



*HSBC Consumer Lending (USA) Inc.
Credit Policy - Appraisal Review*

HSBC APPRAISAL GUIDELINES AND REPORTING REQUIREMENTS

Effective as of January 1, 2008

(Last revision 4/18/2008)

In conjunction with

**Integrated Real Estate Processing
Pittsburgh, PA**

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GENERAL INFORMATION

COMPLIANCE

Appraisals completed for HSBC Consumer Lending (USA) Inc. through Integrated Real Estate Processing (IREP) must conform to Uniform Standards of Professional Appraisal Practice (USPAP), state specific regulations, Fair Housing and Fair Lending Acts, **Freddie Mac Guidelines**, Fannie Mae Guidelines; and to HSBC Guidelines and Reporting Requirements that follow.

APPRAISER QUALIFICATIONS

Effective January 1, 2008, all appraisers must meet the revised Real Property Appraiser Qualification Criteria approved by the Appraiser Qualification Board and adopted by the states.

An appraiser must also meet any state specific requirements, and have an active license in good standing in the state in which the property being appraised is located. Appraisals must be completed by a state licensed appraiser, a certified residential appraiser, or a certified general appraiser.

Appraisals signed by trainees are not acceptable. If a trainee assists in the inspection of the property, or contributes to the development or in the reporting of the appraisal, the trainee's name and the extent of work completed must be noted and detailed in the written appraisal.

NO BRANCH CONTACT

Any and all communication between an appraiser and a branch office must go through IREP. Appraisers should not contact HSBC branch offices directly, and must notify IREP immediately if they are contacted by a branch employee. IREP will remove appraisers that fail to comply from their approved appraiser list for a minimum one year.

DATA SOURCES AND VERIFICATION

Where multiple listing services (MLS) are available, the appraiser must use MLS as well as any other data sources commonly used by appraisers in the same market area. The appraiser must obtain the most current and reliable data available to competently develop a reliable opinion of value and to ensure the appraisal is not misleading.

Sales or listings obtained from an interested party must be verified with a disinterested party. Information, like concessions, condition, modernization and upgrades, must be verified with a realtor or another individual familiar with the physical condition and/or the transaction details of the comparable.

ACCEPTED FORMS

Following Freddie Mac and Fannie Mae forms (dated March 2005) are approved by HSBC for use:

- Form 70 or 1004, Uniform Residential Appraisal Reports (March 2005)
- Form 1000 or 1007 – Single Family Comparable Rent Schedule
- Form 70B or 1004C, Manufactured Home Report
- Form 72 or 1025, Small Residential Income Property Appraisal Report
- Form 216, Operating Income Statement
- Form 465 or 1073, Individual Condominium Unit Appraisal Report
- Form 466 or 1075, Exterior-Only Inspection Individual Condominium Unit Appraisal Report
- Form 2055, Exterior-Only Inspection Residential Appraisal Report (Texas only)
- Form 2000 – One Unit Residential Appraisal Field Review
- Form 2000C – Two- to Four-Unit Residential Appraisal Field Review
- Form 1004D – Appraisal Update and/or Completion Report
- Form 2090 – Individual Cooperative Interest Appraisal Form
- Form 2095 – Exterior-Only Individual Cooperative Interest Appraisal Form

Fannie Mae Forms dated 6/93 must be used for Retrospective Appraisals.

Conforming – Accepted Forms

- Form 2075 – Desktop Underwriter Property Inspection Report (Fannie Mae form)
- Form 2070 – Loan Prospector Condition and Marketability Report (Freddie Mac form)

Use of these two forms is limited in NY by loan criteria.

GUIDELINES AND REPORTING REQUIREMENTS

Section 1: COLLATERAL ISSUES REQUIRING CLARIFICATION FROM IREP

Call IREP for clarification immediately after inspecting the subject property when any of following apply:

- ✓ Subject is a single family residence and is vacant, is in poor condition, or is uninhabitable.
- ✓ Subject has two or more units and more than one unit is vacant.
- ✓ Subject is a second residence or investment property.
- ✓ Subject's highest and best use is other than residential or residential mixed-use, regardless of zoning
- ✓ Subject is a mixed use property (commercial and residential) that does not have a primary use of residential and comparable sales of similar mixed use properties are limited.
- ✓ Subject is a daycare or adult living facility where the residential improvements have been modified to accommodate the special use
- ✓ Subject cannot be rebuilt under present zoning and the possibility of obtaining a variance is unlikely
- ✓ Site exceeds 40 acres or is a working farm
- ✓ An urban or suburban homestead cannot exceed 10 acres—applies to TX only.
- ✓ Subject is a HUD label manufactured home that is not on a permanent foundation, located in a mobile home park, is rented, or is a vacation home.
- ✓ Subject is a single wide manufactured home or single wide with an addition
- ✓ Subject has five or more living units (attached or detached) or is a boarding house
- ✓ There is evidence of extensive deferred maintenance, needed repairs, poor condition, structural inadequacies, unfinished areas, non-permitted additions, an illegal use, or not habitable
- ✓ There is evidence of an active roof leak or damage, basement flooding, black mold or foundation concerns or damage
- ✓ Subject is atypical, unique, or non-conventional (i.e. dome home, earth home, A-frame, converted barn or pole building, cooperative), and there is inadequate data to develop a reliable value opinion even after expanding date and distance parameters
- ✓ Heat source is inadequate for year-round occupancy
- ✓ Adverse environmental conditions affect the site or market area
- ✓ Scope of Work results in a higher than quoted or agreed upon fee
- ✓ Common wells, common septic systems, or private roads that do not have legally enforceable access and maintenance agreements attached to them.
- ✓ Subject or immediate neighborhood is adversely affected by an environmental hazard.
- ✓ Condominiums in project's that do not meet the following requirements:
 - ✓ Owners control the homeowner's association
 - ✓ 90% of all units are sold and closed
 - Condo projects with < 5 units, 100% must be sold and closed
 - ✓ Project is not subject to additional phasing or annexation
 - ✓ Project that has < 5 units is not part of a larger project
 - ✓ Construction of common elements and facilities is complete, including any improvements owned by a master association.
 - ✓ Units are owned in fee simple (no leaseholds)
 - ✓ Owners have sole ownership in and rights to use common areas and facilities.
 - ✓ No single entity owns more than 1 unit in complexes with < 10 units.
 - ✓ No single entity owns more than 10% of total units in complexes with 10 or more units
 - ✓ In projects with < 5 units 100% of the units must be owner-occupied
 - ✓ In projects with 5 or more units 60% of the units must be owner occupied
 - ✓ Subject unit must be the owner's primary residence (rentals and second/vacation homes are not allowed)

Conforming – Condo Requirements

- ✓ Condominium homeowners' association data (may require completion of special form regarding project information); if project information is not available the appraisal should not be completed
- ✓ Condominium projects with < 5 units that do not meet the following requirements.
 - ✓ All except one unit must be sold and closed
 - 2 units – 1 must be sold
 - 3 units – 2 must be sold
 - 4 units – 3 must be sold

Conforming – PUD Requirements

- ✓ One dwellings only
- ✓ Individuals own both the dwelling and the improved site in fee simple
- ✓ Homeowners' association owns and maintains common areas and improvements
- ✓ Association is controlled by the homeowners, a sponsor, or the developer
- ✓ Owners have sole ownership in and rights to use common areas and facilities.

NOTE: Upon clarification, the order may be canceled resulting in a trip or inspection fee.

Section 2: ADDENDUM REQUIRED

Must include:

- 1) Original subject photos - front view, rear view, and street scene
- 2) Comparable sales photos
 - Original photos by the appraiser are preferred, but photos from the office files are allowed.
 - Downloaded MLS photos are acceptable when a) the photos are clear, b) the source of the photos is identified, and c) the appraiser has verified that the MLS photos are correct.
 - The appraiser must inspect the exterior of all the comps from the street whether original photos are used or not.
- 3) Subject photos showing deferred maintenance, remodeling in progress, unfinished additions, structural problems, and any other major physical, functional, or external obsolescence when observed.
- 4) Sketch with dimensions, calculations, and room locations
 - Floor plan identifying rooms when functional obsolescence is present.
 - All dimensions are exterior dimensions unless subject is a condominium or has an unusual second floor that cannot be measure accurately from outside.
- 5) Location map with subject and comparable sales identified.
- 6) FEMA map identifying subject's location when flood insurance is required (HSBC Finance does not require flood insurance in zones C, X, or B)

When available include:

- 1) Plat map identifying subject site
- 2) Plat of survey

Conforming

- Condominiums – homeowners' association data may be required on a special form
- Copy of inspecting appraiser's and supervisory appraiser's license must be included in the addendum of the appraisal report.

Section 3: AFFORDABLE HOUSING

Please refer to Advisory Opinion 14 in USPAP. Competency as defined by USPAP is required before accepting or completing an affordable (subsidized) housing appraisal order. Experience and knowledge of this type assignment goes beyond what is typically required so that the resulting appraisal is not misleading.

The HSBC Finance Affordable Housing Addendum must be completed and attached to the appraisal. The appraisal should be completed "subject to" the affordable housing restrictions and the appraisal must include all required disclosures and disclaimer that may be necessary. The appraised value should reflect the most probable sale price, and that is often the maximum sale price allowed under the program for the individual unit being appraised. This is usually not a market value appraisal, but in some circumstances, market value may be pertinent to the assignment. When unclear, IREP should be contacted for further instructions from their Client.

The required Affordable Housing form is located in the Addendum.

Section 4: DECLINING MARKETS

In 2007, national and local real estate data for many residential markets and submarkets found that some markets declined, some stabilized or had nominal appreciation, and a few had double digit increases. HSBC is global company, but also a local lender concerned with local market conditions. Without local appraisers analyses of their local markets, resulting value opinions could be unreliable and reports misleading. So, we rely on IREP appraisers to provide us with:

- ♦ Details about local market conditions and market trends
- ♦ Factors about the neighborhood and the subject property that affect marketability
- ♦ Accurate property descriptions, and
- ♦ Reasonable value opinions—neither understated nor overstated.

As part of the Scope of Work, appraisers should monitor annual and month-over-month changes in:

- ✓ Housing inventory (current listings)
- ✓ Marketing time
- ✓ Seller and builder concessions
- ✓ Ratio between original listing prices and final sale prices
- ✓ Number of reduced list prices
- ✓ Number of expired listings.

The client is benefited when appraisers

- Address any oversupply, declining values, or marketing times > six months
- Include the most recent sales and most physically similar comps as possible
- Add listings to the Sales Comparison Approach and adjust them on the market grid
- Check for expired listings, prices changes, and contracts pending
- Avoid sales with unusual concessions or conditions attached
- Analyze market data—not just the comparable sales—and report your findings.

Conforming – Declining Markets

Requirements:

Provide following neighborhood marketing data

1. Number of listings
2. Average market time
3. Sale to list price ratio
4. Appearance of seller concessions

See Best Practices

Section 5: LEASEHOLDS

If subject has a leasehold ownership and if leaseholds are common to the market area, complete the appraisal. Leaseholds are common in Maryland and Hawaii.

In Hawaii where leasehold interests are being converted to fee simple, value may be completed “subject to” a change in the type of ownership from leasehold to fee simple with the Client’s prior approval of a “subject to” value opinion.

Section 6: LARGE ACREAGE

Appraise only the parcel of land with the main residential improvements. Final value should not include additional parcels of vacant land or land with additional site improvements that may be owned by the borrower or that may be contiguous to the parcel being appraised.

The appraiser should perform a complete interior and exterior inspection of all site improvements (outbuildings, garages, arena, fencing, etc.) located on the site and that contribute value.

Do not complete the appraisal, but contact IREP for instructions when

1. Present use is not the highest and best use,
 - Highest and best use is residential development or some other type of development,
 - There is excess land that has a separate highest and best use,
2. Subject is a working farm or part of a working farm.
3. Acreage exceeds the 40-acre maximum allowed by HSBC.
4. Zoning does not allow for residential uses or for residential improvements to be rebuilt; residential or mixed residential and agriculture zoning is acceptable.

NOTE: Appraisals based on hypothetical conditions where less than the full acreage is included in value are not allowed.

Section 7: PROPERTY INSPECTION

When inspecting the property, specifically identify the relevant characteristics of the improvements that were inspected. What was observed or not observed. What was evaluated or not evaluated.

Non-permitted additions, unfinished areas, and additional living units on the site cannot be disregarded because of legal or zoning issues or state of completeness. Appraiser must consider the effects on marketability and value of all improvements to the site. If the "as is" condition severely limits subject's marketability, stop the appraisal process and contact IREP for instructions.

The interior and exterior inspection guidelines represent the minimum expectations of the Client based on a typical assignment. Some assignments may require additional steps and a higher level of competency like manufactured housing or appraiser large acreage. Inspections should include all processes and procedures that local appraisers consider reasonable and necessary.

INTERIOR AND EXTERIOR INSPECTION

The minimum requirements of a complete interior and exterior inspection means an appraiser must at a minimum:

- ✓ Access all living units on the site that are considered real estate and view all exterior elevations
- ✓ Access all interior rooms including finished attics
- ✓ Check for adequate access to crawl spaces and attics
- ✓ View the crawl space
- ✓ Check and assess the visible condition of all mechanical systems including heating, plumbing, electrical, etc.
- ✓ Access the basement and all finished or unfinished areas in the basement
- ✓ Check the exterior materials used including the quality and the condition of the siding, roof, overhang, windows, gutters and any other exterior features.
- ✓ Check the materials used, the quality, and the condition of interior finishing including walls, flooring, trim, doors, cabinetry, plumbing fixtures, electrical fixtures, and any other interior features.
- ✓ Assess the visible condition of the foundation, roof, the structure (beams, floor joists, etc.).
- ✓ Require inspections when visible condition suggests the probability of a major concern.
- ✓ Access the interior of all outbuildings that contribute to value and view all exterior elevations.
- ✓ Measure the residence and all major outbuildings including additional living units, garages, barns, arenas, etc.
- ✓ Front, rear, and street scene photos (opposite corner front and rear photos preferred)
- ✓ Take photos of additional living units, major outbuildings, deferred maintenance, and any other factors that positively or negatively impact value.

EXTERIOR ONLY INSPECTION

The minimum requirements of a complete exterior only inspection means an appraiser must:

- ✓ View all the exterior elevations of the residence and outbuildings. View the subject property from the street, if an on-site inspection is not possible.
- ✓ Take front and street scene photos of subject are required. Rear photo should be taken if the appraiser has access to the site.
- ✓ Assess the visible condition of the roof, siding, gutters, overhang, doors, etc. and, require inspections when visible condition suggests the probability of a major concern.

If after the exterior inspection, it is determined that completing this assignment would result in a misleading report or a less than credible value based on USPAP guidelines, do not complete the appraisal. Contact IREP for instructions.

Section 8: DEVELOPMENT AND REPORTING

This section has general and HSBC specific reporting requirements that should help identify the client's needs and expectations as an appropriate scope of work for an assignment is developed.

Scope of Work	<ul style="list-style-type: none">➤ The Scope of Work included in the March 2005 Fannie Mae Forms identifies what is minimally required of the appraiser.➤ Scope is defined by the complexity of the appraisal.➤ The Scope of Work may be expanded, but deletions are not permitted.
Lender/Client	HSBC Finance & IREP
Subject	<ul style="list-style-type: none">➤ The complete property address is required.➤ Post office box is not acceptable.
Neighborhood	<ul style="list-style-type: none">➤ Market condition comments should address the average days on the market.➤ Report the <u>numbers of houses similar to subject</u> that are currently for sale, listed, or have pending contracts.➤ Include supporting comments and data when property values are rapidly appreciating or declining, when a shortage or an oversupply of housing exists, or when the marketing time exceeds six months.
Include One Parcel	<ul style="list-style-type: none">➤ Only the improved tax parcel that the residence sets on should be included in value, even if customer owns more than one contiguous site.➤ If the residential improvement sets on multiple tax parcels or if the inclusion of multiple tax parcels is required for zoning compliance, the parcels may be included in the appraisal.
Zoning	<ul style="list-style-type: none">➤ Include the specific zoning classification with description (i.e. R-1, Single Family Residence or R-4, Two to Four Units).➤ Avoid general terms like residential, apartment, multiple family, etc.
Illegal Use	<ul style="list-style-type: none">➤ If the present use is illegal and highest and best use is residential, appraise the property according to its highest and best use.➤ Analyses of the illegal use impact on value must result in a meaningful appraisal.➤ Any cost to cure associated with eliminating the illegal use must be considered.
Actual Ages	<ul style="list-style-type: none">➤ Include actual ages of subject and comparable sales on Sales Comparison grid.➤ Using comps with similar effective ages is acceptable, if the actual ages are also similar.➤ To ensure that an appraisal is not misleading, it is recommended that newer houses are not compared to older houses, even if their effective ages are similar.
Effective Age	<ul style="list-style-type: none">➤ Reporting effective age on the Sale Comparison grid is optional.➤ Effective age is subjective and usually based on observed condition for the subject. So, it is preferred that the effective ages of sales data are verified through reliable sources that are familiar with the condition, updates, and modernization of the comparable sale.➤ To assist Underwriters in applying policy, effective age of a manufactured home should be reported as a single figure and not a range.<ul style="list-style-type: none">➤ (Example: 6 to 9 years is unacceptable, 7+/- years is acceptable).

Cost to Cure	<ul style="list-style-type: none"> ➤ The cost to cure estimate should include actual contractors' costs of material, professional labor, and profit and overhead. <ul style="list-style-type: none"> ▪ Do not consider materials on site that are not installed or attached. ▪ Do not consider any potential labor by the homeowners. ➤ Cost to cure adjustment in the Sales Comparison Approach should reflect the impact on value and that may differ from the actual cost or cost estimate.
Work Needed	<ul style="list-style-type: none"> ➤ Describe <u>extensive</u> deferred maintenance like needed repairs, incomplete items or additions, and work in progress in detail. ➤ Describe <u>minor</u> deferred maintenance like carpet cleaning or replacement, cosmetic paint, replacing cracked or broken glass in windows, and other features or finishing that show normal wear and tear.
Non-permitted Additions	<ul style="list-style-type: none"> ➤ If an addition was constructed without proper permits, do not complete the appraisal. Call IREP for instructions
Data Sources	<ul style="list-style-type: none"> ➤ Multiple listing service (MLS) data is preferred and is required where available. ➤ Consider all data sources that appraisers typically use in subject's market area
Marketing Time	<ul style="list-style-type: none"> ➤ Where MLS data is available, include days on market (DOM) for each comparable sales and listing included on the market grid. ➤ Explain discrepancies between neighborhood marketing time and days on market of the comps. ➤ In any areas where values are declining, two current listings must be provided. <p style="color: red;"><u>Conforming – Declining Markets Only</u> All comps must include days on market</p>
Time of Sale	<ul style="list-style-type: none"> ➤ Date of sale should be appropriate to the assignment, so that the value opinion developed is reliable and the report is not misleading. ➤ The appropriateness of comp selection cannot be dictated, but the following guidelines are suggested and an explanation required when a comp falls outside these preferred guidelines. <ul style="list-style-type: none"> ➤ Large cities and metropolitan areas – within 6 months ➤ Suburban areas and large built-up subdivisions – within 6 months ➤ Small town location – within 9 months ➤ Unincorporated areas, and properties outlying from or on the outskirts of town – within 9 months ➤ Rural country and remote areas – within 12 months
Gross Living Area	<ul style="list-style-type: none"> ➤ Above and below grade living areas should be valued separately (See Comparable Sales section below for variation). ➤ Finished areas that have ceiling heights lower than typical (seven feet or less), and that limit the use of the space, should not be included in gross living area. ➤ Atypical living areas (i.e. finished attics, areas over garages) may only be included in GLA with explanation, and when the comparable sales have similar living areas or utility. Non-contiguous structures should not be included in GLA. ➤ Calculations of gross living area must be included on the sketch or in the addendum as documentation of the square footage reported.
Gross Building Area	<ul style="list-style-type: none"> ➤ GBA is the square footage of a multiple family residence. In some markets, it is common practice to include basement apartments as living area. ➤ A basement apartment may be included in gross building area, if (1) it is legal or legal non-conforming and can be rebuilt, (2) comparable sales and rentals have similar above and below grade living areas.
Site Size	<ul style="list-style-type: none"> ➤ Include lot size of subject and comparable sales on the sales grid. ➤ Include at least two comps with similar site size (i.e. in-town site compared to in-town site; acreage compared to acreage). ➤ Do not use words like typical, equal, inferior, or similar in place of site size.

<p>Comp Distances</p>	<ul style="list-style-type: none"> ➤ Reasonableness of comp distances is relative to the assignment, individual location, and current economic and local real estate market conditions. Certainly, the closest “comparable sales” are preferred rather than the inclusion of nearby “sales” that are not similar. ➤ The appropriateness of comp selection cannot be dictated, but the following guidelines are suggested and an explanation required when a comp falls outside these preferred guidelines. <ul style="list-style-type: none"> ➤ Large cities and metropolitan areas -- comps should be within blocks up to 0.5 mile away. ➤ Suburban areas and large built-up subdivisions – comps should be within blocks up to 1 mile away. ➤ Small town location – comps should be within 1 mile away. ➤ Unincorporated areas, and properties outlying from or on the outskirts of town -- comps should be with 1 to 5 miles away. ➤ Rural country and remote areas – comps should be within 5 to 15 miles. <p><u>Conforming – Declining Markets Only</u> Must conform and be within following distances: Urban and suburban – up to 12 blocks or 1 mile Rural – up to 10 miles</p>
<p>Comparable Sales</p>	<ul style="list-style-type: none"> ➤ Report the complete address of the comparable sales; include zips codes when possible. ➤ Deduct any concessions or seller points dollar for dollar and use the net sale price ➤ Both the actual and effective ages of the comparable sales analyzed should be similar to subject’s actual and effective age. <ul style="list-style-type: none"> ➤ It is essential when appraising older houses with updates and remodeling completed that actual and effective ages are similar. ➤ It is preferred that below grade living area is not included in gross living area (GLA). However, above and below grade living areas may be combined to determine GLA when the comps have similar above and below grade finish. ➤ Do not use the subject as one of the three primary comparable sales even if it sold within the last year. It can be included as Comp 4 to provide additional data or as a check against a current value opinion that is significantly higher or lower than the sale price. ➤ Property values is > \$600,000, include a minimum of 4 sales or 3 sales and 2 listings (pending contracts allowed). <p><u>Conforming – Declining Markets</u> Used three sales that closed within last six months</p>
<p>New Construction</p>	<ul style="list-style-type: none"> ➤ For newer houses and when competition from new construction exists, include subdivision re-sales, re-sales from outside the subdivision/project/complex, or any combination of above whenever possible. ➤ Sales of new construction should not be used as comparable sales when adequate and reliable re-sale data is available in the development. ➤ Current listings of existing houses or new construction sales/listings may be used as comps four to six when resale data is limited. ➤ Houses that have not been lived in may have similar appeal to new construction even though they were built six months ago or earlier. Ensure the appraisal is not misleading when these comps are used, because the sales may still be affected by new housing premiums common in many markets. ➤ In developments controlled by a single builder, <ul style="list-style-type: none"> ○ Report both the contract and sale dates when a comparable sale is new construction. ○ Investigate whether or not the price included builder concessions, free upgrades, etc. and adjust accordingly. ○ Comments on the number of houses proposed, contracted, and sold, and ○ Analyze the impact of new construction competition on existing homes.

Competitive Listings	<ul style="list-style-type: none"> ➤ Consider current and expired listings of competing properties for sale, especially in a declining market. ➤ Include competitive listings in the report when comparable sales are limited, distant, or dated. ➤ If subject's model is currently available through the builder, provide the current base price and price of major upgrades observed in the property being appraised. ➤ Consider that asking prices of similar properties tend to establish the upper limits of value for the subject property, particularly in developing subdivision and newer complexes and for model matches.
Report Prior Sales & Listings	<ul style="list-style-type: none"> ➤ Report prior transfers of ownership of the customer's property within the last three years and any current or expired listings ➤ Report any prior transfers of ownership of the comps within the last 12 months. ➤ If known, report the last sale of subject regardless of sale date. ➤ Complete necessary due diligence to determine if prior sales of the subject or of the comps are the result of flipping schemes or fraudulent transactions. ➤ If subject sold within the last 12 months, obtain a copy of the sales contract from the homeowner and include it as an addendum. ➤ If a new unit or house was placed or built on a site previously owned by the borrower, report the last sale of the site and obtain the unit price or the actual construction costs, and including the cost of site improvements like garage, deck, well, etc.
Analyzing Prior Sales & Listings	<ul style="list-style-type: none"> ➤ Analyze prior sales of subject within the last three years and any current or expired listings ➤ Analyze any prior sales of the comps within the last 12 months. ➤ The analysis of a prior sale or listing must include, but is not limited to type of deed, contract terms, concessions, special conditions, price reductions, days on market, expired listings, and any market factors or physical characteristics that influence price. ➤ If subject was purchased relatively recently and the current appraised value exceeds typical area appreciation, comment on any major changes to the property or any other factors that justify the value increase. <p>NOTE: All appraisals of properties that sold within the last 12 months where the appraised value is 10% higher than the sale price or construction costs (new housing) are reviewed by HSBC Finance Appraisal Review.</p> <p><u>Conforming – Declining Values</u> Include one and preferably two pending contracts validating stable market</p> <p>See Best Practices in the Addendum.</p>
Cost Approach	<ul style="list-style-type: none"> ➤ Cost Approach must be included when applicable per USPAP. ➤ Land value must be provided even if the Cost Approach is not applicable to the assignment. ➤ Replacement cost new for the improvements must be provided even if the Cost Approach is not applicable to the assignment.
Value Conditions	<ul style="list-style-type: none"> ➤ Final value must be based on subject's present or "as is" condition as of the date of inspection. ➤ Final value "subject to" a certain condition may be acceptable with prior permission of the client. IREP will contact HSBC Appraisal Review for a variance. <p><u>Conforming – Value "subject to repairs"</u> Any appraisal made subject to repairs or finishing will require a final inspection.</p>
Final Value	<ul style="list-style-type: none"> ➤ When adequate and reliable sales data is available the Sales Comparison Approach should be used to determine Final Value. ➤ If a different approach to value is more reliable than the Sales Comparison Approach, do not complete the assignment. Call IREP for instructions.
Certification	<ul style="list-style-type: none"> ➤ Modification to the Certification and the inclusion of a different Certification that differs from that approved by Fannie Mae is not permitted. ➤ Individual certifications cannot be deleted, but additions, like reporting the appraiser's continuing education and professional memberships, are acceptable.

Section 9: DETAIL REQUIRED

Analyze and explain positive or negative factors affecting subject's marketability or value. Areas of the appraisal that may require detailed explanation or description follow:

Subject	<ul style="list-style-type: none"> ▪ Special assessments – address if current or proposed, frequency of payment, duration, purpose, and whether payment in full is required if the property were to be sold ▪ Type of ownership ▪ Vacancy--at least one unit must be occupied
Neighborhood	<ul style="list-style-type: none"> ▪ Rapidly increasing or declining values ▪ Marketing time over six months ▪ Oversupply of housing ▪ Predominant value significantly higher or lower than subject's appraised value, or when appraised value falls outside the neighborhood price range (excluding price extremes).
Zoning	<ul style="list-style-type: none"> ▪ Illegal use <ul style="list-style-type: none"> ▪ Zoning requirements and why use is illegal ▪ Cost to cure to convert the improvements to a legal use ▪ Nonconforming use <ul style="list-style-type: none"> ▪ Determine whether or not the property can be rebuilt ▪ Determine if a variance is needed and if variances are commonly given ▪ Report restrictions placed on rebuilding, if any. <p>See Best Practice in the Addendum on Highest and Best Use.</p>
Site	<ul style="list-style-type: none"> ▪ Shared drives, shared wells, private road access, etc. ▪ Legally enforceable access and maintenance agreements, recorded easement, right-of-ways, etc ▪ Include the approximate number of houses that use shared items, private roads, participate in maintenance agreements, etc. ▪ Multiple tax parcels appraised (i.e. to meet zoning requirements, due to placement of the residence on the site, etc.)
Description of Improvements	<ul style="list-style-type: none"> ▪ Absence of required building or occupancy permits ▪ Property is an over-improvement or has a super-adequacy ▪ Any recent improvements, modernization, and upgrades observed ▪ Negative environmental factors affecting subject or the neighborhood ▪ Needed repairs, replacement, finishing, etc. ▪ Needed inspections
Cost Approach	<ul style="list-style-type: none"> ▪ Land value that exceeds improvements value. ▪ Any form of depreciation that exceeds 50%
Sale Comparison Approach	<ul style="list-style-type: none"> ▪ Identify the criteria and parameters used in comparable data searches if not stated in the Scope of Work ▪ Comps that do not meet distance and time preferences ▪ Actual and effective ages of a comparable sale(s) are not similar to subject's actual and effective ages. ▪ Adjustments for location, view, quality, condition, and functional utility that that are > 10% of sale price ▪ Net adjustments >15% ▪ Gross adjustments >25% ▪ Wide actual and/or adjusted sale price ranges ▪ Placement of final value within the adjusted sale price range ▪ Prior sales or listings of subject per USPAP or state specific requirements ▪ Prior sales of the comps per USPAP or state specific requirements. <p>NOTE: Do not use the comment section to restate or explain obvious adjustments.</p>

Section 10: ACCESSORY UNITS

This section refers to appraisals completed on Form 1004 of additional living units common to single family residences including in-law apartments, guesthouses, cottages, carriage houses, basement apartments, etc.

An accessory unit is a second living unit on the same site as the main residence that does not have a separate highest and best use apart from the main house. It is typically an apartment used as a mother-in-law or granny unit. Accessory units are typically inferior to the main residence in terms of design, size, utility, and amenities, but can be very similar in appeal, quality, and condition. If the main house and the accessory unit are similar in size, the second unit is not truly accessory and other factors of legality and use must be considered.

If an accessory unit is illegal, HSBC does not require the illegal use to be converted to a legal use, but does require that the property is appraised according to its highest and best use—single family residence—using three similar comparable sales. If the Income Approach is applicable to the appraisal, any rental income from the illegal apartment should not be used in developing the Gross Rent Multiplier.

If an accessory unit is legal, the appraisal should include three sales of single family residences with accessory units.

If sales are unavailable, the property may be unique to its market area. Call IREP for instructions on whether to or not complete the appraisal.

- Appraiser should perform a complete interior and exterior inspection and describe the improvements in detail including whether or not the unit is attached or detached.
- If attached, comment on whether or not there is direct access into the main residence.
- Include front and rear photos of the unit(s)

See Best Practices in the Addendum.

Section 11: MANUFACTURED HOUSING

The number and types of manufactured housing (MFH) units available vary substantially in quality of construction and appeal. Terminology also varies from region to region.

Only manufactured homes—doublewide and triplewide—completed in accordance with Department of HUD and constructed in conformance with Federal Manufactured Home Construction and Safety Standards should be completed on Form 1004C. All other types of factory built housing, including modular, should be completed on the URAR Form 1004.

This type of manufactured housing is identified with HUD certification labels that establish the construction standards in effect on the date of manufacture.

When sales data is limited,

- Expand date of sale parameters up to 18 months when appropriate.
- Expand distance parameters appropriately for this market area and type of assignment so that the result is not misleading and the value is reliable.

Do not complete the appraisal and call IREP when

- 1) Three similar sales of manufactured homes (doublewides or triplewides) cannot be located within reasonable search parameters, and data available is inadequate to develop a reliable value.
- 2) The manufactured home is not on a permanent foundation.
- 3) The home is on leased land, rented, or a second home.
- 4) The home is a single wide or single wide with an addition.

Section 12: CONDOMINIUMS, TOWNHOUSES, AND PUD'S

When there are very limited or no current sales from within subject's complex include:

- Must provide data that supports the marketability of the condominium unit, especially in complexes with 10 or fewer units.
- Last model match sale from the complex within the last three years
- Last sale of any model from the complex within the last two years
- Current listing from the complex (model match, if available)
- Explain why there is lack of current market data from the complex
- Use sales in the same building or project when adequate and reliable data is available.
- Comment on any pending or issued special assessments. Consider the effect on overall marketability of the complex and on the market value of the subject unit depending on whether or not the assessment is paid in full or not.

Ineligible condominium properties

- Condominium hotel
- Houseboat project
- Timeshare ownership project
- Leasehold estate
- Multi-dwelling condominiums
- Common interest apartments or community apartment projects
- Manufactured housing condo unit
- Non-conforming use that prohibits rebuilding

Ineligible PUD properties

- Individual owners do not own the land on which their dwelling sits.
- Non-conforming use that prohibits rebuilding

Conforming – Ineligible property

- Condominiums – Dwelling/project is ineligible if sufficient homeowners' association data is not available to complete requirements of the special condo form required

Section 13 - APPRAISAL QUALITY

Appraisal Quality Check (AQC)

To provide opportunities for feedback from the customers (borrower or sales), IREP has a procedure that allows customers to address perceived or potential concerns with an appraisal report.

If factual data pertaining to the subject property or its market area appears to have been overlooked or reported incorrectly, the customer may provide support to document the difference. IREP Quality Control (QC) reviews the information and either responds directly back to the customer or contacts the appraiser for feedback.

Appraisers must review the information provided along with the AQC form and the original appraisal. Appraiser should comment on any changes to the original report or to the value opinion, and explain why the appraisal was revised. Regardless whether or not there is a revision, appraisers' responses must be returned to IREP QC within date/time parameters set by IREP.

AQC can be used when there are concerns with:

- Specific property details, characteristics, or features such as gross living area, lot size and view amenity (i.e. golf course, water front).
- Improvements and upgrades completed in the last 12 months.
- Identification of appropriate comparables from the neighborhood or market area for like properties.

Report Revisions

1. A value should not be revised, unless the appraiser finds errors, omissions, additional comparable data, or some other justification for a change in value.
2. Changing adjustments or condition ratings without justification or support is unacceptable.
3. Support for a change in value is especially critical if the adjusted value range is increased or if the revised value is at the extreme upper end of a wide adjusted range.
4. If a revision is not supported, a written explanation should be provided so that the decision may be communicated accurately to the customer.
5. Any changes to the original appraisal must be reported in a manner consistent with USPAP guidelines for revising appraisal reports. The appraiser must determine if a revised report, an addendum to the original appraisal, or some other type of documentation best conforms to Standards.

Quality Control and HSBC Appraisal Review (HAR)

- IREP may ask an appraiser to consider sales and other data provided by HSBC Appraisal Review (HAR)
- HAR uses national data sources for sales and other data, but this information has limitation. When this data is provided to appraisers, HAR is looking for the appraiser's input on what may or may not be a comparable sale.
- As part of this review process, HAR may request additional comparable sales or listings, multiple listing sheets when available, an expanded scope, or more description for clarification.

Responding to IREP QC and HAR

- Appraisal must respond to requests for additional information, clarification or comparable data with 24 hours or one business day. These requests are usually tied to a pending loan and must be resolve quickly.
- If an appraiser or vendor cannot respond within this time frame due to volume, additional IREP orders will be put on hold until pending appraisal issues are resolved.

Section 14: CORRECTIVE ACTION

Set criteria are consistently used to evaluate the quality, value confidence and reliability of an appraisal, and whether or not to continue or discontinue the services an appraisal provider.

Corrective Action Guidelines:

- ✓ The criteria listed below are not all inclusive and the guidelines are not progressive.
- ✓ An appraiser may move from Active to Ineligible or any stage in between based on only one appraisal depending on the severity of the issues found in the appraisal(s) under review.
- ✓ Appraisers on the ineligible list may be given an opportunity to be reinstated at the discretion of the business unit that placed them on the inactive list.
- ✓ To be removed from an inactive status, prior quality issues must be resolved by either a detailed explanation of concerns originally cited along with current work samples that pass a internal audit completed by HSBC Appraisal Review

Corrective Action Criteria

Watch Status

- Weak scope of work (missed or minimal steps taken to develop and report appraisal)
- Errors in reporting subject, neighborhood and site descriptions
- Failure to properly describe or to provide sufficient detail on subject improvements (condition, needed repairs, unfinished area, modernization, upgrades, etc.)
- Use of comparable sales that are not reasonable alternatives to the subject property or lack of explanation of comp selection
- Weak analyses of data (i.e. low, high or missed adjustments, wide adjusted sale price range, little bracketing of physical characteristics, etc.)
- Failure to analyze prior sales of subject and/or comps
- Weak support for value conclusion (i.e. placement of value in adjusted value range, marketability of comps versus subject, etc.) and final reconciliation
- Low confidence in the overall development and reporting of the appraisal.

Level 1- Ineligible Criteria – *suspended for two years; appraiser must request reinstatement through IREP*

- All criteria for Watch Status
- In developing and reporting the appraisal, a pattern of quality issues are noted in the following areas:
 - Minor violations of Uniform Standards of Professional Appraisal Practice (USPAP)
 - Inadequate inspection of the property
 - Failure to describe and adjust for physical inadequacies affecting value and marketability
 - Failure to report and analyze prior sale of the subject property and comparable sales
 - Failure to use nearby sales and to properly analyze market data
- Misrepresenting or inaccurately reporting comparable data
- Multiple errors on a single report that result in an unreliable appraisal
- Poor customer service including unprofessional behavior during the inspection, unprofessional communication with any involved parties, failure to provide clarification or additional data requested by an HSBC Review Appraiser.

Level 2 – Ineligible Criteria – *permanent suspension*

- All suspend criteria for Ineligible Level 1
- Major violations of USPAP
- Incompetence
 - Inadequate scope of work related to the assignment
 - Poor understanding of common appraisal practices, methodologies or techniques
- Unethical behavior
- Fraudulent behavior or high probability of fraud evident
- Providing a misleading report(s)
- Pattern of using dissimilar or inappropriate comp selections, and of ignoring nearby data
- Pattern of low confidence in value opinions provided
- Pattern of wide adjusted sale price ranges and no support for placement of value within the range
- Pattern of poor customer service – multiple incidents

Corrective Action Process

Process Initiated	An appraisal report fails to pass HSBC internal quality audit or review.
Status Change	Review and audit finding determine the appropriate level of corrective action.
Appraiser Notification	IREP may report status changes, but only to the individual appraiser involved.
Appraiser Requests for Reinstatement	Through IREP, an appraiser with an Ineligible-Level 1 status may request reinstatement after two years
Appraiser's Responsibility	Concerns that caused the original status change must be addressed in detail and work samples provided.
Internal Audit	Review Appraiser consider the merits of an appraiser's response and the credibility of the sample appraisals provided, summarizes the results, and reports any status changes.
Reinstating an Appraisers	Audit results and status changes are communicated to the appraiser through IREP or by HSBC Collateral Quality Manager.

ADDENDUM

TO

HSBC APPRAISAL GUIDELINES

AND

REPORTING REQUIREMENTS

AFFORDABLE HOUSING ADDENDUM

When accepting an appraisal order of an affordable or subsidized housing unit, the Client, HSBC Finance/IREP requests that the appraiser follow the special instructions below.

The appraiser must verify and report the unit's most probable sale price under the terms and restrictions of the affordable (subsidized) housing program that controls the project. *In most cases, the most probable sale price is not the same price that the subject might receive in an open market with no restrictions attached to the individual unit or complex.*

To assist the Client with its lending decision, this addendum must be completed and attached to each appraisal of affordable (subsidized) housing. If unable to obtain this information, do not complete the appraisal. Contact IREP immediately for instructions.

A) Provide the name and phone number of the agency that controls subject's affordable housing development.

B) Provide the maximum sale price for subject property under the affordable housing program restrictions attached to subject's individual unit.

C) Advise whether or not there is sufficient demand for the subject property to sell at the maximum sale price. Consider if demand may be determined by whether or not there is a waiting list of buyers that meet the criteria that would allow them to purchase the subject unit.

D) Is the agency's prior approval required before additional liens or loans are placed on the unit?

E) Does the Lender have the right to pursue restitution through foreclosure?

F) How long is the property restricted by the affordable housing program?

G) How many units are 1) in the development and 2) subsidized?

H) Does the governing agency retain any of the equity accumulated to date? If so, what percentage?

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BEST PRACTICES

Best practices are included for those appraisers that are interested in feedback from HSBC Appraisal Review (HAR) on issues that have evolved during internal reviews and audits. The purpose of this section is to identify issues that impact HSBC lending decisions and to identify areas where additional clarification is often requested in the course of reviewing appraisals for pending loans or auditing appraisal of closed loan as part of our quality control process. It is neither intended to impose conformity nor to presume to provide all the answers. It is intended to inform the appraisers that diligently provide quality work of ways they can assist in providing an appraisal product that best meets HSBC's needs.

DECLINING MARKETS AND VALUE TRENDS – Best Practices

1. Consider the most recent comparable sales whenever possible.
 - ♦ Dated sales may result in a value that is too high in a declining market without adjustments for changes in market conditions.
2. Check the number of comparable houses for sale in the immediate area and whether there have been any recent contracts, price reductions, expired listings, or concession offered.
 - ♦ House has a \$350,000 list price that's been reduced several times—now at \$320,000--and the property still isn't selling?
3. Check for an increase in days on the market and in the general housing supply compared with these same statistics three, six or 12 months ago.
 - ♦ Are there 100 housing for sale in the \$100,000 to \$125,000 prices range today, when there were 30 for sale a year ago?
4. Check for a decrease in new housing starts in your market area, and major concessions being offered by builders.
 - ♦ Are builders offering \$40,000 in upgrades free?
5. Consider any significant changes (decreases) in the list to sale price ratio.
 - ♦ Housing markets where properties typically sold within 3% of their listing price are now selling 10% below the listing price.

Conforming – Declining Markets Only

Requirements that were stated earlier are restated below:

Comp distances allowed

- Urban and suburban – up to 12 blocks or one mile
- Rural – up to 10 miles

Days on market must be provided for all comps

Comparable and market data

- Three comparable sales that closed within the last six months
- One (preferably two) listings with pending contracts validating stable market conditions
- Neighborhood market data
 1. Number of listings
 2. Average market time
 3. Sale to list price ratio
 4. Appearance of seller concessions

REPORTING AND ANALYZING PRIOR SALES – Best Practices

To best serve our customers, it is essential that Underwriters understand value increases over the sale price of the subject property, if the property sold within the last 12 months. All appraisals of properties that sold in the last 12 months are sent to HAR for review.

Therefore it is important that appraisers explain the increase in a way that is reasonable to Underwriting and support the increase in a way that is reasonable to HSBC Appraisal Review. The following best practices are a result of issues found while reviewing appraisals for pending loans or auditing reports in book loan files.

Explain Significant Increases

Best practices when the appraised value is much higher than subject's last sale price.

1. Avoid general, vague, or generic comments like following:
 - a. Values are increasing
 - b. Subject previously sold below market
 - c. This was a non-arms length transaction.
2. Clearly identify improvements, remodeling, major repairs and replacements, or updating completed subsequent to the last sale date.
3. Provide detailed explanation and clearly described improvements, remodeling, repairs, etc. and associated costs when possible.
4. References to a "remodeled" kitchen have been known to mean anything from interior painting to gutting the interior.
 - a. An acceptable response would 'Since last purchase, the kitchen was gutted to the studs and new drywall, cabinets, sink, countertops, flooring, trim, lighting, and built-in appliances were added—estimated cost labor and materials is \$35,000.

Support an Increase

Best practices when the appraised value is much higher than subject's last sale price.

- 1) Caution advised when including higher priced sales that closed around the same time that the subject sold and that appear to be physically comparable when placed on the market grid. However, because of the variances in sales prices, it is evident and highly probable that the comps have superior appeal/features/amenities that have not been addressed through the adjustment process.
 - a) This has been a concern when appraisers compare subject to recent sales, and when appraisers fail to analyze the variances between prior sales of both the subject and comps.
- 2) Avoid resales originally purchased from a builder several years earlier at a significantly higher price than the subject did around the same time.
- 3) Explain any circumstances related to the sale that indicates it is a non-arms-length transaction.
 - a) Prior contract to purchase—include contract date and detail
 - b) Family transaction
 - c) Rent to own—include contract date and detail
 - d) REO sales
 - e) Quit claim deed, etc.
- 4) Provide supporting comments that explain use of proper appraisal practices and techniques.

Consider the following issues when completing the appraisal.

- Prior sale price
- Prior closing date
- Contract date--particularly if contract and closing date vary significantly (i.e. new construction)
- Concessions (seller or builder, including builder incentives)
- Listing information including: exposure time or days on the market (listing date to contract date), original listing price, price reductions, expired listings, etc.
- Explain a value increase or decreases over the purchase price, if subject sold within the last 12 months
 - Support market appreciation and declines
 - Verify subject's condition at time of purchase, and report an negative changes
 - Report any repairs and replacements since purchase along with any related costs
 - Unusual conditions--non-arms length transaction, foreclosure sale, transfer between relatives, etc.

Sales of new houses:

- If custom construction (by self or contractor): verify and report the land sale, construction costs (labor, materials, profit and overhead), etc
- If manufactured unit (double or triple wide): verify and report the land sale, unit costs, installation costs, etc.

HIGHEST AND BEST USE – Best Practices

While a detailed highest and best use analysis is often unwarranted for residential appraising, the appraiser must consider sufficient data to establish that the highest and best use is residential. This is essential to the scope of work, but some appraisers complete an entire appraisal before realizing that the highest and best use of the property is non-residential.

HSBC requires that an appraisal is completed according to its current highest and best use. If it is determined that highest and best use is not a residential or residential mixed use, the appraisal should not be completed and the appraiser must call IREP for direction.

If a property is zoned commercial, but the use and market trends evident in the area are residential, the highest and best use may be residential. If a property is zoned residential, but the use and market trends evident in the area are commercial, the highest and best use may be commercial. Whenever a commercial appraisal is needed, the property would not meet HSBC's collateral guidelines.

ACCESSORY UNITS – Best Practices

When an additional living unit adds value to a property, consider the added value of the improvement to the typical buyer and not a particular buyer--how much would a typical buyer be willing to pay for this feature. If the use is illegal, consider associated costs of returning the residence to a legal use...the contributory value could conceivably be negative.

Include following:

- A discussion of highest and best use, conformance to zoning, and the legality of unit are essential.
- Report whether or not the unit can be rented. Rent from a unit with illegal use cannot be considered in the development of a gross rent multiplier.
- Describe quality and condition of the unit in detail
- Analyze any functional or marketability issue related to uniqueness, placement on site, etc.
- Provide support for the contributory value of the unit(s).

COMPARABLE SALE ADJUSTMENTS – Best Practices

Adjustments to comparable sales are market driven. However, in practice, some appraiser's have not changed dollar adjustments in years. Some appraisers apply identical adjustments for certain amenities and features regardless if the house is worth \$150,000 or \$500,000. Some appraisers do not consider that an adjustment as a percent of value may be a reasonable adjustment.

Consider these scenarios:

Is a \$3,000 location adjustment really meaningful for a property worth \$500,000? The adjustment is less than 1% of value! Is the typical buyer in this price range influenced significantly, by the presence or absence of a \$3,000 amenity?

Consider the reasonableness of a dollar adjustment when analyzed as a percent of total value, especially in high priced residential property.

Is the buyer of a \$400,000 house willing to pay more for a fireplace, than a buyer of a \$150,000? Wouldn't buyer's expectations in the \$400,000 price range be different than that of a buyer in a \$150,000 price range?

- Recognize that the contributory value of an amenity typically varies based on total property value, the buyers' reactions to the presence or absence of the featur

Is an across the board minus adjustment of \$100,000 for an ocean view reasonable when none of the comps have ocean views? Why not \$50,000 or \$75,000 or \$200,000? Further...why is it necessary to use sales with ocean views at all? Are there not more houses without ocean views than those with them?

- Avoid across the board adjustment for location, site, view, quality, and condition.

