FannieMae

Lender Letter LL-2014-02

March 25, 2014

To: All Fannie Mae Single-Family Sellers

Property and Appraisal Requirements for Properties Located in Small Towns and Rural Areas

This Lender Letter is being issued in response to a Federal Housing Finance Agency directive to Fannie Mae to provide a number of clarifications regarding property and appraisal requirements for properties in small towns and rural areas.

Fannie Mae offers mortgage products and establishes eligibility guidelines that are designed to provide mortgage finance opportunities in all market segments. Fannie Mae recognizes that lenders making loans secured by properties located in small towns and rural areas are often faced with challenges that are not found in suburban and urban locations. Residential properties often have characteristics that present difficulties for appraisers, such as unique building types, substantial distances between properties, large lot sizes that may include farmland, and non-public sources for various utilities. General lack of density and homogeneity demand reliance on appraisers with expertise and experience in these markets. Qualified appraisers who understand the characteristics of these markets are key to ensuring compliance with Fannie Mae property eligibility and appraisal requirements.

To date, Fannie Mae's guidance for small towns and rural areas has been intentionally broad to accommodate the diversity of this market segment. However, there are areas within the guidance for which additional clarification is being provided to address certain misconceptions about Fannie Mae's requirements.

This Lender Letter discusses the following policies:

- Appraiser Selection
- Property Eligibility and Special Considerations
- Acceptable Appraisal Practices

Appraiser Selection

Lenders are free to select appraisers for any appraisal assignment, but must ensure that the selected appraiser has the requisite knowledge, expertise, and experience for the specific assignment type and market area.

Appraisal Management Companies and other Third-Party Vendors

A common misconception of Fannie Mae's Appraiser Independence Requirements (AIR) is that lenders are required to use third-party vendors or appraisal management companies (AMCs) to ensure compliance. In fact, lenders are *not* required to use an AMC or any other third-party vendor to order appraisals.

AIR allows lenders to select any of the following:

- in-house appraisers whose function is separate and independent of loan production staff influence and interference,
- independent fee appraisers,
- third-party vendors, or
- AMCs.

Small Lender Exception

Many smaller lenders perceive the use of an AMC as a requirement to achieve separation between mortgage production and the appraisal ordering and quality assurance processes. Although lenders are required to maintain a separation between these processes, many lenders have chosen to use AMCs to ensure compliance. This can be particularly true of small lenders who do not have sufficient staff to allow for a distinct separation between production and quality assurance functions. However, the AIR provides an exception for a small lender as long as the lender is able to demonstrate prudent safeguards and processes to isolate its collateral evaluation process from influence or interference from its mortgage production process.

For additional information, see the *Selling Guide*, B4-1.1-01, General Information on Appraisal Requirements; B4-1.1-03, Appraiser Selection; and the AIR.

Property Eligibility and Special Considerations

Determining property eligibility can be challenging for loans in small towns and rural areas. Zoning, land use, property type, and other influences must all be considered, in addition to property condition and marketability. Many rural properties have mixed use, mixed zoning or other unusual characteristics that make determining property eligibility difficult. Properties may be located on large parcels of land, and/or have numerous outbuildings with secondary uses that are not residential in nature. In addition, property improvements may be very unique and not easily compared with available market data.

Fannie Mae will purchase mortgages in small towns and rural areas provided the properties that serve as collateral are primarily residential in nature and use, given that all other requirements and conditions concerning property eligibility have been met. Unique properties, which include various construction types and techniques, are also acceptable, including log homes, geodesic dome homes, and berm homes.

Fannie Mae will not purchase mortgages on properties that are not primarily residential in nature including, but not limited to, vacant land or property primarily used for agricultural or commercial purposes.

For additional information, see the *Selling Guide*, B2-3, Occupancy and Property Eligibility; B4-1.4-03, Appraisal Report Review: Property Location; B4-1.4-04, Appraisal Report Review: Trend of Neighborhood Property Values, Demand/Supply, and Marketing Time; and B4-1.4-11, Appraisal Report Review: Conformity of Improvements to Neighborhood.

Acceptable Appraisal Practices

Appraisers, like lenders, face unique challenges in the valuation of properties located in small towns and rural areas. This makes appraiser selection an important consideration of the lender. As previously noted, appraisers must have the knowledge, expertise, and experience to perform appraisals in rural markets.

Comparable Sale Selection

Fannie Mae recognizes that the availability of suitable sales for comparison can be challenging. Often, appraisers have very limited market data and available sales may be dated, dissimilar and/or located some distance from the subject property.

Adjustments

Large and numerous adjustments may be necessary to account for differences in location, site size, age, condition and other dominant property features. The adjustments may exceed the generally accepted practice that any variation from the comparable sale price be limited to 15% net and 25% gross adjustments. This is often unavoidable given the limited availability and suitability of comparable data. Whenever possible, appraisers should attempt to balance the analysis by isolating dominant features within the subject property and select sales that compare to those features. For example, a subject property with a large site should be compared to comparable sales with large sites even though the sale may be distant, dated, or dissimilar in order to isolate the contributory value of the subject's site. Comparable sales that are used in this manner can be balanced by sales that are more current, closer in proximity, or those that have very similar improvements in terms of style, design, age, condition, etc.

Distance

Appraisals of properties located in small towns with few sales may require appraisers to select comparable sales from neighboring towns some distance away. Depending on market activity, these sales may also be dated but the best available. The appraiser is responsible for providing an appropriate amount of relevant narrative discussion on current market conditions, available market data and explanation of the analysis and conclusions contained in the appraisal.

Appraisers that possess market knowledge and experience in more rural geographic areas will generally produce credible results that will enable lenders to make appropriate collateral evaluations and underwriting decisions.

For additional information, see the *Selling Guide*, B4-1.4-16, Appraisal Report Review: Sales Comparison Approach; and B4-1.4-17, Appraisal Report Review: Adjustments to Comparable Sales.

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Lenders who have questions about this Lender Letter should contact their Account Team.

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