Take action on top collateral defects

Recent Fannie Mae post-purchase review results reveal an increase in eligibility violations related to appraisal defects. The increased collateral deficiencies create a higher loan repurchase risk for lenders. Understanding and identifying these top defects and the remediation steps can be an effective way to reduce risk. There is no better time for lenders to take immediate action to address collateral defects, mitigate risk, and ensure loan quality by assessing the effectiveness of your appraisal policies and procedures.

Why is a comprehensive collateral review important in identifying appraisal defects?

Fannie Mae requires all lenders to perform a collateral risk assessment — a comprehensive review on all post-closing random quality control (QC) reviews, as well as discretionary reviews, if applicable. Since collateral is the basis for mortgages, it is important that lenders accurately assess the quality of their corresponding appraisals. Fully adhering to Fannie Mae's collateral risk assessment requirements in post-closing QC decreases your risk for collateral defects and presents opportunities to impact quality for your organization.

Identifying transactional risk accurately is vital to managing quality risk and building an effective and strong QC program. Fulfilling the collateral risk assessment requirement helps strengthen your appraisal review procedures and offers a process for developing a feedback loop on the quality of appraisals with your origination department.

Ask yourself:

- Is our staff properly trained to identify quality defects in the appraisal review process?
- Do we utilize Collateral Underwriter® (CU®) in our QC reviews?
- Do our policies and procedures address appraisals with high-risk characteristics (i.e., overvaluation flags, higher CU risk scores, etc.)?
- Are we finding the same types of defects and similar error rates in our appraisal reviews as our investors and are our results aligned and calibrated?
- Do we perform component appraisal reviews in prefunding based on high-risk characteristics, such as overvaluation flags, higher CU risk scores, etc.?
- Have we identified and evaluated the impacts to our organization that result from the failure to detect appraisal defects (borrower sustainability, operational, reputational, and financial risk)?

How do you identify and address appraisal defects?

Become familiar with the applicable sections of the Fannie Mae *Selling Guide*, as well as other resource materials, such as the Post-Closing QC Collateral Risk Assessment Analysis (Form 1033), designed to build the foundation to ensure appraisal quality. Collateral Underwriter and its many features, including unique collateral messaging, can help lenders assess the impact to marketability and overall appraisal quality. However, it is still a vital part of the process to have an appraisal review performed by an individual competent in appraisal theory to identify risks that may not otherwise be detected. CU is unable to read text so reviewing the appraisal is essential to integrate the full scope of the feedback provided within the appraisal report, including the content in text. Remember to validate the information provided by the appraiser.

Review the chart below to learn about the top five collateral defects cited by Fannie Mae:

Fannie Mae - *Selling Guide*	Collateral Defect Name	Sample Defect Details	Sample Collateral Underwriter Message
Section: B4-1.3-09, Adjustments to Comparable Sales (01/31/2017)	**Inadequate Comparable Adjustment(s)**	Use of adjustments that do not reflect market reaction to the differences between the subject property and the comparable sales, not supporting adjustments and failure to make adjustments are considered unacceptable appraisal practices. The appraiser made $100,000 combined adjustment(s) for condition and additional features to sale one, two, and six. The adjustment(s) were unsupported based on research of the MLS data.	**FNM1015:** CU has identified market reaction to Condition, Quality of Construction, or Actual Age that may differ from the adjustment rates used by the appraiser. Ensure that the appraiser had made adjustments accurately reflecting market reaction to each of these attributes. See the CU Adjustments tab for details.
	Failure to Adjust Comparables	Use of adjustments that do not reflect market reaction to the differences between the subject property and the comparable sales, not supporting adjustments and failure to make adjustments are considered unacceptable appraisal practices. The subject property was 40 years old while comparable sale three was 10 years old. Based on our research, the appraiser should have made an adjustment for the difference between the subject and comparable sale(s).	**FNM1012:** CU has identified market reaction to attributes that may differ from the adjustment rates used by the appraiser. Ensure that the appraiser has made adjustments accurately reflecting market reaction. See the CU Adjustments tab for details.
	Use of Physically Dissimilar Comparable Sale(s) - GLA	Fannie Mae's *Selling Guide* states that it is an unacceptable appraisal practice if there is a misrepresentation of the physical characteristics of the subject property, improvements, or comparable sales. The appraiser inaccurately represented the gross living area of the subject property as 1,764 square feet when evidence obtained from the appraisal indicated the subject property had 1,598 square feet of gross living area. The appraisal sketch labeled a room as "other" which was an incomplete garage conversion. This area was inaccurately included in the gross living area calculation.	**FNM1013:** CU has identified market reaction to Above Grade Room Count & Gross Living Area (GLA) that may differ from the adjustment rates used by the appraiser. Ensure that the appraiser has made adjustments accurately reflecting market reaction to these attributes. See the CU Adjustments tab for details.

Fannie Mae - *Selling Guide*	Collateral Defect Name	Sample Defect Details	Sample Collateral Underwriter Message
Section: B4-1.3-08, Comparable Sales (03/02/2022)	**Inappropriate Comparable Sale(s) Selection Due to Location**	Fannie Mae's *Selling Guide* states that comparables that are significantly different from the subject property may be acceptable; however, the appraiser must describe the differences, consider these factors in the market value, and provide an explanation justifying the use of the comparable(s). Appraisers must use comparable sales that are the most locationally and physically similar to the subject property. Comparable sale(s) one and two were considered inappropriate as they were located for higher valued areas without adequate explanation as to why the comparable(s) were used.	**FNM1024:** CU has identified comparable sales that may be more similar in geographical location than those relied on by the appraiser. Ensure that the appraiser has relied on comparables with a similar geographical location. See the CU Comparables tab for details.
	Use of Dissimilar Comparable Sale(s) Due to Site Characteristics	Fannie Mae's *Selling Guide* states that comparables that are significantly different from the subject property may be acceptable; however, the appraiser must describe the differences, consider these factors in the market value, and provide an explanation justifying the use of the comparable(s). Appraisers must use comparable sales that are the most locationally and physically similar to the subject property. Comparable sale(s) one was significantly different in site size than the subject property. The subject property had a .4 acre site while comparable sale(s) one had a 3.0 acre site. The appraiser did not provide an adequate explanation as to why the comparable sale(s) was used.	**FNM1023:** CU has identified comparable sales that may be more similar to the subject than those relied on by the appraiser. Ensure that the appraiser has relied on comparables that are the best and most appropriate for the assignment. See the CU Comparables tab for details.

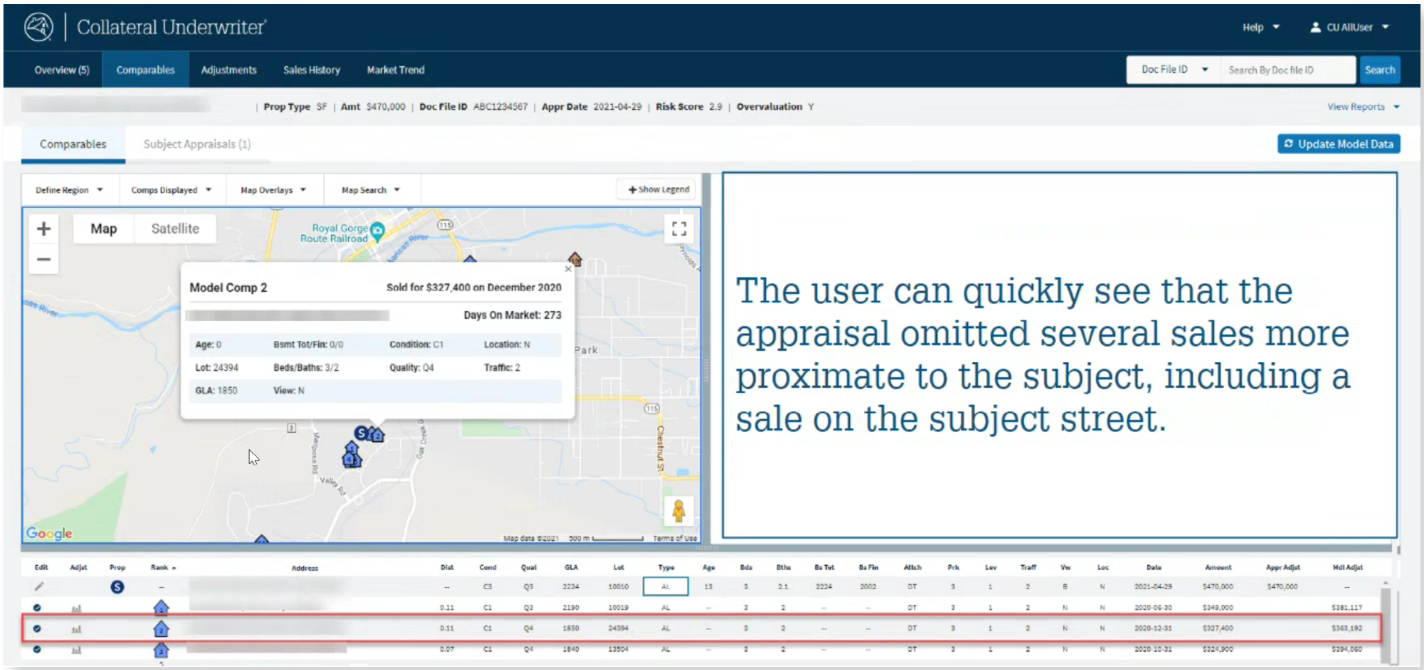
Collateral Underwriter as part of your appraisal review

All model adjustments are the result of statistical regressions and should not be interpreted as Fannie Mae's recommended adjustments. However, appraiser adjustments that vary significantly from model-derived adjustments and adjustments made by their peers in the same market may indicate under- or over- adjustments. Appraisers remain responsible for deriving adjustment rates that represent typical market reaction.

The CU adjustment messages alert users to adjustments on the appraisal that are significantly different from the model-derived adjustments and from adjustments made by other appraisers in the same market.

Lenders should carefully review the appraisal report and the feedback provided in CU to see if there were any special characteristics of the neighborhood or features of the subject (such as pools, accessory units, or outbuildings) not factored in by CU that could have impacted the appraiser's comparable sale(s) selection. CU's aerial photos in the web application can help with this. The appraisal report should also be carefully reviewed for additional context or notes provided by the appraiser.

In the CU example below the Comparables tab displays the appraiser-provided comparable sale(s) alongside the top model-ranked sales. The sale that requires fewest adjustments (as determined by the CU adjustment model) is ranked highest (#1) and other sales are listed in descending order based on the quantity of model adjustments.



Before contacting the appraiser, the lender might consider whether the model-selected comparable sale(s) present **persuasive evidence** for a different value conclusion. Do not send the appraiser or appraisal management company a list of all comparable sale(s) identified by CU; instead, assess and determine the comparable sale(s) that are most reflective of the subject property. The lender may want to ask the appraiser to consider whether these sales should have been included in the appraisal report and if they impact the original value conclusion.

During the QC review, address these **Form 1033** questions:

Fannie Mae - *Selling Guide*	Collateral Defect Name	Post-closing QC Collateral Risk Assessment Analysis (Fannie Mae Form 1033) - Corresponding Questions
Section: B4-1.3-09, Adjustments to Comparable Sales (01/31/2017)	**Inadequate Comparable Adjustment(s)**	**20. Adjustments were reasonable and the appraiser provided support** Check the reasonableness of the adjustments and that they are market-driven (refer to the CU adjustment analysis section).
	Failure to Adjust Comparables	**21. Adjustments were applied in a consistent manner across all comparables** Adjustment methodology should be consistent and supported; any inconsistencies should be addressed by the appraiser (e.g., gross living area [GLA], bed, and bath).
	Use of Physically Dissimilar Comparable Sale(s) - GLA	**26. The comparable sales are suitable substitutes for the subject property** Would the buyer of the comparables purchase the subject property based on the information reported and the photos provided? Did information provided in CU or other sources confirm the sales provided were appropriate?
Section: B4-1.3-08, Comparable Sales (03/02/2022)	**Inappropriate Comparable Sale(s) Selection Due to Location**	**11. Subject location influences are identified correctly** Was the appropriate site location provided along with the impact(s) to value? Reference other sources to ensure the appropriate view was provided; overhead imagery may be helpful.
		15. Subject views are correctly identified Reference other sources to confirm views.
	Use of Dissimilar Comparable Sale(s) Due to Site Characteristics	**24. The comparable property characteristics are reported accurately** Confirm the appraiser accurately described the comparables. Review messages and alerts on the Comparables tab in CU for assistance.
		26. The comparable sales are suitable substitutes for the subject property Would the buyer of the comparables purchase the subject property based on the information reported and the photos provided? Did information provided in CU or other sources confirm the sales provided were appropriate?

Best Practices

- Prioritize risk identification and consider performing targeted reviews during prefunding based on high-risk appraisal attributes, such as overvaluation flag, high-risk scores, CU messages, etc.
- Leverage Form 1033 and collateral risk assessment forms holistically:
  - Utilize these tools during the origination and prefunding appraisal review processes — not just during post-closing reviews.
  - Leverage the recommended appraisal validation tools for post-closing QC collateral risk assessment analysis identified on the last page of Form 1033.
  - Address the impact of the appraisal deficiencies surfaced through these resources, not just the CU messages.

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Next steps

- Review your collateral policies and procedures to safeguard your organization and ensure you meet investor guidelines.
- Validate your organization's collateral policies and procedures are being followed. For example, if your collateral policy requires CU to be reviewed for high-risk attributes, use the **Fannie Mae Connect – CU Usage Metrics Report** to validate adherence to policy.
- Calibrate internal and external (Fannie Mae, HUD, and VA) appraisal review results for gaps in QC testing and internal collateral policies and procedures.
- Develop collateral training for your teams by leveraging information provided by Fannie Mae and other investor results.

Consider implementing some of the recommended best practices and next steps to ensure you're really assessing the collateral quality of each loan either via the prefunding review or in your post-closing QC reviews. Quality appraisals are key to mitigating overall risk to your organization.

Resources

Loan Quality page

Collateral Underwriter page

Collateral Underwriter Learning Center

Selling Guide, Subpart B4: Underwriting Property

Selling Guide, B4-1.3-08, Comparable Sales

Selling Guide, B4-1.3-09, Adjustments to Comparable Sales

Selling Guide, D1-3-04 Lender Post-Closing Quality Control Review of Appraisers and Appraisals

Post-Closing QC Collateral Risk Assessment Analysis (Form 1033)

Fannie Mae Connect

Using Collateral Underwriter Strategically (Boot Camp webcast)