HouseCanary

The Future of Appraisals

How technology will finally democratize home values and modernize real estate

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Key Findings

- Home valuations are nearing autopilot, but the potential consequences of bad valuations mean that we often still need an expert involved. Good data and analytics can inform exactly how much human expertise is required to refine data-backed valuations.
- The streamlining of valuations will unlock remote property investment for a number of large investors, institutional and otherwise, bringing confidence and speed to the real estate investing process and ushering real estate investment into the 21st century.
- As technology-enabled appraisals expand to touch a bigger and bigger slice of the valuation pie in the coming years, they will greatly assist both lenders and investors by drastically reducing turnaround times and speeding up the entire process.
- Using data and analytics as a starting point will allow appraisers to focus on the parts of the appraisal process that the models can struggle with, making their expertise available where it's most needed.
- Even as the data and analytics improve, humans will still be necessary for an appeal or audit, acting as arbitrator for a market whose terms are increasingly dictated by high-end computer models.
- Arming homeowners with an objective estimate will give them agency in the process, granting them a level of independence from the experts who govern the process without replacing them entirely.

The Future of Appraisals

Innovation, technology, automation. These words might light up the eyes of business-owners — but they rarely have the same effect on the professionals they employ, who might see redundancy on the horizon.

However, not all automation directly replaces people because not all jobs are as simple as pulling a crank or pushing a button. Despite the invention of autopilot, we still keep a trained expert in the cockpit at all times.

The future of appraisals will be no different.

Increases in digital processing power and our ability to instantly transmit massive amounts of data has pushed automation past purely physical tasks and now allows us to perform mental tasks more efficiently. The modern ubiquity of information about practically every transaction and commodity has caused us to rethink the mechanics of most industries, yet it hasn't toppled one of the last holdouts — real estate. The inability to reliably appraise a property without boots on the ground has been sand in the gears of the real estate engine, ultimately hindering liquidity and creating market inefficiencies.

But that holdout won't last forever. Today, an industry that was once governed by limited access to information is seeing that data democratized. Innovative startups are finally making property data uniformly accessible, from metropolitan statistical areas (MSA) down to the block level — but the immense quantity of properties and transactions can make it hard to usefully interpret.

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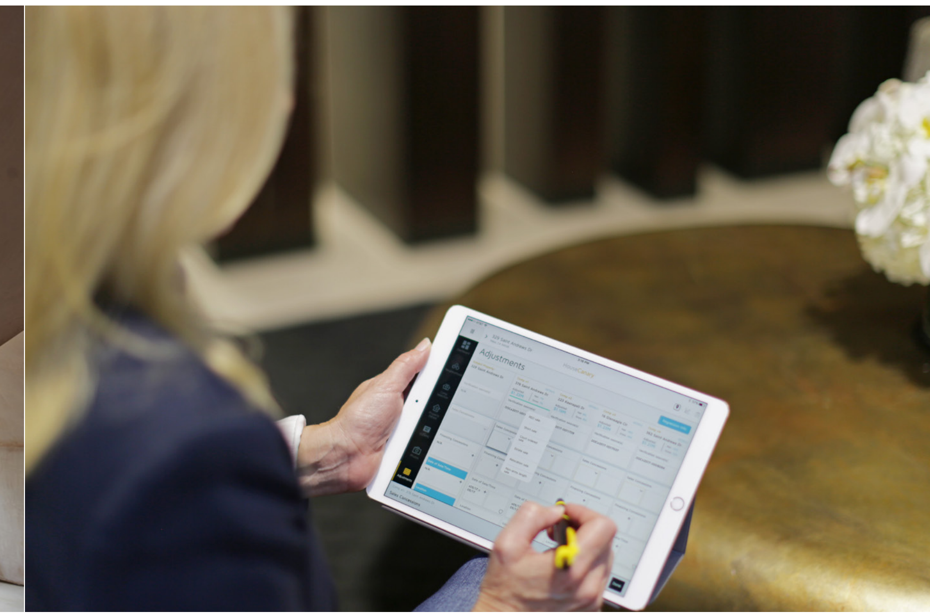
It’s like Morse code: The data are the beeps — and we have more of them than ever before — but if you can’t decipher the signals, you can’t understand the message. The data are the ingredients, the analytics are the recipe, but people will still need to stir the pot.

This combination of more data and better analytics, integrated into capable software, is rapidly increasing the accuracy of Automated Valuation Models (AVMs). Our ability to digitally identify where the property market is currently settled and predict where it’s headed is better than ever before, and it’s drastically changing the the parameters of the appraisal process.

Fannie Mae and Freddie Mac’s recent announcements that they will be offering Property Inspection Waivers and Automated Collateral Evaluations, respectively, are bringing automation into the news, but these alternative valuations still only apply to a small (but growing) fraction of the appraisal universe. The importance and particular challenges of property valuation, especially for unique properties, is causing Fannie and Freddie to be cautious about entirely removing human expertise from the appraisal process, but they are bringing alternative valuations into the mainstream.

Though valuations may be nearing autopilot, the potential consequences of bad valuations mean that, for many properties, we still need an expert to pilot the plane — and good data and analytics can inform exactly how much human expertise is required to refine data-backed valuations.

Chapter 1:
Digital Oil in the Investment Engine



Consider this: Of the more than 15 million single family rental units nationwide, just over 200,000 are owned by institutional investors, or about 2 percent of the market. This is in stark contrast to the multifamily market, where institutional investors own more than 55 percent of units. Investors who own just one unit comprise 45 percent of the SFR market, and 87 percent of investors own 10 or fewer units.[1]

Why is this market so fractured? It is hard to believe that large investors simply lack the desire to utilize an asset class that is putting out an 8.0 percent Effective Gross Yield.[2] Much of this investment gridlock for major institutions has

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1 Source: "[Five things that might surprise you about the fastest-growing segment of the housing market.]" Urban Wire, Urban Institute, Oct. 3, 2017.

2 [HouseCanary Rental Investment (HCRI) Index, Q3 2017].

instead been spurred by the antiquated nature of real estate investment, including the current state of appraisals — but this last gear is finally beginning to turn.

> **“Soon, a real estate investor will be able to look up the vitals of a property as easily as they can look up information about a publicly traded stock.”**

There was a time when, to be a stock trader, you actually had to put on pants, tie your shoes, and head down to Wall Street. Of course, for bonds and equities, that ended years ago, making way for the trading desk. Suddenly, you could buy and sell stocks and bonds from an office anywhere in the country, or even from the comfort of your bed, at a predetermined price that all parties agreed upon.

These advancements are finally reaching real estate investment. The inability to evaluate a property remotely, let alone get reliable information about the market and neighborhood in question, has made remote real estate investment — especially for SFRs — too risky and unwieldy for most major investors. But the streamlining of valuations will unlock remote property investment for a number of large investors, institutional and otherwise, bringing real estate investment into the 21st century.

“Transparency into the value of an asset makes it possible for us to trade it remotely,” explained Josh Seiff, HouseCanary’s Vice President of Business Development. “Real estate will never be an entirely fungible commodity, but accurate valuation can bring a level of confidence and speed to transactions that is lacking today.”

However, analog appraisals present challenges in more sectors than just remote investment. For example, SFR properties are often traded in large portfolios or securities that can be incredibly time-consuming to reliably value. Filing cabinets and paper trails dot every step of the process — slowing turnaround time, making deals harder to close, and bogging down liquidity in the market. Add in the complication of getting a third party to subjectively value each asset, and you’ve got the convoluted mess that is our current market.

While AVMs and technology-enabled appraisals may not represent a complete panacea for these inefficiencies, they will continue to modernize and expedite the entire valuation process. As technology-enabled appraisals expand to touch a bigger and bigger slice of the valuation pie in the coming years, they will greatly assist both lenders and investors by drastically reducing turnaround times and speeding up the entire process. In the end, those in the market who don't adapt to modern appraisal solutions will be unable to keep up with the speed at which their competitors can move.

Following the Global Financial Crisis, both lenders and the investors who purchased the mortgages they packaged faced understandable pressure to implement a more data-based valuation process. This can include AVMs, which are completely data-driven, or technology-enabled desktop appraisals, which combine automated valuations with an appraiser's expertise.

Nearly everyone in the investment and lending supply chain benefits from this change. Lenders will be able to value entire loan portfolios quicker and more reliably than ever before. Investors will have an objective check on the value of collateral packaged into a security, giving them confidence that the value of the properties included was not inflated in order to produce larger mortgages.

Outside of writing mortgages and trading securities, technology-enabled appraisal solutions can help small banks and credit unions save money on yearly and quarterly valuations of loan packages, providing financial relief at a time when regulations have made it harder than ever for small banks to keep their heads above water.

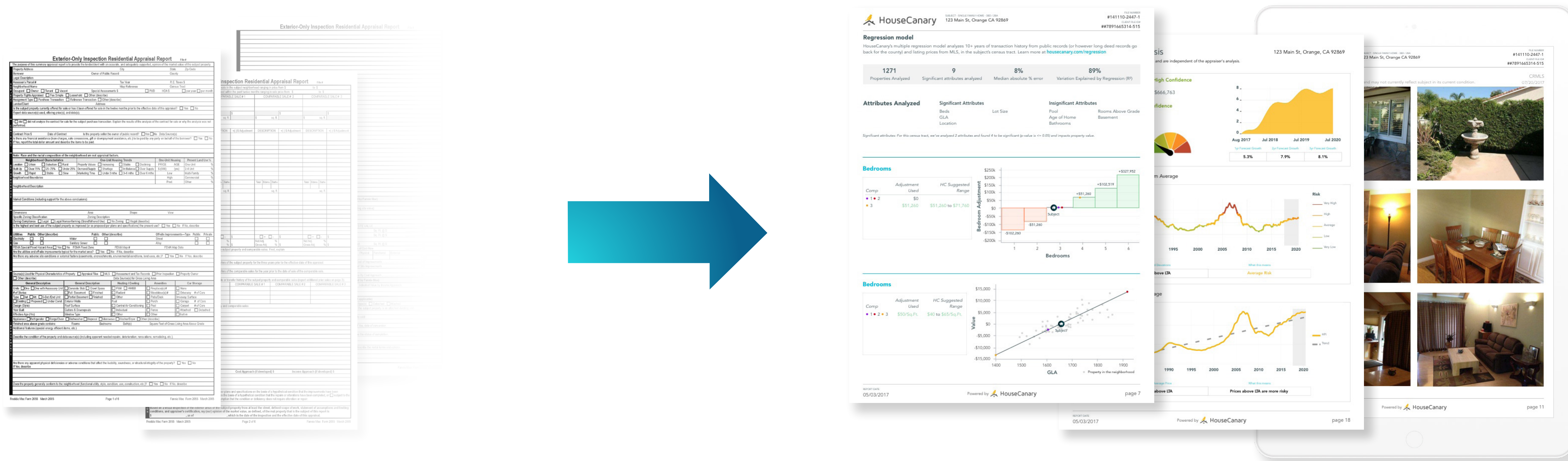
The future of appraisals is already signalling a sea change for nearly every segment of the real estate industry, and the signal is only growing louder. We are not far from a time when investors can see the potential aggregated rental yield of a nationwide portfolio in a matter of minutes — or get a value estimate for a property they see on their morning commute using nothing more than a mobile phone app.

Objective data and consistent analytics are leading us to deeper transparency and making real estate assets more fungible. When you have fungible assets, liquidity is better, which creates better outcomes for everyone in the supply chain.

It means the purchaser doesn't overpay, the seller is fairly compensated, and the whole process is done with a lot more certainty.

This modernization of valuations and appraisals will ultimately be an injection of digital oil into the real estate investment engine, helping the entire vehicle to run smoother and faster — and to last longer without a breakdown.

Chapter 2:
The Forward-Thinking Appraiser



There are some in the appraisal industry who see AVMs as a threat — an assault from Silicon Valley tech entrepreneurs that threatens to turn their beloved art into a science.

And then there are others who have — correctly, by our estimation — seen the inevitable computerization of the valuation process as an opportunity for appraisal professionals. Using data and analytics as a starting point will allow appraisers to focus on the parts of the appraisal process that the models can struggle with, making their expertise available where it's most needed.

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"There is no doubt that data and analytics will continue to transform the industry. The only questions are how it will be transformed and how quickly," said Zach Dawson, Director of Collateral Strategy & Policy for Fannie Mae, in an interview with WorkingRE.com. "Part of that transformation is to think about the highest and best use of an experienced appraiser… Is it data gatherer or local housing market economist? In the future, I'd like to see the process evolve to a point where we can responsibly leverage technology to make the process more efficient and give appraisers the time and resources to focus on what matters most and truly requires their expertise."

If this sounds like nothing more than corporate sweet talk prior to the downsizing — it's not. There are a number of factors that will keep appraisers' indispensable role in the market alive. A more liquid market will facilitate more demand for appraisals, many of which require USPAP compliant practices and will need final value conclusion from a professional. Current AVM technology works quite well with homogenous housing stock, but we'll still need appraisers to appraise more unique properties.

While both Fannie and Freddie are offering alternative appraisals, each has stringent requirements, and those alternatives are only expected to be available for a small percentage of valuations in the market. Although, as of August 2017, Fannie's Property Inspection Waivers are now available for a small subset of purchases as well as refinances, the GSE still expects traditional appraisals to be required for the majority of transactions. More importantly, the GSEs' data systems are modeled off of appraisal data and will require a steady influx of appraiser data to remain afloat — just not for every single loan.

"We are not interested in eliminating appraisals," Fannie Mae CEO Timothy Mayopoulous told HousingWire. "But we should be exploring options electronically," he noted, adding that appraisers should be at their desks, not in the field with a measuring tape or making phone calls to track down homeowners.

Ultimately, appraisers will still be needed to validate and sign off on digital valuations. Desktop appraisals of this sort can be completed in a quarter of the typical time — or less — meaning that, while they often have lower fees, they also have higher per-hour pay rates, potentially double that of a traditional appraisal. With a significant portion of appraisers in the Unites States headed toward retirement, the market will likely require remaining appraisers to adopt modern appraisal solutions just to keep up with demand.

"Forward-thinking appraisers will need to adapt to a market that requires their expertise in different forms, but they shouldn't brace for a market that doesn't require their expertise at all."

Even as the available data and analytics improve, likely expanding the range of mortgages and transactions that utilize alternative appraisals, humans will still be necessary for an appeal or audit, acting as arbitrator for a market whose terms are increasingly dictated by high-end computer models.

Forward-thinking appraisers will need to adapt to a market that requires their expertise in different forms, but they shouldn't brace for a market that doesn't require their expertise at all. Learning to use new software that streamlines the desktop appraisal process may seem intimidating, but this level of training can be completed through webinars and online courses. And those tools and training will only reimplement, not replace, the knowledge they've gained from years in the field.

Whether it's as pilot, arbitrator, or high-end property appraiser, automation can only take us so far: Valuation experts will continue to be an essential part of the real estate market. Instead of swimming upstream, forward-thinking appraisers will build boats, not only adapting to real estate's new technology-fueled ecosystem, but also making themselves an essential piece of it.

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See Into the Future of Real Estate.

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