

2007 Fannie Mae Selling Guide Property and Appraisal Guidelines

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Part XI, Introduction (06/30/02)

This *Part*—Property and Appraisal Guidelines—details our general requirements for analyzing the property appraisal aspects of conventional mortgages secured by one-family 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 ensure 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 also are 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* 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 ongoing 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.

XI, Chapter 1: Appraiser Qualifications (06/30/02)

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 ensure 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.

XI, Chapter 2: Appraisal (or Property Inspection) Documentation (06/30/02)

The lender must disclose to the appraiser any and all information about the subject property of which it is aware, 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 also must 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.

XI, 201: Age of Appraisal (or Property Inspection) (11/01/05)

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 on the *Appraisal Update and/or Completion Report (Form 1004D)*, on 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 Underwriter Property Inspection Report (Form 2075)*.

XI, 202: Status of Construction (08/24/03)

Generally, we require the improvements for the subject property to have been completed when the mortgage is delivered to us. For specific information concerning manufactured homes, please refer to *Part VII, Section 102.07*. We do, however, make some exceptions to this for properties other than manufactured homes and, in such cases, an appraisal report should be developed in accordance with the following criteria:

- 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 two percent 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 percent 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.
- 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 ensure 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.

XI, Chapter 3: Special Appraisal Considerations (06/30/02)

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.

XI, 301: Units in Condominium Projects (11/01/05)

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.

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.

XI, 302: Units in PUD Projects (11/01/05)

A planned unit development 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.

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.

XI, 303: Units in Cooperative Projects (11/01/05)

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 in the appraisal report. [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 generally is 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.

XI, 304: Factory-Built Housing (08/24/03)

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 criterion in defining the appropriate market area and in selecting comparable properties.

XI, 304.01: Manufactured Homes (06/15/07)

Any dwelling unit built on a permanent chassis and attached to a permanent foundation system is a “manufactured home” for purposes of Fannie Mae’s guidelines. Other factory-built housing (not built on a permanent chassis), such as modular, prefabricated, panelized, or sectional housing, is not considered manufactured housing and continues to be eligible under the guidelines stated in this *Guide*.

- A. Property Eligibility. The following eligibility criteria apply to any mortgage that is secured by a manufactured home.
- The manufactured home must be built in compliance with the Federal Manufactured Home Construction and Safety Standards that were established June 15, 1976 (as amended and in force at the time the home is manufactured) and that appear in HUD regulations at 24 C.F.R. Part 3280. Compliance with these standards will be evidenced by the presence of a HUD Data Plate. The HUD Data Plate/Compliance Certificate is a paper document located on the interior of the subject property that contains, among other things, the manufacturer’s name, and trade/model number. In addition to the data required by Fannie Mae, the data plate includes pertinent information about the unit including a list of factory-installed equipment. The HUD Certification Label is a metal plate (sometimes referred to as a HUD “seal” or “tag”) located on the exterior of each section of the home.
 - The manufactured home must be a one-family dwelling that is legally classified as real property. The towing hitch, wheels, and axles must be removed and the dwelling must assume the characteristics of site-built housing. The borrower must own in fee simple the land on which the manufactured home is situated, unless the manufactured home is located in a cooperative or condominium project. Mortgages secured by manufactured homes located on leasehold estates are not eligible.
 - Multi-width manufactured homes may be located either on an individual lot or in a project development (i.e., cooperative, condominium, PUD, or subdivision). Mortgages secured by single-width manufactured homes are eligible for delivery to Fannie Mae only if the manufactured home is located in a Fannie Mae-approved subdivision, cooperative, condominium, or PUD project development.
 - Project acceptance is required for multi-width manufactured homes located in a cooperative, condominium, or PUD project development. Project acceptance also is required if the property is a single-width manufactured home and the project is a PUD. In the case of cooperatives, both the land and dwelling must be owned by the cooperative. In the case of condominiums, both the land and dwelling must be subject to the condominium regime. For further information about project acceptance requirements, see *Part XII*.
 - The manufactured home must be at least 12 feet wide and have a minimum of 600 square feet of gross living area. Further, the manufactured home must have sufficient square footage and room dimensions to be acceptable to typical purchasers in the market area. We do not specify other minimum requirements for size, roof pitch, or any other specific construction details.
 - The manufactured home must be attached to a permanent foundation system in accordance with the manufacturer’s requirements for anchoring, support, stability, and maintenance. The foundation system must be appropriate for the soil conditions for the site and meet local and state codes.
 - If the property is not situated on a publicly dedicated and maintained street, then it must be situated on a street that is community owned and maintained or privately owned and maintained. There must be adequate vehicular access and there must be an adequate and legally enforceable agreement for vehicular access and maintenance.
 - The manufactured home must be permanently connected to a septic tank or sewage system and to other utilities in accordance with local and state requirements.
 - We require the improvements to be completed, and fully paid for, when the mortgage is delivered to us. Specifically, the following must be completed: site preparation for delivery of the manufactured home,

attachment of the manufactured home to the permanent foundation system, permanent connection to the septic or sewage system, and permanent connection to all necessary utilities (water, electricity, gas service, etc.). Exceptions to the foregoing may be only for minor items that do not affect the ability to obtain an occupancy permit (e.g., landscaping, a driveway, a walkway, etc.), subject to all requirements and warranties for *new or proposed construction* provided in our *Part XI, Section 202*. Mortgages secured by *existing* manufactured homes that have incomplete items, such as a partially completed addition or renovation, or defects or needed repairs that affect livability, are not eligible for purchase until the necessary work is completed and fully paid for.

- B. Appraisal Standards. Fannie Mae requires market-based property valuations for manufactured homes demonstrated by a well-developed sales comparison approach to value. This means that the appraiser must develop and report in a concise format an adequately supported opinion of market value based on the sales comparison approach to value and *further supported by* the cost approach to value.

We believe that the unique property and appraisal issues associated with manufactured homes will be most appropriately addressed through supplemental analysis and reporting by the appraiser. We require the appraiser to address more directly, in a standardized format, construction quality, property condition, market acceptance, indicated value by the cost approach, and support for the contributory value of the site.

The appraiser must report the results of a manufactured home appraisal on the *Manufactured Home Appraisal Report (Form 1004C)*. The use of *Form 1004C* will help to ensure that the appraiser inspected, considered, and/or reported (as applicable) the appropriate information including, but not limited to, the:

- manufacturer's name,
- trade or model name,
- year of manufacture,
- serial number,
- certification label number(s) from either the HUD Data Plate or certification label(s),
- type of foundation and utility connections,
- detailed and supported cost approach,
- opinion of the market value of the site, and
- property's conformity to the neighborhood.

Because the appraisal of a new manufactured home often is completed prior to delivery of the home, some of the information needed to complete *Form 1004C* may not be available at the time the appraisal is performed. That information might include the dealer invoice, the HUD Data Plate, certification label number(s), etc. For information not available at the time the appraiser is completing the appraisal forms, the appraiser may appraise the property subject to his or her receipt and review of the items as a condition of the appraisal. Prior to the delivery of the mortgage to us, lenders should obtain a "certification of completion" from the appraiser that includes the previously unavailable information (including a summary of the appraiser's analysis of any previously unavailable dealer invoice), and certifies that the requirements and conditions of the appraisal have been satisfied.

Other requirements include:

- For purchase money mortgages, the lender must provide the appraiser with a complete copy of the executed contract for sale of the manufactured home and land, or if the manufactured home and land are being purchased separately, the executed contract for each. In addition, the lender must provide the appraiser with a copy of the manufacturer's invoice if the manufactured home is new. The appraiser must analyze the contract (and manufacturer's invoice for new homes) and summarize his or her analysis in the appraisal report. The appraiser must not include in his or her value conclusion any non-realty items such as insurance, warranties, furniture, etc. Our appraisal report forms require the appraiser to develop an opinion of value solely for the real property as completed (consisting of the manufactured home, site improvements, and the land on which the home is situated) that is the subject of the appraisal.

- For new manufactured homes, not yet attached to the land (or not yet constructed), an appraisal may be based on either plans and specifications or an existing model home. In such cases, the lender must obtain a “certification of completion” before it delivers the mortgage to us. This certification must be completed by the original appraiser if possible or if not possible, by a substitute appraiser as provided for in [Section 202](#). He or she must verify and state that the improvements were completed in accordance with requirements and conditions in the original appraisal report. The appraiser must also verify the information from the HUD Data Plate. Photographs of the completed improvements (attached to the permanent foundation) must be included.
- 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, adequate vehicular access, and other amenities. Since amenities, easements, and encroachments may either detract from or enhance the marketability of a site, the appraiser must reflect them in his or her analysis and valuation. In addition, the appraiser must comment on them if the site has adverse conditions or is not typical for the neighborhood.
- The appraiser’s opinion of value must be based on the characteristics of the subject property, including the site area. The appraisal report also must indicate whether or not the site is compatible with the neighborhood. The appraiser also should comment on the conformity of the manufactured home to other manufactured homes in the neighborhood. If the site or manufactured home is substantially non-conforming with the neighborhood such that a reliable appraisal cannot be made, the mortgage is not eligible for delivery to us.
- The appraiser must address both the marketability and comparability of a manufactured home by selecting comparable sales of similar manufactured homes, for example, multi-width homes to multi-width homes, etc. In order for the loan to be eligible for delivery to Fannie Mae, the appraiser must use a minimum of two comparable sales of similar manufactured homes. The appraiser may use either site-built housing or a different type of factory-built housing as the third comparable sale. When that is the case, the appraiser must explain why site-built housing or a different type of factory-built housing is being used for the third 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 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.
- In order to further enhance the quality of manufactured home appraisals and to provide the lender with additional information to improve its ability to underwrite the appraisal, we are requiring a detailed and supported cost approach to value for all manufactured home appraisals. The procedure involved in properly developing a detailed cost approach should improve the appraiser’s ability to: (i) recognize differences in manufactured home construction quality; (ii) understand the differences between the comparable sales and the subject property; (iii) extract from the market appropriate adjustments for the sales comparison analysis; and (iv) identify sales of manufactured homes that are similar enough to the subject property to use as comparable sales.

The sales comparison and cost approaches to value are complementary for the valuation of manufactured housing and should support the final value conclusion. The cost approach must, at a minimum, contain the information indicated on [Form 1004C](#). The appraiser may choose to report the results of the cost approach on [Form 1004C](#) or by using a report form from a published cost service as an addendum to the appraisal report form.

Whatever format the appraiser chooses to report the cost approach, the information must be sufficient to allow the lender to replicate the cost figures and calculations.

- C. Sources of Manufactured Housing Data. Traditional appraisal data sources do not provide enough quality manufactured home data for the appraiser to develop a supportable and well-documented manufactured home appraisal. While sources such as MLS and public records are important, the appraiser must develop other data sources such as manufactured home dealers and construction companies/builders experienced in the installation of manufactured homes.

One important source of manufactured housing information is the *N.A.D.A. Manufactured Housing Appraisal Guide*. This publication lists general manufactured home depreciated replacement values based on original factory construction categories. The publication offers a step-by-step process for arriving at the average retail book value for a manufactured home and can be used to develop a cost approach. It is important to note that the N.A.D.A. chart values assume the home is in average condition. The publication provides definitions for “excellent,” “good,” “average,” “fair,” and “poor” condition.

Another source of information is the *Marshall & Swift Residential Cost Handbook*. Marshall & Swift provides information that allows the user to arrive at an estimate of the cost of the manufactured home when new (i.e., replacement cost) based on, among other things, the construction quality. It provides an explanation of the items that allow the appraiser to support his or her conclusion of the overall construction quality of a manufactured home. This is important since condition and quality play a very important role in the value and marketability of manufactured homes.

The appraiser must support his or her opinion about both the quality and the condition of the manufactured home. The *N.A.D.A. Guide* or the *Marshall & Swift Handbook* may be used as additional sources to provide support for the appraiser’s conclusions about the quality and value of a manufactured home.

- A. Modular home. It 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.
- B. Factory-built home that is any other type of prefabricated, panelized, or sectional housing. It 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 to 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 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. We 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.

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-unit or two-unit residence. The property appraisal for a one-unit property should be documented on the *Uniform Residential Appraisal Report (Form 1004)*, while the appraisal for a two-unit 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-family 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 already has 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.)

XI, 306: Mixed-Use Properties (05/06/99)

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.

XI, 307: Properties Affected by Environmental Hazards (06/30/02)

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.

XI, 308: Urban Properties (03/20/95)

The valuation of properties in urban locations that are undergoing rehabilitation also may 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.

XI, 309: Affordable Housing Program Properties (03/20/95)

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 percent combined with a below-market interest rate second mortgage that has a loan-to-value ratio of 25 percent 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 percent ($\$70,000/\$97,500$) and the combined loan-to-value ratio for the first and second mortgages would be 98 percent ($\$95,000/\$97,500$), rather than the 70 percent and 95 percent 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.

XI, 310: Properties in Special Assessment or Community Facilities Districts (03/20/95)

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.

XI, 310.01: Special Assessment Districts (06/30/02)

Special assessment districts (which also may 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 ensure 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.

XI, 310.02: Community Facilities Districts (06/30/02)

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 ongoing 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 ongoing 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.

XI, 311: Properties Subject to Leasehold Interests (03/22/06)

Mortgages secured by manufactured homes located on leasehold estates are not eligible for delivery to Fannie Mae. 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.

XI, 311.01: Appraising Properties Subject to Resale Restrictions (05/01/06)

The terms of the resale restrictions (as well as other restrictions) and the time period within which they are effective can affect the value of the property. In cases where resale restrictions terminate automatically upon foreclosure (or the expiration of any applicable redemption period), or upon recordation of a deed-in-lieu of foreclosure, the appraisal should reflect the market value of the property without resale restrictions. 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 without resale and other restrictions that are terminated automatically upon the latter of foreclosure or any applicable redemption period, or upon recordation of a deed-in-lieu of foreclosure.

In cases where the resale restrictions survive foreclosure or deed-in-lieu of foreclosure, the appraisal must reflect the impact the restrictions have on value and be supported by comparables with similar restrictions. The lender must ensure that the appraiser is aware of the existence of the resale restrictions. The appraisal report must note the existence of the resale restrictions and comment on any impact the resale restrictions have on the property’s value and marketability.

XI, 311.01: Appraising Properties Subject to Resale Restrictions (05/01/06)

The terms of the resale restrictions (as well as other restrictions) and the time period within which they are effective can affect the value of the property. In cases where resale restrictions terminate automatically upon foreclosure (or the expiration of any applicable redemption period), or upon recordation of a deed-in-lieu of foreclosure, the appraisal should reflect the market value of the property without resale restrictions. 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 without resale and other restrictions that are terminated automatically upon the latter of foreclosure or any applicable redemption period, or upon recordation of a deed-in-lieu of foreclosure.

In cases where the resale restrictions survive foreclosure or deed-in-lieu of foreclosure, the appraisal must reflect the impact the restrictions have on value and be supported by comparables with similar restrictions. The lender must ensure that the appraiser is aware of the existence of the resale restrictions. The appraisal report must note the existence of the resale restrictions and comment on any impact the resale restrictions have on the property’s value and marketability.

XI, 312: Leaseholds Held by Community Land Trusts (03/22/06)

Community land trusts are typically nonprofit organizations that acquire land for a variety of reasons—such as to facilitate homeownership 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, 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 also can 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 VII, Section 102.11*). 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.

XI, 312.01: Determining the Fee Simple Value (06/30/02)

In determining the fee simple value of the subject property, the appraiser generally should 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).

XI, 312.02: Determining the Capitalization Rate (06/30/02)

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.

XI, 312.03: Determining the Leasehold Value (06/30/02)

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 percent, and the estimated fee simple value of the subject property is \$100,000.

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

XI, Chapter 4: Reviewing the Appraisal Report (11/01/05)

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

When a new appraisal is required for a mortgage that a lender delivers to Fannie Mae, we expect lenders to perform an underwriting analysis of: (1) the current contract for sale for the subject property for purchase money

transaction; (2) the current offering or listing for sale for the subject property for both purchase and refinancing transactions (if applicable); (3) the current ownership for the subject property for both purchase and refinance transaction; and (4) the sale (or transfer) history of the subject property, and comparable sales for both purchase and refinance transactions.

We require the lender's appraiser to perform the initial analysis based on data researched and analyzed as part of the appraisal process. Our appraisal report forms and the Uniform Standards of Professional Appraisal Practice require the appraiser to analyze and report on any current contract for sale, offering or listing for sale, and recent prior sales (or transfers) of the subject property.

We expect appraisers to analyze and report on the current contract for sale; offering or listing for sale; and, when the information is reasonably available, the sale (or transfer) history of the subject property, and of comparable sales for both purchase and refinance transactions. We also expect appraisers to have the necessary and appropriate data sources for the area in which the property is located and to have the appropriate knowledge and experience to appraise properties in the market areas where they accept assignments. If the appraiser cannot obtain the information needed to perform the required analysis and/or does not have the knowledge and experience to appraise properties in the subject market area, he or she should not accept those appraisal assignments.

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.

XI, 401: The Subject Property (11/01/05)

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 also identify the property rights to be appraised as "fee simple" or "leasehold."

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.

XI, 402: Market Data Research (08/24/03)

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. For specific information concerning sources of manufactured housing data, please refer to [Section 304.01](#).

XI, 403: Neighborhood Analysis (06/30/02)

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-family 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.** These can be identified by various physical characteristics (streets, bodies of water, land uses, types of dwellings, etc.).
- **Neighborhood characteristics.** These 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 (one-eighth acre, two 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.** These 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 ensure 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, ongoing 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.

XI, 403.01: Location (06/30/02)

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 also must 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 ensure 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.

XI, 403.02: Degree of Development and Growth Rate (06/30/02)

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.

XI, 403.03: Trend of Property Values, Demand/Supply, and Marketing Time (01/31/06)

The appraiser must report on the primary indicators of market condition for properties in the subject neighborhood by noting the trend of property values (“increasing,” “stable,” or “declining”), the supply of properties in the subject neighborhood (“shortage,” “in-balance,” or “over-supply”), and the marketing time for properties (“under three months,” “three to six months,” or “over six months”) as of the effective date of the appraisal. We also expect the appraiser to describe the reasons when the trend of property values is declining, supply is an over-supply, or marketing time is over six months.

The appraiser’s analysis of a property must take into consideration all factors that affect value. Because we purchase mortgages in all markets, this is particularly important for market areas that are experiencing significant fluctuations in property values (including sub-markets for particular types of housing within the market area). Therefore, lenders must take appropriate steps to ensure that the appraisers they use analyze listings and contract sales as well as closed or settled sales, and use the most recent and similar sales available as part of the sales comparison approach, with particular attention to sales or financing concessions in markets that are experiencing either declining property values, an over-supply of properties, or marketing times over six months. (Also see [Section 406](#), Sales Comparison Approach to Value.)

XI, 403.04: Price Range and Predominant Price (11/01/05)

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-family 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-family 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-improvement 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.

XI, 403.05: Age Range and Predominant Age (11/01/05)

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-family 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-family 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.

XI, 403.06: Present Land Use (11/01/05)

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-family 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 ensure 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 also must indicate the type of land use and its related percentage. The total of the types of land uses must equal 100 percent.

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 non-residential 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 ensure 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.

XI, 404: Site Analysis (08/24/03)

The property site should be of a size, shape, and topography that is generally conforming and acceptable in the market area. It also must have competitive utilities, street improvements, adequate vehicular access, and other amenities. Since amenities, easements, and encroachments may either detract from or enhance the marketability of a site, the appraiser must reflect them in his or her analysis and evaluation. In addition, 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. For specific information concerning the site area for manufactured homes, please refer to Section 304.01.

XI, 404.01: Zoning (01/31/06)

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 also must 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-family 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 non-conforming, 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 or two-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 based upon its current use 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 also must 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 three-family to four-family 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.)

XI, 404.02: Highest and Best Use (06/30/02)

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.

XI, 404.03: Utilities (06/30/02)

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 ongoing 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](#)).

XI, 404.04: Off-Site Improvements (11/01/05)

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.

404.05: The Lot (06/30/02)

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.

XI, 404.06: Special Flood Hazard Area (11/01/05)

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. 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 one percent or greater chance that a flood level will be equal or exceeded in any given year.) The appraiser also must indicate the specific FEMA flood zone and the map number and its effective date.

Flood Insurance Rate Maps 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.

XI, 405: Improvements Analysis (11/01/05)

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.

If the property that is being appraised includes an accessory apartment, the appraiser should describe it in the appraisal report form.

XI, 405.01: Conformity To Neighborhood (06/30/02)

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.

XI, 405.02: Actual and Effective Ages (06/30/02)

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 generally will 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.

XI, 405.03: Insulation and Energy Efficiency (11/01/05)

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. The appraiser should compare the energy-efficient features of the subject property to those of the comparable properties in the “sales comparison analysis” grid to ensure that the overall contribution of these items is reflected in his or her opinion of the market value of the subject property.

XI, 405.04: Layout and Floor Plans (06/30/02)

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.

I, 405.05: Gross Living Area (11/01/05)

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 ensure 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.

XI, 405.06: Gross Building Area (11/01/05)

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-family 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-grade 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-family 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.

XI, 405.07: Infestation, Dampness, or Settlement (11/01/05)

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.

XI, 405.08: Property Condition (11/01/05)

Based on the factual data of the improvement analysis, the appraiser must express an opinion on the appraisal report form about the condition of the improvements. We expect that appraisals based on an interior and exterior inspection will include a complete visual inspection of the accessible areas of the property. The appraiser is not responsible for hidden or unapparent conditions. The appraiser must report any condition that may affect the value or marketability of the subject property in factual, specific terms. The appraiser also is responsible for noting in the appraisal report any adverse conditions (such as, but not limited to, needed repairs; deterioration; the presence of hazardous wastes, toxic substances, or adverse environmental conditions; etc.) that were apparent during the inspection of the property or that he or she became aware of during the research involved in performing the appraisal. The appraiser must report detrimental conditions of the improvements even if the conditions also are 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 consider all factors that have an impact on value and marketability in the development of the appraisal report. The appraiser is expected to consider and describe the overall quality and condition of the property and identify items that require immediate repair as well as items where maintenance may have been deferred, which may or may not require immediate repair. The appraiser must address any needed repairs or any physical, functional, or external inadequacies in the “comments” section of the appraisal.

We permit an appraisal to be based upon the “as is” condition of the property as long as any minor conditions, such as deferred maintenance, do not affect the livability, soundness, or structural integrity of the property, and the appraiser’s opinion of value reflects the existence of these conditions. Minor conditions and deferred maintenance include worn floor finishes or carpet, minor plumbing leaks, holes in window screens, or cracked window glass. Minor conditions and deferred maintenance are typically due to normal wear and tear from the aging process and the occupancy of the property. While such conditions generally do not rise to the level of a “required repair,” they must be reported.

The appraiser must identify physical deficiencies that could affect the soundness, structural integrity, or livability of the property as part of the appraiser’s description of the physical condition of the property. These may include cracks or settlement in the foundation, water seepage, active roof leaks, curled or cupped roof shingles, inadequate electrical service or plumbing fixtures, etc. When such deficiencies exist or improvements are incomplete, the property must be appraised subject to completion of the specific alterations or repairs. In situations where a condition may need repair but the appraiser may not be qualified to make that decision, the appraiser must appraise the property subject to a satisfactory inspection by a qualified professional. In such cases, the lender must have the property inspected and any material conditions repaired before it delivers the mortgage

to us. The appraiser may be asked to revise his or her appraisal based upon the results of the inspection, in which case the appraiser would incorporate the results of the inspection and measure the impact, if any on the appraiser's final opinion of value.

The lender must review the appraisal report to ensure that the appraiser has not indicated any physical deficiencies or conditions that would affect the livability, soundness, or structural integrity of the property. When there are none, the lender does not need to require minor repairs to be completed before it delivers the mortgage to us. When improvements are incomplete or conditions exist that affect the livability, soundness, or structural integrity of the property, the property must be appraised subject to completion of the specific alterations or repairs. Additionally, the alterations or repairs must be performed, and the lender must obtain a completion report from an appraiser, before it delivers the mortgage to us.

Lenders must take the necessary steps to ensure that a property represents adequate collateral for the mortgage loan. In addition, we recommend that lenders disclose all known property condition issues to the borrower so that the borrower may take any necessary actions to address such issues.

XI, 405.09: Remaining Economic Life (11/01/05)

Because our appraisal report forms 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.

XI, 406: Sales Comparison Approach to Value (11/01/05)

The sales comparison approach to value—traditionally referred to as the market data approach—is an analysis of comparable sales, contract sales, and listings of properties that are the most comparable to the subject property. The Uniform Standards of Professional Appraisal Practice require the appraiser to report a minimum three-year prior sales history for the subject property. We require the appraiser to comply with the minimum requirements of USPAP. For specific information concerning the comparability of manufactured home sales, please refer to [Section 304.01](#).

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 offerings or 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 declining markets because the competing listings and contract sales probably reflect the upper-end of value for the subject property as of the effective date of the appraisal. This analysis will result in more accurate reporting on market conditions, including trends that indicate sale prices for contract sales and asking prices for recent offerings or listings have declined. (Also see [Section 403.03](#), Trend of Property Values, Demand/Supply, and Marketing Time.)

The comparable market data must be verified, analyzed, and adjusted for differences between the comparable properties and the subject property. 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.

XI, 406.01: Sources of Comparable Market Data (06/30/02)

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.

XI, 406.02: Selection of Comparable Sales (06/30/02)

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 ensure 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 often will 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.

XI, 406.03: Adjustments to Comparable Sales (11/01/05)

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.

Our 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 percent of the sales price of the comparable.

When the adjustments exceed 15 percent, 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 percent 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 percent, 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-unit to four-unit properties, the appraiser must report certain unadjusted and adjusted units of comparison for the subject property and the comparable sales. Because purchasers of small residential income properties may rely on these 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.

XI, 406.04: Selection of Comparable Rentals (11/01/05)

In developing the valuation for a two-unit to four-unit 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 ensure 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.

XI, 406.05: Underwriter's Review of Adjustment Grid (11/01/05)

The lender's underwriter should review thoroughly the "sales comparison analysis" adjustment grid. The underwriter should spot check the positive and negative adjustment calculations 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 one percent 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 also can 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.

XI, 406.06: Appraiser’s Comments and Indicated Value (11/01/05)

The appraiser’s analysis for a property should include narrative comments about any current contract for sale, offering or listing for sale, current ownership, and recent prior sales (or transfers) of the subject property and comparable sales. The appraiser’s comments also should 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-unit to four-unit properties, the appraiser also should provide an evaluation of the typical purchaser’s motivation for purchasing the property and an analysis of comparable sales and of any current contract for sale, offering or listing for sale, and recent prior sale of the subject property.

XI, 407: Cost Approach to Value (11/01/05)

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. In addition, we do not require the cost approach to value except for the valuation of manufactured homes.

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.

XI, 408: Income Approach to Value (11/01/05)

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-unit properties when there is a substantial rental market, and it can be an important approach in the valuation of two-unit to four-unit 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.

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-unit rental property in a neighborhood that is dominated by two-unit 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-unit 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-unit to four-unit property because 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 include the supporting comparable rental and sales data, and the calculations used to determine the gross rent multiplier in the appraisal report.

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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 ongoing 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.