A V Metrics

Automated Value Metrics. Flexible Solution. Precision Results

January 20, 2009

Attention: F R B Docket No. OP-13380021"

A V Metrics, L L C is an independent A V M Model validation, testing and collateral consultant serving the lending community. A V Metrics is part of the Collateral Risk Network (C R N) a group of 100+ chief appraisers and senior risk management who participate in an ongoing forum. The C R N includes representatives from Wall Street lenders, the G S E's, retail lenders, wholesales lenders, valuation product vendors and appraisal management companies. This is truly the most experienced and knowledgeable group on real estate and mortgage valuation in the country.

A V Metrics, as part of the C R N Group was tasked with responding to the A V M points and to the Exhibit "B" in particular of your proposed changes to the Appraisal and Evaluation Guidelines. Attached you will find A V Metrics marked up version of the document specific to Exhibit B and a few other points on Alternative Valuations with our proposed deletions, additions and comments.

A V Metrics would like to thank the agencies for issuing this exposure draft and time period for comment. Events in the past couple of years have caused every functional sector within the mortgage and banking industry to reassess processes, procedures and practices. The valuation component is very important to protecting the safety and soundness of the financial structure that directly influences our overall economic foundation.

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The following are areas we feel important in the oversight and regulation of valuation and appraisal. These areas include:

- With the use of various valuation tools and products today including B P O's and A V M's, we attempted to simplify the guidelines to address all valuation products, vendors and solutions. This includes due diligence prior to use, ongoing audits to ensure accuracy and appropriate applications to risk management.
- Documentation of valuation services is important in order to achieve appropriate oversight. This documentation must include identification of the persons or person that engages for the service and the details of that engagement.
- The Definitions addendum provides for a way to express clarification on current practices, products, terminology and terms used in today's lending environment. We have added a number of definitions to provide such clarification.
- The use of technology has been widely used and accepted on the Credit side of the business. The use of technology for collateral valuation is not consistent and still needs further development and understanding. However, the current tools including A V M's do provide a shift towards a more objective solution to the valuation question. We call upon the agencies to encourage institutions to address collateral valuation in a more objective manner and the use of technology to accomplish this goal as it is appropriate with the necessary risk assessments and professional oversight. The appraiser should be allowed to use any and all tools available to produce credible timely results.
- We also tried to address the issue of multiple valuations for the same lending decision. This issue got a number of institutions in trouble with the practice of trying to get the number they wanted by ordering or running multiple valuations.
- We wanted to bring your attention to the Evaluation Appendix. We think the added due diligence expressed for A V M's is so important that it should be implemented for all types of valuation products or services.

We appreciate your attention to this matter and look forward to your final release of the new Guidelines.

Sincerely,

signed. Lee Kennedy, C E O

A V Metrics, L L C

Appendix B
Evaluation Alternatives

The Agencies recognize that evaluation alternatives are available to institutions for developing an estimate of market value. Therefore, institutions should maintain policies and procedures for determining whether an evaluation alternative is appropriate for a given transaction or lending activity, considering associated risk. Such procedures should address risk criteria such as transaction size and purpose, borrower creditworthiness, and leverage tolerance (loan-to-value).

An institution should demonstrate that an evaluation alternatives, such as an automated valuation model (A V M) tax assessment valuation (T A V) **or Broker price opinion (B P O),** provides a reliable estimate of the collateral's market value as of a stated effective date prior to the decision to enter into a transaction. Further, the institution should establish criteria for determining the extent to which an inspection of the collateral is necessary to determine that the property is in acceptable condition for its current or projected use.

An institution's policies and procedures also should address the use of multiple tools or methods for valuing the same property or to support a particular lending activity. These procedures should specify criteria for ensuring that the institution uses the most credible method or tool. An institution should not select a method or tool solely on the basis that it provides the highest value. Examiners will review an institution's policies, procedures, and internal controls to ensure that evaluation alternatives are appropriate and consistent with safe and sound lending practices.

Automated Valuation Model (A V M)

An institution may use an A V M as a valuation method for a transaction in which an evaluation is permitted by the Agencies' appraisal regulations.36 An A V M may be used alone or in conjunction with other supplemental information. An institution should demonstrate, through testing, that the A V M's resulting value and any related information is credible and sufficient to support a credit decision, otherwise another valuation method or tool should be used.

In selecting an A V M or an appropriate valuation method an institution should perform appropriate due diligence to:

• Obtain relevant information about the underlying data the model or provider uses. Among other information, the institution should know the sources and types of data used in a model, frequency of updates, quality control performed on the data, and how data is obtained in states where public real estate sales data are not disclosed;

• Demonstrate an understanding of the modeling techniques of its external A V M providers. An institution should understand the inherent strengths and weaknesses of different model types and methodologies (hedonic, index, and blended) as well as how a particular model or multiple A V M's methodologies perform for different properties;

• Evaluate an A V M model provider's confidence score and determine its usefulness in assessing the model's reliability in determining market values for different properties; and

Ascertain which model(s), process or provider, produces the most credible values for an institution's lending activities.

An institution's policies should establish appropriate practices regarding the use of evaluations and indicate their performance criteria. In establishing evaluation practices, an institution should:

• Address the qualifications and responsibilities of persons or providers designated to select, validate, and administer valuations;

• Establish standards and procedures for validation testing, reviewing and monitoring; 37

• Maintain A V M and collateral valuation performance criteria for reliability and suitability in a given transaction or lending activity based on the institution's risk tolerance;

• Establish procedures for selecting a different collateral valuation method if an institution's performance criteria are not met; and

• Adopt criteria that include establishing standards and procedures for validation testing, for the use of multiple A V M's or valuations to ensure that results are credible.

- A V M's should never allow for manipulation of the data or results by the end user. The use of A V M's that have been influenced by the provider (often referred to as an "appraiser assisted A V M or A A V M") should only be accepted when that "assistance" is specifically disclosed.

Determining Evaluation Use:

In addition to evaluating the results of A V M validation testing as noted below, an institution should establish specific criteria for determining which evaluation alternative is appropriate for a particular transaction. An institution may consider the following questions, among others, in determining whether an A V M or other evaluation alternative may be appropriate for a given transaction:

- Property Type

o Is the property homogeneous such as a detached 1-to-4 family residential dwelling in a typical neighborhood for its market?

o Can the property's address be recognized by the model to ensure that the valuation will reflect the subject property?

- Property Location

o Is the property located in a market with strong sales activity?

o Are aspects about the property's location typical or average for its market (such as the view of the surrounding area or proximity to public or private facilities or services)?

- Property Condition

o Is sufficient information available to assess whether the property is in average or above-average condition consistent with its intended use?

o Is the area or neighborhood free of known adverse conditions that could affect the property's value (such as disrepair from a natural disaster or other events, defective building materials, or environmental concerns)?

• Property Price Range

o Is the property's initial estimated value within the average price range for its market?

• Nature of the Transaction

o Is the property in an area that is known to have minimal cases of fraud?

o Does the frequency of sales of the subject property preclude concern that the property may have been subject to flipping or fraud?

o Is the property owner-occupied?

Validating A V M and Evaluation Results

Institutions should establish standards and procedures for independently validating A V M and evaluation results on a periodic basis. The depth and extent of an institution's validation processes should be consistent with the materiality and complexity of the risk being managed. Institutions should not rely solely on validation testing representations provided by external providers **of the evaluation services or models.** Regardless of whether an institution relies on A V M's or evaluations that are supported by value insurance or guarantees, an institution should still perform appropriate due diligence and validation testing.

An institution should establish an independent model validation process. This process should specify, at a minimum:

• Expectations for an appropriate sample size;

• Level of geographic analysis;

• Testing frequency and criteria for re-testing;

• Standards of performance measures to be used; and

- Range of acceptable performance results.

To ensure unbiased test results, values should be compared to data gathered from sales transactions prior to being recorded in public records. If an institution uses more than one model or evaluation process the cascade also should be validated.

To assess the effectiveness of its collateral valuation practices, an institution should verify whether loans in which an A V M or other alternative evaluation was used to establish value met the institution's performance expectations. An institution should document the results of its validation testing and audit findings and use these findings to analyze and periodically update its practices regarding A V M's and evaluations and the specific underlying methods used in each.

Tax Assessment Valuation (T A V)

An institution may use data provided by local tax authorities as a basis for establishing an estimate of market value for the collateral for a transaction in which an evaluation is permitted by the Agencies' appraisal regulations. T A V's differ among jurisdictions. Therefore, an institution should determine and document how the jurisdiction calculates the T A V and how frequently property revaluations occur.

An institution should perform an analysis to determine the relationship between the T A V 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 T A V to meet or support evaluation requirements. As part of this process, an institution should test and document how closely T A V's correlate to market value. If a reliable correlation between the T A V and the market value can be established, the institution may use T A V's as a basis for an evaluation.

Broker Price Opinions (B P O's)

Broker Price Opinions are commonly used by institutions as an evaluation alternative. B P O's are the result of a local real estate agent developing an opinion as to a properties value using local market data. There are currently **no standards** for these reports. If an institutions uses these reports as an evaluation alternative then they must perform the appropriate due diligence as described above of the provider and their practices including validation. Institutions should be aware of state laws restricting the use of B P O's as an evaluation tool and restrict their use accordingly.

Appendix C
Glossary of Terms

Valuation Cascades or Waterfalls- A valuation cascade or waterfall is the result of acquiring multiple valuation results until one meets a predetermined set of acceptance criteria. These cascades often involve the use of A V M's and appraisal products as well as other alternative evaluation methods. If an institution uses a valuation cascade or waterfall they must document their acceptance criteria (decision logic) in detail within the institutions policies and procedures and show that the cascading criteria is not influenced by valuation shopping to achieve a predetermined value. The acceptance criteria should be based on objective data and validation results.