January 20, 2009

Office of the Comptroller of the Currency
Federal Reserve System
Federal Deposit Insurance Corporation
Office of Thrift Supervision
National Credit Union Administration

Re: Proposed 2008 Interagency Appraisal and Evaluation Guidelines
(Docket ID OCC-2008-0021; Docket No. OP-1338; Docket ID OTS-2008-0012; NCUA RIN 3133-AD38)

Dear Sir or Madam:

The undersigned professional appraisal organizations, representing many thousands of professional real estate appraisers in the U.S., appreciate the opportunity to comment on the 2008 Proposed Interagency Appraisal and Evaluation Guidelines ("Guidelines").

Executive Summary

Our organizations have strong objections to what appears to be the dominant feature of the Guidelines – the exemption of more than a dozen categories of real estate related financial transactions from the professional appraisal requirements of Title XI of FIRREA. Although the November 19, 2008, *Federal Register* request for comment on the Guidelines states that they "are intended to clarify the Agencies' real estate appraisal regulations and promote a safe and sound real estate collateral valuation program," we have reluctantly concluded that they do neither.

We believe the approach to valuation issues reflected in the Guidelines is fundamentally flawed; and is inconsistent with the safety and soundness of bank regulatory reforms promised by the incoming Administration. As a consequence, we are unable to support them and respectfully urge that they be withdrawn and reconsidered so that our recommendations and the recommendations of other stakeholders can be carefully studied and significant revisions made to the current draft.[1]

The Guidelines Fail To Promote Safety and Soundness: Instead of promoting safety and soundness by increasing reliance on professional appraisals of real property collateralizing mortgages and mortgage-backed securities, the Guidelines have the unmistakable effect of sanctioning wholesale avoidance of such reliance. They do so in two ways: First, by directly and indirectly exempting multiple categories of transactions from the requirements for professional appraisals; and, Second, by explicitly sanctioning the use of automated valuation models (AVMs), broker price opinions (BPOs) and tax assessment valuations (TAVs) as acceptable "evaluation" substitutes for the fair market value opinions of professional appraisers. They are not.

For the reasons discussed later in this comment letter, these alternative valuation tools, by themselves, are too often unreliable indicators of the fair market value of property collateralizing loans made by federally insured financial institutions. We fail to understand why the bank regulatory Agencies, which are responsible for assuring the safety and soundness of our financial system and the integrity of the mortgage credit markets, have devoted so much time and attention to allowing regulated institutions to avoid the use of certified, licensed, tested and accountable valuation professionals for so many categories of mortgage-related transactions.

As a consequence of the many exceptions to and exemptions from reliance on appraisals, our organizations have concluded that the proposed 2008 Guidelines represent a step backwards; and that they erode, rather than

[1] We do want to express our awareness and appreciation of the fact that the appraisal requirements of the National Credit Union Administration (NCUA) provide more effective safety and soundness protections relative to the valuation of collateral property than those of the other bank regulatory agencies. Examples of the superiority of the NCUA's overall valuation requirements can be found in various footnotes to the Guidelines.

strengthen, the public policy purpose of Title XI of FIRREA – which is to protect the safety and soundness of the deposit insurance funds and the mortgage markets by ensuring that real property collateral is reliably valued by individuals who are regulated by and accountable to, state appraiser licensing authorities and who have demonstrated a high degree of valuation competency by meeting or exceeding the education, training, experience and testing requirements established by the Qualifications Board of the nonprofit Appraisal Foundation.

The Guidelines Obscure Rather Than Clarify Supervisory Expectations: Rather than clarifying the collateral valuation responsibilities of regulated institutions, the Guidelines actually raise as many questions as they answer. In large measure, this is because the lengthy narrative and extensive details necessary to describe and explain the numerous exemptions from Title XI's professional appraisal requirements – and the occasional exceptions to the exemptions – create confusion and not clarity about the Agencies supervisory intentions. As a consequence, we do not believe that financial institutions, appraisers and other stakeholders will easily be able to determine when an appraisal is or is not actually required for a given transaction.

The Guidelines Ignore The Current Distress Of The Banking System And The Mortgage Markets; And The Importance of Reliable Valuations To The Government's Mortgage Relief Programs : Because we believe the proposed Guidelines minimize the relevancy of professional appraisers and professional appraisals to safe and sound mortgage loan underwriting, we would oppose them even during "normal" times. But, given the current stress on our mortgage credit markets, the large and increasing number of foreclosed or troubled mortgages, the rapid changes in the values of residential properties throughout the country and the many governmental programs designed to assist homeowners by modifying their mortgages, we find the Agencies' preoccupation with authorizing exemptions from professional appraisals, particularly troubling.

As a specific example, we believe the Guidelines are entirely out-of-sync with the government's many programs to assist distressed homeowners. Our organizations enthusiastically support these programs but also recognize that their success is dependent, in some important ways, on accurate appraisals of the fair market value of collateral property (e.g., for loan-to-value purposes; to gauge the extent of possible losses to taxpayers if modified mortgages

default; and to establish accurate current market value when a reduction in loan principal is part of the relief package). Yet, the Guidelines move in precisely the opposite direction. We address this point in some greater detail in the "Discussion" portion of our letter.

While We Generally Support Improvements Made By The Guidelines To The Performance Of Appraisals, We Urge The Banking Agencies To Recognize That The Improvements Could Cause Some Regulated Institutions To Rely Increasingly On Valuation Approaches Whose Requirements Are Far Less Rigorous – But Also Far Less Reliable: While our organizations do not believe the Guidelines foster safety and soundness, we do generally support those provisions which address who can perform "appraisals", the contents of appraisals and the independence of the appraiser. Regrettably, the improvements to the details of the Agencies' Title XI appraisal requirements are greatly outweighed by the fact that far too many transactions are exempted from those requirements in favor of evaluations.

Moreover, we hope the Agencies recognize that the enhanced requirements pertaining to appraisals, while desirable, can have the perverse effect of causing regulated institutions to opt for far less rigorous valuation approaches, such as evaluations and evaluation alternatives (i.e., AVMs, BPOs and TAVs). It is our view that this potentially adverse consequence serves as a secondary, but still important, reason for the Agencies to severely restrict the categories of transactions that are exempted from appraisal requirements.

The Wide Latitude Provided Regulated Institutions With Respect To How Collateral Property Should Be Valued, Not Only Jeopardizes Safety and Soundness, It Also Represents A Highly Inefficient And Ineffective Way For The Agencies To Perform Their Regulatory Functions: Because the Guidelines provide regulated institutions with so much discretion and so many options for determining how collateral property should be valued, regulatory efficiency will be an inevitable casualty. Although the Guidelines reflect a policy of providing regulated institutions with maximum flexibility on the tools available to them to perform collateral valuations, the Agencies also recognize that this almost limitless flexibility brings safety and soundness dangers. As a consequence, instead of adopting a policy which requires institutions to rely on professional appraisals as the preferred approach most likely to produce reliable fair market values, the Guidelines

adopt a permissive approach, but simultaneously promise robust examiner oversight of the institutions' valuation decisions; and task the institutions with establishing elaborate internal controls over their valuation policies. Apart from what we believe are the obvious safety and soundness advantages of relying on valuations by professionally credentialed and state supervised individuals, our organizations are convinced that reliance on state licensed and supervised individuals produces a far more effective and even cost-efficient federal regulatory scheme than one which permits financial institutions almost limitless discretion but which in turn produces a need for extensive banking agency supervision and expensive internal controls.

One good example – but only one – of the inherent inefficiency of the Agencies' permissive policies regarding collateral valuation, is provided in the section on "Tax Assessment Valuation" in Appendix B. In an effort to provide regulated institutions with maximum flexibility on how collateral property should be valued in the dozens of situations where evaluations are permitted, the Agencies allow them to rely not only on AVMs and BPOs, but also Tax Assessment Valuations (TAVs). But, the Agencies simultaneously recognize that TAVs are inherently unsuitable as tools for reliable valuations. So, instead of omitting tax assessments from their list of approved evaluation alternatives, the Guidelines state the following:

> "TAVs differ among jurisdictions. Therefore, an institution should determine and document how the jurisdiction calculates the TAV and how frequently property revaluations occur. An institution should perform an analysis to determine the relationship between the TAV and the market value within a tax jurisdiction. This analysis should be performed for each property type and price tier in a jurisdiction in which the institution considers the use of a TAV to meet or support evaluation requirements. As part of this process, an institution should test and document how closely TAVs correlate to market value. If a reliable correlation between the TAV and the market value can be established, the institution may use TAVs as a basis for an evaluation."

We do not believe such scenarios lead to regulation which is either effective or cost-efficient;

<u>The Guidelines Fail To Address The Responsibilities Of Appraisal Management Companies (AMCs) Relative To The Agencies' Appraisal</u>

Requirements: Requests by banks for appraisal services are increasingly being funneled through Appraisal Management Companies; yet, the Guidelines do not address whether or how the AMCs are responsible for assuring compliance with the Agencies' appraisal requirements. This gap must be closed. We discuss this issue in somewhat more detail in the "Discussion and Questions" section of our comment letter.

Discussion & Questions

(1)(a) The Guidelines lack clarity on the crucial issue of the extent to which the Agencies do in fact require appraisals for transactions over the residential and commercial appraisal thresholds. The section of the Guidelines, "Transactions That Require Appraisals" states that "…**most** real estate related financial transactions over the appraisal threshold are considered federally related transactions and, thus require appraisals." (emphasis added). A footnote to the section references the authority of the Agencies to waive the appraisal requirements up to three years after a declared natural disaster.

We assume that appraisals also are not required for residential or commercial real estate related financial transactions above the thresholds if they fall within the categories of transactions described in Appendix A ("Appraisal Exemptions"). Nevertheless, we question whether there are other situations involving residential or commercial transactions secured by real estate and above the threshold dollar amounts, to which the appraisal requirements do not apply. Are there others and, if so, what are they? Our organizations, regulated institutions and other stakeholders would appreciate clarity on which additional transactions, if any, are exempted from the appraisal requirements;

(b) The Guidelines lack clarity on whether either an appraisal or an evaluation is required for transactions which fall within the "Appraisal Exemption" categories listed in Appendix A. Appendix A lists thirteen categories of transactions which are exempt from the Agencies' appraisal requirements.[2] However, the Guidelines lack clarity on the extent to which

[2] "Appraisal Threshold"; "Abundance of Caution"; "Loans Not Secured By Real Estate"; "Liens for Purposes Other Than the Real Estate's Value"; "Real Estate-Secured Business Loans" [with a transaction value of $ 1 million or less]; "Leases"; "Renewals, Refinancing, and Other Subsequent Transactions"; "Loan Workouts or Modifications"; "Other Changes to Loan Terms"; "Transactions Involving Real Estate

transactions which fall within the categories listed in Appendix A are required to have either an appraisal or evaluation; or, whether, in fact, neither an appraisal nor an evaluation is required.

We assume, with respect to Exemption # 1, that evaluations are required if appraisals are not voluntarily performed by the lending institution; and, we recognize that in two of the additional exempted categories (e.g., "Loans Not Secured by Real Estate" and "Liens for Purposes Other Than the Real Estate's Value") a valuation of real estate might be unnecessary for regulatory purposes. But, as to the remaining exempted categories, we would have the most serious concerns if neither an appraisal nor evaluation were required. Accordingly, we respectfully request clarification on this issue.

Particularly troubling with regard to the above are the exempted categories involving mortgage-backed securities (Exemption 13) and loan modifications and workouts (included in Exemption 7). Our concerns relate to the following:

Mortgage-Backed Securities: We would characterize appraisal exemption number 13 ("Transactions Involving Underwriting or Dealing in Mortgage-backed Securities") – an "unlucky number" for U.S. taxpayers. Given the crisis in our nation's mortgage markets, the dire economic effects of "toxic" mortgage-backed securities and the importance of the value of the properties collateralizing mortgages (whether or not bundled and sold as securities), we urge the Agencies – particularly the Federal Reserve Board – to immediately revisit the public policy basis on which this exemption exists and eliminate it. We can think of no better protection for issuers of and investors in mortgage-backed securities than a requirement for professional appraisals of properties which collateralize the mortgages comprising the securities.

Mortgage Modifications and Workouts: There are several very important federal programs (and some private sector ones, as well) which are designed to modify the terms and conditions of existing mortgages for the purpose of

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Notes"; "Transactions Insured or Guaranteed by a U.S. Government Agency of U.S. Government-sponsored Agency"; "Transactions that Qualify for Sale to, or Meet the Appraisal Standards of, a U.S. Government Agency or U.S. Government-sponsored Agency"; "Transactions by Regulated Institutions as Fiduciaries"; "Appraisals Not Necessary To Protect Federal Financial and Public Policy Interests or the Safety and Soundness of Financial Institutions" [applies to individual transactions and requires a waiver from a supervisory agency]; "Transactions Involving Underwriting or Dealing in Mortgage-Backed Securities".

lowering the mortgage-related costs to distressed homeowners and keeping them in their homes. These programs involve a variety of modification mechanisms – a lower interest rate; a stretching out of the term of the mortgage; and, for the hundreds of thousands of properties where the homeowner is "upside down," a reduction in the principal amount of the loan to the current fair market value of the property. Homeowner eligibility for these programs is based on a number of factors, as are the specifics of the relief granted to eligible homeowners by the government or by private sector entities. Some mortgage relief packages are based, in part, on the current loan-to-value of the distressed property. Additionally, the federal government's mortgage relief programs require American taxpayers to guaranty repayment of the principal or interest, or both, on modified loans.

For modified mortgages which nevertheless default (one-third to one-half of them have already done so), the taxpayers' ultimate liability can only be projected if the government has knowledge of the fair market value of the collateral property at the time of modification.

Clearly, the role of accurate appraisals of properties collateralizing hundreds of thousands or even millions of modified loans cannot be overstated. Given the mortgage crisis we are experiencing and given the taxpayers' obligation to assume losses, it is astonishing that the bank regulatory agencies would continue to propose an exemption from their appraisal requirements of transactions involving mortgage loan modifications or workouts. Surely, it is self-evident that while some might have seen this category of exemption as not entirely unreasonable during normal economic times (we would not have been among them), no one can argue that it is anything but unreasonable and inappropriate now, given the realities of today's deteriorating mortgage marketplace;

(2) The Guidelines authorize evaluations, including reliance on AVMs, BPOs and TAVs, to value collateral not just for transactions at and below the threshold levels but for <u>twelve other</u> exempted categories of transactions, as well. The Agencies' broad authorization for the use of evaluations (and products which are alternatives to evaluations) is inconsistent with the Guidelines' policy pronouncement that "Independent and reliable collateral valuations are core to a regulated institution's real estate credit decisions." If the Agencies truly believe that independent and reliable valuations are core to real estate credit decisions, it is difficult to understand why the

Guidelines permit such widespread use of valuation techniques which are often unreliable and, at best, only marginally reliable.

Automated Valuation Models: While AVMs can be useful as valuation tools in the hands of professional appraisers, by themselves they are highly unreliable indicators of value both because AVMs rarely reflect the external or internal condition of property (important in determining value) and because even their limited utility is primarily applicable only to "cookie cutter" properties.

Broker Price Opinions: Broker price opinions lack reliability for the purpose of establishing fair market value because the individuals performing them lack valuation education, training and testing; because there are no generally accepted standards for how real estate agents and brokers should value property; and, because BPO work is infrequently subject to supervisory oversight by real estate licensing authorities. Moreover, BPOs often lack independence because many of the firms providing them are also engaged in the business of selling and repairing properties.

Tax Assessment Valuations: Our view that TAVs are entirely inappropriate as reliable valuation tools for bank regulatory purposes, has previously been discussed in the "Executive Summary" portion of this letter, in the section on regulatory efficiency and effectiveness.

(3) Definition of "Small and Rural Banking Institution": We agree that because small and rural banking institutions may lack the staff resources necessary to fully separate the valuation and loan production functions, the "prudent minimal safeguard" standard applied by the Guidelines to avoid improper influence within these institutions, is appropriate. In this regard, however, we believe it would be useful to define a "small and rural banking institution" in the Guidelines to protect against abuse;

(4) Appraisal Management Companies Should Explicitly Be Covered By the Guidelines: The Guidelines are essentially silent on how the proposed requirements governing appraisers and appraisals relate, if at all, to Appraisal Management Companies (AMCs). Requests for appraisal services by financial institutions are increasingly being processed through AMCs with a concomitant AMC influence over criteria for the selection of the appraiser, the manner in which the appraisal assignment is processed and the fees paid to the appraiser. AMC control over the appraiser and the appraisal

stands in sharp contrast to an earlier (and, in some cases, existing) system under which banks maintained lists of individual appraisers who they deemed to possess the credentials and independence necessary to perform appraisals for the bank.

We understand that banking agencies publish guidance to their regulated institutions on managing the risks that may arise from their business relationships with third parties used to perform underwriting and other services for them.[3] But, because AMCs are widely known to base their hiring decisions on who will work fastest and cheapest (rather than on who has the most valuation experience and best credentials), we recommend that the Guidelines be applied, specifically, to Appraisal Management Companies; and that they establish specific requirements governing the performance of AMCs to ensure that their hiring practices, fees and other administrative decisions are transparent to the bank and fully consistent with the Agencies' appraisal policies. For example, under the Guidelines ("Selection of Persons Who May Perform Appraisals and Evaluations") "institutions should establish criteria to select, evaluate, and monitor the performance of persons who perform an appraisal or evaluation"; as well as ensure that "the institution's selection process is non-preferential and unbiased" and that "appraisals contain sufficient information to support the credit decision."

If a regulated institution uses AMCs for the performance of appraisals, these and other important responsibilities will be under the direct and immediate control of the AMC and not the bank. We recommend, therefore, that the Guidelines be modified so that all requirements pertaining to appraisals (and to evaluations if the AMC is used for this purpose) are specifically applied to the AMC;

(5) The Guidelines state ("II. Principal Elements of the Guidelines," "Evaluation Content") that "under the Agencies' appraisal regulations, an institution **may** obtain or perform an evaluation of real property collateral in lieu of an appraisal for transactions that qualify for certain appraisal exemptions…. An institution should obtain more detailed evaluations for higher risk real estate related financial transactions or as its portfolio risk increases." (emphases added). We note that the Guidelines do not define the phrases "more detailed evaluations" and "higher risk"; nor do they establish

[3] For example, OCC Bulletin 2001-47, Subject "Third-Party Relationships", Risk Management Principles.

criteria for determining when "portfolio risk increases." Clarity of the Guidelines would be increased if these terms and phrases were defined or examples provided. With respect to use of the word "may" in the phrase "may obtain or perform an evaluation in lieu of an appraisal," we assume that describes the option available to institutions either to use an appraisal or an evaluation; and, does not authorize institutions to opt out of using either one. But, clarity on this question would be appreciated;

(6) Issues Involving "Appendix B – Evaluation Alternatives": Appendix B explains the Agencies' decision to authorize institutions to rely on alternatives to appraisals – such as automated valuation models – for valuing real property collateral, in the many situations in which the Agencies permit "evaluations."

Our central concern, of course, is that by permitting regulated institutions to rely on evaluations and evaluation alternatives for so many categories of real estate lending purposes, the Guidelines diminish safety and soundness. A secondary concern is that the Guidelines, in Appendix B, permit regulated institutions carte blanche latitude to decide whether, when and how to use evaluation alternatives. Specifically, the Guidelines allow the lenders to determine for themselves whether "an evaluation alternative is appropriate for a given transaction or lending activity"; whether "an evaluation alternative, such as an automated valuation model or tax assessment valuation, provides a reliable estimate of the collateral's market value…prior to the decision to enter into a transaction"; whether "an inspection of the collateral is necessary to determine that the property is in acceptable condition…"; and, which valuation tool or method is most appropriate for valuing collateral property in support of a type of lending activity.

While the Guidelines state that bank examiners will review decisions, by institutions, on their selection of alternative valuation tools and methods, we believe that the latitude provided regulated institutions on how to assure that collateral property is reliably valued, for safety and soundness purposes, is excessive and an abdication of regulatory responsibility.

We also note that the Appendix B Guidelines admonish institutions not to select a valuation tool or method based on the likelihood it will produce "the highest value." We agree; but would like to encourage the Agencies to add to the admonition a caution against selecting a valuation tool or method based on lowest cost or on how quickly the valuation can be prepared. We

believe that the selection of an appraisal method based on cost and/or speed jeopardizes safety and soundness.

Finally, we question the usefulness of the advice provided in Appendix B that in determining whether an alternative valuation tool is appropriate, risk factors, such as loan to value ratios, should be considered. We question how the LTV risk can be assessed by the institution without first performing an appraisal for the purpose of establishing a reliable and credible opinion of value as a basis for determining the LTV;

(7) The Guidelines frequently – and erroneously – use the term, "estimate" to describe the results of an appraisal.[4] This terminology may be appropriate to describe the results of "evaluations" and "evaluation alternatives," but it is not a correct characterization of the results of an appraisal. The Uniform Standards of Professional Appraisal Practice (USPAP), which is recognized by the Agencies in connection with their appraisal requirements, defines an appraisal as, "(Noun) The act or process of developing an opinion of value; an opinion of value. (Adjective) Of or pertaining to appraising and related functions such as appraisal practice or appraisal services."

We recommend that all references to "estimates" of value in the Guidelines' discussion of appraisals (or in the Agencies' appraisal regulations) be eliminated and the word "opinion(s)" of value be substituted;

(8) Review Of Appraisals And Evaluations: The Guidelines require institutions to utilize reviews of appraisals and evaluations to ensure that they "adequately support approval of the credit." The Guidelines also state that an institution's appraisal and evaluation review procedures should address the role, independence, and qualifications of the reviewer; the techniques, timing and level of review; documentation requirements; and the appropriate resolution of deficiencies. Review procedures also should address the reviewer's responsibility to verify that the methods, assumptions, data sources, and conclusions are reasonable and appropriate for the particular transaction and property. Persons who review appraisals and evaluations should be independent of the transaction and possess the

[4] For example, in the Guidelines' section, "Transactions That Require Appraisals," it is stated that "Each appraisal must contain an estimate of market value…"; and, "The estimate of market value should consider the real property's current physical condition, use, and zoning as of the appraisal date."

requisite education, expertise, and competence to perform the review commensurate with the complexity of the transaction."

While we support the goals and objectives of the review process stated in the Guidelines, we note their failure to spell out with any specificity whatsoever the nature and extent of the qualifications necessary for an individual to review appraisals and evaluations. We also note that the Guidelines' description of the reviewer's responsibilities lacks detail. Both of these deficiencies would be cured if the Guidelines required that the review process must conform to Standard 3 of USPAP ("Appraisal Review, Development and Reporting").

Accordingly, we urge the Agencies to adopt language governing the review of appraisals and evaluations, that is similar to the language the Guidelines have already adopted in connection with "Minimum Appraisal Standards." That is, something along the following lines: "Reviews of appraisals and evaluations must conform to Standard 3 of the Uniform Standards of Professional Appraisal Practice. That standard includes a requirement that individuals performing review appraisals must comply with USPAP's Competency Rule. Compliance with Standard 3 would ensure that individuals performing reviews for the regulated institutions possess the skills and competency necessary to do so. Adoption, by the Guidelines, of Standard 3 would eliminate any guesswork about who is qualified to perform reviews and how they should be conducted.

Thank you for considering our comments. Our organizations stand ready to meet with the Agencies to further explain our views and our recommendations for fundamental changes to the proposed Guidelines. If you have any questions or wish to discuss these comments, please call the government relations representative of the American Society of Appraisers in Washington, D.C., Peter Barash, at 202-466-2221 or e-mail him at peter@barashassociates.com.

Sincerely,

American Society of Appraisers
American Society of Farm Managers and Rural Appraisers
National Association of Independent Fee Appraisers