**FHFA Response re: Hybrid Appraisals**

Although LendingHome is an approved Seller/Servicer with FNMA, we are not currently an *active* seller. Nonetheless, we believe we have data that might be helpful as FHFA considers options relative to bifurcated or hybrid appraisals, so we are responding to your request for information.

The vast majority of loans LendingHome has been making for the last 5 years are on residential 1-4 unit properties in the fix and flip space. Why we think that may be useful for this discussion, is that the extremely short duration of our loans (12 month term; 7 month average duration) gives us a much more timely feedback loop on the accuracy of the original valuation--not by an additional valuation or review, but rather by the actual sale of the property. So value is no longer a matter of conjecture but of actual market exposure and sale. In the end, that is the only value that really matters.

At the time of origination, we use a combination of our own internal valuations as well as third party hybrid appraisals as the secondary opinion of value. Then we track the eventual exit and sale of our subject properties so we can keep a close watch on both the accuracy of our internal valuations team as well as the third party hybrid appraisals. It is that latter data set that we thought might be helpful to share.

Relative to specific questions posed in the Request for Information (RFI):

* **Question A1.1** -
  + *Is there is a need to provide new valuation solutions that address industry identified issues of appraiser capacity, turn-times, training, and rural and high-volume market coverage?* **A:** Yes. Even before the latest refi boom, the dwindling numbers of appraisers was becoming challenging. The latest refi boom has just exacerbated and highlighted the need for valuation solutions that can leverage the pool of appraisers the industry *does* have available.
  + *What are those potential solutions?***A:** We believe bifurcated or hybrid appraisals are an excellent way to make better use of a dwindling supply of appraisers. We are aware of both FNMA’s & FHLMC’s pilot hybrid appraisal programs, but we have been actively using ValueNet hybrid appraisals from Accurate Group for over 5 years now in our loan origination activities. Hybrid appraisals allow appraisers to focus more of their time and resources on the true ‘art’ portion of the process--which is the analysis of comparables and relative indicators of value. Instead of the more mundane aspects of scheduling appraisals with borrowers and measuring/inspecting the subject property.
  + *What are the risks of these policies and the challenges in implementing them?* **A:** One of the key risks we see is that inspection photos have to give a good representation of the subject property (besides just the basic bed/bath count and the property sketch/measurements portion of the inspection). We believe the inspection process in the current FNMA/FHLMC pilot hybrid appraisals focuses too much on accumulation of data, when the main focus really should be to provide the appraiser with the quality, condition and feel of the property that we feel is best accomplished via pictures.
* **Question A1.4** - *Would utilizing alternative inspection workforces, such as insurance adjusters, real estate agents, and appraisal trainees assist with addressing appraiser capacity concerns? Are there risks of using third-party non-appraisers? If yes, How?* **A:** Absolutely utilizing alternative inspection workforces can help alleviate appraiser capacity concerns. It also makes the process more flexible for the borrower in terms of scheduling inspections because that is no longer tied to the appraiser’s workload. The biggest risks we see are: 1) the risk discussed above that the inspection report photos and commentary don’t accurately convey the property condition; and 2) If hybrid appraisal use is expanded quickly, it is possible that the alternative inspection workforce could be strained just like the appraiser workforce is currently. This latter risk is easier to mitigate than recruiting and training more appraisers, since the inspection job is more focused so training can be more specialized and has a much shorter ramp time.
* **Question B2.6** - Is there any data or evidence you could share regarding the performance of alternative appraisal solutions versus traditional appraisals? **A:** Our data set is not necessarily comparing alternative valuations to traditional appraisals--it is comparing alternative appraisals to the actual market value established when the property is exposed to the market and sold. Because our loans have a 7 month average duration, the time element between origination and the true valuation on sale is minimized. The table below summarizes data on 11,532 property exits over the prior 3 years.

In order to baseline what we consider to be an ‘accurate’ valuation, we ran an experiment a few years ago, where we gave the same valuation assignment for 100 different properties, to 4 different AMCs, as well as to our own internal valuations team. We used the results of that test to baseline accuracy expectations. What we found is that different appraisers completing the same assignment at the same point in time, can differ in their final opinions of value from as little as 11.5% to as much as 24.5%. Given that spread between appraisers, we use the benchmark that being within 15% of the actual sale price upon exit, is considered a reasonably accurate valuation for origination activities. In general, you can see in the table below we tend to trend around 13% difference between the valuation at origination and the actual exit price--with a slight bias towards undervaluation (measured by average error rate, as described below).

The main metric we use for comparison is the absolute error. Absolute error treats overvaluation and undervaluation errors equally and doesn't add a penalty for extreme errors which for us tend to be exits far in excess of our valuation.

As a secondary metric, we also track average error. Although average error is a very poor measure of accuracy because you can have a 0% error by having equal amounts of large errors on the positive and negative sides, it is helpful to show the conservative bias of the valuation process (a negative average shows a bias toward overvaluation and a positive average indicates a bias toward undervaluation). In the table below, you can see that over time, our hybrid appraisers have trended slightly towards undervaluation compared to when we first started tracking this back in 2018.

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| --- | --- | --- | --- |
| **Quarterly Exits vs. Third Party Valuation** | | | |
| **Date Loan Closed** | **Loans with Recorded Exit** | **3rd Party Avg Absolute Error** | **3rd Party Average Error** |
| 2018-01-01 | 1,000 | 13.79% | -1.53% |
| 2018-04-01 | 1,116 | 12.70% | -1.60% |
| 2018-07-01 | 1,193 | 12.37% | -3.25% |
| 2018-10-01 | 1,191 | 12.76% | -2.99% |
| 2019-01-01 | 1,160 | 12.80% | -2.09% |
| 2019-04-01 | 1,368 | 13.11% | -2.21% |
| 2019-07-01 | 1,347 | 13.31% | -3.29% |
| 2019-10-01 | 1,364 | 13.08% | -0.61% |
| 2020-01-01 | 1,144 | 11.35% | 2.40% |
| 2020-04-01 | 649 | 13.23% | 1.96% |

It is worth noting that the vast majority of those valuations in the table above are for an As-Repaired Value. So one of the things contributing to differences between the valuation at origination and actual exit price, has to do with whether or not the project was completed according to the original scope of repair work or not. We have a much smaller sample of As-Is Valuations (AIV) and those generally have absolute error rates of 7-8% (still with a tendency toward undervaluation) although they can also swing drastically for smaller sample sizes:

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| --- | --- | --- | --- | --- |
| **AIV Only - Quarterly Exits vs. Third Party Valuation** | | | |  |
| Date Loan Closed | Loans with Recorded Exit | **3rd Party Avg Absolute Error** | **3rd Party Average Error** | Alert |
| 2018-01-01 | 37 | 17.52% | 5.08% | Small Sample |
| 2018-04-01 | 73 | 11.52% | 1.05% |  |
| 2018-07-01 | 75 | 8.51% | -0.08% |  |
| 2018-10-01 | 107 | 8.86% | -0.20% |  |
| 2019-01-01 | 84 | 7.16% | 1.70% |  |
| 2019-04-01 | 91 | 7.63% | 4.00% |  |
| 2019-07-01 | 95 | 6.37% | 3.63% |  |
| 2019-10-01 | 86 | 7.96% | 4.80% |  |
| 2020-01-01 | 62 | 5.83% | 3.91% |  |
| 2020-04-01 | 32 | 35.92% | -21.39% | Small Sample |

In summary, we believe hybrid appraisals are a USPAP compliant, accurate way to value properties at loan origination. And they provide the ability to ‘stretch’ the capacity of our existing limited pool of appraisers in a responsible way.