January 19, 2007

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

Re: Additional Guidance on Using Automated Valuation Methods.

Dear Mr. Williams:

Our office recently responded to your request regarding the permissibility of automated valuation methods (AVMs) to determine the value of real property for "junior mortgages." OGC Op. 06-0824 (October 31, 2006). We stated a credit union cannot rely solely on the value an AVM provides to meet the requirement of a written estimate of value but an experienced, disinterested individual's review is required. We have received several inquiries asking about the requirement and believe the following additional guidance will be helpful. As a preliminary matter, we note NCUA's appraisal rule is similar but not identical to the appraisal rules of other federal financial institution regulators and financial institutions other than credit unions should consult with their regulators on appraisal matters.

NCUA's appraisal rule exempts certain transactions from the requirement of a formal appraisal but requires a "written estimate of market value" for transactions with a value of $250,000 or less and transactions involving an existing extension of credit. 12 C.F.R. §722.3(d). The appraisal rule requires the written estimate of market value be "performed by an individual" with no interest "in the property" and who is "qualified and experienced to perform such estimates of value for the type and amount of credit being considered." *Id*.

A previous legal opinion addressed the human involvement required in the valuation process for non-federally related transactions. OGC Op. 94-0909 (October 7, 1994). That opinion stated a tax assessment, coupled with review by a loan officer, meets the valuation requirement in §722.3(d); the opinion also noted other steps the credit union included in its valuation process. Similarly, an AVM can be used to meet the valuation requirement in conjunction with review by a loan officer or an individual with knowledge, training, and experience in the real estate market where the loan is being made. A loan officer's review of a tax assessment or AVM can ensure the written estimate is sufficiently accurate to protect the credit union's interest throughout the term of the loan.

The Office of Examination and Insurance asked us to note in this legal opinion that the agency has also received inquiries about previous guidance issued by the Federal Financial Institution Examination Council. In 2005, NCUA and other federal financial regulators issued joint guidance for managing credit risks associated with home equity lending that also contained guidance on collateral valuation. *See*, NCUA Letter to Credit Unions (LCU) 05-CU-07 (May 2005). Among other subjects, the joint guidance addressed the due diligence an institution should undertake in evaluating AVM products.

> When AVMs are used to support evaluations or appraisals, the financial institution should validate the models on a periodic basis to mitigate the potential valuation uncertainty in the model. . . . The validation process includes back-testing a representative sample of the valuations against market data on actual sales (where sufficient information is available).

Credit Risk Management Guidance for Home Equity Lending, May 16, 2005, p. 5 (enclosure to LCU 05-CU-07). The joint guidance recommends credit unions validate the AVM product and output for each AVM loan.

In addition, NCUA and the other federal financial regulators issued joint guidance regarding the independence of the appraisal and evaluation function. See NCUA Letter to Credit Unions (LCU) 05-CU-06 (March 2005). The March 2005 guidance, recommends appraisals and evaluations be independent from loan production staff[1] as a sound business practice. Specifically, the guidance states, "[c]redit unions should ensure no single person has the sole authority to make credit decisions involving loans on which [the person] ordered or reviewed the appraisal or evaluation. Further, lending officials, officers, and directors should abstain from any vote or approval involving loans for which they performed the appraisal or evaluation." LCU 05-CU-06 (March 2005). However, although this is a sound business practice it is not a regulatory requirement. NCUA recognized in the preamble discussion in both the proposed and final appraisal rules that, in certain cases, it may be necessary for credit union loan officers or other officials to perform appraisals. 55 Fed. Reg. 5614, 5618 (Feb. 16, 1990), 55 Fed. Reg. 30193, 30206 (July 25, 1990).

Also, please note NCUA's appraisal rule requires individuals who provide a written estimate of market value to have no direct or indirect interest in the property. 12 C.F.R. §722.3(d). A direct interest would arise, for example, if the

[1] The loan production staff consists of those responsible for generating loan volume or approving loans, as well as their subordinates. This would include any employee whose compensation is based on loan volume. Employees responsible for the credit administration function or credit risk management are not considered loan production staff.

individual performing the written estimate owned all or a part of the property being evaluated. An example of an indirect interest would be a situation in which the individual owns the property adjacent to the property being evaluated, and the written estimate could likely affect the individual's property value. *See*, 55 Fed. Reg. 5614 (February 16, 1990).

Credit unions with questions about their particular processes and use of AVMs in meeting the requirement for a written estimate of market value can consult their examiner, regional office or state supervisory authority.

Sincerely,

/S/

Sheila A. Albin
Associate General Counsel

OGC/MIG:bhs
06-1219
cc: Mark A. Treichel, Region I Director