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Automated valuation models provide an answer to appraiser shortage

The critical role of data in determining true value

Veros

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Some of the hottest housing markets hit double digit growths last year while at the same time fees and delays related to the appraiser shortage continue to rise, throwing a wrench into an otherwise smoothly running mortgage machine. How will this impact 2017 as new loan programs look to expand the credit box?

According to Appraisal Institute data from June 2016, the number of appraisers has dropped 22% since 2007, and the average age of appraisers is now 53, with few younger workers entering the field. The decline is partly due to a mismatch of regulations and licensing requirements, which demand 2,500 hours of appraisal experience on one hand, but bar apprentices from performing full appraisals on the other.

Without a change in those regulations, appraisers have no incentive to bring on apprentices, and, with no clear path to employment, the number of appraisers will continue to dwindle. The Appraisal Institute predicts that the number could drop as much as 30% in the next 10 years.

Collateral valuations are a critical part of any loan, so the shortage of qualified appraisers puts up a serious roadblock in the mortgage process, especially for lenders who rely fully on appraisals for all transactions. Lenders in a 2016 Stratmor survey reported that appraisal turn times had increased 70% for purchase loans and 81% for refinance loans.

In hot markets, the appraiser shortage is especially disruptive. According to *The Seattle Times*, about three fourths of the homes listed in that city spark bidding wars, resulting in multiple inspections and appraisals on the same property. CNBC reported in September that it was taking up to seven weeks to get a traditional appraisal in some areas.

For lenders, waiting for these types of durations on an appraisal puts the entire loan process in jeopardy as rate locks expire and borrowers are unable to afford higher payments. Now that the market is in a new, higher rate environment, closing delays can ruin a homeowner's chances to get their preferred home and negatively affect the lender's bottom line. *The Denver Post* reported that closing times had climbed to 43 days in September, versus 39 days a year earlier. The chairman of the Denver Metro Association of Realtors said the closing delays were a direct result of an appraiser shortage.

Quality could also suffer in the midst of this shortage. Appraisers called in from outside a community — sometimes as far away as another state — may not be qualified to accurately assess a property's true value. And under an increased workload, appraisers may have less time for due diligence. In the Denver area, buyers are paying surcharges to move up the waiting list, pressuring appraisers to perform more appraisals per day than in the past.

With no end in sight to this shortage, when is it time to bring appraisal alternatives to the forefront?

While full appraisals are mandated for purchase mortgages, other situations don't require a traditional appraisal, including pre-qualification at loan origination, prefunding, post-closing quality control, real estate owned (REO) management and portfolio retention.

For these situations, lenders and servicers can leverage alternatives to determine a property's value, including:

- Automated Valuation Models (AVM)
- Property Condition Reports (PCR)
- Broker Price Opinions (BPO)
- Home Price Indices (HPI)
- Residential Evaluations
- Small Balance Commercial Evaluations
- Desktop Appraisals
- Desktop Appraisal Reviews

While no one tool is best for all valuation needs, appraisal alternatives are designed to give lenders and others a variety of tools to value property, augmenting the traditional appraisal with options that fit individual situations. These tools harness the vast amount of data flowing through the marketplace to provide accurate, timely valuations without having to rely on appraisers.

Alternatives to full appraisals have gained increasing attention and support in the last several years. In November 2016, the House Financial Services Subcommittee on Housing and Insurance held a hearing on Modernizing Appraisals to "examine the appraisal industry since the creation of the Appraisal Subcommittee in 1989, review the Dodd-Frank Act's impact on appraisers, consumers and stakeholders, and explore the future of appraisals, including alternative home valuation methods."

Improving appraisal accuracy has been a high priority of both Fannie Mae and Freddie Mac since the financial crisis, and both employ AVMs as a crucial part of their appraisal risk management systems. In November, Fannie Mae expanded its AVM use, waiving the need for an appraisal on certain refinance loans. Fannie Mae had previously given Property Inspection Waivers on about 3% of its loans and said its new approach could boost that to 10%.

AVMs address two areas of specific concern since the foreclosure crisis: valuation quality and neutrality, while relieving the pressure on appraisers. AVMs report a fact-based representation of a property's value and they are transparent, so companies can apply internal and third-party testing and the industry can measure and benchmark AVM results.

Following the lead of the GSEs, lenders, servicers and investors have welcomed the opportunity to minimize their risk and get a transparent view of property valuation by using appraisal alternatives alongside traditional appraisals.

DEEP DATA

The success of any AVM solution relies on the quality and depth of the data that it uses. Financial institutions already rely on high-integrity data sources to do everything from verify a borrower's income to evaluate their credit worthiness. Leveraging the same kind of automated model for property valuation is a viable alternative to full appraisals that gives lenders both accuracy and efficiency.

Additionally, the breadth of AVM testing across the entire AVM market has unequivocally demonstrated that improvements in data quality and quantity, combined with more sophisticated modeling, have brought AVMs up to a point at which there is wide agreement on their reliability and effectiveness.

A panel at the MBA's Risk Management, QA and Fraud Prevention Forum in 2016 found that AVM performance had increased significantly over the past seven years, and that the combination of AVMs and AVM technology with other valuation products provides a strong risk-management solution.

Presented by Darius Bozorgi, president and CEO of Veros Real Estate Solutions, the panel reported that on a national level, AVM hit rates were more than 90%, and more than 85% of valuations were found to be accurate to the P10 standard (percentage within 10%). AVMs achieved even better performance at the state and metro-level, with AVMs returning hit rates of more than 95% in Los Angeles, California, Maricopa County, Arizona, Cook County, Illinois, and Queens County, New York.

These stats demonstrate that across the commercially viable AVM providers, the ability to return an AVM is exceedingly high and amazingly accurate. AVMs are highly adaptable for use in a variety of scenarios, whether utilized on an individual report basis with supporting sales data, sourced from highly comprehensive databases; or in bulk across large portfolios. Portfolios also allow users to combine useful data points including market forecast data, first-mortgage data or market risk data.

Given the objectivity, cost-efficiency, and quick return time (within seconds) of AVMs, now is the time for lenders to seriously consider these tools to lessen the burden on appraisers and allow them to focus on the transactions that need their expertise most.

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