The Good, The Bad And The Fuzzy: Where AVMs Score And Miss

The first mistake companies make is believing that automated valuation models are infallible.

By George Demopulos

The wavering state of the housing market and the economy, along with tighter new regulations, has left banks and mortgage companies with obstacles at every turn. As a result, these businesses have looked for ways to save money and improve operational efficiencies. One way they have tried to do this is with an increase in the use of the automated valuation model (AVM) in the appraisal process.

In theory, AVMs are faster, cheaper and more accurate than an individual appraiser. Faster and cheaper, yes. However, the question of accuracy is another matter. Although AVMs can certainly be a valuable resource for appraising property, they are far from being infallible.

For those who have never used the technology, an AVM is an online service that typically calculates the value of a particular property at a specific point in time by analyzing the range in sales prices of similar properties throughout the years, as found in county record historical data. Sometimes, this is called a comparable sales report.

Although AVMs may offer savings in time and costs, a question arises as to whether or not companies using AVMs are merely taking a shortcut that is ultimately cheating the consumer out of an accurate, quality appraisal. One problem that seems to be occurring due to the accessibility and low cost of AVMs is the apparent desire for some lending institutions to replace the human appraiser with AVMs, rather than utilizing the technology as a tool within the larger real estate appraisal and valuation process.

AVMs are speedy in their data harvesting. However, the speed of the valuation does not equate to its accuracy. There are many important factors in determining the true value of a property at a specific time, most of which cannot be accurately reported by an AVM.

First, and most importantly, an AVM cannot tell you if the property, in fact, exists. When using an AVM as research in a complete appraisal report, a lender or appraiser should do a brief drive-by of the property to verify that it is where it is supposed to be. The physical drive-by also includes other information absent from an AVM report, such as the condition of the structure and the quality or appeal of the location.

In addition, an AVM cannot tell you if a specific property is in an area with a declining market, or if it is in an area that has become increasingly popular. For example, an AVM cannot tell you if a property has water views, mountain views or other scenic landscapes that give the property unique qualities that are more valuable than a property of the same size, condition and quality but with duller views, such as of dreary office buildings or crowded parking lots.

So the question becomes, are the properties that the AVM is comparing really comparable? Or, are they just comparable on paper, in numbers and figures, and in statistical data? AVMs can considerably compromise the quality of a property valuation if the data are not properly analyzed - that is the prime difference between raw data and business information.

Another important factor that should be taken into consideration when using an AVM is equally troubling: The age of the data undergoing AVM analysis is not always clear. An automated valuation tool cannot clearly tell the difference between the value of a home in 2006 versus its value in 2010. In addition, many AVMs often fail to provide accurate reports, because it is possible and common for an automated valuation tool to come up with a value based on a previous foreclosure sale or short sale, or to produce a value based on a property that was sold to a family member at a price far below the market value - when, in fact, the true value of these homes may be hundreds of thousands of dollars more.

In these specific instances, the simple data alone that is generated by an AVM cannot be taken for exactly what it is. It must be used as a basis
for further research and assessment, rather than a final conclusion.

**Now, the good news**

It is not fair to say that AVMs are completely irrelevant in the appraisal process. To their credit, this technology can offer a quick, efficient and low-cost way of gathering an abundance of sales data from properties comparable to the subject property.

Banks often use AVMs internally to double-check their portfolio, and many larger lending institutions use them to double-check the accuracy of the appraisals they receive. However, in cases where they are used to verify an appraisal done by an appraiser, it is generally expected that the lending institution will notify the appraiser ahead of time so that they are aware that their detailed, analytical appraisal will be compared with the result of computerized data. This allows appraisers to know if there is a possibility of a discrepancy and, therefore, enables them to deliver an explanation, if necessary.

Appraisers often use AVMs for potentially tough appraisals, in order to back up the extensive research that they have already done. The AVM, in this case, serves as a confirmation of the appraisal’s validity.

AVMs can also be a great tool for enhancing risk management. When used as a supplemental element to a standard appraisal, an AVM can help to lower the risk of fraud, because the data are pulled directly from factual data records, and when the results of the AVM are included in the final valuation report, it makes it nearly impossible for an appraiser to finagle the numbers.

Many AVMs can also be customized to deliver specific information, such as a particular group of properties based on geographic area, price range, property type, etc., which allows the researcher to focus on a specific type of property, rather than having to weed through information that does not compare to the property in question. Some AVMs can even provide an estimated value of a property, regardless of whether there is prior sales information available, and others can tell you how many times a property has been sold over a specific period of time.

As long as all parties take both the benefits and current limitations of AVMs into careful consideration, this technology can play a significant and valuable role in the valuation process, and will likely become increasingly prevalent in the mortgage industry as technology continues to advance.

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