



ISSUE PAPER

Subject: Automated Valuation Models (AVMs)

Issue: Automated Valuation Model (AVM) technology can augment and streamline the appraisal process, but currently lacks standardization which would benefit the industry. Standardization is needed in terms of investor requirements, interface with fraud detection systems, data standards, and accuracy measurements.

Background: AVMs are models that calculate a value for a residential real property by accessing data from commercially available databases of real estate public records. These databases are typically compiled from county assessor and county recorder sources, but can also access data from appraisal and Multiple Listing Service (MLS) sources. AVMs can provide instant property valuations, thus speeding one of the slowest steps in the origination cycle.

Mortgage lenders use AVMs to augment or sometimes replace the existing appraisal process, performing quality control, and for flagging potential fraud. AVM use as a substitute or augmentation to the appraisal process is more prevalent for Home Equity Lines of Credit (HELOCs) and term refinance mortgages than for purchase mortgages. AVMs are primarily used in the origination of a loan, but are also used later on to perform risk analysis in secondary and servicing purchase transactions.

While the cost of an AVM valuation is usually significantly lower than a traditional appraisal, many lenders believe that AVMs entail greater risk of inaccuracies because the underlying data may lag changes in the market and there is no physical inspection of the property by an appraiser.

Currently there is little standardization in the AVM industry. The valuation results and confidence scoring (and scoring ranges) from different AVM systems can vary depending on the models used. This variation makes direct comparisons among different AVMs difficult.

The MBA Residential Technology (ResTech) Steering Committee and industry lenders have identified several AVM issues where MBA may be able to help.

The lack of standardization among investors occurs in terms of requirements they may have for AVMs used in the loans they purchase. Investors' requirements are often independent and different from each other, and investors will often run their own AVM on a pool, which may or may not be similar to the model that the lender used in originating the mortgages. The investors' model results are sometimes the basis of

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negotiations for the repurchase of loans. Thus, the lack of standardization in terms of investor AVM requirements increases a mortgage lender's risk in using AVMs.

There is also a lack of standardization among AVM providers as to how their AVM service plugs into additional fraud detection services the AVM provider may offer. As consolidation in the real-estate services area increases, many services are collapsing AVMs into a package of services (Title, Appraisal, Hazard, etc). AVM providers are especially combining fraud-detection elements into their service packages. These elements provide lenders with a score or probability that fraud is present, indicating that the lender should perform further checks prior to loan closing. There is a lack of standardization as to the type of potential fraud that the AVM is flagging (i.e. over-valuation or a property flip) and how the AVM flag interacts with other types of potential fraud that is being flagged by the fraud detection service.

Additionally, there is a lack of data standardization in the AVM industry, including naming fields for the types of values and defining these fields on an industry-wide basis. The MISMO® Real Estate Property Information (REPI) Workgroup (www.mismo.org) is finalizing standards for full Appraisal transactions and SMART® eAppraisals. REPI plans to incorporate various data fields for AVMs to address this standardization issue.

Another area of data standardization is the “refresh” rate of the AVM vendors' underlying data repositories. The refresh rate refers to how frequently the AVM providers' modeling data is updated from its original sources. This could become a problem in a rapidly declining housing market.

This could be mitigated by establishing a “best practice” of a regular, standardized report that AVM providers would send to their customers. This report would outline, in a uniform fashion, the types or actual referenced underlying data repositories (or sub-providers) being utilized in their scoring process, and the currency of those data repositories and their updates. Between 2002 and 2005, when prices were appreciating in many markets, AVM “undervalued” property values. The concept of collateral value in the real estate is very fluid. Sometimes even appraisers have challenges finding an appropriate data set to support their conclusions.

Finally, the lack of standards is not so much related to the AVM “scores,” but the process of model validation, particularly in measuring the accuracy of the models relative to the appraisal reports. This lack of standardization makes it difficult for mortgage lenders and others to compare the strengths and weaknesses of various AVMs.

To address some of the above issues, along with continued fierce competition and aggregation of more and more data repositories, hybrid AVM solutions are continuing to emerge. These solutions are meant to give lenders increased trust in the performance of the AVM by coupling the automated model with additional checks and balances. These hybrid AVM solutions can be broken down into three sub-categories:

- AVM coupled with an Appraiser – this is the most traditional model right now and the only model that receives official support. It could be done by combining the

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AVM into the loan package with a “live” appraisal, or by having a local certified appraiser review the values of an AVM to determine if more action needs to be taken.

- Combined AVMs – This is where a lender requests that an AVM provider combines its own methodology with that of one or more AVMs, creating a combined value.
- Insured AVMs – Generally, this is an insurance policy that insures the value assigned to a property by the AVM. There are still many open questions regarding what is insured, when it is insured, how it is insured, etc.

Some lenders have started to combine AVMs with credit and borrower data to produce “collateral scores” for pricing loans and determining the most cost-effective collateral review tool.

In conclusion, the mortgage banking community has welcomed the additional quality and automation that AVMs can provide to the origination process. But there are some key issues that need to be worked out with the industry and other AVM working groups that would better establish accountability of an AVM value within the context of a mortgage transaction, and ultimately allow for the “apples-to-apples” comparison that many lenders are so interested in being able to make.

MBA Position: MBA believes that AVM technology is an important emerging tool in residential mortgage banking, especially when used to augment existing processes. MBA recommends that the industry standardize investor acceptance requirements, standardize how AVMs interface with fraud detection systems, and standardize the underlying data information, including refresh rate.

If possible, MBA, in collaboration with the AVM industry and other Associations, should establish objective certification criteria by which AVM product and service providers can be measured against, to meet the secondary market acceptance criteria. As a result of AVM data and transaction standardization, along with standardized reporting and certification criteria, AVM technology will provide better-quality information to the industry, and ultimately become even more useful and widely adopted.

Status: The MBA Residential Technology Steering Committee has met with AVM specialists to vet the issues and create these positions. This position was approved by the Committee in June 2006 and forwarded to members of other MBA residential committees for their review.

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