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Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

John G. Walsh
Acting Comptroller of the Currency
U.S. Department of the Treasury
250 E Street, SW
Washington, DC 20219

Helen R. Kanovsky
General Counsel
Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552

Subject: Credit Risk Retention — OCC (Docket No. OCC-2011-0002, RIN 1557-AD40), *Federal Reserve System* (Docket No. R-1411, RIN 7100-AD-70), *FDIC* (RIN 3064-AD74), *FHFA* (RIN 2590-AA43), *SEC* (File No. S7-14-11, RIN 3235-AK96), *HUD* (Docket No. FR-5504-P-01, RIN 2501-AD53);

Ladies and Gentleman:

On behalf of the nearly 30,000 members of largest professional associations of real estate appraisers in the United States, thank you for the opportunity to comment on the Proposed Rule on *Credit Risk Retention*.

Our organizations support the Agencies' proposals relating to "Qualifying Appraisals", and we urge they be retained in the Final Rule. This includes the Agencies proposal for Qualifying Residential Mortgages ("QRMs"), where we echo the Agencies' belief that this requirement "will ensure the integrity of the appraisal process and the credibility of the estimate of the market value of the residential property." Thorough and credibly developed collateral risk assessment is a central tenet of prudent mortgage lending.

Likewise, we support the full appraisal requirements relating to commercial real estate (CRE). Such mortgages should be fully documented and supported by credible opinions of market value prepared in conformance with uniform appraisal standards. Further, the Agencies proposed six-month "shelf life" for commercial real estate appraisals used in loan originations is reasonable and consistent with industry standards. However, it is worth noting that prudence may require more frequency updates to appraisals if there is evidence of material changes in the market. We urge the Agencies to incorporate such a requirement in the Final Rule and note that such appraisal "updates" are common in rapidly changing markets and can be completed in a cost efficient manner under the Uniform Standards of Professional Appraisal Practice (USPAP).

We also support the proposed rule's requirements relating to environmental hazards and potential impacts on market value. However, we believe the Final Rule could be enhanced with a requirement that review of environmental assessments be included in the appraisal scope of work and that environmental site assessments be provided to appraisers expediently during the appraisal assignment process. We understand that many banks

separate the appraisal and environmental functions and accept appraisals of property with a hypothetical condition - "as if clean" - when the environmental site assessment may say otherwise. Collateral risks can be dramatically reduced if all information relating to the property are provided to, and analyzed by, the appraiser. Simple calculations of cost to cure may not adequately address the effect on value for some environmental conditions. As such, we urge expansion of these provisions to require delivery of the environmental site assessment to the appraiser where environment impacts are found.

Combined Loan to Value Ratios

We are concerned about the provisions relating to the proposed CRE loan to value ratios. The federal banking agencies are proposing to require a combined loan-to-value (CLTV) ratio of less than or equal to 65 percent for qualifying CRE loans. The proposed rule notes:

The recent crisis has demonstrated that the use of very low capitalization rates generally results in significantly higher market values for some CRE properties. Where the capitalization rate used in the appraisal is less than the 10-year interest rate swap rate plus 300 basis points, the maximum CLTV ratio requirement will be 60 percent to mitigate the effect of an artificially low capitalization rate.

Generally, we are unsure what is meant by "very low" Cap Rates, as the term is not adequately defined. More importantly, the proposal inappropriately implies that properties with lower Cap Rates lead to "artificial" market values. Without trying to defend improperly developed "very low" Cap Rates, there are legitimate reasons that some Cap Rate indications are low. A Cap Rate is simply the first year Net Operating Income (NOI) divided by the Value. There are some properties which have NOI increases in subsequent years which influence value and thus the Cap Rate. Current investor analysis is moving away from Cap Rate Analysis and toward Discounted Cash Flow Analysis (DCF) which can account for changing NOI more efficiently than more simplistic Cap Rate analysis. Real balance is seen in properties that can produce positive cash flow compared to the debt service (Debt Coverage Ratio DCR). Appraisers can and should analyze valuation results in light of the indicated DCR found at a Cap Rate. Negative DCR's should be avoided in Qualified Loans. A thorough and credibly developed appraisal will report such occurrences and provide market information that supports the opinion of value.

If there is evidence to suggest the cap rate is not supported by market information or contains an artificially high value, we question why such an appraisal would be accepted. If such circumstances exist, the Agencies should suggest reconsideration of the primary loan decision.

It is important to note that tax implications often influence rates of returns. There was a time in the not too distant past when negative equity dividends resulted in lower overall rates - but those rates, in that market, were largely supportable.

Further, concerns over the contents of appraisals can also be addressed by completing through appraisal reviews in conformance with USPAP or by ordering a second appraisal prior to origination. We urge the final rule to incorporate provisions relating to appraisal review and second appraisals rather than imposing a lower CLTV where one may unnecessarily constrain credit to higher performing properties.

Use of Alternative Valuation Services

The Proposed Rule seeks comment on the following question:

Should other valuation approaches be considered in determining the value of the real property pledged on the mortgage transaction?

Broker Price Opinions ("BPOs")

While broker price opinions (BPOs) or broker opinions of value (BOVs) may have a role to play in asset management and disposition where allowed by state law, their use in loan origination is highly suspect, in our view. Where appraisers are bound by law to be unbiased, objective and independent, real estate brokers are bound by their fiduciary relationship with their bank and generally do not adhere to enforceable standards. This is recognized by recent public policy pronouncements such as the Dodd-Frank financial reform act, which prohibits

BPOs from being used as the primary basis of valuation in loan origination and the Interagency Appraisal and Evaluation Guidelines, which make clear that BPOs do not satisfy the definition of an “evaluation.” Fundamental mortgage lending practice relies on completely prepared real estate appraisals, as proposed by the Agencies. As a result, we see no sound public policy purpose to allow BPOs to satisfy full documentation requirements for credit risk retention.

Automated Valuation Models (“AVMs”)

Typically, an automated valuation models (AVMs) may be used in the process of reviewing a real property appraisal reports, although use in this area is not without its own concerns. Appraisal reviewers may use AVMs to test the reasonableness of value conclusions in reports if there is a basic understanding of how the AVM works, can use the AVM properly, determines that use of the AVM is appropriate for the appraisal review assignment, and believes the AVM output is credible and sufficient for the appraisal review assignment. However, we do not believe it is appropriate for an AVM to be accepted under the proposed definition of “Qualifying Appraisal” as it represents the lowest form of real estate collateral due diligence. The proposed rule advances fully documented loans, where rigorous due diligence is conducted. Therefore, we urge retention of the proposed rule full appraisal requirement here too.

Liquidity Concerns

Where concerns are being expressed by the mortgage, consumer and real estate industries relating to liquidity to the real estate market, we urge the Agencies to find ways to build in flexibility to support a healthy flow of credit. We believe as the Agencies do that full appraisals are a necessity for prudent mortgage lending, and we offer one suggestion that may be helpful to these concerns. Appraisal review is an important aspect of collateral risk assessment. However, many banks allow appraisal review to be conducted by non-appraisers or rely on automated tools. Such practice increases risks to the banking system.

Risks are lowered when appraisal reviews are completed by qualified appraisers in conformance with uniform appraisal standards. As such, appraisal reviews prepared in conformance with Standard 3 of USPAP may lessen the need for higher down payments. We support the Agencies investigating whether fully documented appraisals, accompanied by fully documented appraisal reviews may support lowering down payment requirements and raising low-to-value ratios. This is one way in which the concerns regarding liquidity could be addressed through the appraisal process. We would be pleased to discuss this idea in greater detail as the Agencies develop the Final Rule.

Conclusion

Overall, we are supportive of the appraisal provisions contained in the proposed rule, and we believe the best way to restore the trust of investors and ward off future financial crises is by the hiring of competent, objective, independent real property appraisers. We stand committed to working with you to assist with this highly important endeavor.

Thank you for the opportunity to comment on the Proposed Rule. Should you have any questions or need additional information, please contact Bill Garber, Director of Government and External Relations, Appraisal Institute, at 202-298-5586 or bgarber@appraisalinstitute.org, or Brian Rodgers, Manager of Federal Affairs, Appraisal Institute, at 202-298-5597 or brodgers@appraisalinstitute.org.

Sincerely,

Appraisal Institute
American Society of Farm Managers and Rural Appraisers