Rating Services Point to Growing Use of Appraisal Alternatives as a Market Concern

Alternatives to traditional appraisals are attracting increasing interest among U.S. mortgage market participants, which would potentially weaken the credit quality of new residential MBS, according to rating service analysts.

Lima Ekram, an analyst at Moody’s Investors Service, said mortgage market participants are exploring the use of property appraisal alternatives, in some cases, “to reduce operational costs, increase efficiencies and address the shrinking ranks of US property appraisers.”

Appraisal alternatives that have drawn more attention include hybrid appraisals, broker price opinions (BPOs) and automated valuation models (AVMs), according to Moody’s recent research. The various alternatives pose different risks, it said.

Hybrid appraisals rely on information from on-site examination of a property conducted by a third party, often a real estate agent or broker. Appraisers use the information to evaluate the property value. The concerns are that quality of information from site visits may be subpar, and appraisers may be less likely to capture local market nuances.

BPOs by real estate brokers and agents have attracted more attention since the 2008 financial crisis. However, this method of valuation lacks appraisers’ expertise and incentives, and can be based on less reliable information.

AVMs assess public records and other data to evaluate a property. The method will depend on the quality of the data and models used and is sometimes less sensitive than humans to changes in market trends.

The increased use of alternatives to traditional appraisals signals potential risks, the research said. “Their use in tasks that affect the credit quality of RMBS securitization collateral could, however, lead to a weakening of new RMBS transactions,” Ekram said.

Analysts at Fitch Ratings said they have similar concerns. Roelof Slump, a managing director in Fitch’s U.S. RMBS group, said any movement towards a substantial weakening or greater streamlining of the appraisal process could be a concern.

“The accuracy of value of the property is very important. So when we talk about things that potentially increase the risk of property value not being accurate, that can create risk uncertainty and would bring uncertainty to a potentially higher level in our credit analysis,” he added.

Moody’s research included analysis for both non-agency and agency RMBS, which means Fannie Mae and Freddie Mac are heading toward the same potential risks, Ekram said.

Karen Mann, a certified appraiser for 38 years, said she’s sad about the increased use of appraisal alternatives, although she understands that some lending institutions are looking for alternatives to close loans faster.

Appraisal alternatives are more accurate for homes that are nearly all the same than for homes that are of different age, style and communities, she noted. “If you are going to use alternative valuations, you have to be very careful. In the area where I live, where no two homes are the same, alternative valuation would not work very well,” she added.