ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

April 1, 2008

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MORTGAGEE LETTER 2008-09

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TO: ALL APPROVED MORTGAGEES
**   ALL FHA ROSTER APPRAISERS**

SUBJECT: Second Appraisal Requirements/Limits on Cash-Out Refinances

Mortgagee Letter 2007-11, announcing the FHASecure initiative, also included information regarding appropriate appraisal practices in declining markets; those instructions remain in effect. Now, with FHA in position to insure mortgage amounts greatly in excess of what has been its experience as a mortgage insurer, we believe it prudent to set forth additional underwriting and collateral assessment practices for "high-balance" loans.

Specifically, for mortgage amounts that will exceed the January 1, 2008 conforming limit of $417,000, FHA is establishing a second appraisal requirement for loans on properties in declining areas, and limiting the loan-to-value for cash-out refinances. These requirements are further described below and are effective for all mortgages with FHA case number assignments made on or after the date of this mortgagee letter.

<u>Second Appraisal Requirements in Certain High-Cost Areas</u>

Recognizing FHA's counter-cyclical role in the mortgage market, and its ability to help stabilize declining housing markets, FHA is not at this time establishing higher downpayment requirements or borrower credit bureau score thresholds for properties located in declining areas. However, to mitigate risk to the FHA insurance fund as well as FHA borrowers, FHA will require a second appraisal for higher balance loans secured by properties in declining markets as indicated on the appraisal report or determined by the lender using other sources.

<u>When is a Second Appraisal Required?</u> A second appraisal will be required when:

- The loan amount, excluding the upfront mortgage insurance premium, will exceed $417,000, <u>and</u>
- The LTV[1], excluding upfront MIP, equals or exceeds 95%, <u>and</u>
- The property is determined as being in a declining market.

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[1] Loan-to-Value is defined as the mortgage amount, excluding any financed upfront mortgage insurance premium, divided by the lower of the adjusted sales price or the appraiser's estimate of the property's value.

How is a declining market determined?

- <u>By the appraiser</u>: The appraisal report requires the appraiser to indicate if the property is located in a declining area in both the neighborhood section of the appropriate appraisal form as well as in the housing trend section, and/or determine if there is an "over-supply" of properties. The certifications contained in the appraisal reporting forms are supplemental standards to the Uniform Standards of Professional Appraisal Practice (USPAP) and Certification # 14 specifically requires an appraiser to consider and report on all conditions that impact value. Appraisers must provide specific support for any conclusions noted in the Housing Trend section of the appraisal report and research local price trends, relying upon such services as local Multiple Listing Services or others as described below.

- <u>By the lender</u>: The lender may determine through services such the S&P/Case-Schiller Index, Office of Federal Housing Enterprise Oversight (OFHEO) Index or National Association of Realtors (NAR) statistics, or through an automated underwriting system, e.g., Fannie Mae's Desktop Underwriter or Freddie Mac's Loan Prospector, that the property is located in a declining market area.

Who can perform the second appraisal?

The second independent appraisal must be completed by a FHA roster appraiser selected by the Direct Endorsement lender that is underwriting the mortgage. The lender independently engages the appraiser and is not to request a second case number through FHA Connection. The fee for the appraisal may be passed onto the borrower as any other closing cost.

What form must be used for the second appraisal?

If the property is a one-unit detached house, the second appraisal may be an exterior-only appraisal using form Fannie Mae/Freddie Mac 2055; any repair requirements noted in the original interior-exterior appraisal report must be adhered to if the second appraisal is an exterior-only appraisal. Condominium units including detached site-condominiums; manufactured housing; and 2-4 unit properties are not eligible for exterior-only second appraisals and must be completed on the appropriate appraisal form.

When must the mortgage amount be reduced?

If the second appraisal has an estimated value more than 5 percent lower than the original appraisal, the <u>maximum mortgage</u> must be predicated upon the lower of the two appraised values.

What does the lender do with the second appraisal?

The second appraisal, when required, is to be included in the FHA insurance binder. If the second appraisal is used to recalculate the maximum mortgage amount, the mortgagee must enter the appropriate information in the appraisal logging screen in the FHA Connection or functional equivalent.

Pressure on Appraiser and Conflicts of Interest

The lender and appraiser must also avoid conflicts of interest which affect, either in reality or in appearance, the credibility of the appraisal. A lender may not choose an appraiser that has any interest, direct or indirect, in the property being appraised. In addition, a lender may not choose an appraiser that is employed by an appraisal company that owns, is owned by, is affiliated with or has any financial interest in the builder or seller of the property. Instances of undue pressure or influence on an appraiser reported to FHA will result in appropriate disciplinary actions against the lender involved.

Loan-to-Value Limits for Cash-Out Refinances

If a homeowner is pursuing a cash-out refinance and the loan balance exclusive of FHA's upfront mortgage insurance premium will exceed $417,000, the loan-to-value may not exceed 85 percent of the appraiser's estimate of value.

If you have any questions regarding this mortgagee letter, please contact the FHA Resource Center at 1-800-CALL-FHA (1-800-225-5342).

Sincerely,

Brian D. Montgomery
Assistant Secretary for Housing-
  Federal Housing Commissioner