/Compliance Certificate that is located inside the manufactured or modular home.

- The appraiser must address both the marketability and comparability of a factory-built home, by using comparable sales of similar factory-built homes. For example, modular homes should be compared to modular homes, single-width manufactured homes should be compared to single-width manufactured homes, multi-width manufactured homes should be compared to multi-width manufactured homes, etc. If at least three comparable sales of factory-built homes are not available, the appraiser may use either site-built housing or a different type of factory-built housing as one of the comparable sales. When that is the case, the appraiser must use at least two comparable sales of similar factory-built homes, explain why site-built housing or a different type of factory-built housing is being used for the one comparable sale, and make (and support) appropriate adjustments in the appraisal report. If the appraiser is unable to find two comparable sales of similar factory-built homes, the mortgage is not eligible for delivery to us since the market value of the property cannot be adequately measured and supported.
- The appraiser must not create comparable sales by combining vacant land sales with the contract purchase price of a factory-built home (although this type of information may be included as additional supporting documentation).

## **Updating an Appraisal Report**

We require that the subject property must have been appraised within the twelve months that precede the date of the note and mortgage. If the appraisal will be over twelve months old on the date of the note and mortgage, we require a new appraisal. Furthermore, if any appraisal report will be more than four months old on the date of the note and mortgage, we require the appraiser to at least inspect the exterior of the property and to review current market data in order to make a determination about whether the property has declined in value since the date of the original appraisal. When the appraiser determines that the property has not declined in value, the appraiser must provide a certification to that effect. When the appraiser determines that the property has declined in value, the lender must obtain a new appraisal. These processes are an "update" of the original appraisal report, which means that they are an extension of the original appraisal report that changes the effective date of the opinion of value to reflect a current date. An update can be reported in different formats -- such as in an appraisal report form or in a letter. Regardless of how the appraisal update is reported, it is an appraisal that incorporates (usually by reference) information included in the original appraisal report.

Generally, the original appraiser should complete the certification of value; however, the lender may use a substitute appraiser. (The lender should note in its files why the original appraiser was not used.) In such cases, the substitute appraiser must review the original appraisal and certify that the original appraiser's estimate of market value was reasonable on the date of the original appraisal report and that the property has not declined in value.

## **Adding, Modifying, or Deleting Limiting Conditions on an Appraisal Report**

Our appraisal report forms include standard appraiser certifications and limiting conditions. These required certifications and limiting conditions are intended to serve our needs in underwriting a mortgage by telling us what the appraiser did and did not do in the assignment and defining those areas for which the appraiser should and should not be held responsible. From time to time, appraisal trade associations and others recommend that appraisers add special limiting conditions to their appraisal reports to limit the appraiser's liability.

Although we permit an appraiser to add some certifications to our appraisal report forms, we will *not* purchase or securitize a mortgage for which the appraiser has added, modified, or deleted a limiting condition on the appraisal report. The lender must review the appraisal report to verify that no additional limiting conditions have been added and that none of the standard limiting conditions has been modified or deleted.

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Lenders who have questions about the policies and processes discussed in this Announcement should contact their Underwriting Consultant in their lead Fannie Mae regional office.

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