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January 21, 2009

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington, DC 20551
Docket No. OP-1338

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 1-5
Washington, DC 20219
Docket Number OCC-2008-0021

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Comments/Legal ESS

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: OTS-2008-0012

Ms. Mary F. Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428
RIN 3133-AD38

Re: Proposed Interagency Appraisal and Evaluation Guidelines
73 Fed. Reg. 69647 (November 19, 2008)

Dear Sir or Madam:

Freddie Mac appreciates the opportunity to comment on the Proposed Interagency Appraisal and Evaluation Guidelines ("Proposed Guidelines") issued by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation and the National Credit Union Administration (collectively, the "Agencies").

The Agencies have issued the Proposed Guidelines "to re-enforce the importance of sound collateral valuation practices."[1] Like the Agencies, Freddie Mac believes that independent and reliable collateral valuations are central to credit decisions and we support efforts to enhance the independence of appraisers to protect the integrity of the appraisal process. We have reviewed the Proposed Guidelines with these shared objectives in mind.

[1] 73 Fed. Reg. 69647, 69649 (November 19, 2008)

In general, Freddie Mac purchases mortgage loans that meet the standards included in our *Single-Family Seller/Servicer Guide* (the "Guide"). For a mortgage to be eligible for sale to Freddie Mac, we require acceptable collateral. Our Guide describes Freddie Mac's requirements for determining that the collateral is acceptable, including describing the situations in which the mortgage Seller must obtain an appraisal, as well as the circumstances in which the mortgage Seller may use alternative evaluation methods. In addition, our Guide provides standards governing such matters as appraiser selection, solicitation, compensation, conflicts of interest and corporate independence to further strengthen the appraisal process.

After reviewing the Proposed Guidelines, we recommend:

I. maintaining the current appraisal exemptions for real estate related financial transactions involving government sponsored enterprises ("GSEs"),
II. updating the appraisal exemption threshold to reflect current transaction values,
III. not requiring prior approval for the use of automated valuation models ("AVMs") in pre-funding reviews,
IV. clarifying the term "loan production staff" so that employees in a reporting relationship to loan production staff or management will not be considered independent,
V. requiring an institution which had obtained a more comprehensive or detailed appraisal or evaluation to use that evaluation rather than a less detailed evaluation alternative to underwrite a loan, and
VI. eliminating borrower characteristics as a reason to require a detailed collateral evaluation.

Our comments and recommendations are described more fully below.

I. Retaining Appraisal Exemptions for Real Estate Transactions Involving GSEs

The Agencies requested comments on the exemption from the regulatory appraisal requirements for residential real estate transactions involving the GSEs.[2] Under the Agencies' current real estate appraisal regulations, as restated in Appendix A of the Proposed Guidelines, an appraisal is required unless the real estate-related financial transaction falls into one of twelve exemptions. Among other exemptions, the Agencies' appraisal regulations,12 C.F.R. § 323.3, exempt the following real estate-related financial transactions:

- The transaction is wholly or partially insured or guaranteed by a U.S. government agency or U.S. government sponsored agency (Exemption 9)
- The transaction either
  - Qualifies for sale to a U.S. government agency or U.S. government sponsored agency; or
  - Involves a residential real estate transaction in which the appraisal conforms to the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation appraisal standards applicable to that category of real estate. (Exemption 10)

[2] *Id.* at 69651.

When the Agencies adopted Exemption 9, they determined that the standards of these programs were adequate and it was unnecessary to require that the applicable transactions meet the separate appraisal requirements of the Agencies' regulations and the federal loan program standards. The Agencies stated that,

> exemption [10] permits regulated institutions to originate, hold, buy, or sell transactions that meet the qualifications for sale to [Freddie Mac and Fannie Mae] without obtaining a separate appraisal conforming to the agencies' regulations. . . . The agencies believe that permitting regulated institutions to follow these standardized appraisal requirements, without the necessity of obtaining a separate appraisal or an appraisal supplement for conformance with the banking agencies' regulations, will reduce regulatory burden and increase an institution's ability to buy and sell these types of loans, improving the institution's liquidity.[3]

We recommend that the Agencies retain the exemptions for real estate-related financial transactions involving GSEs. Freddie Mac agrees with the conclusions of the Agencies when they issued the Guidelines inasmuch as requiring an appraisal to meet both the standards adopted by the Agencies and the standards Freddie Mac applies would increase the compliance burden and reduce liquidity. Freddie Mac continues to require appropriate appraisal standards. We conduct regular reviews of our appraisal standards and recently re-evaluated the appraisal standards and processes we require for evaluating the collateral that secures the mortgages sold to us.

II. Adjust the Appraisal Threshold

The Agencies requested comments on all aspects of the Proposed Guidelines. In this regard, the appraisal regulations contain an exemption "for transactions with a transaction value equal to or less than the appraisal threshold." The "appraisal threshold" is defined as "transactions with a transaction value of $250,000."

Freddie Mac recommends adjustment of the appraisal threshold to reflect current transaction values. The cap on the transaction threshold has not changed since it was initially promulgated in 1994 and should be updated. At the time the appraisal threshold was promulgated, the conforming loan limit for 1-unit residential properties was $203,150. All residential loans made under the conforming loan limit for 1-unit residential properties, including those not eligible for sale or otherwise involving a GSE, remained exempt based on the transaction value from the appraisal requirements until 2000. In 2000, the conforming loan limit for 1-unit residential properties was raised to $252,700 and it now stands at $417,000 with the exception of certain high-cost areas.

III. Use of AVMs

Under the Proposed Guidelines, the Agencies state that "[w]ith *prior approval* from its primary regulator, an institution may employ various techniques, such as automated

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[3] 59 Fed. Reg. 29482, 29494 (June 7, 1994).

tools or sampling methods, for performing pre-funding reviews of appraisals or evaluations supporting lower risk single-family residential mortgages."[4] The Proposed Guidelines would require prior approval for the use of an AVM in pre-funding review of appraisals. We recommend deleting the prior approval requirement where an institution is using an AVM to review appraisals or evaluations. Requiring prior approval of AVMs may discourage institutions from using such tools - which are likely to improve the accuracy of a valuation - as part of their review processes. Freddie Mac has found its own AVM, Home Value Explorer ("HVE"), and a related tool, Home Value Calibrator ("HVC"), valuable for identifying appraisals at risk of value inflation.[5]

IV. Definition of "Loan Production Staff"

Under the Proposed Guidelines, employees involved in an institution's collateral valuation program (both appraisal and evaluation functions) should be independent of employees involved in loan production. The Proposed Guidelines exempt from the definition of "loan production staff" "employees responsible for credit administration or credit risk management." This exemption applies regardless of whether the credit administration or risk management employees report to or supervise the loan production staff or loan production management.[6] Freddie Mac believes that anyone who reports to or supervises the loan production function should not be involved in an institution's collateral valuation program. As a result, we would recommend clarifying the language that states "[e]mployees responsible for credit administration or credit risk management are not considered loan production staff"[7] by adding a caveat such as the following, "unless such employees are in a reporting relationship to loan production staff or management."

V. Use of Evaluation Alternatives

In Proposed Appendix B of the Guidelines, "Evaluation Alternatives," the Agencies recommend that institutions maintain policies and procedures for determining whether an evaluation alternative is appropriate for certain transactions or lending activity. The Agencies specify certain elements that should be contained in the institution's policies and procedures. Freddie Mac suggests including a statement in Appendix B that would require an institution that had obtained a more comprehensive or detailed appraisal or evaluation to use that evaluation rather than seek more favorable results using a less detailed evaluation alternative to underwrite a loan.

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[4] 73 Fed. Reg. at 69656. (Emphasis added.)

[5] Freddie Mac owns and licenses distribution of a proprietary AVM called HVE as well as a quality control tool, HVC, which measures the risk that an appraisal or value estimate of a property may exceed the property's actual market value.

[6] 73 Fed. Reg. at 69661.

[7] *Id.* at 69661.

IV. Detailed Collateral Evaluation Should Not Be Triggered by Borrower Characteristics

The Proposed Guidelines state that a more detailed evaluation may be necessary for certain transactions if one or more of the factors listed in the Proposed Guidelines applies. The factors include transactions where the borrower has high risk characteristics.[8]

Freddie Mac recommends deleting the language suggesting that a more detailed evaluation may be necessary where, irrespective of whether there is collateral risk, the transaction has "borrowers with high risk characteristics." A more detailed collateral evaluation may unnecessarily increase cost for low income or low credit score borrowers whose income and credit have separately been considered in assessing the risk of the transaction.

Freddie Mac shares your goal of establishing and maintaining sound collateral valuation practices. We believe that our suggestions for further updating and clarifying aspects of the Proposed Guidance are consistent with this goal and will help maintain the liquidity of real estate-related transactions. Please feel free to contact me if you have any questions with respect to these comments.

Sincerely,

LM Ledbetter

Lisa M. Ledbetter

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[8] *Id.* at 69655.