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# AMCs: Reconsider The Notion Of AVM Cascades For Home Equity Lending.

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# AMCs: Reconsider the notion of AVM cascades for home equity lending.

## *A White Paper about AMCs and the Sale of Automated Valuation Models*

by Robert L. Walker, CMB, CMT, MBA

### ***Note from the Author***

*This is the third in a series of white papers about VeroPRECISION™, a superior valuation alternative to the traditional AVM cascade approach. VeroPRECISION was developed specifically for distribution by Appraisal Management Companies for the home equity application. At Veros, our objective is to equip AMCs with an AVM decision engine that optimizes the AVM experience for the lender while leveraging the expertise and valuation acumen of the Appraisal Management Company.*

*The first white paper entitled, “Choosing AVM Accuracy and Suitability over the traditional AVM cascade,” addresses the notion that traditional cascade logic is about hit rate and not accuracy. Focusing on hit rate and relying on AVMs to value properties when they are inappropriate for AVM use results in a significant loss in valuation accuracy.*

*This second white paper entitled, “Are Properties Ever Unsuitable for an AVM?” focuses on properties that were deemed unsuitable for AVM use by VeroPRECISION. We valued these 107 properties with five independent AVMs and assessed their accuracy in relation to recent appraisals on the same properties. The results were eye-opening.*

### **BACKGROUND: AMCS AND THEIR VALUE CONTRIBUTION**

Lenders have placed their faith in Appraisal Management Companies (AMCs) for some time. This trust is well founded since AMCs are required to understand the nuances of collateral valuation on a national scale. This task is something that few lenders want to take on, nor do they have the resources to do so.

As expected, AMCs act as the prudent risk manager and consultant on matters related to collateral valuation. Their recommendations are always subject property based. If the subject property is a small rural home with massive acreage, then the indicated appraiser is one with rural property experience. If the subject property is an apartment complex with 10-units, an appraiser with income property experience is the right person for the assignment. The implications are obvious. AMCs find the right appraiser for the relevant property assignment.

The same analogy can be applied to appraisal or valuation products. Based on the underwriting risk, lenders and AMCs work to select the relevant valuation product for the lending assignment. For many years, the drive-by appraisal (FNMA 2055) was the product of choice for home equity lenders. In 2018, the preferred product may be an evaluation, or a desktop appraisal. In the default servicing segment, the preference is almost always the Broker Price Opinion (BPO). The obvious conclusion is that AMCs recommend appropriate valuation products based upon the nature of the subject property, the complexity of the valuation assignment, and the nature of the lending situation.

## HOME EQUITY LENDING AND AVMS.

The use of AVMs for equity lending really started to take off in the early 2000s. The end-user challenge was that there were multiple national brands vying for attention, yet none of them were available on the same platform or location. A little-known firm called C&S Marketing changed all that. C&S pioneered AVM use in two critical ways. Most importantly, C&S was probably the first firm to place all the AVM brands under one central platform, known then as AVM Select. Secondly, C&S developed the notion of an AVM “cascade.” A cascade was a sequence of AVMs designed to secure maximum coverage or hit rate. Subsequently, AVM testing firms developed “model preference tables” at the county level to make early cascades more sophisticated. The widespread awareness and utilization of AVMs today has its roots in the innovative and highly successful efforts of C&S Marketing.

When the Interagency Appraisal and Evaluation Guidelines were published in 2010, it seemed like it was the regulatory intent to mitigate some perceived “abuses” of AVM utilization. The solution became an “evaluation.” An evaluation was some combination of an AVM, a property condition report, and valuation oversight or reconciliation of the AVM and the property report. During this time one of the most vocal regulatory critics of AVMs was fond of stating at conferences, “Just tell me if the subject property is suitable for AVM analysis, yes or no.” Meanwhile the founder of the most well-known AVM testing firm was often quoted as saying, “The most important thing I can tell you is when NOT to use an AVM.”

The signals from the regulators and the AVM testing community have been present for several years. The message is that everyone conceptually understands that AVMs are not appropriate valuation tools for **all properties**, but no one has stepped up to determine AVM suitability at the property level, until now. The product is known as VeroPRECISION™. VeroPRECISION is the AVM cascade alternative that first determines if the subject property is a viable candidate for AVM analysis, yes or no.

## THE EVOLVING ROLE OF AMCS IN HOME EQUITY LENDING

For home equity lending in 2019, most AMCs run the lender’s AVM cascade of choice. Then a property condition report may be ordered and a reconciliation of the two becomes an “evaluation.” Some lenders still avoid AVMs altogether because they believe that their accuracy can be inconsistent depending on the subject property.

Veros believes that it is time for AMCs to retake the “higher ground” on home equity valuations by reclaiming their role as the trusted entity that determines when and if an AVM is the appropriate valuation product for the subject property. Instead of dealing with the time-consuming vagaries of low confidence AVMs (and their associated erroneous values), AMCs need to embrace the inconvenient truth that most everyone readily acknowledges: **Not every property is a suitable candidate for AVM analysis!** Gone are the days of AVM cascades optimized for coverage or hit rate as popularized many years ago by C&S Marketing. Not surprisingly, many lenders still engage AVM cascades today, and they compel their AMCs to use Brand X Cascade across all properties. Lenders engage AMCs on this level because they don’t know that there are more accurate AVM cascade alternatives available through their AMC of choice. For AMCs it is time to educate the home equity lending community about how AMCs can help them implement a more intelligent and accurate approach to home equity valuations.

VeroPRECISION is the first industry valuation decision technology that determines upfront if the subject property is a suitable candidate for AVM analysis, yes or no. If yes, the product runs the industry's two top performing, independent AVMs simultaneously (not in sequence like a cascade) and the subsequent value is determined. If the subject property is determined non-suitable for AVM analysis, then that valuable information is returned to the user FREE of charge. The customer is **only** charged when a usable AVM is delivered.

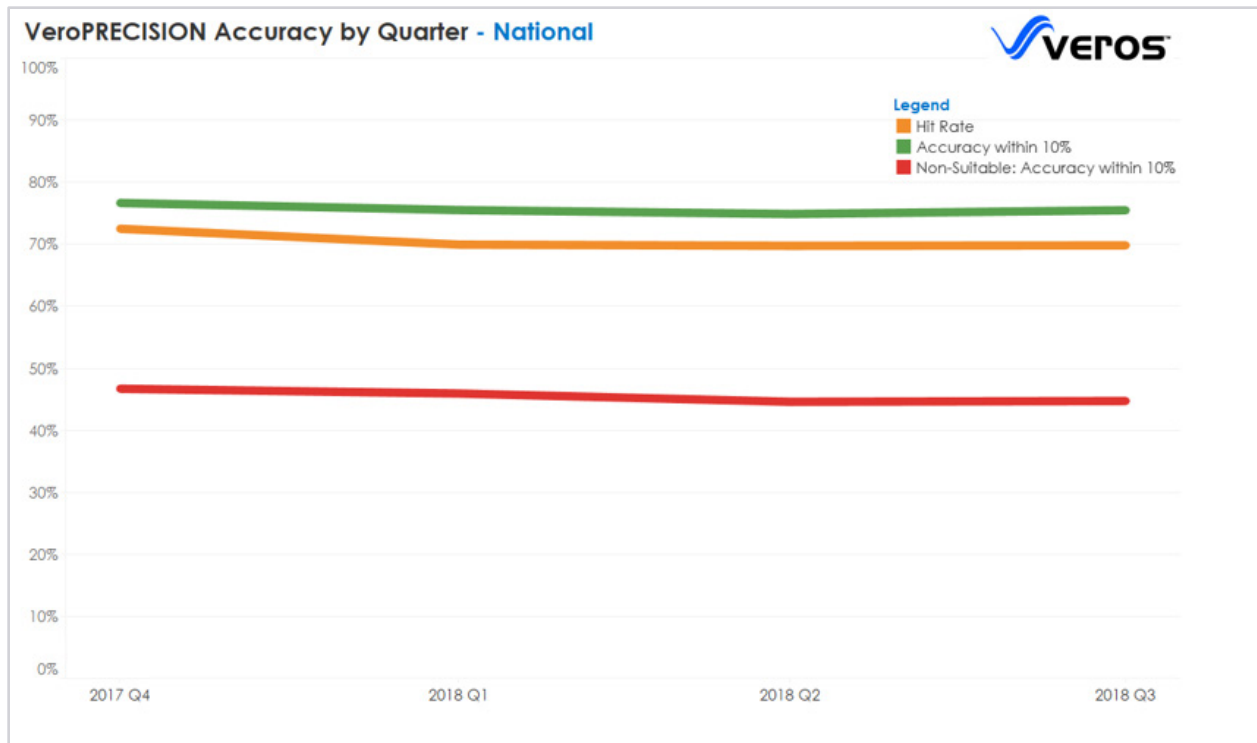
Everyone knows that the more similar the subject property is to neighborhood norms, the easier the valuation assignment. Also, the more information we know about the subject property, its sales and listing history and the recent sales of nearby properties, the easier the valuation assignment becomes. VeroPRECISION's property suitability engine takes all this into account when it makes the binary decision to render a valuation on the subject property or not.

In those cases in which the subject property has been determined a non-candidate for AVM analysis, it is particularly important to leverage the added value of an AMC. In these cases (about 30 percent of properties nationally; less in some areas and more in others), the AMC and the lender need to jointly establish the "trade-up" valuation product when the AVM is not indicated for the subject property. For many AMCs something akin to this process happens every day in production, the difference with VeroPRECISION is that the suitability determination is made with empirical justification before an AVM is ever ordered, and at no cost to the end user or AMC. This creates a completely seamless process flow without a bunch of stops and starts when the AVM is called into question.

## **HOW CAN AN AMC DETERMINE THAT THE "SUITABILITY" ENGINE IS WORKING INSIDE VEROPRECISION?**

In the end, it is the valuation accuracy of VeroPRECISION, or any valuation technology that matters most. How you get there can be interesting, but valuation accuracy (however defined) is the bottom line. If time and money were not a consideration, then all home equity loans would be subject to a traditional interior inspection appraisal like the ones used for first mortgages. However, time and cost are very real constraints. Therefore, it does make sense to test the AVM results of VeroPRECISION against recent appraisals on the same property to estimate valuation accuracy. The data shown below compares the VeroPRECISION value, and competitors' AVM values (where indicated) to a recent appraisal on the same property.

The VeroPRECISION AVM suitability functionality contributes significantly to valuation accuracy that is not achievable by any single commercially available AVM in the market today. For perspective, a top-tier AVM typically has an accuracy rate, when compared to recent appraisals of about 65% nationally. The chart below based upon testing 30,000 observations per month for 12 months, shows that VeroPRECISION achieves a valuation accuracy level of about 75%+ nationally.



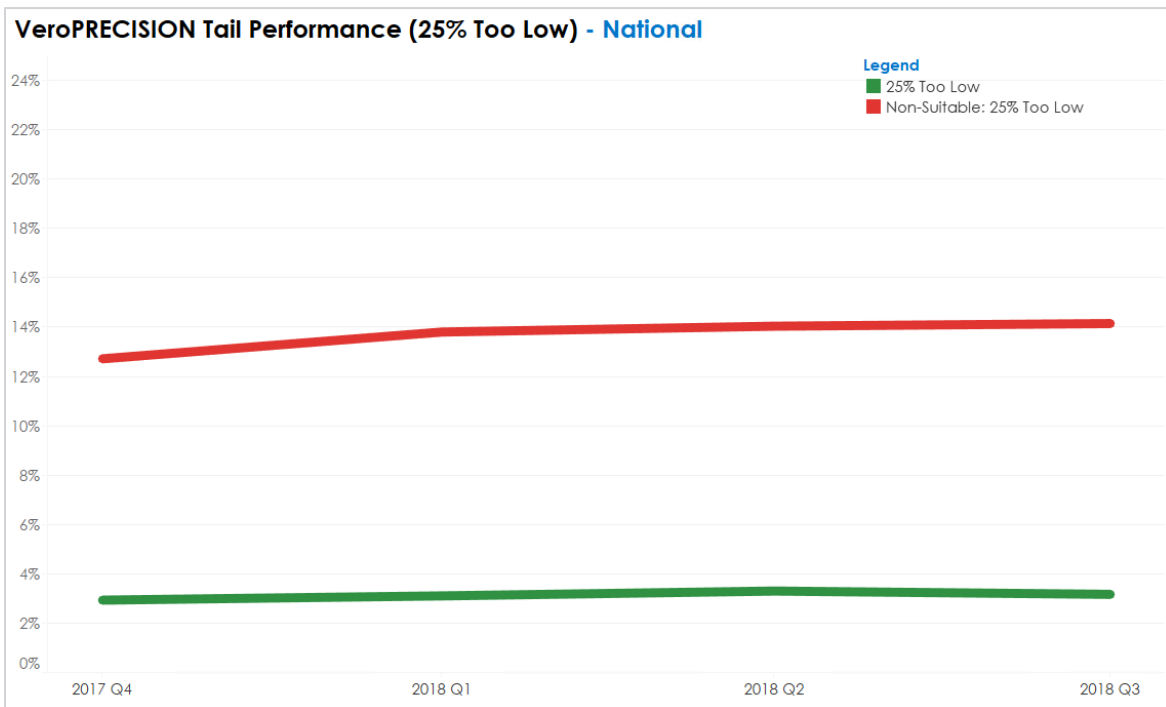
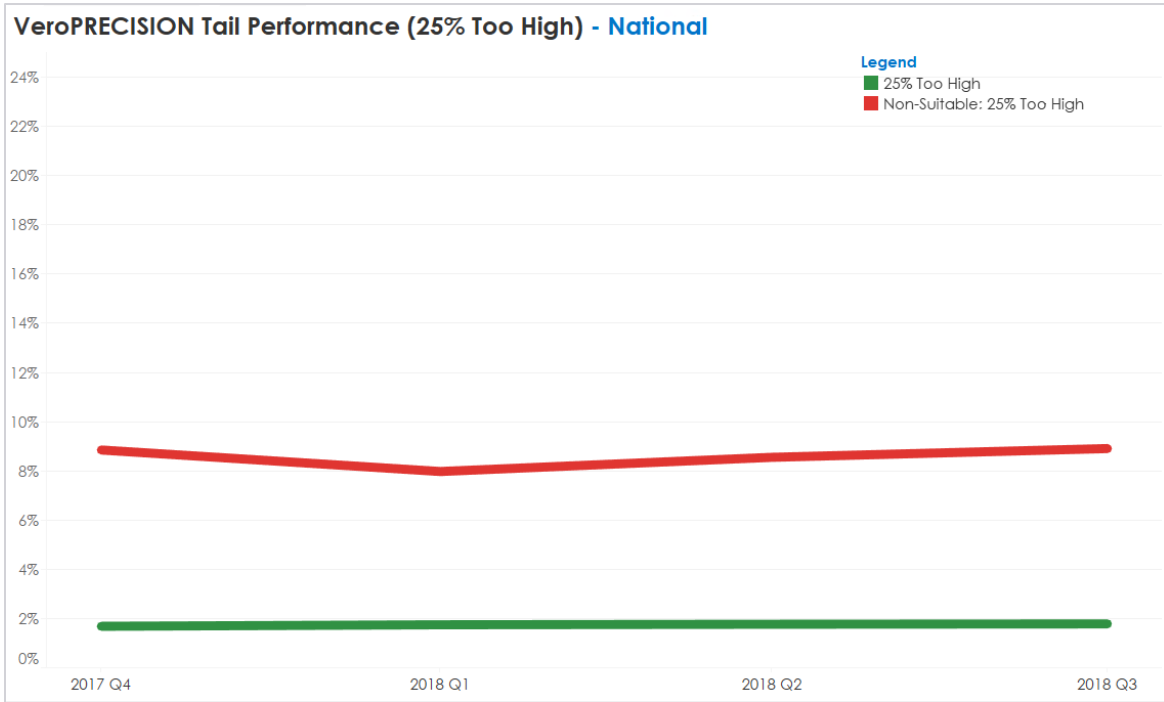
Contributing to the valuation accuracy of VeroPRECISION is the suitability engine that screens out properties that are not viable candidates for AVM utilization and, as such, will result in inaccurate valuations. It makes sense, therefore, that properties deemed unsuitable for AVM use by VeroPRECISION should have a much lower accuracy level. To test that proposition, we ran five independent AVMs on 107 unsuitable properties. Note that the valuation accuracy level, within 10% of the appraised value, is less than 50%. When a high-quality AMC sees large and repeating valuation errors from an appraiser, what does it do? If the appraiser's incorrect valuation approaches aren't corrected, the AMC immediately stops sending orders to the appraiser. That's exactly what VeroPRECISION is doing. It halts the unsuitable AVMs from being returned. Unfortunately, the repeated use of AVMS on unsuitable properties is what transpires when lenders use traditional AVM cascades.

**WHEN COMPARED TO THE RECENT NON-PURCHASE APPRAISAL BENCHMARK VALUES, HERE ARE THE RESULTS:**

Brand	P10*	MDAE (median absolute error)
AVM1	43%	16.9%
AVM2	51%	12.6%
AVM3	43%	17.9%
AVM4	40%	20.8%
AVM5	50%	20.1%
<b>AVG</b>	<b>45%</b>	<b>17.6%</b>

\*P10 represents the percentage of observations within plus or minus 10% of a recent appraised value.

The level of valuation outliers (values with a 25% or greater variance) is four to eight times greater with non-suitable AVM properties when compared to suitable properties. This is strong evidence (shown below) that AVMs are not appropriate valuation tools on non-suitable properties as determined by VeroPRECISION.





## SUMMARY

1. AMCs need to re-establish themselves as the experts on home equity valuations and the astute use of AVMs. Lenders' ideas about the use and utility of AVM cascades are outdated and can cause very sub-optimal results in terms of valuation accuracy and valuation outliers. Since the days of C&S Marketing lenders have viewed themselves as the resident experts on the use of AVMs. Times have changed, and AMCs can provide some much-needed education and insights related to the use of AVMs.
2. VeroPRECISION is the tool AMCs can use to demonstrate a higher level of understanding and appreciation of AVM strengths and weaknesses to their customers. The fundamental building blocks of AVM cascades are research-based county level look-up tables. These look up tables tell lenders the most accurate AVM in that county or location. That was a fine approach and it served lenders well in the early 2000s. Now there is a new technology that evaluates AVM suitability at the property level. This is the information and understanding gap that AMCs can fill for their home equity valuation customers. The empirical evidence to support VeroPRECISION as an appraisal alternative (and clearly an AVM cascade replacement) in home equity lending is very compelling.
3. VeroPRECISION eliminates some of the troubling process challenges associated with home equity valuations and AVMs. Many times, an AMC is compelled to run an AVM cascade. What happens when the AVM is low confidence? Many times, the lender pays for it and throws it out, only to perform an alternative valuation product. Does this inefficient process sound vaguely familiar? If so, it can be streamlined by VeroPRECISION, since it only outputs high confidence AVM values and routes unsuitable properties immediately to the trade-up valuation product of choice for that lender customer as determined by their AMC.
4. Veros wants our AMC/reseller customers to be very successful because AMCs are among our largest sales and distribution partners. We view our AMC resellers as our primary customers. As such, we will do whatever it takes to offer product and sales training on VeroPRECISION and all the Veros product offerings. We want to make our due diligence testing data available to our partners as well. At Veros, we want to be our AMC partner's "go-to" resource for all things related to automated valuation technologies and services.



## **ABOUT THE AUTHOR**

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With more than 20 years in the analytics and automated valuation space for residential real estate, Robert Walker has built a solid reputation for product innovation, providing market insight, and anticipating customer needs. In his current role of Vice President of Sales for Veros, Mr. Walker is responsible for leading the company's sales team and market strategy and for driving innovation and creating a disruptive force in the market. Mr. Walker holds a BS in Economics from Vanderbilt University and received an MBA from Columbia University Graduate School of Business. He also has the rare honor of holding both the Certified Mortgage Banker® (CMB®) and the Certified Mortgage Technologist (CMT) Designations. Mr. Walker may be reached at [866.458.3767](tel:866.458.3767) or [RWalker@veros.com](mailto:RWalker@veros.com).

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