

## APPENDIX A: VALUATION OF REAL ESTATE OWNED PROPERTIES

### A-1 REAL ESTATE OWNED (REO)

FHA's Real Estate Owned (REO) properties are a result of paying a claim to a lending institution and the lender transferring ownership of the property to HUD. Typically, title to REO properties is held by the lender prior to transfer to HUD due to the borrower's default on the mortgage.

The appraisal process is HUD's primary tool for determining the listing price of FHA REO properties. FHA appraisers provide preliminary verification that FHA's Minimum Property Requirements (MPR) for existing housing and Minimum Property Standards (MPS) for new construction have been met for properties evaluated as "insurable" or "insurable with repair escrow" prior to being listed for sale.

#### A. Appraiser Requirements for REO properties

Requirements for appraisers who perform REO appraisals are the same as for appraisers of any other property type. An appraiser of REO property must be state licensed or certified in the state in which the property is located and listed on the FHA Appraiser Roster.

#### B. Appraisal Requirements for REO properties

Per Mortgagee Letter 2005-34 and Revised Appendix D to Handbook 4150.2, the appraiser must report the appraisal on the applicable property specific revised Fannie Mae appraisal reporting form.

Under "Assignment Type" in the Subject Section of the applicable property specific appraisal reporting form, the appraiser is to mark the box labeled "other" and indicate that the property being appraised is a HUD Real Estate Owned (REO) property. If the appraiser is performing a land only appraisal which is not reported on a Fannie Mae appraisal reporting form, the appraisal must note, in bold font, that the property being appraised is a REO property in the section of the report providing information on the subject property.

The guidance provided in Appendix D, Appraisal Protocol, to Handbook 4150.2, applies equally to REO properties, unless otherwise indicated in the guidance presented in this appendix.

REO properties are to be appraised "as-is". The Dictionary of Real Estate Appraisal, Fourth Edition, Appraisal Institute defines an "as-is" value as follows:

"The value of specific ownership rights to an identified parcel of real estate as of the effective date of the appraisal; relates to what physically exists and is legally permissible and excludes all assumptions concerning hypothetical market conditions or possible rezoning."

The "as-is" value is the market value for the property as it exists on the effective date of the appraisal.

The appraisal report shall consist of the applicable property specific appraisal reporting form, all required exhibits and a copy of the Property Condition Report (PCR).

M&M contractors are required to complete a PCR prior to ordering an appraisal of a REO property. The PCR contains information specific to the condition and functionality of the property. Prior to performing a site visit of a REO property, the appraiser must be provided a copy of the PCR by the M&M contractor.

The appraiser must coordinate a specific time for a full site inspection of the property with the property manager. Generally, a REO property is secured with the utilities de-activated. The appraiser should request that the M&M contractor make sure the utilities, including the mechanical systems, are activated at the time the appraiser makes the property inspection. If an appraisal is completed without the utilities turned on and/or the mechanical systems functioning, the appraiser must note this in the appraisal report and must rely upon the information provided by the M&M contractor in its Property Condition Report (PCR); reference the PCR in the applicable sections of the appraisal report (condition of property or physical deficiencies) as well as append a copy of the PCR to the appraisal report.

There will be occasions when the appraisal of a REO property may involve extraordinary conditions which dictate additional research, documentation and due diligence on the part of the appraiser. For example, a single family property that features a second unit which is an illegal use due to non-compliance with the local zoning code/regulations, the appraiser must provide an estimate of the costs necessary to bring the property into compliance. The appraiser should provide documentation for such conclusions, such as a copy of the pertinent portion of the zoning code and a summary of any discussions with local authorities. When appraising a REO property that is impacted by complex or extraordinary circumstances, the appraiser must contact the M&M Contractor for guidance and clarification before completing the appraisal. The M&M Contractor may, in turn and in cases of problematic appraisals, seek additional guidance from the Homeownership Center that has jurisdiction over the locality where the property is located. Any discrepancies between the information contained in the PCR and what the appraiser observed during the inspection of the property must be noted and highlighted in the appraisal report.

A land appraisal may be warranted when the improvements are in such deteriorated condition as to provide no contributory value to the property or when condemnation proceedings by the local authority have acquired the improvements in part or in their entirety. In such cases, when the supporting land represents the value of the property, the appraiser must report the appraisal on a form or in a narrative format that must address, at minimum, the following:

- Detailed information similar in scope to the Subject section of Fannie Mae Form 1004 March 2005 (Uniform Residential Appraisal Report) including, but not limited to, property address, legal description, owner of record, occupancy, assessment/tax information, and property rights appraised.
- Detailed information similar in scope to the Site section of Fannie Mae Form 1004 March 2005 (Uniform Residential Appraisal Report) including, but not limited to, size, zoning, highest and best use, shape, topography, drainage, utility availability, and location in a FEMA designated Special Flood Hazard Area.

- A sales grid similar in scope to that presented in the Sales Comparison Approach section of Fannie Mae Form 1004 March 2005 (Uniform Residential Appraisal Report) including, but not limited to, detailed information on three comparable sales, attributes, number of comparable unimproved sale properties and offered/listed for sale properties.

Form FW 68, Land Appraisal Report, is an acceptable reporting format.

The appraiser must adjust the sales of comparable, unimproved building lots/sites for differences in location, size, zoning, utility connection and/or availability, site improvement and any other pertinent factors. Any costs incurred in razing the existing improvements and/or clean up should be extracted from the value of the supporting land to arrive at a final conclusion of value.

### **C. Scope**

The appraiser must develop and report the appraisal in accordance with the scope of work requirements established by USPAP and HUD/FHA.

### **D. Contractual Responsibility of Appraisers**

The appraiser is hired by the M&M contractor and, therefore, has a contractual responsibility to the M&M contractor. Additionally, as with any appraisal performed for a HUD/FHA program, the appraiser has an obligation to perform appraisal services commensurate the standards and requirements of HUD/FHA.

### **E. Intended Use of Appraisal**

The intended use for an REO appraisal is to estimate the “as is” market value of the property in order to provide a basis for determining the listing price of the property for marketing purposes.

### **F. Intended User**

The intended user of a REO appraisal is the M&M contractor, the lender (under certain circumstances) and HUD/FHA.

### **G. Statement of Insurability**

The following definitions shall apply to the insurability of a REO property:

Insurable: Properties marketed as "insurable" are those that meet FHA's Minimum Property Requirements (MPR) for existing housing and Minimum Property Standards (MPS) for new construction at the time of the appraisal in their as-is condition without repairs being necessary.

Insurable With Repair Escrow: A property that requires no more than \$5,000 for repairs to meet FHA's MPR or MPS as estimated by the PCR and as reviewed and determined to be reasonable by the appraiser, is eligible to be marketed for sale in its as-is condition with FHA

mortgage insurance available, provided the purchaser(s) establishes a cash escrow to ensure the completion of the required repairs. Purchaser(s) are permitted to include in the mortgage an amount equal to 110% of the estimated cost of the repairs.

Uninsurable: Properties offered for sale "Uninsured" do not meet, in their as-is condition, FHA's MPR or MPS and the cost of repairs identified by the appraiser, to meet MPR or MPS, are estimated to exceed \$5,000. Uninsurable properties can qualify for FHA's Section 203(k) rehabilitation program and, depending upon the scope and extent of repairs needed, the Streamlined (k) Limited Repair Program.

A Statement of Insurability, in bold font, must be included in the Comment section of the appraisal report. This Statement of Insurability shall indicate if the property can be sold with FHA mortgage insurance (meets MPR if existing construction or meets MPS if new construction) either (1) in its "as-is" state without repairs or (2) in its "as-is" state with repairs costing \$5,000 or less with repair escrow or (3) uninsurable. In appraising REO properties, as with the performance of any FHA appraisal, a FHA Roster appraiser must denote any deficiency to the supporting site or improvements in the appraisal report. The appraiser is to note those repairs necessary, together with a cost to cure, to bring the property into compliance with either MPR or MPS.

The marketing categorization, "Insurable with conditions", introduced in Mortgagee Letter 2000-27 and defined under "HUD REO Marketing Approaches" is no longer available. All other instructions and requirements outlined in Mortgagee Letter 2000-27 remain unchanged except where updated by the guidance and requirements provided in Mortgagee Letters 2005-34 and 2005-48.

## **H. Effective Date of Value**

The effective date of value is the date when the appraiser performs the site visit for the subject property. If another date is used as the effective date, the appraiser must specifically indicate:

- the alternative date (with detailed explanation of why)
- the date when the subject property was physically inspected

## **I. Additional Appraisal Requirements**

The appraiser must value the subject property from the information gathered and arrive at an estimated market value of the subject property based on the requirements detailed in the Appraisal Protocol, issued as an attachment to Mortgagee Letter 2005-48.

A building sketch is required, but a floor plan or room layout of the property is not required unless there is evidence of functional obsolescence. Representative interior photos are required in cases where there is significant interior repair (in excess of \$5,000 repair costs) required.

## **A-2 Sales Comparison Approach**

Typically, the Sales Comparison Approach is the most applicable approach to estimate the

market value of a REO property. Appraisers may utilize sales comparables from other REO transactions **only** when such sales are deemed to be the best available for the market area **and** they meet all of the following criteria:

- located in the subject neighborhood or reasonable proximity
- comparable property subject to reasonable adjustment
- sold with a willing buyer and seller
- exposed to the market for a reasonable period

Appraisers are reminded that an explanation, as well as support, must be provided for any adjustments to the sales price of comparable sales that exceed the guidelines set forth in Revised Appendix D: Appraisal Protocol, pages D-31, D-68, D-98 and D-127, attachment to Mortgagee Letter 2005-48.

Inclusion of vacancy rates, rates of foreclosure and a discussion of foreclosure sales in the subject's market area may be used as additional support for reliance on sales of other REO transactions.

Do not use distressed sales such as Sheriff Sales. These sales do not involve a willing seller nor are they exposed to the market under normal conditions. The resulting value indication derived from the use of such sales is not consistent with the definition of market value.

### **A-3 Reporting Requirements**

As with any appraisal performed by a FHA Roster Appraiser, an REO appraisal must be performed in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP).

Other reporting requirements are as follows:

- With each appraisal, the appraiser must provide a list of any buyer incentives that would enhance the marketability of the property to provide an incentive to buy the property unrepaired as opposed to repaired.
- For all property constructed before 1978, the appraiser must condition the appraisal on the completion of a lead-based paint test.
- For appraisals of vacant lots (land), complete a land appraisal report form.