

Guidance for Lenders and Appraisers

April 2009

Fannie Mae views lenders as our partners in ensuring the continued viability of the residential lending market and the continued availability of affordable mortgage financing for home purchases and refinancing. We rely on lenders to make underwriting decisions that result in “investment quality” loans; that is, loans for which it has been established that there is a reasonable expectation that the borrower is able and willing to repay the mortgage debt and that the property constitutes sufficient security for the mortgage.

In turn, lenders rely on appraisers to provide them with thorough, accurate, and objective appraisal reports that result in reliable opinions of market value so they can make prudent underwriting decisions. The appraisal is used to judge the property’s acceptability for the mortgage loan requested in view of its value and marketability.

The underwriter will use the information provided in the appraisal report, along with other data, to determine whether the property meets Fannie Mae’s requirements for an investment quality loan. Fannie Mae expects the lender to place as much emphasis on underwriting the property and reviewing the appraisal as on underwriting the borrower’s creditworthiness. Therefore, it is important for the appraiser to provide the lender with a reliable opinion of the market value of the property with adequate and accurate data supporting the conclusions of the appraisal report.

Fannie Mae provides the following guidance to the lender and appraiser to supplement the policy requirements in the Fannie Mae *Selling Guide* for performing and underwriting the property appraisal securing mortgages delivered to Fannie Mae.

Contents

Chapter 1 – Appraiser Selection and the Appraiser’s Role in the Appraisal Process	3
Appraiser Selection.....	3
Information Provided to the Appraiser	4
The Appraiser’s Role in the Appraisal Process.....	4
Objective and Unbiased Appraisals	5
Unacceptable Appraisal Practices	5
Appraisal Fraud Awareness.....	6
Chapter 2 – Preparing and Reviewing the Appraisal Report.....	7
Overview.....	7
Fannie Mae Appraisal Forms.....	8
Appraiser Certification Number 23.....	8
Manually Underwritten Loans	9
DU Underwritten loans.....	9
Subject Section	10
Contract Section	10
Neighborhood Section	10
Neighborhood Analysis	12
Neighborhood Boundaries	12
Neighborhood Characteristics.....	12
Example of Reporting Unfavorable Conditions	13
Factors That Affect the Value and Marketability of Properties in the Neighborhood	13

Degree of Neighborhood Development and Growth Rate	13
Declining Markets	14
Assessment of Market Conditions	14
Market Condition Tracking Services	14
Predominant Age of Neighborhood.....	14
Property Location.....	15
Present Land Use	15
Conformity of Improvements to Neighborhood	16
Site Section.....	16
Highest and Best Use of the Site	16
The Lot.....	16
Special Flood Hazard Area	17
Improvement Analysis	17
Actual and Effective Ages of the Improvements	17
Properties Affected by Environmental Hazards	17
Sales Comparison Approach to Value	18
Selection of Comparable Sales.....	18
Selection of Comparable Rentals for Two- to Four-Unit Properties	19
Rural Properties	19
Properties in Established Subdivisions, Condominiums, or PUDs	20
Properties in New or Recently Converted Subdivisions, Condominiums, or PUDs	20
Adjustments to Comparable Sales.....	20
Two- to Four-Unit Properties.....	21
Verification of a Sales Transaction	21
Valuation Analysis and Final Reconciliation	21
Income Approach to Value	21
When to Use the Income Approach to Value.....	21
Calculating Market Rent.....	21
Cost Approach to Value.....	22
Understanding Estimates for Cost Approach to Value.....	22
Reproduction Cost Estimate	22
Physical Depreciation	22
Functional Depreciation	22
External Depreciation.....	22
Chapter 3 – Developing Appraisals for Special Types of Properties	23
Special Assessment and Community Facilities Districts – Overview.....	23
Special Assessment Districts.....	23
Community Facilities Districts	23
Leaseholds Held by Community Land Trusts	24
Determining the Fee Simple Value	25
Determining the Capitalization Rate	25
Determining the Leasehold Value.....	25
Units in Condominium, PUD, or Cooperative projects.....	26

Chapter 1 – Appraiser Selection and the Appraiser’s Role in the Appraisal Process

Appraiser Selection

Fannie Mae requires a lender to use an appraiser who has the knowledge and experience that is required to perform a professional quality appraisal in a specific geographic location for the particular property type for which the lender needs an appraisal. The appraiser must also have knowledge about, and access to, the necessary and appropriate data sources for the area in which the appraisal assignment is located.

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

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

Fannie Mae believes that it is important for a lender to use an appraiser who has the appropriate knowledge and experience, rather than taking advantage of this flexibility. Fannie Mae further believes that the use of an appraiser who has both appropriate knowledge of specific geographic markets and experience in appraising specific property types will help to ensure the accurate valuations and appropriate appraisal practices that are necessary for fair lending. A lender must not assume—simply based on the fact that an appraiser is state-licensed or state-certified—that the appraiser is qualified and knowledgeable about a market area or is aware of the appropriate market data sources for the area and will be able to obtain access to them. If an appraiser is not knowledgeable about a particular location, is not experienced in appraising a particular type of property, or is not familiar with (or does not have access to) the appropriate data sources, a lender should not give the appraiser assignments in that market area or for that particular type of property.

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

Fannie Mae requires a lender to use appraisers who are state-licensed or certified (in accordance with the provisions of Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989).

Lenders are solely accountable for the performance of the appraisers they select and must make all required representations and warranties related to the appraisal and condition of the property. Lenders must not assume that an appraiser is qualified simply based on:

- membership in, and professional designation from, an appraisal organization, or
- the fact that he or she is state-licensed or state-certified.

Lenders must use appraisers who have the requisite knowledge required to perform a professional quality appraisal for the specific geographic location and particular property type.

If lenders choose to rely on specific appraisers or appraisal services to review the qualifications of—or even to select—an individual to perform appraisals, lenders should establish appropriate qualifications to ensure acceptable individuals are selected.

Fannie Mae recommends lenders require the appraiser or appraisal service that makes the selection to assume full responsibility for the quality of the appraisal. (Note: Imposing this responsibility on the appraiser or appraisal service does not relieve the lender of its warranties related to the appraisal or the condition of the property.)

When evaluating an appraiser's qualifications, lenders should review:

- the appraiser's education
- the appraiser's experience
- sample appraisals
- professional affiliations
- references from prior clients
- references from prior employers

Professional appraisal designations can be helpful in evaluating an appraiser's qualifications, particularly when the designation is from a nationally recognized organization that has formal experience, education, and ethics requirements that are strongly administered. If lenders consider appraisal designations in their evaluations, they should be familiar with the appraisal organization's specific requirements to ensure that the designation is evaluated appropriately.

Before using an appraiser's services, lenders should be satisfied that the appraiser has demonstrated the ability to perform quality appraisals. When a new appraisal is required for a mortgage that a lender delivers to us, the lender warrants that the property has been appraised by a state-licensed or state-certified appraiser.

If state-licensed or state-certified appraisers use professional assistance provided by others, the appraiser must:

- acknowledge in the report the extent of professional assistance provided by others
- acknowledge in the report the specific tasks performed by other individuals
- certify that the named individual(s) is/are qualified to perform the tasks

Information Provided to the Appraiser

The lender is responsible for providing the following to the appraiser:

- A copy of the sales contract
- Any additional pertinent information that the lender is aware of that is not included in the sales contract

The Appraiser's Role in the Appraisal Process

Fannie Mae requires 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.

Objective and Unbiased Appraisals

A number of laws—federal, state, and local—prohibit discrimination in the appraisal of housing. Fannie Mae believes professional appraisers fully understand that discriminatory valuation and appraisal reporting practices are not only illegal, but also unethical.

Unintentional discrimination, however, can occur as the result of what an appraiser states—or fails to state—in the appraisal report.

Redlining—the intentional or unintentional designation of a specific area as unacceptable for mortgage lending—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.

A factor that is not predictive of risk is race. Racial redlining is illegal under federal law. Other factors that serve as a proxy for race are equally impermissible.

Unacceptable Appraisal Practices

Because Fannie Mae holds the lender responsible for the quality of the appraisal used to support the value of a security property, the lender should take appropriate action to ensure that the appraisers it uses do not engage in unacceptable practices. The following are examples of appraisal practices that Fannie Mae considers unacceptable:

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

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

Appraisal Fraud Awareness

Fannie Mae believes the likelihood of fraud or misrepresentation increases when lenders are not able to confirm the owner of the subject property based on publicly available information. Confirming and documenting the current owner of the property based on publicly available information as part of the loan origination process helps to ensure a meaningful analysis of the sale or transfer history of the subject property.

Examples of acceptable documentation confirming the current owner include, but are not limited to, the following:

- the appraiser's analysis and conclusions in the appraisal report,
- a copy of a recorded deed or mortgage,
- a recent property tax bill or tax assessment notice,
- a title report,
- a title commitment or binder, or
- a property sale history report.

NOTE: Note: This documentation is especially important for transactions involving an assignment or sale of a contract for sale and/or "back-to-back," "simultaneous," or "double" transaction closings or double escrows to support the property acquisition, financing, and closing.

Chapter 2 – Preparing and Reviewing the Appraisal Report

Overview

This chapter includes instructions for appraisers to follow when preparing the report, as well as instructions for lenders/underwriters to follow when reviewing the report. Fannie Mae requires specific appraisal report forms for each property and inspection type for manually processed mortgages and mortgages underwritten through Desktop Underwriter® (DU®). Fannie Mae appraisal report forms and the property appraisal and underwriting processes have been developed with the intent of ensuring that:

- the Uniform Standards of Professional Appraisal Practice are followed, and
- Fannie Mae policies are entirely consistent with, and supportive of, fair lending practices.

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

Fannie Mae appraisal report forms provide a concise format for presenting both the appraiser's description of the subject property and the valuation analysis that leads to the opinion of market value. There is one appraisal report form for reporting an appraisal for each property and inspection type for both DU and manually processed mortgages. The appraisal report form that should be used generally depends on the type of property and property inspection required. The appraiser must complete our forms in a way that will clearly reflect the thoroughness of his or her investigation and analysis and provide the rationale for the opinion of market value.

Although the scope of work for the appraisal or the extent of the appraisal process is guided by our appraisal report forms, the forms do not limit or control the appraisal process. The appraiser's analysis should go beyond any limitations of the forms, with additional comments and exhibits being used if they are needed to adequately describe the subject property, document the analysis and valuation process, or support the appraiser's conclusions. The extent of the appraiser's data collection, analysis, and reporting must be determined by the complexity of the appraisal assignment. For example, the scope of work for an appraisal based on an interior and exterior property inspection reported on the Uniform Residential Appraisal Report (Form 1004) is based on the complexity of the appraisal assignment and the reporting requirements of the appraisal report form, including the stated definition of market value, statement of assumptions and limiting conditions, and certifications. The appraiser is required, at a minimum, to:

- perform a complete visual inspection of the interior and exterior areas of the subject property,
- inspect the neighborhood,
- inspect each of the comparable sales, at least from the street,
- research, verify, and analyze data from reliable public and/or private sources, and
- report his or her analysis, opinions, and conclusions in the appraisal report.

The stated scope of work on the appraisal report forms reflects the minimum level of research and analysis required. The appraiser can expand the minimum scope of work for the appraisal and report on any additional research or analysis that was necessary and performed based on the complexity of the appraisal assignment.

Computer software programs designed to reproduce Fannie Mae appraisal report forms are acceptable. The sequence of the information as well as all of the specific information—including the instructions, entries, directions, etc.—must be exactly as they appear on the official Fannie Mae form(s). Appraisers can expand the minimum scope of work for the appraisal report with any necessary, additional research or analysis based on the complexity of the appraisal assignment.

The need for expanded scopes of work should be the exception, not the norm, for appraisals on typical one-unit properties. When the complexity of the property analysis extends beyond the limitations of the Fannie Mae forms, appraisers must provide additional comments and exhibits as needed to adequately describe the subject property, document the analysis and valuation process, or support the appraiser's conclusions.

Fannie Mae Appraisal Forms

- Form 1004, Uniform Residential Appraisal Report (interior and exterior inspection)
- Form 1004C, Manufactured Home Appraisal Report (interior and exterior inspection)
- Form 1004D, Appraisal Update and/or Completion Report
- Form 1004MC, Market Conditions Addendum (required effective 4/1/09)
- Form 1025, Small Residential Income Property Appraisal Report (interior and exterior inspection)
- Form 1073, Individual Condominium Unit Appraisal Report (interior and exterior inspection)
- Form 1075, Exterior-Only Inspection, Individual Condominium Unit Appraisal Report
- Form 2055, Exterior-Only Inspection, Residential Appraisal Report
- Form 2090, Individual Cooperative Interest Appraisal Report (interior and exterior inspection)
- Form 2095, Exterior-Only Inspection, Individual Cooperative Interest Appraisal Report

Appraiser Certification Number 23

The intended user is the party for whom the appraiser is writing the report, which is the lender/client for a residential mortgage finance transaction. Fannie Mae's appraisal report forms clearly identify the intended user as defined by the Uniform Standards of Professional Appraisal Practice as the lender/client. The acknowledgment of other parties that often rely on the appraisal report is not meant to expand the list of intended users. Instead, it is meant to clarify that others, although not intended users, often rely on the appraisal report as part of a mortgage finance transaction.

The appraiser's certification number 23:

- clarifies that the appraiser is accountable for the work quality, and
- acknowledges that certain parties beyond the lender/client and/or intended user often rely on the appraisal report and such reliance is customary and reasonable.

Other parties include:

- the borrower
- another lender at the borrower's request
- the mortgagee or its successors and assigns
- mortgage insurers
- government-sponsored enterprises

- other secondary market participants

NOTE: The use of this additional notice or statement may help to clarify the identification of the intended user as addressed in the Uniform Standards of Professional Appraisal Practice and on Fannie Mae's appraisal report forms.

Manually Underwritten Loans

All manually underwritten mortgage loans sold to Fannie Mae require an appraisal based on an interior and exterior property inspection and must be reported on the appropriate form depending on the property type, unless the specific product guidelines permit a less than full appraisal.

DU Underwritten loans

When a mortgage is processed in DU, the system will recommend the use of one of three levels of property fieldwork: an appraisal based on an interior and exterior property inspection; an appraisal based on an exterior-only property inspection; or an exterior-only property inspection. Regardless of the recommended level, the lender remains responsible for the quality of the fieldwork and must manage the property appraisal (or inspection) process, select the appraiser, and order the appraisal (or property inspection) report.

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

DU's option of performing an appraisal based on an exterior-only inspection of the property is predicated on the appraiser's ability to obtain sufficient information about the physical characteristics of the property from reliable sources. The appraiser's description of the physical characteristics of the property should be based on what he or she considers to be reliable data sources for the property and location. The appraiser should use the same type of data sources that he or she uses for comparable sales—multiple listing service information, tax and assessment records, observations from prior inspections, previously prepared appraisal files, information provided by the property owner, etc.

If the appraiser's exterior-only inspection of the property and available data sources do not provide sufficient information about the property to perform the appraisal, the exterior-only inspection appraisal must be upgraded to an appraisal with an interior and exterior inspection reported on Form 1004. If the following conditions exist, the appraisal must be upgraded: the appraiser cannot adequately view the property from the street, apparent adverse physical deficiencies or environmental conditions are observed, or the appraiser needs additional information about the physical conditions of the property.

For loans underwritten through DU, factors that contribute to the level of DU fieldwork recommendations include information in DU's database as well as:

- "standardized" property address
- loan purpose (such as purchase or refinance)
- occupancy
- property type
- eligibility
- purchase price
- loan amount
- appraised value or lender's estimated value as entered in the Appraised Value field

- number of units
- combined loan-to-value ratio

Lenders may elect to obtain the minimum documentation recommended by DU or may decide to require the appraiser to provide additional documentation for any reason. Some examples of reasons that additional documentation might be requested include:

- subject property that is significantly larger or smaller than the properties in the neighborhood
- subject property that is significantly older or newer than the properties in the neighborhood
- subject property has apparent physical deficiencies requiring significant repairs

Subject Section

The first section of Fannie Mae appraisal report forms is used to identify and describe the location of the subject property. The appraiser must:

- identify the subject property by its complete property address and legal description; a post office box number is not acceptable
- indicate the nearest intersection if a house number is not available
- provide information about property taxes and special assessments
- indicate the occupancy status of the property
- describe the property rights to be appraised
- summarize financing data and sales concessions
- identify the borrower, the current owner, and the client
- include an addendum to the appraisal report that fully describes or simply refers to the subject property's location in the public records when the legal description is lengthy
- identify the property rights to be appraised as “fee simple” or “leasehold”
- 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
- provide a brief description of the items on the appraisal report form
- indicate the transaction type, such as refinance or purchase

Contract Section

The appraiser must analyze and report on:

- any current contract for sale
- the owner of public record
- financing data and sales concessions

Neighborhood Section

The results of a neighborhood analysis enable appraisers 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.

Generally accepted appraisal standards and Fannie Mae appraisal report forms require appraisers to research, analyze, and report factors in the neighborhood that may affect market value or marketability of properties in the market area.

Fannie Mae purchases mortgages secured by properties in all neighborhoods and areas provided the property is acceptable security for the mortgage based on value and marketability. Property location, neighborhood characteristics, and trends are critical factors that must be considered in the appraisal process.

The following are determinants appraisers use in the property valuation process, but are not factors in determining whether a particular neighborhood is acceptable or not:

- property location
- neighborhood characteristics
- neighborhood trends

*NOTE: **Lenders** must ensure that **appraisers** adequately research 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.*

*NOTE: If **appraisers** do not consider all relevant data, overlook relevant data sources, or rely 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.*

Appraisers must:

- understand the value-influencing characteristics in the neighborhood
- 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
- perform a neighborhood analysis 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
- 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, but are not limited to:

- the existence of vacant or boarded-up properties in the neighborhood
- the level of essential local support services

Examples of governmental forces that must be considered include, but are not limited to:

- regulations imposed on properties
- laws imposed on properties
- taxes imposed on properties

Environmental forces that must be considered include, but are not limited to:

- the existence of hazardous waste sites on or near the property
- the proximity of a property to an airport

The appraiser must determine, analyze, and consider the factors that should be considered in the valuation process based on identification of all forces or factors that have the potential to influence the value of the property.

Lenders must ensure that the appraisal's neighborhood analysis indicates:

- collection of pertinent data
- the appraiser conducted a visual inspection of the market area to observe physical characteristics and determine boundaries
- the appraiser identified land uses and any signs that the land uses are changing

Neighborhood Analysis

Fannie Mae's appraisal report forms and guidelines do not require rating or judging the neighborhood. However, appraisal reports must provide objective neighborhood analysis by identifying:

- neighborhood boundaries
- neighborhood characteristics
- factors that affect the value and marketability of properties in the neighborhood

The appraiser should explain any changes that have occurred that might influence the marketability of the properties in 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.

Neighborhood Boundaries

Neighborhood boundaries can be identified by various physical characteristics including, but not limited to:

- streets
- bodies of water
- land uses
- types of dwellings

Neighborhood Characteristics

If market evidence indicates a characteristic has an effect on the value or marketability of neighborhood properties or the market area, the characteristics must be considered in the valuation process.

Neighborhood characteristics include:

- structures and architectural styles, such as
 - detached
 - attached
 - row or townhouse
 - colonial
 - ranch
 - Victorian

- current land use, such as
 - single-family residential
 - commercial
 - industrial
- typical site size, such as
 - one-eighth acre
 - two acres
- street patterns or design, such as
 - one-way street
 - cul-de-sac
 - court

Example of Reporting Unfavorable Conditions

If a property is located in an neighborhood that has vacant or boarded up properties that affect the value and/or marketability of properties in the neighborhood, the appraiser must address these conditions in his or her analysis and appraisal report, and use comparable sales from the same neighborhood (whenever possible) to ensure that any effect of the vacant or boarded-up properties is taken into consideration in the development of the opinion of market value for the subject property. The appraiser should also address the reasons for the vacancies or boarded-up properties in factual terms (by providing data related to such things as demand/supply, foreclosure rates, tax sales, etc.) and discuss how this factor affects the market value and marketability of the property being appraised and other properties in the neighborhood.

Factors That Affect the Value and Marketability of Properties in the Neighborhood

Factors that affect the value and marketability of properties in the neighborhood may include:

- 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

Degree of Neighborhood Development and Growth Rate

The degree of development of a neighborhood (which is referred to as “built-up” on the appraisal report forms) is the percentage of the available land in the neighborhood that has been improved. The degree of development of an area may indicate whether a particular property is residential in nature. When underwriting a mortgage secured by a property located in a rural or relatively undeveloped area, the lender should focus on the characteristics of the property, zoning, and the present land use to determine whether the property should be considered residential in nature.

For example, if the typical one-family building site in a particular area (based on the zoning, the highest and best use of the land, and the present land use) is two acres in size, the mortgage will be eligible for purchase or securitization regardless of the percentage of the total appraised value of the property that the site

represents—as long as the appraiser demonstrates through the use of comparable sales that the property is a typical residential property for that particular neighborhood.

Because Fannie Mae does 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.

Declining Markets

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.

Assessment of Market Conditions

Lenders may rely on a market condition tracking service to assist in the market condition analysis. Once the lender determines the type of market where the property is located, the lender must ensure that current market conditions are identified and analyzed in the valuation process and described in the appraisal report.

Market Condition Tracking Services

Fannie Mae encourages lenders to select and use market condition tracking services that they deem appropriate. There are several services available that can be used by lenders and appraisers to assess the current market conditions, including:

- **S&P/Case-Shiller® Index.** This index relies on purchase price and related information obtained from county assessor and recorder offices.
- **Federal Housing Finance Agency (FHFA) Index.** This index uses data from conforming, conventional mortgages provided by Fannie Mae and Freddie Mac, and includes both purchase and refinance information. Lenders and appraisers may use the index based on purchase loans only for indications of market decline. Purchase-only indexes at the state level can be found at <http://www.ofheo.gov/HPI.aspx>.
- **National Association of REALTORS® (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.

Predominant Age of Neighborhood

The appraisal must indicate the age range and predominant age of properties in the subject neighborhood.

The age range must reflect the oldest and newest ages for similar types of residential properties and, in some cases, for competing properties. For example:

- one-unit properties when the property being appraised is a two-unit to four-unit property
- condominium units when the property being appraised is a cooperative unit

NOTE: *Isolated high and low extremes must be excluded from the range.*

The predominant age in the neighborhood is the one that is most common or most frequently found.

The appraisal can state the predominant age as a single figure or as a range if that is more appropriate.

NOTE: **Appraisers** must independently select properties that represent the age range and predominant age, rather than merely relying on the same properties 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.

Property Location

The Neighborhood Analysis section of the appraisal report must indicate:

- the appraiser conducted a visual inspection of the market area to observe physical characteristics and determine boundaries
- the appraiser identified land uses and any indications that land uses are changing

NOTE: *When required, **appraisers** 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.*

NOTE: **Lenders** must review the neighborhood description to confirm that the appraiser used comparable sales from within the subject neighborhood.

Present Land Use

Fannie Mae's 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 nonresidential land uses—including residential multifamily properties, other properties that are used to provide commercial services (such as groceries and other neighborhood stores) in support of the local neighborhood, industrial properties, etc.

When different land uses and property types are present in a neighborhood, that fact should be considered a neighborhood characteristic that the appraiser needs to take into consideration when performing the neighborhood analysis and defining the neighborhood boundaries. To 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 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.

Conformity of Improvements to Neighborhood

Subject property improvements should conform to the neighborhood in terms of age, type, design, and materials used for their construction.

There should be comparables of similar size to the subject property to support the general acceptability of a particular property type.

NOTE: **Lenders** should be aware that many older neighborhoods have favorable heterogeneity in architectural styles, land use, and age of housing. Older neighborhoods are especially likely to have been developed through custom building; this variety may be a positive marketing factor.

Site Section

Highest and Best Use of the Site

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 an improvement to be considered the highest and best use of a site, it must:

- be legally permitted
- be financially feasible
- be physically possible
- provide more profit than any other use of the site would generate

The Lot

The following are all important factors pertaining to the subject property lot:

- topography
- shape
- size
- drainage

Drainage must be away from the improvements to avoid collection of water in or around them. Steep slopes are generally unfavorable conditions because they may cause:

- erosion
- difficulty in maintaining a lawn
- difficult access to the property or to a garage

NOTE: **Lenders** must carefully review appraisal reports for properties that have sites larger than those typical for residential properties in the area.

Special Flood Hazard Area

Fannie Mae's appraisal report forms provide an area for the appraiser to indicate whether the subject property is located in a Special Flood Hazard Area that is identified on the Federal Emergency Management Agency's (FEMA) Flood Insurance Rate Maps.

Appraisers must indicate:

- the specific FEMA flood zone
- the map number
- the map's effective date

FEMA Insurance Rate Maps include areas that are within the 100-year flood boundary. Note that 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.

Flood Insurance Rate Maps are available from FEMA (see www.fema.gov).

Improvement Analysis

Lenders must take the necessary steps to ensure that a property represents adequate collateral for the mortgage loan.

The appraiser should describe the visible features of the dwelling (the number of stories above ground, the architectural style, and the materials used for the foundation and exterior walls, for example), as well as all aspects that call upon the appraiser's experience and knowledge as a professional appraiser.

Actual and Effective Ages of the Improvements

Fannie Mae does not place a restriction on the actual age of the dwellings. Older dwellings that meet Fannie Mae's general requirements are acceptable.

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 age of a property is good indication of its condition.

- A property that has been well maintained generally will have an effective age that is somewhat lower than its actual age.
- 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.

NOTE: *Lenders should pay particular attention to the condition of the subject property in their review of any appraisal report that requires the appraiser to address the actual and effective ages of a property.*

Properties Affected by Environmental Hazards

Fannie Mae 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.

Lenders must:

- exercise sound judgment in determining the acceptability of the property

- make the final decision about the need for inspections and the adequacy of the property as security for the mortgage requested

For example, since Fannie Mae requires 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.

Sales Comparison Approach to Value

The sales comparison approach to value—traditionally referred to as the market data approach—is an analysis of comparable sales, contract sales, and listings of properties that are most comparable to the subject property.

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

The Uniform Standards of Professional Appraisal Practice (USPAP) require appraisers to report a minimum three-year prior sales history for the subject property.

The appraisal report 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 similar property of equal desirability and utility if 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.

Selection of Comparable Sales

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. must be researched, analyzed, and considered in the appraisal report.

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, comparable sales from the same neighborhood or affected area must be researched, analyzed, and used in the appraisal report whenever possible. This ensures any effect of these value-influencing characteristics is taken into consideration in the development of the opinion of value for the property.

A minimum of three comparable sales must be reported as part of the sales comparison approach to value. More than three comparable sales can be submitted to support the opinion of market value provided at least three are actual settled or closed sales.

Comparable sale properties that are not truly comparable to the subject property or are in competing neighborhoods are acceptable provided the reason for the use of the comparables is adequately documented and explained. The appraisal must include a discussion of how a competing neighborhood is comparable to the subject neighborhood.

NOTE: 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 appraisal analysis.

The appraiser should use comparable sales that have been settled or closed within the past 12 months. However, the appraiser may use older comparable sales if he or she believes that they are 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 past 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 subject property can be used as a fourth comparable sale or as supporting data if it was previously sold and closed or settled.

Contract offerings and current listings can be used as supporting data if appropriate.

Selection of Comparable Rentals for Two- to Four-Unit Properties

In developing the valuation for a two-unit to four-unit property, the appraisal must provide analysis of the most current and most comparable rental properties that are available to develop an estimated market rent for the subject property.

For two- to four-unit properties, at least three rental comparables, which do not have to be the same comparables used in the sales comparison analysis, must be reported and analyzed by the appraiser.

The comparable rental data must be reconciled and provide support for the estimated market rents for the individual subject units, providing information about:

- lease dates
- number of vacant units
- actual rents
- estimated market rents for the subject property

The appraisal report should ensure 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 otherwise stated in the appraisal report.

Rural Properties

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.

Comparable sales located a considerable distance from the subject property can be used if they represent the best indicator of value for the subject property.

The appraisal must include an explanation of why the particular comparables were selected.

When underwriting mortgage loans secured by properties located in rural or relatively undeveloped areas, **lenders** must determine whether the property should be considered residential in nature by focusing on:

- the characteristics of the property
- zoning
- the present land use

If the typical one-family building site in a particular area is two acres in size based on the zoning, the highest and best use of the land, and the present land use, the mortgage is eligible for purchase or securitization regardless of the percentage of the total appraised value of the property that the site represents provided comparable sales demonstrate that the property is typical for that particular residential neighborhood.

Properties in Established Subdivisions, Condominiums, or PUDs

Comparable sales from within the same subdivision or project as the subject property must be used if the subdivision or project has resale activity.

Resale activity from within the subdivision or project should be the best indicator of value for properties in that subdivision or project.

NOTE: Use of comparable properties located outside of the established subject neighborhood must be explained in the appraisal analysis.

Properties in New or Recently Converted Subdivisions, Condominiums, or PUDs

The subject property must be compared to other properties in its general market area as well as to properties within the subject subdivision or project.

The appraiser must 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, provided it is a good indicator of value for the subject property.

NOTE: Sales or resales from within the subject subdivision or project are preferable to sales from outside the subdivision or project, provided the developer or builder of the subject property is not involved in the transactions.

Adjustments to Comparable Sales

The subject property is the standard against which the comparable sales are evaluated and adjusted. Comparable sales must be adjusted to the subject property.

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.

NOTE: Sales and financing concessions are adjusted to the market at the time of sale. Dollar adjustments must reflect the market’s reaction to the difference in the properties, not necessarily the cost of the difference. Each comparable sale used in the sales comparison approach to value must be analyzed for differences and similarities between it and the subject property.

Analysis and adjustments to comparable sales must be based on market data for the particular neighborhood and for competing locations—not on predetermined or assumed dollar adjustments.

Adjustments must be made without regard for the percentage or amount of the dollar adjustments.

Two- to Four-Unit Properties

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.

Verification of a Sales Transaction

It is important for the appraiser to ensure that the data he or she is providing in the appraisal report is accurate. When the appraiser is provided with comparable sales data by a party that has a financial interest in either the sale or financing of the subject property, Fannie Mae requires the appraiser to verify the data with a party that does not have a financial interest in the subject transaction. However, when appraising new construction, the appraiser may need to rely solely on the builder of the property he or she is appraising to provide comparable sales data, as this data may not yet be available through typical data sources such as public records or multiple listing services. In this scenario, it is acceptable for the appraiser to verify the transaction of the comparable sale by viewing a copy of the HUD-1 Settlement Statement from the builder's file.

Valuation Analysis and Final Reconciliation

The valuation sections of Fannie Mae's 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.

Reconciliation is an ongoing process throughout the research and analysis performed during the appraisal process. In the final reconciliation, an explanation of reasonableness and validity of the indicated values are expected to be provided as well as the quality and quantity of the available data. The reconciliation should report which approach or approaches were used and which were provided the most weight. The reconciliation is also where the final opinion of market value is provided.

Income Approach to Value

Fannie Mae does not accept appraisals that rely solely on the income approach to value as an indicator of market value.

The income approach to value is based on the assumption that market value is related to market rent, or income that a property can be expected to earn.

When to Use the Income Approach to Value

The income approach to value is primarily appropriate in:

- one-unit property neighborhoods that constitute a substantial rental market
- the valuation of two-unit to four-unit properties

Calculating Market Rent

For the income approach to value, appraisers multiply the total gross estimated monthly market rent for the subject property by a reconciled gross monthly rent multiplier. 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.

Cost Approach to Value

Understanding Estimates for Cost Approach to Value

For the cost approach to value, appraisers must:

- estimate the reproduction cost of new improvements,
- subtract the amount of depreciation from all causes, and
- add an opinion of value for the site if it were vacant and available to be developed to its highest and best use.

Reproduction Cost Estimate

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

Physical depreciation, traditionally referred to as physical deterioration, is a loss in value that is caused by deterioration in the physical condition of the improvements.

Appraisers generally classify physical deterioration as “curable” or “incurable.”

Curable physical deterioration refers to items of deferred maintenance, such as painting or items currently in need of repair, such as broken stair rails.

Incurable physical deterioration is a defect caused by physical deterioration that cannot be practically or economically corrected. .

Functional Depreciation

Functional depreciation, traditionally referred to as functional obsolescence, is a loss in value that is caused by:

- defects in the design of the structure, such as inadequacies in such items as architecture, floor plan, or sizes and types of rooms
- changes in market preferences that result in some aspect of the improvements being considered obsolete by current standards, such as the location of a bedroom on a level with no bathroom, or access to a bedroom only through another bedroom

External Depreciation

External depreciation, 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).

Chapter 3 – Developing Appraisals for Special Types of Properties

The following sections provide Fannie Mae’s guidance for appraising special types of properties including properties located in special assessment and community facilities districts, leaseholds held by community land trusts, condominiums, Planned Unit Developments (PUDs), and cooperative projects.

Special Assessment and Community Facilities Districts – Overview

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 such as roads, sewer services, schools, police and fire protection services, libraries, etc.

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

The effect that the special assessment district has on the value of the property should be noted in the appraisal report. The appraiser should note whether the district is undergoing financial difficulty and how that affects the value or marketability of the property. Current and expired listings, pending contract sales, and recently closed sales within the district will help provide this information. If the measure of the effect of the financial difficulty is not measurable; for example, because it is so recent or no comparable market data is available, the property is not eligible for purchase or securitization by Fannie Mae.

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.

Community Facilities Districts

Assessments used to repay tax-exempt bonds for community facilities districts become an ongoing responsibility of the property owner similar to state and local property taxes.

The assessment lien and the obligation to pay the assessment pass with the title to the property when ownership of the property is transferred.

The term of the assessment obligation can be lengthy, up to 40 years—unless the assessment is prepaid. In some cases, prepayment for a single-family property can be expensive based on the extent of the improvements that were financed, the size of the dwelling, and the year the property was purchased.

Legislation granting the special assessment generally requires full disclosure to purchasers of a property located in a community facilities district, and the lender should also communicate this to the appraiser. The appraiser should consider the reaction to the market, if any, to the assessment by analyzing similarly affected comparable sales and note the effect of the assessment in the appraisal report.

Leaseholds Held by Community Land Trusts

Community land trusts are typically nonprofit organizations that acquire land for a variety of reasons—such as to facilitate 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 (typically 99 years), renewable ground lease. Because of the affordable terms that it offers, a community land trust usually includes in its ground lease restrictions on borrower eligibility, as well as on the resale of the property improvements.

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

When a leasehold interest is held by a community land trust, the appraiser must analyze the property subject to the ground lease. Since the community land trust typically subsidizes the sales price to the borrower, that price may be significantly less than the market value of the leasehold interest in the property. The resale restrictions (as well as other restrictions) that may be included in the ground lease also can affect the value of the property. However, the lender and the borrower must execute Fannie Mae Form 2100, Community Land Trust Ground Lease Rider, which stipulates that resale restrictions terminate in the event of foreclosure or deed in lieu of foreclosure. The land records for the subject property must include adoption of the terms and conditions that are incorporated in the 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 restrictions that are removed by the Uniform Community Land Trust Ground Lease rider.

Determining the Fee Simple Value

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 Fannie Mae requires the appraisal of the subject property to be based).

Determining the Capitalization Rate

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

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

Determining the Leasehold Value

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

Example: Assume that the annual ground rent from the community land trust’s ground lease is \$300, the market-derived capitalization rate is 5.75 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 Fannie Mae’s appraisal report forms do not include space to provide all 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 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.”

Units in Condominium, PUD, or Cooperative projects

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

The appraisal of an individual unit in a **condominium project** requires the appraiser to:

- analyze condominium projects as well as the individual units
- pay special attention to the location of the individual unit within the project
- pay special attention to the project's amenities
- pay special attention to the amount and purpose of the owners' association assessment since marketability and value of the individual units in a project depend on marketability and appeal of the project

A **PUD** is a project or subdivision that consists of common property and improvements that are owned and maintained by an owners' association for the benefit and use of the individual units within the project.

For a project to qualify as a PUD, the owners' association must:

- require automatic, nonseverable membership for each individual unit owner
- provide for mandatory assessments

NOTE: *Note: 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
- pay special attention to the location of the individual unit within the project
- pay special attention to the project's amenities
- pay special attention to the amount and purpose of the owners' association assessment since marketability and value of the individual units in a project generally depend on the marketability and appeal of the project

A **cooperative project** is a multi-unit property in which those who purchase units are actually buying shares in the ownership of the project as a whole. When a cooperative unit is appraised, an opinion of the market value of the cooperative interest, or the shares, of that area assigned to the individual unit is determined.

An important determination to be made when the subject property is a cooperative is how acceptable housing cooperatives are for the particular market area. The availability of comparable data for similar cooperative units will help in making this determination. If research indicates a preference for condominium units over cooperative units in the market area, adjustments should be reflected in the comparable sales accordingly.

Forms and additional information are available on www.efanniemae.com.