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Viewpoint

The need for AVM testing standards

In an interview with Real Estate Technology Insight, **Darius Bozorgi**, president & CEO of Veros Software discusses lender adoption of AVMs and explains the importance of establishing testing standards. The Real Estate Information Professionals Association (REIPA) has approved the formation of an Automated Valuation Model Standards Committee whose charter is in the process of being finalized.

REIPA formed its committee in response to the request made by a number of AVM developers, including Basis100, Hansen Quality, Fidelity National, First American, Fiserv, Real-Info and Veros. Bozorgi has been elected chairman of that committee.

Why is it important that we set testing standards for AVMs and what areas most need standards?

There is the issue of standards in AVM testing to solicit valid and meaningful results. Here, we talk about the preparation of appropriate test samples, including types of properties tested, appropriate benchmarks used for comparison and the determination of various accuracy metrics, types of data requested for output, etc.

Standards in AVM evaluation would address how output should be reviewed and what the various conclusions are that can be drawn based on results from testing and actual production. If evaluating accuracy, is median absolute error better than mean absolute error? How do these decisions change based on assumptions that error distributions are normal or not?

There are issues of standards in performance or best practices in the development of AVMs and their associated analytics. For example, what is the most appropriate definition of a confidence score? We also need to consider whether it is appropriate to expect developers of these products to deliver on the same scales and with the same meanings for ease of comparison or use in multi-AVM systems.

In the relatively near future, MISMO standards applicable to AVMs and other collateral assessment alternatives will be finalized. In part, these standards will attempt to address the electronic delivery of the types of information typically found in an AVM. The issue of standards is a potentially misleading one and should be considered both with caution and in incremental steps. AVM clients have a very wide range of uses and associated risk tolerances.

Even within one lender, different programs may require an alternative approach to AVM selection and implementation. Practical realities of business and the mortgage landscape lead to varying conclusions as to what makes a good or optimal AVM for varying and sometimes conflicting scenarios.

How accurate are the AVMs available today and what do you believe is the minimum accuracy that should be accepted?

AVM accuracy for the industry as a whole has significantly increased in the last 12-to-18 months. This is due, in part, to better data from multiple sources, data processing enhancements, and the implementation of more dynamic valuation





methodologies. Accuracy will vary from AVM to AVM by geographic coverage, property types, price range, etc. One “general rule of thumb” that is often referenced in terms of an accuracy yardstick is the number of properties within plus or minus 10 percent of a valid and meaningful benchmark (ideally the sales price in an arms-length transaction).

For more accurate representations of accuracy and usability, the user should have some idea of the distribution of values within that range which may lead to a very different conclusion of suitability for an intended use. There are a host of other meaningful metrics that provide valuable insight into AVM accuracy, including median absolute error, mean absolute error, standard deviation, analysis of error at specific points in the distribution, etc. One other important aspect regarding accuracy is the percentage of outliers that an AVM produces, in particular with regard to overvaluations.

Are lenders and their investors beginning to trust automated valuations?

Lenders and investors are not only trusting AVMs more, but increasing their usage in a wide range of settings. For example, our customers use AVMs throughout all aspects of the mortgage process, starting from marketing, pre-qualification, origination (both purchase and seconds), quality assurance and compliance, due diligence, servicing, retention, portfolio review and securitization. Users range from small credit unions to the largest lenders in the country and Wall Street. In addition, the industry is seeing the introduction of new and related collateral assessment tools that include insured AVMs, hybrid AVM solutions that add the perspective of a local real estate professional, fraud scoring, forecasting, risk-based pricing tools and collateral and other risk scores. These tools are here to stay. Their acceptance and use is increasing at unprecedented rates, but all for very valid reasons—they add significant value to the process.

Some have said that lenders can save so much by using AVMs that they would be able to afford to self insure against losses on the small percentage of loans that both go into default and have a bad collateral valuation. Do you agree?

I am not sure if the cost savings alone would allow lenders to self insure against these losses. Any self-insured retention, effective or otherwise, is more likely related to a lender’s experience with and ability to quantify risk of loss. If anything, I firmly believe that effective use of these and related tools will help further limit the number of loans that go bad with or without bad collateral valuations. I would expect that many lenders perform at least some type of loss severity analysis that may take into account the impact of AVMs on both the models and corresponding results.

What will it take to increase adoption of AVMs?

I expect the AVM market will increase almost tenfold over the next five years. Knowledge transfer and education are key to further AVM acceptance and adoption. At Veros, we proactively embrace the notion that AVM developers can effectively explain how these products work on most levels without exposing any proprietary information. Further, we take it upon ourselves to explain the pros and cons of AVM, when and in what circumstances an AVM is best used, and identify how AVMs and their related collateral analytics can be most effectively integrated into a particular customer’s organization, considering intended use and appetite for risk. Finally, greater acceptance of these tools by the secondary markets, the investors, GSEs and rating agencies will push their use to new heights.

Darius H. Bozorgi is CEO & President, Veros Software. He has several years experience in the world of automated collateral assessment products and other predictive technology based decision-support applications for the financial services, aerospace and engineering industries.

Bozorgi co-founded Veros Software after spending most of his early career practicing law in Chicago, where he specialized in civil litigation for one of Illinois’ largest law firms. He has also been involved in the successful capitalization and operation of several technology and finance ventures.

He has served on the board of directors of several companies and currently serves on the board of Credit One Corp., located in Santa Ana, California.

Bozorgi received his J.D. from Chicago-Kent College of Law and his undergraduate business degree from the University of Michigan, Ann Arbor.

Bozorgi is frequently asked to lecture and speak on practical applications of predictive technologies in the financial services industry. He lives in Southern California with his wife and two children.