

Statement on New Interagency Appraisal and Evaluation Guidelines



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Statement on New Interagency Appraisal and Evaluation Guidelines

On December 2, 2010, five federal banking agencies — the OCC, FRB, FDIC, OTS and NCUA — issued their long-awaited revision to the Interagency Appraisal and Evaluation Guidelines that were first issued in 1994. The revised guidelines became effective following *Federal Register* publication on December 10, 2010. The revised guidelines apply to all real estate-related financial transactions originated or purchased by a regulated institution or its operating subsidiary for its own portfolio or as assets held for sale, including activities of commercial and residential real estate mortgage operations, capital markets groups, and asset securitization and sales units. These guidelines are in addition to the FRB's interim final rule on appraisal independence and related matters that will become effective on December 27, 2010 and for which compliance is mandatory on April 1, 2011. While the federal banking agencies have taken the Dodd-Frank Act into consideration in revising the guidelines, it is likely that there will be extensive rulemaking in the future to implement the appraisal and valuation provisions of Dodd-Frank. The federal banking agencies have acknowledged that further guideline revisions may be necessary to address these future regulations.

The revised guidelines place considerable focus on risk-based appraisal review, automated valuation model (AVM) requirements, and valuation updates during the life of the loan. CoreLogic® is pleased to confirm that our product suite is available to assist clients in quickly conforming to the revised guidelines.

Appraisal Review

The agencies reaffirmed that appraisal review is an important component of safe and sound lending practices, and added that such a review should be risk focused:

The Agencies expect “an institution to establish an effective, risk-focused process for reviewing appraisals and evaluations prior to a final credit decision.” [Emphasis added]

The required risk-focused approach is used to determine the depth of the review needed to ensure that appraisals and evaluations contain sufficient information and analysis to support a financial institution's decision to enter into the transaction. The CoreLogic suite of collateral risk tools, already deployed by 12 of the top 20 residential mortgage lenders in the U.S., achieve such a risk-focused collateral screening method. In this regard, we just completed a review comparing the early payment default (EPD) rates of mortgage lenders and servicers that actively review appraisals using our LoanSafe® Collateral Manager tool with the EPD rates of mortgage lenders and servicers that are not using a CoreLogic collateral risk tool. We found that overall EPD rates are twice as high for mortgage lenders and servicers that do not use one of our collateral risk tools!

AVM Use

AVMs have evolved over the past 20 years into sophisticated risk management tools with predictable, consistent accuracy in both volatile and stable real estate markets. As a result, AVM use has expanded from appraisal review and portfolio update into the loan origination process. In the guidance, the agencies affirmed an important role for AVMs in residential lending, noting:

“An AVM may be used for a transaction provided the resulting evaluation meets all of the supervisory expectations in the Evaluation Development and Evaluation Content sections in the Guidelines, is consistent with safe and sound banking practices, and produces a credible market value conclusion.”

The guidelines identify three criteria that institutions must consider in determining whether an AVM is an acceptable evaluation method:

1. The AVM must satisfy the “Evaluation Development and Evaluation Content” requirements
2. The AVM must meet the independence standards required by “safe and sound banking practices”
3. The AVM solution must be tested and monitored to ensure that it “produces a credible market value conclusion”

We have reviewed the specific guideline requirements relative to our AVM products and determined that our existing product suite (including our ValueView AVM + Inspection product) already conforms to those requirements. Let’s examine each of the criteria individually.

AVM Development and Documentation Requirements

While the guidelines confirm that AVMs are an acceptable collateral valuation alternative under the criteria stated above, it is also clear that the financial institution must have appropriate policies in place to identify the proper circumstances for use of an AVM.

“An institution should establish policies and procedures for determining an appropriate collateral valuation method for a given transaction considering associated risks.”

The agencies note that various factors must be considered in determining whether an AVM is an appropriate choice, including:

- ▶ Overall AVM performance (including “tail risk”)
- ▶ Minimum internal confidence score for when an AVM may be used
- ▶ Ability to preclude value shopping when more than one AVM is used for the same property
- ▶ Prevalence of mortgage fraud in the vicinity of the subject property
- ▶ Occurrence of natural disasters or major economic events
- ▶ Where the AVM’s tolerance is outside a specified range
- ▶ An atypical property relative to the neighborhood

Our product platforms, including Vector™, AVMSelct® and RealQuest®, permit clients to order and accept AVMs based on each of these requirements. For example, many clients already use our products to screen for mortgage fraud (using LoanSafe Collateral Manager or HistoryPro®) as well as natural disasters prior to an AVM call. Some clients establish their own rules while others subscribe to the Custom Cascade Service from CoreLogic. The Custom Cascade Service tests CoreLogic AVMs, industry AVMs, and LoanSafe Collateral Manager against client data and all recorded property sales. Clients set the thresholds for AVM performance, use of fraud and natural disaster screens, and property-typicality measures. These thresholds are applied against a comprehensive data set to produce the corresponding cascade rules.

At CoreLogic, we’re committed to ensuring that our clients have the information they need to make good decisions about AVM use. Whether clients subscribe to our lender-quality AVMs (PASS®, ValuePoint®4, PowerBASE®6 and Home Price Analyzer®), our standard cascades (GeoAVM™ Core and GeoAVM™ Precision) or our Custom Cascade Service, we provide regular performance updates based on our comprehensive nightly testing protocol (Vector Testing System). These performance updates note overall performance, as well as tail risk, for the nation, each state, and certain large counties.

AVM Report Content Requirements – Providing Sufficient Information

“An evaluation should contain sufficient information detailing the analysis, assumptions, and conclusions to support the credit decision. An evaluation’s content should be documented in the credit file or reproducible. The evaluation should, at a minimum:

- ▶ *Identify the location of the property.*
- ▶ *Provide a description of the property and its current and projected use.*
- ▶ *Provide an estimate of the property’s market value in its actual physical condition, use and zoning designation as of the effective date of the evaluation (that is, the date that the analysis was completed), with any limiting conditions.*
- ▶ *Describe the method(s) the institution used to confirm the property’s actual physical condition and the extent to which an inspection was performed.*
- ▶ *Describe the analysis that was performed and the supporting information that was used in valuing the property.*
- ▶ *Describe the supplemental information that was considered when using an analytical method or technological tool.*
- ▶ *Indicate all source(s) of information used in the analysis, as applicable, to value the property, including:*
 - ◆ *External data sources (such as market sales databases and public tax and land records);*
 - ◆ *Property-specific data (such as previous sales data for the subject property, tax assessment data, and comparable sales information);*
 - ◆ *Evidence of a property inspection;*
 - ◆ *Photos of the property;*
 - ◆ *Description of the neighborhood; or*
 - ◆ *Local market conditions.”*

The ValueView product from CoreLogic combines our industry-leading AVMs with a property inspection. This product adds an external inspection and property photos to the AVM result. This additional information is very important, given the guidelines’ statement that the valuation method should address the property’s actual physical condition and characteristics. Moreover, a financial institution can leverage this additional information to determine whether it would be prudent to request an appraisal based on the property’s external condition relative to other homes in the neighborhood.

With respect to the guidelines’ requirement that the analysis, supporting information and supplemental information for an AVM be described, we provide confidential detailed AVM data and methodology documentation directly to clients or prospective clients who have executed an acceptable nondisclosure agreement. This documentation includes data sources, methodologies, internal testing protocol and other information relevant to the production of our AVMs. If you are a current CoreLogic client, please feel free to request this documentation directly from your relationship manager.

“Safe and Sound” Practices Require Valuation Independence

The guidance makes more than 50 references to independence in the collateral valuation process, stating repeatedly that the valuation must be independent of the transaction and the financial institution’s loan production staff. How is this relevant to AVMs, which by definition produce the same value no matter who makes the request? The recent inclusion of listing data into AVMs brings the importance of independence to the forefront. We recently issued a paper on the use of MLS data in AVMs that can be found at corelogic.com under “Research and Trends.” In a nutshell, the issue is that certain listing data, such as the listing price, are clearly established by parties who have a direct financial interest in the transaction. Does this mean that no listing data should be included in an AVM? We think the prudent use of specific data listing elements (such as comparable property characteristics and inventory trends) helps AVMs generate accurate values without exposure to inappropriate influence by parties interested in the transaction. At CoreLogic, we carefully research and monitor all data elements that we use in our AVMs, and we are comfortable that our lender-quality AVMs

produce independent results.¹ But our financial institution clients' opinions are what really matter. We document our use of listing data in our detailed AVM methodology reports, and encourage conversations to provide clients the information they need to make good decisions based on their specific risk management goals.

AVM Testing, Documentation and Updates – Producing Credible Results

The guidelines make clear that financial institutions should establish policies and procedures that govern their use of AVMs. To do so, financial institutions must have a complete understanding of the current and ongoing performance of the AVMs they use.

“When selecting an AVM or multiple AVMs, an institution should:

- ▶ *Perform the necessary level of due diligence on AVM vendors and their models, including how model developers conducted performance testing as well as the sample size used and the geographic level tested (such as, county level or zip code).*
- ▶ *Establish acceptable minimum performance criteria for a model prior to and independent of the validation process.*
- ▶ *Perform a detailed validation of the model(s) considered during the selection process and document the validation process.*
- ▶ *Evaluate underlying data used in the model(s), including the data sources and types, frequency of updates, quality control performed on the data, and the sources of the data in states where public real estate sales data are not disclosed.*
- ▶ *Assess modeling techniques and the inherent strengths and weaknesses of different model types (such as hedonic, index, and blended) as well as how a model(s) performs for different property types (such as condominiums, planned unit developments, and single family detached residences).*
- ▶ *Evaluate the vendor's scoring system and methodology for the model(s). Determine whether the scoring system provides an appropriate indicator of model reliability by property types and geographic locations.”*

Regarding validating AVM results, the guidelines state:

“An institution should establish standards and procedures for independent and ongoing monitoring and model validation, including the testing of multiple AVMs, to ensure that results are credible. An institution should be able to demonstrate that the depth and extent of its validation processes are consistent with the materiality of the risk and the complexity of the transaction...”

“In the AVM validation procedures, an institution 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.*
- ▶ *Range of acceptable performance results.”*

At CoreLogic, our Vector Testing Services (VTS), which includes patent-pending technology, provides a complete and exhaustive method of testing AVM performance. To simulate the functioning of the AVM in a real-world, real-time environment, the system is designed to keep the AVM “blind” to any actual recent sales activity on the subject property. Each night, when we receive new sales data on properties, we run all CoreLogic AVMs and cascades on each property before loading the sale transaction into the AVM database. Using this test methodology, the AVM has no knowledge of the sale transaction, so is truly blind to it. This approach is consistent with the guidance's mandate for AVM testing.

¹ We also offer AVM products that more aggressively leverage listing data. These products are targeted to nonlending uses, such as real estate brokers (RealAVM™) and consumer marketing (PASS® Prospector).

Furthermore, VTS tests AVMs against every arm's length sales transaction in every county in our database. Our market-specific data covers 98 percent of all U.S. ZIP codes and 3,100 counties in all 50 states and the District of Columbia, representing 99 percent of the U.S. population, 97 percent of all properties (145 million). It's difficult to envision a more comprehensive AVM test dataset than VTS offers. The performance data can be split out by property type, price tiers or any geographic level.

The guidelines state, *"An institution should not rely solely on validation representations provided by an AVM vendor."* At CoreLogic, we encourage all clients to validate our test data using their own pipeline as benchmarks. We support, at no charge to clients, reasonable validation testing.

Life-of-Loan Valuation Updates

The guidelines focus on portfolio management, creating a loop between collateral risk trends and portfolio review.

"Prudent portfolio monitoring practices include criteria for determining when to obtain a new appraisal or evaluation... The criteria should address... changes in market conditions."

"An institution should be able to demonstrate that it has sufficient, reliable, and timely information on market trends to understand the risk associated with its lending activity."

The Market Trends database from CoreLogic is specifically well-suited to meet this requirement. Every month, we combine ZIP-code-level public recordings of home sales, prices and foreclosure filings with mortgage performance into a single dataset that provides a unique monthly snapshot of market trends. Market Trends allows clients to identify market health at a granular level. Within those markets, clients use Market Trends for benchmarking, analyzing portfolio risk, understanding valuation trends, and uncovering local real estate trends.

Conclusion

At CoreLogic, we're committed to providing our clients with a suite of products that support guideline compliance and all applicable appraisal and valuation regulations. We assist our clients and partners with documentation and due diligence concerning all our products and services to facilitate informed decisions regarding their use and support compliance with the guidelines.

About CoreLogic

CoreLogic is a leading provider of consumer, financial and property information, analytics and services to business and government. The company combines public, contributory and proprietary data to develop predictive decision analytics and provide business services that bring dynamic insight and transparency to the markets it serves.

CoreLogic has built the largest and most comprehensive U.S. real estate, mortgage application, fraud, and loan performance databases and is a recognized leading provider of mortgage and automotive credit reporting, property tax, valuation, flood determination, and geospatial analytics and services.

More than one million users rely on CoreLogic to assess risk, support underwriting, investment and marketing decisions, prevent fraud, and improve business performance in their daily operations. Formerly the information solutions group of The First American Corporation, CoreLogic began trading under the ticker CLGX on the NYSE on June 2, 2010. The company, headquartered in Santa Ana, Calif., has more than 10,000 employees globally with 2009 revenues of \$2 billion. For more information visit corelogic.com

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