The Path to Appraisal Modernization

How to align stakeholders, processes, and technology for a new approach to valuation.

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Foreword

Over the past decade, the mortgage industry, like many other industries, has benefited from a digital revolution. A customer base that increasingly expects a digitized experience coupled with the rise of mortgage technology companies has transformed the way real estate transactions are conducted. Today, efficiency, accessibility, and transparency are all paramount.

Despite this, not all aspects of the real estate industry have progressed equally into the digital age. The valuation process—a critical component of almost every real estate transaction—has been slow to innovate and progress. A recent survey conducted by STRATMOR group found that appraisals take an average of 16 business days to complete and even longer in rural areas. With an industry-wide goal of delivering one-click digital mortgages, the valuation aspect has some catching up to do.

Recently, we've seen some progress in this regard, with the permanent acceptance of desktop appraisals and plans to introduce other hybrid appraisal options. These are great first steps for the industry, and the following chapters will dig into what it means and what the new era of valuation could look like.

While it's clear that the residential valuation industry is in the midst of great change, this white paper makes the case that the future of valuation is not going to arrive as an instantly automatable process. Before we reach the one-click mortgage, we need to address the basics first—such as weeks-long scheduling cycles, manual invoicing, and labor-intensive data entry that can cause errors and lengthen turn times.

It will be crucial to fix the obvious gaps in the appraisal operation process ahead of any larger changes. For every initiative like desktop appraisals or alternative valuation methods, it will take support from lenders and their technology partners to empower appraisers with the right tools and information before any innovation is adopted. Appraisers and appraisals will long have a place in the valuation process since their skills and expertise are not easily replicable, no matter the technological advances in the industry. It is only once the existing process is optimized that industry stakeholders will become more receptive to the evolution of real estate valuation, which will involve experimenting and exploring more automated, innovative valuation solutions.

I hope this white paper provides its readers a vision of how we can embrace innovation and technology as we pave the way for the future of valuation.

Brian Zitin, *CEO & Co-Founder, Reggora*

The Challenge with Valuation Today

Every day, countless individuals and institutions engage in some form of residential real estate transaction. The real estate industry accounts for trillions of dollars annually, making it one of the largest and most important industries to our economy. Whether it's a mortgage lender issuing a loan, a home insurance company providing an insurance quote, a real estate agent listing a house, or an investor purchasing a mortgage-backed security, billions of dollars are exchanged daily in the residential real estate market.

Although these types of transactions appear different at the surface level, they share one common aspect: they rely heavily on the assemblage of data that facilitates a valuation of the property. The most notable example of this, naturally, is the need for mortgage lenders to determine the actual value of a property before issuing a loan. However, the reliance on valuation data extends far past home loans. For example, home insurance providers need to understand the replacement cost of a home before providing quotes, just as how J.P. Morgan or Goldman Sachs use the valuation of properties to gauge risk levels before investing in mortgage-backed securities.

In other words, valuation data is critical to the success of the real estate industry. Yet, despite its importance, the real estate industry has been unable to standardize valuation data in such a way that is reliable and accessible en masses. This shortcoming is especially stark when compared to other industries. The car valuation market, for example, is so streamlined that car owners can go to a leading site like Kelly Blue Book, input certain vehicle specifications, and then immediately know (within a certain margin of error) the approximate value of their vehicle.

More importantly, trust in Kelly Blue Book is so strong that car buyers and sellers rely on Kelly Blue Book to facilitate car sales without any intermediaries or third-party valuators. With services like Carvana, the consumer can transact for the new car, including trading in their existing car, without ever stepping foot on a car lot. The lack of this level of standardized property and valuation data inhibits a fully-automated lending process; the residential real estate industry is searching for such comprehensive solutions.

Valuation data, on the other hand, lacks both a verifiable self-reporting tool and any kind of agreed-upon specifications that would allow for easy data aggregation and visualization. To understand this better, it is useful to take a deeper dive into the various sources of real estate data available to the market. Typically, residential real estate data is available in four ways: gathering the information by a valuation professional (appraiser), through local multiple listing services (MLS) that list property details for properties for sale, through public record data that track transaction history and basic property information, or through private entities like Zillow or Redfin that rely upon aggregating publicly available property data that can be refined through self-reporting.

Each of these systems comes with a set of problems:

- *Private companies who provide real estate data often depend on sellers and real estate agents to input property data, which is not always verifiable or accurate.*

- *Public record data also varies by locale and lacks the desired granularity needed to produce an accurate valuation. When was the last time a representative of your local tax assessor was granted interior access to your house to update the assessment records?*

- *Valuation professionals do not utilize standardized approaches to collecting property-specific standards. For example, only Fannie Mae requires the American National Standards Institute (ANSI) measurement standard. Freddie Mac and other market stakeholders have not adopted the standard and instead rely on appraisers to report reliable calculations and measurements to calculate finished and unfinished living areas.*

- *There are hundreds of MLSs across the country, each hyper-localized and with its own reporting format, which makes it difficult to compare trends from one region to another.*

In an ideal world, valuation data would contain a certain number of standardized variables that a third party or homeowner could gather and then easily input—similar to Kelly Blue Book—which would then run an algorithm to produce an approximate value of a home.

In a sense, this is what the industry has already done, albeit in a more manual and labor-intensive manner. For decades, the industry's solution to inconsistent valuation data has been to employ appraisers to travel to the property, collect relevant data and record measurements and determine the value of the properties in question. Appraisers are highly trained to perform rigorous inspections of homes, evaluate all of the specifications of the properties, and ultimately propose "gold standard" valuations that are relied upon by the stakeholders involved in any given transaction.

Why does the industry rely so heavily on appraisers? Because currently, an appraiser does the best job of validating the property data as an independent observer. The appraiser analyzes between 800 to 1200 data points that affect a property's value, including the type of land the property is built on, the components of building improvements, and the influence of factors outside of the property that impact the marketability and value of a property.

Appraisers also offer professional assessments based on first-hand observations in the local marketplace as an appraiser can visit thousands of properties over the course of a decade. These observations can include what components are present in the marketplace for newer construction, older construction, and everything in between, including what the marketplace requires when it comes to remodeling and for general property upkeep. For mortgage lending transactions, each appraisal utilizes a standardized reporting form that is completed by the appraiser, regardless of whether the property is in Maine or California, allowing all stakeholders to reliably compare property valuations across geographies.

While appraisers are an indispensable part of the valuation process, there are two foreseeable challenges that should encourage the industry to embrace additional valuation methods. The first is that the pool of current appraisers is declining, partially due to high barriers to entry into the profession. As a result, it may become increasingly difficult for lenders to find qualified appraisers to provide in-person valuations with required time constraints to remain competitive in their marketplace.

The second reason is the manual nature of the existing appraisal process, which will hinder the larger real estate industry's technological advancement—especially the realization of the one-click digital mortgage. While legacy management software signals some transformation for appraisals, a disjointed solution that includes manual clicks won't push the industry forward. It will take a solution that fully integrates appraisals into the one-click mortgage to reach the future of mortgage.

As the real estate industry continues to embrace technology and innovation, it is imperative that the valuation component also evolves. As a result, two questions immediately arise: what does the future look like, and how do we get there?

$75,000

In annual losses due to revenue leakage

Manually invoicing orders wasted 20+ hours per month at City Bank

7 days

Appraisal scheduling issues

The average lender takes 3+ days to find an appraiser and another 3+ days to schedule the appraisal, according to STRATMOR research

12.3%

Closings delayed due to appraisals

Issues within the appraisal process accounted for 12% of delayed closings in January 2022, according to STRATMOR research

30 days

Lengthy turn times

A manual appraisal workflow ran turn times to nearly one month at North Easton Savings Bank

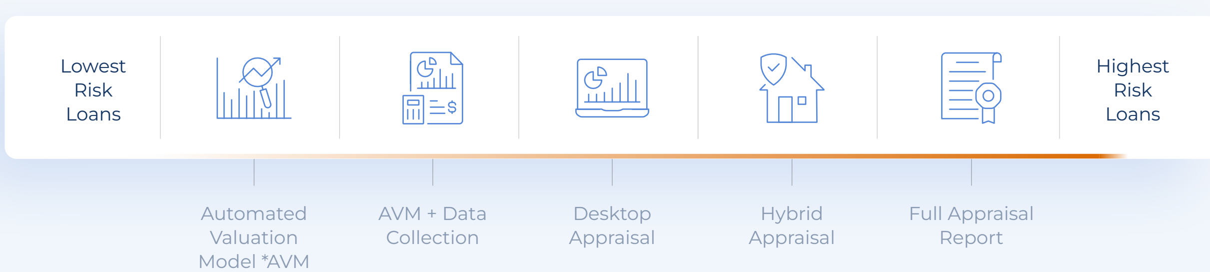
Appraisal optimization addresses issues for lenders, such as the above frustrations

The Vision for Valuation

The long-term vision for valuation is a process that relies on a combination of technology, data, and human intervention to drastically reduce turn times, lower costs, and eliminate redundant manual processes—all without sacrificing appraisal quality.

Achieving this goal will involve adopting a risk-based approach, which would recommend different valuation methods depending on the type of property in question. For example, a standard ranch-style dwelling in a large subdivision in Texas that is up for sale may rely on the recent sales of 20 other similar ranch-style properties around it to help determine its valuation. Standardized properties such as this, when data is abundant and variations are low to moderate, would not warrant the same level of underwriting scrutiny compared to a unique, complex property in rural Maine. This system will allow stakeholders to select a different valuation type—full appraisal, desktop appraisal, automated valuation model, or others—depending on the complexity of a given property and the data constraints within their respective markets.

What a risk-based model looks like:



Lowest Risk

- Prior Appraisal
- Simple Properties
- Homogeneous Properties
- Low Credit Risk

Highest Risk

- Complex Properties
- Minimal Historical Data
- Non-homogeneous Properties
- High Credit Risk

We're already seeing this approach becoming a reality in the industry, with the introduction of desktop appraisals as a permanent fixture accepted by Fannie Mae and Freddie Mac in March of 2022. In addition, Freddie Mac announced that they would replace their current appraisal waiver program—automated collateral evaluation (ACE)—with ACE+ PDR (property data report) for certain types of mortgages. This change will allow sellers and borrowers to continue to benefit from originating loans without an appraisal while continuing to mitigate risks specific to the physical collateral.

"We feel this is the right time really with regard to appraisal modernization efforts. [Desktop appraisals are] the latest innovation in our appraisal modernization efforts."

- Scott Reuter, Chief Appraisal Officer, Freddie Mac from "Understanding Desktop Appraisals with Fannie Mae and Freddie Mac" webinar

This process is practical from both an efficiency and cost perspective. As Steve Dondero, former Vice President at Goldman Sachs, points out, there is an interesting paradox in the valuation of standard residential properties since "it's faster and cheaper to valuate a non-complex property through alternate valuation methods today with a relatively high degree of confidence, but performing an actual appraisal on that same property continues to be slow and expensive."

It is useful to break this down a little further to demonstrate what a partially automated process would look like in practice. Once a property needs an appraisal, an automated system will gather public data on the property to determine its complexity and what kind of valuation method is best suited for the property. In this hypothetical, let's assume that the property needs some hybrid model of both human input and automation.

In such a situation, a third-party inspector (like an appraisal trainee, a real estate agent, a gig economy style worker, or even a homeowner) could use a mobile application to take specific pictures of the property and input a handful of verifiable variables. This data will then go to an appraiser at a desktop who can complete the valuation process and produce an appraisal report. This final value is then compared against an automated algorithm based on value indexing and/or recently sold properties to ensure there is no significant deviation in value.

This system—even one that requires human interaction—can shorten the valuation process by several days. With STRATMOR data showing that it takes on average 16 days to complete an appraisal, the aim of a two-day appraisal without any sacrifice in quality should be the north star for the industry. In this ideal scenario, properties will still receive the requisite level of underwriting scrutiny based on the appropriate risk while balancing speed, convenience, and accessibility across the industry.

Freddie Mac has taken a leap forward with the announcement of ACE + PDR, showing its commitment to appraisal innovation. The goal is to allow the marketplace to continue to find ways to shorten turn times through efficiency while allowing for the identification and mitigation of risk. As stated in the bulletin first announcing the addition of ACE, "This change will allow Sellers and Borrowers to continue to benefit from originating loans without an appraisal while mitigating risks and ensuring we purchase Mortgages secured by properties in acceptable condition."[1]

[1] *Bulletin 2022-6: Automated Collateral Evaluation (ACE) Eligibility, March 16, 2022, Freddie Mac* https://my.sf.freddiemac.com/updates/guide/bulletin-2022-6/

Likewise, Fannie Mae aims to take the industry into the future, listing digital transformation in the mortgage process as the top benefit in its documentation outlining the implementation of desktop appraisals. "Leveraging the wealth of big data, the power of advanced analytics, and the speed of technology, appraisers can perform desktop appraisals without physically inspecting the property." [2]

These advances are promising, but the industry can't rely on a "build it, and they will come" mentality, either. The mortgage industry—lenders in particular—need to enable the end-user and create buy-in for advances in real estate valuation. Desktop appraisals, for example, rely on the use of photos and floor plans rather than the sketches that are acceptable for traditional appraisals. There are a number of solutions for each of these requirements, which range from the usage of techs such as LiDAR and the information provided to the appraiser by real estate agents to support desktop appraisals.

While this long-term thinking is prudent, the industry needs to fully be confident in these automated systems and mobile apps before they are accepted as standard. In reality, many automated solutions have been available to lenders for decades. However, the lack of standardization and efficiency in the existing process has made lenders wary of rapid innovation or high-risk options. As a result, the future of valuation will be a process that requires experimentation, analysis of real estate transaction data, and a stamp of approval from not only direct stakeholders but secondary market investors.

We can begin to experiment with these new forms of valuation at scale only after we first solve the existing pain points in the appraisal process. It's only once stakeholders feel comfortable that the existing process can be streamlined that they will consider investing in more advanced, automated processes at scale.

[2] *Fannie Mae - About Desktop Appraisals, March 2022 (update), Fannie Mae* https://singlefamily.fanniemae.com/media/30361/display/

Industry Fragmentation & the Outdated Appraisal

Before we discuss fixing the appraisal process, let's review the challenges we're facing. Due to both the size of the real estate industry and the shock waves from the 2008 housing crisis, real estate industry stakeholders are justifiably concerned about risk propensity. This concern has contributed to the industry's acceptance of the existing appraisal process—although the current system is lengthy and costly, it accounts fully for risk.

The appraisal's length and total cost can largely be attributed to two core issues: industry fragmentation and manual workflows.

After the 2008 reforms, the Federal Housing Finance Agency adopted the Appraisal Independence Requirements (AIR) in an effort to ensure that real estate appraisals were truly independent, creating consistent requirements across lenders. The AIR had a number of effects; notably, it severely limited the ways that lenders could directly interact with appraisers. Restrictions were placed on communication between loan production personnel and appraisers valuing a property. These restrictions resulted in the development of an independent in-house appraisal processing department for some lenders or reliance on an outsourced third party called an Appraisal Management Company (AMC) for others to obtain an appraisal. This change added a number of additional layers to the workflow between appraisers and lenders. An unintended consequence was a stifling of communication and a decreased level of appraisal process transparency.

Additionally, this fragmentation has resulted in increased costs and slower adoption of new technology. Major lenders often align with a number of AMCs across the country that work with countless appraisers. The lenders, AMCs, and appraisers often use different platforms to communicate, request orders, facilitate payments, and more. These technology formats impede the efficiency of a simple appraisal request, as working with AMCs or employing large in-house processing departments creates labor-intensive processes that drive up costs for lenders.

The fragmentation in the industry is also apparent when looking at the inefficiencies around market information. Due to a lack of standardization among lenders and systems, a lender, Lender A, ordering an appraisal in a particular region does not know if another lender down the street, Lender B, is already sending an appraiser to that neighborhood in the next few days. As a result, Lender A must go through the process of contacting and scheduling their very own appraisal with their very own appraiser, only to have them drive out to a location on the same block as Lender B's appraiser.

The fragmentation is only compounded by the fact that those involved in the appraisal process are highly reliant on manual workflows, leading to human errors and elongated processing times. For starters, even the act of finding an appraiser to appraise a property is often completed via email instead of an automated "Uber-style" allocation algorithm. Once an appraiser agrees to an order, fee negotiations begin, which can add hours and days to the process. Then, there is the confusion about property access. Lenders have a relationship with their borrower, not the seller's real estate agent. As a result, appraisers often have to play phone tag with the real estate agents involved in the sale, who has actual control of access to the property. Then comes scheduling the viewing of the property, which on average is a seven-day process, according to STRATMOR research. In other words, before an appraiser even steps foot on a property, they engage in a number of manual logistical tasks that can take up to a week to complete.

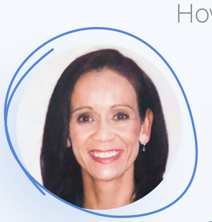
The bottom line is that the current appraisal process results in turn times that simply take much longer than they actually should, which inevitably increases opportunities for increased costs and delays for mortgage lenders and their customers.

The lack of technology and logistics optimization in the appraisal is especially apparent when contrasted with how much the mortgage industry as a whole is committed to realizing a "one-click digital mortgage." Lenders are investing in new point of sale systems, eTitle software, and automated payment processing options in an effort to encourage tech-savvy buyers into the market and create a fully seamless experience. However, until the appraisal process becomes a priority, issues and delays within the loan cycle will remain.

Embracing Technology for Change

We mentioned earlier that the future vision for valuation can only be reached once we've addressed the challenges across the appraisal process. So let's dig in.

As the first step, the industry needs to adopt existing, modern technology solutions to fix the fragmentation and manual nature of the appraisal experience. Many of these platforms exist today and don't require much time or effort to implement into an appraisal workflow. Once this is done, both turn times and costs can be reduced at scale.



How can technology help appraisal's logistics inefficiencies? In a nutshell, it can offer a streamlined, all-in-one platform for all appraisal needs—from lenders to AMCs to secondary market investors to appraisers. Amanda Hill, Head of Mortgage Solutions at Reggora, pointed out in a HousingWire article about digital transformation that the ideal state for the market is not only achievable but should be a top priority because "borrowers at all stages of homeownership are looking for user-friendly, online experiences with full visibility into the process. Modern technology is key for lenders who want to stay competitive in this regard."

If all appraisal stakeholders used a single appraisal system to order, monitor, and review their appraisals, a large portion of the fragmentation within the industry would be removed, taking laborious manual tasks with it and giving borrowers the experience they crave.

Consider that today's appraisal industry operates similar to how the taxicab industry operated a decade ago. In order to call a cab, you would have to look up your local cab companies and call them until one agreed to pick you up at a predetermined time for an uncertain price. You had no ability to monitor when the cab would actually arrive and no contact information to your driver directly. Today? You can choose from a ridesharing platform to instantly order a ride for a predetermined price and track the progress of your ride throughout. When the ride is completed, you can offer specific feedback that translates into accountability measurements for the service provider, and payment is completed automatically.

The appraisal is in the middle of a similar revolution with appraisal management solutions. When lenders, AMCs, and appraisers all operate on the same data-driven platform, then appraisal orders can be instantly matched with AMCs or appraisers ready to accept the order. With a platform handling logistics, the fee schedule can be preset, and the due date can be clearly established before the appraiser accepts the order. Additionally, advanced software can provide the appraiser with the basic property information that gives insight into any property complexities so that they understand the scope and scale of the appraisal before accepting. Logistical issues like inspection scheduling are also addressed in modern platforms as brokers and property owners can input time slots when they are available for an inspection, allowing appraisers to simply select the windows that fit into their schedule.

Then, once the order is accepted, lenders receive step-by-step status updates on the order's progress. When the order is completed, the appraisal can be uploaded to a portal and run through a quality control review engine that automatically flags issues that may trigger a second look by the appraiser to address a possible inconsistency or error so that when the lender receives the appraisal, it is in its final form. If this sounds like science fiction, it shouldn't, as this type of system exists now to help align all parts of the appraisal process.

As Ken Dicks, Director of Appraisal Compliance and Initiatives at Reggora and appraiser for 35 years, points out, “the alignment of lender and appraiser expectations could be understood earlier in the process, which would streamline some of the most manual and time-consuming aspects of the process.”

There are also additional benefits to a streamlined appraisal workflow. In a more standardized, tech-depending appraisal system, issues like payment processing, quality control, status updates, and more will all be accessible and integrated into a single interface. These optimizations may seem simple at first, but in aggregate, they create a more efficient process that benefits all parties involved.

The GSEs recognize that appraisers will benefit from a modernized appraisal process. Jake Williamson, Senior Vice President of Single-Family Collateral Risk Management at Fannie Mae, hit on the topic of a more efficient and fair valuation process in an April 2022 blog for Fannie Mae. Williamson acknowledged that for decades the process for carrying out an appraisal was the same manual process and notes, “an appraiser visited the property armed with a clipboard, tape measure, and camera, then performed an analysis and submitted a report."

Williamson writes that these new technologies and approaches will reduce travel time and the reliance on manual tasks and states, “appraisers can devote more time to doing what they are trained to do: analyze property data and form an expert opinion of value.” Williamson further points out that a tech-driven process can reduce time spent on a single appraisal, increasing volume and income for appraisers, as well.

Above all, embracing technology would enable industry stakeholders to witness the value that technology can provide in modernizing the appraisal process. If this is accomplished, then the industry can start to explore other benefits of technology that will usher in the future of valuation.

The Future of Valuation is Here

An optimized appraisal workflow will benefit not only the individual parties involved but also the real estate industry as a whole. Once appraisal logistics are improved and the infrastructure to support appraisal innovation allows technology to play a larger role in the appraisal process, the industry will benefit from more tech-savvy forms of valuation. The change will not be immediate but incremental and deliberate, and much of it can be facilitated by optimizing the existing valuation infrastructure.

Once the existing logistics of appraisals have been streamlined, new tech-oriented forms of valuation will become increasingly viable. The desktop appraisal is a great example. Third-party non-appraisers, like homeowners or real estate agents, can now leverage verifiable technology such as 3D imaging tools to provide data to licensed appraisers, who in turn can issue appraisal reports without leaving their desks.

Naturally, however, the industry must ask itself how it wants to set a standard for what success looks like when it comes to alternative forms of real estate valuation. How will it ensure that newer processes are not actually assuming more risk from these non-traditional forms of valuation? To account for this, the industry will need to analyze for any corollaries between valuation types and loss results. Once this standard is set, we can begin to develop a deeper understanding of risk thresholds.

All industry stakeholders—from secondary markets to title insurance companies—will benefit from a more innovative valuation model. Katelyn Johnson, Principal at American Family Ventures, points out that "home insurances spend millions of dollars every year conducting appraisals for new policyholders. As we move to a more digital age, insurance companies have a renewed emphasis on lowering operational costs to be more profitable and have fewer inconveniences - an automated appraisal solution is a necessary part of this equation." Similarly, Steve Dondero believes that capital market stakeholders like Goldman Sachs and J.P. Morgan will also "relish a valuation process that is not burdened by issues of responsiveness and cost."

Finally, it is important not to forget about the value that a modern valuation industry provides consumers. Ultimately, the consumer experience and satisfaction drive many real estate transactions. As a result, if the industry invests the time and resources in improving the experience to a more tech-focused, streamlined system while relying on the expertise of local professionals to assess risk, it will benefit consumers and, ultimately, the bottom line.

About Reggora

Reggora is driving appraisal innovation with our modern, two-sided platform for mortgage lenders and appraisal vendors.

With Reggora, mortgage lenders across the country are processing more appraisals than ever before while delivering an enhanced borrower experience. Lenders benefit from faster appraisals and fewer manual tasks thanks to capabilities such as advanced payment processing, algorithmic appraisal ordering, automated appraisal quality control, status updates, and more. In addition, an open API along with robust LOS and POS integrations help align lenders' tech stacks to deliver unprecedented operational efficiency.

Schedule a demo today

Reggora.com/demo-request