

July 2007

## **Collateral Valuation Practices and Declining Markets**

### **Frequently Asked Questions Relating to Announcement 07-11**

#### **Summary**

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

#### **General**

##### **Q1. Does Announcement 07-11 state a new Fannie Mae Policy?**

Announcement 07-11 does not establish new policies regarding the responsibilities of the lender or the terms of the mortgage loan when properties are located in a declining market. The Announcement is designed to provide guidance to assist lenders in determining current market conditions, and to reiterate existing policies related to the lender’s and appraiser’s responsibilities for ensuring the appraisal is accurate and completed in accordance with our appraisal standards.

##### **Q2. Is there an expiration date on the guidance provided in Announcement 07-11?**

The guidance provided in Announcement 07-11 applies to all current and future deliveries of mortgage loans to Fannie Mae, regardless of current market conditions or rate of decline in home values.

##### **Q3. Is there a special feature code that will be required at delivery?**

No special feature code is required for delivery of a mortgage loan secured by a property determined to be located in a declining market.

#### **Declining Markets**

##### **Q4. What is the definition of a declining market?**

There is no standard definition of a declining market. In general, based on the tracking of home prices in a certain geographic location (state, Metropolitan Statistical Area, ZIP code, etc.), a declining market is one in which home prices are currently declining.

**Q5. Will Fannie Mae purchase loans in a declining market?**

Yes, Fannie Mae purchases mortgage loans in all markets across the country, including those in a declining market.

**Q6. Is the lender or appraiser responsible for determining whether or not a property is in a declining market?**

Both the lender and appraiser are ultimately responsible for determining whether a property is located within a declining market. The appraiser may indicate this in the neighborhood section of the appraisal report and/or the lender may make an independent decision based on its tracking of home prices in a certain area. We expect the lender to address any discrepancies between the information reflected in the appraisal report, and the results of the lender's own due diligence by requesting additional information and justification from the appraiser.

**Q7. How should a lender determine if a property is located in a declining market?**

The Announcement lists several third-party sources that track current market conditions, indicating both appreciating and declining markets. The list of sources in the Announcement is not all inclusive; lenders must determine which source best meets their needs, and should explore other sources not listed. We will also add a new message in Desktop Underwriter® (DU®) Version 5.7 (to be released July 22, 2007) that will appear on loan casefiles for properties located in areas that may be experiencing a decline in property value, as well as markets in which it is difficult to assess home values.

**Q8. What third party source is the best for tracking current home price trends?**

The Announcement provides several third-party sources that track this information, however, these are just a few of the many resources available to lenders. If the lender decides to use one of these services they are responsible for deciding which service they believe provides the information they need to determine that the appraisal reflects accurate market conditions.

**Desktop Underwriter® (DU®)**

**Q9. What is the new DU message for properties located in declining markets?**

The text of the DU message is as follows:

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

**Q10. What should a lender do when they receive the DU message?**

The DU message is designed as a tool to help lenders identify mortgage loans secured by properties in certain areas where it appears there has been a decline in property values. Lenders are expected to use their discretion in relation to all transactions and perform the level of due diligence they believe necessary to become satisfied that the appraisal report has been accurately completed.

**Q11. What should the lender do if DU returns the new message, but the lender thinks the property is not in a declining market?**

The DU message is intended to be an additional tool for lenders to assess market conditions in declining markets. It is within the lender's discretion to determine whether additional actions are warranted, as the lender is ultimately responsible for the appraised value used in support of the mortgage loan transaction.

**Q12. What should the lender do if DU does not return the message, but the lender thinks the property is in a declining market?**

The DU message is not designed to capture every declining market or market in which additional review of the appraisal is warranted based on recent home price trends. If the lender believes a transaction is secured by a property located within a declining market, but they did not receive the DU message and the appraisal also does not indicate declining property values, the lender should obtain additional clarification or justification from the appraiser, as warranted.

**Q13. What if the lender resubmits a loan to DU Version 5.6? Could this result in the new message being fired?**

No. This new message will not be returned on DU Version 5.6 loan casefiles. However, as stated in the Announcement and Supplement, lenders are expected to use their discretion in relation to all loans delivered to Fannie Mae. This would include loan casefiles submitted to DU Version 5.6.

**Q14. If DU returns the message, will this impact the fieldwork recommendation?**

Casefiles receiving the DU message related to declining markets will be required to obtain a full interior and exterior inspection appraisal report.

**Manually Underwritten Mortgage Loans**

**Q15. What about loans that are underwritten manually?**

As always, it is the lender's responsibility to determine if the subject property is located in a declining market. In instances where the lender manually underwrites the loan, the lender and appraiser must independently determine whether the property is located within a declining market. This can be accomplished through a variety of means, including the use of

third-party home price tracking services as referenced in the Announcement. The declining market message on loans underwritten through DU is provided as a convenience to lenders to highlight areas where it appears there has been a decline in values. There is no difference; however, in the lender's responsibility to comply with our appraisal guidelines between loans underwritten manually or through DU.

### **The Appraisal**

#### **Q16. How can a lender verify that the appraiser has accurately indicated the property is not in a declining market?**

Generally accepted appraisal standards and our appraisal report forms require the appraiser to include support for his/her conclusions regarding market conditions, including housing trends. The Neighborhood Section of the appraisal is the primary area where the appraiser would indicate whether property values are increasing, stable or declining. If the lender believes the property is in a declining market and the appraisal indicates otherwise, the lender should request additional information from the appraiser that supports the appraiser's conclusion.