Valuation 2.0

How to navigate the brave new world of appraisals

By Mark R. Linné, MAI

The valuation profession faces changes as profound as any in its history. While change defines every profession and all sectors of society, it is clear that market forces—most recently the collapse of the subprime lending market—have driven home the point that collateral valuation matters.

What are the lessons to be learned from the events of 2007, and how will the valuation profession move forward to ensure the public trust and provide its clients with products and services that enhance the accuracy of collateral valuation? What are the drivers that are presently impacting our profession, and how can we leverage the current realities of the market to take advantage of these trends?

It is clear that data, data standards, analytics and the industry’s search for quality are at a tipping point that is leading us as an industry to opportunity. The search for methods of satisfying client needs will finally bring all of the disparate data, technology and methods together in a paradigm shift for our profession, leading finally to a redefinition and evolution of the profession, a change some have termed Valuation 2.0.

Why Valuation 2.0?
The term Web 2.0 often refers to a perceived second generation of the Internet, describing the manner in which information and users are connected. It represents a maturation of the Web and
a change in the way software developers and end-users use webs to connect themselves. Integral to such development are the data standards that facilitate that connection.

In much the same way as the Internet is undergoing a transformation from Web 1.0 to Web 2.0, changes in valuation auger a similar transformation in the manner in which valuation is perceived, analyzed and delivered to users of valuation services. How can appraisers position themselves, and what can thought leaders, practitioners and valuation futurists teach us with respect to positioning ourselves to not only survive, but grow and prosper?

All About Data
Perhaps the biggest trend that will impact our profession is the realistic possibility that in the near future we will have access to more data than we ever believed possible. For the first 75 years of our profession’s existence, appraisers existed in an environment that was characterized by a dearth of data. How will the profession cope when it has access to most, if not all, of the data within the market? Do we have the tools, education and methodologies to evaluate this cascade of information? Time will likely tell. In the meantime, what general trends are on the horizon, what are the trends that are likely to have the greatest impact on the appraisal profession? What should appraisers be watching?

The topic of data standards was considered by a panel at last year’s Mortgage Bankers Association’s Multi-Family Asset Administration and Technology Conference. The apt title of that panel presentation was “The Property Data Revolution.” Describing the efforts to bring data standards to the appraisal and mortgage lending as “revolutionary” is itself revolutionary.

Perhaps the most critical points that were made by the panel include the observation that standards create order from chaos, make data and information more understandable, and put information into context. Standards will ensure that real estate and valuation data flow to all parties within a transaction, eliminating transaction friction, and leading to a more efficient and transparent marketplace.

It is clear in talking to lenders, vendors and industry insiders that data standards will not only change how data is presented to clients, it could affect how properties are appraised and analyzed.

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Bottom Line
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is just one segment of their dictionary, which also includes construction, government, management and brokerage, among others. OSCRE is different than MISMO in that MISMO’s core focus is data standards that are specific to mortgage-related and real property reporting information, compared with OSCRE, which goes beyond data standards into business process standards.

MISMO. The mortgage industry, an important driver in the greater real estate industry, has been working toward data standardization through MISMO, the Mortgage Industry Standards Maintenance Organization. Since it was formed in 1999, MISMO’s primary goal has been to finalize the residential and commercial standards that will focus on an entirely electronic mortgage. Clients of appraisers have created the impetus toward standards, demanding more consistency, efficiency and transparency within the appraisal process. They, in turn, have been moving in this direction because of the demands of their customers—the consumer.

While much of MISMO’s attention for the last several years has focused on the residential side of real estate through its Real Estate Property Information Work Group, an effort toward commercial standards has recently accelerated under its Commercial Appraisal Work Group.

The main focus of the Commercial Appraisal Work Group has been the incorporation and adoption of the Appraisal Institute’s Commercial Data Storage Standards, which has been underway for more than three years. The CDSS contain approximately 2,000 distinct data elements for commercial properties, and are slated for adoption by both MISMO and OSCRE as both bodies continue to promulgate data standards for commercial finance and general real estate uses.

The next major goal of the Commercial Appraisal Work Group is the development of an Appraisal Synopsis, which is a core third-party element of the Asset Summary Report that is widely utilized as a reporting mechanism and format within the CMBS marketplace. The Commercial Appraisal Work Group will identify which of the 2,000 potential data elements contained within a commercial appraisal report
are significant and meaningful for the initial metrics that are relevant to a credit decision by a lender. Lenders currently have no means to effectively extract this information without costly rekeying of the essential data, and this initial deliverable will provide an appropriate and beneficial introduction to the MISMO data standards effort.

This incremental approach to data standards adoption will permit users to experience the benefits of standards without having to change all of their internal processes simultaneously. MISMO is working on the aggregation of relevant participant examples of real-world synopses that are currently in use throughout the industry. This serves two purposes: The first is to ensure stakeholder participation and involvement in the process (thus facilitating adoption and buy-in), and the second relates to an understanding of the breadth of current industry best practices in the usage of an appraisal synopsis.

MISMO already has achieved broad industry participation and support, but it continues to work toward assembling a broad-based group of industry practitioners that includes lenders, appraisers, academics and vendors. By playing an important role in the greater drive toward standards, appraisers can firmly establish their position as stakeholders.

**Appraisers and AVMs**

It has long been assumed by appraisers that AVMs have stolen much of the appraisal business they used to get. While it is true that AVMs have emerged over the last decade as a viable collateral valuation alternative in certain circumstances, there are other products, namely broker price opinions or BPOs, that are responsible for the lion’s share of the revenue loss, replacing form appraisals with cheaper, faster alternatives. For too long the financial markets have focused on BPOs to gauge the appropriateness of a loan and the underlying collateral. Even though most lenders will admit they use BPOs more for the general market information they provide than for their ultimate value conclusions, the truth of the matter is that BPOs are being used in quantities that would shock and dismay appraisers.

This perspective is changing quickly, dramatically and to the benefit of the appraisal profession. As subprime woes continue, there is a clear indication of a “flight to quality” in collateral valuation. BPOs are on the way out by many significant lenders. The question of the moment is: “What will replace them?” Unless appraisers can provide a product that meets the lending industry’s needs, we will once again be shut out.

As AVMs have gained an ever-increasing share of the marketplace, appraisers have been unable to offer a meaningful alternative, and the entire industry has essentially been bifurcated, with AVMs on one side and appraisers on the other. AVMs were constructed to offer standalone collateral valuation solutions. The role of appraisers was never considered or even contemplated; they were intended primarily to assist lenders in the collateral valuation process.

The fact that at present appraisers do not use AVMs to any meaningful degree appears to lend credibility to the fact that there is a problem. The problem is a system that does not include the appraiser at the front end. The appraiser becomes an afterthought in this process. AVM vendors, cognizant of push-back from various stakeholders, have attempted to meet the need by creating “integration” with an appraiser. This attempt has not been successful, because it transfers an unacceptable risk to the appraiser. It changes a valuation without appraisal risk into a product that is expected by the market to represent a more reliable valuation.

Appraisers have been reluctant to embrace AVMs for a number of reasons. The most significant reason, it is suggested, is the lack of an appropriate and comprehensive framework for interacting with, analyzing and drawing conclusions from that data. It should be recognized, however, that the statistical methodology and mass appraisal technology has always been available to appraisers. Because of the encroachment in the appraisal world by AVM vendors, however, appraisers have not embraced the technology or the techniques.

A further problem is that there are no turn-key solutions available to appraisers.
The construction of even a local AVM is remarkably difficult, requiring significant skill-sets and data costs that are beyond the reach of most valuation professionals.

Appraisers can offer this type of product to the market. There is some room at the table for appraisers to join this conversation. We must be prepared, however, to offer not just our traditional quiver of products, but demonstrate to our clients that we can meet their needs with a broad array of streamlined and meaningful information. Quality will always prevail, but it must come clothed in products that meet the needs of the market for speed and cost. By providing a solution for this client need, valuation professionals will emerge with the opportunity to dominate the market, and will no longer have to share the field with inferior and ultimately unsatisfying substitutes.

Discussions with industry experts reveal that the availability of an interactive, appraiser-influenced product would open a floodgate of acceptance by appraisers and additionally satisfy lender demands for an AVM that is used and interpreted by an appraiser. By embracing AVMs and modeling technology, valuation professionals will be able to take advantage of this knowledge integration and provide substantial financial rewards. They will be able to leverage this technology toward other valuation processes, providing market opportunities throughout the fabric of the current appraisal profession. With markets declining in most parts of the country, there is recognition that a solid, supportable value has merit and must be the ultimate goal.

The solution is getting appraisers more engaged in the system, the process and the solution. They can’t expect to be part of the solution if they are not involved in crafting the process. Appraisers have an opportunity to reshape the discussion and create a collaborative opportunity to develop a better product—a product that the market needs, wants and has an appetite for.

**Bottom-Line Realities**

As has been the case in all facets of the knowledge-based economy, data standards in real estate will be the catalyst for redefining real estate analysis. As standards become mainstream and their use and adoption increases, members of the appraisal profession have three potential courses of action. They can ignore the message, with a perspective that standards have a way to go before their impact is truly felt; they can participate in the process and help, as stakeholders, to shape and focus the standards that are developed; or they can, at the very least, be aware of and stay abreast of the progress of standards, so that they can adapt to meet the challenges that standards adoption will bring.

Ultimately, the answer is truly changing the appraisal paradigm. Appraisers need data sifted, analyzed and pushed to them. Alternative information should be suggested and presented. Adjustments should be extracted from the market and offered to the appraiser. All of the essential data necessary for whole market analysis should be provided to enable a more complete understanding of the subject and its market. Ultimately, it’s all about putting the appraiser in control and leveraging the available data and technology to empower the appraiser and benefit their client.

This is what the appraiser needs, and more increasingly, this is what they should demand.

The best days of the appraisal profession are not behind us but, rather, are awaiting us in the near future. It will be our responsibility to be vigilant, aware of the changes that are ongoing and ultimately take advantage of the brave new world that awaits.

The availability of new tools and technology that will interact with the profusion of data will change the face of valuation. The question that appraisers must answer is what role they wish to play in defining Valuation 2.0.

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