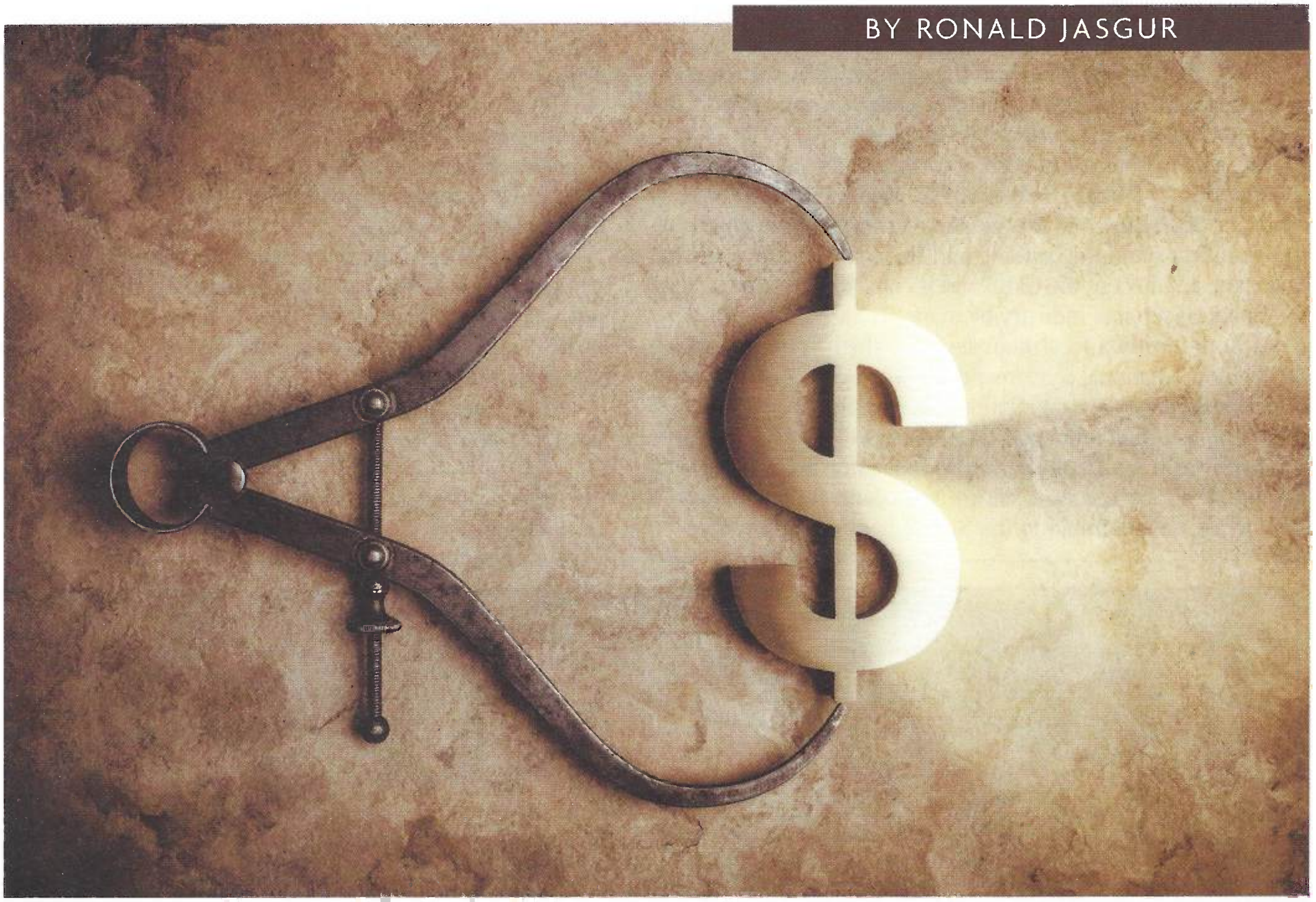
Variations on Value



BY RONALD JASGUR

Is a property worth what the market will pay? Not in today's housing market.

In the early days of the Internet, there was an email joke that circulated among those of us in the mortgage and housing space. It went something like this: There were three or four different views of the same house. The seller's view looked palatial, as if the house were worth more. The buyer's view showed the house as smaller and worth less. The assessor thought it was gold-plated. And the appraiser saw the house as a run-down shack. $ Too bad that joke isn't making the rounds in people's inboxes right now, because it's truer today than ever before. $ Valuation has never been an easy thing to assess, and today is no different. Yet despite the hills and valleys our industry has endured in

PHOTOGRAPHY BY GARY S. CHAPMAN / GETTY IMAGES the past five years—and with all we've supposedly learned—we are no smarter today in assessing housing value than we were before everything crumbled.

When determining the value of a property, we must look at all perspectives. We must be risk-averse and open-minded at the same time. We must listen to the market as much as we listen to the "valuation specialists."

The only problem is, the banks are holding the purse strings and their risk-averse stance makes it difficult to see the true picture.

We all have a stake in determining best value in order to right a market that's been toppled over on its side for too long.

And to determine best value, we have to let all voices chime in.

Our technologies regularly reveal blatant valuation errors that drop our jaws to the floor every time.

Value isn't the same to everyone

It's one thing to bring cash to the table and pay what you think a property is worth. It's another to do so when asking for financing.

When you're putting up your own cash for a purchase, most of us think more carefully and cautiously—both bank and individual.

But that doesn't explain why an appraisal or broker price opinion (BPO) convinces a lender that a home is worth, say, $60,000 in today's market when an investor comes along with $100,000 to put on the table.

More importantly, when 10 would-be buyers agree that the house is worth $100,000, shouldn't the bank question the valuation process and take a closer look at the data and methods that influence valuation?

Wouldn't that help all of us—even the lender trying to approve a buyer's loan to make the purchase happen?

We are only as good as the tools we use to determine value. In today's market, every valuation product is flawed, and everyone in the industry knows it.

All losses and workflow decisions are made based on estimated value provided by individuals who may or may not have incentive to skew numbers. Every tool we have—appraisals, BPOs and automated valuation models (AVMs), to name a few—are based on history. At best, those numbers show what happened last week, last month or last year—and certainly don't reflect the true value of a property today.

There's another important factor influencing our assessment abilities today. We're all once bitten, twice shy.

After the bubble burst in 2007, we hunkered down to evaluate how we got here and all of us became wary of creating another free fall. We're gun-shy now instead of trigger-happy like we used to be.

Being too free with money created the worst housing mess this country has seen since the Great Depression. Being too tight with it could prolong the mess further.

But what can we use to replace the tools everyone is already comfortable with?

We can start by embracing technology and understanding the breadth of possibility for more accurately seeing the current picture.

We're only as good as our data

Data determines everything in this industry. Good data will set us free; bad data will keep us penned in. Look at the abundance of bad data in the distressed-assets marketplace today.

The default servicing industry has more information available than ever before, yet even when so much information piles up (unemployment, foreclosure and other data layered overtop appraisals and BPOs), industry leaders are still left with an estimate or opinion of value that doesn't reflect the most important resource of all: the buyers in the marketplace right this minute who are interested in purchasing a particular property.

As Woodward Asset Capital has created software solutions OfferSubmission® and VerifiedShortSale® and worked through their development, execution and acceptance, we've become increasingly frustrated that so many servicers and banks still aren't paying attention to what the market is saying about value. And we are convinced that is the only way to facilitate a true recovery.

Existing models of valuation are inherently flawed because they are subject to human selection and error. In reviewing 2012 data from OfferSubmission, we find that 23 percent of all listings in our system consistently sell above the bank's list price, which the client formulates based upon appraisals, BPOs and automated modeling just like they always have.

When negotiating a real estate–owned (REO) or short sale, we must consider what the actual market is willing to pay today. Throw that in with all the other indicators—past history, yes, but also best projections for tomorrow. Balance everything for the true path.

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Consider this example: A foreclosed house in Chicago that sold in June was listed at $53,900 with a BPO at $50,000 and an appraisal at $49,000. The bank fielded 75 offers. The property sold for $154,157—286 percent over list.

Here's another example: A foreclosed house in Austin, Indiana, listed at $12,500, with BPO at $12,500 and appraisal at $12,000. It sold for $24,000. And yet another: A foreclosed house in San Diego, listed at $204,750 (with BPO at $195,000 and appraisal at $180,000), sold for $301,000, with 76 offers.

In the traditional way of selling REO, the bank would never see 75 offers, of course, and the listing agent would always get his or her own buyer's deal to the closing table at the (ridiculously low) list price. Yet, these examples speak to the fact that the traditional way of marketing distressed assets leaves a lot of money on the table.

Even valuation experts agree that determining true market value is almost impossible.

In a July 2012 blog interview on our company website, Lou Spampinato, chief executive officer of Irvine, California–based Real Value, an asset valuation firm, concurred, saying: "There are great, big gaping holes in the process of doing valuations. . . . We know this industry is misguided in the tools and processes we have to determine housing value and yet we keep using them, relying on them, despite our frustration."

Valuations are a problem in every aspect of the mortgage business, from distressed assets to originations.

Because value isn't the same to everyone, we need a 360-degree view to really understand what a property is worth. With all the tools available to us, spewing more data than we can consume, let's figure out a way for the data to set us free.

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Manipulation

A huge part of what got us into this mess in the first place comes down to bad manipulation of data to make deals happen at all cost.

When values were skyrocketing, appraisers were accused of working for the loan officer, doing whatever was possible to get the loan closed. It used to be that there was some wiggle room and schmooze work that could move numbers slightly to achieve a sale. Now, the pendulum has swung in the complete opposite direction and manipulation of data is helping the more risk-averse among us.

It's not quite that people are sabotaging deals, but certainly deals are more difficult today because value remains so subjective. We rely on human selection and understand that there is no such thing as a perfect appraisal.

While the appraiser is supposed to truly be an independent third party today, providing an objective opinion on value to the bank, it seems like the appraised value is a far cry from what everyone else in the marketplace thinks way too often.

Because our technologies allow a buyer's agent to submit offers directly to the bank or asset manager for review in all 50 states, we regularly see giant variations between offer amounts and the seller's list price based on the third-party valuation. And it isn't always those properties that sell way above list price that catch our attention. It's equally important to recognize when, for instance, a property is appraised for $250,000 and a dozen offers or more suggest the property is worth in the range of $150,000 to $175,000. Often we see what the seller considers to be "low-ball" offers eventually accepted months later, after a number of price reductions that finally get the price in line with what the market had been saying all along.

In improving real estate markets, we must consider what the market is willing to pay. And the market should not be defined as one offer, a singular oddity. I'm talking about an open and competitive market where a dozen offers well above list price add up to a whole lot of people who believe a house is worth more than somebody's professional opinion.

And we should listen also to those bringing cash to the table—perhaps the best indicator of value we have.

When financing is not part of a transaction and appraisals don't matter, the amount of cash someone is willing to put down, out of pocket, speaks volumes to what a property is worth.

Take a closer look: If an appraisal comes in for a property at $100,000 and a dozen investors show up at the table offering $75,000 cash, doesn't that mean the house may truly be worth only $75,000? Today's banks aren't lending on that higher value—being gun-shy in the wake of the last boom-and-bust cycle. And in an era of low down payments, most occupant-buyers don't have the extra cash to pay the difference.

But if enough buyers wave that higher-price flag, it's time to pay attention. That is what we mean by having a true 360-degree view of a property's value, in a marketplace where perception is indeed reality.

Bridging the world of distressed assets and originations

While this question of valuation may figure prominently in the distressed-assets marketplace, it's important that the originations folks pay attention, too.

With technology at our fingertips showing facts and figures—purchase history, marketplace offers, perception and action alike—originations can benefit from the abundance of buyer activity.

In the old paperwork-heavy days, originations had no clue what went on in REO, and for good reason—it didn't matter and it didn't translate.

But it should.

At our company via our OfferSubmission REO platform, we collect data from willing buyers. For every sold property that fields an average of 5.5 offers, the one taken leaves 4.5 buyers in the market, still searching. That's 4.5 potential bank customers who might be in the market for mortgage financing. And the one who landed the deal—he's also fair game for other bank products.

In business, there are only two ways to grow the bottom line: get new people in the door and sell more to the people you've already secured as customers. And we all know it's far easier to pull off the second option.

There are other values that the mortgage space needs to consider besides the value of a property on which it's lending. Technology today can connect us with all kinds of people—homebuyers, yes, but also people in the market for deposit accounts, credit-card customers, those looking for car loans or another house, people who want loans for other reasons. The opportunities are numerous.

When you look at an industry dependent on building relationships, you expand the potential for lifelong, loyal customers. How much is that worth?

Without technology, we don't know who these potential customers are. Today's buyers are shopping the marketplace, utilizing financing with strong credit history and standing. In today's economy, you can't even contemplate a home purchase without excellent credit and solid employment. Those are the kinds of customers we all want, and they are here, at our fingertips, if we mine the data correctly.

That makes the whole REO buyer space a whole lot more valuable to originations and the bank as a whole than we ever thought.

Finding new ways to get to the same customers with additional products is a promising new business horizon. This turns the conversation on value in another direction—it's no longer just the perceived value of one property; now it's the value of one customer over a lifetime.

The long view

A year ago, Louise Braun, a suburban Detroit appraiser and Realtor®, contacted me to voice her frustration that the listing prices of foreclosures in no way resemble the appraised values.

"What a damned nightmare this market is for homeowners, Realtors, appraisers, flippers and local governments, school districts and county governments," she said.

She took issue with new uniform appraisal rules, insisting that basing value on the past—recently sold properties, something not quite near comparable, transactions that happened in a different economic time and circumstance—will never create true market value.

In today's marketplace, we must think of the big picture so much more than just that one sale on the table in front of us. Step back from the day-to-day workflow and see that minor changes in perspective or the use of new technologies go a long way to endear a servicer to an investor.

Clearly the way we have always done valuation no longer works, especially in the wake of an extreme market high and its subsequent unparalleled crash. It's time to do business differently—smarter; breaking out of old, bad habits and instituting new processes, procedures and thoughtful approaches to how we determine dollar value for housing.

We're not quite there yet. But we're getting there. And it won't be a moment too soon. **MB**

Ronald Jasgur is president of Woodward Asset Capital, Southfield, Michigan, the parent company of OfferSubmission®, VerifiedShortSale® and PurchasePipeline®. He can be reached at rjasgur@woodwardassetcapital.com.