Appraisal quality control review best practices

Appraisal quality deficiencies are among the most common defects issued in Fannie Mae's post-acquisition due diligence reviews. As we regularly engage with customers and discuss their internal quality results, we see a notable lack of calibration on appraisal findings. This should be an alarm bell related to one of your key controls – your quality control (QC) results.

Ask yourself:

- Is there a noticeable difference between the results from your internal QC and what Fannie Mae has identified in our review results? Are your internal QC review results adequately reflecting your risk?

- Does your organization view the appraisal review process only as a pass/fail exercise, without recognizing that technical errors made on one loan may be benign, but could be significant on the next loan?

- Given the revisions to the appraisal QC process announced in **SEL-2021-04**, how is your staff positioned to make the most of this enhanced requirement for your organization?

- Do you view the policy update as an *opportunity* to use your QC resources to do a deeper dive into your appraisal quality processes regarding loans that exhibit potential appraisal quality issues?

The top appraisal quality defect subcategories identified in our reviews, with examples of each, are:

- **Appraisal data integrity:** The appraiser inaccurately represented the condition and/or quality of construction as C2 when evidence indicated the subject property was C3.
- **Comparable selection:** Comp sale two was considered inappropriate as it was 10 miles away and in a different city without explanation. Similar, more appropriate sales were available.
- **Appraisal adjustments:** The appraiser made a $10k adjustment for a basement to comp sale one; however, the adjustment was incorrectly applied as it should have been negative and not positive.

Defects like the first example, where the *subject property* is not accurately described, can result in an over/under valuation defect and can possibly impact the *representation and warranty relief on the subject property value*, even with a Collateral Underwriter® (CU®) risk score of 2.5 or lower. For the defects related to comparable selections and adjustments, you should be asking the question: can the selections be considered true comparables? Certain appraisal errors may have little impact on value; however, if these types of quality or analysis errors are unaddressed, subsequent findings could result in significant defects (repurchases).

What can your company do today?

- At origination, ensure your collateral review process effectively identifies and addresses known quality issues.
- Throughout the QC process, use your QC review results to generate actionable insights to help identify appraisal quality risks and ensure they are appropriately mitigated at the time of loan underwriting or during your prefunding reviews.

Origination best practices

- Evaluate your appraisal underwriting process:
  ◦ Fannie Mae requires the lender to review all appraisals, even those that qualify for representation and warranty relief on value by receiving a CU risk score of 2.5 or less.
  ◦ Consider a bifurcated review process that assigns appraisals with indicators of poor quality (based on CU scores, messages, flags) to more experienced staff appraisers or well-trained senior underwriters.
  ◦ Leverage the CU risk assessment, focusing on loans with higher CU risk scores or certain CU flags and messaging. Consider implementing a process where a second signature or management review is required (e.g., CU risk scores of 4 or 5 and/or an Overvaluation Flag).
  ◦ How do you reconcile indicators of poor appraisal quality in your process? If you don't, how do you quantify that increased risk and reserve for higher loan loss potential?
- Meet with your internal appraisal department (if applicable) or appraisal management company at least quarterly to discuss appraisal defects.

QC requirements

We have replaced the previous appraisal QC requirements with a new collateral risk assessment for all loans selected for a QC review in the post-closing random sample, including removing the 10% field review requirement (see **SEL-2021-04**, effective May 5, 2021). The collateral risk assessment must:

- Reconcile known quality issues identified in CU or other valuation tools
- Determine the property meets eligibility requirements
- Assess the appropriateness of comparable sales
- Assess the appropriateness of the data presented in the report
- Conclude that the rationale for the reconciliation of value is supported
- Prescribe corrective actions for defects identified in the appraisal process

To assist lenders in performing reviews, we're providing a new, optional Post-Closing QC Collateral Risk Assessment Analysis (**Form 1033**). While this worksheet will aid in a comprehensive review of the origination appraisal, it is not mandatory and is not a substitute for the requirements found in the *Selling Guide*.
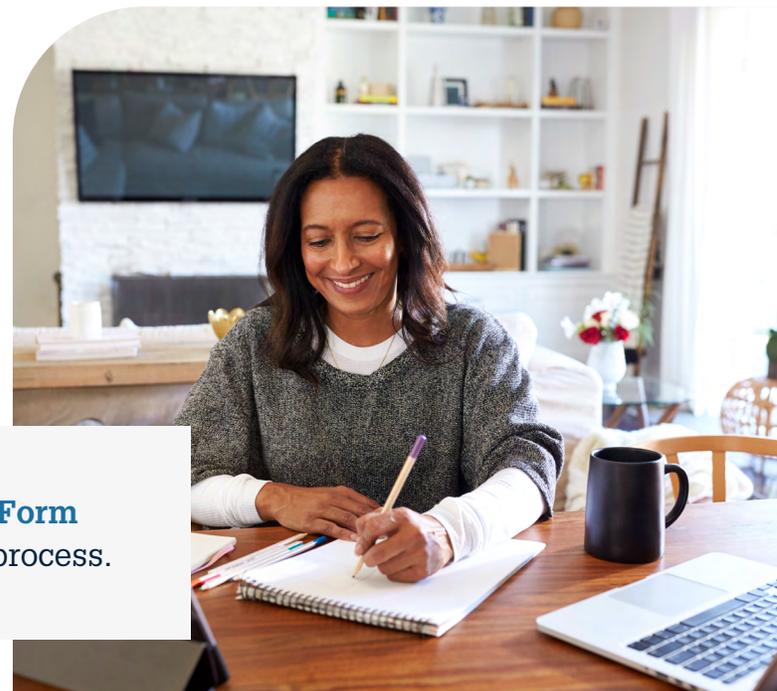
Use the new Collateral Risk Assessment Analysis (**Form 1033**) as part of your comprehensive appraisal QC process.

QC best practices

- Review your Fannie Mae appraisal quality defects and calibrate to your own review process and understand what creates disparate results.
- Develop an appraisal quality scorecard based on appraisal quality feedback from Fannie Mae and your own QC findings to help identify specific trends or gaps and develop training opportunities or process improvements.
- Align your QC review with Fannie Mae's process; ensure your QC staff is trained to effectively apply available appraisal tools, including CU.
- Include the CU risk score with the appraisal quality defects in your QC reports to gain additional insight into possible root cause for quality errors.
- Leverage Fannie Mae's CU training.
- Use Fannie Mae's appraisal quality feedback to target loans with potential appraisal quality concerns, such as those with high CU risk scores (2.6 - 5). Feedback sources include *Submission Summary Reports* on appraisal uploads to the Uniform Collateral Data Portal® (UCDP®), reports in Fannie Mae Connect™, and the workflow function in CU.
- Target *higher LTV* loans in prefunding selections because potential defects could cause a negative impact to the property value and are more likely to result in an ineligible loan. Also use prefunding samples to target loans with high CU risk scores and appraisal quality flags.
- Ensure the collateral risk assessment performed on the loans in your random post-closing sample addresses the key requirements described in the *Selling Guide* (see Resources section under Next Steps).

Next steps

Having a robust and holistic appraisal review program in place, in both originations and prefunding/post-closing QC, can better position your company to effectively manage appraisal quality regardless of market conditions.

Ask yourself: are you fully leveraging Fannie Mae tools, post-acquisition loan review results, and all other available data to produce loans with the highest appraisal quality possible? Now is the time to do all you can to mitigate appraisal quality risk.

Resources:
- For more insight and additional appraisal quality defect examples, see LL-2021-01 Appraisal Risk Management Policy Reminders and Resources
- Assess your risk with our Appraisal Management and Appraiser Independence Requirements Seller/Servicer Risk Self-assessment
- For our full policy, see *Selling Guide* D1-3-04, Lender Post-Closing Quality Control Review of Appraisers and Appraisals (as updated May 5, 2021)
- Use the Optional Post-Closing QC Collateral Risk Assessment Analysis (Form 1033) as part of your appraisal QC process

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