

Fannie Mae Selling Guide (04/12/2002)

Part XI - Property and Appraisal Guidelines

This Part-Property and Appraisal Guidelines-details our general requirements for analyzing the property appraisal aspects of conventional mortgages secured by one- to four-family properties. It also discusses special considerations for certain types of housing-units in condominium, PUD, and cooperative projects; manufactured (and other factory-built) homes; Community Living group homes; mixed-use properties; properties affected by environmental hazards; urban properties; affordable housing program properties; properties located in special assessment or community facilities districts; properties subject to leasehold interests (including those held by community land trusts); and energy-efficient properties-that merit special consideration in the property and appraisal review. Because the evaluation of a property is such a vital part of the risk analysis, we expect a lender to place as much emphasis on underwriting the property and reviewing the appraisal as it does on underwriting the borrower's creditworthiness.

We require the appraiser to provide complete and accurate reports; to report neighborhood and property conditions in factual and. specific terms; to be impartial and specific in describing favorable or unfavorable factors; and to avoid the use of subjective, racial, or stereotypical terms, phrases, or comments in the appraisal report. The opinion of market value must represent the appraiser's professional conclusion, based on market data, logical analysis, and judgment. When the information or methodology of an appraisal requires additional clarification or justification, the lender's underwriter must obtain from the appraiser any information that is necessary to make an informed decision concerning the property.

We require that the appraiser and the lender follow appropriate practices in the property valuation and underwriting processes. Our appraisal standards specifically prohibit the development of a valuation conclusion that is based on race, color, religion, sex, handicap, familial status, or national origin. The effectiveness of our property underwriting guidelines is dependent on the ability of a lender and its appraisers to avoid the use of potentially discriminatory practices in the property appraisal and underwriting processes.

We hold the lender responsible for the accuracy of both the appraisal and its assessment of the marketability of the property; therefore, it is important for a lender's underwriters to understand their role in the appraisal process and their relationship to the appraiser.

- The appraiser's role is to provide the lender with an accurate, and adequately supported, opinion of value and an accurate description of the property.
- The underwriter's role is to review the appraisal report to assure that it is of professional quality and is prepared in a way that is consistent with our appraisal standards, to analyze the property based on the appraisal, and to judge the property's acceptability as security for the mortgage requested in view of its value and marketability.

These requirements are intended to provide guidance to an underwriter and an appraiser about the type of information that is needed to make a prudent underwriting decision. They are also designed to provide our minimum acceptable appraisal standards. We recognize that our guidelines may not address every appraisal problem; therefore, we allow the appraiser discretion to properly develop the value opinion. The appraiser must, however, provide sound reasoning in his or her appraisal report for any decisions he or she makes that are not specifically covered by our guidelines.

This Part XI consists of four Chapters:

- *Chapter 1-Appraiser Qualifications*-discusses the lender's responsibility for selecting appraisers and for reviewing their appraisals both initially and on an on-going basis, the use of supervisory or review appraisers, and our right not only to refuse to accept appraisals prepared by specific appraisers, but also to refer unacceptable appraisal reports to the appropriate state appraiser licensing or regulatory boards for investigation and action.
- *Chapter 2---Appraisal (or Property Inspection) Documentation*-describes the various appraisal (or property inspection) report forms that are to be used to document an appraisal (or property inspection) and any required exhibits to them; discusses requirements related to the age of an appraisal (or property inspection) report; explains the types of appraisals needed for new, proposed, and existing construction; and references the various certifications that an appraiser must make.
- *Chapter 3-Special Appraisal Considerations*-discusses considerations that should be given to properties with unusual features, points out the need for properties to meet specific eligibility criteria in order for the mortgage to be delivered to us, and explains the detrimental effect that certain environmental conditions can have on a property's value.
- *Chapter 4-Reviewing the Appraisal Report*-discusses the requirements for analyzing a property and its appraisal.

Chapter 1. Appraiser Qualifications

It is essential that a lender obtain an independent, disinterested examination and valuation of the property that secures a mortgage it intends to sell to us; therefore, the lender must select the appraiser and order (and receive) the appraisal report for each mortgage transaction, rather than allowing the borrower or any other party who has an interest in the transaction (such as the property seller or the real estate broker) to do so. The lender must not attempt to apply pressure or otherwise unduly influence the appraiser to reflect certain results in his or her analysis or reporting. However, this does not mean that a lender cannot question the appraiser's findings or provide factual information (such as comparable market data) for further consideration by the appraiser. This approach will assure that the appraiser will remain free of any outside influence in the valuation process.

We do not approve appraisers. Therefore, when selecting an appraiser, a lender must not give any consideration to an appraiser's representation that he or she is approved or qualified by Fannie Mae. Because a lender is solely accountable for the performance of the appraisers it selects, the lender must take appropriate steps to ensure that an appraiser is qualified to perform appraisals for the particular types of property and the property locations that it intends to refer to that appraiser.

If a lender chooses to rely on a specific appraiser or appraisal service to review the qualifications of-or even to select-an individual to perform appraisals for the lender, the lender should establish appropriate qualifications to ensure that acceptable individuals are selected. We recommend that the lender require the appraiser or appraisal service that makes the selection to assume full responsibility for the quality of the appraisal. However, imposing this responsibility on the appraiser or appraisal service will in no way relieve the lender of its warranties related to the appraisal or the condition of the property.

Section 101 – Selection of Appraisers

When evaluating an appraiser's qualifications, a lender should review the appraiser's education and experience, sample appraisals, professional affiliations, and references from prior clients and employers. Professional appraisal designations can be helpful to the lender in evaluating an appraiser's qualifications, particularly when the designation is from a nationally recognized organization that has formal experience, education, and ethics requirements that are strongly administered. If the lender considers an appraisal designation in its evaluation, it should be familiar with the appraisal organization's specific requirements to assure that the designation is evaluated appropriately. However, federal law prohibits a lender from selecting or hiring an appraiser based solely on the appraiser's membership in any particular appraisal organization or from not hiring an appraiser based solely on his or her lack of membership in any organization.

The appraiser must be experienced in appraising the types of properties that the lender intends to use his or her services for, have access to the necessary data sources, and be currently active in appraisal work. Before using an appraiser's services, the lender should be satisfied that the appraiser has demonstrated the ability to perform quality appraisals.

A lender must not assume that an appraiser is qualified simply based on his or her membership in, and professional designation from, an appraisal organization or the fact that he or she is state-licensed or -certified.

Section 101.01 – Licensing and Certification Requirements

We require a lender to use appraisers that are state-licensed or -certified (in accordance with the provisions of Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989) to appraise the properties that secure mortgages it intends to deliver to us. The lender (and any third-party originators it uses) must be aware of, and in full compliance with, state laws for licensing and certification of real estate appraisers. The lender must document that the appraisers it uses are licensed or certified as appropriate under the applicable state law, either by including the license or certification number with the appraiser's list of qualifications that the lender has on file or by retaining a copy of the license or certification in the file the lender maintains for the appraiser. The appraiser must note his or her license or certification number on the individual appraisal report forms.

When a new appraisal is required for a mortgage that a lender delivers to us, the lender warrants that the property has been appraised by a state-licensed or –certified appraiser. Our appraisal report forms define the appraiser as the individual who personally inspected the property being appraised, inspected the exterior of the comparables, performed the analysis, and prepared and signed the appraisal report as the appraiser. This definition does not preclude an appraiser from relying on individuals who are not state-licensed or –certified to provide significant professional assistance (such as an appraiser trainee or an employee of the appraiser doing market data research or data verification) in the development of the appraisal. The state-licensed or –certified appraiser who signs the appraisal report must acknowledge in the report the extent of the professional assistance provided by others and the specific tasks performed by each such individual and must certify that the named individual(s) are qualified to perform the tasks. Under some state laws, a lender’s use of an unlicensed or uncertified appraiser who is working as an employee or sub-contractor of a licensed or certified appraiser will satisfy the state’s licensing and certification requirement, as long as the appraisal report is signed by a state-licensed or –certified “supervisory” or “review” appraiser.

If a lender is unable to make the required warranty regarding the use of a state-licensed or –certified appraiser because it is experiencing significant delays in obtaining appraisals as the result of a scarcity of state-licensed or –certified appraisers in the state or locality, it must document the individual mortgage file with a copy of an authorized temporary waiver of the appraiser licensing and certification requirements (or a copy of its letter requesting such a waiver). Requests for these temporary waivers should be directed to the Appraisal Subcommittee of the Federal Financial Institutions Examination Council.

Section 101.02 – Knowledge and Experience Requirements

We expect a lender to use an appraiser who not only has the knowledge and experience that is required to perform a professional quality appraisal for the specific geographic location and the particular property type for which the lender needs an appraisal, but also has knowledge about, and access to, the necessary and appropriate data sources for the area in which the appraisal assignment is located.

The Competency Rule of the Uniform Standards of Professional Appraisal Practice requires a state-licensed or -certified appraiser who does not have both the knowledge and experience required to perform an appraisal competently to disclose his or her lack of knowledge and experience to the client before accepting an appraisal assignment. This rule acknowledges that the background and experience of appraisers varies widely and that the lack of knowledge and/or experience can lead to inaccurate property valuations and inappropriate appraisal practices. The Uniform Standards allow an appraiser

who does not have the appropriate knowledge and experience to accept an assignment as long as he or she

- discloses the lack of knowledge and/or experience to the client before accepting the assignment;
- takes all steps necessary or appropriate to complete the assignment competently; and
- describes in the appraisal report his or her lack of knowledge and/or experience and the steps he or she has taken to complete the assignment competently.

We believe that it is important for a lender to use an appraiser who has both the appropriate knowledge and experience, rather than taking advantage of this flexibility. We further believe that the use of an appraiser who has both appropriate knowledge of specific geographic markets and experience in appraising specific property types will help to assure the accurate valuations and appropriate appraisal practices that are necessary for fair lending. 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. If an appraiser is not knowledgeable about a particular location, is not experienced in appraising a particular type of property, or is not familiar with (or does not have access to) the appropriate data sources, a lender should not give the appraiser assignments in that market area or for that particular type of property.

Because the experience and knowledge of appraisers varies widely, a lender that chooses to rely on a specific appraiser or appraisal service to review the qualifications of (or even to select) individuals to perform appraisals for the lender should establish appropriate appraiser qualification criteria and review procedures to assure that the third party takes all of the above issues into consideration in its selection process.

Section 101.03 – Use of Supervisory or Review Appraisers

We allow an unlicensed or uncertified appraiser who works as an employee or sub-contractor of a licensed or certified appraiser to perform a significant amount of the appraisal (or the entire appraisal if he or she is qualified to do so)—as long as the appraisal report is signed by a licensed or certified "supervisory" or "review" appraiser and is acceptable under state law. In some cases, a lender may request that the appraisal reports prepared by a specific state-licensed or -certified appraiser be co-signed by his or her employer or contractor as a "supervisory" appraiser either because that is a tradition in the locality or because it wants to acknowledge the relationship between the appraiser and the employer or contractor. When a "supervisory" appraiser is used, the "supervisory" appraiser must certify that he or she directly supervises the appraiser who prepared the appraisal report, has reviewed the appraisal report, agrees with the statements and conclusions of the appraiser, agrees to be bound by some of the same certifications that the appraiser made, and takes full responsibility for the appraisal report.

If an appraiser is performing a "review" function that is different from the one discussed above, he or she must prepare a separate review report and attach it to the appraisal report being reviewed. For instance, this approach would apply when a lender chooses to use an appraisal service and one of the conditions of the delegation is that the appraiser or appraisal service must assume responsibility for the appraisal.

Section 102 – On-going Review of Appraisals

A lender must continually evaluate the quality of the appraiser's work through the normal underwriting review of all appraisal reports, as well as through the spot-check field review of appraisals as part of its quality assurance system. The lender may use our *Residential Appraisal Field Review Report* (Form 2000) for the spot-check appraisal component of its quality assurance system if it chooses to do so, but we do not require use of that form. The lender must be satisfied that any appraisers it uses for spot-check field reviews are well-qualified. The lender must have sufficient knowledge of our appraisal requirements to enable it to determine that the appraiser has properly addressed our specific criteria, the appraiser has developed objective and unbiased appraisals, and the appraiser has not engaged in any unacceptable appraisal practices.

Section 102.01 – Objective and Unbiased Appraisals

A number of laws-federal, state, and local-prohibit discrimination in the appraisal of housing. We believe professional appraisers fully understand that discriminatory valuation and appraisal reporting practices are not only illegal, but also unethical. Unintentional discrimination, however, can occur as the result of what an appraiser states-or fails to state-in his or her appraisal report. A lender must make sure that the appraisers it uses describe the property and the neighborhood in factual, unbiased, and specific terms. The lender and the appraiser must assure that the integrity of the loan decision is not influenced by subjective, racial, or stereotypical terms, phrases, or comments in the appraisal report. An appraiser must not use subjective phrases or comments in the appraisal report. Examples of unacceptable terminology include "pride of ownership," "no pride of ownership," "lack of pride of ownership," "poor neighborhood," "good neighborhood," "crime-ridden area," "desirable neighborhood or location," and "undesirable neighborhood or location." Other subjective terminology that can result in erroneous conclusions being reached is equally unacceptable.

Discrimination can also result when an appraiser makes unsupported assumptions or interjects personal opinion or perceptions about factors in the valuation process that may or may not affect the use and value of a property. We require the appraiser to consider all factors that have an effect on value and to be objective and unbiased in his or her development of the opinion of market value in the appraisal report. The appraiser and the lender must not make unsupported assumptions or interject personal opinions or perceptions about any factors, whether or not the factors affect the use and value of the property. We specifically prohibit an appraiser from basing (either partially or completely) his or her analysis and/or opinion of market value on the race, color, religion, sex, handicap, familial status, or national origin, of either the prospective owners or occupants of the property being appraised or the present owners or occupants of the properties in the vicinity of that property.

Our appraisal report forms for one- to four-family properties are designed to provide for an objective and unbiased description and analysis of the neighborhood, site, and improvements. Factors that influence the value of the properties in the neighborhood must be identified and analyzed in the valuation process and described in the appraisal report. Failure to address and note adverse factors or conditions that affect value or marketability with respect to the neighborhood, site, or improvements is an unacceptable appraisal practice. We specifically require the appraiser to certify that he or she has taken into consideration in the valuation process the factors that have an effect on value and has not knowingly withheld any significant information from the appraisal report. We also require the appraiser to certify that he or she has no present or prospective personal interest or bias with respect to the participants in the transaction and that the analysis and/or the opinion of market value in the appraisal report was not based (either partially or completely) on the race, color, religion, sex, handicap, familial status, or national origin of either the prospective owners or occupants of the subject property or the present owners or occupants of properties in the vicinity of the subject property.

We require the appraiser's comments to be stated in specific, factual terms that are supported by the information included in the appraisal report. Including an unsupported descriptive comment or drawing an unsupported conclusion from subjective observations is an unacceptable appraisal practice that may have a discriminatory effect. The appraiser's comments that address an unfavorable condition—such as the existence of an adverse environmental or economic factor—must discuss how the condition affects the value and/or marketability of the property being appraised and explain how the condition was taken into consideration in the valuation process. In such cases, we expect the appraiser's analysis to reflect and include comparable sales that are similarly affected, whenever possible. For example, if a property is located in an urban neighborhood that has vacant or boarded-up properties that affect the value and/or marketability of properties in the neighborhood, the appraiser needs to address these conditions in his or her analysis and appraisal report, and to use comparable sales from the same neighborhood (whenever possible) to assure that any effect of the vacant or boarded-up properties is taken into consideration in the development of the opinion of market value for the subject property. The appraiser would also need to address the reasons for the vacancies or boarded-up properties in factual terms (by providing data related to such things as demand/supply, foreclosure rates, tax sales, etc.) and discuss how this factor affects the market value and marketability of the property being appraised and other properties in the neighborhood.

Section 102.02 – Unacceptable Appraisal Practices

Since we hold the lender responsible for the quality of the appraisals it uses to support the value of a security property, the lender should take appropriate action to assure that the appraisers it uses do not engage in unacceptable practices. The following are examples of appraisal practices that we consider as unacceptable:

- Development of and/or reporting an opinion of value that is not supportable by market data or that is misleading;
- Development of a valuation conclusion that is based—either partially or completely—on the sex, race, color, religion, handicap, national origin, or familial status of either the prospective owners or occupants of the subject property or the present owners or occupants of the properties in the vicinity of the subject property; or that is based on any other factor that local, state, or federal law designates as being discriminatory, and thus, prohibited;
- Inclusion of inaccurate factual data about the subject neighborhood, site, improvements, or comparable sales;
- Failure to comment on negative factors with respect to the subject neighborhood, subject property, or proximity of the subject property to adverse influences;
- Failure to analyze and report any current agreement of sale, option, or listing of the subject property and the prior sales of the subject property and the comparable sales;
- Selection and use of inappropriate comparable sales or the failure to use comparable sales that are locationally and physically the most similar to the subject property;
- Creation of comparable sales by combining vacant land sales with the contract purchase price of a home that has been built or will be built on the land;

- Use of comparable sales in the valuation process even though the appraiser has not personally inspected the exterior of the comparable properties by, at least, driving by them;
- Use of adjustments to the comparable sales that do not reflect the market's reaction to the differences between the subject property and the comparable sales, or the failure to make adjustments when they are clearly indicated;
- Use of data---particularly comparable sales data---that was provided by parties who have a financial interest in the sale or financing of the subject property without the appraiser's verification of the information from a disinterested source. For example, it would be inappropriate for an appraiser to use comparable sales provided by the real estate broker who is handling the sale of the subject property, unless the appraiser verifies the accuracy of the data provided with another source and makes an independent investigation to determine that the comparable sales provided were the best ones available;
- Development of and/or reporting an appraisal in a manner or direction that favors either the cause of the client or any related party, the amount of the opinion of value, the attainment of a specific result, or the occurrence of a subsequent event in order to receive compensation and/or employment for performing the appraisal and/or in anticipation of receiving future assignments; and
- Development of and/or reporting an appraisal in a manner that is inconsistent with the requirements of the Uniform Standards of Professional Appraisal Practice that were in place as of the effective date of the appraisal.

Section 103 – Refusal to Accept Certain Appraisals

From time to time, we may refuse to accept appraisals prepared by specific appraisers or we may notify a lender that we will no longer accept appraisals prepared by a given appraiser. When we notify a lender that we will no longer accept appraisals from a particular appraiser, we will allow the lender a certain amount of time to clear its mortgage pipeline. After that, it must not submit to us any mortgages secured by properties appraised by that individual.

We may also refer unacceptable appraisal reports to the appropriate state appraiser licensing or regulatory boards for investigation and action. Our decision to make such referrals does not affect the lender's responsibility for managing the property valuation and appraisal review process.

Chapter 2. Appraisal (or Property Inspection) Documentation

The lender must disclose to the appraiser any and all information about the subject property that it is aware of, if the information could affect either the marketability of the property or the appraiser's opinion of the market value of the property. Specifically, the lender must make sure that it provides the appraiser with all appropriate financing data and sales concessions for the subject property that will be, or have been, granted by anyone associated with the transaction. 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. If the lender is aware of additional pertinent information that is not included in the sales contract, it should inform the appraiser. Information that must be disclosed includes:

- settlement charges;
- loan fees or charges;
- discounts to the sales price;
- payment of condominium/PUD fees;
- interest rate buydowns, or other below-market-rate financing;
- credits or refunds of the borrower's expenses;
- absorption of monthly payments;
- assignment of rent payments; and
- non-realty items that were included in the transaction.

The lender must also disclose to the appraiser any information about an environmental hazard in or on the subject property or in the vicinity of the property that it obtains from the borrower, the real estate broker, or any other party to the transaction so the appraiser can consider any influence the hazard may have on the value and marketability of the property.

Section 201 – Age of Appraisal (or Property Inspection)

The property must have been appraised (or inspected, if that is the level of property fieldwork recommended for a Desktop Underwriter-processed mortgage) within the 12 months that precede the date of the note and mortgage.

When an appraisal report will be more than four months old on the date of the note and mortgage—regardless of whether the property was appraised as proposed or existing construction—the appraiser must inspect the exterior of the property and review current market data to determine whether the property has declined in value since the date of the original appraisal.

- If the appraiser indicates that he or she believes that the property has declined in value, the lender must obtain a new appraisal for the property.
- If the appraiser indicates that he or she believes that the property has *not* declined in value, the lender should request the appraiser to provide an update to the appraisal, based on his or her exterior

inspection of the property and knowledge of current market conditions. The inspection and the appraisal update must occur within the four months that precede the date of the note and mortgage.

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 appraisal update; however, the lender may use a substitute appraiser. In such cases, the substitute appraiser must review the original appraisal and express an opinion about whether the original appraiser's opinion of market value was reasonable on the date of the original appraisal report. The lender should note in its files why the original appraiser was not used.

When a property inspection report for a Desktop Underwriter-processed mortgage will be more than four months old on the date of the note and mortgage, the appraiser must re-inspect the property and prepare a new *Desktop Underwater Property Inspection Report* (Form 2075).

Section 202 – Status of Construction

Generally, we require the improvements for the subject property to have been completed when the mortgage is delivered to us. However, we do make some exceptions to this and, in such cases, an appraisal report should be developed in accordance with the following criteria:

- For *new* or *proposed construction*, an appraisal may be based on either plans and specifications or an existing model home, if the lender obtains a certification of completion before it delivers the mortgage to us. This certification should be completed by the appraiser, state that the improvements were completed in accordance with the requirements and conditions in the original appraisal report, and be accompanied by photographs of the completed improvements.

When the completion of certain items that are included as part of the sales contract-such as landscaping, a driveway, or a sidewalk-or other minor items that do not affect the ability to obtain an occupancy permit has to be postponed for some reason, the lender may deliver the mortgage before these postponed items are completed if it represents and warrants that the postponed improvements will be completed within 180 days after the date of the mortgage note. The appraisal report must show both the cost of completing the postponed items and the "as completed" value of the property after completion of the postponed improvements, although no dollar-for-dollar adjustments should be made. The cost of completing any minor improvements must not represent more than 2 % of the "as completed" appraised value of the property.

- The lender must establish a "completion escrow" for the postponed improvements, by withholding from the purchase proceeds funds equal to 120% of the estimated cost for completing the improvements. However, if the contractor or builder offers a guaranteed "fixed price" contract for completion of the improvements, the funds in the "completion escrow" only need to equal the full amount of the contract price.
- The lender and the borrower must enter into an escrow agreement that determines how the lender will manage and disburse funds from the escrow account. Once a certificate of completion is obtained, the lender must release the final draw from the escrow account (which should include any funds in excess of the amount needed to pay for completion of the postponed items). The final title report must not show any outstanding mechanic's liens or take any exceptions to the postponed improvements or the escrow

agreement. If the final title report is issued before the completion of the improvements, the lender must obtain an endorsement to the title policy that ensures the priority of our lien.

- For *existing construction*, an appraisal may be based on the "as is" condition of the property if minor conditions that do not affect the livability of the property exist-such as minor deferred maintenance-as long as the appraiser's opinion of value reflects the existence of these conditions. The lender must review carefully the appraisal for a property appraised in an "as is" condition to assure that the property does not have any physical deficiencies or conditions that would affect its livability. If there are none, the lender does not need to require minor repairs to be completed before it delivers the mortgage to us.

When there are incomplete items or conditions that do affect the livability of the property-such as a partially completed addition or renovation-or physical deficiencies that could affect the soundness or structural integrity of the improvements, the property must be appraised subject to completion of the specific alterations or repairs. In such cases, the lender must obtain a certificate of completion from an appraiser before it delivers the mortgage to us. The certification does not need to include photographs of the property unless those that accompanied the original appraisal report are no longer representative of the completed property.

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

Section 203 – Appraisal (or Property Inspection) Reports

Our appraisal report forms recognize the Uniform Standards of Professional Appraisal Practice as the minimum appraisal standards for the appraisal industry. In addition, we have established our own separate appraisal requirements to supplement the Uniform Standards because we believe that this is necessary to assure that all of our specific concerns are addressed for any given appraisal. Our appraisal report forms are designed in a way that results in an appraiser's being in full compliance with our requirements if he or she provides all of the information required by the forms and presents the applicable data accurately and completely.

The appraisal report forms we use provide a concise format for presenting both the appraiser's description of the subject property and the valuation analysis that leads to the opinion of market value. The appraisal report that should be used generally depends on the underwriting method and the type of property that is being appraised. The appraiser must complete our forms in a way that will clearly reflect the thoroughness of his or her investigation and analysis and provide the rationale for the opinion of market value. Although the scope or extent of the appraisal process is guided by our appraisal report forms, the forms do not limit or control the appraisal process. The appraiser's analysis should go beyond any limitations of the forms, with additional comments and exhibits being used if they are needed to adequately describe the subject property, document the analysis and valuation process, or support the appraiser's conclusions. The extent of the appraiser's data collection, analysis, and reporting must be determined by the complexity of the appraisal assignment.

An appraiser may use computer software programs that are designed to reproduce our appraisal report forms-including programs that have "expandability" features that allow increases in areas of the forms that call for the insertion of narrative comments. However, the sequence of the information-as well as all of the specific information (including the instructions, entries, directions, etc.)-must be exactly as it appears on the hard-copy of the form(s).

A lender may accept an appraisal report that is transmitted electronically using facsimile (fax) machines, Internet connections, wireless transmissions, or any other types of transmissions that use public or private telephone lines-as long as the appraisal report adequately identifies the appraiser and includes a reproduced signature of the appraiser whose name appears on the report, and the lender represents and warrants to us that the appraisal report was created by the appraiser identified on the appraisal report and that the appraisal report is the complete and unaltered report submitted by the identified appraiser. The lender may store any appraisal reports it receives (whether they are originally provided as paper documents or in electronic format) by using any photographic, electronic, optical, or other storage technology that enables it to retrieve and reproduce a complete and clear copy of an appraisal report (and its related addenda, photographs, and attachments) at any time in response to a request from us. Regardless of the transmission or storage method used, the lender will be responsible for the accuracy of the information and the integrity of the documents and for assuring that the appraisal was prepared in accordance with our appraisal guidelines.

Section 203.01 – Manually Underwritten Mortgages

We have five different appraisal forms that can be used for manually underwritten mortgages, depending on either the type of property being appraised or the type of mortgage that is secured by the property. The appraiser must use our latest version of one of the following forms and include any other data-either as an attachment or addendum to the appraisal report form-needed to adequately support the opinion of market value:

- *Uniform Residential Appraisal Report* (Form 1004), for one-family properties and units in planned unit developments (including those that have an illegal second unit or accessory apartment that we will consider as acceptable security) that secure either first or second mortgages. Form 1004 may also be used for two-family properties, if each of the units is occupied by one of the co-borrowers as his or her principal residence or if the value of the legal second unit is relatively insignificant in relation to the total value of the property (as might be the case for a basement unit or a unit over a garage). In addition, appraisals for units in condominium projects that consist solely of detached dwellings may be documented on Form 1004, if the appraiser includes an adequate description of the project and information about the owners' association fees and the quality of the project maintenance;
- *Small Residential Income Property Appraisal Report* (Form 1025), for two- to four-family properties (including those that are located in PUD projects);
- *Individual Condominium Unit Appraisal Report* (Form 1073), for one-family properties that are units in condominium projects;
- *Individual Cooperative Interest Appraisal Report* (Form 1075), for one-family properties that are units in cooperative projects; or
- *Desktop Underwriter Quantitative Analysis Appraisal Report* (Form 2055), for one-family principal residences and second homes (including units in condominium and PUD projects), provided the appraiser inspects both the interior and exterior of the property (If the property secures a Streamlined Purchase Money Mortgage Option 1, only the exterior of the property needs to be inspected.)

Section 203.02 – Desktop Underwriter-Processed Mortgages

We have three different streamlined appraisal forms that can be used for Desktop Underwriter-processed mortgages that are secured by one-family properties—the *Desktop Underwriter Quantitative Analysis Appraisal Report* (Form 2055), the *Desktop Underwriter Qualitative Analysis Appraisal Report* (Form 2065), and the *Desktop Underwriter Individual Cooperative Interest Appraisal Report* (Form 2095). In addition, we have a fourth form—the *Desktop Underwriter Property Inspection Report* (Form 2075)—which an appraiser uses to document an exterior property inspection (but not to provide an opinion of market value) when we rely on the property valuation performed by Desktop Underwriter's proprietary automated valuation models. Our *Small Residential Income Property Appraisal Report* (Form 1025) should be used for Desktop Underwriter-processed mortgages that are secured by two- to four-family properties.

When a mortgage is processed in Desktop Underwriter, the system will recommend the use of one of three levels of property fieldwork. Regardless of the recommended level, the lender remains responsible for the quality of the fieldwork and must manage the property appraisal (or inspection) process, select the appraiser, and order the appraisal (or property inspection) report. One of the following levels of property fieldwork and review will be recommended by Desktop Underwriter based on the results of its risk analysis for a mortgage:

- The appraiser must perform both an interior and an exterior inspection of the property, and summarize the results of his or her analysis on the current version of either the *Desktop Underwriter Quantitative Analysis Appraisal Report* (Form 2055) or the *Desktop Underwriter Individual Cooperative Interest Appraisal Report* (Form 2095), depending on the type of property;
- The appraiser should, at a minimum, perform only an exterior inspection of the property, and summarize the results of his or her analysis on the current version of either the *Desktop Underwriter Quantitative Analysis Appraisal Report* (Form 2055), the *Desktop Underwriter Qualitative Analysis Appraisal Report* (Form 2065) or, if applicable, the *Desktop Underwriter Individual Cooperative Interest Appraisal Report* (Form 2095); or
- The appraiser should, at a minimum, perform only an exterior inspection of the property, and summarize the results of the inspection on the *Desktop Underwriter Property Inspection Report* (Form 2075).

The level of fieldwork recommended by Desktop Underwriter represents our minimum documentation requirements for the property. The lender may choose either to obtain the minimum documentation we require or to ask the appraiser to provide additional documentation (based on the specific characteristics of the individual case).

Desktop Underwriter's option of performing an appraisal based only on an exterior inspection of the property is predicated on the appraiser's ability to obtain sufficient information about the physical characteristics of the property from reliable sources. The appraiser's description of the physical characteristics of the property should be based on what he or she considers to be reliable data sources for the property and location. The appraiser should use the same type of data sources that he or she uses for comparable sales-multiple listing service information, tax and assessment records, observations from prior inspections, previously prepared appraisal files, information provided by the property owner, etc. If the exterior inspection of the property does not provide enough information for the appraiser to perform the appraisal, the appraiser must also inspect the interior of the property. For example, the appraiser might choose to inspect the interior of the property if he or she cannot adequately view the property improvements from the street; is unable to reconcile significant discrepancies among available data

sources with respect to size, condition, or other factors about the property; identified apparent physical deficiencies or adverse property conditions during the exterior inspection; needs additional information for a property that is undergoing rehabilitation; etc.

Section 204 – Exhibits to Appraisal (or Property Inspection) Reports

We require certain exhibits to support each appraisal (or property inspection) report. The exhibits may vary depending on the underwriting method, the type of property, whether the borrower is purchasing the property as a residence or for investment purposes, or the type of property inspection performed.

Section 204.01 – Manually Underwritten Mortgages

Unless we specify otherwise, we require the following exhibits for any appraisal report that is used for a manually underwritten mortgage:

- A street map that shows the location of the subject property and of all comparables that the appraiser used;
- An exterior building sketch of the improvements that indicates the dimensions. (For a unit in a condominium or cooperative project, the sketch of the unit must indicate interior perimeter unit dimensions rather than exterior building dimensions.) Generally, the appraiser must also include calculations to show how he or she arrived at the estimate for gross living area; however, for a unit in a condominium or cooperative project, the appraiser may rely on the dimensions and estimate for gross living area that are shown on the plat in such cases, the appraiser does not need to provide a sketch of the unit as long as he or she includes a copy of the plat with the appraisal report. A floor plan sketch that indicates the dimensions is required instead of the exterior building or unit sketch if the floor plan is atypical or functionally obsolete, thus limiting the market appeal for the property in comparison to competitive properties in the neighborhood;
- Clear, descriptive photographs (either in black and white or color) that show the front, back, and a street scene of the subject property, and that are appropriately identified. (Photographs must be originals that are produced either by photography or electronic imaging.);
- Clear, descriptive photographs (either in black and white or color) that show the front of each comparable sale and that are appropriately identified. (We do not require photographs of comparable rentals and listings.) Generally, photographs should be originals that are produced by photography or electronic imaging; however, copies of photographs from a multiple listing service or from the appraiser's files are acceptable if they are clear and descriptive;
- Certification of completion or appraisal update-either as a letter or as a form that provides the necessary information-if applicable;
- An *Operating Income Statement* (Form 216) or a similar cash flow and operating income statement, if the property is an investment property (including a two- to four-family property in which the applicant will occupy one unit as a principal residence). Generally, the statement may be prepared by either the applicant or the appraiser (although the applicant for a Community Living mortgage must prepare the statement). (When the applicant prepares a Form 216, the appraiser's comments on the reasonableness of the projected operating income must be included on the form. When the appraiser prepares a Form 216, the lender must make sure the appraiser has operating statements; expense statements related to mortgage insurance premiums, owners' association dues, leasehold payments, or subordinate financing payments; and any other pertinent information related to the property.);

- A *Single-Family Comparable Rent Schedule* (Form 1007), if the property is a one-family investment property (other than one that secures a Community Living mortgage); and
- Any other data-as an attachment or addendum to the appraisal report form-that are necessary to provide an adequately supported opinion of market value.

Section 204.02 – Desktop Underwriter-Processed Mortgages

The exhibits required for any appraisal or property inspection report that is used for a Desktop Underwriter-processed mortgage are based on the type of property inspection that Desktop Underwriter recommends:

- If Desktop Underwriter recommends an exterior only inspection of the property--using either the *Desktop Underwriter Quantitative Analysis Appraisal Report* (Form 2055), the *Desktop Underwriter Qualitative Analysis Appraisal Report* (Form 2065), or the *Desktop Underwriter Individual Cooperative Interest Appraisal Report* (Form 2095)-the only exhibits we require are a street map that shows the location of both the subject property and the comparable sales and a photograph that shows the front scene of the subject property. When Forms 2055 and 2065 are used in connection with a one-family investment property, the *Single Family Comparable Rent Schedule* (Form 1007) should accompany the appraisal report.
- If Desktop Underwriter recommends an exterior only inspection of the property-using the *Desktop Underwriter Property Inspection Report* (Form 2075)-the only exhibits we require are a street map that shows the location of the subject property and a photograph that shows the front scene of the subject property.
- If Desktop Underwriter recommends both an interior and exterior inspection of the property-using either the *Desktop Underwriter Quantitative Analysis Appraisal Report* (Form 2055) or the *Desktop Underwriter Individual Cooperative Interest Appraisal Report* (Form 2095)-we require all of the same exhibits that are used to support the appraisal forms for manually underwritten mortgages (as discussed in Section 204.01 above).

Section 205 – Definition of Market Value

Our definition of market value is intended to assure that appraisals reflect an opinion of market value after adjustments for any special or creative financing or sales concessions-such as seller contributions, interest rate buydowns, etc.-have been made. The appraiser must certify that he or she used the following definition of market value:

Market value is the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing= of title from seller to buyer under conditions whereby: (1) buyer and seller are typically motivated; (2) both parties are well informed or well advised, and each acting in what he considers his own best interest; (3) a reasonable time is allowed for exposure in the open market; (4) payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and (S) the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

*Adjustments to the comparables must be made for special or creative financing or sales concessions. No adjustments are necessary for those costs which are normally paid by sellers as a result of tradition or law in a market area; these costs are readily identifiable since the seller pays these costs in virtually all sales transactions. Special or creative financing adjustments can be made to the comparable property by comparisons to financing terms offered by a third party institutional lender that is not already involved in the property or transaction. Any adjustment should not be calculated on a mechanical dollar for dollar cost of the financing or concession but the dollar amount of any adjustment should approximate the market's reaction to the financing or concessions based on the appraiser's judgment.

The asterisk section of the definition provides consistent interpretation for the appraiser. Specifically, we want to emphasize that the phrases "...those costs which are normally paid by sellers as a result of tradition or law in a market area; these costs are readily identifiable since the seller pays these costs in virtually all sales transactions..." refer to all of the sellers in a specific market area. No distinction is made between a specific group of sellers, builders, developers, or individuals in the resale market---they are all considered to be individual sellers in the market. To illustrate: When a property seller is paying part of the purchaser's settlement or closing costs-or is paying for an interest-rate buydown or other below-market financing-but virtually all of the other sellers in the market are *not* doing the same as a result of law or tradition, the appraiser would need to make an adjustment even if there are other groups of sellers-such as builders-who are also offering concessionary financing.

The appraiser can adjust a comparable property that has special or creative financing or sales concessions by comparing it to other properties that had financing terms offered by a third party institutional lender-as long as that lender is not already involved in the subject property or transaction. The appraiser should use his or her judgment in establishing the dollar amount for any adjustment to assure that it approximates the market's reaction to the financing or concession at the time of the sale.

Section 206 – Certifications and Statements of Limiting Conditions

Each of our appraisal (or property inspection) report forms includes an appraiser's certification (and, if applicable, a supervisory appraiser's certification) and a statement of limiting conditions. Some forms include the limiting conditions and certifications as part of the form itself; others require the use of a separate document as an exhibit to the appraisal report.

- The *Statement of Limiting Conditions and Appraiser's Certification* (Form 1004B) must be included as an exhibit for appraisals prepared on the *Uniform Residential Appraisal Report* (Form 1004), the *Small Residential Income Property Appraisal Report* (Form 1025), the *Individual Condominium Unit Appraisal Report* (Form 1073), or the *Individual Cooperative Interest Appraisal Report* (Form 1075). Form 100413 includes ten limiting conditions and nine appraiser's certifications, as well as a supervisory appraiser's certification.

To acknowledge that the current version of the Form 1004B was used and to assure the lender that the appraiser is certifying to our current definition of value, the appraiser must insert "06/93" in the blank that references "Freddie Mac Form 439/Fannie Mae Form 1004B (Revised

)" in the "Reconciliation" section of the applicable appraisal report form.

- A Statement of Limiting Conditions and Appraiser's Certification is included as part of the form for appraisals prepared on the *Desktop Underwriter Quantitative Analysis Appraisal Report* (Form 2055), the *Desktop Underwriter Qualitative Analysis Appraisal Report* (Form 2065), and the *Desktop Underwriter Individual Cooperative Interest Appraisal Report* (Form 2095). Each of these appraisal

forms includes nine contingent and limiting conditions and eleven appraiser's certifications, as well as a supervisory appraiser's certification.

- A Statement of Limiting Conditions and Appraiser's Certification is included as part of the form for property inspections prepared on the *Desktop Underwriter Property Inspection Report* (Form 2075). Because this form is not used to express the appraiser's opinion of market value, it includes only a few contingent and limiting conditions, five appraiser's certifications, and the supervisory appraiser's certification.

The appraiser may not make a change or a deletion to the appraiser's certifications, although he or she may make additional certifications on a separate page or form. Acceptable additional certifications might include those required by state law, those related to the appraiser's continuing education or membership in an appraisal organization, or those related to the appraiser's compliance with privacy laws and regulations in the development, reporting, and storage of an appraisal and the information on which it is based. (An appraiser may not add additional limiting conditions.) The lender is responsible for reviewing any additional certifications made by an appraiser to assure that they do not conflict with any of our policies or with the standard certifications on our various appraisal forms or Form 1004B.

Chapter 3. Special Appraisal Considerations

Some types of properties require special consideration in the property and appraisal review processes to recognize the special contributions of unusual features, the detrimental effect of certain environmental conditions, or the need to meet specific criteria in order for a mortgage secured by the property to be eligible for delivery to Fannie Mae.

Units in condominium, PUD, or cooperative projects also require special consideration because of the interrelationship between the property being appraised and other units within the development or project. We will purchase or securitize unit mortgages in condominium, PUD, or cooperative projects that meet our project eligibility criteria. To determine project eligibility, a lender often needs access to certain project information that is not always readily available—such as information about the project's insurance coverage, legal documents, or budget; the payment status of owners' association (or cooperative corporation) fees; and the ownership and occupancy status of individual units within the project. For this reason, we allow the lender to rely on the appraiser, the owners' association (or cooperative corporation), the management company, the real estate broker, and the project developer as sources for information, although we expect the lender to make a diligent effort to ensure the accuracy of the information obtained from these sources. Project acceptance—and the availability of financing—often depends on the willingness of the owners' association, cooperative corporation, or management company to obtain and provide requested information.

Section 301 – Units in Condominium Projects

A condominium project is one in which individual owners hold title to units in the project along with an undivided interest in the real estate that is designated as the common area for the project.

Appraisals for condominium units that secure manually underwritten mortgages are usually documented on the *Individual Condominium Unit Appraisal Report* (Form 1073) or the *Desktop Underwriter Quantitative Analysis Appraisal Report* (Form 2055). However, we will accept appraisals of detached condominium units on the *Uniform Residential Appraisal Report* (Form 1004), if the appraiser includes an adequate description of the project and information about the owners' association fees and the quality of the project maintenance. Desktop Underwriter will specify the level of property analysis and review for Desktop Underwriter-processed mortgages that are secured by condominium units.

The appraisal of an individual unit in a condominium project requires the appraiser to analyze the condominium project as well as the individual unit. The appraiser must pay special attention to the location of the individual unit within the project, the project's amenities, and the amount and purpose of the owners' association assessment since the marketability and value of the individual units in a project depend on the marketability and appeal of the project itself.

Section 302 – Units in PUD Projects

A planned unit development (PUD) is a project or subdivision that consists of common property and improvements that are owned and maintained by an owners' association for the benefit and use of the individual units within the project. For a project to qualify as a PUD, the owners' association must require automatic, nonseverable membership for each individual unit owner, and provide for mandatory assessments. Zoning should not be the basis for classifying a project as a PUD.

Appraisals for PUD units that secure manually underwritten mortgages are generally documented on the *Uniform Residential Appraisal Report* (Form 1004) or the *Desktop Underwriter Quantitative Analysis Appraisal Report* (Form 2055). To assure that all the specific eligibility criteria for a new

PUD project are adequately addressed, it may be necessary to use an addendum to Form 1004 to provide information for appraisals related to attached units in new PUD projects (particularly when the developer is still in control of the owners' association). Desktop Underwriter will specify the level of property analysis and review for Desktop Underwriter-processed mortgages that are secured by PUD units.

The appraisal of an individual unit in a PUD requires the appraiser to analyze the PUD project as well as the individual unit. The appraiser must pay special attention to the location of the individual unit within the project, the project's amenities, and the amount and purpose of the owners' association assessment since the marketability and value of the individual units in a project generally depend on the marketability and appeal of the project itself.

Section 303 – Units in Cooperative Projects

When an appraiser evaluates a cooperative unit, he or she must develop an opinion of the market value of the cooperative interest. The cooperative interest is the cooperative shares or other evidence of an ownership interest in the cooperative corporation and the accompanying occupancy rights (excluding the cooperative interest's *pro rata* share of the debt service of the blanket mortgage). In other words, the cooperative interest is the equity portion that is over and above the *pro rata* share of the blanket mortgage(s).

To determine the value of the cooperative interest, the appraiser must consider and report among other things, the information listed below on the *Individual Cooperative Interest Appraisal Report* (Form 1075) or the *Desktop Underwriter Individual Cooperative Interest Appraisal Report* (Form 2095). [Much of this information can be obtained from the *Request for Cooperative Project Information* (Form 1074), if the management agent, cooperative board, or project sponsor/developer uses this form to respond to the lender's or the appraiser's inquiries for project information. When Form 1074 is used, the appraiser may either transcribe the appropriate information to the applicable appraisal report or attach Form 1074 to the report as an addendum.]

- The number of shares attributable to the unit and the number of shares issued and outstanding for the cooperative corporation;
- The name of the lienholder, the lien position, and the amount and repayment terms of all project blanket financing;
- The *pro rata* share of the blanket mortgage payments that are attributable to the unit, as determined by dividing the number of shares attributable to the unit by the total number of project shares;
- The *pro rata* share of each lien that is attributable to the unit;
- Any tax abatements or exemptions that are attributable to the unit, and their remaining term and provisions for escalation of real estate taxes. (The dollar amount by which the taxes will increase and the year in which the increase will occur should be shown); and
- Any monthly maintenance fees (including utility charges if they are part of these fees), monthly special assessments, ground rent, or other fees for the use of the facilities that are attributable to the unit, and their type, amount, and term (if applicable).

The appraiser must use reliable sources to obtain data on the cooperative project, the individual subject unit, and the comparable properties, and indicate the name of each source on the appraisal report (or in an addendum to it). The appraiser must address any factors that could result in an increase to the monthly debt service for the subject unit. For comparison purposes, the appraiser should indicate in the "sales comparison analysis" adjustment grid the dollar amount of the monthly assessments for each of the comparable sales.

In many areas, there is limited experience with the cooperative form of ownership. The appraiser always must comment on the acceptance of housing cooperatives in the market area. The degree of acceptance is generally reflected in the availability of similar comparable sales data for cooperative units. If there is limited market acceptance of the cooperative form of ownership, or if it is a relatively new form of ownership in the market area, the appraiser must address any effect that has on the marketability and value of the unit that is being appraised. Because we are concerned about the marketability of the subject property, the appraiser must compare the subject unit to the general market area as well as to other units in the subject cooperative project. This comparison should help demonstrate market acceptance of cooperative units in the area. If the appraiser believes that the submission of more than the three required comparable sales is appropriate to support the opinion of market value, he or she should submit other comparable sales-including contracts for sale-as additional supporting data. Comparable sales must be from similar types of projects--townhouses, mid-rise, high-rise, etc.-that have similar common amenities and recreational facilities.

Generally, when an appraiser appraises a unit in a cooperative project, he or she should use sales of cooperative units as comparables. However, the appraiser may use sales of condominium units as comparables if cooperative unit sales are not available, as long as he or she explains why those types of comparables were used. When there is a preference for condominium ownership in the subject market area, the appraiser must adjust the condominium comparables to reflect the reaction of the market to the cooperative unit.

If the subject property is a unit in a new or recently converted cooperative project, the appraiser should select as comparables one closed or settled sale from the subject project (if one is available) and two closed or settled sales from outside of the project. If closed or settled sales are not available in the subject project, the appraiser should use comparable sales from competing projects. When the subject property is a unit in an established cooperative project-one that has resale activity-the appraiser should use as comparables two closed or settled sales from within the subject project (if available) and one closed or settled sale from a competing project.

The appraiser must report the value of the cooperative interest, excluding its *pro rata* share of the blanket mortgage(s). This value reflects the market value for the cooperative interest of the unit. [To illustrate: When the indicated value of the unit encumbered by the blanket mortgage(s) is \$100,000 and its *pro rata* share of the blanket mortgage(s) is \$25,000, the value estimate that the appraiser should report for the cooperative interest of the unit is \$75,000.] The appraiser certifies in the appraisal report that the *pro rata* share of the blanket mortgage(s) on the real estate has not been included in the opinion of the market value of the cooperative interest.

Section 304 – Factory-Built Housing

Factory-built housing includes manufactured homes, modular homes, and other types of prefabricated housing. We purchase mortgages secured by factory-built housing that is designed as a one-family dwelling, assumes the characteristics of site-built housing, and is legally classified as real property. We require the factory-built home to be permanently affixed to a foundation system that is appropriate for the soil conditions of the site and designed to meet local and state codes.

The appraiser must identify the type of factory-built housing that is to be appraised since that is an important criteria in defining the appropriate market area and in selecting comparable properties.

- *A manufactured home* must be built (and installed) under the Federal Manufactured Home Construction and Safety Standards that HUD established in 1976, as they were in force at the time the home was manufactured. This can be verified by the presence of a HUD Data Plate/Compliance Certificate that is located inside the home, The appraiser must include as part of his or her appraisal report some of the information that is included on the certificate-the manufacturer's name, the trade/model name, the year of manufacture, and the serial number.
- *A modular home* must be built under the Uniform Building Code that is administered by the state agency that is responsible for adopting and administering building code requirements for the state in which the modular home is installed.
- *A factory-built home that is any other type of prefabricated, panelized, or sectional housing* does not have to satisfy either HUD's Federal Manufactured Home Construction and Safety Standards or the Uniform Building Codes that are adopted and administered by the state in which the home is installed, The home must conform with local building codes in the area in which it will be permanently located.

We do not have minimum requirements for width, size, roof pitch, or any other specific construction detail for manufactured homes, modular homes, or any other types of factory-built homes. Rather, each home must have sufficient square footage and room dimensions to be acceptable to typical purchasers in the subject market area. Since quality can account for large differences in the values of factory-built homes, it is important for the appraiser to become familiar with the features that affect the quality of a factory-built home so that the information can be included in the appraisal report (if needed) to support his or her opinion of value.

The process of selecting comparable sales for factory-built housing is generally the same as that for selecting comparable sales for site-built housing. The appraiser must address both the marketability and comparability of a manufactured home by selecting comparable sales of similar manufactured homes-comparing single-width homes to single-width homes, multiwidth homes to multiwidth homes, etc, If at least three comparable sales of similar manufactured 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 manufactured 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, An appraiser who is unable to locate sales of manufactured homes that are truly comparable to the subject property may decide that it is appropriate to use as comparables either older sales of similar manufactured homes or sales of similar manufactured homes that are located in a competing market so that he or she can establish a baseline for the "sales comparison analysis" and determine sound adjustments to reflect the differences between the comparable sales that are available and the subject property. The appraiser should analyze and report a sufficient number of comparable sales to support his or her opinion of value (which may require the use of more than three comparable sales in some cases). The appraiser must not "create" comparable sales by combining vacant land sales with the contract purchase price of the home (although he or she may use this type of information as additional supporting documentation). If the appraiser is unable to develop a reliable appraisal based on at least two comparable sales of similar manufactured homes, the mortgage is not eligible for delivery to us.

We also require the appraiser to address both the marketability and comparability of modular homes and other types of factory-built housing. When the subject property is modular, prefabricated, panelized, or

sectional housing, we do not require that one or more of the comparable sales be the same type of factory-built housing (although using comparable sales of similar types of homes generally enhances the reliability of the appraiser's opinion of value). We do expect the appraiser to include in the appraisal report the most appropriate comparable sales data to support his or her opinion of value for the subject property.

Section 305 – Community Living Group Homes

The group home that secures a Community Living mortgage must maintain its residential nature and have no modifications that would make it unacceptable as a one- or two-family residence. The property appraisal for a one-family property should be documented on the *Uniform Residential Appraisal Report* (Form 1004), while the appraisal for a two-family property should be documented on the *Small Residential Income Property Appraisal Report* (Form 1025). The appraiser generally does not need to use other group home properties as comparable sales in developing the sales comparison approach to value because we expect the appraised value to reflect the value of the group home as a typical one- or two-family residence. The appraiser will not need to analyze and report comparable rental properties on the *Single-Family Comparable Rent Schedule* (Form 1007) since the room and board payments received under the contract with the state or local funding agency are not dependent on, or comparable to, market rents. However, we do expect the lender's underwriter to review the rent information that appears on our *Operating Income Statement* (Form 216) or a similar cash flow and operating income statement and to make any adjustments that are needed for any income and expense items that appear unreasonable for the market in which the group home is located.

When the loan proceeds are used to fund repairs or rehabilitation to the group home property, the appraiser must have demonstrated competence and experience in evaluating properties for rehabilitation financing.

- If the rehabilitation work has already been completed, the appraiser's opinion of value must reflect the completion of the improvements-and the borrower must provide evidence showing that the work was paid for from the borrower's own funds.
- If the rehabilitation work has not been completed, the appraiser must review the plans and specifications (and attach them to the appraisal report) and provide an opinion of the "as completed" value of the property. The "as completed" value must be supported by market data that demonstrates the contributory value of the repairs and renovations. We will not require a second appraisal after completion of the repairs or renovations-as long as the appraiser provides a certification of completion stating that the work was completed in accordance with the plans and specifications. (If the original appraiser is not available: to make the certification of completion, the lender may use a substitute appraiser provided that the appraiser reviews the original "as completed" appraisal so that he or she can certify that the property was completed in accordance with the plans and specifications.)

Section 306 – Mixed-Use Properties

Although we will purchase or securitize mortgages that are secured by properties that have a business use in addition to their residential use-such as a property with space set aside for a day care facility, a beauty or barber shop, a doctor's office, a small neighborhood grocery or specialty store, etc.-we have special eligibility criteria for them. Therefore, the appraiser must provide an adequate description of the mixed-use characteristics of the subject property in the appraisal report and the lender must make sure that it considers these criteria and adequately addresses them. Specifically, for a mixed-use property to be acceptable, the following criteria must be met:

- The property must be a one-family dwelling that the borrower occupies as a principal residence.
- The mixed use of the property must represent a legal, permissible use of the property under the local zoning requirements.
- The borrower must be both the owner and the operator of the business.
- The property must be primarily residential in nature.
- The market value of the property must be primarily a function of its residential characteristics, rather than of the business use or any special business-use modifications that were made.

Section 307 – Properties Affected by Environmental Hazards

If the real estate broker, the property seller, the property purchaser, or any other party to the mortgage transaction informs the lender that an environmental hazard exists in or on the property or in the vicinity of the property, the lender must disclose that information to the appraiser and note the individual mortgage file accordingly. (We also require the lender to disclose such information to the borrower, and to comply with any state or local environmental laws regarding disclosure.)

When the appraiser has knowledge of any hazardous condition (whether it exists in or on the subject property or on any site within the vicinity of the property)-such as the presence of hazardous wastes, toxic substances, asbestos-containing materials, urea-formaldehyde insulation, radon gas, etc.-he or she must note the hazardous condition in the appraisal report and comment on any influence that the hazard has on the property's value and marketability (if it is measurable through an analysis of comparable market data as of the effective date of the appraisal) and make appropriate adjustments in the overall analysis of the property's value.

We do not consider the appraiser to be an expert in the field of environmental hazards. The typical residential real estate appraiser is neither expected nor required to be an expert in this specialized field. However, the appraiser has a responsibility to note in the appraisal report any adverse conditions that were observed during the inspection of the subject property or information that he or she became aware of through the normal research involved in performing an appraisal.

In rare situations, a particular environmental hazard may have a significant effect on the value of the subject property, although the actual effect is not measurable because the hazard is so serious or so recently discovered that an appraiser cannot arrive at a reliable opinion of market value because there is no comparable market data (such as sales, contract sales, or active listings) available to reflect the effect of the hazard. In such cases, the mortgage will not be eligible for delivery to us.

We will purchase or securitize a mortgage secured by a property that is affected by an environmental hazard if the effect of the hazard is measurable through an analysis of comparable market data as of the effective date of the appraisal and the appraiser reflects in the appraisal report any adverse effect that the hazard has on the value and marketability of the subject property or indicates that the comparable market data reveals no buyer resistance to the hazard. To illustrate: We are frequently asked to address the eligibility of mortgages secured by properties that are located in neighborhoods affected by radon gas or the presence of hazardous wastes. In such situations, we expect the appraiser to reflect any adverse effect or buyer resistance that is demonstrated and measurable through the available comparable market data. Therefore, when a property is located in a neighborhood that has a relatively high level of radon gas or is near a hazardous waste site, we expect the appraiser to consider and use comparable market data from the same affected area because the sales prices of settled sales, the contract sales prices of

pending sales, and the current asking prices for active listings will reflect any negative effect on the value and marketability of the subject property.

Although our guidelines expressly require the appraiser to include in the appraisal report comments about any influence that an environmental hazard has on the value and marketability of the property and to make appropriate adjustments to the overall analysis of the value of the property, we expect the lender to oversee the performance of the appraisers it employs. The lender must make the final decision about the need for inspections and the adequacy of the property as security for the mortgage requested. We expect the lender to exercise sound judgment in determining the acceptability of the property. For example, since we require the appraiser to comment on the effect of a hazard on the marketability and value of the subject property, the appraiser would have to note when there is market resistance to an area because of environmental hazards or any other conditions that affect well, septic, or public water facilities. When the lender has reason to believe that private well water that is on or available to a property might be contaminated as the result of the proximity of the well to hazardous waste sites, the lender is exercising sound judgment if it obtains a "well certification" to determine whether the water meets community standards.

Section 308 – Urban Properties

The valuation of properties in urban locations that are undergoing rehabilitation may also present some unique property valuation and underwriting issues. For example, some lenders underwrite mortgages in urban areas on a block-by-block basis. Block-by-block underwriting and appraisal analysis is acceptable in cases in which rehabilitation has started in the block in which the subject property is located (or in facing blocks that are visible to the property), but has not yet spread to the rest of the neighborhood. This enables the appraiser and the lender's underwriter to place weight on the positive influences of the rehabilitation efforts.

To a large extent, a block-by-block analysis simply focuses on the appraiser's definition of the neighborhood. Urban locations that are undergoing rehabilitation may involve relatively small neighborhoods (perhaps limited to a block or just a few blocks) because of the level of rehabilitation and buyer demand for properties that are being improved. In such cases, it is appropriate for the appraiser to emphasize the sales of properties that are undergoing rehabilitation (or that have been rehabilitated) in the immediate neighborhood (which is the block in which the property is located or facing blocks that are visible to the property). We expect the appraiser to demonstrate that local market conditions make block-by-block analysis appropriate, by illustrating that market evidence indicates that the rehabilitation of the properties in the neighborhood (or the general revitalization of the neighborhood) is a trend, not an isolated occurrence. If there is a lack of truly comparable sales in the neighborhood--either because of the level of rehabilitation or the relatively low number of sales transactions--the appraiser may need to analyze and use as comparable sales not only less similar properties from the subject neighborhood, but also properties from competing neighborhoods.

Section 309 – Affordable Housing Program Properties

Our standard appraisal policies and property underwriting guidelines apply to all mortgages we purchase, including those originated under affordable housing programs. Our standards specifically prohibit redlining and other unacceptable appraisal practices, and support the valuation of residential properties in all markets. The valuation of single-family properties that secure mortgages sold to us under affordable housing programs may present unique issues because of some of the features offered--such as below-market-rate financing, subsidized second mortgages, grants, and tax abatements.

The appraiser's role does not change when appraising a property that is sold under an affordable housing program. The appraiser is responsible for providing the lender with an accurate and adequately supported opinion of market value for the real property (based on our standard definition of market value) and a complete, accurate description of the property. The appraiser's opinion of the market value for the property must reflect the normal consideration for the property as of the effective date of the appraisal. Furthermore, the appraiser must adjust the comparable sales to reflect the effect of special or creative financing or sales concessions that were granted by any party associated with the sale of the property.

One of the options available for our community lending products-Community Seconds-has three components-a low down payment from the borrower, a conventional first mortgage, and a subsidized second mortgage. (See Part VIII, Chapter 2, for more information.) When this option is used, it would not be uncommon, for example, for the first mortgage to have a market-rate of interest and a loan-to-value ratio of 70% combined with a below-market interest rate second mortgage that has a loan-to-value ratio of 25% and forgivable or deferred terms. In such cases, buyers may be willing to pay a higher price for the property because of the special financing terms for the second mortgage. To acknowledge this, the appraiser needs to compare the property being appraised to comparable properties that sold without special financing terms and to make appropriate adjustments to any of the comparable sales that were sold with special or below-market-rate financing. To take this example further, assume that the security property for a Community Seconds transaction sold for \$100,000 as part of a local affordable housing redevelopment effort that included several similar transactions in the same neighborhood-and that the amount of the first mortgage is \$70,000 and the amount of the subsidized second mortgage is \$25,000. If similar houses that had market-rate financing sold for \$97,500, the appraiser (assuming that all other factors are equal) would need to adjust the comparable sales that had special financing to reflect the \$2,500 premium that the buyer was willing to pay for the special financing package associated with the Community Seconds transaction. The lender's underwriter would then make his or her underwriting decision based on the knowledge that the appraiser valued the real property at \$97,500, rather than the sales price of \$100,000. Because we calculate loan-to-value ratios based on the lower of the sales price or the appraised value, the underwriter should keep in mind that the actual loan-to-value ratio for the first mortgage would be 72% ($\$70,000/\$97,500$) and the combined loan-to-value ratio for the first and second mortgages would be 98% ($\$95,000/\$97,500$), rather than the 70% and 95% ratios that result when the sales price is used as the "value." For this reason, it is critical for the underwriter to separate the valuation of the property from the underwriting of the mortgage.

Section 310 – Properties in Special Assessment or Community Facilities Districts

Alternative methods for raising the capital necessary to satisfy utility and infrastructure requirements are sometimes used in the development of new residential communities. Generally, this involves the creation of local districts-special assessment districts or community facilities districts--that have the authority to assess homeowners for the cost of developing utility services and various infrastructure facilities (roads, sewer services, schools, police and fire protection services, libraries, etc.). We expect the lender to know whether or not a property is located in one of these districts and to be aware of the effect that assessments levied by the district could have on property values and the marketability of the subject property. The lender's appraiser, therefore, must give special consideration to the valuation of properties located in these districts.

Section 310.01 – Special Assessment Districts

Special assessment districts (which may also be called special tax districts or municipal utility districts) provide a specific service to homeowners living in a designated area. They are most often established to provide water or other utilities in areas that are not served by existing city or municipal utility services.

The need for these districts arises when an existing utility service does not have sufficient capacity (or may not find it economically feasible) to provide services for newly created subdivisions that are located beyond its current operating area. State law governing the establishment of special assessment districts varies greatly, as does the financial strength of the individual districts. The districts are granted the authority to assess owners of properties within their boundaries for funds that will be used to cover their operating costs and debt service.

Special assessment districts that are established to serve newly developing subdivisions with utilities often base their financial plans (and the amount of the assessment charged to each property owner) on the expected number of properties in the area to be served. The district then depends on the continuation of development to maintain its budget expectations. If, for any reason, development stops short of the degree of development that the district anticipated in preparing its budget, the district can become financially distressed and may need to impose an additional assessment on the existing homeowners.

When the property being appraised is located in a special assessment district, the lender should request the appraiser to report on any special assessments that affect the property. If the special assessment district is experiencing financial difficulty and that difficulty has an effect on the value or marketability of the subject property, the appraiser must reflect that in his or her analysis and note it in the appraisal report. To assure that the reaction of the market to the potential liabilities that may arise within a financially troubled special assessment district is reflected in his or her analysis, the appraiser should consider current and expired listings of properties for sale within the district and any pending contract sales and recent closed sales within the district. There may be some instances in which the financial difficulty of a special assessment district is so severe that its actual effect on the value and marketability of a property is not measurable because there is no comparable market data available to enable the appraiser to arrive at a reliable opinion of market value. When this is the case, a mortgage secured by a property in that district will not be eligible for delivery to us-at least until such time as an active market develops that will enable the appraiser to demonstrate the value and marketability of the subject property.

Section 310.02 – Community Facilities Districts

Some jurisdictions have passed legislation that creates community facilities districts and permits them to levy a special tax to fund the capital costs of a wide variety of public improvements, as well as the on-going operation and maintenance costs of a limited number of public services. Proceeds of the special tax are used to support the sale of tax-exempt bonds for the various capital improvements-roads, sewer services, schools, police and fire protection services, and libraries-that are allowed under the legislation.

The assessment that will be used to repay the tax-exempt bonds becomes an on-going responsibility of the property owner (similar to state and local property taxes). The assessment lien (and the obligation to pay the assessment) passes with the title to the property when ownership of the property is transferred. The term of the assessment obligation can be quite lengthy (up to 40 years-unless the assessment is prepaid). In some cases in California, prepayment estimates can range from \$20,000 to \$40,000 for a single-family property, depending on the extent of the improvements that were financed, the size of the dwelling, and the year it was purchased.

Such legislation generally requires full disclosure of the special assessment to any purchaser of a property located in a community facilities district. Therefore, a lender originating mortgages in community facilities districts should disclose to the appraiser any information that it becomes aware of regarding special assessments on a given property. The lender also should caution its appraisers in general about the need to be aware of whether or not the subject property and the comparable sales are located within (or affected by) a community facilities district since properties subject to an assessment

by one of these districts often compete against properties that are either subject to a significantly different special assessment or to no assessment at all. The appraiser must consider the reaction of the market (if any) to the assessment for the applicable community facilities district in his or her analysis by analyzing similarly affected comparable sales, and should note the effect of the assessment in the appraisal report.

Section 311 – Properties Subject to Leasehold Interests

When a mortgage is secured by a leasehold estate (or is subject to the payment of "ground rent"), the borrower has the right to use and occupy the real property under the provisions of a lease agreement (or ground lease) for a stipulated period of time, as long as the conditions of the lease are met. (When the lease holder is a community land trust, there may be significant restrictions on both the purchase and resale of the property; therefore, we provide more detailed guidance on appraising this type of leasehold estate in Section 312 below) The valuation of a property that is subject to a leasehold interest may require a complex analysis, so an appraiser should develop (and attach as an addendum to the appraisal report form) a thorough, clear, and detailed narrative that identifies the terms, restrictions, and conditions of the lease agreement or ground lease and discusses what effect, if any, they have on the value and marketability of the subject property.

In developing the sales comparison approach to value, the appraiser generally should use as comparable sales properties that have similar leasehold interests. When there are a sufficient number of closed comparable sales of properties with similar leasehold interests available, the appraiser should use them in its analysis of the market value of the leasehold estate for the subject property and report them in the "sales comparison analysis" grid on the applicable appraisal report form. However, if not enough comparable sales with the same lease terms and restrictions are available, the appraiser may use sales of similar properties with different lease terms or, if necessary, sales of similar properties that were appraised as fee simple estates-as long as he or she explains why the use of these sales is appropriate. In such cases, the appraiser must make an appropriate adjustment on the "sales comparison analysis" grid to reflect the market reaction to the different lease terms or property rights appraised.

Section 312 – Leaseholds Held by Community Land Trusts

Community land trusts are typically nonprofit organizations that acquire land for a variety of reasons-such as to facilitate home ownership among lower-income individuals and families or to maintain a permanently affordable housing stock in a given community. To reduce development costs to an affordable level, a community land trust uses grants, gifts, and subsidy dollars to acquire land (and then retains ownership of that land). The sales price for the improvements situated on the land does not include the subsidy amount used to acquire the land, which means that a borrower will pay a lower purchase price for his or her home (often less than the leasehold interest in the property). The trust offers the borrower a long-term (typically 99 years), renewable ground lease. Because of the affordable terms that it offers, a community land trust usually includes in its ground lease restrictions on borrower eligibility, as well as on the resale of the property improvements.

In selecting an appraiser to provide an opinion of value for a leasehold held by a community land trust, the lender must make sure that the appraiser is knowledgeable and experienced in the appraisal techniques-direct capitalization and market derivation of capitalization rates-that are necessary to appraise this type of property.

When a leasehold interest is held by a community land trust, the appraiser must analyze the property subject to the ground lease. Since the community land trust typically subsidizes the sales price to the borrower, that price may be significantly less than the market value of the leasehold interest in the

property. The resale restrictions (as well as other restrictions) that may be included in the ground lease can also affect the value of the property. However, we have developed a ground lease rider that the lender and the borrower must execute to remove such restrictions from the community land trust's ground lease (see Part VIII, Section 302). The land records for the subject property must include adoption of the terms and conditions that are incorporated in this ground lease rider. In view of these concerns, it is important that the appraised value of the leasehold interest in the property be well supported and correctly developed.

The appraiser must use a three-step process to develop his or her opinion of value-(1) determine the fee simple value of the property by using the sales comparison analysis approach to value, (2) determine the applicable capitalization rate (and convert the income from the ground lease into a leased fee value by using the market-derived capitalization rate), and (3) determine the leasehold value by reducing the fee simple value by the leased fee value. When this appraisal technique is used, there is no need to document the actual land value of the security property. The appraiser must develop the opinion of value for the leasehold interest under the hypothetical condition that "the property rights being appraised are the leasehold interest without the resale and other restrictions that our ground lease rider removes when we have to dispose of a property acquired through foreclosure." The lender should advise the appraiser that he or she must include the following statement in the appraisal report:

This appraisal is made on the basis of a hypothetical condition that the property rights being appraised are the leasehold interest without resale and other restrictions that are removed by the Uniform Community Land Trust Ground Lease rider.

Section 312.01 – Determining the Fee Simple Value

In determining the fee simple value of the subject property, the appraiser should generally use as comparables sales of similar properties that are owned as fee simple estates. However, if this is not possible, the appraiser may use sales of properties that are subject to other types of leasehold estates-as long as he or she makes appropriate adjustments (based on the terms of their leases) to reflect a fee simple interest.

When the community or neighborhood has sales activity for other leasehold estates held by a community land trust, the appraiser should discuss them in the appraisal report, but should not use them as comparable sales since, in all likelihood, the sales prices will have been limited by restrictions in the ground lease (and thus the sales transaction would not be comparable to the hypothetical condition-no restrictions-on which we require the appraisal of the subject property to be based).

Section 312.02 – Determining the Capitalization Rate

When the community has an active real estate market that includes sales of properties owned as fee simple estates and sales of properties subject to leasehold estates (other than those held by community land trusts), the appraiser can use the most direct method for determining the capitalization rate-extracting it from the market activity (with all things being equal). To extract the capitalization rate, the appraiser should divide the annual ground rent for the properties subject to leasehold estates by the difference in the sales prices for the comparable sales of properties owned as fee simple estates and the comparable sales of properties subject to leasehold estates.

If there are no available comparable sales of properties subject to leasehold estates (other than those held by a community land trust), the appraiser may develop a capitalization rate by comparing alternative low-risk investment rates (such as the rates for long-term bonds) and selecting a rate that best reflects a "riskless" (safe) rate.

Section 312.03 – Determining the Leasehold Value

To determine the leasehold value of the subject property, the appraiser must first convert the annual income from the community land trust's ground lease into a leased fee value by dividing the income by the market-derived capitalization rate. The appraiser should then reduce the estimated fee simple value of the subject property by this leased fee value to arrive at his or her opinion of the leasehold value of the subject property.

Example: Assume that the annual ground rent from the community land trust's ground lease is \$300, the market-derived capitalization rate is 5.75%, and the estimated fee simple value of the subject property is \$100,000.

- $\$300 \text{ annual rent} / 5.75\% \text{ capitalization rate} = \$5,217.39 \text{ (rounded to } \$5,200)$
- $\$100,000 \text{ fee simple value} - \$5,200 \text{ leased fee value} = \$94,800 \text{ (leasehold value)}$

Because our appraisal report forms do not include space to provide all of the details required for appraising a property subject to a leasehold held by a community land trust, the appraiser will need to attach an addendum to the appraisal report to provide any information that cannot otherwise be presented on the appraisal report form. On the actual appraisal report form, the appraiser should indicate "leasehold" as the property rights appraised, provide the applicable ground rent paid to the community land trust, show the estimated fee simple value for the property in the "sales comparison analysis" grid, and report the "leasehold value" as the indicated value conclusion. The appraiser should also check the box for "subject to the following repairs, alterations, or conditions" and add the following at the end of that statement: "See attached addendum for development of capitalization rate and an expanded discussion of the comparable sales used and considered."

Section 313 – Energy-Efficient Properties

A lender may consider a newly constructed dwelling as energy-efficient if it is built in compliance with qualifying energy conservation programs that the National Association of Home Builders (NAHB) classifies as meeting the NAHB Thermal Performance Guidelines or if it is constructed in a manner that meets or exceeds the standards established by the Council of American Building Officials (CABO) 1992 Model Energy Code. New construction—as well as existing homes—may also be qualified as energy-efficient through an appraiser's or an energy consultant's development of an energy-efficient rating using either a rating form from the Energy Rated Homes of America or Part 1 of our *Energy Addendum* (Form 1004A).

The appraiser must include an evaluation of the energy-efficient characteristics of the property and an overall rating—of "high" "adequate," or "low"—for the energy efficiency of the dwelling in the applicable appraisal report form. The lender may take the energy savings into consideration when evaluating the borrower's debt-to-income ratio, if the property receives an overall rating of "high" (as discussed in Part X, Section 302.08). Generally, a dwelling must include features from each of the following three major categories to receive a "high" rating:

A. Insulation and infiltration. We require insulation with adequate "R" values and infiltration barriers in the form of the following:

- Insulation in ceilings, roofs, or attic floors that are over conditioned spaces, in exterior walls, under floors that cover unheated areas, around slabs, around heating or cooling ducts or pipes that run through unconditioned spaces, around the sill area, and around the water heater;

- Special fireplace devices or features, such as combustion-air and -flue dampers, and a fire door;
- Sealing of the sole plate and penetrations of the exterior shell; and
- Dampers for exhaust fans.

B. Windows and doors. We require either double-or triple-pane windows or storm windows, and either storm doors or insulated doors. We also require caulking and weatherstripping around windows and door areas and at the sill area.

C. Heating and cooling systems. We require the following types of heating and cooling systems:

- New efficient heating and cooling systems, or appropriate modifications to an existing system;
- Zoned heating and/or air conditioning;
- Automatic set-back thermostats; or
- Solar equipment or design.

Regardless of the method used for qualifying a dwelling as energy-efficient, the appraiser must consider the reaction of the market to the energy-efficient improvements (or proposed alterations) and reflect their contributory value in the "sales comparison analysis" adjustment grid. This adjustment must be based on the appraiser's analysis of comparable sales. When adequate comparable sales are not available, the appraiser may use Part 2 of the *Energy Addendum* (Form 1004A) to develop an opinion about the value of the energy-efficient items, which should be equal to the lesser of the present worth of the estimated savings in utility costs and the installed cost of the energy-efficient items (as adjusted for physical, functional, or external depreciation).

Chapter 4. Reviewing the Appraisal Report

Our appraisal report forms and the property appraisal and underwriting processes we use for one- to four-family properties have been developed with the intent of assuring that the Uniform Standards of Professional Appraisal Practice are followed and that our policies are entirely consistent with, and supportive of, fair lending practices.

This Chapter discusses key factors that are taken into consideration when preparing an appraisal report, and is intended to provide a lender with a usable, working reference tool for reviewing an appraisal that is documented on the various appraisal forms that are used for mortgages delivered to Fannie Mae. Not all of the topics discussed will appear on each appraisal report form, but the material is presented in the general order in which the topics appear on most forms.

An appraisal that is properly developed and reported on one of our appraisal forms is considered a summary appraisal report that complies with the applicable sections of the Uniform Standards of Professional Appraisal Practice.

- Appraisals that are documented on the *Uniform Residential*

Appraisal Report (Form 1004), the *Small Residential Income Property Appraisal Report* (Form 1025), the *Individual Condominium Unit Appraisal Report* (Form 1073), or the *Individual Cooperative Interest Appraisal Report* (Form 1075) are considered as complete appraisals (and thus are not subject to the Departure Rule of the Uniform Standards).

- Appraisals that are documented on the *Desktop Underwriter Quantitative Analysis Appraisal Report* (Form 2055), the *Desktop Underwriter Qualitative Analysis Appraisal Report* (Form 2065), or the *Desktop Underwriter Individual Cooperative Interest Appraisal Report* (Form 2095) are generally considered as limited appraisals (and are subject to the Departure Rule of the Uniform Standards) because we do not require that the cost and income approaches to value be used in connection with them. However, appraisals documented on these forms may be considered as complete appraisals if the cost and income approaches to value are not applicable because the omission of these approaches for a particular type of appraisal assignment is not a departure from the Uniform Standards (and the appraiser specifically identifies the appraisal as a complete appraisal in the appraisal report).

Section 401 – The Subject Property

The first section of our appraisal report forms is used to identify and describe the location of the subject property; to provide information about property taxes and special assessments; to indicate the occupancy status of the property; to describe the property rights to be appraised; to summarize financing data and sales concessions; and to identify the borrower, the current owner, and the client.

The appraiser must identify the subject property by its complete property address and legal description; a post office box number is not acceptable. The appraiser should indicate the nearest intersection if a house number is not available. When the legal description is lengthy, the appraiser may attach the full description as an addendum to the appraisal report, or may refer simply to its location in the public records.

The appraiser must identify the property rights to be appraised as "fee simple" or "leasehold." in addition, the appraiser must indicate whether the subject property is located in a PUD or condominium project, if the appraisal for a PUD or condominium unit is documented on the *Uniform Residential*

Appraisal Report (Form 1004) or the appraisal for a PUD unit is documented on the *Small Residential Income Property Appraisal Report* (Form 1025).

The appraiser must state the total dollar amount of the loan charges and/or concessions that will be paid by the seller (or any other party who has a financial interest in the sale or financing of the subject property) and provide a brief description of the items on the appraisal report form. If the appraiser knows that the appraisal will be used for a refinance transaction, he or she should indicate that on the form.

Section 402 – Market Data Research

The appraiser is responsible for adequately researching market data from all reasonably available and appropriate sources of information for the location and property type being appraised (including public records transfer information and, if appropriate, data from local real estate brokers who are not active in the local multiple listing service)-even if this results in the appraiser spending more time and incurring additional expenses in performing appraisal assignments in certain geographic locations or for particular property types. If the appraiser does not consider all relevant data, overlooks relevant data sources, or relies on incomplete data in the research and analysis stage of the appraisal process, the result may be a poor quality appraisal that could have a discriminatory effect. For example, when the only data that is researched and relied on is data obtained from a sales data reporting service or a local multiple listing service-and that data source was not used for most of the sales transactions in a particular neighborhood or market area-the appraiser may arrive at an inaccurate opinion of value.

Section 403 – Neighborhood Analysis

Property location is a fundamental characteristic that influences the value of residential real estate. Therefore, it is a critical factor that must be considered in the appraisal process. Neighborhood characteristics and trends also influence the value of one- to four-family residences; therefore, they are also key elements in the appraisal process. Because we purchase mortgages secured by properties in all neighborhoods and in all areas-as long as the property is acceptable as security for the mortgage based on its value and marketability-property location, neighborhood characteristics, and neighborhood trends are determinants that the appraiser uses in the property valuation process, but are not factors in determining whether a particular neighborhood is acceptable or not.

Our appraisal report forms and guidelines do not require the appraiser to rate or judge the neighborhood. We do, however, require the appraiser to perform an objective neighborhood analysis by identifying (1) neighborhood boundaries, (2) neighborhood characteristics, and (3) the factors that affect the value and marketability of properties in the neighborhood.

- *Neighborhood boundaries* can be identified by various physical characteristics (streets, bodies of water, land uses, types of dwellings, etc.).
- *Neighborhood characteristics* can be addressed by the types of structures and architectural styles in the neighborhood (detached, attached, row or townhouse, colonial, ranch, Victorian, etc.); current land use (single-family residential, commercial, industrial, etc.); typical site size (1/8 acre, 2 acres, etc.); or street patterns or design (one-way street, cul-de-sac, court, etc.).
- *Factors that affect the value and marketability of properties in the neighborhood* can be addressed by such things as the proximity of the property to employment and amenities, employment

stability, appeal to the market, changes in land use, access to public transportation, adverse environmental influences, etc.

Generally accepted appraisal standards and our appraisal report forms require the appraiser to research, analyze, and report on the factors in the neighborhood that may affect the market value or marketability of the properties in the market area. Failing to report such factors or conditions in the appraisal report and/or making assumptions about those factors that might affect value without performing adequate market research are unacceptable appraisal practices. The appraiser must understand the value-influencing characteristics in the neighborhood and arrive at an appropriate neighborhood description and opinion of value for the property-even if this requires more extensive research for particular property types or for properties in certain geographic locations.

An appraiser must perform a neighborhood analysis in order to identify the area that is subject to the same influences as the property being appraised (based on the actions of typical buyers in the market area). The results of a neighborhood analysis enable the appraiser not only to identify the factors that influence the value of properties in the market area, but also to define the area from which to select the market data needed to perform a sales comparison analysis. To perform a neighborhood analysis, the appraiser should collect pertinent data, make a visual inspection of the market area to observe its physical characteristics and determine its boundaries, and identify land uses and any signs that the land uses are changing. The appraiser should extend the search of the subject market area as far as necessary to assure that all significant influences affecting the value of the subject property are reflected in the appraisal report, using his or her best judgment to determine and describe the neighborhood boundaries. The lender's underwriter should review carefully the neighborhood description to confirm that the appraiser used comparables from within the subject neighborhood in his or her analysis.

We expect the appraiser and the lender's underwriter to be aware of the varying conditions that characterize different types of neighborhoods or market areas. Conditions that are typical in certain neighborhoods may not be present in other neighborhoods or market areas. This does not mean that the existence of certain types of conditions or characteristics are unacceptable, rather it is an indication that they must be viewed in context with the nature of the area in which the property is located. For example, some urban neighborhoods consist of a variety of property types that have different uses. It is not uncommon to find properties that have mixed-uses-such as residential properties that also have child-care facilities, doctor or dental offices, and other types of business or commercial uses. The presence of mixed-use properties or a variety of property types within a neighborhood should be viewed as a neighborhood characteristic that the appraiser considers when performing the neighborhood analysis and describing the neighborhood boundaries.

The appraiser must consider the influence of market forces--economic, governmental, and environmental- on property values in the neighborhood or market area. *Economic forces* that must be considered include such things as the existence of vacant or boarded-up properties in the neighborhood, the level of essential local support services, etc. Examples of *governmental forces* that should be taken into consideration include the regulations, laws, and taxes that are imposed on properties. *Environmental forces* that must be considered include, among other things, the existence of a hazardous waste site on or near the property, the proximity of a property to an airport, etc. On the other hand, certain other factors that are not appraisal factors--the racial or ethnic composition of a neighborhood or the age or sex of the individuals who live in a particular neighborhood or market area--must not be considered in the valuation process.

The appraiser must determine, analyze, and consider the factors that should be considered in the valuation process based on his or her identification of all forces or factors that have the potential to influence the value of the property. If an appraiser can demonstrate by market evidence that a

characteristic has an effect on the value or marketability of the properties in the neighborhood or market area, he or she should consider it in the valuation process; otherwise, the appraiser should not consider it. The appraiser also must not make unsupported assumptions or interject personal opinion or perceptions about market forces or other factors that may or may not affect the use and value of a property. For example, a property located in an older neighborhood can be as sound an investment as a property located in a new neighborhood, and a property located in a neighborhood inhabited primarily by members of one race can be as sound an investment as one located in a racially mixed neighborhood or in a neighborhood inhabited primarily by members of a different race. The appraiser must report neighborhood conditions in factual, specific terms and be impartial and specific in describing favorable or unfavorable factors in a neighborhood.

We do not designate certain areas as being acceptable or unacceptable-in other words, we do not "red-line." Redlining can occur when perceived property risks are based on improper locational factors-such as the arbitrary granting of unfavorable loan terms on the basis of geographic area-or when the perceptions of risk are derived from factors that do not predict risk-either reliably or at all. An example of a factor that is not predictive of risk is race-and racial redlining is illegal under federal law. Other factors that serve as a proxy for race are equally impermissible. The appraiser and the lender's underwriter must be sensitive to these impermissible factors and apply our guidelines in a consistent, equitable manner. None of our property guidelines is intended to foster redlining-if any provision is interpreted to do so, it has been misunderstood.

Some lenders underwrite mortgages in urban areas on a block-by-block basis. Block-by-block underwriting and appraisal analysis is acceptable in cases in which rehabilitation has started-either in the block where the subject property is located or in facing blocks visible to the property-but has not yet spread to the rest of the neighborhood. This enables the lender's underwriter to place weight on the positive influences of a neighborhood in an urban area that is being rehabilitated. The acceptability of this type of appraising or underwriting is conditioned on the appraiser demonstrating that local conditions make it appropriate and that all essential factors are considered.

The appraiser should explain any changes that have occurred that might influence the marketability of the properties within the neighborhood. For example, the appraiser must comment if there is market resistance to a neighborhood because of the known presence of an environmental hazard. The lender must be satisfied that the neighborhood will be acceptable to a sufficient number of buyers to support an active, on-going market for the property.

Our appraisal report forms require the appraiser to address a number of important factors that are used to analyze the effect that the neighborhood has on the marketability of the property. Some of the key factors are discussed in the following subsections.

Section 403.01 - Location

We will purchase or securitize mortgages that are secured by residential properties in urban, suburban, or rural areas. An "urban" location relates to a city, a "suburban" location relates to the area adjacent to a city, and a "rural" location relates to the country or anything beyond the suburban area. We do not designate certain areas as being acceptable or unacceptable. To be eligible for purchase or securitization, a mortgage must be secured by a property that is residential in nature--based on the characteristics of the subject property, zoning, and the present land use. We do not purchase or securitize mortgages on agricultural-type properties (such as farms, orchards, or ranches), on undeveloped land, or on land development-type properties.

The appraiser and the lender's underwriter must be sensitive to the varying conditions that characterize different types of locations. The appraiser must also consider the present or anticipated use of any adjoining property that may adversely affect the value or marketability of the subject property. Conditions that are typical of certain types of locations may not be present in other locales. This does not mean that the conditions are unacceptable, rather that they must be viewed in context with the nature of the area in which the security property is located. A few examples to illustrate this are shown below:

- If the subject property is located in a rural area that is relatively undeveloped or one in which properties often have large lot sizes, the appraiser may have to go a considerable distance to find properties that can be used to develop an opinion of value for the subject property.
- If the subject property is located in a suburban or urban area, the appraiser will most likely use comparable properties in the immediate vicinity of the property since suburban and urban areas are usually more highly developed and comparable sales typically are available in the subject neighborhood. However, if the property is located in an area in which there is a shortage of recent truly comparable sales-either because of the nature of the improvements of the subject property or the relatively low number of sales transactions in the neighborhood-the appraiser might need to analyze and use as comparable sales properties that are not truly comparable to the subject property. This is acceptable as long as the appraiser adequately documents his or her analysis in the appraisal report and explains why such comparables are being used.
- If the subject property is located in an urban neighborhood that has vacant or boarded up properties, the appraiser will need to look at comparable properties in the same neighborhood to assure that any effect of the vacant or boarded up properties is taken into consideration in developing the opinion of value for the subject property.

A lender must give properties with outbuildings special consideration in the underwriting and appraisal review. Properties with minimal outbuildings-such as a small barn or stable--that are of relatively insignificant value in relation to the total appraised value of the subject property are acceptable if they are typical of other residential properties in the subject area. For example, a property that has a small barn or stable is acceptable if the appraiser demonstrates through the use of comparable sales with similar improvements that the improvements are typical of properties for which an active, viable residential market exists. If the outbuildings do not represent typical residential improvements for the location and property type, the typical purchaser in the market would probably recognize minimal, if any, contributory value for them. A property with an atypical minimal outbuilding is acceptable to us, as long as the appraiser's analysis reflects little (or no) contributory value for it.

On the other hand, the presence of significant outbuildings-such as a large barn, a storage area or facilities for farm-type animals, or a silo-will probably indicate that the property is agricultural in nature. In such cases, the lender must review the property appraisal to determine whether the improvements are residential or agricultural in nature, regardless of whether the appraiser assigns any value to the outbuildings.

All properties must be readily accessible by roads that meet local standards. Certain aspects of the location of a property will require special consideration. For example, properties in resort areas that attract people for seasonal or vacation use are acceptable only if they are suitable for year-round use. Any property that is not suitable for year-round occupancy-regardless of where it is located-is unacceptable.

Section 403.02 – Degree of Development and Growth Rate

The degree of development of a neighborhood (which is referred to as "built-up" on the appraisal report forms) is the percentage of the available land in the neighborhood that has been improved. The degree of development of an area may indicate whether a particular property is residential in nature. When underwriting a mortgage secured by a property located in a rural or relatively undeveloped area, the lender should focus on the characteristics of the property, zoning, and the present land use to determine whether the property should be considered residential in nature. For example, if the typical one-family building site in a particular area (based on the zoning, the highest and best use of the land, and the present land use) is two acres in size, the mortgage will be eligible for purchase or securitization regardless of the percentage of the total appraised value of the property that the site represents--as long as the appraiser demonstrates through the use of comparable sales that the property is a typical residential property for that particular neighborhood.

Because we do not purchase or securitize mortgages secured by agricultural-type properties, undeveloped land, or land-development-type properties, the lender must review carefully the appraisal report for properties that have sites larger than those typical for residential properties in the area. Special attention must be given to the appraiser's description of the neighborhood, zoning, the highest and best use determination, and the degree of comparability between the subject property and the comparable sales. If the subject property has a significantly larger site than the comparables used in the appraiser's analysis, the subject property may not be a typical residential property for the neighborhood.

Section 403.03 – Property Values

The appraiser must indicate whether property values in the subject neighborhood are "increasing," "stable," or "declining." Maximum financing is acceptable when property values are stable or increasing. The lender generally must not offer maximum financing in any instance in which property values are declining.

Section 403.04 – Demand, Supply, and Marketing Time

An over-supply of housing is not desirable since it indicates that properties are selling slowly with a lot of competition. An over-supply of properties may be a neighborhood-wide or a city-wide problem. In either case, the appraiser must comment on the reason for the over-supply and its effect on the value of the property.

Marketing time is the average time that it takes for a reasonably priced property to sell in the subject neighborhood. When marketing time for a particular area is greater than six months, the appraiser must comment on the reason for the extended marketing period and its effect on the value of the property.

Section 403.05 – Predominant Occupancy

Some of our appraisal report forms provide an area for the appraiser to categorize the predominant occupancy status of the neighborhood-as "owner" or "tenant" and as "vacant (0-5%)" or "vacant (over 5%)"-as part of his or her description of the neighborhood.

The fact that the properties in a neighborhood are predominantly owner-occupied or tenant-occupied is a characteristic of the neighborhood that the appraiser needs to take into consideration when performing the neighborhood analysis and defining the neighborhood boundaries. To assure that any effects (positive or negative) of occupancy status will be reflected in the sales comparison analysis, the appraiser should select comparable sales from within the same neighborhood whenever possible. If the

appraiser uses comparable sales that are outside of the subject neighborhood, he or she may need to make "neighborhood" or "location" adjustments to the sales comparison analysis for any sales that are not subject to this same neighborhood characteristic.

Section 403.06 – Price Range and Predominant Price

The appraiser must indicate the price range and predominant price of properties in the subject neighborhood. The price range must reflect high and low prevailing prices for residential properties that are comparable to the property being appraised (one-family properties, two- to four-family properties, condominium units, or cooperative units) and, in some cases, for competing properties (one-family properties when the property being appraised is a two- to four-family property or a condominium unit, or condominium units when the property being appraised is a cooperative unit). Isolated high and low extremes should be excluded from the range, which means that the predominant price will be that which is the most common or most frequently found in the neighborhood. The appraiser may state the predominant price as a single figure or as a range (if that is more appropriate).

When the subject property has a sales price (or value) that exceeds the upper price range, the property is considered as an "over-improvement" for the neighborhood. The property is considered as an "under-improvement" if its sales price (or value) is less than the lower price range. If the subject property is an over-improvement, the mortgage terms generally should be more conservative because the property may not be acceptable to typical purchasers. The appraiser must explain why the property is an over- or under-improvement and comment on the adjustments that were made in the "sales comparison analysis" adjustment grid to reflect that condition.

The lender should consider whether a property in an urban area is among those being renovated. Since demand for this type of property can be strong, the property should not be regarded as over-improved if there is a strong market interest, which is indicated by the existence of comparable properties.

Section 403.07 – Age Range and Predominant Age

The appraiser must indicate the age range and predominant age of properties in the subject neighborhood. The age range should reflect the oldest and newest ages for similar types of residential properties (one-family properties, two- to four-family properties, condominium units, or cooperative units) and, in some cases, for competing properties (one-family properties when the property being appraised is a two- to four-family property or a condominium unit, or condominium units when the property being appraised is a cooperative unit.) However, isolated high and low extremes should be excluded from the range. The predominant age is the one that is the most common or most frequently found in the neighborhood. The appraiser may state the predominant age as a single figure or as a range (when that is more appropriate). The appraiser should select independently the properties that he or she uses to represent the age range and predominant age, rather than merely relying on the same properties he or she used to illustrate the price range and predominant price.

The age of a property should be within the general age range of the neighborhood. Normally, neighborhoods are developed over a relatively narrow span of time so that most dwelling units will fall within a particular age range. A property that has an age outside of the general age range must receive special consideration. Unless there is strong evidence of long-term neighborhood stability, a new dwelling in an old neighborhood will carry some marginal risk. Conversely, an old dwelling in a newly developed area is generally acceptable if renovation will result in its conforming to the neighborhood.

Section 403.08 – Present Land Use

Some of our appraisal report forms provide an area for the appraiser to report the relative percentages of the developed land in the neighborhood when discussing the present land use, rather than simply referring to the zoning classifications. The appraiser should report separately the percentage of developed one-family sites, developed two- to four-family sites, etc. Undeveloped land should be reported as vacant. In addition, if there is a significant amount of vacant or undeveloped land in the neighborhood, the appraiser should include comments to that effect to assure that he or she adequately describes the neighborhood. If the present land use in the neighborhood is not one of those listed on the appraisal report form-such as parkland-the appraiser must also indicate the type of land use and its related percentage. The total of the types of land uses must equal 100%.

Typically, dwellings best maintain their value when they are situated in neighborhoods that consist of other similar dwellings. However, some factors that are typical of a mixed-use neighborhood-such as easy access to employment centers and a high level of community activity-can actually enhance the market value of the property through increased buyer demand. Urban neighborhoods also frequently reflect a blend of residential and nonresidential land uses-including residential multifamily properties, other properties that are used to provide commercial services (such as groceries and other neighborhood stores) in support of the local neighborhood, industrial properties, etc.

When different land uses and property types are present in a neighborhood, that fact should be considered a neighborhood characteristic that the appraiser needs to take into consideration when performing the neighborhood analysis and defining the neighborhood boundaries. To assure that any positive or negative effects of the mixed land uses are reflected in the sales comparison analysis, the appraiser should select comparable sales from within the same neighborhood whenever possible. If this is not possible, the appraiser may need to make "neighborhood" or "location" adjustments to the "sales comparison analysis" grid for any sales that are not subject to this same neighborhood characteristic.

Section 403.09 – Changes in Land Use

Some of our appraisal report forms provide an area for the appraiser to indicate whether the present land use in the neighborhood is "likely" or "not likely" to change or whether it is "in process" of changing. If the land use is likely to change or is in the process of changing, the appraiser should indicate the anticipated new land use(s). The present land use, the predominant occupancy composition, and the likelihood that either will change may be an indicator for determining whether a neighborhood is undergoing transition. However, a "neighborhood in transition" description must not be used to refer to the racial or ethnic composition--or the prospective racial or ethnic composition---of a neighborhood. If the appraiser indicates that an area is undergoing transition, he or she should describe the changes and comment about their effect on the marketability and value of the subject property.

Section 403.10 – Competitive Properties

When the subject property is a two- to four-family property, the appraiser must include in his or her appraisal report listing information about at least three competitive properties from the subject neighborhood, choosing available listings that represent the most current, similar, and proximate competitive properties to the subject property. The listing comparables can be the rental comparables or the sales comparables that are used later in the appraiser's market data analysis (as long as they are currently listed for sale). Although we do not require it, the appraiser may also provide additional comparisons of properties listed for sale outside of the subject neighborhood if he or she chooses to do so, as long as they are relevant to the analysis. We are primarily concerned about competitive properties that are for sale in the subject neighborhood; therefore, if there are fewer than three competitive

properties for sale in that neighborhood, the appraiser should simply state that fact in the "comments" section of the appraisal report form and provide an explanation of why that is the case (for example, because of an under-supply, non-conforming property types, etc.).

The appraiser must provide a narrative comparison of the competitive listings that are comparable to the subject property, describe the general market conditions that affect two- to four-family properties in the subject market area, and identify trends in listing prices, average days on market, and recent changes. The purpose of reporting active listings is to provide support for the primary indicators of market condition (growth rate, property values, demand/supply, and marketing time). The analysis of active listings should be used to evaluate both the inventory of two- to four-family properties currently for sale in the subject neighborhood and competing with the subject property, as well as the recent price and marketing time trends that affect the subject property.

Section 404 – Site Analysis

The property site should be of a size, shape, and topography that is generally conforming and acceptable in the market area. It must also have competitive utilities, street improvements, and other amenities. Since amenities, easements, and encroachments may either detract from or enhance the marketability of a site, the appraiser must comment on them if the site has adverse conditions or is not typical for the neighborhood. If there is market resistance to a property because its site is not compatible with the neighborhood or with the requirements of the competitive market, the lender should underwrite the mortgage more carefully and, if appropriate, require more conservative mortgage terms

Section 404.01 - Zoning

The appraiser is responsible for reporting the specific zoning classification for the subject property. The appraiser must include a general statement to describe what the zoning permits-"one-family," "two-family," etc.-when he or she indicates a specific zoning such as R-1, R-2, etc. The appraiser must also include a specific statement indicating whether the improvements represent a legal use; a legal, but non-conforming (grandfathered) use; or an illegal use under the zoning regulations; or whether there is no local zoning.

We generally will not purchase or securitize a mortgage on a property if the improvements do not constitute a legally permissible use of the land. We do make certain exceptions to this policy, as long as the property is appraised and underwritten in accordance with the special requirements we impose as a condition to agreeing to make the exception:

- We will purchase or securitize a *mortgage that is secured by a one- to four-family property or a unit in a PUD project* if the property represents a legal, but non-conforming, use of the land-as long as the appraiser's analysis reflects any adverse effect that the non-conforming use has on the value and marketability of the property.
- We will purchase or securitize a *condominium unit mortgage or a cooperative share loan* from a project that represents a legal, but nonconforming, use of the land only if the improvements can be rebuilt to current density in the event of their partial or full destruction. (In such cases, the mortgage file must include a copy of the applicable zoning regulations or a letter from the local zoning authority that authorizes reconstruction to current density)

- We will purchase or securitize a *mortgage secured by a one family property that includes an illegal additional unit or accessory apartment* (which may be referred to as a mother-in-law, mother daughter, or granny unit) as long as the illegal use conforms to the subject neighborhood and to the market. The property must be appraised in conformity with its legal use, that of a one-family property (and the borrower must qualify for the mortgage without considering any rental income from the illegal unit). The appraiser must report that the improvements represent an illegal use and demonstrate that the improvements are typical for the market through an analysis of at least three comparable properties that have the same illegal use. The lender must also make sure that the existence of the illegal additional unit will not jeopardize any future hazard insurance claim that might need to be filed for the property. We will not purchase or securitize a *mortgage secured by a two- to fourfamily property that includes an illegal accessory apartment*.
- We will not purchase or securitize a *mortgage secured by a property that is subject to certain land-use regulations (such as coastal tideland or wetland laws) that create setback lines or other provisions that prevent the reconstruction (or maintenance) of the property improvements if they are damaged or destroyed. (The intent of these types of land-use regulations is to remove existing land uses and to stop land development-including the maintenance or construction of seawalls-within specific setback lines.)*

Section 404.02 – Highest and Best Use

The highest and best use of a site is the reasonable and probable use that supports the highest present value on the effective date of the appraisal. For improvements to represent the highest and best use of a site, they must be legally permitted, financially feasible, and physically possible, and must provide more profit than any other use of the site would generate. All of these criteria must be met if the improvements are to be considered as the highest and best use of a site.

A strict theoretical highest and best use analysis identifies the perfect improvements for a site-assuming that the site is vacant and available to be developed. The appraiser's highest and best use analysis of the subject property should consider the property as it is improved. This treatment recognizes that the existing improvements should continue in use until it is financially feasible to remove the dwelling and build a new one, or to renovate the existing dwelling. If the use of comparable sales demonstrates that the improvements are reasonably typical and compatible with market demand for the neighborhood, and the present improvements contribute to the value of the subject property so that its value is greater than the estimated vacant site value, the appraiser should consider the existing use as reasonable and report it as the highest and best use.

On the other hand, if the current improvements clearly do not represent the highest and best use of the site as an improved site, the appraiser must so indicate on the appraisal report. In such cases, we will not purchase or securitize a mortgage that is secured by the subject property.

Section 404.03 - Utilities

For a mortgage to be eligible for purchase or securitization, the utilities of the property must meet community standards and be adequate, in service, and accepted generally by area residents. If public sewer and/or water facilities-those that are supplied and regulated by the local government-are not available, then community or private well and septic facilities must be available and utilized by the subject property. If community facilities are used, the owners of the subject property must have the right to access those facilities, which must be viable on an on-going basis. Generally, private well or septic facilities must be located on the subject site. However, off-site private facilities are acceptable if the

inhabitants of the subject property have the right to access them and if there is an adequate, legally binding agreement for their access and maintenance.

If there is market resistance to an area because of environmental hazards or any other conditions that affect well, septic, or public water facilities, the appraiser must comment on the effect of the hazards on the marketability and value of the subject property (as discussed in Section 307).

Section 404.04 – Off-Site Improvements

Some of our appraisal report forms provide an area for the appraiser to state the type of any off site improvements-streets, curbs/gutters, sidewalks, street lights, and alleys--that are present and indicate whether they are publicly or privately maintained.

The property should front on a publicly dedicated and maintained street that meets community standards and is accepted generally by area residents. If the property is on a community-owned or privately owned and maintained street, there should be an adequate, legally enforceable agreement for maintenance of the street. A street that does not meet city or state standards frequently requires extensive maintenance, and property values may decline if it is not regularly maintained. If a property fronts on a street that is not typical of those found in the community, the appraiser must comment on the effect of that location on the marketability and value of the subject property.

The presence of sidewalks, curbs and gutters, street lights, and alleys depends on local custom-if they are typical in the community, they should be present on the subject site. The appraiser must comment on any adverse conditions and address their effect on the marketability and value of the subject property.

Section 404.05 – The Lot

The topography, shape, size, and drainage of the lot are all important factors. Steep slopes that cause erosion, difficulty in maintaining a lawn, or difficult access to the property itself or to a garage are generally unfavorable conditions. Drainage must be away from the improvements to avoid the collection of water in or around them.

Section 404.06 – Special Flood Hazard Area

Some of our appraisal report forms provide an area for the appraiser to indicate whether or not the property is located in a Special Flood Hazard Area that is identified on the Federal Emergency Management Agency's (FEMA) Flood Insurance Rate Maps (FIRM). These maps include areas that are within the 100-year flood boundary. (Note: The term "100-year flood" does not mean that a flood will occur once in every 100 years, but rather that there is a 1% or greater chance that a flood level will be equal or exceeded in any given year.) The appraiser must also indicate the specific FEMA flood zone and the map number and its effective date.

Flood Insurance Rate Maps (FIRM) can be obtained by contacting FEMA at the address, telephone number, fax number, or Web site shown below:

FEMA Map Service Center

P.O. Box 1038

Jessup, MD 20794-1038

Telephone: 1-800-358-9616

Fax: 1-800-358-9620

Web site: web1.msc.fema.gov.

If any part of the principal structure is located in a Special Flood Hazard Area-zones A, AE, AH, AO, AR, A1-30, A-99, V, VE, VO, or V1-30-flood insurance is required. If the principal structure is not located in the Special Flood Hazard Area, flood insurance is generally not required.

Section 405 – Improvements Analysis

The appraiser must provide a clear, detailed, and accurate description of the improvements that is consistent with the level of fieldwork we require in connection with the appraisal assignment. The appraiser should be as specific as possible (commenting on such things as needed repairs, additional features, modernization, etc.) and should provide supporting addenda, if necessary.

Some of our appraisal report forms require the appraiser to provide a comprehensive description of the improvements, which should include a general overall description and specific descriptions of the exterior, foundation, basement, insulation, interior surfaces, heating and cooling systems, kitchen equipment, attic, amenities, and car storage. If the property that is being appraised includes an accessory apartment, the appraiser should describe it in the "comments" section of the "improvements analysis" portion of the appraisal report form.

Section 405.01 – Conformity To Neighborhood

The improvements should generally conform to the neighborhood in terms of age, type, design, and materials used for their construction. If there is market resistance to a property because its improvements are not compatible with the neighborhood or with the requirements of the competitive market--because of adequacy of plumbing, heating, or electrical services; design; quality; size; condition; or any other reason directly related to market demand--the lender should underwrite the mortgage more carefully and, if appropriate, require more conservative mortgage terms. However, the lender should be aware that many older neighborhoods have favorable heterogeneity in architectural styles, land use, and age of housing. For example, older neighborhoods are especially likely to have been developed through custom building; this variety may be a positive marketing factor.

In the appraisal and underwriting process, special consideration must be given to properties that represent special or unique housing for the subject neighborhood. Mortgages secured by nontraditional types of housing--such as earth houses, geodesic domes, log houses, etc.--are eligible for delivery to us, provided the appraiser has adequate information to develop a reliable opinion of market value. It is not necessary for one or more of the comparable sales to be of the same design and appeal as the property that is being appraised (although appraisal accuracy is enhanced by using comparable sales that are the most similar to the subject property). On a case-by-case basis, both the appraiser and the underwriter must independently determine whether there is sufficient information available to develop a reliable opinion of market value. This will depend on the extent of the difference between the special or unique property and the more traditional types of houses in the market and the number of such properties that have already been sold in the market area.

- If the appraiser cannot locate recent comparable sales of the same design and appeal, but is able to determine sound adjustments for the differences between the comparables that are available and the subject property and to demonstrate the marketability of the property-based on older comparable sales, comparable sales in competing neighborhoods, the existence of similar properties in the market area, and any other reliable market data-the property is acceptable as security for a mortgage delivered to us.
- If the appraiser is not able to find any evidence of market acceptance and the characteristics of the property are so significantly different that he or she cannot establish a reliable opinion of market value, the property is not acceptable as security for a mortgage delivered to us.

We do not specify minimum size or living area requirements for properties. However, dwelling units of any type should have sufficient living area to be acceptable to typical purchasers or tenants in the subject market area. There should be comparables of similar size to the subject property to support the general acceptability of a particular property type.

Section 405.02 – Actual and Effective Ages

We do not place a restriction on the actual age of the dwellings. Consequently, a mortgage secured by an older dwelling that meets our general requirements is acceptable. The improvements for all properties must be of the quality and condition that will be acceptable to typical purchasers in the subject market area.

The relationship between the actual and effective ages of the property is a good indication of its condition. A property that has been well maintained will generally have an effective age somewhat lower than its actual age. On the other hand, a property that has an effective age higher than its actual age probably has not been well maintained or may have a particular physical problem. In such cases, the lender should pay particular attention to the condition of the subject property in its review of any appraisal report that requires the appraiser to address the actual and effective ages of a property.

Section 405.03 – Insulation and Energy Efficiency

Some of our appraisal report forms provide an area for the appraiser to state the "It" value for insulation (if he or she is aware of it) and to comment on the adequacy of the insulation. The appraiser should list the additional energy-efficient features in the "comments" area. The appraiser should also compare the energy-efficient features of the subject property to those of the comparable properties in the "sales comparison analysis" grid to assure that the overall contribution of these items is reflected in his or her opinion of the market value of the subject property.

An energy-efficient property is one that uses cost-effective design, materials, equipment, and site orientation to conserve nonrenewable fuels. Special energy saving items should be recognized in the appraisal process. The nature of these items and their contribution to value will vary throughout the country because of climactic conditions and differences in utility costs.

Section 405.04 – Layout and Floor Plans

Dwellings with unusual layouts, peculiar floor plans, or inadequate equipment or amenities generally have limited market appeal. A review of the room list and floor plan for the dwelling unit may indicate an unusual layout-such as bedrooms on a level with no bath, or a kitchen on a different level from the dining room. If the appraiser indicates that such inadequacies will result in market resistance to the subject property, he or she should make appropriate adjustments to reflect this in the overall analysis. On

the other hand, if market acceptance can be demonstrated through the use of comparable sales with the same inadequacies, no adjustments are required.

Section 405.05 – Unit/Room List

The *Uniform Residential Appraisal Report* (Form 1004) and the *Individual Condominium Unit Appraisal Report* (Form 1073) include a "room list" section to describe the subject property and provide a column for the square footage per level, as well as space for a summary of the above-grade room count(s) and the above-grade gross living area for the finished area.

The *Small Residential Income Property Appraisal Report* (Form 1025) includes a "unit/room" list section to describe the subject property and requires the appraiser to indicate the square feet per each unit. The unit/room list section gives the appraiser the flexibility to report the units individually or to report them as a single line entry if they are all equal in size. The total square footage reported in the unit/room list section of Form 1025 should reflect the net rentable area of the property (and, as such, will not necessarily equal the gross building area).

The *Individual Cooperative Interest Appraisal Report* (Form 1075) and the *Desktop Underwriter Individual Cooperative Interest Appraisal Report* (Form 2095) do not include a "room list" section. Form 1075 provides space for the appraiser to indicate a summary of both the finished area "above grade" and the finished area "below grade"-breaking it down by total rooms, bedrooms, baths, and square feet of gross living area. Form 2095 provides space for the appraiser to indicate a summary of the finished area-breaking it down by total rooms, bedrooms, baths, and square feet of gross living area.

The *Desktop Underwriter Quantitative Analysis Appraisal Report* (Form 2055), the *Desktop Underwriter Qualitative Analysis Appraisal Report* (Form 2065) and the *Desktop Underwriter Property Inspection Report* (Form 2075) do not include a "room list" section.

Section 405.06 – Gross Living Area

The most common comparison for one-family properties (including units in PUD, condominium, or cooperative projects) is above-grade gross living area. The appraiser must be consistent when he or she calculates and reports the finished above-grade room count and the square feet of gross living area that is above-grade. For units in condominium or cooperative projects, the appraiser should use interior perimeter unit dimensions to calculate the gross living area. In all other instances, the appraiser should use the exterior building dimensions per floor to calculate the above-grade gross living area of a property. Only finished above-grade areas should be used--garages and basements (including those that are partially above-grade) should not be included. We consider a level to be below-grade if any portion of it is below-grade--regardless of the quality of its "finish" or the window area of any room. Therefore, a walk-out basement with finished rooms would not be included in the above-grade room count.

Rooms that are not included in the above-grade room count may add substantially to the value of a property--particularly when the quality of the "finish" is high. For that reason, the appraiser should report the basement or other partially below-grade areas separately and make appropriate adjustments for them on the "basement and finished areas below-grade" line in the "sales comparison analysis" grid. To assure consistency in the sales comparison analysis, the appraiser generally should compare above-grade areas to above-grade areas and below-grade areas to below-grade areas. The appraiser may deviate from this approach if the style of the subject property or any of the comparables does not lend itself to such comparisons. However, in such instances, he or she must explain the reason for the deviation and clearly describe the comparisons that were made.

Section 405.07 – Gross Building Area

Gross building area, which is the total finished area (including any interior common areas, such as stairways and hallways) of the improvements based on exterior measurements, is the most common comparison for two- to four-family properties. The gross building area must be consistently developed for the subject property and all comparables that the appraiser uses. It should include all finished above- and below-grade living areas, counting all interior common areas (such as stairways, hallways, storage rooms, etc.), but not counting exterior common areas (such as open stairways).

We will accept the use of other comparisons for two- to four-family properties (such as the total above-grade and below-grade areas as discussed above in Section 405.06), as long as the appraiser explains the reasons he or she did not use a gross building area comparison and clearly describes the comparisons that were made.

Section 405.08 – Infestation, Dampness, or Settlement

If the appraiser indicates that there is evidence of wood-boring insects, dampness, or settlement, he or she must comment on its effect on the marketability and value of the subject property. The lender must provide either satisfactory evidence that the condition was corrected or submit a professionally prepared report, which indicates that- based on an inspection of the property-the condition does not pose any threat of structural damage to the improvements.

Section 405.09 – Property Condition

Based on the factual data of the improvement analysis, the appraiser must express an opinion about the condition of the improvements. The appraiser must report the condition of the improvements in factual, specific terms. Any condition that may affect the value or marketability of the subject property must be reported to assure that the appraiser adequately describes the property. The appraiser must report a detrimental condition of the improvements even if that condition is also typical for competing properties. For instance, the appraiser should note if a property is characterized by deferred maintenance or a lack of updating even if the same condition applies to competing properties in the neighborhood.

The appraiser must address any needed repairs or any physical, functional, or external inadequacies in the "comments" section. In addition, the appraiser must address adverse environmental conditions (such as, but not limited to, hazardous wastes, toxic substances, etc.) that are present in the improvements, on the site, or in the immediate vicinity of the subject property in the space provided for that purpose.

Section 405.10 – Remaining Economic Life

Because our appraisal report forms that are used for manually underwritten mortgages are designed to meet the needs of several different user groups, they address the remaining economic life for the property being appraised. However, the appraiser does not need to report the remaining economic life for a mortgage that will be delivered to us. Even if the appraiser does report this information, the lender does not need to consider it because any related property deficiencies will be discussed in the sections of the appraisal report that address the improvements analysis and comments on the condition of the property. We have no requirement that the mortgage term have any correlation to the remaining economic life of the property.

Section 406 – Sales Comparison Approach to Value

The sales comparison approach to value-traditionally referred to as the market data approach-is an analysis of comparable sales, contract offerings, and current listings of properties that are the most comparable to the subject property. The appraiser's analysis of a property must take into consideration all factors that have an effect on value, recognizing that a well-informed or well-advised purchaser will pay no more for a property than the price he or she would pay for a similar property of equal desirability and utility if it were purchased without undue delay. To accomplish this, the appraiser must analyze the closed or settled sales, the contract sales, and the current listings of properties that are the most comparable to the subject property in order to identify any significant differences (or elements of comparison) that could affect his or her opinion of value for the subject property. This is particularly important in soft or declining markets because the competing current listings and contracts probably reflect the upper-end of value for the subject property as of the effective date of the appraisal (and we expect the appraiser to accurately report and reflect market conditions as of that date). The comparable market data must be verified, analyzed, and adjusted for differences between the comparable properties and the subject property. On most appraisal forms, the appraiser will identify these adjustments by assigning a dollar value to reflect the market's reaction to any features of the comparable properties that differ from those of the subject property. However, when the *Desktop Underwriter Qualitative Analysis Appraisal Report* (Form 2065) is used, the appraiser will identify the adjustments in terms of relative value relationships between the features of the comparable properties and those of the subject property without assigning an estimated dollar value to the relationships.

Section 406.01 – Sources of Comparable Market Data

The appraiser's opinion of market value is no better than the reliability of the comparable data that is used; therefore, the appraiser must exercise due diligence to ensure the reliability of the comparable sales data that he or she uses. The appraiser must report his or her data and/or verification source(s) for each comparable sale on the appraisal report form. An appraiser may use a single source for the data and verifications or multiple sources if they are needed to adequately verify the comparable sales. The quality of the data available varies from source to source and from one locality to another. In view of this, a single data source may be adequate if the appraiser uses a source that provides quality sales data that is confirmed or verified by closed or settled transactions. On the other hand, if the appraiser's basic data source does not confirm or verify the sales data, the appraiser will need to use additional sources. When comparable sales data is provided by a party that has a financial interest in either the sale or financing of the subject property, the appraiser must reverify the data with a party that does not have a financial interest in the subject transaction.

Section 406.02 – Selection of Comparable Sales

We require an appraiser to research, analyze, and consider influences that may affect value based on market evidence (such as closed sales, contract sales, and properties for sale in the market area; market studies; etc.). For example, if a property is located in a neighborhood that includes (or is close to) an airport or hazardous waste site or that has relatively high property taxes or vacant or boarded-up properties, we expect the appraiser to research, analyze and use comparable sales from the same neighborhood or affected area (whenever possible) in his or her analysis. This will assure that any effect of these value-influencing characteristics is taken into consideration in the development of the opinion of value for the property.

If a property is located in an area in which there is a shortage of truly comparable sales-either because of the nature of the property improvements or the relatively low number of sales transactions in the neighborhood-the appraiser might need to use as comparable sales properties that are not truly

comparable to the subject property or properties that are located in competing neighborhoods. In some situations, sales of properties that are not truly comparable or sales of properties that are located in competing neighborhoods may simply be the best comparables available and the most appropriate for the appraiser's analysis. The use of such comparables is acceptable as long as the appraiser adequately documents his or her analysis and explains why these comparable sales were used (including a discussion of how a competing neighborhood is comparable to the subject neighborhood).

The appraiser must report a minimum of three comparable sales as part of the sales comparison approach to value. The appraiser may submit more than three comparable sales to support his or her opinion of market value, as long as at least three are actual settled or closed sales. Generally, the appraiser should use comparable sales that have been settled or closed within the last 12 months. However, the appraiser may use older comparable sales if he or she believes that it is appropriate, and selects comparable sales that are the best indicators of value for the subject property. The appraiser must comment on the reasons for using any comparable sales that are more than six months old. For example, if the subject property is located in a rural area that has minimal sales activity, the appraiser may not be able to locate three truly comparable sales that sold in the last 12 months. In this case, the appraiser may use older comparable sales as long as he or she explains why they are being used.

The appraiser may use the subject property as a fourth comparable sale or as supporting data if the property previously was sold (and closed or settled). If the appraiser believes that it is appropriate, he or she also may use contract offerings and current listings as supporting data. However, in no instance may the appraiser create comparable sales by combining vacant land sales with the contract purchase price of a home (although this type of information may be included as additional supporting documentation).

For properties that are in established subdivisions or for units in established condominium or PUD projects that have resale activity, the appraiser should use comparable sales from within the same subdivision or project as the subject property if there are any available. Resale activity from within the subdivision or project should be the best indicator of value for properties in that subdivision or project. If the appraiser uses sales of comparable properties that are located outside of the subject neighborhood, he or she must include an explanation with the analysis.

For properties in new subdivisions or for units in new (or recently converted) condominium or PUD projects, the appraiser must compare the subject property to other properties in its general market area as well as to properties within the subject subdivision or project. This comparison should help demonstrate market acceptance of new developments and the properties within them. Generally, the appraiser should select one comparable sale from the subject subdivision or project and one comparable sale from outside the subject subdivision or project. The third comparable sale can be from inside or outside of the subject subdivision or project, as long as the appraiser considers it to be a good indicator of value for the subject property. In selecting the comparables, the appraiser should keep in mind that sales or resales from within the subject subdivision or project are preferable to sales from outside the subdivision or project as long as the developer or builder of the subject property is not involved in the transactions.

Because rural properties often have large lot sizes and rural locations can be relatively undeveloped, there may be a shortage (or absence) of recent truly comparable sales in the immediate vicinity of a subject property that is in a rural location. This means that the appraiser will often need to select comparable sales that are located a considerable distance from the subject property. In such cases, the appraiser must use his or her knowledge of the area and apply good judgment in selecting comparable sales that are the best indicators of value for the subject property. The appraiser should include an explanation of why the particular comparables were selected in his or her analysis.

Section 406.03 – Adjustments to Comparable Sales

Each comparable sale that is used in the sales comparison approach to value must be analyzed for differences and similarities between it and the property that is being appraised. The appraiser must base his or her analysis and any adjustments to the comparable sales on the market data for the particular neighborhood and for competing locations—not on predetermined or assumed dollar adjustments. If an appraiser's adjustments to comparable sales (or the reconciliation of the comparable sales) are based on unsupported assumptions or personal opinion that cannot be supported by market data, poor quality appraisals that could have a discriminatory effect may result.

Comparable sales must be adjusted to the subject property—except for sales and financing concessions, which are adjusted to the market at the time of sale. The appraiser must make appropriate adjustments for location, terms and conditions of sale, date of sale, and the physical characteristics of the properties. "Time" adjustments must be representative of the market and should be supported by the comparable sales whenever possible. The adjustments must reflect the time that elapsed between the contract date (or the date of the "meeting of the minds") for the comparable sale and the effective date of the appraisal for the subject property.

The subject property is the standard against which the comparable sales are evaluated and adjusted. Thus, if an item in the comparable property is superior to that in the subject property, a negative adjustment is required to make that item equal to that in the subject property. Conversely, if an item in the comparable property is inferior to that in the subject property, a positive adjustment is required to make that item equal to that in the subject property. If an item in a comparable property is equal to that in the subject property, no adjustment is required.

A. Quantitative sales comparison analysis. Most appraisal forms require the appraiser to use a quantitative sales comparison analysis in which he or she assigns a dollar value to reflect the market's reaction to any features of the comparable sales that differ from those of the subject property. The proper selection of comparable properties minimizes both the need for, and the size of, any dollar adjustments. However, when there are no similar or truly comparable sales for a particular property—because of the uniqueness of the property or other conditions—the appraiser must select comparable sales that represent the best indicators of value for the subject property and make adjustments to reflect the actions of typical purchasers in that market. Dollar adjustments must reflect the market's reaction to the difference in the properties, not necessarily the cost of the difference. Swimming pools, electronic air filters, intercom systems, elaborately finished basements, carpets, and other special features generally do not affect value to the extent of their cost.

We have established guidelines for the net and gross percentage adjustments that underwriters may rely on as a general indicator of whether a property should be used as a comparable sale. Generally, the dollar amount of the net adjustments for each comparable sale should not exceed 15% of the sales price of the comparable. When the adjustments exceed 15%, the appraiser must comment on the reasons for not using a more similar comparable. Further, the dollar amount of the gross adjustments for each comparable sale should not exceed 25% of the sales price of the comparable. The amount of the gross adjustment is determined by adding all individual adjustments without regard to the positive or negative adjustments. When the adjustments exceed 25%, the appraiser must comment on the reasons for not using a more similar comparable.

Individual adjustments that are excessively high should be explained by the appraiser and reviewed carefully by the lender's underwriter. In some circumstances, the use of comparables with higher-than-normal adjustments may be warranted, but the appraiser must satisfactorily justify his or her use of them.

The appraiser must research the market and select the most comparable sales that are available for the subject property, and then adjust them to reflect the reaction of the market to the differences (except for sales and financing concessions) between the comparable sales and the subject property, without regard for the percentage or amount of the dollar adjustments. If the appraiser's adjustments do not fall within our net and gross percentage adjustment guidelines, but the appraiser believes that the comparable sales used in the analysis are the best available, as well as the best indicators of value for the subject property, the appraiser simply has to provide an appropriate explanation. If the extent of the appraiser's adjustments to the comparable sales is great enough to indicate that the property may not conform to the general market area, the lender's underwriter must review the property carefully.

For two- to four-family properties, the appraiser must report certain unadjusted units of comparison for the subject property and the comparable sales—the sales price per gross building area, the sales price per unit, and the sales price per room. Because purchasers of small residential income properties may rely on these unadjusted units of comparison, the appraiser should consider them in his or her analysis and reconciliation if they are relevant to the typical purchaser's motivation in the subject market area.

B. Qualitative sales comparison analysis. The *Desktop Underwriter Qualitative Analysis Appraisal Report* (Form 2065) enables the appraiser to use a relative or qualitative sales comparison analysis (instead of providing actual dollar adjustments) to reflect the differences in features between each of the comparable sales and the subject property, by indicating the market's reaction to any significant variations for each feature listed in the "sales comparison analysis" grid. The "paired" data analysis comparison logic, which is consistent with the way that buyers and sellers typically evaluate the differences between properties, is similar to the logic required by other appraisal forms. However, in this case, the appraiser does not have to quantify and report the market's reaction by assigning a dollar value to each variation.

- If a feature of a comparable sale is superior to, or more favorable than, the same feature for the subject property, the appraiser should report a negative (-) relationship.
- If a feature of a comparable sale is inferior to, or less favorable than, the same feature for the subject property, the appraiser should report a positive (+) relationship.
- If a feature of a comparable sale is equal to the same feature for the subject property, the appraiser should report an equal (=) relationship.

Our definition of market value requires the appraiser to make adjustments to the comparable sales for any special or creative financing sales concessions. The appraiser does not have to quantify the dollar amount of such concessions on Form 2065, but he or she must consider whether the sales price of a comparable sale was affected by the concessions and, if it was, report a negative (-) relationship.

In the overall comparison of the subject property and the comparable sales, the appraiser must take into consideration the value relationships for each of the features of the properties, and, for each comparable sale, the appraiser must indicate whether the property is superior, equal, or inferior to the subject property. In developing his or her opinion of the market value of the subject property, the appraiser should give the most weight to the comparable sales that are the most similar to the subject property based on the relative comparison analysis.

Section 406.04 – Selection of Comparable Rentals

In developing the valuation for a two- to four-family investment property, the appraiser must analyze the most current and most comparable rental properties that are available to develop an estimated market rent for the subject property. The appraiser must report and analyze at least three rental comparables (which do not have to be the same comparables used in the sales comparison analysis). The appraiser should reconcile the comparable rental data and provide support for the estimated market rents for the individual subject units, providing information about lease dates, number of vacant units, actual rents, and estimated market rents for the subject property. The appraisal report should assure the lender that the units and properties selected as comparables are comparable to the subject property (in terms of both the units and the overall property) and accurately represent the rental market for the subject property, unless the appraiser states otherwise in the report.

Section 406.05 – Underwriter’s Review of Adjustment Grid

The lender's underwriter should review thoroughly the "sales comparison analysis" adjustment grid. The underwriter should spot check the positive and negative adjustment calculations when a quantitative sales comparison analysis is used because there are many places in which an error can be made in the use of dollar adjustments.

The underwriter should pay particular attention to the following areas. Because a substantial variance raises questions about the validity of using a specific comparable sale, the appraiser must have addressed the reason for a variance.

A. Proximity to subject property and location. The description of the proximity of the comparable sale to the subject property must be specific (e.g., two blocks south). Whenever possible, the appraiser should use comparable sales in the same neighborhood as the subject property because the sales prices of comparable properties in the neighborhood should reflect the same positive and negative locational characteristics.

B. Sales price. The sales price of each comparable sale should be within the general range of the appraiser's opinion of market value for the subject property. A \$100,000 comparable sale for a \$75,000 subject property would raise questions about the validity of the comparable.

C. Sales or financing concessions. The dollar amount of sales or financing concessions paid by the seller must be reported for the comparable sales if the information is reasonably available. Examples of sales or financing concessions include interest rate buydowns or other below-market rate financing; loan discount points; loan origination fees; closing costs customarily paid by the buyer; payment of condominium, PUD, or cooperative fees or assessment charges; refunds of (or credit for) the borrower's expenses; absorption of monthly payments; assignment of rent payments; and the inclusion of non-realty items in the transaction.

Generally, sales or financing data for comparable sales—such as the mortgage amount, loan type, interest rate, term, and any fees or concessions the seller paid—is available. The appraiser should obtain this information from an individual who was a party to the comparable transaction (the broker, buyer, or seller) or from a data source that the appraiser considers to be reliable. We recognize that there may be some situations in which sales or financing information is not available because of legal restrictions or other disclosure-related problems. In such cases, the appraiser must explain why the information is not available—however, we will not accept an explanation that indicates that the appraiser did not make an effort to verify the information. In all other cases, the appraiser must provide the sales and financing concession information that was available (and verified) for the comparable sales. If the appraisal report

form does not provide enough space to discuss this information, the appraiser should make an adjustment (or a relative relationship assessment) for the concessions on the form and include an explanation in an addendum to the appraisal report.

When a quantitative sales comparison analysis is used, the amount of the negative dollar adjustment for each comparable with sales or financing concessions should be equal to any increase in the purchase price of the comparable that the appraiser determines to be attributable to the concessions. The need to make negative dollar adjustments for sales and financing concessions and the amount of the adjustments to the comparable sales are not based on how typical the concessions might be for a segment of the market area—large sales concessions can be relatively typical in a particular segment of the market and still result in sale prices that reflect more than the value of the real estate. Adjustments based on mechanical, dollar-for-dollar deductions that are equal to the cost of the concessions to the seller (as a strict cash equivalency approach would dictate) are not appropriate. We recognize that the effect of the sales concessions on sales prices can vary with the amount of the concessions and differences in various markets. The adjustments must reflect the difference between what the comparables actually sold for with the sales concessions and what they would have sold for without the concessions so that the dollar amount of the adjustments will approximate the reaction of the market to the concessions.

Positive adjustments (or relative relationship assessments) for sales or financing concessions are not acceptable. For example, if local tradition, or law results in virtually all of the property sellers in the market area paying a 1% loan origination fee for the purchaser, and a property seller in that market did not pay any loan fees or concessions for the purchaser, the sale would be considered as a cash equivalent sale in that market. The appraiser should recognize comparable sales that sold for all cash or with cash equivalent financing and use them as comparable sales if they are the best indicators of value for the subject property. Such sales can also be useful to the appraiser in determining those costs that are normally paid by sellers as the result of tradition or law in the market area.

D. Date of sale/time adjustment. We will accept more than three comparable sales as part of the appraisal report, but at least three of them must be actual settled or closed sales. The appraiser should provide the date of the sales contract and the settlement or closing date for each comparable sale. Unless the appraiser believes that the exact date is necessary to understand the adjustments, only the month and year of the sale need to be reported. If the appraiser does not report both the contract date and the settlement or closing date, he or she must identify the reported sale date as either the "contract date" or the "settlement or closing date." If the appraiser reports the contract date only, he or she must state whether the contract resulted in a settlement or a closing.

E. Above-grade room count and gross living area. Only finished above-grade areas should be included in the calculation of the gross living area for a one-family property or a unit in a condominium or PUD project. The appraiser should consider the basement and other partially below-grade areas separately and adjust for them accordingly. The room count and gross living area should be similar for the subject property and all comparable sales. For example, a four bedroom comparable sale generally is not acceptable to support the value of a two bedroom subject property. The appraiser must address large differences between the subject property and the comparable sales since they raise doubts about the validity of the comparable sales as good indicators of value.

F. Over-improvements. In some instances, the improvements can represent an over-improvement for the neighborhood, but still be within the neighborhood price range—such as a property with an in-ground swimming pool, a large addition, or an oversized garage in a market that does not demand these kinds of improvements. The appraiser must comment on such over-improvements and indicate their contributory value in the "sales comparison analysis" adjustment grid.

Because an over-improved property may not be acceptable to the typical purchaser, the lender's underwriter must review appraisals on this type of property carefully to ensure that the appraiser has reflected only the contributory value of the over-improvement in his or her analysis.

Section 406.06 – Appraiser's Comments and Indicated Value

The appraiser's analysis for a property should include narrative comments about any prior sales of the subject property and the comparable sales, as well as about any current agreement of sale, option, or listing of the subject property. The appraiser's comments should also reflect his or her reconciliation of the adjusted (or indicated) values for the comparable sales and identify the sales that were given the most weight in arriving at the indicated value for the subject property. For two- to four-family properties, the appraiser should also provide an evaluation of the typical purchaser's motivation for purchasing the property and an analysis of any current agreement of sale, option, or listing for the subject property.

Section 407 – Cost Approach to Value

The cost approach to value assumes that a potential purchaser will consider building a substitute residence that has the same use as the property that is being appraised. This approach, then, measures value as a cost of production. The reliability of the cost approach depends on valid reproduction cost estimates, proper depreciation estimates, and accurate site values. We will not accept appraisals that rely solely on the cost approach as an indicator of market value.

We do not require the appraiser to consider the cost approach to value for any appraisal that is documented on the *Desktop Underwriter Quantitative Analysis Appraisal Report* (Form 2055), the *Desktop Underwriter Qualitative Analysis Appraisal Report* (Form 2065), or the *Desktop Underwriter Individual Cooperative Interest Appraisal Report* (Form 2095). Furthermore, the appraiser does not need to consider the cost approach to value when appraising a unit in a condominium or cooperative project since this approach may be impractical for estimating the value of an individual unit because each unit is an integral part of the project development.

The cost approach to value may be a good indicator of value for newer or renovated properties that are one- to four-family residences, or detached, semi-detached, or townhouse units in PUD projects. However, as the effective age of a property increases, the reliability of the cost approach may decrease because the depreciation estimates may be subjective. An appraiser should use his or her best judgment regarding the applicability of the cost approach to value when the property being appraised is an older property; however, if the appraiser does not use the cost approach, he or she must explain why it was not used and provide an opinion of value for the site.

The appraiser arrives at the indicated value of a property by estimating the reproduction cost of new improvements, subtracting the amount of depreciation from all causes, and adding his or her opinion of value for the site if it were vacant and available to be developed to its highest and best use.

- The *reproduction cost estimate* should reflect the cost of construction based on the current prices of producing a replica of the property being appraised--including all of its positive and negative characteristics. Although the construction materials used for the estimate should be as similar as possible to those used for the subject property, they do not have to be exactly the same.
- *Physical depreciation* (which is traditionally referred to as physical deterioration) is a loss in value that is caused by deterioration in the physical condition of the improvements. An appraiser generally classifies physical deterioration as "curable" or "incurable." Curable physical deterioration

refers to items of deferred maintenance—for example, painting or items currently in need of repair (such as broken stair rails). Incurable physical deterioration refers to other items that currently are not practical or feasible to correct—for example, furnaces or roof shingles that have not reached the end of their economic life.

- *Functional depreciation* (which is traditionally referred to as functional obsolescence) is a loss in value that is caused by defects in the design of the structure—for example, inadequacies in such items as architecture, floor plan, or sizes and types of rooms. It also can be caused by changes in market preferences that result in some aspect of the improvements being considered obsolete by current standards—for example, the location of a bedroom on a level with no bathroom, or access to a bedroom only through another bedroom.
- *External depreciation* (which is traditionally referred to as economic obsolescence) is a loss in value that is caused by negative influences that are outside of the site, such as economic factors or environmental changes—for example, shopping centers, expressways, or factories that are adjacent to the subject property.

In reviewing the appraisal report, the lender should make sure that the appraiser's analysis and comments for the cost approach to value are consistent with comments and adjustments mentioned elsewhere in the appraisal report. For example, if the neighborhood or site description reveals that the property backs up to a shopping center, the lender should expect to see an adjustment for external depreciation in the cost approach. Similarly, if the improvement analysis indicates that it is necessary to go through one bedroom to get to another bedroom, the lender should expect to see an adjustment for functional depreciation.

Section 408 – Income Approach to Value

The income approach to value is based on the assumption that market value is related to the market rent or income that a property can be expected to earn. Its use generally is appropriate in neighborhoods that consist of one-family properties when there is a substantial rental market, and it can be an important approach in the valuation of two- to four-family properties. However, it generally is not appropriate in areas that consist mostly of owner-occupied properties since adequate rental data generally does not exist for those areas. We will not accept an appraisal if the appraiser relies solely on the income approach to value as an indicator of market value.

We do not require the appraiser to consider the income approach to value for any appraisal that is documented on the *Desktop Underwriter Quantitative Analysis Appraisal Report* (Form 2055), the *Desktop Underwriter Qualitative Analysis Appraisal Report* (Form 2065), or the *Desktop Underwriter Individual Cooperative Interest Appraisal Report* (Form 2095).

To arrive at the indicated value by the income approach to value, the appraiser multiplies the total gross estimated monthly market rent for the subject property by a reconciled gross monthly rent multiplier. (Because of the way the appraiser's opinion of value is derived under this approach, the income approach to value provides a reliable indication of value only when the comparable sales are truly comparable.)

- *Estimated market rent* is based on an analysis of comparable rentals in the neighborhood. After appropriate adjustments are made to the comparable properties, their adjusted (or indicated) values are reconciled to develop an estimated monthly market rent for the subject property.

- The *gross rent multiplier* is determined by dividing the sales prices of comparable properties that were rented at the time of sale by their monthly market rent, which is then reconciled to create a single gross rent multiplier (or a range of multipliers) for the subject property.

The appraiser must use his or her best judgment regarding the applicability of the income approach to value. An instance in which the income approach may not be an appropriate indicator of value involves the appraisal of a two-family rental property in a neighborhood that is dominated by two-family properties that are owner-occupied. In such cases, the appraiser does not need to develop a gross monthly rent multiplier, but must report the estimated market rent for the subject property. In such cases, the appraiser should provide an appropriate explanation of why he or she chose to report in this manner.

When the property being appraised is a one-family property that will be used as an investment property, the appraiser must prepare a *Single-Family Comparable Rent Schedule* (Form 1007) in addition to the appropriate appraisal report form. [This form is not required for a two- to four-family property since the *Small Residential Income Property Appraisal Report* (Form 1025) provides substantially the same information, nor is it required for a Community Living group home mortgage.] When the appraiser is relying on the income approach to value, he or she should attach the supporting comparable rental and sales data, and the calculations used to determine the gross rent multiplier, as an addendum to the appraisal report form.

Section 409 – Valuation Analysis and Final Reconciliation

The valuation sections of our appraisal report forms enable an appraiser to develop and report in concise format an adequately supported opinion of market value-based on the cost, sales comparison, and income approaches to value (as applicable), and, in the case of small residential income properties, on comparable rental data. If the appraiser believes that additional information needs to be provided because of the uniqueness of the property or some other condition, he or she should provide additional supporting data in an addendum to the appraisal report form.

The reconciliation process that leads to the appraiser's opinion of market value is an on-going process throughout the appraiser's analysis. In the final reconciliation, the appraiser must reconcile the reasonableness and reliability of each applicable approach to value and the reasonableness and validity of the indicated values and the available data, and then must select and report the approach or approaches that were given the most weight. The final reconciliation must never be an averaging technique.

If the appraiser has provided a comprehensive and logical analysis of the neighborhood and the property, the lender's underwriter should be able to reach a sound conclusion on the adequacy of the property as security for the mortgage.