

Real Estate Article

Automated Valuation Models USPAP Regulations?

The rise of Internet home valuation tools, such as Zillow.com, has provided consumers tremendous benefits, which before were only available to real estate professionals and appraisers. Instead of having professional appraisals or learning complicated appraisal techniques, Zillow.com offers a "Zestimate" to nearly anyone with a mailing address who wants a quick, rough estimate - not a technical appraisal -- of their properties current market value. Zillow also provides a service that finds comparables for a certain home and makes adjustments automatically. The Automated Valuation Model (AVM) that Zillow uses to compute its Zestimate is proprietary.

Although the website clearly states that a Zestimate is not a substitute for a professional appraisal, it does claim that the Zestimate values fall within a specific percentage of the homes current market value. Under a clearly labeled hyperlink on the homepage titled "Zestimate Values & Accuracy," the site states that the integrity of the Zestimate value can be jeopardized by incomplete or incorrect data used in its AVM algorithm. However, the Web site does cite that the values obtained by a Zestimate can be shared with a real estate professional.

Despite the disclaimer on Zillow.com and the many beneficial tools zillow.com offers, some see Zillow's Zestimate as misleading and dangerous to the average consumer. As reported in an article in the New York Times on October 31, 2006, the National Community Reinvestment Coalition (NCRC) filed a formal complaint with The United States Federal Trade Commission against Zillow, citing the following: Zillow's practices violate the Federal Trade Commission Act and undermine congressional intent to ensure a healthy, precise, open and robust housing and mortgage market, as stated in Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), the Federal Fair Housing Act, and related civil rights and consumer protection laws. 2

According to the New York Times article, the NCRC is "an umbrella group that organizes local communities against lenders and other financial institutions that they see as using discriminatory practices." 1 In the NCRC complaint, data shows that many Zestimate values are inconsistent with Zillow's stated margin of error - especially in low-income neighborhoods. Furthermore, the NCRC argues that the "average consumer" is unaware that automated valuation models do not have to adhere to the Uniform Standards of Professional Appraisers Practice (USPAP) because the disclaimer is "tucked away." 2 As a result, the NCRC contends: The average consumer who relies upon information on the www.Zillow.com internet site mistakenly believes that he or she is receiving a valuation equivalent to one conducted by a valuation professional. 2

The NCRC is calling for the FTC to permanently restrain Zillow from providing home value estimates. 1 Also, the NCRC recommends that Zillow and other companies with similar public AVMs be subjected to the same USPAP regulations as appraisers because they estimate the market value of property. It should be noted that under USPAP guidelines, Zillow is legally allowed to provide free value estimates with no liability, reporting, or record keeping requirements. 2 However, appraisers are completely liable for satisfying these requirements because they are "designed to protect all parties of the [financial] transaction." 2 Issue: Should the NCRC's proposal for Zillow.com and other online AVM's who estimate the current market value of real estate be subject to the same USPAP regulations as appraisers?

One argument against the NCRC's proposal is that Zillow doesn't claim to be, and is technically not an appraiser. In a clearly accessible disclaimer on zillow.com, Zillow explicitly states that the Zestimate values do not serve as the equivalent of an appraised value, and should not be used in influencing a financial decision. In fact, directly on the home page, directly under the calculate Zestimate link, it has a link that brings you to these disclaimers. There is no other information on the homepage that even addresses the market value of homes, or alludes to what a Zestimate is. Therefore, since USPAP regulations were created and intended to protect the integrity of information used in Federally Related Transactions and other financial transactions, they should not apply to Zillow. 3

One argument for the FTC to adopt the NCRC proposal is that despite Zillow's intentions, there is evidence - according to the NCRC -- suggesting that the Zestimate is being used by some of the real estate and lending community to perpetuate fraud. 2 However, the NCRC does not cite any specific sources for this information. Even if this information is not being used to perpetuate fraud, the reality is that Zillow's inaccurate data could be dramatically influencing the outcome of financial decisions and impacting market value. Essentially, the Zestimate is in part playing the role of a traditional appraisal in the marketplace, so it should be subject to the same regulations. Moreover, empirical evidence shows that minority, low-income neighborhoods are over-represented in the share of Zestimates that are undervalued, and upper-income neighborhoods are over-represented in the share of Zestimates that are overvalued. 2 Unless the proprietary algorithm that Zillow uses is disclosed to the USPAP, it is unclear whether Zillow's impact on market values is swayed by racial and ethnic considerations. Stakeholders Homeowners NCSB Builders Internet Users Appraisers Impoverished Uneducated Politicians Zillow.com Real Estate Agents Misinformed Zillow Users Developers USPAP Schools Students Minorities Land Owners Potential Home Buyers Potential Home Sellers Investors Mortgage Brokers Banks Other AVM websites N.A.R. Yahoo Real Estate Solutions

Subject Zillow, and similar automated valuation models, to USPAP regulations: In order to protect lenders, borrowers,

and prevent discrimination in the marketplace, it is essential to make sure Zillow and similar AVMs adhere to the same regulations as professional appraisers. If the algorithms used by these AVMs are unable to effectively meet the regulatory standards, they should be restrained from providing value estimates to the public. Force people using Zillow and similar automated valuation models to accept a user agreement: Currently, it is not necessary to read the disclaimer before making a Zestimate query. The FTC should stipulate that Zillow force its users to accept a legal user agreement by submitting an electronic signature. This user agreement could state all the significant aspects of the disclaimer, and hold people who improperly use Zillow's information for illegal purposes liable under the law.

Leave Zillow as it is, but let regulators check the algorithm: As long as the algorithm does not consider discriminatory elements, Zillow is actually providing a very beneficial service in the marketplace. Giving the average consumer these tools makes the relationship between clients, agents, and appraisers more transparent. For example, it is much easier for consumers to observe if they are being taken advantage of by people who they believe to be "experts". Also, the disclaimer is easily available and there are no evident sources using the service to perpetuate fraud. Opinion

I think the best solution is to force users of Zillow and other automated valuation models to accept a legally binding user agreement that clarifies how the information obtained from a Zestimate can be legally interpreted. However, I find it hard to believe that people using Zillow don't understand that the information they receive from a Zestimate is not the equivalent of a professional appraisal, and that its value estimates have a large impact on decisions involving financial transactions. If Zillow were to adopt this practice, I think it would hedge some liability and further ensure that its users completely understand its services.

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