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Announcement 02-13

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Amends these Guides: Selling

Revised One-Unit Residential Appraisal Field Review Report

On July 31, 2002 we released the *One-Family Residential Appraisal Field Review Report* for a test and comment period that ended on November 15th. We received very positive feedback from lenders and appraisers on our revised appraisal field review process and report form. We would like to thank the many individuals and organizations that shared their views with us, especially the Appraisal Institute for the valuable assistance that they provided on this initiative.

A copy of the revised and re-titled *One-Unit Residential Appraisal Field Review Report* (Form 2000, dated December 2002) is attached. This report form replaces the test version of Form 2000 and the existing *Residential Appraisal Field Review Report* (Form 2000, dated November 1989) for reviews of appraisals on *one-unit* properties (including individual units in condominium, cooperative, and PUD projects). Reviews performed on appraisals of *two- to four-unit* properties should continue to be reported on the November 1989 version of Form 2000. Fannie Mae will develop and release an enhanced appraisal review process and report form for two- to four-unit properties for a test and comment period early next year.

Overview of Revised Form 2000

The revised Form 2000 features a report format that:

- defines the role of the review appraiser;
- addresses the purpose, the intended use, and the scope of work for the appraisal field review assignment;
- provides guidance on performing the appraisal review and completing the report form;
- provides a standardized sales comparison analysis adjustment grid that supports the review appraiser's new opinion of value; and
- includes a statement of limiting conditions and the appraiser's certifications.

A Form 2000 appraisal field review is a “phased” assignment:

- The review appraiser is required to provide only minimal information when he or she concludes that the appraisal report under review has been properly developed, adequately supported, and the value conclusions were reasonable.
- When the appraiser’s review indicates that the opinion of value was unreasonable and/or reveals material errors in the factual data in the report, market data to support his or her disagreement with the original appraisal is required.

Dividing the first two pages of the report form into three principal sections has reinforced this concept. Section I must be completed for all assignments. Section II is completed only if the review appraiser determines that the data in the original appraisal report was not factual and accurate, or that the original value conclusion was unreasonable. Section III is completed in addition to Section II only if the review appraiser determines that the original value conclusion was unreasonable. Page three provides guidance for the lender and the appraiser on the appraisal review function and page four contains the review appraiser’s certifications and statement of limiting conditions.

Purpose of Appraisal Review and Intended Use

The purpose of an appraisal field review is to verify the accuracy of the factual data and conclusions and to determine the reasonableness of the value opinion contained in the appraisal report. When the review appraiser determines that the value opinion expressed in the appraisal report is unreasonable, the review appraiser must develop and report his or her own opinion of value, as of the effective date of the original appraisal. The review appraiser must provide a well-documented report that demonstrates the analysis and supports the reviewer’s opinions and conclusions.

Form 2000 is intended to be used for quality assurance. As part of our quality assurance reviews, we use our appraisal review process to determine if an appraisal was developed and reported in accordance with our property and appraisal policies and guidelines, and if the property represents adequate security for the mortgage loan. For lenders, our enhanced appraisal review reporting process is an optional tool that will help to maintain the integrity of both the property appraisal and loan underwriting processes. We recommend that lenders use the revised Form 2000 for the appraisal review component of their quality assurance systems.

As part of our quality assurance efforts, based on our examination of independent appraisal field review reports, we refer unacceptable appraisal reports to state appraiser licensing or regulatory boards for any investigation and action they consider appropriate. In such cases, we provide the state board with a copy of the appraisal review report and the original appraisal report. Our objectives in referring appraisal reports to state appraiser licensing or regulatory boards are to:

- emphasize our continuing efforts to maintain the quality of appraisals;

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

Scope of Work

The Scope of Work section of Form 2000 defines the minimum steps that the review appraiser must take to competently perform the assignment. The appraiser may need to expand the scope of work beyond our minimum requirements because of the complexity of the assignment. However, at a minimum, the review appraiser must:

- read the entire appraisal report under review;
- inspect the subject property and comparable sales described in the appraisal report from the street (if the review appraiser inspects the interior of the subject, he or she must note that in the appraisal review report);
- inspect the neighborhood in which the subject is located;
- research all appropriate data;
- verify the data in the original appraisal report using all reliable sources; and
- assume the property condition reported in the original appraisal report is accurate unless there is evidence to the contrary.

Unacceptable Appraisal Practices

To assist lenders in identifying potential appraisal problems, we are providing the following list of the most common appraisal deficiencies that have been identified through our quality assurance efforts (and we will illustrate in the remainder of this Announcement how our revised appraisal review process and report form can help to identify these potential problems):

- unsupported opinions of market value;
- improper selection of comparable sales;
- creation of comparable sales;
- unsupported adjustments in the sales comparison approach;
- inadequate analysis of, and reporting on, the sales history of the subject property and comparable sales;
- lack of analysis of, and reporting on, the listing, offering, or contract sale for the subject property; and
- misrepresentation of the physical characteristics of the subject property, improvements, or comparable sales.

Section I – This section is to be completed for all assignments.

- Question 1. - Sale/Transfer and Listing History**

The review appraiser, as part of the normal research process, must provide a three-year sale/transfer and listing history for the subject property prior to the effective date of the original appraisal, regardless of the scope of the appraisal under review. It is important to note that this is a minimum requirement. There are some jurisdictions in which the sales price or other information may not be disclosed, but the review appraiser must still report the fact that a transfer has taken place. The review appraiser must ultimately decide when he or she has sufficient information to understand the value of the subject property and its marketability.

When reviewing listing information, the review appraiser should consider active listings, pending sales, and expired listings. The failure to analyze any current agreement of sale, option, or listing of the subject property and the prior sales of the subject property and the comparable sales is an unacceptable appraisal practice. Simply listing the results of the research is not sufficient. The review appraiser must analyze the data to understand the effect this information has on the opinions and conclusions in the report under review.

Effective January 1, 2003, the Uniform Standards of Professional Appraisal Practice (USPAP) will 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 the USPAP. The review appraiser must indicate if the original appraisal report contained the appropriate prior sale(s) and/or prior listing(s) of the subject property. The review appraiser should also comment if any omitted sale/transfer and/or listing information would have had an effect on the opinions or conclusions in the original appraisal report.

- Question 2. - Factual and Accurate Data**

An important objective of an appraisal review is to determine if material errors exist in the original appraisal report and what effect, if any, they had on the opinions and conclusions of the appraiser. After verifying the data in the report under review, the review appraiser may find minor errors that do not affect the credibility of the report or the value opinion. In such cases, the review appraiser must answer “Yes” to Question 2, summarize the review findings, and explain why the errors do not affect the appraisal report.

The opposite finding, however, will be true for some appraisal reviews. That is, there will be errors of fact or analysis that will impact the credibility of the appraisal. In such cases, the review appraiser must provide an explanation of the issues and complete Section II of the review report. Unsupported differences of opinion must be avoided.

- **Question 3. - Final Opinion of Market Value**

The review appraiser must indicate whether the original opinion of market value was reasonable as of the effective date of the original appraisal report. If the answer is “Yes,” then the review appraiser should provide a brief summary, including the identification of any minor factors that do not affect the final value conclusion. Development of and/or reporting an opinion of value that is not supportable by market data or that is misleading are considered unacceptable appraisal practices.

Because appraisers’ opinions can vary, the review appraiser must have conclusive evidence to support his or her determination that the original value opinion was unreasonable. We have not defined “unreasonable” because we believe that a number of factors impact the review appraiser’s decision, including, but not limited to, the availability of data and the complexity of the appraisal assignment. The review appraiser must make that determination based on the nature of the appraisal under review. The review appraiser must also complete both Sections II and III when concluding that the original value was unreasonable.

Section II – This section is to be completed only if the review appraiser answers “No” to Section I, Questions 2 or 3.

- **Question 1. - Neighborhood Analysis**

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 review appraiser must determine if the results of the neighborhood analysis enable the reader to identify the factors that influenced the value of properties in the defined market area from which the comparable sales were selected and if adequate market data was available to perform the appraisal.

The review appraiser must determine if the analysis of the neighborhood is consistent with the approaches to value or other statements made in the appraisal report. If they are not and the review appraiser has adequate support for his or her conclusion, then a more detailed explanation is necessary for this question.

- **Question 2. - Site Analysis and Highest and Best Use**

It must be noted on the appraisal report if the property is of a size, shape, and topography that is generally conforming and acceptable in the market area. The appraisal report should also note any adverse site conditions, specifically where there is market resistance to a property because the site is not compatible with the neighborhood. When the appraisal report identifies factors that affect the value or marketability of the subject property, the review appraiser must determine if the factors

have been taken into consideration in the approaches to value. Simply stating that a potential problem exists without adequate explanation or support is unacceptable.

The vast majority of appraisals on one-unit properties note the subject property's highest and best use as the existing use. The original 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. The original appraiser's selection of comparable sales should demonstrate 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 vacant site value.

- **Question 3. - Zoning Classification and Description**

The appraisal report must contain the specific zoning classification for the subject property and a general statement that describes what the zoning permits. Since many non-residential zoning codes permit residential uses, we require the appraisal report to include the actual city, county, or state zoning classification. The review appraiser must determine if the reported zoning classification is correct and whether the existing residential use is permitted.

- **Question 4. - Improvements**

The appraisal report must contain a clear, detailed, and accurate description of the improvements. We do not limit the level of detail that the appraiser should report. Appraisal and appraisal review reports must contain addenda and other attachments if necessary to adequately describe the property. Omitting important data due to the reporting limitations of a report form is an unacceptable appraisal practice.

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, the appraisal report should provide a detailed explanation and describe the effect on the value and marketability of the subject property. If the subject property is unique, or a non-traditional type of housing, the review appraiser should expect to see detailed information about the improvements and support for their acceptance in the marketplace. This is a key element in the selection of, and support for, the comparable sales used in the sales comparison approach.

The review appraiser should consider additional sources to determine if the appraiser's calculations of above grade gross living area are reasonable. Slight variations in gross living area will have little or no effect on the final value conclusion. If the appraiser has convincing evidence that the gross living area is incorrectly stated then he or she should report the error, include the reviewer's source for the correct information, and consider the effect on the value of the subject property.

Property condition is an area where appraisers and review appraisers often disagree. The review appraiser is required to examine the original appraisal from the perspective of the appraiser, consistent with the effective date of the appraisal. It is possible, given the difference in time between the appraisal review and the original appraisal, that the condition of the subject property may have changed. In order to help eliminate the potential for unsupported differences of opinion based on the current property condition, the review appraiser must assume that the condition reported in the original appraisal is accurate unless there is evidence to the contrary. This evidence may be from sources such as, but not limited to, older listing information, a prior inspection by the review appraiser, or an interview with one of the parties involved in the transaction or another individual who previously inspected the property.

- **Question 5. - Approaches to Value**

The review appraiser must analyze all of the approaches to value considered by the original appraiser. While the majority of appraisals do include the appropriate valuation approaches, the more important issue is the sufficiency and accuracy of the data and whether or not the approaches have been correctly applied. The use of adjustments to the comparable sales that do not reflect the market's reaction to the differences between the subject property and the comparable sales, or the failure to make adjustments when they are clearly indicated, are unacceptable appraisal practices.

The original appraisal report should contain adequate information for the reader to understand the rationale for the individual adjustments and their application to the approach to value. These adjustments are expected to be market-based. The review appraiser must explain when he or she disagrees with a specific adjustment (or adjustments) and support why other adjustments are more appropriate.

- **Question 6. - Selection of Comparable Sales**

We require the appraiser (and review appraiser) to research, analyze, and consider influences that may affect value. We expect the appraiser (and review appraiser) to analyze and use comparable sales, contract sales, and current listings from the same neighborhood or market area. This helps to assure that any value-influencing characteristics are taken into consideration in the development of the opinion of value for the subject property. However, 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 (and review appraiser) may need to use comparable sales that are less comparable to the subject property, or properties that are located in competing neighborhoods. In some situations, sales of properties that are less comparable or sales of properties that are located in competing neighborhoods may simply be the best sales available and the most appropriate for the appraiser's (and review appraiser's) analysis. The use of such comparable sales is acceptable as long as the appraiser (and review appraiser) adequately documents his or her analysis and explains why these sales were used, including a discussion of how comparable a different neighborhood is to the subject neighborhood.

The process of selecting comparable sales for manufactured housing is generally the same as selecting comparable sales for site-built housing. The appraiser (and review appraiser) must address both the marketability and comparability of a manufactured home by selecting comparable sales of similar manufactured homes – comparing single-width homes to single-width homes, multi-width homes to multi-width homes, etc. If at least three comparable sales of similar manufactured homes are not available, the appraiser (and review appraiser) may use either site-built housing or a different type of factory-built housing as one of the comparable sales. When that is the case, the appraiser (and review appraiser) must report at least two comparable sales of similar manufactured homes, explain why site-built housing or a different type of factory built housing is being used for the one comparable sale, and make (and support) appropriate adjustments in the appraisal report. The appraiser (and review appraiser) 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 area when they are unable to locate current or more proximate sales.

The selection and use of inappropriate comparable sales, or the failure to use comparable sales that are locationally and physically the most similar to the subject property, or the use of adjustments to the comparable sales that do not reflect the market's reaction to the differences between the subject property and the comparable sales, or the creation of comparable sales by combining vacant land sales with the contract purchase price of a home, are all unacceptable appraisal practices.

Section III – This section is to be completed only if the review appraiser answers “No” to Section I, Question 3.

- Question 1. - Provide detailed reasoning for disagreement with the opinion of value in the original appraisal report.**

The review appraiser must provide the reasons for disagreement with the original opinion of value. These reasons must be supported by facts.

- Question 2. - State all extraordinary assumptions used.**

The review appraiser must also make clear the extraordinary assumptions he or she used in arriving at the opinion of value. (For example, the review appraiser might state: “It is assumed that the condition of the subject, as stated in the original appraisal report, is accurate.”)

- Question 3. - Provide a new opinion of value, as of the effective date of the original appraisal report under review.**

To improve the consistency of the information provided and to aid the client when reviewing the appraisal review report, we included a sales comparison grid, which is similar to the one used on our appraisal report forms. We did not include the sales history section in the grid because the review appraiser addresses this information in

Section I. However, the review appraiser must provide a three-year sale/transfer history for the comparable sales. The report form also provides an area to reconcile the different value indications from the sales comparison grid. The appraiser must explain why the sales he or she selected were better than the sales used in the original appraisal report (if they are different) and why the individual adjustments in the new sales grid are the most appropriate for the subject property. The review appraiser must express his or her opinion of value for the subject property as of the effective date of the appraisal under review if he or she believes that the original opinion of value was unreasonable.

Guidance for Completing the One-Unit Residential Appraisal Field Review Report

Page 3 of the form provides guidance on completing the appraisal review report. Most of these instructions are self-explanatory, but we believe that the following items warrant special attention:

- Item 3 defines the review appraiser. We did not provide the option for a “supervisory appraiser” because we believe it is important for the review appraiser to be qualified and have adequate experience to critically study the work of another appraiser. The person signing the appraisal review report must be the same person that reviewed the original appraisal report, performed the analysis, and inspected the subject property and all comparable sales.
- Item 5 instructs the review appraiser to assume that the condition reported in the appraisal report is accurate, unless there is evidence to the contrary. The review appraiser must be careful not to allow the current condition of the subject property to improperly influence his or her judgment about the condition of the property as of the effective date of the original appraisal.
- Item 8 requires the review appraiser to provide a sale/transfer and listing history for the subject property for the three years prior to the effective date of the original appraisal. There are some jurisdictions in which the sales price or other information may not be disclosed, but the review appraiser must still report the fact that a transfer has taken place.
- Item 12 requires the review appraiser to explain why the comparable sales in the original appraisal report should not have been used. This cannot be just a matter of personal preference. The review appraiser’s explanation must make it clear (based on available market evidence) why the original comparable sales were not appropriate. A simple statement that the sales were not the best available is inadequate.
- Item 15 requires the review appraiser to support his or her decision to provide different comparable sales, explaining why the new comparables are better than the ones used in the original appraisal report. The review appraiser must be certain that his or her data and response are consistent with the information provided in Item 12.

Certifications

Page 4 of the form includes the statement of limiting conditions and the appraiser's certifications. Although we permit a review appraiser to add some certifications to the Form 2000, he or she must not add a new limiting condition to the form or modify or delete a limiting condition that already appears on the form. This page also includes the identification of the review appraiser, the lender/client, a statement of value (only if the review appraiser answered "No" to Question 3 in Section I), and the effective date of the original appraisal.

Required Exhibits

The following exhibits are required for a *One-Unit Residential Appraisal Field Review Report*:

- front view photograph of the subject property and each comparable sale included in the original appraisal and any additional sales provided with the appraisal review;
- street scene photograph of the subject property; and
- location map indicating the subject property and all comparable sales included in the original appraisal report under review and any additional sales provided by the review appraiser.

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

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Senior Vice President

Attachment