Long Live the King

Ernest W. Durbin II, SRA, AI-RRS

Many trace the genesis of our current financial crisis to events on Wall Street in the late summer of 2007. Exotic mortgage instruments, “creative” mortgage-backed securities and credit default swaps fashioned by The Street began to unwind during this period. Really, the crisis began well before 2007, and not on Wall Street but on Main Street. In the fall of 2007 investment markets lost confidence in the value of the underlying collateral these instruments were based on; residential properties scattered throughout the United States of America.

Investors no longer take for granted the value of residential properties aggregated into portfolios. Gone are the days when we assume that values will only go up and collateral is suddenly as important as credit score. In response to this change of mindset, a new emphasis has been placed on the valuation process. Appraiser independence, geographic competency, and a new focus on market conditions are just the forward to future chapters of change in the valuation space. Appraisals performed post-meltdown are different than those before. Underwriting standards have tightened and reports require are much more detailed supporting evidence, particularly regarding market conditions surrounding the subject property.

Every appraisal is now scrutinized at several levels. Automated rules are run on the appraisal report both at the desktop level and after received by the lender or an appraisal management company. AVMs are run on every appraisal report to spot check the value provided by the appraiser. Most of these AVMs contain their selection of comparable properties. In many instances the appraiser is asked to review data provided by these alternative products after completing the report. At times, field or desk review appraisals are ordered as well. In preparing their reports, appraisers must anticipate the questions that will come from this additional analysis. No appraisals are “easy” any longer; the attitude towards collateral has changed.

New technologies are also emerging in response. Fannie Mae and Freddie Mac are implementing the Uniform Loan Delivery Dataset (ULDD), the Uniform Appraisal Dataset (UAD). These new dataset will drive data quality and standardization. On September 1, 2011, all appraisals will be completed using the Uniform Appraisal Data set (UAD). As a result, the GSEs will be able to collect standardized data from appraisals performed around the nation. As of March 19, 2012, all conventional loan deliveries to the GSEs will have to be delivered in the MISMO v.3.0 XML format and meet required ULDD data points. These are giant steps forward in digitizing the valuation report and process.

Alternative valuation methodologies will use standardized data like those required by Fannie and Freddie to fuel new valuation reports. These new report formats will be solely delivered by XML data stream. Rich in statistics, the next generation of appraisal reports will combine the subtlety of local market expertise with the power of detailed regression analysis. Appraisers will leverage their expertise with online tools that provide analytics beyond manual ability. Just around the corner, these new technologies will provide more detailed and accurate valuations.

In order to restore confidence in the mortgage-backed securities market, investors must trust the value of the underlying collateral. Antiquated and sometimes fraudulent valuation practices contributed to residential market malaise we are currently in. It will certainly take a while to restore this confidence. The proper valuation of the residential real estate securing the portfolio is key. The corrective measures taken by appraisers and underwriters since the fall of 2007 are a start. Real confidence will come when tranches can be marked to market based on standardized data and new emerging valuation technologies. Collateral is king again and accurate valuation of the securing assets is key to restoring confidence in investor markets. Long live the King.