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Tech Report

Expand your use of AVMs

What does automated valuation model (AVM) use for purchase loans have in common with e-mortgages? Both appear to be on a slow adoption curve.

At the MBA Tech conference in San Diego, the Tower Group's **Craig Focardi** told the audience during an e-mortgage session that AVMs for first-lien originations have seen adoption by just 5 percent of lenders over the last eight years (granted, AVMs have seen much greater adoption in the home equity business). E-mortgages have mirrored the AVM adoption curve so far. In 2004 (which he considered to be year five for e-mortgages), just 0.0006 percent of lenders were doing e-mortgages — the number rose to just 0.001 percent in 2005.

But valuation tools remain a top priority for lenders. We recently conducted an informal reader poll regarding their overall IT plans for 2006. We asked, "Of the following, which would you consider your top priority?" Answers included:

- Increase use of AVMs — 37 percent
- Automate underwriting/decisioning — 26 percent
- Electronic closing (with e-signing) — 21 percent
- Document imaging — 11 percent
- Other — 5 percent

Some say now is a great time to add AVMs to your arsenal in preparation for the next refi surge. Chief appraisers, chief risk officers and others charged with managing valuation can start expanding AVM use in other innovative ways, as well as to automate more of the business, and those lenders that haven't started yet can get an initial AVM strategy off the ground. For that latter group, the most important question to ask regarding AVMs may well be, "Where to begin?"

Get started

AVMs are gaining credibility in the marketplace, despite the decline in refinance activity, said **Julie Joseforsky**, president of KeyBank Mortgage. KeyBank uses AVMs for both purchase and refinance transactions, although the vast majority of its AVM volume is for the latter. A large portion of its home equity production is reliant upon AVMs.

As lenders move toward greater use of AVMs, they'll have to manage changes to their loan underwriting and credit policies, Joseforsky said. For example, underwriters who are used to reviewing traditional appraisals have to become familiar with faster, data-based tools.

"Your first instinct is to evaluate the AVM much like you evaluate an appraisal," Joseforsky said. "You end up spending more time with the product than is necessary. It's not a hard transformation to make. ... Over time, you come to trust the data that's available."

TransUnion Settlement Solutions' **Paul Chesia**, business analyst, automated valuation services, works with lenders to develop, test and implement AVMs (TransUnion's own Collateral Market Value, as well as other platforms) and





cascades. He sees AVMs being used at the front end of the loan process, as well, to get a more accurate value of a property.

Lenders preparing to make refi or home equity offers to a loan candidate or a pool of candidates are also using the tools to monitor equity changes and make appropriate product offerings.

“They want to know how much equity someone has, and then they would look for current value on that property,” he said.

Prospecting and lead generation is an excellent way for lenders to get their feet wet with AVMs, Joseforsky noted.

This includes not only identifying good refinance candidates but also offering online help tools consumers can use to gather market data for properties they’re investigating or to research a possible refinance. These consumer-focused AVMs are less robust than the models lenders use internally.

“Most of the tools on lenders’ Web sites are pretty watered-down,” Joseforsky said. “They’re not going to have the strength you would find from a lender’s perspective. But it will provide the consumer with enough information that they’ll feel much more comfortable with the process.”

Qualifying platforms

Lenders are becoming savvier in evaluating AVMs and determining where they can use them, according to Chesia.

One trend he has detected is that lenders are increasingly turning to AVMs based on greater loan details. In the past, criteria for where they could use an AVM were fairly simplistic and rigid. For example, lenders might have had a blanket policy of not using an AVM for a \$150,000-plus loan, but now that they’ve incorporated more loan attributes into that decision, they might consider using an AVM score if the credit score is greater than 650 or the LTV is less than 60 percent.

“We’re seeing a lot more decisioning logic coming into play,” Chesia said. “In the past, we just didn’t have the logic available to us to go that granular.”

When he works with lenders, model testing is critical.

“The competitive nature of the AVMs has forced them to be more proactive in increasing their accuracy and the frequency of the data load,” he said. “By going through the proper testing cycles, you can really make a lender feel comfortable as far as which AVMs provide the best value.”

To validate a valuation model, he first helps lenders find a proper sample size based on their footprint, using benchmark transactions in the area from the past 60 days. TransUnion next sends out that sample to each of the AVM suppliers, who value the properties. It then analyzes the AVMs to see which offer the best coverage in key areas and which were the most accurate.

Chesia also performs analysis for cascades. The important questions to consider when using multiple AVMs include which cascade order is best in accuracy and overall hit rate.

Even when they’re operating only at a regional level, many lenders are using cascades, he added. Some are using one cascade nationwide, rather than at the state or county level.

“We base that on their geography. If they’re only in a couple states, we then look at their AVM usage at the county level. Usually, we do an 80-20 split. Wherever 80 percent of their business is, that’s where we look to do a cascade. If 80 percent of their business is in two or three counties, we’ll look to do a cascade at those counties. The remainder of those counties will just have one overall cascade,” he said.

Joseforsky offered advice for lenders interested in reducing their risk through cascades.

“If it’s their first time, perhaps the best way to get comfortable is to use a vendor management company that already has experience and a cascading product in place. That helps to create institutional knowledge,” she added. Because each AVM provider has its own rules for probability of accuracy, lenders can set thresholds for those probability factors within their cascades. “If you don’t get a hit relative to the threshold you set in place, you try another provider in the hopes that their data comes back with a higher degree of probability,” she said, “The product is only as good as the data supplier.”

First mortgage adoption

Fannie Mae’s and Freddie Mac’s loan purchase



requirements haven't allowed for widespread use of AVMs on purchase transactions. However, Chesia predicted that as adoption of the technology expands in the refinance sphere, some overflow into first-mortgage originations will take place. More sophisticated and detailed credit policies will ease that evolution.

Veros CEO **Darius Bozorgi**, whose company offers the VeroVALUE AVM, said it's a promising time for AVMs in purchase transactions.

As the loan market shrinks and the business shifts from a focus on refinances to purchase deals, lenders face a more competitive environment and will turn to automated tools for underwriting to gain an edge. AVMs will help them close deals faster, pre-qualify consumers and give approval in a shorter period of time.

"[When lenders] have a consumer come to them, they want to close that deal as quickly as they can and keep that consumer off the street. One lender doesn't want to wait two to three weeks to close a deal when Joe Consumer is talking to competitors on the next block," Bozorgi said.

The same "need for speed" concept applies in other areas, too. When a wholesale lender is considering a deal, it faces the same competition as a retail lender. The selling lender is probably shopping loans around, as well. "That's why you see a lot of wholesale lenders with automated underwriting systems have AVMs heavily integrated as part of the underwriting process," Bozorgi added.

One step up, Wall Street investors also want to close deals rapidly and objectively. They're using AVMs to evaluate loan pools quickly. The tools can help ensure that lenders and investors get updated scores to determine how current the seller-supplied values are.

"No lender wants to sacrifice accuracy and objectivity just for speed," Bozorgi said. "You don't know what you're underwriting or buying as an investor."

Objectivity is also why AVMs are being implemented to counteract appraisal pressure. Bozorgi noted that in markets where either values are declining or appreciation is slowing, appraisal pressure mounts and AVMs become more valuable as an independent measure and check of property valuations.

"There are a lot of people advocating that an AVM be run on everything that comes through the door, if for

nothing else other than a check. That can be done relatively inexpensively for a lender. It gives them that extra check relative to credit risk," he said.

Expanded uses

Bozorgi recommends that lenders start off using AVMs not in underwriting but in a quality control role. He agreed with both Joseforksy and Chesia that marketing represents a fast-growing application for the technology. Mortgage companies can analyze markets to determine in what areas of the country they will focus their marketing campaigns or even locate new branches.

Using AVMs within a marketing portfolio, lenders can subset a pool for a more targeted campaign. According to Bozorgi, some companies using AVMs in this manner have increased conversion rates by 200 to 300 percent.

"A lender on a particular marketing campaign may have [seen] around 1 percent conversion or less," he said. "With these more targeted campaigns where they're using tools such as AVMs, they're seeing those conversion rates go up to 4 to 6 percent. That's a huge increase."

Another area where there's a strong need for AVMs is servicing. AVMs help lenders assess the inherent risk in portfolios on a continual basis, he added. Working with sub-sections of a portfolio, they can anticipate which parts will be problematic and be proactive in managing risk.

The valuation scene evolves

AVMs are attracting a great deal of attention as lenders look to boost their margins and run faster and leaner. To help you as you design and refine your automated valuation strategy, we'll continue to examine adoption by mortgage companies, as well as new uses for these important tools. Down the road, we'll be looking at how AVMs are performing in the long term compared to full appraisals. Stay tuned!