

Reviewing Appraisals in Today's Mortgage Market

The appraisal report is one of the most important documents in a loan file because it supports the underwriter's determination of whether there is sufficient and appropriate collateral to back the mortgage transaction.

In today's housing market, the risks associated with property appraisals have become more apparent due to declining home values in many areas across the country and the increasing number of foreclosures and distressed sales. As a result, the mortgage industry has placed greater emphasis on ensuring the quality, integrity, and accuracy of appraisals and appraisal reviews.

To determine if an appraisal provides a credible property value and if the appraisal report is acceptable, you need to be aware of key aspects of the appraisal and the appraisal review process. Let's take a closer look at some of the common pitfalls in the appraisal process and best practices that help ensure quality appraisals.

Does the property support the mortgage transaction?

When underwriting an appraisal, it is critical that you evaluate the appraisal report for completeness, accuracy, and consistency to make sure the appraised value reflects the current market value of the property. Spotting discrepancies and red flags in an appraisal report is a critical part of the appraisal review. Here are a few things you should watch out for:

- **Properties located in a declining market.** Declining home values in many markets pose one of the greatest challenges to performing appraisals and appraisal reviews. The existence of an oversupply of properties for sale, extended marketing times, and a slow growth rate in the area may be indications that the market is declining. Consider the property's location, comparable sales, and neighborhood characteristics, among other things, when reviewing the appraisal report to help you determine if a property is located in a declining market. Make sure the appraiser accounted for these factors in the analysis, and fully documented the degree to which these factors influenced the property's value. Active listings in the area can provide secondary support for determinations of value that represent the most current market conditions.
- **Overvaluation of property value.** An inflated appraised value creates a credit risk because the loan-to-value ratio is understated and the collateral may not adequately support the mortgage transaction. In declining markets, the possibility of overvaluation increases, which makes it even more critical to use current market data. It is important to thoroughly review the appraisal report and make sure that the appraised value is credible and fully supported by the information and analysis provided within the appraisal report.
- **Inappropriate comparable sales and adjustments.** The appraiser's selection of comparable sales is critical to providing an accurate opinion of value based on market data. The appraiser must certify that the comparable sales chosen are those most similar to the subject property. Of critical importance is the location of the comparable sales in relation to the subject property. When reviewing the appraisal report, make sure to closely examine whether the adjustments are properly supported and reasonable. Typically, the higher the value of the adjustments, or the amount of adjustments made, the more likely the comparable sales might not be representative of the subject property.

When reviewing the appraisal report, watch out for:

- Properties located in a declining market
- Overvaluation of property value
- Inappropriate comparable sales and adjustments
- Market value and concessions
- Appraisals for nontraditional property types

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- **Market value and concessions.** The appraiser's opinion of value must reflect the market value of the subject property. Freddie Mac requires that adjustments to the comparables be made for special or creative financing or sales concessions. No adjustments are necessary for those costs that are normally paid by the seller of the property as a result of tradition or law in a market area. These costs are those that the seller generally pays in the majority of sales transactions. Section 44.3(c) of the *Single-Family Seller/Servicer Guide* (Guide) details Freddie Mac's requirements regarding adjustments for special or creative financing or concessions.
- **Appraisals for nontraditional property types.** Make sure that appraisals completed for manufactured homes, condominiums, and properties in planned unit developments and leasehold estates meet Freddie Mac requirements. Freddie Mac requirements include specific eligibility requirements, as well as additional appraisal requirements, for such property types. We also require additional qualifications for appraisers conducting appraisals of manufactured homes. Freddie Mac's appraisal requirements for these property types can be found in Guide Chapters H33 (manufactured homes), 41 (leasehold estates), 42 (condominiums), and 43 (planned unit developments).

Best practices to ensure sound appraisal reviews

A high quality appraisal should provide an opinion of market value that is well supported and documented. An appraisal report should offer a clear and thoughtful analysis of all factors that impact the market value of the property. The analysis should be backed up by information that is recent, accurate, relevant, and market-based. To help you assess and ensure the quality of an appraisal, some best practices to consider are:

Appraiser qualification and selection

- › At a minimum, the appraiser must be a state-certified or state-licensed real estate appraiser eligible to perform appraisals in the state in which the property is located and experienced in the appraisal of properties similar to the property being appraised or inspected. Review an appraiser's licensing and performance at least once each licensing cycle.
- › Ensure that turnaround times for appraisers to perform appraisals are reasonable. Unreasonable turnaround times may adversely affect the quality and accuracy of appraisals.
- › Select an appraiser who is knowledgeable in the subject property's market area when ordering appraisals or inspections in central city neighborhoods and rural areas. Appraisers are more likely to use nontraditional databases for appraisals in these areas, which may be subject to complex factors influencing the value and marketability of individual properties.

Underwriter qualifications

- › Make sure your underwriting staff is properly trained and kept abreast of market trends so that they can determine if an appraiser's opinion of value meets the definition of "market value," and that the appraisal is accurate and fully supported.
- › Your underwriting staff should be familiar with Uniform Standards of Professional Appraisal Practice, applicable laws and Freddie Mac appraisal requirements, including the Home Valuation Code of Conduct (HVCC).

Evaluating the quality of the appraisal

- › Use automated valuation models (AVMs) and other tools as part of your origination or quality control process to detect fraud and objectively measure the accuracy of the appraisal. Freddie Mac recommends the use of Home Value Explorer®, Home Value Calibrator® or other validated and tested AVMs, as well as other collateral valuation tools, to assess the quality and accuracy of appraisals.
- › If Loan Prospector®, Freddie Mac's automated underwriting system, provides a feedback message stating that the value of the subject property may be excessive you should carefully review the appraisal to ensure that it is accurate, and that the value is fully supported.
- › It is useful to have policies and procedures in place for your valuation processes that include an escalation and governance process when an AVM or other tool indicates that an appraised value is in question.

Appraisal reviews

When underwriting and reviewing an appraisal, make sure there are no inconsistencies in:

- Appraisal photos
- Maps used to identify the location of the subject property and comparable sales

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- Subject property sales history and comparable sales documentation supporting any adjustments
- Appraiser signature and license number
- Report date
- › Ensure processes are in place for comparing the appraisal, loan application, and title work for consistency.
- › Thoroughly review the mortgage file to identify and investigate the following appraisal red flags:
 - Comparable sales not independently verified or recorded
 - Value not supported by the comparable sales, and/or the comparable sales are not appropriate
 - Incorrect appraisal report form or inspection type for the transaction
 - Inconsistent or unexplained adjustments, numerous adjustments, across-the-board adjustments or all net adjustments in the same directions (upward or downward)
 - Photos that portray the subject property to be inferior or dissimilar to the comparable sales
 - Typographical and mathematical errors
 - Appraiser is not familiar with the market in which the property is located
 - Appraisal ordered prior to the sale contract date
 - The required completion certification is not in the mortgage file
- › Have valuation policies and procedures in place to address the following:
 - The selection of appraisers in compliance with the HVCC and Freddie Mac requirements, and monitoring the quality and accuracy of appraisals
 - Knowledgeable staff underwriting appraisals and performing quality control review of appraisals
 - Appraiser's opinion of value reflects the cash-equivalent price without undue stimulus such as concessions
 - Use of AVMs and other tools to monitor appraisal quality

Freddie Mac requirements for underwriting the appraisal

Freddie Mac's purchase requirements are anchored by the “[three Cs of underwriting](#),” and include “collateral” that supports the mortgage transaction. Freddie Mac Seller/Servicers are accountable for the quality, integrity and accuracy of the appraisal and other documentation.

We recognize the challenges that current market conditions pose in connection with determining accurate property values. To help you address these challenges, we encourage you to become familiar with appraisal and collateral requirements detailed in Chapter 44 of the Guide. In this Guide chapter you'll find our requirements and guidance with regard to:

- Property eligibility
- Appraisers and the appraisal report
- The inspection report
- The use of AVMs
- Representations and warranties regarding the subject property
- The HVCC

For more information

To learn more about our requirements and to keep abreast of changes to our policies and underwriting requirements:

- Visit the [Freddie Mac Learning Center](#) for a variety of resources on underwriting including recorded webinars, live classroom sessions, and quick references.
- Review the Guide that details all the requirements for doing business with Freddie Mac. Access the Guide [through the AllRegs® link on FreddieMac.com](#).
- Use our [Loan Prospector Documentation Matrix](#) as a reference to document your loans submitted to Loan Prospector.
- Review our July 10, 2009 [Guide Bulletin 2009–18](#) for additional best practices for underwriting appraisals.
- Review our October 9, 2009 [Guide Bulletin 2009–24](#) for additional information and best practices regarding property eligibility.