

October 31, 2006

Kenneth E. Williams, President/CEO
Infinity Federal Credit Union
202 Larrabee Road
Westbrook, ME 04092

Re: Use of Automated Valuation Methods.

Dear Mr. Williams:

You have asked if it is permissible for credit unions to use automated valuation methods (AVMs) to determine the value of real property for “junior mortgages.” NCUA’s appraisal rule requires an appraisal by a state-certified or licensed appraiser for all real estate-related financial transactions, with nine, specific exceptions. The appraisal rule does not except loans from its requirements based on the seniority of the mortgage. Two transactions, while excepted from the formal appraisal requirement, nevertheless require “a written estimate of market value.” While an AVM cannot be used in place of an appraisal by a state-certified or licensed appraiser, we think, subject to the cautions noted below, an AVM may be useful in meeting the requirement for a “written estimate of value.”

Infinity Federal Credit Union (Infinity) offers mortgage loan products that permit it to take a second lien on the property offered as collateral, require no closing costs, and are processed within 24 hours. Infinity uses an AVM combined with ValueGuard Insurance (ValueGuard) instead of an appraisal to determine the value of the real property for these loans. An AVM is a computerized property value system using comparable or repeat sales indexes to determine property value and, generally, does not include an onsite examination of the property. Our understanding is ValueGuard insures automated values up to \$250,000, covering a lender for losses up to \$100,000 for any difference between the AVM report and the actual appraised value of a property. Integrated Loan Services, available at <http://www.ils.com> (as of September 26, 2006). One exception to the requirement in the appraisal rule for a formal appraisal is for transactions of \$250,000 or less but we understand Infinity does not limit its second-lien mortgages to \$250,000 or less.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 requires a real estate appraisal in any federally related transaction, subject to the rules of federal financial institution regulators. Pub. L. 101-73, §1110, 103 Stat. 514 (1989); 12 U.S.C. §3339. A federally related transaction is any real estate-related financial transaction entered into by any federally insured credit union that requires an appraiser’s services. 12 C.F.R. §722.2(e). When an appraisal is

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required, a state certified or licensed appraiser must perform it. 12 C.F.R. §722.3(a).

Under NCUA regulations, certain real estate-related financial transactions do not require an appraisal performed by a state certified or licensed appraiser. The exception most likely to apply to second mortgages is the exception for transactions with a value of \$250,000 or less. 12 C.F.R. §722.3(a)(1). Although a formal appraisal is not required, transactions with a value of \$250,000 or less must still be supported by a "written estimate of market value." 12 C.F.R. §722.3(d). The other exception requiring a written estimate of value is essentially one for re-financings with no additional credit extension. 12 C.F.R. §722.3(a)(5). The appraisal rule requires that an individual who has no interest in the property and is qualified and experienced for the type and amount of the credit being considered must perform the written estimate of market value. 12 C.F.R. §722.3(d).

While AVM technology can augment the appraisal process, it is not a substitute for an appraisal or independent valuation. An AVM obviously does not meet the requirement for an appraisal by a state-certified or licensed appraiser, and our opinion is a credit union cannot rely solely on the value an AVM provides to meet the requirement of a written estimate of value. The appraisal rule contemplates the involvement of an experienced, disinterested individual who prepares the written estimate of value.

AVMs can be useful to qualified professionals who understand the limitations of an AVM and can verify its consistency with the professionals' own knowledge of the market where a particular property is located. AVMs, for example, those based only on tax records or comparable sales, may not reflect recent changes or events affecting a particular market and, of course, do not reflect the physical condition of a particular property.

Insurance, such as that provided by ValueGuard, may be helpful and provide protection against inaccurate AVMs but, as with any insurance product, credit unions need to understand the terms and limitations of coverage. Further, credit unions must still meet the appraisal rule's requirements regardless of whether they have purchased insurance such as ValueGuard.

Sincerely,

Sheila A. Albin
Associate General Counsel