

Why We Need a National Collateral Database

By Bill Rayburn, CEO, FNC Inc.

The establishment of credit bureaus did a lot for the U.S. financial sector. But does anyone realize how it all started? In the 1830s, the first third-party credit reporting agencies (CRA) were established. They were one of the first businesses that were national in scope, and actually functioned much like a modern-day franchise. They were set up as a network of offices across the country. When the typewriter and carbon paper were developed in the 1870s, greater efficiencies were introduced. The information that was accumulated was more widely available, more accurate, and covered a much larger geographical area.

By the 1970s CRAs had consolidated enough that we could begin to get a more holistic picture of individual borrowers' credit behavior. The advent of mainframe computers made it possible for lenders and merchants to efficiently compile and exchange consumer data. Regional players strengthened their positions and exchanged information with one another. The next turning point was the 1980s with the advent of micro-computing and further consolidation of CRAs into three major, national entities. With more powerful computing and even more comprehensive data, came more sophisticated analytic techniques and ultimately, credit scoring. Obviously, it took a high degree of cooperation to develop a nationwide, generally accepted credit reporting and scoring system.

But Credit's Not All ...

While recognizing the intense value of credit reporting and the tremendous efficiencies it has introduced to consumer lending in the U.S., evaluating borrowers' credit is but one side of the equation in mortgage lending. The other variable the lender must address to make the best possible lending decision is evaluation of the collateral behind the mortgage. This is especially critical in subprime lending where default probabilities (and likelihood of assets returning to REO) are higher. Given certain credit qualities, the probability of default is small. As credit quality drops, however, lenders become more concerned with the quality of the collateral. In the case of subprime lending, therefore, the more lenders know about the collateral, the better their decisions and the more proactive they can be in the event that the asset returns to their charge.

The time has come for U.S. financial institutions to band together to establish a national collateral database, much like institutions did 30 to 40 years ago when national credit reporting was established. Central to the national collateral database would be property values and physical characteristics information that could be used to raise the bar on collateral analysis. This database would be fueled by appraisal data contributed by lenders, along with publicly recorded data from local municipal offices.

The benefits of a national collateral database would be:

- Origination—better and faster valuation methods to automate and enhance funding decisions, while putting capital into the hands of consumers more quickly and economically—which is what HUD’s proposed RESPA reforms are all about. The better quality the data, the more reliable AVMs become. Take that a step further and envision with me automated collateral scoring.
- Secondary marketing—better, smarter issuances on the sale of whole loans. Where loan pools are now tranced predominately on the credit-worthiness of borrowers, with a national collateral database fueling a scoring system, attributes of the actual assets backing the mortgage could be factored in.
- Servicing/default management— qualified, proactive decisions about the loan, with due consideration to the collateral itself (how liquid might the asset be considering its attributes, accurate estimate of LTV, etc.)
- Servicing/loss mitigation—minimize potential losses, armed with instant access to accurate information about the property and the context of the property in its market.

The U.S. financial industry is consolidating. Where locally gathered borrower and collateral information once sufficed for a highly fragmented, localized industry of local and regional lenders—today’s national mega lenders require data from a broader, more diverse geographic area. Drawing the comparison again to credit reporting, the cleaner and more comprehensive the residential property data can become, the more utility it will provide to lenders and consumers alike—and the more widespread and significant the efficiencies that can be introduced.

The Hurdles We’re Leaping

To reach this ideal, however, a national collateral database has a number of challenges to overcome. The first challenge is that of obtaining good quality real estate information. The traditional sources of property data have been communities-based public records, mainly from the tax assessors’ offices of government municipalities. The problem is, the quality and nature (varying degrees of completeness and may or may not be electronically available) of these data are disparate depending upon what part of the country it comes from. Another source is multiple listings services (MLS), but once again, though electronically based, these are disparate, localized sources lacking data quality control assurances for consistency across the country. The next logical challenge, then, is how to consolidate these various sources of collateral data into one, comprehensive, consistent, quality database to which supplemental complementary data could be added.

FNC, in a joint venture with the Appraisal Institute, began work on just such a database three years ago—the Appraisal Institute (AI) Residential Database. Currently, with more than 80 million records nationwide, the bulk of the data is public record data. There is significant appraisal data coverage in California, Washington, Oregon, Nevada, Arizona,

and parts of Texas and this was accomplished through FNC's acquisition of the California Market Data Cooperative (CMDC) in 2000. While there have been some contributions of data to the AI Residential Database, the level of contribution is not yet what we had anticipated. Clearly, from what we have learned from the history of credit reporting, unless there is a critical mass of data (implying broad adoption), a national collateral database will remain more vision than reality. So let's talk about what some of the resistance been, inhibiting some of the nation's largest lenders from contributing residential property data.

1. Times have been good. So good in fact, that the volume of loans coming in the door has enabled the big lenders to establish proprietary collateral databases. Which leads to...
2. Data is an asset-- Why cooperate with my competitors, they are evidently thinking, and share what I perceive as a competitive edge (proprietary market information) with my competitors? This was the same type of thinking that was held by many in the commercial real estate industry 12 to 15 years ago when it came to sharing vacancy and rental rate information. Today, however there are a number of property databases and real estate indices that have been established thanks to cooperative reporting of information and the benefits have been enormous if one compares the level of sophistication of real estate analysis today versus 12 years ago.

Also, what happens when times are not as robust as recent years and mortgage volumes recede (as is likely in 2003)? The scope and power of a national collateral database would certainly outweigh that of proprietary databases, especially in terms of the application of analytics that could be derived.

3. Lenders are uncertain about real estate information disclosure under the Gramm-Leach-Bliley Act (GLB)-- growing concerns about personal information privacy issues related to individual identifying information in real property records. After extensive analysis of GLB, FNC has determined that much of the information about the collateral in a mortgage transaction is not restricted by the Act because it is not considered nonpublic personal information (that is, it consists primarily of publicly available information). Some information used in a mortgage transaction, however, such as a customer's name, loan number, tax identification number, or the fact that customer is applying for a loan from a particular lender, will be nonpublic personal information and subject to restrictions on sharing. Even though certain information about collateral may be shared freely, prudence dictates that lenders and appraisers manage collateral information with care and sensitivity and not re-use it outside the purposes for which it was collected, that is real estate valuation, management and analysis. The mortgage industry must educate consumers

about the ultimate benefits to them of a national collateral database that relies on disclosure of residential property values at the time of transaction—benefits such as shaving 75% of the time and paper out of the loan origination process thanks to sophisticated analytics fueled by fresh, quality data.

4. Many lenders have not had adequate IT infrastructure to efficiently mine their own data, let alone begin to share it. All of this is changing, however, with broader acceptance of extensible markup language (XML), which ensures that data can be transmitted to and from different electronic formats. Take appraisals, for instance. To overcome barriers to acceptance and adoption of the new XML standard by appraisal forms software companies, FNC worked in conjunction with the Appraisal Institute to develop definitions for a residential real estate data storage and transmission standard based on XML. FNC built toolkits based on the standard that allow software companies to easily enable their legacy software to communicate with the new XML protocols (dubbed “AI Ready”). Thanks to innovations such as this, lenders are now in a position to leverage property data that in the past would have received limited use (due to its being paper-bound). With data now available in an open transmission format, and information architectures now more open as well, data is more readily shareable than ever before.

Support for a national collateral database is growing. Yes, it has taken a tremendous amount of resources to get this initiative off the ground, but the vision for what this could ultimately mean for the mortgage industry in terms of efficiencies and qualified decision-making—for both primary and secondary mortgage markets—is enormous. Don’t forget one of the most fundamental rules of economics. The more perfect the information, the more perfect the market. It won’t be long before we see mortgage approvals/closings reduced to two to three days, default and loss mitigation losses shrink to a fraction of current losses, and the confidence behind loan pools sold to secondary markets boosted many times over, thanks to the cooperation of this great nation’s lending institutions who have the foresight and the experience to know what a national collateral database could do for the U.S. financial system—much like the rewards brought about through national credit reporting over the last 30 years.