



*Announcement 07-11*

*July 13, 2007*

*Amends these Guides: Selling*

## *Collateral Valuation Practices and Declining Markets*

### *Introduction*

An accurate value for the property securing a mortgage loan is important in all markets, but the value becomes difficult to evaluate when the subject real estate market is experiencing a decline in property values (“declining market”). Recent trends indicate that certain markets are experiencing a decline in property values. One of the potential problems in a declining market is the overstatement of property values in appraisal reports. This may result in the borrower not having an accurate property valuation, and overvaluation of a property could result in increased loan losses should the mortgage loan subsequently default.

Fannie Mae purchases mortgage loans secured by properties in all markets across the country to further our mission of promoting affordable homeownership. We offer mortgage products and establish eligibility guidelines that are designed to provide opportunities in all market segments. It is acceptable, and expected, that a lender will deliver mortgage loans to Fannie Mae that are secured by properties located in declining markets. It is also expected that the appraiser will utilize generally accepted appraisal standards and our appraisal report forms which 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. We therefore expect that lenders delivering mortgage loans to Fannie Mae will assess not only the borrower’s ability to qualify for the mortgage loan, but also objectively assess the collateral that will secure the mortgage loan.

This Announcement:

- Provides general guidance and resources for lenders to more accurately evaluate market conditions;

- Provides a new *Desktop Underwriter*<sup>®</sup> (DU<sup>®</sup>) message that will be generated when it appears that a property may be located within a declining market;
- Provides general guidance for manually underwritten mortgage loans; and
- Reiterates Fannie Mae's existing appraisal guidelines published in the *Selling Guide*.

## **Determination of Market Conditions**

There is no standard industry definition of what constitutes a declining market. It is within the appraiser's and lender's discretion to determine if the appraisal accurately reflects the current market conditions. In general terms, a "declining market" is one in which home prices are currently declining.

There are several services available that can be used by lenders and appraisers to assess the current market conditions, including:

- S&P/Case-Schiller<sup>®</sup> Index. This index relies on purchase price and related information obtained from county assessor and recorder offices.
- Office of Federal Housing Enterprise Oversight (OFHEO) Index. This index uses data from conforming, conventional mortgages provided by Fannie Mae and Freddie Mac, and includes both purchase and refinance information. Lenders should use the index based on purchase loans only for indications of market decline. Purchase-only indexes at the state level can be found at [www.ofheo.gov/download.asp](http://www.ofheo.gov/download.asp).
- National Association of REALTORS<sup>®</sup> (NAR) statistics on changes in median prices. NAR releases statistics on state-by-state existing-home sales and metropolitan area median home prices each quarter.

These third-party sources can be accessed via the Internet and may require subscriptions. In addition, several other entities provide reports that track current home prices on a subscription/fee basis. The lender and appraiser are ultimately responsible for leveraging industry tools and data to monitor the market conditions to ensure that the appraisal reflects an accurate indication of market value. Accordingly, the above listing is not all-inclusive. We encourage lenders to select and use market condition tracking services that they deem appropriate.

## **New DU Message for Properties Located in Declining Markets**

Fannie Mae will implement a new message in DU to advise lenders when a property appears to be located within a declining market. This new message will be available in DU Version 5.7, scheduled for release on July 22, 2007. The new DU message will appear on loan case

files for properties located in areas that have been identified as experiencing a decline in property values, as well as markets in which it is difficult to assess home values.

In these instances, DU will provide the following message to lenders:

*The subject property has been identified as being located in either an area of declining home prices or in an area where it may be difficult to assess home values. The lender should carefully review the appraisal to ensure that the appraiser has appropriately analyzed property value trends and overall market conditions to arrive at the value provided. The lender should request additional support from the appraiser if it determines that the appraisal does not accurately reflect current market conditions (e.g. the declining property values field is not checked when market conditions suggest otherwise.) Please refer to our Property and Appraisal Guidelines in Part XI of the Selling Guide.*

As real estate market conditions continue to change, we may update the criteria used to generate this new message as appropriate.

It is important to note that this new DU message is intended to be an additional tool for lenders to assess market conditions and is not designed to capture every market in which additional appraisal review may be warranted. Lenders are expected to use their discretion in relation to all transactions and to perform the level of due diligence they believe necessary to become satisfied that the appraisal report has been accurately completed.

### **Assessment of Market Conditions for Manually Underwritten Mortgage Loans**

Lenders that deliver manually underwritten mortgage loans must take appropriate steps to assess market conditions and determine if the appraisal accurately reflects current market conditions and value. Lenders may rely on a market condition tracking service to assist in this analysis. If the lender determines that the property is located within a declining market, the lender must ensure that current market conditions are identified and analyzed in the valuation process and described in the appraisal report.

### **Reiteration of Appraisal Guidelines**

As stated in Part XI of the *Selling Guide*, lenders are ultimately responsible for the accuracy of both the appraisal and its assessment of the marketability of the property. In addition, both the lender and the appraiser have certain responsibilities related to the valuation, as reiterated below.

#### *Lender Responsibilities*

The lender has the sole responsibility for managing the appraiser relationship and general activities of the appraiser it selects. As such, the lender should verify that the appraiser provides an accurate, independent, and adequately supported opinion of the value and property description, and has considered available public and non-public information concerning local trends in home prices.

At a minimum, the lender is expected to:

- Review the appraisal report to ensure consistency with our appraisal standards, analyze the property based on the appraisal, and evaluate the property's acceptability as security for the requested mortgage loan in view of its market value and marketability.
- Ensure that the appraiser analyzes listings and contract sales, if available, along with the most recent closed or settled sales. If the lender determines that the appraisal does not accurately reflect the current market conditions, the lender is expected to request additional clarification or justification from the appraiser, as necessary, to make an informed decision about the property value.
- Have appropriate business controls in place to ensure that no actions are taken by its employees, agents, or third-party originators that may compromise the accuracy of the appraisal report. Such controls may include separating the appraisal ordering process, if possible, from those who have a financial interest, both internal and external, in the transaction. It is unacceptable for a lender's employee, agent, or third-party originator to apply pressure or unduly influence the appraiser to reflect certain results in his/her analysis or reporting. Any identified instances of appraiser pressure will cause the mortgage loan to be subject to immediate repurchase by the lender.

#### Appraiser Responsibilities

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. We expect the appraiser to accurately report on the primary indicators of market conditions in a given neighborhood whether increasing, stable, or declining.

At a minimum, the appraiser is expected to:

- Use the most recent and similar comparable sales available as part of the sales comparison approach. Because excessive sales concessions can artificially inflate the sales price of a property, particular attention should be given to unusual sales or financing concessions in markets experiencing:
  - Declining property values,
  - An over-supply of properties, or
  - Marketing times in excess of six months.
- Provide an objective assessment of the primary indicators of market conditions in a given neighborhood whether they are increasing, stable, or declining. For example, when indicators such as price changes, supply and demand, and market activity reflect a decline in property values, an over-supply of homes, and/or marketing times in excess of six months, Fannie Mae expects that the appraiser has considered

these factors as part of his or her analysis, and accurately reflects this information in the appraisal report.

- Describe the reasons for these trends and indicate what, if any, impacts these trends have on the opinion of the market value for the subject property. It is unacceptable for the appraiser to ignore these issues and not report the factual property value trends and market conditions.
- Research and/or review available information regarding the home price trends of the market in question.

Fannie Mae has published a Frequently Asked Questions (FAQ) document to provide additional guidance and insight into the information presented in this Announcement. The FAQs are available to lenders on [www.efanniemae.com](http://www.efanniemae.com).

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Lenders who have questions about this Announcement should contact their Customer Account Team for additional information.

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