

Update Your Valuation Strategy For Greater Accuracy

***Relying solely on automated valuation models
may not be the best course of action.***

By Jon Davis

Investors have long deployed automation as part of their collateral valuation strategy. Typically, when investors are analyzing a pool of loans for purchase or re-evaluating existing portfolios, they utilize an automated valuation product up front to help understand collateral-related risk. Lower-risk loans - those where the automated value model (AVM) value or automated neighborhood risk score supports a low risk of overvaluation - require a lesser degree of additional scrutiny.

Higher-risk loans - those where the AVM value or automated neighborhood risk score indicates a higher risk for overvaluation, or those in areas with limited available data - are usually escalated to a much more expensive field valuation product.

Certainly, in today's volatile real estate market, investors can ill afford to take chances with collateral valuation. They need to know exactly what is in their portfolio - but it's not an easy task. Collateral values, especially in some areas of the country, are still very volatile. Within a market, certain types of properties may be holding their values, while the bottom is falling out for other types. Even at the neighborhood level, one area can

be in much better shape than another nearby neighborhood.

The fact is, many diverse market conditions exist within the same city. Even within the same neighborhood, separate conditions may exist for different property types or price ranges. This environment certainly challenges investors as they analyze portfolios. The results from an AVM might return a high confidence rating but still not accurately reflect neighborhood factors. Even costly on-site appraisals don't always tell investors everything they need to know - especially about the impact of upcoming foreclosure properties that could flood the local housing market with inventory.

Beyond valuation data

Automated valuation models are great tools for providing ballpark valuation estimates in homogenous areas with rich, recent real estate data sets. AVMs all have their own proprietary analytics, but there is a standard range of data that these models always include. All of them factor in available information about the characteristics of subject properties, the year of their last sale, the purchase price, recent sale prices of comparable properties in the area and so on. Some may also incorporate published data about unemployment rates and other economic indicators in an

attempt to factor in local conditions.

When AVMs produce values that are outside of an investor's variance tolerance, indicating collateral that is potentially overvalued, the investor often escalates the process to order a broker price opinion (BPO) from real estate agents or brokers in the field to obtain more precise values for the collateral backing the loans in their portfolio. These BPOs are developed with an on-site view of the properties and supplemented by the knowledge these agents and brokers have of their markets.

But that's still not enough to get a true reading on a property's value.

The problem with AVMs, BPOs and even full appraisals is that the data that can have a dramatic impact on property values reside outside of the standard valuation process. Those data include information about how many properties in the area are 90 or more days delinquent, how quickly properties are going delinquent (the rate of deterioration in the market), the number of properties that are already in foreclosure and the number of real estate owned properties (REOs).

The data also include historical price trends, one- and two-year price trend forecasts, delinquency, foreclosure and REO trends, percentage of REO sales, average number of days on the market, absorption rates, and foreclosure and REO timelines. Not all of these data are readily available

Jon Davis is managing director of LPS Applied Analytics' Valuation Group, based in San Diego. He can be reached at jon.davis@lpsvcs.com.

from public record resources - as such, it is rarely included in the valuation process. Yet, in today's market, this information is critical to the ability of investors to gain accurate insight into the collateral value and the valuation risk in their portfolios.

The answer is not simply to purchase data - most investors don't have time to pour through reams of data in an effort to make sense of a local market. However, with the automa-

tion tools that are currently available and expert analysis of the critical data that reside outside of the valuation process, collateral valuation accuracy can soar.

In this complex market, there is no one approach that will bring about the valuation certainty that investors need to make decisions. Investors must analyze many factors to determine the most appropriate valuation approach to use on their portfolios,

including loan-to-value ratio, property location and availability of data, and delinquency status, to name just a few. Loans considered to be higher risk in the aforementioned categories require more thorough local analysis.

There simply is no perfect market out there, and no matter how stable a local market looks to an automated valuation model, there is usually more going on than meets the eye. **SME**