

From: Mike Marchywka <marchywka@hotmail.com> on 11/28/2008 08:50:04 AM

Subject: Appraisal and Evaluation Guidelines

To: regs.comments@federalreserve.gov
Subject: comment in response to Docket No. OP-1338 FEDERAL RESERVE SYSTEM
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Hi,
I'm responding to the request for comment published in

<http://files.ots.treas.gov/730042.pdf>
<http://edocket.access.gpo.gov/2008/E8-27401.htm>

E-mail: regs.comments@ots.treas.gov. DEPARTMENT OF THE TREASURY Office of Thrift Supervision Docket ID [OTS-2008-0012] Please include ID OTS-2008-0012 in the subject line. regs.comments@federalreserve.gov. FEDERAL RESERVE SYSTEM [Docket No. OP-1338]

I am suggesting that the appraisal process, or real estate transaction process more generally, should include a requirement that supporting data be made available to the public for independent automated analyses as with similar procedures in place in other fields. These comments are directed more at the ability of the public to serve as a check-and-balance on appraisers and loan parties rather than ideas of immediate relevance to making a contemplated transaction. However, they serve the goal of keeping appraisals "reasonable" and need to be considered when defining appraisal guidelines and standards. Public action based on this information could include a decision to invest in a home, contact a regulator, or buy a related security. I apologize if these remarks reflect ignorance of existing resources but in most other fields I have been able to find automated access to data I need with a quick web search. If the facilities I am requesting do exist, then please make them more well known.

I have provided 6 comments outlining issues with getting more data to a larger audience followed by a few paragraphs of additional details and examples:

1) The current crisis reminds us that we can't glibly use "market price" as a synonym for "economic value" or other forms of worth appropriate to secure a loan. The appraiser, if used as a basis for valuing a transaction, is in a unique position to obtain information relevant to both of these but can not determine either unambiguously. "Market price" is often clouded with various incentives and conflicts in prior transactions that may not be transparently reported. The soundness of a transaction better relates the the economic value of the collateral rather than the current market price. Economic value guesstimates generally involve predictions about the future and can not be made unambiguously.

2) The decision to enter into a loan or underlying real estate transaction, even if not contemplated to involve secondary parties, impacts a number of people

beyond the homeowner and mortgage lender and therefore creates an interest for external entities to be able to evaluate valuation claims made by the transacting parties. Interested parties may include other potential home buyers, stockholders in the lending entity, and anyone else who benefits from efficient markets.

3) Insiders or licensed or "approved" people in any industry have an inherent conflict, normally resulting in opinions which flatter their own products or services as their income tracks the amount of money coming into the industry. With home appraisals, it is not even practical for an "expert" in a single area to estimate the economic or other value, as opposed to fair market price, for a home. Recent transaction prices may reflect interest conflicts on the part of prior parties and can't be relied upon to remain near the value of the collateral.

4) We have computers. This sounds obvious and maybe irrelevant but it reminds us of an important tool for keeping people honest as described below. The converse of this is that AVM's, like VAR's, which are made possible with computers, do not remove the need for human judgment. Several computer analyses from other parties may provide additional checks and balances on models that seem to work during typical market conditions. Many models have issues and controversies no less severe than those which attempt to model natural phenomena such as global warming. The public needs input data, not just model output.

5) Market participants and Americans are not stupid, but we can be ignorant without the right policies in place. It is ignorance that leads to inefficiencies (bubbles and panics) of no economic value. Any policy that hopes to prevent market disruptions needs to let more people be better informed, preventing information monopolies, but without ignoring privacy concerns or infringing "intellectual property" or related rights that come from the creation of data or "work products" through personal time and effort.

6) Something as simple as a database of XML format URAR's would be a big help but there are a lot of options for integration with other data sources. Apparently these can be obtained by FOIA request but they do not exist in a central searchable database.

I am generally advocating that more emphasis be given to publication of factual data about subject property and the related area. In the immediate situation, this would include things like physical inspection from someone familiar with land, improvements, and local market conditions. Appraisal and inspection data would be made available by automated methods to allow interested external parties to analyze the data with ad hoc methods, perhaps integrated with information from Census and IRS, requiring that machine readable (not just interactive "web interfaces") be made available and free. Appraisers would generally be required to be diligent, observant, and honest, but not have to be exceptional in their ability to be unbiased. Given the inability to determine the interests and conflicts of all parties involved with a transaction, it is desirable to let external observers, with their own interests, evaluate the raw property information themselves. Automated data processing methods now make this possible as an alternative to a reliance on unbiased "experts." Regulators of other industries provide similar types of data in similar ways and could serve as models for many real estate related records.

Details, Supporting Comments, Parallels in Other Fields :

As a stock owner, former homeowner and computer programmer with some simulation

background, who regularly searches many literature sources in various industries and fields, I have noted problems with attempts to make markets more efficient only by regulation of "qualified experts" to give influential opinions. In real estate, parties who are supposed to be adversarial, such as a buyer and seller, have found various ways to collude and avoid free market checks and balances, often benefiting from the ignorance of others while adding no economic value.

If you believe some press accounts like this,

http://www.businessweek.com/magazine/content/08_48/b4110036448352.htm?campaign_id=mag_Nov20&link_position=link20

neither the real estate industry itself, the public at large, nor the government have been able to stop certain activities that we suspect of causing today's problems. Clearly there is more need for accurate, factual data to get to more people who can use different means to keep markets rational.

Today's volatility records are set for really only one reason, record uncertainty which is largely equivalent to ignorance. Ignorance reduction is appropriately an interdisciplinary concern (not requiring a real estate insider to fix). The interdisciplinary nature of valuation today requires better use and less abuse of information technology resources to integrate input from peripheral parties and other parts of the economy.

Any field that requires specialized knowledge usually creates interests and conflicts which can not be removed, even with heroic or parental levels of regulation. Recently, large bubbles have been created by simple neglect of fundamentals even by the experts and "insiders" who are supposed to know better, including those who presumably had incentives to control these deviations. A more effective approach to consider is to make markets more informed and reduce the power and abuse potential for people such as "qualified appraisers". Even in a global economy, all real estate is still local. It is global access to local information about the real estate that facilitates efficient and fair markets independent of geography. AVM's, like VAR's or other models and simulations, can be as biased as their authors and need to be checked against reality. Assumptions and results can be controversial or completely wrong, even if the underlying phenomena are not as complicated as, say, global warming. Independent access to data is essential. Rather than worry solely about making sure the selected appraiser is independent, or the algorithm for "THE" automated model is sensible, free access to the data will make it more likely that any biases can be discovered, even if after several transaction decisions have been made, at least in time to prevent runaway market situations.

Bubbles and panics occur because market prices deviate from some (perhaps hypothetical) equilibrium value related to their "economic value." The economic value of an asset, even a home, relates to things like the discounted cash flow attributable to it. And for sure, this depends upon present supply and demand but also many economic factors. Considerations may include the total number of people who may want to live in the home IN THE FUTURE, and the local sources of income from which these people could pay their mortgages IN THE FUTURE. It is unreasonable for an appraiser to be an expert in all demographic and economic factors that may effect these parameters, and he probably will not be psychic. But an external observer, with a computer and access to the right data source and more available time, could make various valuation tests for a variety of actions, including contacting the lender or supervisory authority. These public analyses would obviously not occur soon enough or be conclusive enough to be used for a given transaction decision, but would serve as an

overall sanity check on institutions, appraisers, and the industry in general.

Homes also experience various kinds of depreciation or wear-and-tear. Besides the mantra "real estate only goes up", which presumably is derived from "they aren't making any more land", there also seems to be this notion that "residential buildings have infinite lifetimes" and it is difficult for the larger financial markets, or even the neighbors, to get an idea of the state of the housing inventory or, in the present case, collateral. While historically inspection and appraisal tasks have been somewhat distinct, and indeed even achieved by opposing sides of a loan transaction, this distinction makes little sense as the value of the collateral depends upon its servability. Given a recent influx of speculators and flippers into the market, who probably had put less emphasis on the quality of home repairs than long-term owners, some attempt to look for excessive depreciation could be important. Further, increasing amounts of REO or vacant "on the market" real estate suggests that maintenance patterns and various forms of value reduction (vandalism, etc) could become common concerns. Valuation guidelines need to take into account "human nature" and the realities of the market. Indeed, the whole point of having an inspector or appraiser is to verify claims or representations that have already been made by other parties. Details of the collateral's condition are quite relevant to value and need to be verified.

These are not all issues which can be comprehensively determined by an inspection or a diligent survey of recent market activity, but require integration of data from neutral sources or those with opposing interests. Some that come to mind include the local government entities which record real estate transactions, the various court systems, census and IRS. As far as I know, there is no "API" or other means by which a computer program could be written to get all the recent recorded real estate transactions in a given area and integrate that with data from the IRS, courts, or Census. This is a tremendous problem if my perceptions are accurate. It seems that URAR's are available by a FOIA request (for example, <http://www.vba.va.gov/ro/roanoke/rlc/forms/Appraiser2008.pdf>) but certainly they do not seem to be made public in a uniform, computer readable format in reasonable time. In cases where they could be revealed by request, there is little reason to not just publish them via a central facility proactively. Courts and records offices seem to have a diverse array of systems with similar access concepts, none of which appear to be helpful. A quick google search for local records offices turns up automation unfriendly things, such as this (first thing on google that illustrates my concerns) designed for real estate professionals rather than the general public,

<http://www.co.stlouis.mn.us/slcportal/SiteMap/HomePage/Departments/RecordersOffice/RealEstateRecords/OnlineContractPage/tabid/921/Default.aspx>

"St. Louis County offers online subscription service to the real estate professional which provides access to the County Recorders real property records and the County Auditors property tax records by subscription service. The access fee is \$120.00 per month payable in advance for six months"

If they want to offer a fee based service with additional user interface that would be fine as long as they had a free access system for scripts to allow researchers to collate needed information. In any case, there does not appear to be a uniform programmatic way of getting real estate records. Perhaps an API for local records offices would be a good idea for a federal standard. If this already exists, it should be better publicized somewhere. The US Court systems "PACER" service seems to have similar problems,

<http://pacer.psc.uscourts.gov/faq.html>

being neither automation friendly nor free- the token charges greatly complicate use and development of things like scripts. Apparently, the OCC uses a "data vendor" for some of its own mortgage performance research,

<http://www.occ.treas.gov/ftp/release/2008-65b.pdf>

The census does provide many statistics via FTP, which is just fine given the relatively static nature of their data compared to the more dynamic data that comes from real estate and court events. I have no idea what, if any, local level statistics the IRS provides but apparently county level 2006 publications are currently available for a charge,

<http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96809,00.html>

There needs to be a way to verify, at least at the neighborhood level, that the incomes and income sources reported to taxing agencies, for which there is no incentive to overstate income, correlate with those reported to and by the mortgage industry. Income of interested potential and current owners, as well as the source of that income, are relevant to determining the economic value of the appraised location.

If inspectors and appraisers made all relevant data available, and if all related agencies made statistics available in a computer readable (an "API" accessible from scripts, not just the interactive human "web interface") in reasonable time, if not "Real Time", then interested parties, ranging from market analysts to concerned citizens, could run their own valuations and sanity checks before making substantial decisions. There is no reason for and no benefit from delegating conclusions such as "valuation" to the judgement of an appraiser who may focus on only a few issues that have historically been useful but may fail as things change.

I would point to medicine as one unrelated field to consider for examples that may help show that these issues are not peculiar to real estate and that public access to supporting data, not just expert conclusions, provide effective support for allowing non-experts or "outsiders" to better understand or value a product by integrating information from many specialties. The FDA regulates the business side (marketing claims) of drugs while the NCBI (see link below) provides an access system for medical literature. Patients or researchers have obvious interest in both scientific and regulatory details. Biotech investors are routinely in a situation of buying stock of companies that attempt to develop complex products. The public is constantly complaining, often in reaction to some new incident, that the FDA regulatory process needs to be changed. The FDA also has a recurring problem with conflict of interest as specialists in a field tend to have financial interests. There is clearly a need for experts, but the data source for much of their expertise is readily available to interested parties via the NCBI online library. This information is provided in a format suitable for automated evaluation which is separate from their interactive web interface. Almost all medical literature is available free and automated access methods are provided. It may make sense for some real estate transactions, court documents from federal to local, and appraisal documents to be made available with a similar API,

http://www.ncbi.nlm.nih.gov/entrez/query/static/eutils_help.html

The public with access to computer tools is in a good position to examine the

evidence the experts use in making their claims to determine how reasonable they are. You or your doctor are free to examine clinical trial results of approved drugs, not just accept the FDA's approval, reported side effects, or even the lab and academic results that support or refute a given drug's profile. A similar situation should exist in the more mundane field of real estate, where many people can appreciate the factors that lead to valuation if only they have relevant supporting data in a usable format.

The beneficiaries of the above system include the interested public, patients trying to assess the quality of their own care, investors trying to determine the evidence supporting a biotech company's development plan, and of course those interested in basic science and research. Valuing a developmental stage biotech company may seem unrelated to home appraisals but I challenge anyone to distinguish a stock chart of FNM from any recent failed biotech company(suggesting similar amounts of uncertainty but also a bit of an attempt at dry humour). In biotech, a tentative lab result from an enthusiastic respected expert is often used as the basis for large investments that later evaporate. Better use of supporting data, rather than reliance on conclusions from experts alone, can help make better use of capital. Given that real estate valuations are subject to more knowable constraints, there doesn't seem to be any reason for the volatility of the two industries to be similar, suggesting that we could benefit from additional information in the more mundane real estate field. The parallels between biotech and real estate investors are direct, homeowner and patient a little less clear, while academic and industrial researchers clearly benefit in both fields. There are repositories not just for research articles(containing expert opinions along with much supporting data), but also uniformly formatted raw data itself (for example, this may be a bit obscure for most people but it is an interesting facility for raw data, <http://www.ncbi.nlm.nih.gov/projects/geo/info/faq.html>).

The FDA also provides access to things like the Adverse Events Reporting System, <http://www.fda.gov/cder/aers/default.htm> which is essentially public access to raw data on individual cases that help suggest potential problems with drugs. It is difficult for me to demonstrate here [I haven't tried] that these resources have led to provable improvements in biotech securities markets or the drug regulation process, but consider the situation in their absence.

The real-time nature of real estate information would require adaptation to the above examples, but there are examples where this can be accommodated too. The SEC, for example, offers real time access to company filings,

<http://www.sec.gov/cgi-bin/browse-edgar?action=getcurrent>

optionally in a computer readable XML format. Something like this for all real estate events or transactions (for URAR's as an example, but also including everything from building permits to foreclosures to more detailed appraisal and inspection data) would be a great asset for those interested in examining the state of the industries. Certainly the volume of data would be large but manageable at least with regional facilities or some design care. I would also point out that if properly done to include all building and land use activities, such facilities would allow additional benefits such as maps (from Google Maps to your personal navigation devices) being updated automatically in real time (and don't forget that the GPS system is a case study in public benefit from a free government information source).

For valuations based exclusively on market price, an appraiser hired to support a particular transaction never has to do anything as he always has a willing buyer and willing seller and therefore a good estimate of "fair market value." Of course, we know this idea to be wrong but appealing to prevailing market conditions alone does nothing to independently check the price compared to value as collateral. This recent bubble should remind us that market prices can decouple from economic value and the loan evaluation process requires information about both. Stable efficient markets are maintained with accurate information about both the current market prices and value of the relevant assets. There is always room for guessing about the future economy, but we shouldn't have to guess about the current local economy or physical condition of the collateral that public shareholders rely upon to secure our investments. We can not rely solely upon the conclusions made by an appraiser no matter how objective or well trained, and certainly not if inspection related data is ignored. We have information processing technology that makes it feasible and reasonable for appropriate external checks to be made on loan party claims while preserving privacy and intellectual property rights and it makes sense to consider ways to facilitate these when formulating collateral valuation guidelines and procedures. Something as simple as a database of all URAR's that could be discovered by a FOIA request would be a big help but clearly a lot more could be done.

Thank you.