

VeroSCORESM



BEST PRACTICE GUIDE

How to Execute a Meaningful Test of Appraisal Scoring Technology



BACKGROUND

In the not too distant past, appraisals were conducted with no standardization of data formats, terminology, rating levels, or delivery to any end user. Traditional methods of delivering appraisals, such as faxing or sending reports via U.S. mail and courier, were still in place. Important documents were received inconsistently and in a written format, requiring manual input of data, increasing the opportunity for error and leaving no avenue to leverage or analyze the report's data through available technology.

With these issues at play, and with no efficient mechanism to verify appraisal data between stakeholders, the door was left open for mortgage fraud through over-valuation of properties, ultimately contributing to the collapse of the American housing market.

The collapse led to changes in government regulations, industry standards and a re-structuring of the loan origination process across the nation. These changes include the creation of the Uniform Appraisal Dataset (UAD) which defines all fields required for an appraisal submission and standardizes definitions and responses for report fields, the adoption of MISMO as the industry-wide, open source data standard for the transmission of appraisal data, and the development of the Uniform Collateral Data Portal® (UCDP®), a single portal for the electronic submission of appraisal data to Fannie Mae and Freddie Mac, and the Electronic Appraisal Delivery (EAD) portal for appraisal submissions to FHA. This shift paved the way for the implementation of more meaningful technology to the lending process and allowed for the integration and enforcement of data integrity and validation along with closer monitoring of organizations delivering appraisal information.

Today..

With the costs of compliance layering expense on the origination process, automation of appraisal review has become more important than ever to help lenders increase efficiency and confidence related to risk. There are several software options available on the market today with the intended purpose of streamlining data acceptance from appraisers, with some tools verifying information with public and private data sources, and performing some level of analysis to ultimately deliver a 'score' to aid in making risk-related decisions.

Although there are several appraisal scoring options available, optimal solutions will examine each appraisal for potential risk within and outside of the appraisal. Identifying the best solution to fit your company's needs can be overwhelming, especially since there is no standard format or formula among the various industry offerings.

While this variation allows lenders to evaluate a variety of different tools and ultimately select the solution that best fits their organizational needs, it can create challenges in designing an “apples to apples” comparison in the procurement process. If a test is not designed properly or if decisions are made upon the report format alone, these variations between offerings may not become evident until after the tool is in use within the user's workflow and lending decisions have already been made.

By following the best practices outlined in this white paper, an organization will be better equipped to identify the product that delivers the solution needed to make informed risk decisions.

IDENTIFY YOUR APPRAISAL WORKFLOW & CHALLENGES

Prior to identifying appraisal scoring vendors and solutions to compare, it is vital to clearly understand a few appraisal-related issues relevant to your organization:

What is the workflow regarding loan origination data and appraisals?

This will allow you to identify a solution that will best support your processes and determine when/how a scoring tool should enter your valuation process.

For example: Will the tool be used by underwriters or reviewers to support your existing process? Will the tool be a component of existing technology to determine valuation flow and routing or will it be relied upon as a stand-alone report for validation?

What issues or challenges are you experiencing?

Knowing this upfront will enable you to pay special attention to any solutions presented that will solve or minimize those critical issues.

For example: Does your organization deliver to Fannie Mae and/or Freddie Mac? If so, are you experiencing challenges with repurchase demands that could be remediated through enhanced capabilities to identify and remediate potential risk upfront?

What are your current turn times for appraisal review and what automated turn time will enable your reviewers to be more efficient in their roles?

It is important to enter into an evaluation process with an expectation of what improvements you will experience and if there is a variance between vendors.

For example: Are your reviewers wasting time on appraisals that are non-compliant or incomplete?

Determine what your organization's 'thresholds' are for acceptable levels on all parts of the appraisal report and any related data that may be provided. What is your organization's view of appraisal risk and the criteria for compliance? For example, do the property comparables in an appraisal need to be within a specific distance or date range? Do you care about the comparable properties that were not selected? Is your organization seeking an evaluation of the accuracy of the final estimate of value? Will you require certain types of risk to be identified and elevated to specific types or levels of review (i.e. senior reviewers)?

In order to garner a realistic evaluation of products and be able to determine which tool will enhance your process and generate beneficial results, you need to understand your current situation and expectations.

DETERMINE CANDIDATES

There are a number of appraisal review technology tools available on the market, each with their own unique set of features and perspective on appraisal review. For this reason, it is vital to understand the various components, capabilities, strengths and weaknesses of each solution before a tool is implemented into your business process. Ensure that you clearly understand what information is provided in the report - clarify what score definitions, what score values mean and how you should utilize the data provided.

Veros recommends that you create a list of 'must-haves' and 'nice-to-haves' prior to evaluation.

- What input format does the appraisal report need to be in for the tool? XML, PDF, etc.?
- How automated is the tool?
- Is there an ability to identify compliance issues with current industry standards such as UAD, UCDP and EAD findings prior to submission?
- How are the results reported back to the user? Simplistic, color-coded indicators? Numerical rating of analysis? Is any supplemental information provided?
- Are recommended 'next steps' provided?
- Is the appraisal data compared against trusted public records for validation and verification?
- Does the tool validate the appraiser's license status and geographic regions licensed to appraise?
- Are comps in the appraisal measured against recent sales in the area to help ensure they are the best comparisons?
- Does the tool evaluate against a reliable automated valuation model (AVM) or other viable alternative as a benchmark against the appraised value? If so, is that value displayed in the report? How does this align with your organization's policies for Reg. B compliance?
- Can the tool integrate with other technology you are using in the loan origination flow?

APPRAISAL DATA SAMPLING

Obtain XML Data: The optimal appraisal data format for evaluating and using the top appraisal scoring technology is XML. If first-generation PDF files are the best source of test data available, quality appraisal scoring tools will be able to automatically assist with extraction. However, even the best extraction tools can present errors which will alter the results of the scoring tool and ultimately impact the tool's opinion of appraisal quality and risk.

If XML data is not being stored within your organization, it is likely that your appraisal forms vendor or the vendor assisting you with the delivery appraisal data to UCDP or EAD can provide it to you.

It is important to note that non-first-generation PDFs (i.e. copies of copies) cannot be extracted. If optical character recognition (OCR) is used, there is even greater variability of successful translation. Finally, manual translation is both more costly, time consuming and prone to its own set of errors.

The best test should most closely mirror what the process would / should be in production. XML both as an input and an output is strongly recommended.

Ensure Test Files Are Recent: Appraisal scoring tools utilize today's regulations. Any appraisals performed before practices such as UAD (i.e. 2009 or earlier) were implemented will clearly be non-compliant and will fail in key components of the tool's analysis, which should be built upon current rules and regulations.

Sophisticated scoring tools will also compare the appraisal data to recent validated data sources and outdated data will present similar red flags. For example, an appraisal from 2015 will include three or more comps and include the sales price for those properties at the time the report was created. When run through a current appraisal scoring tool, there may be more recent sales data for those same properties, thereby flagging the appraisal as having inaccuracies when in fact the data from the appraisal is simply not up-to-date, but could very well have been accurate at the time the report was submitted.

Additionally, a quality scoring tool will also make an opinion as to the accuracy of the appraised value. As housing values change over time, dated appraisals may appear to be more or less accurate when they conflict with more current estimates of value made by the automated tool. Finally, compliance rules change over time. Testing an older appraisal file against current compliance rule sets is likely to generate a high percentage of false positives.

Veros recommends that your sample appraisals are conducted within 3 months of the test, but no more than 6 months.

Gather Generous Sample Size:

To run a successful and measurable test of any scoring tool, it is imperative to have enough test cases to prove the overall accuracy and effectiveness of the tool and to ensure that anomalies in any one report do not overly skew results. Additionally, the test cases should be a good representation of your book of business and should include a cross-section of variables (i.e. price tiers, geography, property types or loan types) as well as multiple vendor sources (if applicable).

Veros recommends a test sample of files that is statistically significant to the size, scale and make-up of your organization ~ consider a test size that represents a month or quarter of production.

PREPARATION FOR TESTING

Conduct Internal Review of Files: Prior to selecting the test sample of appraisal reports, conduct an internal review to determine which appraisals your organization believes to be low risk vs. high risk, incomplete or non-compliant, or otherwise noteworthy.

Analysis during the selection of appraisal score tool candidates should have revealed the other metrics available through each tool. Understand what those metrics are so that your team can identify the importance of those metrics to your organization and measure those criteria in your initial review of the sample files prior to transmission. For example, if a tool measures risk related to comparable properties, it would be helpful to identify which appraisals in your population were identified as having reliable vs. questionable vs. inaccurate comparables.

Veros recommends that you keep your findings confidential within your team in order to gather a true measurement of the tool's scoring success.

Transmission of Testing Files: Provide test appraisal files in a secure delivery system. The vendor should be able to provide a secure FTP drop site to which your team or XML-supplying vendor can upload the files. This site can also serve as the receive location once the final test results are prepared.

Short Return Timeframe: Automated tools should have a short leash in the testing phase to ensure that the test is using the automated technology in a realistic production environment. Overly generous timelines allow vendors time to view, modify or manually affect the results.

A typical timeline for a scoring test of XML appraisal data is no more than 48 hours but may vary for extremely large sample sets.

ANALYZING RESULTS FROM TEST RUNS

Collect Results: Each vendor should return the appraisal scoring results to you within the timeframe you established prior to the test being conducted. This timeframe should be the same across all participating vendors (i.e. 48 hours within a reasonable date span, if not run concurrently.) Results returned outside those time constraints should be noted and the results should be closely analyzed to ensure that they have not been modified or adjusted.

Compare Vendor Results with Internal Results: How do the results generated by each vendors' tool compare to the internal measurements identified by your organization prior to the test? Is there agreement between your low and high risk files and those identified by the appraisal scoring technology? Additionally, sharing your insights will assist the vendor in better optimizing their scoring technology.

Review your internal findings with the vendor to ensure alignment.

Where PDF extraction was utilized, the review of results becomes even more critical in order to identify whether discrepancies are related to extraction issues or to the tool itself.

Assess Alignment of Technology with Organizational Needs: Some appraisal scoring technology generates results with limited data and next step recommendations indicated with color codes while other solutions provide numerical scores with more detailed analysis and data to support the scores.

Identify the level of data your organization requires to make your risk assessments and decisions.

Technology Security:

It is imperative to ensure that your appraisal information is safe from foreseeable threats in security and data integrity. Ensuring data security requires discussions with potential vendors regarding their security infrastructure. You will want to verify that the vendor you choose has appropriate security measures in place and ideally these measures should be independently audited with proof thereof. If you will require the integration of your appraisal scoring tool with other technology providers in your valuation chain, inquire if the candidate company has an integration already in place with your other vendor(s), what their process (and cost) will entail and what the company's track record is for successful system-to-system integrations. In addition, for any implementation that will have an impact on loan production, verify the system availability of your vendor to ensure that your production will not be delayed by any system being down.

Ensure that all data from the vendor will be transmitted in a secure and encrypted format.

Customer Support: Choosing the right solution is important and ensuring that the company will be there for you if any issues arise is equally important. Obtain details on the organization's customer support structure and process including whether customer support resources are in-house or out-sourced. Does the customer service team have direct access to developers and/or product managers in the event that issues arise?

Clarify what the vendor's policy is on turnaround time for a response.

CONCLUSION

With the increased requirements of today's regulatory and oversight environment, the mortgage industry is facing more challenges than ever before. Lenders are judged on each detail of their transactions and the appraisal is especially scrutinized for risk as a key component of the lending decision.

No appraisal scoring tool should be meant as a substitution for proper oversight by the lender or as a "guarantee" of compliance.

The intent of an automated appraisal scoring tool should be to validate and verify appraisal data in a timely manner and shine a spotlight on those appraisals that require further scrutiny, enabling informed decision-making and reduced risk. From a reviewer's perspective, more detailed information allows for productive discussions with appraisers on reports which require revision and can strengthen future business interactions.

The time invested in properly and thoroughly evaluating appraisal scoring technology (or any technology for that matter) will be richly rewarded with a successful on-boarding, instilling confidence that the tool will add value, make resources more efficient, increase objectivity, and reduce risk with a clear, complete analysis of the appraisal data.



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