DEVALUED, DENIED, AND DISRESPECTED: HOW HOME APPRAISAL BIAS AND DISCRIMINATION ARE HURTING HOMEOWNERS AND COMMUNITIES OF COLOR

HYBRID HEARING

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DEVALUED, DENIED, AND DISRESPECTED: HOW HOME APPRAISAL BIAS AND DISCRIMINATION ARE HURTING HOMEOWNERS AND COMMUNITIES OF COLOR

Tuesday, March 29, 2022

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the committee] presiding.

Members present: Representatives Waters, Sherman, Meeks, Scott, Green, Cleaver, Perlmutter, Himes, Foster, Beatty, Vargas, Gottheimer, Lawson, Axne, Casten, Pressley, Lynch, Adams, Tlaib, Dean, Ocasio-Cortez, Garcia of Illinois, Garcia of Texas, Williams of Georgia, Auchincloss; Hill, Posey, Luetkemeyer, Huizenga, Wagner, Barr, Williams of Texas, Emmer, Zeldin, Loudermilk, Mooney, Davidson, Budd, Kustoff, Gonzalez of Ohio, Rose, Steil, Gooden, Timmons, and Sessions.

Chairwoman WATERS. The Financial Services Committee will come to order.

Without objection, the Chair is authorized to declare a recess of the committee at any time.

Today's hearing is entitled, "Devalued, Denied, and Disrespected: How Home Appraisal Bias and Discrimination are Hurting Homeowners and Communities of Color."

I now recognize myself for 4 minutes to give an opening statement.

Today, we will take a closer look at discrimination against homeowners and communities of color in the appraisal process. Last Congress, I convened a hearing to examine the state of the appraisal industry, including the lack of diversity in the profession, and unequal valuation of homes in communities of color, those owned by people of color. Since then, I have engaged the appraisal industry and profession in critical conversations around the need to address these inequities, as we have seen increasing reports of appraisal bias and alleged discrimination. However, there is still much to be done.

A home's value is critical to closing the wealth gap and ensuring that communities of color build generational wealth. Both overvaluation and undervaluation of a home are harmful to buyers and homeowners by either saddling a buyer with a home worth less than the debt they take on or selling short homeowners of their nest egg. Bias and discrimination in appraisals can result in perpetuating historical disinvestment in communities of color, lowering home values for communities of color, locking people of color out of home ownership opportunities, and contributing to the widening of racial and ethnic wealth and home ownership gaps. We must not forget that home appraisal discrimination based on race, color, sex, religion, national origin, familial status, disability, and age is illegal.

However, recent news reports have shown that the appraisal bias faced by homeowners of color is still a reality. We have all seen the articles. A Black family seeks to have their home appraised, and when they are physically present or leave their family pictures within the home, they receive a low appraisal. When they "Whitewash" their homes by removing their pictures and other indicators of Blackness and insert those of fictitious White families, all of a sudden, the appraisal jumps in value. These are not just anecdotes. Data bears out the disperate appraisal treatment of homes owned by Black and Latinx homeowners compared to homes owned by White homeowners. As a result, studies have found that a home in a White neighborhood is valued 2 times higher than comparable homes in Black and Latinx neighborhoods.

That is why I have drafted legislation to be discussed at today's hearing. My bill, the Fair Appraisal and Inequity Reform Act of 2022, addresses appraisal bias and discrimination by establishing a new Federal Valuation Agency—responding to a key recommendation made by President Biden's Interagency Task Force on Property Appraisal and Valuation Equity.

I thank the witnesses for appearing here today, and I yield back.

I now recognize, as acting ranking member, the gentleman from Arkansas, Mr. Hill, for 5 minutes.

Mr. HILL. Thank you, Madam Chairwoman, for holding this hearing today.

Accurate appraisals are a vital component of the home-buying process. They provide important guidance to lenders offering mortgages as well as financial protection to taxpayers backing those loans. This is important given the magnitude of the total value of all outstanding U.S. mortgage debt, which is currently about $12 trillion. As a former community bank chief executive officer and executive for many years, I know the essential role of appraisals in providing market confidence to home-buying families who deserve a fair and honest valuation of their investment, and, for the lenders, true security about the value of their collateral. In other words, honest, independent appraisals are incredibly important to maintaining the safety and integrity of mortgage lending in our country and in our families' accounts.

So when we hear allegations of how racial bias in the valuation process is systemic, that is a problem for many reasons. First, it is wrong and unlawful, not to mention immoral, to discriminate against someone in these transactions on the basis of race, color, religion, sex, disability, familial status, or national origin. Such discrimination is a crime, and if a crime is being committed, our government is committed to stopping it.

Some have alleged, often based on anecdotes or broad assumptions, that racism exists in the appraisal profession, which, in turn, perpetuates systemic racism. That is a charge which demands serious consideration, not to mention hard evidence to back it up. Yet, a lot of questions remain about what exactly is happening here, and also why. And I hope our witnesses today can help shed some light on the actual facts before we in Congress leap to conclusions.

I would note that while this hearing is focused on the potential impact of undervaluations in appraisals, there should be equally serious concern by members of this committee about the impact of overvaluations and appraisals. Overvaluations require consumers to take on more debt, reduce the affordability by endlessly-spiraling home prices at ever higher and higher levels, literally destroying, as we saw in 2008, nearly $16 trillion worth of household wealth.

As a commercial banker during the 2008 crisis, I saw firsthand that destruction through overvaluations by irrationally-exuberant appraisers, lenders, and buyers. And a generation previously, as a Treasury official responsible for helping stand up the Resolution Trust Corporation in the early 1990s, I know this firsthand from the savings and loan crisis of the late 1980s and early 1990s.

So if, in fact, we are going to demand fairness and accuracy in appraisals, and we should, it is critical to examine all of the factors that harm the appraisal quality, that lower competition and inhibit market innovation. That is the only way we are going to ensure that we get a fair market valuation of assets for both lenders and those households who are making their sometimes very first most important financial decision, investing in a home. And I hope we can accomplish that today and do it in a bipartisan manner.

And with that, Madam Chairwoman, I yield back the balance of my time.

Chairwoman WATERS. Thank you. I now recognize the gentleman from Missouri, Mr. Cleaver, for 1 minute.

Mr. CLEAVER. Thank you, Madam Chairwoman, and thank you for holding this important hearing. Although this committee has held broad hearings on the appraisal industry in the past, I appreciate that this discussion squarely calls out bias and discrimination in home appraisals.

In March of last year, I authored a bicameral letter with colleagues in the House and Senate, including this committee, demanding that the Federal Financial Institutions Examination Council (FFIEC) and regulators take immediate action to address disparities in home valuations for communities of color. Studies have shown that appraisal bias is prevalent throughout the country. Research from Fannie Mae and Freddie Mac has demonstrated that appraisal disparities broadly exist for communities and borrowers of color.

Separately, research from the Federal Housing Finance Agency (FHFA) analyzed millions of appraisals and found evidence of bias in the neighborhood description of valuation reports, including some explicit references to race and indirect comments alluding to it. In April of last year, my colleague on the committee, Congressman Torres of New York, and I introduced the Real Estate Valuation Fairness and Improvement Act, which proposed an Interagency Task Force similar to the Interagency Task Force on Property Appraisal and Valuation Equity (PAVE) Task Force announced by the Administration in June of last year.

I am thankful for your leadership, Madam Chairwoman, and the leadership in this Administration, for tackling appraisal bias head-on.

I yield back.

Chairwoman WATERS. Thank you very much. I would now like to welcome our distinguished witnesses: Mr. Pledger M. Bishop III, the president of the Appraisal Institute; Mr. David S. Bunton, the president of the Appraisal Foundation; Mr. Dean Kelker, the senior vice president and chief risk officer of SingleSource Property Solutions, who is testifying on behalf of the Real Estate Valuation Advocacy Association; and Ms. Lisa Rice, the president and CEO of the National Fair Housing Alliance.

I will now recognize the gentleman from Minnesota, Mr. Emmer, to introduce our final witness.

Mr. EMMER. Thank you, Madam Chairwoman, and thank you, Mr. Hill, and thank you to all of the witnesses who are joining us today. I just want to use this quick minute to extend a warm welcome to one of our witnesses today, Mr. Tobias J. Peter. Mr. Peter is a dedicated research fellow and the assistant director of the American Enterprise Institute's Housing Center. He is the author of several reports on housing policy and consistently provides invaluable insights into our housing markets. Mr. Peter is also a constituent of mine from St. Cloud, Minnesota, and I have been fortunate to know Toby for the past 4 years. Mr. Peter, thank you for joining our committee today, on behalf of the committee in the Sixth District. Thank you for lending Congress your time and expertise as we explore ways to strengthen our housing markets.

I yield back.

Chairwoman WATERS. Thank you. You will each have 5 minutes to summarize your testimony. You should be able to see a timer that will indicate how much time you have left in your testimony. And without objection, your written statements will be made a part of the record.

Mr. Bishop, you are now recognized for 5 minutes to present your testimony.

STATEMENT OF PLEDGER M. BISHOP III, PRESIDENT, THE APPRAISAL INSTITUTE

Mr. BISHOP. Thank you, Chairwoman Waters. The Appraisal Institute is deeply concerned about recent allegations of bias and discrimination in housing and appraisal. When just one individual can face concern and uneasiness about bias or discrimination during an appraisal assignment, we must stop and listen to seek and understand the consumer's experience. Further, where issues or problems are identified, we must seek to understand the causes and work with stakeholders to resolve them.

To be an appraiser is to be independent and unbiased; it is our ethos and at the core of the professional appraiser. There is no benefit to an appraiser in violating this public trust. We firmly believe most appraisers uphold this high standard and strive to learn more and develop protocols to increase confidence and credibility in their work.

Discrimination exists, and the appraisal profession is not immune. I believe communities of color face discrimination in appraisals. The same is true in other aspects of housing and real estate, as well as within other parts of our society. It is an unfortunate part of our history as a nation.

At the same time, we believe the appraisal process is sound. We do not believe appraisal bias is rampant, but rather isolated. We understand that one instance is unacceptable. No profession is immune. What is important is that we have meaningful enforcement when appraiser bias concern occurs, and that we give our members the tools to recognize it and interrupt it. Systemic bias, when it exists, is present in sales transactions. Appraisers cannot control the actions of buyers and sellers or others involved in the housing market.

Moving forward, this will require more study and creativity on the part of all of the participants, including the appraisers. The appraisal process has come under study and review by several researchers, think tanks, and Government-Sponsored-Enterprises (GSEs). Although some of the results to bias in appraisal are preliminary, and others have produced contradictory conclusions, these findings have educated all stakeholders to better understand the appraisal process and how it fits into a larger ecosystem of mortgage finance.

We strongly believe that even one instance of appraisal bias is unacceptable. We believe that the Department of Veterans Affairs' Tidewater Initiative would serve as a strong model for combating concerns over bias and discrimination. There is no program like it in the industry for balancing consumer rights of appeal with appraisal independence. This kind of mitigation on the front end would clearly be helpful to address some of the concerns recently reported in the media. There is a belief held by some that the appraiser controls or sets the market, where the appraiser is assigning value to property, and buyers, sellers, and agents interested in the market then respond to the appraisal. In actuality, the market is driven by buyers and sellers, and their actions are reflected in the purchase price, which includes terms of sale, sales concessions, and other considerations.

Purchase price is a fact. We know what it is. Appraisers analyze the facts and apply unbiased local market knowledge and professional judgment as an independent professional to develop a credible and well-supported opinion of value for specific property as of a single date. An opinion is not a fact that can be found. Opinions require support and should be logical and follow reasoning. Any formal appraisal review requires forensic analysis and understanding. These points are missing from today's conversations.

We also strongly support appraiser, lender, and consumer education goals found in the PAVE Action Plan. Our organization has been active in developing education and supporting valuation bias and fair housing education requirements for appraisers at the Federal and State levels. New State laws that have been enacted over the past 2 years can serve as models for other States looking to bolster education, awareness, and understanding. We stand ready to assist in fostering greater understanding of the appraisal process for all stakeholders.

In closing, we must be careful to balance the proposals for increased regulatory requirements on appraisers and potentially significant additional work in the event value conclusions are challenged with the efforts to make this an attractive and attainable and diverse profession. We see the difficulties of attracting new individuals to the profession under the current appraisal business and regulatory environment. Overbearing regulation may make the profession unattractive and dissuade new entrants to the profession.

The proposed increased regulation, review, and audit of appraiser files resulting from a complaint of undervaluation due to bias does not reference due process. Due process must remain a central part of any reform. We need better consumer appeal processes, but we also need to protect appraiser independence. This is a difficult balance, but it is one that is necessary to protect the health of our banking and real estate markets.

We look forward to working with the committee to continue to collaboratively work towards fair and reasonable solutions for all. Thank you.

[The prepared statement of Mr. Bishop can be found on page 66 of the appendix.]

Chairwoman WATERS. Thank you, Mr. Bishop.

Mr. Bunton, you are now recognized for 5 minutes to present your testimony.

STATEMENT OF DAVID S. BUNTON, PRESIDENT, THE APPRAISAL FOUNDATION

Mr. BUNTON. Thank you, Madam Chairwoman, Mr. Hill, and members of the committee. The Appraisal Foundation greatly appreciates the opportunity to appear before you today to offer our perspective on the state of the real estate appraisal profession. By way of background, I have served as a senior staff member of the Foundation for the past 32 years. And prior to that, I had the privilege of serving as a senior congressional staff member for a dozen years.

Let me begin with a few words about who we are and what makes us different. We are a nonprofit founded 35 years ago before the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA). We are not an advocacy group or a trade association. Rather, we are an umbrella organization composed of over 100 organizations and government agencies with an interest in valuation. Our work product covers all aspects of appraisal: real property; personal property; mass appraisal; and business valuation.

More than 30 years ago, Congress authorized us to provide private sector expertise in the real property appraiser regulatory system under Title XI of FIRREA. The Foundation does not have any regulatory or enforcement authority, but we provide the tools for the regulatory community. Specifically, we set the minimum education and experience requirements one must meet in order to obtain a State credential.

We are the authors of the national uniform appraiser exams, which are used by all 55 States and Territories. And we are the authors of the generally recognized standards of conduct known as the Uniform Standards of Professional Appraisal Practice. These standards, which lay out professional standards appraisers must follow, have prohibited appraisers from acting with bias or discriminating against protected classes since day one, which was over 30 years ago.

The allegations of bias and discrimination we have seen in the press make it clear that more must be done to protect the public's trust in the appraisal profession. Even before these press reports were beginning to emerge, The Appraisal Foundation was taking action and collaborating with others to address concerns of bias, discrimination, and a lack of diversity in the appraisal profession.

With the Appraisal Institute, we developed one of the first symposiums on this important issue, and also conducted a comprehensive diversity survey of appraisers to determine where we are today and also to be able to measure future success.

We are also proud to be a sponsor of the Appraiser Diversity Initiative (ADI) established by the Appraisal Institute, Fannie Mae, Freddie Mac, and the National Urban League.

And later this week, we will be meeting with Lisa Rice and her colleagues with the National Fair Housing Alliance to discuss the future composition of our boards, our establishing an advisory council composed of organizations that represent fair housing, civil rights, and consumer interests, and advising them of our engagement of the nationally-recognized fair housing law firm, Relman Colfax, to assist us in our efforts going forward.

With the release of the PAVE Task Force report last week, we look forward to meeting with them to discuss their recommendations regarding ways to work collaboratively on their ideas to increase the Federal Government's role within the appraisal regulatory system without dismantling it entirely, as well as increasing the amount of fair housing education that is required of appraisers. We would also like to discuss any barriers to entry that need to be addressed.

Regarding removing possible barriers to entry, I am pleased to report on an alternative pathway for aspiring appraisers to gain experience, without the need of finding a supervisory appraiser, through computer-based simulated training. Think of flight simulators for appraisers. Trainees could be exposed to an almost limitless number of valuation challenges, and once the training is completed, they will have met the experience requirement and can sit for the State exam. Providers indicate that there will be more than one simulated training module available to aspiring appraisers before the end of this year.

I must note here that the draft Fair Appraisal and Inequity Reform Act of 2022 is deeply concerning. This legislation, if enacted, would negatively disrupt the appraisal regulatory system, including the 55 States and Territories who have incorporated the uniform appraisal standards and qualifications into their laws and regulations for over 30 years. In addition, there are over 3 decades of case law which cite our standards. We are concerned that the mere existence of this draft legislation may suspend or stall development of the simulated training modules I just mentioned, modules that open the doors to those not able to find a supervisor, and which were noted in the PAVE report as an experience alternative. Rather than dismantling the system, we should be looking at ways to work collaboratively to address concerns about the Federal Government's role within the appraisal regulatory system without dismantling it.

Again, The Appraisal Foundation appreciates the opportunity to share this perspective today, and we look forward to working with all of you. Thank you.

[The prepared statement of Mr. Bunton can be found on page 72 of the appendix.]

Chairwoman WATERS. Thank you, Mr. Bunton.

Mr. Kelker, you are now recognized for 5 minutes to present your testimony.

STATEMENT OF DEAN KELKER, SENIOR VICE PRESIDENT AND CHIEF RISK OFFICER, SINGLESOURCE PROPERTY SOLUTIONS, ON BEHALF OF THE REAL ESTATE VALUATION ADVOCACY ASSOCIATION (REVAA)

Mr. KELKER. Good morning, Chairwoman Waters and distinguished committee members. I am here representing the Real Estate Valuation Advocacy Association, otherwise known REVAA, to share the perspective of appraisal management companies (AMCs).

AMCs are third-party service providers engaged by banks and non-bank lenders to manage appraisal panels to complete residential assignments in compliance with State law and Federal appraisal independence requirements. Since the 1960s, U.S. financial institutions have outsourced services to AMCs due to their expertise, efficiency, and focus on Federal and State regulatory compliance.

However, following the Dodd-Frank Act and the creation of Federal and State requirements to license AMCs in each State, the AMC business model grew and was used by both large and small lenders to help them remain compliant with Federal and State banking and mortgage regulations. All 50 States and the District of Columbia have adopted a federally-compliant AMC licensing program, which is typically located with the same regulator for appraisers.

While AMCs have contact with appraisers and their lender clients, AMCs do not have much direct consumer contact. They are agents of the lender to facilitate the procurement of an appraisal or property evaluation. AMCs are required to follow Federal and State public policy related to fair housing and discrimination. It is our intention to be an active part of the collective solution as the recommendations of the PAVE Task Force final report are further discussed and new policy with revisions implemented.

AMCs have robust quality control programs in place to examine appraisal reports after the initial delivery by the appraiser. These reviews are done to ensure compliance before the appraisal report or valuation is delivered to the lender and are not used at this point in time to determine a lending decision.

Any appraisal management company quality control process must comply with two important components of appraiser independence under the Truth in Lending Act. The first is to ensure that the AMCs comply with Federal and State appraiser independence requirements, including not attempting to directly or indirectly influence the independent judgment of the person preparing the valuation.

AMCs perform a quality assurance review in compliance with appraiser independence, which permits the AMC to ask an appraiser for three major items: first, to consider additional appropriate property information, including consideration of additional comparable properties that may be relevant in the analysis of the property; second, to provide additional detail or explanation to support the valuation provider's value conclusion; and finally, to correct any errors that may have surfaced in the appraisal report.

Federal Interagency Appraisal and Evaluation Guidelines mandate that lenders are responsible for the safety and soundness of the property valuations. Most lender clients outline requirements for the AMCs that they have engaged to perform quality control as part of the overall services performed on their behalf. State laws vary, but most have a requirement that AMCs must audit the work of appraisers on their panel, although the details of how many appraisals must be reviewed or the extent of the review can vary.

AMCs review their panel of independent fee appraisers to grade appraiser performance on past assignments, research State boards to determine if there is any disciplinary history, and require background checks to determine if there is any criminal history. Individual assignments include a letter of engagement that outlines assignment-specific criteria required by the client as well as the AMC. If a red flag is identified through an automated or manual review of an appraisal, the concern is escalated to a more intensive review based on the nature or severity of the concern. Reconsideration of value may be requested by the lender or the borrower through the lender. Any questions or issues identified are addressed by the AMC with the appraiser who completed the appraisal.

REVAA supports a vibrant and diverse appraiser industry. The future of appraisal needs to retain a human component, which is why we support the recruitment of new appraisers to help revitalize the profession for the next generation. The reliance on appraisers and appraisal products creates an important need to help ensure the sustainability of the profession. Consumers, residential mortgage lenders, secondary markets, and AMCs all rely on a plentiful supply of qualified appraisers to meet the anticipated demand.

The current experience and education requirements of becoming an appraiser are overly-burdensome, creating a roadblock for the recruitment and training of new appraisers. REVAA supports removing barriers in the recruitment and training of new appraisers. Modernization should incorporate new technologies and learning techniques to recruit and train future appraisers just as they are used for other industries. This includes the nationwide adoption of innovative initiatives such as the Practical Applications of Real Estate Appraisal (PAREA) or other alternatives that are created to make it easier to recruit, train, and retain a diverse future generation.

[The prepared statement of Mr. Kelker can be found on page 86 of the appendix.]

Chairwoman WATERS. Thank you, Mr. Kelker.

Ms. Rice, you are now recognized for 5 minutes to present your testimony.

STATEMENT OF LISA RICE, PRESIDENT AND CEO, NATIONAL FAIR HOUSING ALLIANCE (NFHA)

Ms. RICE. Chairwoman Waters, Ranking Member McHenry, and members of the House Financial Services Committee, thank you for the invitation to testify today on appraisal bias and reform, an issue which affects millions of people across the country. My name is Lisa Rice. I am the president and CEO of the National Fair Housing Alliance (NFHA), representing over 170 local fair housing groups. NFHA's goal is to eliminate all forms of housing discrimination and ensure equitable housing opportunities for all people and communities.

The NFHA, along with its partners, Dane Law and the Christensen Law Firm, issued a groundbreaking review of the appraisal standards and appraisal qualification criteria to examine if there was evidence of potential bias in a study commissioned by the Appraisal Subcommittee. We also had the honor of briefing the PAVE Interagency Task Force on several occasions and applaud their comprehensive action plan.

For most Americans, their home is their single-most important asset and holds the key to wealth, stability and opportunity for their families. But America's long history of discriminatory housing policies has undervalued homes for people of color, and entrenched an unfounded association between race and risk. Today, the Black-White homeownership gap is larger than it was when the Fair Housing Act was passed in 1968, and the wealth gap between White households and households of color remains large and persistent.

The Fair Housing Act's promise of fair and equitable housing is unfulfilled. We have all heard the shocking stories of appraisal bias from across the country, including stories of, "Whitewashing," where homeowners of color have had to go through the excruciating experience of removing all evidence of their racial identity just to receive a fair appraisal, from Carlette Duffy in Indiana, who received an increase of almost $150,000 after asking a White friend to pose as her brother, to the Austin family in California, who received an increase of almost a half a million dollars after asking a White friend to pose as the homeowner.

These disturbing and even heartbreaking stories have shined a light on the serious shortcomings in the appraisal process. While some may say that these are just a bad few apples, researchers from a variety of backgrounds, using a variety of datasets and methodologies, all come to the same conclusion: The current appraisal system leads to adverse outcomes for borrowers of color on a systemic basis. So far, these racial and ethnic disparities cannot be explained by legitimate nondiscriminatory factors.

Congress must address bias in the valuation process and the urgent need for reform. Based on our research and outreach to fair housing, appraisal and lending groups, and researchers and academics, we respectfully offer the following recommendations for your consideration.

The appraisal industry has long operated in a relatively closed, self-regulated framework, which has imposed burdens on consumers as well as small businesses. Congress should encourage The Appraisal Foundation, or TAF, to improve its processes. Congress should also develop the board vision outlined in the Fair Appraisal and Inequity Reform Act, which would elevate the Appraisal Subcommittee to a new Federal agency. To address the risk of broad discretion and underfunded enforcement efforts, Congress should encourage TAF to revise the appraisal standards. Congress should also provide the Federal Valuation Agency with rulemaking authority for the standards and ensure adequate funding under the Fair Housing Initiatives Program.

Congress should encourage the appropriate regulators to promulgate the automated valuation rule. Congress should also provide the Federal Valuation Agency with the rulemaking authority to ensure that all valuation methods are fair, unbiased, transparent, and consistent. To address appraiser shortages and lack of diversity, Congress should encourage TAF to revise the appraiser criteria. Congress should also provide the Federal Valuation Agency with rulemaking authority to set reasonable criteria, require comprehensive fair housing training, and require national registration with a unique ID. Finally, to improve research, compliance, and enforcement, Congress should encourage the regulators to immediately enter into a data-sharing agreement and should provide the CFPB with rulemaking authority to develop a public valuation database.

Thank you for the opportunity to appear before you today. I look forward to answering your questions.

[The prepared statement of Ms. Rice can be found on page 211 of the appendix.]

Chairwoman WATERS. Thank you, Ms. Rice.

Mr. Peter, you are now recognized for 5 minutes to present your testimony.

STATEMENT OF TOBIAS J. PETER, ASSISTANT DIRECTOR, AEI HOUSING CENTER

Mr. PETER. Chairwoman Waters, Ranking Member McHenry, and distinguished members of the committee, thank you for the opportunity to testify today, and thank you, Congressman Emmer, for the nice introduction.

The case for centralizing appraisal standards and criteria under a new Federal agency as proposed under the Fair Appraisal and Inequity Reform Act is not justified. It is based on unsubstantiated claims of systemic bias and racism in the housing sector, and represents an unwarranted power grab by the Federal Government, and is one step towards the Federal Government setting fiat home values. Amending the appraisal process risks mis-valuating millions of properties, which could have serious repercussions for minority neighborhoods and rural areas, where home sales are sparser.

Last week's report by the Interagency Task Force on the Property Appraisal and Valuation Equity (PAVE) alleged inequities within current home lending and appraisal processes for communities of color. The work cited by PAVE contains serious red flags, which were obvious from a cursory look. The work of the AEI Housing Center has debunked the Brookings study and the Fannie Mae exploratory note, which were both heavily relied on in the PAVE report and this hearing's memo, long before the PAVE report was written. Most importantly, these studies conflate race with socioeconomic status or SES, and by that I mean income, buying power, marriage rates, credit scores, and so forth. Once adjusted for differences in SES, race-based gaps found in these studies either entirely or substantially disappear, which raises serious questions regarding a race-based explanation.

While individual appraiser bias certainly exists, the PAVE report admits that the exact number of instances of valuation bias is difficult to assess. We have undertaken a study with over 240,000 loans for which we knew the race of the borrower. Our statistical analysis found that racial bias by appraisers on refinance loans is uncommon and not systemic. These results in our methodology have been confirmed by other academic research. All of this work was ignored by PAVE. Further, research by Fannie Mae, which directly contradicted Freddie Mac's preliminary findings, was so selectively cited at this point, that it was lost. It is questionable how PAVE could arrive at this conclusion when its own report admits a lack of data.

Furthermore, this lack of data is the fault of the government. Two years ago, we outlined a statistical approach using existing data that would have allowed FHFA, Fannie Mae, and Freddie Mac to identify bad actors using existing data. This offer was ignored. Now, 2 years later, we are debating a task force report and a draft bill based on cherry-picked data, discredited research, and flawed conclusions, suggesting a lack of interest in getting to the truth and an alternative motive to provide an excuse for centralizing appraisal valuation standards and appraiser criteria in the Federal Government.

Instead of this bill, agencies should get to work using existing data. These data should be anonymized and made available to independent researchers to verify, as a bipartisan group of Senators agreed at last week's Senate Banking Committee hearing. This would allow bad actors, whether racially-biased or incompetent, to be removed immediately from the profession, as they should be. Additionally, since PAVE has misdiagnosed the problem, its proposed agency actions will not address racial and ethnic differences in homeownership rates, financial returns of owning a home, or median wealth. Instead, it will likely make these differences worse or divert attention from finding effective solutions.

Rather than discredited claims of systemic appraiser bias, homeowners and communities of color are being hurt by the combination of low SES, which certainly reflects a legacy of past racism and lingering racial bias, which leaves Blacks at a large income and wealth disadvantage relative to most Whites, and foreclosure-prone Federal lending practices.

Research finds that Black and Hispanic homeowners experience lower returns than White homeowners, which it attributes almost entirely to the higher prevalence of distressed home sales, and not appraiser bias. The study finds that the disparity in distressed home sales explains about 40 percent of the Black-White gap in housing wealth at retirement. It also notes that, importantly, absent financial distress, houses owned by minorities do not appreciate at slower rates than houses owned by non-minorities, which, again, directly contracts the PAVE report.

Foreclosure-prone affordable housing policies have been targeted at low-income and minority borrowers. These policies subsidize debt by providing excessive leverage and lower rates. Coupled with a supply shortage, the increased demand from additional leverage has fueled unforgiving boom-bust home price cycles. During the financial crisis, these policies contributed to over 10 million foreclosures, which were proportionally higher in low-income and minority neighborhoods. Notwithstanding massive subsidies and lending, Federal housing policies have not built generational wealth.

A Federal takeover of the appraisal industry could have serious consequences similar to prior housing task forces, such as the 1967 Presidential Task Force on Housing and Urban Development, which ended up destroying many American cities, especially Black neighborhoods, or the 1995 National Homeownership Strategy, which ended in millions of foreclosures. Mis-valuing millions of properties could have similar consequences, with minorities once again being the victims.

Thank you.

[The prepared statement of Mr. Peter can be found on page 97 of the appendix.]

Chairwoman WATERS. Thank you very much. I now recognize myself for 5 minutes for questions.

Mr. Bunton, in your invitation to testify, the committee asked that you provide in your written testimony the racial, ethnic, and gender diversity of all Appraisal Foundation staff, boards, and members. Some stakeholders and industry professionals have identified the Foundation's minimal appraisal standards and qualifications as contributing to barriers to entry for the appraisal industry, especially for lower-income individuals, people of color, and women, so it matters who is thinking about writing and setting those standards. Others argues that those standards have a role to play in the lack of diversity in an industry that is about 98-percent White, and nearly 70-percent male.

I would like to know more about the current composition of the Foundation's board. What is the current racial, ethnic, and gender makeup of each board, including the Foundation's qualifications board and standards board and the board of trustees?

Mr. BUNTON. Thank you very much, Madam Chairwoman. I will start off with the Foundation staff. Fifty percent of the Foundation's staff are people of color. I hired every one of them. The Appraiser Qualifications Board is composed of nine people. The last four people who were appointed over the last 2 years included an African American, a Native American, and also a Hispanic woman, and 3 of the 4 appointees were women. So, of the nine right now, three are women and two are minority. The Appraisal Standards Board has seven members, three women and four men, and there is one woman who identifies as a Native American. The board of trustees has 21 people. I am going to kind of guess here, I would say, I think it is 9 percent minority and about 38 to 40 percent women.

Chairwoman WATERS. In what year did each of the three boards welcome the first board members of color? Has that been recently?

Mr. BUNTON. The Appraiser Qualifications Board was appointed in 1989, and had a person of color on it at that time. He was the assessor for the City of Atlanta.

Chairwoman WATERS. Okay. You have three boards?

Mr. BUNTON. That is correct. There has not been a person of color on the Appraisal Standards Board. We have had a person of color on the board of trustees for close to 20 years.

Chairwoman WATERS. On the board of trustees, is there an African American?

Mr. BUNTON. Yes.

Chairwoman WATERS. And the other two boards that you mentioned, each of them have one African American?

Mr. BUNTON. The Qualifications Board has one African American, and one Hispanic, Native American. The Standards Board does not have an African American, and has one woman who identifies as Native American.

Chairwoman WATERS. Thank you very much. Yes or no, do you believe the lack of diversity at your organization and on its boards has contributed to some of the bias and discrimination that has been well-documented here today?

Mr. BUNTON. No. In fact, in the last 2 years, since February of 2020, we have been actively working on a number of diversity, equity, and inclusion efforts. We hired an outside consultant to make sure that we go out to get people on the boards that you were just referencing. We gave this consultant the entire portfolio, our application, how we solicit applications, the questions we ask, how we rank candidates. That person came back with suggestions and we have implemented them starting this year as far as improving the diversity of our boards.

Chairwoman WATERS. Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act envisions the relationship between the Appraisal Subcommittee and The Appraisal Foundation to be that of grantor and grantee. Presumably, this relationship would provide a check and balance on the Foundation by the Federal Government for the implementation of congressionally-required minimum appraisal standards and qualifications. So, while the subcommittee has made $2 million in grant funds available to the Foundation over the last 2 years to support Title XI related activities, The Appraisal Foundation did not accept these funds for Fiscal Year 2021. Whether intended or not, the Foundation is able to effectively sidestep the Federal oversight by rejecting the Federal funds.

In the past, Mr. Bunton, the Appraisal Subcommittee has objected to burdensome education requirements that perpetuate barriers to entry for the profession, and Federal regulators recently sent a joint letter to the Foundation regarding Fair Housing concerns with the Appraisal Standards Board's ethics, rules, and Advisory Opinion 16. When the Federal Government objects to your industry standards and qualifications in this way, do you have an obligation to fully address these obligations? Yes or no?

Mr. BUNTON. Yes, and we have a separate meeting with those agency representatives.

Chairwoman WATERS. Do you believe Federal oversight is needed in the establishment of minimum uniform standards and qualification criteria? Yes or no?

Mr. BUNTON. Yes.

Chairwoman WATERS. Do you believe your standard should be subject to the Administrative Procedure Act, to ensure that the public has an opportunity to comment and that your organization appropriately considered these views, yes or no?

Mr. BUNTON. Yes.

Chairwoman WATERS. Thank you very much. I yield back.

Mr. Hill, you are now recognized for 5 minutes.

Mr. HILL. Thank you, Madam Chairwoman. And as you know, our distinguished ranking member, Mr. McHenry, was not able to be with us this morning. I ask unanimous consent to insert his opening statement in the record.

Chairwoman WATERS. Without objection, it is so ordered.

Mr. HILL. Thank you, Madam Chairwoman.

Mr. Bishop, of course the housing market has been booming. House prices are double-digit. There is a real shortage of housing out there. Prices have gone up, but we drove interest rates to zero. So, it has been a booming time for people trying to do mortgage finance over the past 2 years particularly, and I understand there is a shortage in the workforce of appraisers. Is that true?

Mr. BISHOP. Yes, sir.

Mr. HILL. And is it worse in rural areas?

Mr. BISHOP. That is what I understand.

Mr. HILL. The PAVE recommendations for the Administration talk extensively about a, "well-trained, accessible, and diverse appraiser workforce." Is that a goal you share?

Mr. BISHOP. Yes, sir.

Mr. HILL. What actions are you taking to work with our private appraisers around the nation to encourage and help advance training for people of color to operate and serve as leaders in the industry at the grassroots level?

Mr. BISHOP. That is a great question. There are several things that we have undertaken. The first is the Appraisal Diversity Initiative (ADI). It is a collaborative effort between Fannie Mae, Freddie Mac, the National Urban League, and the Appraisal Institute, and it is backed by Chase Bank, which made a $3 million commitment to help this endeavor. What ADI has accomplished so far is through a bunch of seminar-type events, they have identified minorities and people of color who want to enter the appraisal profession, and about 150 of those individuals have been selected and have entered the program.

Mr. HILL. That is good. How many licensed appraisers are out there in the U.S. right now, more or less?

Mr. BISHOP. Roughly 75,000.

Mr. HILL. Okay. So, that is a small step in the right direction. I know my colleague, Alma Adams from North Carolina, will probably talk to you at length about our initiatives with our Historically Black Colleges and Universities (HBCUs), which are great places to recruit. Do you have people actively recruiting on those campuses?

Mr. BISHOP. Yes, sir. One of the endeavors of the Appraisal Institute is the University Relations Committee, and we are just kicking off a pilot program now to get into the universities. Our members are there already, and this is an endeavor to organize it and make it more efficient, and our targets are HBCUs, community colleges, and universities across the United States.

Mr. HILL. Thank you, Mr. Bishop.

Mr. Peter, back in 2010, I referenced in my comments about my experience in the 2008 crisis for appraisal mania, and certainly, I witnessed it when I was at the Treasury Department from the results of the late 1980s, particularly in the savings and loan industry. In 2010, Democrats enacted the Dodd-Frank Act as a part of that was financial system overhauls. The Democrats in charge at that time made it illegal to violate appraisal independence. Is that right?

Mr. PETER. I believe so.

Mr. HILL. How is the process harmed when you have valuations that are not independent or fairly conducted?

Mr. PETER. I think the process can be seriously harmed from a politicization of the appraisal process. For one, if that were to happen, the government could potentially over-valuate or mis-valuate properties on a massive scale. This would exacerbate home price boom-and-bust cycles, and it would expose the most borrowers with the least financial wherewithal to potential swings which led—

Mr. HILL. Yes, thank you. I think we witnessed that several times in recent years in our economy, most recently in the 2008 crisis. Are there any data out there on the effectiveness of those prohibitions? In other words, is there any data to support the integrity of an independent appraisal process?

Mr. PETER. I am not sure. I would have to get back to you on that, sir.

Mr. HILL. How about data on the effectiveness of the anti-discrimination prohibitions in the Equal Credit Opportunity Act (ECOA) or in Title VIII?

Mr. PETER. We, at the American Enterprise Institute, at the Housing Center, have undertaken a study of 240 refinance loans.

Mr. HILL. How many?

Mr. PETER. Of 240,000 loans, and what we found when we looked at them was that there was no systemic appraisal bias. As a whole, we looked at the industry, and we found no systemic bias.

Mr. HILL. Okay. On average, how many reported violations are there each year of ECOA or Title VIII, do you think?

Mr. PETER. The last numbers that I have seen from [inaudible] that they were in the low double digits.

Mr. HILL. Okay. Thank you, Madam Chairwoman. I yield back.

Chairwoman WATERS. Thank you.

The gentleman from New York, Mr. Meeks, who is also the Chair of the House Committee on Foreign Affairs, is now recognized for 5 minutes.

Mr. MEEKS. Thank you, Madam Chairwoman. And I thank the witnesses for their testimony.

Let me follow up with Mr. Bishop on some of the questioning that the chairwoman was asking back and forth with Mr. Bunton, when she discussed with Mr. Bunton about the board. My concern also on top of that, Mr. Bishop, is that I could not agree more with the chairwoman that diversity and inclusion is extremely important in this industry. And when I looked at the Bureau of Labor Statistics report, it shows that of the approximately 80,000 appraisers in this country,—these are the individuals who are actually out there appraising—97.7 percent of them identify as White. So, it seems that there is a complete lack of diversity, which I believe also can feed into systemic issues of Black homeowners receiving lower property appraisals than White homeowners.

Can you speak to, what are the barriers? Are there barriers? Why would it be so lopsided? Are there barriers to individuals getting in to be appraisers?

Mr. BISHOP. Yes, sir. It is difficult to get into the appraisal business, particularly the residential side of the business. Most appraisal companies are small, and independently-owned, with one or two appraisers in the company, and the common theme is, they do not have time to take somebody and train them. They cannot afford to pay them while they are doing it, and it takes away from their time to produce their own appraisal, so it costs them money. That is the common theme, which suggests that the current supervisor-trainee model is not adequate for allowing entrants into the market, particularly in the smaller residential-type appraisal businesses. That is where the PAREA—Practical Applications for Real Estate Appraisal—is an alternative to earning appraisal experience by working for someone like me, who would take you and mentor you through a 6-month or 1-year process to learn the basics of appraising a residential house, and then you could get licensed.

The PAREA Program will actually involve taking these individuals and training them, and they will be matched up with someone like me, an experienced appraiser. We envision it as a series of case studies where they start off with a basic appraisal, and each one gets a little bit more, not nuanced or complicated, but it takes them through what a residential appraiser would experience, working with me as their mentor, so that on the outcome, they would then be qualified as a licensed appraiser to go start doing appraisals.

Mr. MEEKS. Mr. Bishop, I want to follow up with you because, to me, any time you have an industry like that, and it seems to be a block, it always comes to the point where there are excuses. I am not saying that you are giving one today, you are telling it as it is, but others give excuses which block people from getting in, and we have to open that up. And I think that is an area Congress can work on also, so that we can eliminate these barriers that continually exist. And I would like to follow up with you, but I am limited on time.

Mr. BISHOP. Yes, I would be glad to follow up in writing on any questions you have.

Mr. MEEKS. Yes, please.

Mr. BISHOP. Or just call me and I can talk to you.

Mr. MEEKS. Very good. Let me jump to Ms. Rice, because I have another question that, truth of the matter is, I do not know which is best. Ms. Rice, unconscious bias is pervasive throughout so many different aspects of the mortgage and lending process, and I do not know which one is best. One is prescriptive and the other one is more algorithm-driven. Which is best, because I can see abuses in both? What would you say is the best way to utilize it?

Ms. RICE. Congressman Meeks, thank you for the question. I worked on a case a number of years ago in which a judge opined that appraising was an art and not a science, and the art is where we bring in a lot of discretion, subjectivity. And I think what we are trying to do is move the field away from being more discretionary and having a lot of subjectivity in the process to one that is more scientific, more uniform, and more standardized. The algorithmic-based systems can be problematic because they are using data that has bias embedded and baked into the data.

Mr. MEEKS. Thank you.

Ms. RICE. So, both need help.

Chairwoman WATERS. Thank you, Mr. Meeks.

The gentlewoman from Missouri, Mrs. Wagner, is now recognized for 5 minutes.

Mrs. WAGNER. Thank you, Madam Chairwoman.

Mr. Peter, the PAVE Task Force acknowledged in its own report that, "Much of the gap in rates of homeownership can be traced to socioeconomic factors that differ on average between Black and White homeowners." The task force went on to recommend 21 actions. Did any of those relate to the above statement?

Mr. PETER. No, they did not.

Mrs. WAGNER. What would be the result of taking these actions if they result in improper evaluation of homes?

Mr. PETER. Thank you for the question. The consequences could be really catastrophic, particularly for minorities and people living in rural areas. There, you do not have as many home sales, so if you mis-valuate properties in this area, you could easily exaggerate home price boom-and-bust cycles, which would expose those to a larger default.

Mrs. WAGNER. And whom do you think would be most affected by the taking of these actions and the improper valuation of homes?

Mr. PETER. It would be mostly lower-income people, and there is a history of this every time the Federal Government has gotten involved in the housing market. They tried to fix big problems, like in 1967 when they tried to eliminate all substandard housing. It has crashed and burned, and it has ruined neighborhoods, particularly for minorities in lower-income neighborhoods. Likewise, in 1995, there wasthe National Homeownership Strategy, where the goal was to raise the national homeownership rate up past levels that we have ever seen before. And, of course, it created a massive home price boom that later came crashing down and ended up in millions, tens of millions of foreclosures, and it ended up wrecking the economy. And, again, the people hurt the most were lower-income minorities.

Mrs. WAGNER. Mr. Peter, have past Presidential task forces or strategies on housing topics—and you just outlined a few examples here—created meaningful changes or results? And, probably more importantly, what should be our takeaway from the previous times that the Federal Government has substantially increased its role in the housing market?

Mr. PETER. I think we really need to be careful with Federal takeovers of the appraisal industry, and as I already mentioned, in the past, these actions have crashed and burned. And again, if you were to repeat something like this, the danger of doing it wrong could far outweigh the benefits of doing it right. And furthermore, I think the Federal Government has not proven its case. All of the claims in the PAVE report are unsubstantiated, and instead, we should be focusing on improving the socioeconomic status of lower-income minority Americans so we can actually address the root causes and not the symptoms here.

Mrs. WAGNER. The root causes, absolutely. Mr. Peter, if the recommendations of the PAVE Task Force went into effect, could you detail what some of the results might be for potential home buyers in rural America?

Mr. PETER. As I stated before, I think it would potentially misvalue homes in rural areas, and the consequences could be dire, but then also, the PAVE report talks about releasing data publicly. And, of course, the data would be restricted, the data that can be released to the public would be heavily restricted, at which point it would actually be useless to use for independent researchers such as myself to verify what the government has done. But the PAVE Task Force is recommending, and then the government would be having all the data internally, but after the PAVE Task Force's recommendations and what they have come up with, I am very skeptical that the government is going to come up with the proper analysis. And, hence, I think we need to be very careful about the PAVE Task Force recommendations.

Mrs. WAGNER. I thank you very much for your very frank and honest input. I, too, am skeptical of most of these Federal agency task forces and recommendations going forward. I thank you for your testimony.

I thank all of our witnesses, and I yield back the remainder of my time.

Chairwoman WATERS. Thank you very much. The gentleman from Georgia, Mr. Scott, who is also the Chair of the House Agriculture Committee, is now recognized for 5 minutes.

Mr. SCOTT. Thank you, Madam Chairwoman. Ms. Rice, I want you to help shine a light on just who has generational wealth in America today, and also the many ways in which this kind of accumulated wealth can impact the social mobility of the average American family. So, to start with, who would you say holds the majority of American wealth today?

Ms. RICE. Congressman Scott, thank you for the question. We know that we have grave racial wealth disparities in the United States. When it comes to households with children, families with children, Black households have $0.01 of wealth for every $1 of wealth held by White households, and Latino households have $0.08 for every $1 of wealth held by White households.

Mr. SCOTT. That is very remarkable. Now, tell me some of the common ways that middle-class people inherit wealth?

Ms. RICE. Many families inherit wealth because they get it from their parents, and that wealth is passed down, and for the typical family, most wealth is held in home equity. So, homeownership really is the path to wealth-building and has been the path to wealth-building for the typical American family for hundreds of years.

Mr. SCOTT. I am glad you mentioned real estate as one of the assets that families pass down to their children and grandchildren. But also in your testimony, you also say, "Home value in the United States is the cornerstone of generational wealth." And you further stated that historical appraisal practices have created some of the worst inequities and inequalities among Black and Hispanic families. So, Ms. Rice, can you explain to us how lower appraisals limit the amount of equity that a homeowner can earn from their home if they were to sell or refinance?

Ms. RICE. Certainly. Thank you for the question. When a home is undervalued, what that means is that as the borrower is paying down their mortgage debt, they are not seeing an appreciation in the equity that they are able to amass in the home. And the lower the equity in your home, that means that you are not going to be able to transfer as much wealth to your children when you make your transition.

Mr. SCOTT. What do you believe is the root cause of this under-evaluation, and how can we here in Congress work together towards a more equitable valuation of homes?

Ms. RICE. There are many root causes, and this is an issue I have been working on for almost 40 years. One of the root causes is a lack of diversity in the appraisal field, a lack of familiarity with appraisers who are appraising properties in underserved communities of color. We also have a long, long history of race-conscious policies in the appraisal sector, and that data has flooded our marketplace, if you will. And a lot of the technologies that we use in the appraisal field are built on data that is embedded with this biased information, and that also yields disparate outcomes.

Mr. SCOTT. Mr. Kelker, Ms. Rice mentioned technology. Do you believe that technology, such as online appraisals, is the answer to ending discrimination in the appraisal industry?

Mr. KELKER. I don't believe that is the sole answer to ending discrimination. However, the addition of technology-based solutions help a third party, whether it is an AMC or a lender, to evaluate the quality of the appraisal data that they are receiving from the field. So, it helps—

Mr. SCOTT. Thank you.

Mr. KELKER. Okay.

Mr. SCOTT. My time has expired. Thank you, sir.

Mr. KELKER. Certainly.

Chairwoman WATERS. Thank you very much. The gentleman from Texas, Mr. Sessions, is now recognized for 5 minutes.

Mr. SESSIONS. Madam Chairwoman, thank you very much.

Mr. Bunton, you have sat through this entire hearing, been here, heard the testimony of the president of The Appraisal Foundation. You have listened to Ms. Rice and others today talk about the numbers of people, supposedly the data that is flawed, the data that might be biased, the lack of minority participation. I heard you enumerate the people who work within your industry that are on your boards, the people who would represent you and The Appraisal Foundation. The chairwoman spoke of this in her few minutes. She was highlighting the issues, and discrimination, and bias that became very apparent today in the hearing.

Would you tell me what you think you heard that was discrimination and bias? Is your takeaway as the president that you would walk out of here and say to your organization, I heard in this hearing this discrimination and bias and what you might want to do about it, because I have heard numbers that suggest minority participation back home in States, in localities, do not necessarily represent the numbers that we want. But what did you hear?

Mr. BUNTON. I think there is a problem, the press reports. There are three things I would talk about as far as bias and discrimination. One, identify the problem. Right now, there is no aggregation of data, how many complaints are actually out there at the State level, Civil Rights Commission, or with HUD, so that is one.

Mr. SESSIONS. Was there testimony given today related to that, because we heard that the numbers don't exist there.

Mr. BUNTON. Correct. That is what I am saying. We need to find that out. We need to get our arms around the size of the problem. If we don't know where we are today, how will we measure success 12 months from now? There are a lot of anecdotal, a lot of press reports, very concerning press reports, but I have not seen any specific data that tells me the depth and breadth of the problem.

Mr. SESSIONS. Do you think this hearing today developed that issue? Are you going to walk out and say, well, this hearing produced results that I need to go back, or are you going to have to go back and define these yourself as opposed to this hearing producing them?

Mr. BUNTON. I think it is important to focus on the issue. It is an important issue, from our perspective, the area of awareness, education, making sure appraisers are aware of unconscious bias. But also one other thing, sir, and that is enforcement. The Federal entity, the Appraisal Subcommittee, when it goes out and does compliance reviews to the various States, it does not check for consistent compliance of our standards. So we write the standards, but if we are not checking on the enforcement of it, we are going to have a problem.

Mr. SESSIONS. What are they there to do if they are not there to check on the—

Mr. BUNTON. They check administrative matters, like when the case was filed, how long did it take to adjudicate it, and things like that. But they do not seem—

Mr. SESSIONS. They sure seem to be biased in that process.

Mr. BUNTON. It is a little surprising that doesn't occur.

Mr. SESSIONS. It does or does not occur?

Mr. BUNTON. It does not occur.

Mr. SESSIONS. It does not occur. So, perhaps part of what we need to do is to ask the questions of those people who do these audits, and you are suggesting you have not seen that bias that is there.

Mr. BUNTON. That is correct.

Mr. SESSIONS. I want to be very sympathetic to any person who would choose to enter the marketplace in any area that would be important for them based upon their qualifications and desires.

And I want to be very much supportive of not just Mr. Meeks' comments, but also the chairwoman. I am simply saying I did not hear these in the testimony that was given today. So, it would be my one question for you to go back and to really listen to what Ms. Rice said about things that are embedded in databases.

I saw from her testimony what may have been old data. There was no date that appeared. For us here today, perhaps if this were 1983, I thought those terms that were embedded in, what she brought forth were out of the norm also, so I want to agree with her. But I would like to have you go back and take a look at the databases that you look at across the country and see what your current snapshot is, because I want to be very sympathetic to the ideas that this bias or discrimination exists. And I want to thank the chairwoman in this endeavor, and I think that we need to look deeper for those viewpoints. And I thank the chairwoman for bringing this together today.

Chairwoman WATERS. You are welcome. The gentleman from Texas, Mr. Green, who is also the Chair of our Subcommittee on Oversight and Investigations, is now recognized for 5 minutes.

Mr. GREEN. Thank you, Madam Chairwoman. I, too, greatly appreciate this hearing today, and I have had some experience with these circumstances. I have talked to REALTORS and persons who claim that their properties have been undervalued. This starts with the person who appraises the property. Sometimes, the attitudes are not such that you feel comfortable with the person you are working with, but let us get beyond that and you get your appraisal. At some point, you decide that this is not an appropriate appraisal. It is too low. You have to now go to your bank, you have to now try to get the person who made the actual appraisal to reconsider, and that attitude that you experienced at the genesis of the process becomes even more prevalent as you challenge the appraisal.

Discrimination is illogical. It makes no sense for people to do it, but it happens. And it seems to me that there should be some process by which persons who receive an undervalued appraisal can appeal to someone other than the bank and the person who initiated the original appraisal. So let me ask you Ms. Rice, your thoughts on some sort of process that gives us at least some third party to appeal to.

Ms. RICE. Thank you so much, Congressman Green, for the question, and I did want to correct something for the record. The anecdotes and the research in my testimony is all recent. It is not dated information. It is all very recent, within the past couple of years. So your question about the reconsideration process is very important, because oftentimes, when consumers experience undervaluation, the first thing that they have to do is go back to the lender and ask the lender to order a second appraisal or have the appraiser reevaluate it. And so, the call is made by the lender. It is not made necessarily by the appraiser or made by the consumer. If the lender will not grant the request for reconsideration, then the initial appraisal, which may undervalue the property, will stand.

So we agree with you absolutely, Congressman Green, that there has to be a reform of that process. And what we are suggesting is that consumers be considered, that the law be changed so that consumers are considered as the intended user for the appraiser. After all, it is the consumer who pays for the appraisal, so the consumer should have the right to request a reconsideration and have that request granted.

Mr. GREEN. Ms. Rice, perhaps the industry itself could do more to monitor these things. For example, if you had some sort of third party involved, some entity that is not vested in this process, you can track the number of persons who are giving us appraisals that are undervalued. You can then have that information compiled such that the things that have been talked about earlier that we don't have, we could have that information. Are your thoughts in the reclamation process having the third party or some entity to perform this function of re-evaluation?

Ms. RICE. One of the things that we do agree on is that the Appraisal Committee should be elevated to a Federal agency, and it could be that third-party agency that you are talking about, Congressman Green, that has expanded and increased authority to provide oversight. One of the things I do want to point out is that there has been a lot of talk about the over-appraisal of values in the lead-up to the foreclosure crisis. But I want to point out that most of those abuses, the lion's share of them happened in the subprime sector, which was not regulated. So, we do need appropriate regulation over the valuation of properties.

Mr. GREEN. Thank you, and I will just close with this: Unfortunately, many people will never experience what it is like to be alone with a person of a different hue, who has an attitude, and you are trying your best to appeal to the person, but this person, for whatever reasons, chooses to treat you with disrespect. That happens in this process.

Thank you, and I yield back.

Chairwoman WATERS. Thank you very much, Mr. Green.

The gentleman from Florida, Mr. Posey, is now recognized for 5 minutes.

Mr. POSEY. Thank you, Chairwoman Waters. Mr. Peter, are there any peer-reviewed studies or meta analyses of multiple studies that establish a strong case for the existence of racial bias in real estate appraisals?

Mr. PETER. No, sir, I am not aware of any. In fact, I am only aware of studies that disprove it.

Mr. POSEY. The purpose of a real estate appraisal is to provide an estimate of market value on a property that is prospectively going to be sold or bought. What does your research suggest about the accuracy and overall error rates associated with single appraisals that is a reliable metric of market value, and what should be done to improve the overall accuracy of appraisal methods?

Mr. PETER. Thank you, sir. That is a great question. And what our research has shown is that under-appraisals, as they come in, actually provide a great value to borrowers. So if the appraisal comes in far below the negotiated sale price, it provides a consumer benefit, because the borrower now has the opportunity to go back and renegotiate the sale price. It gives him power to go back to the seller.

And oftentimes, what the research found—Fannie Mae found that the larger the difference is between the actual negotiated sale price and the undervaluation, the larger degree of revaluation and the greater the consumer benefit. And also, the research shows that there is not much drop-off, meaning not many loans that come in under-appraised end up dropping off the market. So, they are just getting renegotiated and still get done.

Mr. POSEY. Very good. Now, who gets harmed when an appraisal comes in for more than the actual value that it should be?

Mr. PETER. Could you repeat that?

Mr. POSEY. Who is harmed when—

Mr. PETER. Oh, who is harmed?

Mr. POSEY. —when an appraisal comes in.

Mr. PETER. Yes. If an appraisal comes in low in a purchase transaction, it ultimately benefits the buyer, but the seller, of course, has to renegotiate, and they are losing some money on the sale price. But you cannot have it both ways. If under-appraisals are the issue, then you are providing a benefit to the consumer and the seller is losing somebody. You cannot have it both ways.

Mr. POSEY. Yes. I would think that to insist that appraisal just meets the criteria that somebody wants can do more harm to that person than good. Do you agree with that assessment?

Mr. PETER. Yes, absolutely. And on refinance appraisals, oftentimes it is the approach comes in, what do you need, and that oftentimes allows borrowers to borrow more than they can actually afford. And what we have seen is kind of the studies out there from Kermani and Wang from UC Berkeley which show that actually, if you wouldn't have all of these foreclosures in these neighborhoods, the home price appreciation in White and majority-minority neighborhoods would actually be similar, but it is the foreclosures that bring down the return for these minority borrowers. So that is, I think, what we need to address. Next to socioeconomic status, I think we need to really address the lending practices that exist in some of these minority neighborhoods.

Mr. POSEY. Very good. I appreciate it, and I yield back, Madam Chairwoman.

Chairwoman WATERS. Thank you. The gentleman from Missouri, Mr. Cleaver, who is also the Chair of our Subcommittee on Housing, Community Development, and Insurance, is now recognized for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman. Ms. Rice, are you familiar with the term, "rubophobia?"

Ms. RICE. No, sir, I am not.

Mr. CLEAVER. Maybe I made it up. But the point is, there are those of us who have apprehension about some of this new technology like artificial intelligence (AI). And so, we are becoming well-known across the country as either [inaudible] or we are suffering from, "rubophobia." The issue is, human beings tend to trust AI as much as they trust other human beings. So, when we talk about bias, do you believe that bias can be programmed into AI?

Ms. RICE. Congressman Cleaver, thank you for the question. Yes, absolutely. AI systems, algorithmic systems are just a reflection of human performances. AI reflects what happens in the marketplace, so if there is discrimination in the marketplace, then the AI system or the algorithm doesn't have to be an artificially intelligent system; it could be a linear regression system. It will pick up and reflect the bias that is embedded into the data. So, if you have communities of color where there are sort of systemic undervaluations of prices, any algorithmic model that is going to value a property is going to repeat the undervaluation. And, in fact, algorithmic systems could actually amplify bias and undervaluation.

Now, I heard my colleague here, Mr. Peter, say that he thinks that undervaluation of a property is a good thing for consumers. I don't want my property undervalued, because it is a not a good thing for consumers in the long run. Accurate appraisals are what we want. That is the goal, not undervalued or overvalued appraisals. Neither are good.

Mr. CLEAVER. You can also practice some psychiatry. Thank you. It is helping treat me. Mr. Peter, do you believe that there are dangers in AI, in particular as we as we think about the issue of appraisals?

Mr. PETER. Yes, I think there are some concerns that are out there, and I am not an expert on this. But I would like to add at the same point, that you have these models that could also be tweaked, even without AI, especially when you have competition between Fannie and Freddie. If they were to be put in charge of these AVMs, they could compete with each other and it could lead really to a race to the bottom. It happened during the 2000s with automated underwriting systems, where they progressively competed against each other. Each one thought they were smarter than the other, but because they were the market, it led to detriments to consumers.

Mr. CLEAVER. Thank you. Actually, I don't have enough time for everybody to deal with this, but LBJ pushed through the Fair Housing Act of 1968. Is there an immediate need to upgrade the Fair Housing Act of 1968?

Mr. BISHOP. I am not familiar enough with the Fair Housing Act of 1968, but there is a Fair Housing Act out there right now that appraisers should get educated on. If they haven't, then we are in support of the PAVE Action Plan recommendation to educate appraisers. Nothing could help an appraiser more than to learn about the history of the housing markets, and redlining, and things along that line that were completely inappropriate up to this point in time. They also need to learn about their unconscious bias, how to recognize it, and then how to interrupt it so that it doesn't appear in their reports. Fair Housing is part of that education along with everything else and we support that.

Mr. CLEAVER. Thank you. I yield back my time.

Chairwoman WATERS. Thank you. The gentleman from Missouri, Mr. Luetkemeyer, is now recognized for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman. Mr. Bishop, you are the sole appraiser on this panel, if I am not mistaken. That is your business that you run. Is that correct?

Mr. BISHOP. Yes, sir.

Mr. LUETKEMEYER. I was a bank examiner for a couple of years, and I was in the banking business for 30 years as well as the insurance business. I have looked at, if not hundreds, thousands of appraisals through my time, and I have gone through lots and lots of situations where people come in and they want you to over-appraise or under-appraise, based on whatever they are trying to accomplish with the mortgage they are trying to get or the insurance they are trying to get.

It is interesting to watch a different dynamic of how this all goes on. But I also have a really, really good friend, one of my closest friends, who is an appraiser, and he constantly talks to me about the problems in the field itself today and the industry with people not wanting to come in because of the restrictive nature of the regulations that came out a few years ago with regards to having to have a college education. You have to have 2 years of apprenticeship. I am not sure if those are still the samec, because when I, myself, and Mr. Cleaver over here were chairman and ranking member of the Housing and Insurance Subcommittee a few years ago, we worked on this issue a little bit.

Can you tell me the problems that we have right now with the appraisal process, of getting educated to become an appraiser, that we need to maybe take a look at? I think my friend, Mr. Sessions, here had a great discussion with Mr. Bunton a minute ago with regards to enforcement. And I think those two go together from the standpoint that we need to get the right people in there who had the right education, rank balance of this, and then be able to enforce the folks who are bad actors in there to clean it up and maybe do a better job so we don't have this perceived problem we are talking about this morning.

Mr. BISHOP. Yes, sir. That is a great question. As I alluded to or answered earlier, the Appraisal Diversity Initiative (ADI) is one step. The University Relations Committee Program that the Appraisal Institute has is another step to get the profession exposed to young folks at college level in HBCUs, community colleges, and universities. That is underway right now as well. The present Institute has had the education and relief foundation available for scholarships for women and minorities for a number of years to help them pay the cost of the initial education that licensing requires, that is what ADI does. ADI is simply a scholarship program. There are 150 folks who have entered at age 18, and have graduated and been placed in positions to do appraisals as trainees, and another 100 or so in a program right now.

Mr. LUETKEMEYER. Okay. Let me stop right there. I think there are a couple of problems here. One is education, the amount of education that you have to have to be able to qualify to get your appraisers license, the amount of time it takes to become an appraiser, the apprentice process, because they just said a while ago that the appraisers don't want to have a trainee there because it takes away from their time, and costs them money. And a person going through the apprentice process really can't afford to have 4 years of education, not being able to get really much of an income for 2 years as they go through the apprentice process as well. I think those are problems with all of that, and it deters people from getting in. And I can tell you, I have 13 counties in my district, and I am going to bet that, safely, 7 to 8 of them are probably going to have a single appraiser in the county, or none, zero. There is a huge problem with people beginning in the profession being able to actually do the work.

And so, I think we need to work with both the Foundation and the Institute to try and find a way to make itz, not necessarily easier, but to streamline the process here so that people can become appraisers and fill a need here or fill a gap, because I can tell you the time it takes to get one if you do a closing alone, it might take another 30 days to 6 weeks to get an appraisal because of the lack of people in a profession. That is a big problem when you are trying to finance a new home or buy a new home and get it appraised and get it financed.

Mr. BISHOP. Yes, I have experienced that for about 30 years, trying to hire appraisers and get them through the initial training process. It is 3 education programs that costs you about $2,500. You can do it over about 3 or 4 weeks if you really press hard. Most people take a little bit longer—

Mr. LUETKEMEYER. Are you guys looking at a new way to streamline this, put some processes in place, new education requirements?

Mr. BISHOP. Right. We are the appraisers. So if we don't set the policy for education, the Foundation does.

Mr. LUETKEMEYER. Mr. Bunton?

Mr. BUNTON. Yes, the hearing you referenced a few years ago, since that time, we have reduced the amount of experience required for the licensure level from 2,000 hours over 12 months, to 1,000 hours over 6 months. There is no more college required for the license level. For certified residential, we reduced the experience to 1,500 hours, and we eliminated the 4-year degree, and now it is an associate's degree or equivalent with 10 classes. And as I mentioned earlier, with the simulated training, you don't need to supervise appraisers anymore—

Mr. LUETKEMEYER. Sir, have you seen an improvement in the numbers as a result of that?

Mr. BUNTON. Yes.

Mr. LUETKEMEYER. Okay. Thank you very much. I yield back.

Chairwoman WATERS. Thank you. The gentleman from Colorado, Mr. Perlmutter, who is also the Chair of our Subcommittee on Consumer Protection and Financial Institutions, is now recognized for 5 minutes.

Mr. PERLMUTTER. Thanks, Madam Chairwoman. And I guess where I am coming from is I would like more education and less discrimination. That is what I would like to see so that we have a system that really works for everybody, that there isn't bias against a person, there is no bias to go high on the loan, or high on the mortgage, or low on the mortgage. I represented a lot of appraisers as part of my law practice over the years, both commercial and residential. So appraisers are really important to the whole process, and we have to make sure it is as transparent and honest and without bias as possible. And I think everybody who is testifying today would agree with that.

I will start with you, Ms. Rice. You have given some anecdotes and some other pieces of data within your testimony, including the one you kind of mentioned earlier in your testimony about a couple where there was a $145,000 increase in the home's appraisal when it was a White woman who greeted the appraiser versus the Black man. And for anybody who sees that kind of differential, it has to be infuriating. In your presentation, you have a recommendation for congressional action, your testimony describing how Congress should encourage the Foundation to limit discretion and provide more consistency in the appraisal process. Can you amplify that, elaborate on that for me, please?

Ms. RICE. Certainly. There is not one panacea. There are a number of things that need to be addressed. For example, the common way that appraisers are required to conduct what is called a sales comparison, use the sales comparison approach to appraise a property, now that standard is set by the Government-Sponsored Enterprises (GSEs), not necessarily by The Appraisal Foundation. But that sales comparison approach yields more discretion and subjectivity into the process because the appraisers can select which comparables they are using, and then the appraiser also has to use their expertise in order to make adjustments to get the comparable to match the subject property.

That whole process is highly subjective. So, we are advocating sort of using more standardized procedures and policies to select comparables and to determine adjustments, but also there can be other approaches that could be adopted. We don't have to use the sales comparison approach, and this is something that we did in the insurance industry. We helped move the insurance industry from being more artistic in the valuation of property to a more scientific approach that didn't involve the greater utilization of technologies to make sure that you are getting the measurements accurate, that you are getting the number of rooms accurate, that you are getting the type of materials accurate, and things of that nature. But it moved to a much more scientific and more accurate approach.

Mr. PERLMUTTER. Okay. And I guess back when I was representing appraisers, and this is more on the commercial side, you had sales, you had income, and you had cost. You looked at all three, and at this point, you have to really trust the appraiser to take those three things into consideration to come up with an appropriate appraisal. I guess I would like to talk to you, Mr. Bishop, and to you, Mr. Bunton. Have either of you, in an effort to get rid of a potential bias in the system, been working with the Urban League, Fannie Mae, or Freddie Mac, to attract a more diverse workforce so that we know that appraisers across the country look like the country?

Mr. BISHOP. Right. Absolutely, the appraisers should mirror the communities, the faces of the communities they work in, and that is the diversity effort. And the endeavors that I mentioned, another problem or another potential roadblock is when an appraiser is a trainee, the client won't allow a trainee to go look at a property, a bank, so I will have to go look at it with them. They can't go on their own. Even though I determine, as their mentor, that they are completely capable of inspecting a property on their own, it is the client's regulation, the lender's regulation that a trainee cannot be the sole person to do the property inspection. So, there is somewhat of a barrier right there just from the client.

Mr. PERLMUTTER. Yes. My time has expired, so thank you. And, Mr. Bunton, I will get back to you. Thank you. I yield back.

Chairwoman WATERS. Thank you. The gentleman from Texas, Mr. Williams, is now recognized for 5 minutes.

Mr. WILLIAMS OF TEXAS. Thank you, Madam Chairwoman. And I want to commend you, Mr. Peter, for your testimony and body of work demonstrating that a few bad actors should not be used to label the entire appraisal industry as racist. But before we get into more questions, poking holes into this narrative being driven by the Democrats, I wanted to take a second to talk about the President's budget request that was released yesterday.

In this proposal, President Biden wants to implement a tax on unrealized gains that he estimates will generate over $360 billion in tax revenue. He wants the IRS to act as an appraiser. Now, imagine that. Imagine the IRS acting as an appraiser and assigning a taxable value on a variety of illiquid assets. I am very concerned that this unconstitutional tax is being considered because it says the President is inserting a third party, which is the IRS, which hasn't had quite that good of a record in the past on these issues, so to estimate a tax value on asset instead of the free market.

An appraisal value of something is irrelevant if there are no buyers willing to pay for it. I know about that because I am in the car business. And we are talking about appraisals in the housing markets, so there must be a lender willing to give the prospective borrower the land or the loan based on the appraised value of a home. Now, this two-party agreement doesn't exist in the President's proposal to generate tax revenue based on unrealized gains and this market is completely removed from the equation. So while we are told this will only affect the ultra-wealthy, we all know that this is not true. If this proves to generate increased tax revenues, the thresholds will be lowered to affect many more people in the future, mainly all people.

So, Mr. Bunton, can you discuss the negative consequences of taxing unrealized capital gains?

Mr. BUNTON. I think that is a little bit out of my league, so I am not really competent, to be candid with you.

Mr. WILLIAMS OF TEXAS. Would you like to answer that, Mr. Peter?

Mr. PETER. I kind of have the same answer, but if I may, sir, I would like to make a point about Congressman Green's earlier point about finding a third party to perform evaluation of appraisers. Two years ago, we developed a statistical approach at the AEI Housing Center that would tell you within a day's work if appraiser A is perhaps biased, if appraiser B is not, if appraiser C is just incompetent. So, I would like to volunteer the AEI Housing Center for such an approach if FHA, Fannie Mae or Freddie Mac were to make the data available to us on an anonymized basis.

Mr. WILLIAMS OF TEXAS. Okay. I will just say some of the negative consequences of taking unrealized capital gains, that is dangerous because they have no cost and they just guess, and the consumer or the borrower is the one who pays the price.

Competition is a form of government protection or consumer protection, and if you have an appraiser who understands true market value of a house, the owner can request a second opinion. Now, this process takes more time and more money, something that lenders want to avoid as much as possible. The accuracy is extremely important for the lenders, which are the ones that hire the appraisers in order to underwrite a loan for the correct amount. So, rather than looking to centralize this process and create more avenues for lawyers to get involved, we should be looking at ways to get more appraisers into the market. We talked about that today.

The bottom line is, you create more competition, which basically can drive prices down. And if you have more competition, lenders will have more options to choose from if the appraisers there use consistently undervalued homes. Lenders will choose to do business with the businesses based on their performance and accuracy, so the best appraisers will rise to the top while the others will lose their market share. So, a competitive marketplace will drive out bad actors as it does in everything, and not another layer of government bureaucracy.

Mr. Peter, my last question is, what are some of the ways we can increase the number of appraisers in the market so we can ensure that this is as competitive an industry as possible?

Mr. PETER. This seems probably a question more appropriately directed at my colleagues here. But what we have outlined in our previous work is that the appraisal industry should actively recruit with minority Black colleges to diversify the industry. But at the same time, scapegoating the whole industry certainly is not going to be good for finding new recruits to the industry.

Mr. WILLIAMS OF TEXAS. What I will say is that competition is key in anything. We have competition among the private sector. The consumers decide what the prices are, which drives prices down and takes services up, and that is what we need to be doing. The IRS can never touch that. They don't understand competition and they don't understand services.

With that, Madam Chairwoman, I yield back.

Chairwoman WATERS. Thank you. The gentlewoman from Ohio, Mrs. Beatty, who is also the Chair of our Subcommittee on Diversity and Inclusion, is now recognized for 5 minutes.

Mrs. BEATTY. Madam Chairwoman, thank you, and I would also like to thank the witnesses for being here today. Madam Chairwoman, a special thank you to you for being a consistent champion of housing and funding. I was pleased also to see the President has requested an $11 billion increase to HUD's budget for the 2023 Fiscal Year to address the housing challenges in the nation. And we certainly do have challenges that we have yet to overcome, many of which we have discussed or heard from our witnesses today.

And that leads me to my first question, which is for you, Ms. Rice. But before the question to you, let me just say thank you as a point of personal privilege in knowing you, and knowing that the Congressional Black Caucus Foundation during our ALC gave you a housing award for all of your work.

You shared in your testimony anecdotal information about Black homeowners facing appraisal biases. We frequently know and have heard of the stories of Black families having to, "Whitewash," their homes, which means removing all traces of their rich culture and heritage, resulting in the home receiving a higher valuation price than its original appraisal by 40 percent or more. I have experienced this firsthand as a child, with my father. I believe it is not possible for the Uniform Standards of Professional Appraisal Practice to say that biases in appraisals are prohibited when individuals are forced to remove traces of their race or ethnicity in order to receive a fair valuation of their home.

Do you think the basis of the valuation process should be reevaluated to identify opportunities for potential appraisal bias?

Ms. RICE. Congresswoman Beatty, thank you so much for the question. Yes, I do.

Mrs. BEATTY. Okay. Let me go to my next question, and I may have time to come back with a follow-up, Ms. Rice.

This question is for Mr. Kelker. One of the things most glaring from the PAVE report and all of the witnesses' testimony today is the lack of consistent data collection on appraisals and property valuation over time. As Chair of the Subcommittee on Diversity and Inclusion, we previously issued requests for data from banks, from asset management firms, and from insurance companies. And we did this in an effort to promote diversity as well as to promote transparency and to establish a baseline measure for future success in D&I practices, but also for changing cultures and creating equity.

Can you explain how the impact of data collection of residential property appraisals can promote equity in home valuation? If we have enough time, what would be the primary area of focus when collecting specific types of data for the appraisal industry?

Mr. KELKER. The data that would be collected would be the physical characteristics as well as the market data that is contained in appraisals. But with respect to any individual AMC, I don't think anyone has enough concentration of data to actually be very useful. That data ultimately ends up at places like Fannie and Freddie, but through FHA, where I believe it can be accumulated and analyzed and in many ways become useful to the marketplace and for regulatory purposes.

Mrs. BEATTY. Thank you. Ms. Rice, let me circle back and ask you, how can the appraisal industry mitigate implicit and unconscious bias in the valuation of residential property?

Ms. RICE. Training on fair housing issues is critically important and updating the current training that appraisers have to receive, we think is necessary. We think that there are gaps in the current training program, but we also have to change the system, because it is in part the system that is driving some of the disparities that we are seeing. So, we have to change the system so that we are increasing standardization for more uniform outcomes and more accurate appraisals.

Mrs. BEATTY. Okay. I yield back. My time is up.

Chairwoman WATERS. Thank you. The gentleman from Tennessee, Mr. Kustoff, is now recognized for 5 minutes.

Mr. KUSTOFF. Thank you, Madam Chairwoman, and thank you to the witnesses for appearing today.

Mr. Bishop, we talked about the PAVE report that was released last week. I think we all know that the regulatory structure for real estate appraisal is outdated. We have talked about that. It has been untouched since 1989. I have a bill, H.R. 5756, the Portal for Appraisal Licensing (PAL) Act, which I introduced with Congressman Perlmutter. It is bipartisan legislation that would establish a nationwide cloud-based licensing system for real estate appraiser certification and licensing. It would also direct the Appraisal Subcommittee to work with State appraisal regulatory agencies to establish consistent license application and renewal procedures for appraisers.

Could you talk about how this legislation, if it were enacted, could increase coordination across State lines, and whether it would help the profession?

Mr. BISHOP. Thank you, and that is a great question. Absolutely, it would help. I am licensed in three States. I have a primary State right now. In the last 5 years, I have been fingerprinted twice for two different States. I have 3 application renewals, one in January, one in April, and one in June. One is very easy and accommodating. It is almost a formality. For the others, I have to recreate basically what I am recreating from my primary State to give that State, which is duplication, and it takes time to do that. There are a lot of appraisers that are in multiple States, as many as 30 and 40. The PAL Act, which we support and really wish that it could get passed, would simply be a data warehousing, a place for all of the appraiser data. My fingerprints should be in one place that any State could see. My education will be in one place that any State could see. It wouldn't change the State registration process for the individual States. I would still have to apply, still pay their fees, but all of the certification and identification criteria would be warehoused in one spot.

And the most important thing about the PAL Act is, if I were to get in trouble in my primary State and leave or be forced or asked to leave, right now, I could go to another State and possibly set up, and they wouldn't know it because there is no collaboration between them. If the PAL Act were in place, that would go on my record in my primary State, and any other State could see it.

Mr. KUSTOFF. I hate to argue against myself, but thinking about the other side, can you think of any reason or any arguments not to enact the PAL Act?

Mr. BISHOP. None.

Mr. KUSTOFF. That is a great answer. Thank you very much. Mr. Peter, in November of last year, November of 2021, The New York Times published a column about Orange Mound, which is a community in Memphis, just outside my district. It has struggled, but it is a very proud community. From 2009 to 2019, property values in Orange Mound decreased around 30 percent. Can you discuss, if you would, the impact that the Great Recession had on low-income and minority communities, and why communities like Orange Mound have had a difficult time recovering since then?

Mr. PETER. Yes, absolutely. I am not familiar with your particular community, but I can speak more broadly about lower-income minority communities in general. And what happened was during the run-up in the housing boom, during the 2000s, these communities took on a lot of leverage and a lot of it was government-sponsored or government-driven. And because of this over-leverage, which drove up prices higher and higher, the ensuing collapse in home prices was much more severe in these neighborhoods. And these borrowers also had less financial resiliency to withstand the leverage that was provided to them because oftentimes, they had employment issues, or they had marital issues. Once you increase prices in these neighborhoods by the motion that we did, and oftentimes these borrowers got in late into the housing boom.

They got in, in 2005, 2006, 2007, so they really didn't have much time to build up equity. They were predominantly hurt and really quickly hurt once the market turned and house prices started collapsing, so they were the last ones in, and they were the first ones out. And because of the devastation wrought by the financial crisis, you also had a lot of foreclosures. You had a lot of homes that fell in disrepair. And these communities just had a really hard time catching up and repairing some of the damage done, that came about from problematic lending standards, which was driven by the government.

Mr. KUSTOFF. Thank you, Mr. Peter. I yield back.

Chairwoman WATERS. Thank you. The gentlewoman from Massachusetts, Ms. Pressley, who is also the Vice Chair of our Subcommittee on Consumer Protection and Financial Institutions, is now recognized for 5 minutes.

Ms. PRESSLEY. Thank you, Madam Chairwoman. When we say, "Black Lives Matter," that must also mean that Black communities matter, Black businesses, Black homes, and Black wealth matters. And yet, the systemic evaluation of Black communities and homes adds up to around $156 billion in lost equity, equity that could have been invested in education, in starting small businesses, or as a buffer during the financial hardship. Ninety-seven percent of appraisers are White and almost 70 percent are men. And while lack of diversity in the field and individual biases undoubtedly contribute to the discrimination Black people face, the widespread undervaluation of Black-owned homes points to a more systemic issue concerning how we appraise homes, and the industry writ large.

Ms. Rice, homes in Black neighborhoods are valued 23 percent less, on average, than those in comparable White neighborhoods, despite similar characteristics and amenities. The average homeowner in a Black neighborhood loses $48,000 per home due to appraisal bias. Don't you agree that this indicates a wider issue of systemic racism in the appraisal industry?

Ms. RICE. Yes, I do. There is definitely a systemic problem.

Ms. PRESSLEY. Thank you. We cannot separate the rampant appraisal bias against Black homeowners from our nation's history of segregation and redlining. When establishing a property's value, appraisers use comparable sales of similar properties in that neighborhood. However, they often select lower-value comparable sales in Black and minority neighborhoods, leading to undervalued appraisals.

Ms. Rice, even if appraisers use appropriate comparable sales, can you tell us how historical discriminatory practices, such as redlining, are baked into current property values perpetuating the impact of past discrimination today?

Ms. RICE. Thank you, first of all, Congresswoman Pressley, for the question. What redlining does, both lending redlining and insurance redlining, is it causes a restriction of competition in the market, so you have a decreased number of transactions. You have a decreased number of players in those communities, and some of those communities don't have access to lending or insurance products at all. When you rob a community of competition, you are automatically deflating valuations in those communities, because you are not supporting the demand that otherwise could be there.

Ms. PRESSLEY. And building upon that, Ms. Rice, how do these compounding effects of low appraisals in a community dampen home values in that neighborhood, reducing the realized wealth of all of the homeowners who live there?

Ms. RICE. Right. Because of the way that appraisals are done in the residential space, the sales comparison approach, in order to assess the property value for your subject property, you have to rely on values of adjacent properties in that community where the subject property is located. So, if all of the values, or if even some of the values of those properties upon which you are relying for your comparables are deflated or artificially deflated, that is going to result in a deflation of the value for your subject property.

Ms. PRESSLEY. Thank you. I yield back.

Ms. RICE. Is it okay if I mention one thing, because I am very familiar with the Orange Mound community in Tennessee?

Chairwoman WATERS. Yes, please go ahead.

Ms. RICE. First of all, the Orange Mound community has suffered from decades and decades and decades of redlining practices and discrimination. There has always been a hyperconcentration of subprime mortgage lenders operating in that community. Orange Mound wasn't subjected to subprime lenders in 2004, 2005, or 2006. Just as most communities of color throughout the United States, it has always been subjected to a hyperconcentration of subprime lenders in those communities that utilize abusive lending products which drive consumers into foreclosure. So. it has nothing to do with government policies, or Federal policies, or anything like that. It was all market-based and it was all private sector, market-based abusive practices that caused hyper foreclosures in the Orange Mound neighborhood, and, ultimately, distressed property sales in that community.

Chairwoman WATERS. Thank you. The gentlelady yields back.

The gentleman from Tennessee, Mr. Rose, is now recognized for 5 minutes.

Mr. ROSE. Thank you, Chairwoman Waters, and thank you to our witnesses for taking time from your schedules to join us today. I will dive right into my questioning.

Under the agency actions to advance valuation equity, the PAVE report describes steps that should be taken for building a well-trained, accessible, and diverse appraiser workforce. It states that agencies should update appraiser qualification criteria related to the appraiser education experience and examination requirements to lower barriers to entry in the appraiser profession, while at the same time increasing requirements for anti-bias, fair housing, and fair lending training for appraisers. Mr. Peter, does increasing training requirements lower barriers to entry and make the industry more attractive to prospective appraisers?

Mr. PETER. First of all, to back up, I think the government has not made the case that there is widespread and systemic bias going on, and I think the evidence in the PAVE report is more than flawed. For example, the FHFA blog post that is mentioned, while there is no excuse for the incendiary language used, it cites 16 examples out of millions of appraisals that use such language, but the total instances where these were occurring was not provided. So, this really suggests to me that the total number couldn't have been very large.

Similarly, the Freddie Mac report that the PAVE report relied on was entirely contradicted by a study by Fannie Mae and also by a study that we have done in-house. And then, the Brookings Institution report that was referred to earlier, which claimed that the 23-percent undervaluation in certain neighborhoods, which a large minority presents, the study said that by just using 23 control variables, we control for all the differences in home care group characteristics and neighborhood amenities. That is just a preposterous statement to make.

And with our research that we have done, we show that by just adding one additional variable, so going from 23 to 24 variables, by adding the credit score of all of the borrowers in the neighborhood, which is a very powerful indicator for socioeconomic status, we can explain away the entire difference that the Brookings study attributed to raising the socioeconomic status. So, I think we should address socioeconomic status first before we address anything else.

Mr. ROSE. Thank you. And, Mr. Bishop, I would also be interested in hearing your thoughts on this question.

Mr. BISHOP. Right. Obviously, if you increase requirements, then it makes it a longer process, and a more expensive process. And anybody looking at it to get in is going to see increasing as a negative. I don't know why, how they would see that as a positive, other than if they were of the mindset that with education, more is better. But, yes, increasing requirements would be a negative.

Mr. ROSE. Thank you. One of the action items of the PAVE report is that HUD will require FHA lenders to track usage and outcomes of reconsiderations of value and to report this data to the FHA so that HUD can evaluate the impact that reconsiderations of value might have on possible discrimination. Mr. Peter, would the cost of increased reporting requirements like this impact the cost of buying a new home?

Mr. PETER. Ultimately, yes, but I think it is not needed. The data already exists. Fannie Mae and Freddie Mac already have the data. Two years ago, we developed a statistical approach to test every single appraiser in this country for racial bias—2 years ago. This has not been done. We went to Fannie Mae and Freddie Mac. We suggested it, do this or give us the anonymized data and we will do it for you. Two days later, we could give you the answer if appraiser A is biased, appraiser C is maybe incompetent, and then, you do some more investigation of these cases, but that has not been done. So, this really suggests to me that there is an ulterior motive which really sets up the stage for Federal Government to take over the appraisal process.

Mr. ROSE. Sure. And appraisals are typically done under tight timelines, as we know, that buyers and sellers have agreed upon in most cases. Mr. Peter, and Mr. Bishop, in the little time we have left, would any of the task force's recommendations slow down the appraisal process and risk sales falling through? Mr. Bishop, I will let you go first.

Mr. BISHOP. Well, yes, it is timeline-centric, and appraisers turn it in on a deadline, and it is nearly the day before. So, yes, increasing that could prolong the closings, ultimately.

Mr. ROSE. Mr. Peter?

Mr. PETER. Yes, I would concur with that.

Mr. ROSE. Okay. Thank you both. And, Chairwoman Waters, I yield back.

Chairwoman WATERS. Thank you. The gentleman from Illinois, Mr. Foster, who is also the Chair of our Task Force on Artificial Intelligence, is now recognized for 5 minutes.

Mr. FOSTER. Thank you, Madam Chairwoman. Some of the worst damage that was done in the bursting of the housing bubble 10 years ago happened to minority communities where people invested into houses at the peak of the bubble value. And I just want to follow up on Representative Hill's comments about the damage that can be done by overvaluing appraisals and encouraging people to make decisions which, in retrospect, wreck their lives, that we made some progress in Dodd-Frank with the ability-to-pay requirements that at least guaranteed that if you kept your job, you could maintain the mortgage payments. It did not protect you, however, from ending up underwater if you invested into a bubbly market.

And about 10 years ago, I gave a series of presentations at the American Enterprise Institute on a concept that for essentially countercyclical loan-to-value limits, instead of just using the appraised value, which was meant to be a snapshot of what the market value was today, you would give also look at the probability that this was a bubbly market. The simplest way to do this is if the local housing index had appreciated by 20 percent or 40 percent in the last few years, you would actually only allow the loan to be made against, not the current market value, the appraised value of the house, but what the appraisal would have been 5 years ago was corrected by the housing index. And at the time, the American Enterprise Institute, and I think others, had some enthusiasm for following up on mechanisms for making that happen. Is there anyone who is familiar with the state-of-the-art? Yes, please?

Mr. PETER. Yes, very recently, we suggested exactly this countercyclical approach to FHFA in its request for input on its capital rule. So, we have taken this concept and proposed it to the regulator. Of coursec, it was unfortunately ignored, but in terms of better mortgage products that build equity much faster. And we have a proposal out there that would work by shortening amortization schedules, so going with a 20- or 15-year mortgage but providing assistance to lower-income, first-generation homebuyers so that they could have set the difference in payment between a 30-year and a 20-year mortgage. This would allow them to build equity much faster. It could provide basically a vaccine to the entire neighborhood. If prices would decline, it gives people more staying power. And it is not just one person, but if you provide it to multiple people in this area, they could all benefit from each other and—

Mr. FOSTER. Sure. That was a huge chain reaction in neighborhoods where people would end up underwater, lose their jobs, and the house would get dumped onto the market in foreclosure, and then everyone in the neighborhood would be further underwater and just fend for itself. But the tough part about that is that part of the solution is to say, when a bubble is happening, you have to say, no, this is a bad thing for you to invest in. You have to buy a smaller house or perhaps no house at all with the amount of equity you have. And this is a very tough conversation. And I think that is one of the reasons why there was some industry opposition at the time, but that is a thread that is continuing.

So, I would like to encourage you to keep thinking about that and look at specific ways to implement that because that was sort of the missing piece in a lot of this discussion.

Mr. PETER. Congressman, we are going to follow up with you on this proposal.

Mr. FOSTER. Okay. Any other—yes?

Ms. RICE. Thank you so much for your question, Congressman Foster. And one thing that I would like to remind everyone is that in the lead-up to the foreclosure crisis, most of the abuses that we saw, the hyper-valuation of properties occurred in the subprime space, which was highly unregulated. But also, most of the loans that were generated in the subprime space were refinances, not home purchases. So, we also have to be careful as we look at the appraising of assets, of properties, when homes are being refinanced as well. That can also lead to grave problems and disparities. And many of the cases that are now sort of winding their way through HUD, or DOJ, or through the courts, or that are at private fair housing organizations involve refinance situations. The Austin family, for example, were refinancing their home, and that was the situation.

Mr. FOSTER. No, I agree. Some of the most tragic conversations I had were with families who lost homes they have been in for 40 years.

Ms. RICE. Exactly.

Mr. FOSTER. Anyway, my time is up. I yield back.

Chairwoman WATERS. The gentleman from Ohio, Mr. Gonzalez, is now recognized for 5 minutes.

Mr. GONZALEZ OF OHIO. Thank you, Chairwoman Waters, and thank you to our witnesses for being here today and for your testimonies. Let me start by saying something I think is pretty obvious, which is that it is important that we identify ways to reduce wealth disparities, and that promoting homeownership and building equity is an incredibly important piece of the equation, especially for young families. It is my hope that we can work in a bipartisan way in this committee and throughout others to incentivize building and help create new pathways to homeownerships for all Americans. One of my favorite sayings that I have always tried to live by is, "In God we trust. All others bring data." I don't know exactly who said it, but I think it is pretty valuable.

And, Mr. Peter, I want to start with you because you talk a lot about the data that was used in the PAVE study. And I would like for you to comment specifically on the quality of the data that was used, what was rejected. And maybe just from your standpoint, if data is ultimately going to help us solve this problem, and I think it is, start with a good set of clean data, let us see what it tells us, and then let us make the necessary adjustments. Walk me through your sort of analysis, if you will, at a high level of the quality of the data and the analysis used.

Mr. PETER. Initially, we were equally shocked by these reports in the newspapers about appraisal discrimination, but then we thought, well, we could use the data that already exists and that we have within the Housing Center to really get to the bottom of this. And we ran a statistical approach where we could test the entire housing market, and we found that systemic bias was not widespread. That is what we found for the entirety of the market.

Mr. GONZALEZ OF OHIO. So, was the data that PAVE relied on faulty, or was it lacking context?

Mr. PETER. Some of the data that PAVE used, which was the study by Freddie Mac, was never released to the public. Once we read the report, we went to Freddie and said, hey, could you release the data so we could replicate what you have done, and also we have some ideas that we think would be important to test namely what is the impact of socioeconomic status on these differences that you are finding, and Freddie Mac said, no, we can't do this. But then, we went to—

Mr. GONZALEZ OF OHIO. Why? It seems like we would want that data public. I would love to see it.

Mr. PETER. I would like to see it, too.

Mr. GONZALEZ OF OHIO. I would like to have the academic community really analyze this, and speed it up, and let us see what is there.

Mr. PETER. We then went to a third-party provider who had similar access to similar data, and the data will still be under the pay wall, but we fed them the code that they should be running. And they ran the code for us, and then we discovered the differences that Freddie Mac found and attributed to race-based were not race-based. They were actually due to socioeconomic status.

Mr. GONZALEZ OF OHIO. Okay. So from your analysis, the conclusion is that there are other factors that are—

Mr. PETER. There are very much other factors, and we have not really explored them.

Mr. GONZALEZ OF OHIO. I want to go back to something that I think is sort of the crux of the whole thing, which is we want to close the racial wealth gap. I think that is a noble goal that we all share, and it has been persistent and it has been stubborn, and we haven't been able to sort of crack it. Housing is a component of that obviously. From a housing solution standpoint, what policies would you advocate for that could help us close the racial wealth gap?

Mr. PETER. Number one, we need more supply.

Mr. GONZALEZ OF OHIO. Supply of houses.

Mr. PETER. Supply of houses. The lack of a supply of houses is what is driving up home prices, and it is pricing out lower-income minorities from the market. That has been going on for the last couple of years, and it is a real tragedy. So, that is number one. We need more supply, but at the same time, this is not a Federal Government issue. This is a local and State issue, and it needs to be handled at those levels, and there is already movement in that direction by certain States, California, for example. If California can pass this, anyone else should be able to pass this.

Mr. GONZALEZ OF OHIO. Yes.

Mr. PETER. At the same time, for foreclosure of loan lending practices, the practices where you give borrowers more and more debt that they cannot sustain, that is really dangerous. And especially borrowers who get in late in the boom cycle, they are the first ones to get foreclosed on, so we need to break this cycle. And there is academic research which conclusively shows that neighborhoods in minority and White neighborhoods would have the same home price appreciation, so you would be building the same amount of equity, but at the same rate of equity. The difference is that minorities tend to default more, and that wipes them out completely, so we need to break that cycle, and we need better loan products. We have the Wealth-Building Home Loan out there. We have the LIFT home program out there that we have proposed.

Mr. GONZALEZ OF OHIO. I have 30 seconds. Better mortgage products, I agree completely. Go as deep as you can on that in 30 seconds. What do we need?

Mr. PETER. We need to subsidize wealth-building and not debt. Down payment assistance, for example, would just get fed through and drive up home prices higher. So if two people want to buy the same home and you give everyone $20,000 more, that would get capitalized in higher home prices. What we are proposing is, buy down the interest rate. By buying down the interest rate, you are building up more equity each month, so you are building up this cushion that protects it from foreclosures. That would be one big step that we should undertake, and if there is Federal Government money to be spent for it, a limited amount, that would be fine.

Mr. GONZALEZ OF OHIO. Thank you, and I yield back.

Mr. PERLMUTTER. [presiding]. The gentleman's time has expired.

The gentleman from Florida, Mr. Lawson, is now recognized for 5 minutes.

Mr. LAWSON. Thank you, Mr. Chairman, and I welcome all of the witnesses to the committee today. And I probably want Mr. Bishop and Mr. Bunton to comment on this. There had been many cases regarding discriminatory appraisers from people of color. I remember hearing about a family in Jacksonville, Florida, which is in my district, who wanted to refinance their home and pay down the mortgage. When the appraiser came back with a shockingly low estimate, they decided to get a second appraisal with a new appraiser, that made the home appear as if the husband was doing the appraisal. He just happened to be married to a Black female. And what they did was, they took down all of the pictures and everything in the house to make it appear that it was only a White person included, and all of a sudden, the second appraisal went up 40 percent, which is pretty significant to go up 40 percent.

Mr. Bishop, first, what happens in a situation like this if a complaint is filed with the appraisal company for discrimination, bias? How is it reported, and how is the issue handled?

Mr. BISHOP. Thank you for your question. And it is important to understand that any time a property owner feels like they have been discriminated against in the appraisal process, they should do exactly what those folks did, which is just start asking questions why, if they truly feel that way. I don't know enough about the situation to be able to render an opinion as to why there was a 40-

percent higher conclusion on the second appraisal. But what I can tell you is that if I were to be given the two appraisals, and we could understand the scope of work, then we might understand why there was a difference in the conclusion. It could have been a mistake. It could have been a different set of instructions. But absolutely, if the reason was because those homeowners had to take the decoration of their home and change it, that is just unacceptable.

Mr. LAWSON. Okay. Mr. Bunton?

Mr. BUNTON. I would suggest that they file a complaint with the Florida Real Estate Appraiser Board. Our standards clearly prohibit bias and discrimination, and that is the yardstick that board would use on the actions of those appraisers. And they have a wide array of disciplinary actions ranging from a warning letter to suspension, revocations, and fines, but that is the recourse that a homeowner would have.

Mr. LAWSON. This is a hypothetical question to the panel. I know my time is running out. Does the appraiser sometimes form a relationship with financial institutions, the banks and so forth, and have an expectation from the banks, the financial institutions, that the appraiser will come in at a same amount when they are dealing with minorities? The lenders—

Mr. BUNTON. Is that to me as well?

Mr. LAWSON. Yes.

Mr. BUNTON. Yes.

Mr. LAWSON. I would like to know, because some institutions only want to use the same appraisers.

Mr. BUNTON. Right.

Mr. LAWSON. And so, is it a relationship established that in order for you all to do business, you have to come in with an appraisal that is the amount that each financial institution is looking for?

Mr. BUNTON. The Dodd-Frank Act had a whole section on appraiser independence. This used to be a huge problem. "If you don't hit the number, I am not going to use you anymore." And now, it is much more of an arm's-length transaction. So, if that kind of conversation is occurring, then the Federal banking agency that is in charge of that bank should be notified, because that is against the law.

Mr. LAWSON. Okay. Would anyone else care to comment?

Mr. BISHOP. Yes, I would. The structure setup, the regulatory structure setup within most lending institutions now doesn't allow me to talk directly to the lender. I talk to an intermediary, kind of like an appraisal manager. That is where the appraisal management company concept comes in. It puts a wall up between the appraiser and the borrower in both commercial and residential. So, I wouldn't even be able to talk to the lender in such a circumstance. And if that is going on, if they are circumventing that, then absolutely, that is against the law.

Mr. LAWSON. Okay. I have some other questions I may have to submit in writing, but anyway, my time is running out. And with that, I yield back.

Mr. PERLMUTTER. The gentleman from Florida yields back.

The gentleman from South Carolina, Mr. Timmons, is now recognized for 5 minutes.

Mr. TIMMONS. Thank you, Mr. Chairman. The appraisal industry is by its very nature somewhat subjective. The metrics we use to measure the value of properties are constantly changing, and the true value of properties varies from bar to bar, depending on their priorities. I bought a property 11 years ago, and the value has changed over 10 times because people are moving into Greenville, South Carolina. They are moving into the upstate from all over the country. We have cranes everywhere. It is fantastic. Let's go to a different part of South Carolina where people are not moving. The population growth, demographics, all of these variables make it really hard to have consistency. But I would say that the appraisal industry overall is doing a good job, and I hope the appraisal we are about to do on the property that I have comes back great. Fingers crossed.

But Mr. Peter, I want to ask, is there an opportunity to make use of technologies, such as Automated Valuation Models (AVMs) to try and eliminate some of this subjectivity?

Mr. PETER. Yes, and there is certainly already some of that in use. Fannie and Freddie are using now what is called appraisal waivers. This started even before the pandemic, but because of the pandemic, it really got turbocharged, where people basically submit a self-evaluation of the property's value. And then, Fannie and Freddie check, does it fall within our range, and if it does, then you don't need an appraisal. The problem with this is, and we have looked at this in great detail, is that so far, we haven't found that it is actually having a salutary effect in the market, but we have found evidence of gaming.

And once it becomes widespread knowledge in the marketplace, which it always does, then you could have problems through gaming the system. And especially when Fannie and Freddie are competing against each other for market share, it could really get problematic because they are trying to move out the risk curve a little bit further and further to gain business, of course at the expense of the other who does the same who responds in kind. And we have seen this during the 2000s with automated underwriting where this could quickly spiral out of control and then you end up with a massive bust.

Mr. TIMMONS. The gaming—are they just manipulating factors in the appraisal, or how are they gaming the system?

Mr. PETER. What we have found is there is a certain amount of punching at a certain LTV point. For example, at an 80 LTV that, you know if you go $1 above 80, you need mortgage insurance. So, what we found is that at 80, at an LTV, generally a value that is awarded with a waiver is much greater than the value awarded by an appraiser. I don't really know how exactly this happens, but there is some evidence that at these price points, at the same at 80, at 70, at 60, every time where the pricing changes, that with a waiver, you get a higher valuation. And of course, if someone figured this out at these price points, it is easier to see how this could eventually become widespread throughout the market, and then you end up with waivers awarding higher values across-the-board in human appraisals.

Mr. TIMMONS. Are there any standards in place, common data standards for AVMs?

Mr. PETER. As far as I am aware, there are not. This is all in a black box that Fannie and Freddie have. And we think for AVMs to be used, you should have capital to back it up to withstand your losses, but Fannie and Freddie are chronically undercapitalized. They don't have the capital to back this up. So if a private lender is using AVM, you have the capital to withstand any severe losses, but with the government doing it, there is always the danger that you don't have capital and to get gamed and exploited.

Mr. TIMMONS. Sure. Thank you. The Consumer Financial Protection Bureau (CFPB) has shown interest in publishing a rulemaking on AVMs. I tend to favor a light-touch regulatory system that is very clear in its rulemaking and consequences. The CFPB tends to take the complete opposite tack under this Administration. Under Director Chopra, they love to issue opaque and burdensome rules so they can regulate industry by enforcement. What impact would overreach by the CFPB in this space have on the industry, and does the CFPB have a strong record of appropriately regulating emerging technology?

Mr. PETER. The problem with the government taking this whole process over is always that it could be politicized eventually. And it is easy to see how you could quickly be mis-valuing properties across the whole country, for political purposes of increasing valuation in minority neighborhoods, for example. But of course, if you don't use the market— let the market decide what the real value is. You can easily see how you could be driving a housing boom, and then eventually, when the party is over and the music stops, as it always does, you are going to have a massive price correction.

Mr. TIMMONS. So, AVMs could be used effectively using appropriately-transparent variables and making sure that the algorithms are all—there are no politics in it.

Mr. PETER. If a private lender is doing this, with enough capital, how about it? No problems with AVMs. We use AVMs in our research all the time.

Mr. TIMMONS. Thank you, Mr. Peter. Mr. Chairman, I yield back.

Mr. PERLMUTTER. The gentleman from South Carolina yields back.

The gentlewoman from North Carolina, Ms. Adams, is now recognized for 5 minutes.

Ms. ADAMS. Thank you, Mr. Chairman, and I thank Chairwoman Waters and Ranking Member McHenry for hosting today's hearing. And to our witnesses, thank you for your attendance.

Mr. PERLMUTTER. Ms. Adams, there seems to be a problem with your microphone. You might see what happened there. Let's stop the clock for a second.

Ms. ADAMS. Can you hear me now?

Mr. PERLMUTTER. Just barely. We heard you loud and clear for a second or two, and then it kind of was muted or muffled again.

Ms. ADAMS. What about now?

Mr. PERLMUTTER. Just barely, yes.

Ms. ADAMS. Can you hear me now?

Mr. PERLMUTTER. It's getting better.

Ms. ADAMS. Can you hear me now?

Mr. PERLMUTTER. Just barely. I think what we would like to do is to move on to Mr. Davidson, and then come back to you, if that is okay.

Ms. ADAMS. Yes, Mr. Chairman. What about now?

Mr. PERLMUTTER. Now, we can hear you.

Ms. ADAMS. Great. Thank you so much. I want to thank Chairwoman Waters and Ranking Member McHenry for hosting the hearing. And to our witnesses, thank you as well.

For far too many of our neighbors pursuing the American Dream, a decent, affordable place is just that: a dream. I am proud that this committee is working with the Biden Administration on the PAVE Task Force to help turn what is too often a dream into reality. Collectively, one common thread I have heard today is that we don't want bias. We all want to treat people fairly. We all want to make sure that our neighbors and friends and families can enjoy the fruits of their labor in the comfort of their own fairly-appraised homes. And one of the ways we do that is straightforward: We need to train, we need to recruit, and we need to retain more diverse talent.

One of my proudest efforts here in the Congress was founding the bipartisan HBCU Caucus—that is, for Historically Black Colleges and Universities (HBCUs)—which I Chair with French Hill of Arkansas, who serves with me here on the Financial Services Committee, and he has been a great partner as we fight to secure resources. In fact, I attended his HBCU summit in Little Rock this past October, and we shined a spotlight on the need for companies to strengthen their pipelines of diverse talent by working with our HBCUs. That is the essence of the HBCU Partnership Challenge. That is what it does. We facilitate those connections. And that is why, for my Fifth Annual STEAM Days of Action, which is going on right now, we are convening members with the HBCU presidents, corporate partners, and Members of Congress.

Mr. Bishop, in your testimony you discussed your Appraisal Diversity Initiative, and I am glad to see that you are thinking seriously about how to diversify your workforce. So my question is, to what extent have you tapped into HBCUs to help build a diverse workforce, and how can we help you and your colleagues in the industry further your efforts?

Mr. BISHOP. Thank you, Congresswoman Adams. That is an awesome question, and the answer is in our University Relations Committee. We have reached out to HBCUs, as well as community colleges and universities, and we are placing ambassadors in each of those educational facilities. And those ambassadors will be our members who will introduce the appraisal profession to their students, and I would welcome any help. I can put you in contact if we can communicate with the member who is the Chair of the University Relations Committee, and he is right now in the middle of that process of identifying contacts at the schools and HBCUs as well. And if we need help there, it would be greatly appreciated.

Ms. ADAMS. We have the expertise, and we certainly are willing to do it. Thank you so much.

Mr. Kelker, in your testimony you also discussed the need to train and retain a diverse future generation of appraisers, and I completely agree with that. So to be clear, you have an obligation to every American to do so. My question is, have you and your colleagues partnered with any HBCUs or other schools to begin training that diverse future generation of appraisers that you are looking for, and if not, how can we help you do so?

Mr. KELKER. I would say that to date, we have not done a partnership with college campuses, largely because our qualification requirements are determined by our client base. And at this point in time, we are not allowed to use trainees or people with less experience yet. So until we can do something with some of those requirements, it is difficult to work on a pipeline of people that we can use.

Ms. ADAMS. Thank you so much. Thank you, Mr. Kelker, and I have about a minute left. I yield that remaining time to Ms. Rice to respond to the comments that Mr. Peter made about existing research in this area.

Ms. RICE. Thank you so much, Congresswoman. Yes, I take exception to the AEI's approach to research in this area because what they are doing is essentially applying certain socioeconomic factors that are highly correlated to race to try to mitigate away or explain away disparities, real disparities that exist in the marketplace. For example, Mr. Peter mentioned credit scores. And if you just add credit scores into the equation, then it explains away the disparities that we are seeing in property valuations. But credit scores are highly correlated to race and the racial composition of the neighborhood, but appraisers don't use credit scores when they are assessing the property value.

Mr. PERLMUTTER. Thank you, Ms. Rice. I am going to—

Ms. RICE. It would be totally inappropriate for them to do that.

Mr. PERLMUTTER. Ms. Rice, Ms. Adams' time has expired.

Ms. ADAMS. I am of time. Thank you, Mr. Chairman. I yield back.

Mr. PERLMUTTER. The gentlelady from North Carolina yields back.

The gentleman from Ohio, Mr. Davidson, is now recognized for 5 minutes.

Mr. DAVIDSON. I thank the chairman. I also thank the chairwoman and the ranking member for scheduling another hearing on housing, but at least it is a new topic on how we appraise the value and to the extent that race is a motivating factor in valuations, and evaluations have sort of a trade school kind of approach. There is a right answer within a range. So, when you look at disparity in valuation, I think it is interesting to see some of the research that you have done, Mr. Peter, in this space. There are lots of correlations. Ms. Rice, you highlighted that. And maybe that is where we can pick up.

Frankly, in your testimony you cite a Brookings study from 2018 to support your claim that there is an inherent bias because somehow there is a disparate impact in valuations. And I am just curious, when you look at the granularity of that, you picked up on credit scores as a factor, but to what extent do you see that? You can continue your thought, Ms. Rice. But also in the same neighborhood, same block, do you get a different valuation on a comparable property? There are certainly some things that we should be alerted to, but could you address that?

Ms. RICE. Certainly, and thank you so much for the question. We did in part base our analysis on the Brookings Institution study, but we also based it on the analysis done by the Federal Housing Finance Agency (FHFA), which found that in thousands of appraisals recently conducted, there existed inappropriate language and references to race or racial composition of a neighborhood or the racial demographics of a neighborhood. We also based it on the Fannie Mae study and the Freddie Mac study. So, there are multiple studies—

Mr. DAVIDSON. I appreciate what you cite. And maybe, Mr. Peter, I would just give you a chance to respond to that, and I appreciate the research that you have gotten. Maybe you could clarify what your point is there?

Mr. PETER. Yes. Thank you. In regards to the FHFA blog post, it cited 16 examples, and it said that out of millions of appraisals, there were thousands of instances, but it also cited that there were a lot of false positives. So the fact that it didn't provide the exact number suggests to me that it cannot be very large. That is number one.

The second part about the Brookings study is that credit scores were just mentioned, and it was a study done by the Federal Reserve Board, so not just a research study, but underwritten by all of the Fed Governors, and from 2005, which found that credit scores are raised blind. So, that is the evidence. That is a fact. And similarly, in the Brookings study, they used single mothers with children under 18 as a control variable, as an explanatory variable. This, of course, is very much correlated with race, too. So if Brookings is using it, why can't we be using credit scores?

And regarding your point about location, location is very important. And even if you have the same home, an identical home newly built right next to each other, but one has beach access, and the other one doesn't have beach access, you could easily see how that could really be affecting home valuations. And the Brooking study has nothing in there that controls for natural amenities, so that is another flaw of this study.

Mr. DAVIDSON. Yes, location, location, location, is certainly a huge factor there. And I think there are some things that we could probably disagree on and certainly have for a couple of hours now. But I think one of the things we can't disagree on is, if there is discrimination, there is legal recourse. We have already made it illegal to do this activity. So if we identify it, what is the state of lawsuits? What kind of lawsuits are being brought for this kind of discrimination? We are having a hearing on it. Is it all throughout our courts all over the country, Mr. Peter?

Mr. PETER. I am not very familiar with lawsuits. I don't think there are many instances. Based on our data, which suggests that discrimination, racial bias by appraisers is not widespread and systemic, so I think that is where we should be starting.

Mr. DAVIDSON. I would like to just slightly shift our focus to kind of go to, where is the housing market headed? I recently saw an interview by Gary Berman from Tricon Residential where he discussed the shift in housing demand, specifically pertaining to millennials. And Mr. Berman stated that on a weekly basis, there are roughly 200 to 300 homes available, and that his company gets roughly 10,000 leasing inquiries. He attributes much of this demand to millennials who desire to move into, "turnkey dwellings," where the burden of maintenance is on someone else. I have two questions: first, do you agree with this; and second, what are the long-term implications for the housing market?

Mr. PETER. The longstanding problem is that we have been not supplying enough housing. And what has been holding back the supply is really government regulation, especially in the land-use front. So if we were to allow moderately higher density in areas around walkable, commercial areas, I think, by right, that would make a large impact.

Mr. DAVIDSON. Yes, thanks for addressing supply. My time has expired, and I yield back.

Mr. PERLMUTTER. The gentleman's time has expired.

The gentlewoman from Pennsylvania, Ms. Dean, is now recognized for 5 minutes.

Ms. DEAN. Thank you, Mr. Chairman, and thank you to all of our witnesses for testifying today about disparities in home valuations.

I want to take a moment to step back and reiterate why we are having this hearing. In our country, homeownership is literally rooted in the foundation of our country, and it is and remains one of the most important tools for families to build wealth. It can mean having the means to help pay for your kids going to college, or to help you retire with dignity. And in fact, for decades, our government policy supported White families in becoming homeowners, while excluding families of color from the same opportunity. Now, as we look at appraisals today, regardless of some of the arguments on the data, it is nevertheless clear that families of color are too often not getting a fair shake. And I don't understand an argument that, oh, a low appraisal might do you some good. That seems really insufficient, puzzling, and disappointing to me.

I represent a district in the suburbs of Philadelphia. Multiple studies have found that in Philadelphia, homes in Black neighborhoods are devalued by 27 percent compared to similar homes in White neighborhoods. Ms. Rice, can you speak to the impact of this chronic under-evaluation, particularly the compounding effect in terms of wealth-building?

Ms. RICE. Thank you so much, Congresswoman Dean, for the question. Certainly, in individual instances it can be devastating, because a person could lose the ability to purchase a home, if the property is under-appraised, but in a refinance situation, the family could lose the ability to lower their monthly debt. They could lose the ability to send their children to school or to start a business, and ultimately, the lower property valuations translate to tens of thousands of dollars per family of lost wealth for that family, lost wealth that family could use in order to sustain them through financial difficulties and other kinds of issues.

Ms. DEAN. And over time, over decades, in terms of, if you wanted to move up to a larger house, if your property value is chronically and unfairly held back, it will limit your ability and your mobility. Mr. Bishop, how do we ensure that appraisers clearly understand their obligations under the Fair Housing Act and the Equal Credit Opportunity Act?

Mr. BISHOP. Thank you for your question, Congresswoman Dean. The education, education awareness, it is in our canons, it is in our ethics, it is in our guidelines. We just amended the canons. We amended the guidelines. We have enhanced our ethics to address those situations more stringently than we had. Basically, it is good for any business or any entity that has been around a long time to revisit their bylaws, regulations, structures, things like that. And that is what we have done, and we are going to continue to do it. We have an education that we are developing right now for our members to take in those areas that you just addressed in question.

Ms. DEAN. Thank you very much, and if I can, I will try to fit in both Mr. Kelker and Mr. Bunton. The demographics of the appraisal industry do not reflect our country's diversity, we all can see that, and the numbers sadly support that. Appraisers are overwhelmingly White male and approaching the age of retirement. I say that not as a statement of any insult, but just as a statement of fact, and a lack of diversity is impacting property values and appraisals. Mr. Kelker, how are appraisal management companies engaging in diversity and inclusion efforts?

Mr. KELKER. As a matter of course, we attempt to recruit as broadly as we can, specifically in markets where we believe that they are underserved or the coverage is thin. But just given the numbers that have been discussed during this hearing, there are very few candidates who are available. And during the last couple of years when the market has been as hot as it has been, we have had trouble recruiting anyone, because everyone is busy. I think the real solution is to improve the number of people coming into the profession so that there is a greater pool to recruit from.

Ms. DEAN. You have 2 seconds, Mr. Bunton.

Mr. BUNTON. —for the simulated training that I talked about before.

Ms. DEAN. Terrific. Thank you very much. That is what I was thinking, back to education, and I yield back. Thank you, Mr. Chairman.

Mr. PERLMUTTER. The gentlelady's time has expired. We have been going for 2 hours and 45 minutes, and I think it is time to let the witnesses stretch their legs, so, without objection, we will take a 5-minute recess.

[brief recess]

Mr. PERLMUTTER. Take your seats, please. Thank you. Okay. We will begin again.

The gentleman from California, Mr. Sherman, who is also the Chair of our Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, is now recognized for 5 minutes.

Mr. SHERMAN. It seems that we are dealing with two separate issues here. One is whether certain neighborhoods are underappreciated, and the other is whether individual houses are given a low value just because an African-American or Hispanic family lives there. Ms. Dean points out to us that neighborhoods in Philadelphia that are predominantly populated by people of color tend to appraise for 27 percent less. A low price might be good for the buyer, but it is bad for the seller. It is bad for the refinancer. But a low appraisal doesn't do anybody any good. But we should not blame appraisers for the racism that has existed and continues to exist in our society.

An appraiser looks at a home and accurately determines that it is going to sell for $300,000. They can't give an appraisal of $400,000 by saying if it hadn't been for the racism that led to the road being here instead of there, if it hadn't been for the racism that led to the trash dump being here rather than there, then the house would be worth $400,000. The appraisal industry has to deal with a society where racist decisions have led to certain neighborhoods selling for less than they otherwise would. And racism is not just something that existed in the past, it exists today, and has an effect on whether property sells in one neighborhood for less than it would sell, the exact same physical structure, in another neighborhood.

I want to focus, though, on the issue of undervaluing a particular house because it seems that the seller is a family of color. We had the widely-publicized example of bringing in an appraiser while there are pictures on the walls of an African-American family, taking those pictures down, putting a different couple sitting there as if they are the owners, putting up pictures of a White family and the house appraising for more. Mr. Peter, I am sure you are familiar with those reports. Do they reflect a tendency of appraisers to undervalue a particular house simply because it seems to be inhabited by an African-American family?

Mr. PETER. Thank you, Congressman. I certainly believe that there are instances where appraisers are biased. However, our research, based on 240,000 loans, which is the only study that has actually used big data, shows that this bias is not systemic and widespread. And there is also academic research that has backed this up as of recently, and Fannie Mae research comes to the same conclusion. Soc, I think when we find under-appraisals in largely minority neighborhoods, that Freddie Mac pointed out in its research, once we start controlling for socioeconomic status differences—

Mr. SHERMAN. In my questioning here, I am not looking at full neighborhoods. I am saying the same house in the same location gets appraised differently. I will ask Pledger Bishop to also respond to this. Is this just one idiosyncratic article, or is there more evidence to say that an appraiser would appraise the house differently based upon the ethnicity of the pictures on the wall?

Mr. BISHOP. Thank you for your question, Congressman Sherman. I have heard of those stories and read about those stories. And that is about what I know. I know about the allegations. And if true, if that is really what happened, and if the appraiser did that because they are biased, then that is unacceptable. And they should be taken care of.

Mr. SHERMAN. That is a problem more likely to affect cities other than Los Angeles. So much of Los Angeles is tract homes, and for an appraiser to look at the Milan model in a home where there are 50 identical homes in the neighborhood and come up with a row of appraisal is going to be very different than in some of our older cities where the homes are one of a kind.

Mr. PERLMUTTER. Mr. Sherman?

Mr. SHERMAN. Yes.

Mr. PERLMUTTER. Your time has expired, sir.

Mr. SHERMAN. Thank you.

Mr. PERLMUTTER. The gentleman from California yields back.

The gentleman from Illinois, Mr. Garcia, is now recognized for 5 minutes.

Mr. GARCIA OF ILLINOIS. Thank you, Mr. Chairman, and Mr. Ranking Member. And I want to thank all of the witnesses for joining us today to address the issue of home appraisal bias and discrimination. In 2021, the Latino homeownership rate remained steady, and Latinos are projected to represent half of new homeowners in the next decade. However, discrimination against Latinos in the appraisal process poses a serious harm to our community and contributes to the widening wealth gap in our nation. Communities of color deserve the opportunity to purchase or sell a home at a fair price to build wealth. We must take action so that Latino and Black communities are not shortchanged by a discriminatory system that aims at keeping neighborhoods, like the ones I represent, segregated and undervalued.

A question for Ms. Lisa Rice. In your testimony, you reference qualitative research that has displayed appraisers as active participants of discrimination against communities of color. One appraiser assumed neighborhoods were, "getting better," and housing values were increasing, "because all of the Mexican people were moving out." I represent a district with working-class Latino and immigrant families, communities, and this community has been hit hard by gentrification and displacement and discrimination within the appraisal process. Can you speak to the impact of discrimination in the housing market and how that has perpetuated gentrification and the undervaluation in communities of color?

Ms. RICE. Thank you, Congressman Garcia, for the question. Yes, discrimination has very debilitating impacts, not just for the individual consumer involved, because when an individual consumer experiences discrimination, they can be denied a housing opportunity. And we know that homeownership leads to stability and other great benefits for families, particularly families with children. So, for example, homeownership for families with children leads to higher educational attainment for children. There are many, many benefits to homeownership.

Denying people the opportunity or doing anything that would result in denying a person an opportunity for homeownership has debilitating impacts for that family, but it also has debilitating impacts for a community. And let me say, I don't think that most appraisers are discriminatory or out there practicing discrimination, but I definitely think that we have some systemic issues and we also have some appraisers who are engaging in behaviors that they should not be.

Mr. GARCIA OF ILLINOIS. Thank you for that. A question for Mr. Bishop. The issue of discrimination at every point in the housing market, from loan applications to appraisals, is exacerbated by the lack of diversity in the housing and appraisal field. A recent report found that 85 percent of appraisers nationwide were White, and less than 5 percent identified as Latino. Can you speak towards the major challenges for recruiting diverse appraisers and what more can be done to shift these numbers?

Mr. BISHOP. That is an excellent question, Congressman Garcia. And as I have said before, we have ADI, we have the Appraisal Institute, AIERF, with scholarships. Those are scholarships. We have our efforts in the universities to promote the profession at that level. And other than that, the obstacles to this are simply time required and expense required in just obtaining a license, and then post-licensing, getting the experience. We have talked about it. PAREA should satisfy the experience part. The ADI Initiative, the Appraisal Institute Education Relief Fund should provide opportunities in the cost arena. So short of that, we have to promote the profession as viable for entrance into the profession and introduce it, and that is the tricky part. Believe it or not, in my experience, in my world, it is second-job, third-job opportunity folks who find appraising and want to get in, so they are not coming out of the university. So we have to find those folks, too, and try to promote the profession in order to diversify.

And this is a top priority for the Appraisal Institute. Our strategic planning board adopted a new strategic plan in the last quarter and diversity was one of the top initiatives from that strategic plan.

Mr. PERLMUTTER. The gentleman's time has expired.

Mr. GARCIA OF ILLINOIS. Thank you for that. My time has expired. Mr. Chairman, I yield back.

Mr. PERLMUTTER. The gentleman yields back.

The gentlewoman from Texas, Ms. Garcia, who is also the Vice Chair of our Subcommittee on Diversity and Inclusion, is now recognized for 5 minutes.

Ms. GARCIA OF TEXAS. Thank you, Mr. Chairman, and I want to thank the chairwoman for bringing this really important topic to our attention and giving us an opportunity to discuss it. And I must say, Mr. Chairman, that I feel a little kind of almost distraught at some of the comments that I have heard, and I apologize that I have been bouncing back and forth between here and the Judiciary Committee, so I didn't get to hear them all. But it is just perplexing to me why we are where we are today on this issue. It doesn't appear to be a new issue. And I don't know how long these groups have been working on this issue, but it is really disheartening to see that we are where we are today. And as has already been said by so many others, this is about building generational wealth. It is about especially minorities gaining access to a home and then passing it on to their children, being able to sell it, being able to leverage it.

And it is unfortunate that the appraisal process has proved to be unreliable and consistently holding back minorities who seek to close the wealth gap and build financial homeownership. We have already heard all the numbers, and I am just going to repeat the number of appraisers again: Out of 80,000 appraisers, 97 percent are White. I don't think I have seen that number in any other sector. Why is that? What is it that you all have not been doing that you should have been doing 10 years ago? This is now a very structural issue. Four percent Latino, 1 percent Black, and 1 percent Asian, and then the breakdown with male and female is 69 to 30. And I heard Mr. Kelker say that—I think I heard him say, and I am hopeful I didn't hear it right—somebody tells you that you can't go to universities to recruit. Is that what you said, sir?

Mr. KELKER. That is not what I said. What I said was that our clients really determine who we can use in terms of experience. And someone coming right out of school generally does not have enough experience, would be a trainee, or within sufficient experience to be approved to do work for pretty much any of our clients.

Ms. GARCIA OF TEXAS. But I thought I heard you say that you weren't allowed to recruit, when you were responding to the question about recruitment in Historically Black Colleges and Universities, and, I will add, Hispanic-Serving Institutions. Do you actively recruit at these universities to try to get it down from the 97.7-percent White?

Mr. KELKER. We don't recruit at colleges. We recruit generally in a marketplace where we are looking for experienced appraisers.

Ms. GARCIA OF TEXAS. But the question is why, sir? That is the thing that I find so perplexing. If we know we have a problem, what is stopping you from recruiting at colleges? I am not understanding.

Mr. KELKER. I think what I am trying to convey is that recruiting at colleges, while we could recruit, we could not use those individuals until they get licensed and get sufficient experience to meet our client's requirements.

Ms. GARCIA OF TEXAS. I see we are not making any movement here. So, let me ask the two folks who mentioned scholarships. What kind of scholarships are there, how many do you have, and are you actively recruiting at HBCUs and at Hispanic-Serving Institutions to make sure we do get minority appraisers?

Mr. BISHOP. Yes, we are, and the scholarships are plentiful. Initially, they will cover the education.

Ms. GARCIA OF TEXAS. And do you go to the colleges to make sure they know that there are scholarships available, and there is a career track there for them to seek?

Mr. BISHOP. That is what the ambassadors and the appraisal—

Ms. GARCIA OF TEXAS. And how long have you been doing that, sir?

Mr. BISHOP. We have been in the universities. This is a concerted effort at consolidating and identifying in the university so that we can promote that.

Ms. GARCIA OF TEXAS. Sir, the question was how long have you been doing this?

Mr. BISHOP. Right. It is 2 years.

Ms. GARCIA OF TEXAS. Because the numbers do not reflect that anybody is doing anything.

Mr. BISHOP. We started with the University Relations 2 years ago.

Ms. GARCIA OF TEXAS. And what about you, sir? You put your hand up really quickly, because—

Mr. BUNTON. Yes, we are starting it this year when we rolled out this simulated training, so they will have the education, simulated training, and even sit for the State exam. There is a lot of corporate interest in these scholarships for minorities and for—

Ms. GARCIA OF TEXAS. But you are just starting this year. What is your goal?

Mr. BUNTON. Right. Our goal?

Ms. GARCIA OF TEXAS. Yes. What is your goal? What is your target?

Mr. BUNTON. Our target is, we did a diversity study of the profession last year to see if all of those numbers we hear from the Bureau of Labor Statistics are the same. Our goal is to make appraisal professionals look more like America. So, we are going to start with, depending on the corporate support that we get, as many people as we can possibly get through the system.

Ms. GARCIA OF TEXAS. Mr. Chairman, my time has expired. And I did have a question for Ms. Rice, but I will submit it for the record. Thank you, and I yield back.

Mr. PERLMUTTER. The gentlelady's time has expired, and she yields back.

The gentlewoman from Michigan, Ms. Tlaib, is now recognized for 5 minutes.

Ms. TLAIB. Thank you so much, Mr. Chairman, for taking the time and recognizing me. Thank you so much, all of you, for really leading this important effort. In Michigan, we know just how important homeownership is in empowering communities of color to build wealth.

All 12 of the communities that I represent are in Wayne County, Michigan. And we have lost more Black homeownership than any other State in the country, in Michigan, but Wayne County really was hit the hardest. I was alarmed, but not surprised, to read Detroit Future City's report which, Mr. Chairman, if I may, I would like to submit for the record, this week on homeownership in Detroit, which found that Black mortgage applicants were consistently more likely to be denied more than White applicants across all income groups.

In fact, upper-income Black applicants were denied more frequently than moderate-income White applicants. The most frequent reasons cited for denial were credit history and appraisals. We all know this is unacceptable. I know my folks are really tired of being studied. They are exhausted by the task forces, and the commissions. We already know what the issue is. Very little has been done to minimize and monitor the appraisers' use of discretion, particularly with regards to fair housing. And I think we have seen the harms that approach has caused to residents in communities like mine. And again, Madam Chairwoman, if I may, I would like to submit for the record, Detroit Future City's report.

Chairwoman WATERS. Without objection, it is so ordered. Thank you.

Ms. TLAIB. Mr. Bunton, how can the Uniform Standards of Professional Appraisal Practice be improved to limit discriminatory appraiser discretion and mitigate fair lending risk?

Mr. BUNTON. Our Standards Board is actually viewing the ethics rule right now to make sure it is abundantly clear. One of the things that we want to make sure is that people understand that they file a complaint with their State appraiser regulatory agency because most agencies published the disciplinary action. And that would be a huge deterrent for appraisers when they see their colleagues being disciplined by the governing body.

Ms. TLAIB. So, like telling on, that is good. Ms. Rice, in your view, what would be the benefits of minimizing and monitoring discretion in the appraisal process?

Ms. RICE. I apologize. I didn't hear that.

Ms. TLAIB. Oh, that is okay. I talk really fast. I'm sorry. Ms. Rice, so what would be the benefits of minimizing and monitoring discretion in the appraisal process?

Ms. RICE. Minimizing discretion would lead to more standardization and uniformity in the process so that we remove subjectivity. Discretion and subjectivity have been found in thousands of fair housing cases to lead to discriminatory outcomes.

Ms. TLAIB. I know you heard a little bit about my district, but also in my district, the condition of our housing stock presents an additional challenge to mortgage lending appraisals. Much of our housing stock was built in the early and mid-20th Century and is in need of costly repairs. In fact, more than half of the homes in my district are valued at less than $100,000. Detroit Future City's report found that in some Detroit neighborhoods, unoccupied homes need an estimated $80,000 to $120,000 just in home repair, while the house itself may be offered at $20,000 to $60,000. There are very few home improvement loans available to my residents, just like many of our folks across the country, and residents are denied at a higher rate for home purchases. It is clear that the system isn't working for communities like mine.

And so, Ms. Rice, do you have any recommendations for how the appraisal industry should address this gap in home valuations created by home repair needs?

Ms. RICE. It would be extremely difficult for the appraisal industry to be able to address those kinds of gaps because they are so deep. And they are caused by so many errant factors, and so that is one of the reasons. I will just say that we have supported things like the Neighborhood Homes Investment Act to make up that gap that is needed for those repairs.

Ms. TLAIB. With that, and this is for anybody on the panel, are there ways that we can better integrate home repair needs into the appraisal and home mortgage process? This is something that continues to come from much of the members of the housing justice work group that I created. How do we address that? Any other ideas and policy changes?

Ms. RICE. Yes. There is a mortgage product called an Acquisition Rehab Mortgage product. And what happens then is the appraiser will assess the value of the home after the repair is done. If that after-repair value comes out where it needs to be, then the loan can go through. The homeowner can purchase the house and rehab it.

Ms. TLAIB. Thank you so much. It is a very, very important hearing. I appreciate it. I yield back, Madam Chairwoman.

Chairwoman WATERS. Thank you. The gentlewoman from Georgia, Ms. Williams, who is also the Vice Chair of our Subcommittee on Oversight and Investigations, is now recognized for 5 minutes.

Ms. WILLIAMS OF GEORGIA. Thank you, Madam Chairwoman. Unfortunately, the City of Atlanta, in my district, leads the nation in the racial wealth gap. Addressing the root causes of the racial wealth gap will help us create the promise of the American Dream for all, regardless of their race or ZIP Code, while adding trillions in output to our economy. One of the biggest routes to address is disparities in homeownership, which accounts for 27 percent of the Black-White racial wealth gap. Unfortunately, bias and discrimination in appraisals have systemically lowered home values in neighborhoods that have more residents of color, across generations. This has inhibited wealth-building for Black and Brown communities.

Mr. Bishop, how important is it for the appraisal industry to be reflective of the neighborhoods they are assessing across our country, to help end systemic undervaluation of homes in neighborhoods that have more residents of color?

Mr. BISHOP. Thank you for your question. It is very important. Diversity is one of our top initiatives in our new strategic plan. And I have gone through several initiatives to try to promote diversity, including community colleges, HBCUs, or University Relations Committee efforts, ADI, and our Appraisal Institute Education & Relief Foundation scholarships. In addition to that, the PAREA Program is envisioned to open the doors for the experience component of licensing to allow individuals entering the profession a quicker path to licensing.

Ms. WILLIAMS OF GEORGIA. Thank you, Mr. Bishop. I am currently working on legislation to help expand the appraisal workforce, including adding appraiser trainees to the National Registry of Appraisers. By doing this, we can ensure that more trainees can gain experience and become licensed. So Mr. Bishop, to follow on that, how can an effort like this to better integrate the training pipeline help recruit and retain more diverse appraisal professionals into the industry?

Mr. BISHOP. I would expect that as more new entrants of diverse individuals, people of color, and women and other minorities are entering the program or the profession, they should be telling their colleagues and your peers about this, which should generate more interest in creating more diversity. And so, that would be one place where it would start.

Another place where we might be able to help this is to get some of the clients that I worked for to allow trainees to do some of the inspections and do the appraisals we heard. Mr. Kelker already talked about how their clients won't allow trainees to be considered for their business model. We get that in my market a lot with the folks in my office, the trainees. It takes longer for them to get their experience hours to get licensed. So, that would be another area where acceptance of a trainee in the appraisal jobs that are out there would help as well.

Ms. WILLIAMS OF GEORGIA. Thank you, Mr. Bishop. Ms. Rice, what other common-sense steps can be taken to ensure that efforts to resolve appraiser shortages also serve to significantly increase diversity in the industry?

Ms. RICE. Thank you so much for the question. There are many steps that can be taken, but the one that I will mention here is the increased use of technology. Now, it will not be a panacea, and we have to make sure that the technology is debiased, and there are plenty of mechanisms for doing that. My agency, the National Fair Housing Alliance, just released a new framework, a state-of-the-art framework for effective monitoring of algorithmic systems to make sure that they are debiased. But increased use of technology can help us build more science into the process, more uniformity into the process, and more accuracy into the process.

Ms. WILLIAMS OF GEORGIA. Thank you, Ms. Rice, and thank you, Madam Chairwoman, for leading in this work as we continue to close the racial wealth gap in this country. I yield back the balance of my time.

Chairwoman WATERS. Thank you. Will the gentlelady yield to me? Thank you. I would like to ask a question. What are the qualifications for being an appraiser? What do you require?

Mr. BUNTON. For the entry level, for the licensed level, it is 150 hours of valuation education. That is classroom hours, not credit hours. It is 1,000 hours of experience over 6 months, and then you must sit and pass a State exam.

Chairwoman WATERS. So, you said you reduced the requirements from 4 years to 2 years?

Mr. BUNTON. That is for the next category, for certified residential.

Chairwoman WATERS. Okay. Thank you.

Mr. BUNTON. For license, there is no college requirement whatsoever.

Chairwoman WATERS. So, experience counts a lot?

Mr. BUNTON. It does.

Chairwoman WATERS. And how much experience do you have to have if you have very little college?

Mr. BUNTON. You must have 1,000 hours of experience over a minimum of 6 months. That makes you minimally qualified.

Chairwoman WATERS. So, over a period of 6 months that you have done what?

Mr. BUNTON. You have worked with a supervising appraiser in the field to perform assignments, because there is such a variety of real estate out there, that you need a certain amount of seasoning.

Chairwoman WATERS. So, if you have an experienced Realtist—do you know what a Realtist is?

Mr. BUNTON. Yes.

Chairwoman WATERS. Okay. If you have experienced Realtists, say they have been in the business for 5, 10 years, how does that experience count?

Mr. BUNTON. I don't really know.

Chairwoman WATERS. It doesn't count. We are going to talk about it later. Thank you very much.

The gentleman from Massachusetts, Mr. Auchincloss, who is also the Vice Chair of the committee, is now recognized for 5 minutes.

Mr. AUCHINCLOSS. Madam Chairwoman, I am happy to yield some time back to the chairwoman if she wants to continue that line of questioning.

Chairwoman WATERS. Thank you very much. I would appreciate that, because what I am thinking is that we have a lot of experienced Realtists. And it seems as if there are ways in which people could basically become an appraiser without having formalized education, and I want to know how it all works.

Mr. BUNTON. It is something that our Qualifications Board has looked at for a long time. There are many people in the real estate industry, so to speak, who have a—

Chairwoman WATERS. How does that experience count?

Mr. BUNTON. It doesn't count right now.

Chairwoman WATERS. So if you are a Realtist, and you have been doing this for 15 years, and now you want to become an assessor, you have to start from scratch and get some training and education?

Mr. BUNTON. Yes.

Chairwoman WATERS. Thank you very much. I yield back. That is what we have to deal with.

Mr. AUCHINCLOSS. I appreciate the chairwoman calling another edifying hearing on housing issues. And for this and any other subject on housing, I feel compelled to start with the imperative as we look to lower costs for families in America, and as we look to rectify the injustices of redlining and other discriminatory measures that we build more housing. We need to build more housing in this country. My home State of Massachusetts, I regret to say, is one of the laggards here.

In the last 20 years, in the Greater Boston metropolitan area, round numbers, we have created something like 2.5 jobs for every one housing unit. And you don't need to be an appraiser or a Ph.D. economist in housing issues to understand what happens next. Housing prices gallop by double-digit inflation, and its lower-income base stayers who are left behind are disproportionately, people of color. So, we need to build more housing. I am proud to say that the Housing Choice Act of Massachusetts is making progress there, but it needs a whole-of-government effort, including, in my opinion, tying infrastructure funding at the Federal level to liberalization of land use regulations at the State and local levels. The Federal Government needs to have leverage here.

Turning now to the issue at hand, Mr. Bunton, for you first, please. Following the housing crisis, Fannie Mae conducted a study about the accuracy of appraisals during the home buying process. And this study found that two appraisers can evaluate the same home at the same time of day, but that knowledge of the contract price can affect its valuation, that there is significant confirmation bias. Now, Fannie Mae and Freddie Mac hold the majority of residential mortgages, north of 60 percent, and we know that information like that from any Federal agency should help guide policy and standards. Based on this report, did your organization put in place new standards to reduce confirmation bias?

Mr. BUNTON. No.

Mr. AUCHINCLOSS. If you would like to follow up on the record with any approaches you might take in the future to reduce confirmation bias, I know the committee would appreciate that.

Mr. BUNTON. Will do.

Mr. AUCHINCLOSS. For Mr. Kelker, an Appraisal Management Company (AMC) is supposed to provide a barrier between the lender and the appraiser to decrease improper influence. Do you think that this barrier has affected confirmation bias?

Mr. KELKER. I don't know if it has affected confirmation bias. I think when an appraiser has a purchase agreement in front of them that has a certain value on it, say it is $200,000, that when he or she does an analysis of the property, if they come up with $198,000 instead of 200,000, then there is back and forth between the AMC and the appraiser, the AMC and the lender. So if the contract price is within the range, they are generally going to go with the contract price. Value is not absolute. It occurs in ranges.

Mr. AUCHINCLOSS. Very well. Ms. Rice, I want to give you the floor for this final minute. You had been mentioning in your previous answer the importance of technology here, not a panacea, as you said, but potentially a source of support. Are there any tools currently at appraisers' disposal to detect implicit bias in real time before it gets to the lender? Any kind of red flag technology?

Ms. RICE. No. No, there isn't.

Mr. AUCHINCLOSS. Might that technology be important as we look to reduce bias in appraisals?

Ms. RICE. Yes. If it were built correctly, yes, it would.

Mr. AUCHINCLOSS. And are there standards by which that technology could be evaluated to ensure that it was built correctly, to your knowledge?

Ms. RICE. Yes.

Mr. AUCHINCLOSS. Where are those standards?

Ms. RICE. I mentioned that we just released a framework.

Mr. AUCHINCLOSS. Terrific. Thank you, Ms. Rice. And, Madam Chairwoman, I yield back, and thank you again for a great hearing.

Chairwoman WATERS. The gentlewoman from New York, Ms. Ocasio-Cortez, is now recognized for 5 minutes.

Ms. OCASIO-CORTEZ. Thank you, Madam Chairwoman, and thank you to our witnesses who are here sharing their testimony today.

Today, we are focusing on the discriminatory and racist practices in home appraisals in our country. But we also know that many Black families and communities are disproportionately facing foreclosure now that pandemic foreclosure moratoriums have ended and mortgage servicers are beginning to ramp up back to full capacity.

Madam Chairwoman, I ask for unanimous consent to submit for the record the City article highlighting New York City's Black neighborhoods facing a foreclosure crisis.

Chairwoman WATERS. Without objection, it is so ordered.

Ms. OCASIO-CORTEZ. In New York City, we are starting to see that the majority Black ZIP Codes had an average of 8.48 percent of homeowners who had fallen behind on their payments for more than 30 days. That percentage is 4 times that of the majority White ZIP Code average, and 1.5 times that of the majority Hispanic ZIP Code average from September. Ms. Rice, data suggests that New York City's Black neighborhoods, which were devastated by the economic shocks and the pandemic as well as decades of predatory lending, are most at risk of foreclosure. Is this consistent with what you have observed?

Ms. RICE. Yes.

Ms. OCASIO-CORTEZ. We also know that most of the Black neighborhoods with high concentrations of struggling homeowners are in Southeast Queens and in many parts of the Bronx, areas that lenders had previously targeted with subprime loans in the run up to the 2008 financial crisis. Ms. Rice, we know that none of these financial institutions ever really paid a true cost for the financial crisis that they precipitated, especially not for the kinds of financial discrimination that Black homeowners faced and continue to face. Would you say that is a fair assessment?

Ms. RICE. Yes, it is.

Ms. OCASIO-CORTEZ. In your opinion, at the very least, in the short term, should loan servicers provide loan modifications in order to make residents' monthly payments more doable to avoid foreclosure?

Ms. RICE. Yes.

Ms. OCASIO-CORTEZ. What we are seeing here is a history and a blatant pattern. We have the pandemic and the way that banks had serviced their mortgages and loans during the pandemic. You also have that compounding on the injustices and one of the greatest wealth transfers out of the Black community in the entire United States during the 2008 financial crisis. But what we are also seeing is that we know when faced with the possibility of foreclosure, residents are more likely to sell their homes out of desperation, only to then be faced with discrimination in the appraisal value of their home when they are trying to get out of it.

Ms. Rice, the U.S. Bureau of Labor Statistics found that of the roughly 80,000 appraisers in the United States, 97.7 percent identify as White, correct?

Ms. RICE. That is correct.

Ms. OCASIO-CORTEZ. And we also know that across all majority Black neighborhoods, owner-occupied homes are undervalued by $48,000 per home on average, amounting to $156 billion in cumulative losses to Black wealth, correct?

Ms. RICE. That is correct, as per the Brookings Institution.

Ms. OCASIO-CORTEZ. This is a scandal. This is shocking, and it should truly be an affront to every single person in this country who believes in any form of financial, social, and economic equity. In fact, a study by the Brookings Institution found that on average, homes in neighborhoods where the share of the population is 50-percent Black are valued at roughly half the price as homes in neighborhoods with no Black residents. We must do better. And it has just laid bare the legacy from redlining to the way that that has transformed into, accumulated, and built into the eventual 2008 subprime loan crisis because it was Black, and Brown, and low-income communities that were especially targeted with subprime loans, and then for the pandemic foreclosure rates to be higher.

Ms. Rice, do you have any advice for us as Members of Congress, or even the general American public, in what we should be doing in order to right this wrong?

Ms. RICE. Sure. I see the time is running out, so I will just say briefly, adopt the recommendations in the PAVE Action Plan, and implement those actions. And we also have a bevy of recommendations that we put forth in our analysis and study of the appraisal industry that I also would recommend being put in place.

Ms. OCASIO-CORTEZ. Thank you very much.

Chairwoman WATERS. Thank you very much.

I now ask unanimous consent to insert statements from James Park, executive director of the Appraisal Subcommittee of the Federal Financial Institutions Examination Council, and from Jillian White, Head of Better-Plus at Better.

Without objection, it is so ordered.

At this time, I would like to thank our witnesses for their testimony today.

The Chair notes that some Members may have additional questions for these witnesses, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

With that, this hearing is adjourned.

[Whereupon, at 1:29 p.m., the hearing was adjourned.]

A P P E N D I X

March 29, 2022

Hearing: Full Committee Appraisal Hearing
Member: Ranking Member McHenry
Date: March 29, 2022
Time: 2.72 min (373 words)

Thank you, Madam Chair, for holding this hearing today.

Accurate appraisals are a vital component of the homebuying process.

They provide important guidance to lenders offering mortgages, as well as financial protection to the taxpayers backing those loans.

This is important given the magnitude of the total value of all outstanding U.S. mortgage debt, which currently totals $12 trillion dollars.

Appraisals also add market confidence to homebuying consumers, who deserve a fair and honest valuation of their investment.

In other words, honest, independent appraisals are incredibly important in maintaining the safety and integrity of mortgage lending in America.

So when we hear allegations of racial bias in the valuation process, that's a major problem, for many reasons.

It is unlawful—not to mention immoral–to discriminate against someone in these transactions on the basis of race, color, religion, sex, disability, familial status, or national origin.

Such discrimination is a crime. And if a crime is being committed, our government should be committed to stopping it.

Some have alleged, often based on anecdotes or assumptions, that racism exists in the appraisal profession that helps perpetuate systemic racism.

That's a serious charge that demands serious consideration, not to mention hard evidence to back it up.

Yet, a lot of questions remain about *what* exactly is happening here, and also *why*, and I hope our witnesses today can help shed some light on the facts before we leap to any conclusions.

I would note that while this hearing is focused on the potential impact of under-valuations in appraisals, there should be an equally serious concern about the impact of over-valuations in appraisals.

Over-valuations require consumers to take on more debt, reduce affordability by endlessly spiraling home prices ever higher and higher, and literally destroyed $16 trillion dollars' worth of household wealth back in 2008.

If we are going to demand fairness and accuracy in appraisals – which we should –it is critical that we examine all of the factors that harm appraisal quality, lower competition, and inhibit market innovation.

That's the only way to ensure we can get a fair market valuation of assets for both lenders and purchasers.

I hope that we can accomplish that today, in a bipartisan manner.

Thank you, and I yield back.

Written Testimony of Pledger M. (Jody) Bishop, MAI, SRA, AI-GRS
President of the Appraisal Institute
Before the House Committee on Financial Services

March 29, 2022

Thank you for the opportunity to testify at today's hearing. The Appraisal Institute is deeply concerned about recent allegations of bias and discrimination in housing and appraisal. When just one individual conveys concern or uneasiness about bias or discrimination during an appraisal assignment, we must stop and listen, and seek to understand the consumer's experiences. Further, where issues or problems are identified, we must seek to understand the causes and work with stakeholders to resolve them.

To be an appraiser is to be independent and unbiased. It is our ethos and at the core of a professional appraiser. There is no benefit to an appraiser in violating this public trust. We firmly believe most appraisers uphold this high standard and strive to learn more and develop protocols to increase confidence and credibility in their work.

Appraisers are subject to the Fair Housing Act and Equal Credit Opportunity Act. Bank regulations require independent and unbiased appraisals, as do the requirements of the government-sponsored enterprises and loan guarantee agencies. Further, appraisers are subject to state licensing requirements that include adherence to uniform appraisal standards requiring appraisers to perform their work in an unbiased and objective manner. These requirements should be vigorously enforced.

The appraisal process has come under study and review by several researchers, think tanks, and the government-sponsored enterprises, and that has been welcomed by the Appraisal Institute. Although some of the results as to bias in appraisal are preliminary and others have produced contradictory conclusions, these findings have educated all stakeholders to better understand the appraisal process and how it fits into a larger ecosystem of mortgage finance and risk management. We strongly believe that even one instance of appraisal bias is unacceptable.

To directly address the issues that have been identified, the Appraisal Institute has conducted our own introspective review of the profession and launched several collaborative initiatives.

Prioritizing Diversity, Equity, and Inclusion

Since 2019, the Appraisal Institute has helped lead the Appraiser Diversity Initiative (ADI), an industry collaboration with Fannie Mae, Freddie Mac and the National Urban League that promotes the appraisal profession to diverse communities. ADI helps raise awareness by hosting workshops (both in person and virtual) throughout the United States. These workshops educate participants about professional opportunities in real estate appraisal, inviting interested participants to apply for education scholarships.

ADI is a private sector initiative, but it was recognized by the Property Appraisal and Valuation Equity (PAVE) Task Force Action Plan for its early progress in addressing diversity issues within the profession. As of today, the program has awarded approximately 150 scholarships with 18 individuals who have completed the education requirements and been successfully placed in positions. Around 100 individuals are currently enrolled in the required qualifying education courses. For 2022, the initiative's goal is to host at least seven events and provide 200 scholarships to support minorities and women in the appraisal profession.

ADI has secured several sponsors that have provided additional support in adviser, supervisory and field experience sponsorship, financial support, hosting workshops, as well as promoting and advertising upcoming workshops. This includes a $3 million commitment from Chase Bank in support of the ADI.

Other Activities

Beyond the ADI, decreasing barriers to entry into the profession is something the Appraisal Institute is focused on through the development of a Practical Applications of Real Estate Appraisal (PAREA) program. PAREA will provide an alternative to the traditional supervisory appraiser-trainee model for gaining experience in real estate appraisal. Through PAREA, experience is cultivated in a simulated environment without the need to identify a supervisory appraiser. PAREA leverages technology, and the vast body of knowledge of the Appraisal Institute and the network of the National Society of Real Estate Appraisers – the nation's oldest and largest professional association of black real estate appraisers - to present valuation scenarios to aspiring appraisers. These scenarios are monitored by a team of experienced real estate appraiser mentors. It is akin to pilots who gather flight experience in cockpit simulators or surgeons that expand their skills virtually. This application is rapidly under development, and we hope to bring it to market next year. Participant priority will be given to veterans, minorities, and women and those in underserved rural areas.

The AI also promotes the services of minorities and women through the Minority and Women's Directory of the AI Find an Appraiser service. This directory helps clients identify diverse appraisal service providers throughout the country, where service and practice areas can be cross-referenced by property type and other factors. This program also allows members to report additional credentials they may hold, including Minority Business Enterprise designations.

An internal review of policy and procedure has led to the adoption of a new Strategic Plan by our Board of Directors that recognizes diversity, equity and inclusion as a top priority. As part of this proactive effort, the AI has adopted a diversity statement, and is currently conducting a review of policies and procedures in developing a diversity action plan approved by the Board of Directors.

We have also been involved in surveying the profession to better understand demographics. Clearly, there is a great deal of work to be done here, as the profession heavily leans white, male and a high percentage are nearing retirement. We do not capture race, ethnic, or gender information of our membership or Board of Directors, but photographs of our Board of Directors can be found on our website1. We have conducted or helped develop surveys in recent years, and we are supportive of the Appraisal Subcommittee's Census/Survey project announced last year and assisted their researchers in the initial scoping.

Leading Education Development

Our organization has been active in developing education and supporting valuation bias and fair housing training requirements for appraisers at the federal and state levels. This work continues, but it has benefitted by new state laws that have been enacted over the past two years that can serve as models for other states looking to bolster education, awareness and understanding.

- The Appraisal Institute has worked with state legislators and other stakeholders to encourage the adoption of fair and reasonable requirements for currently licensed and certified appraisers to complete valuation bias and fair housing continuing education on a one-time or recurring basis. California, Minnesota, New York, and Virginia have recently enacted new laws to require continuing education in these topic areas. These new requirements are in addition to long standing requirements for fair housing qualifying education in Ohio. Several other states are considering similar requirements.

- In 2021, California passed the "Fair Appraisal Act" [2] that contains multiple provisions related to appraisal bias. All residential sales contracts must include a statement promising that appraisals are unbiased and not influenced by improper or illegal considerations. Refinance transactions must have the same statement included within the loan documents provided to borrowers. The state's Bureau of Real Estate Appraisers (BREA) must change its complaint form to include a way for individuals to note their belief that their appraisal was below market value; BREA is required to collect data regarding complaints that allege low valuations and report its findings to the state legislature on or before July 1, 2024. Further, the legislation makes it a violation of licensing law for appraisers to base their opinions of value on any of the recognized protected characteristics and makes it a

[1] Available at https://www.appraisalinstitute.org/about/about-the-appraisal-institute/board-of-directors/

[2] AB-948 Bureau of Real Estate Appraisers: disclosures: demographic information: reporting: continuing education.

violation of the California Fair Employment and Housing Act for appraisers to discriminate based on any of the recognized protected characteristics.

- Two states – Illinois and Maryland – each have legislation currently pending that would create a task force to study whether there are things that can be done on a state level to ensure that all appraisals are fair and equitable and to reduce barriers to entry into the profession. Many of the topics to be considered by these task forces are like those studied by the PAVE Task Force and that were discussed in the Appraisal Subcommittee's "Identifying Bias and Barriers, Promoting Equity: An Analysis of the USPAP Standards and Appraiser Qualifications Criteria" report.

The Appraisal Institute is the profession's leading provider of appraisal education, and we have been active in the development of education for appraisers and others on valuation bias and fair housing. We have hosted several recent events with industry partners on fair housing and valuation bias issues, which have been made available free to the public and appraisal community. We have also commissioned the development of a seminar for appraisers on valuation bias issues, which we hope to debut later this year. Lastly, at the upcoming Appraisal Institute Annual Conference in August, we will be hosting several sessions that focus on diversity and ethics, and valuation bias related issues. We have proven to be a willing partner with stakeholders, and we remain open to building additional relationships that help further education and awareness of these important issues.

Ethics and Guidance

Over the past two years, the Appraisal Institute has strengthened its ethics rules and Code of Professional Ethics (CPE). This includes a revised definition of "Personal Characteristics" in the CPE to include more recognized protected classes and those applicable laws may provide further protection for personal characteristics. Further, we approved a new ethical rule that one must refrain from conduct that is detrimental to the Appraisal Institute, the profession and the public. This prohibits the development of an analysis, opinion or conclusion and the transmission of a report based on protected classes and any personal characteristics under applicable law unless consideration of a particular personal characteristic is relevant to the assignment. [3]We also updated our canons to prohibit biasness in valuation practice with the added statements making it clearer that the prohibition of bias in development and reporting of an analysis, opinion and conclusions specifically extends to protected classes and protected characteristics under applicable law. Lastly, our Board of Directors has approved an exposure draft to further strengthen the ethics rules pertaining to when an appraiser engages in discriminatory conduct and makes derogatory statements based on actual or perceived personal characteristics. This proposal extends the conduct requirements of an AI member, candidate, practicing affiliate or affiliate anytime they identify themselves as someone who provides appraisal, review, or other valuation related services, and includes examples of violations of the ethical rules.

In the area of guidance, in 2020, the Appraisal Institute released a *Guide Note on Personal Characteristics and Valuation Practice.* An appraiser must be unbiased. An appraiser's opinions and conclusions must be prepared in an unbiased manner, and they must be credible, which means they must be supported with relevant data and analyses. This Guide Note confirms that appraisers and reviewers have a professional responsibility to ensure that appraisals are prepared fairly and without bias relating to personal characteristics. Personal characteristics are characteristics of an individual or group of individuals such as (but not limited to) race, color, religion, national origin, gender, sexual orientation, gender identity or expression, marital status, familial status, age, receipt of public assistance income, disability, or any protected characteristic under applicable law. The characteristics of people – including but not limited to people who occupy a subject property, live in the area, or are in any way associated with a transaction – are, with limited exceptions, not relevant to the development of any value opinion. Relevant characteristics in the valuation of a property include its physical and economic characteristics, not the personal characteristics of those who are in any way connected to the property. Value is an

[3] One example might involve analysis of age-restricted housing.

economic concept. Value is created because there is effective demand, not because of the characteristics of people.

The PAVE Report

The Appraisal Institute actively participated in the listening sessions held during the development of the PAVE Action Plan, and we met multiple times with agencies and Biden administration staff to discuss ideas and issues of concern. This includes facilitating a "ride-along" with a Designated Member of the Appraisal Institute for members of the PAVE Task Force to illustrate the appraisal process.

Reconsideration of Value

One portion of the Action Plan we strongly support is the issuance of guidance and new policies to improve the processes by which a valuation may be reconsidered if the initial value is lower than expected. The policies for a reconsideration of value (ROV) can vary depending on the type of institution and oversight mechanisms. This leads to frustration for both borrowers and appraisers. "The original appraisal stands" is commonly communicated to borrowers in response to a ROV request, with no explanation of the level of review that was completed, the qualifications of the reviewers, or any justification for supporting the original appraisal.

We believe the Veterans' Administration's (VA) "Tidewater Initiative" would serve as a strong model for the industry to implement, balancing consumer rights of appeal with appraiser independence. The Tidewater Initiative is a formal process established by the VA for when an appraisal is below a contract price. Once a VA appraiser supports a value opinion and invokes the Tidewater Initiative, the parties are notified, and they have two days to provide additional relevant information to the appraiser. That information is reviewed and the VA decides whether the value is correct. In the distant past, and prior to appraiser licensing requirements, this type of arrangement was common as a matter of courtesy, offering opportunities for stakeholders to provide additional relevant information and to mitigate any concerns prior to completion of the appraisal. This kind of mitigation on the front end would clearly be helpful to address some of the concerns recently reported in the media.

Education and Awareness

We also strongly support the appraiser, lender and consumer education goals found in the Action Plan. Our organization has been active in developing education and supporting valuation bias and fair housing education requirements for appraisers at the federal and state levels. This work continues, but it has benefitted by new laws that have been enacted over the past two years that can serve as models for other states looking to bolster education, awareness and understanding. Further, the Task Force and agencies involved in the implementation of the Action Plan will undoubtedly require greater education, awareness and understanding of the appraisal process moving forward, whether related to enforcement through appraisal review or basic understanding of appraisal methods and techniques. We stand ready to assist in fostering greater understanding of the appraisal process for all stakeholders.

PAL Act Information Sharing

The Action Plan includes many recommendations for interagency coordination and action, including information sharing between agencies. One item of the Action Plan that stands out is the need for interagency coordination on information sharing amongst appraisers and appraisal management companies across state lines. We have long advocated for states to coordinate the licensing functions through a common platform, or portal, like the Nationwide Mortgage Licensing System for mortgage originators. This proposal has been introduced in the last two sessions of Congress as the Portal for Appraisal Licensing Act (HR 5756). We strongly suggest this bill serve as a foundation for future regulatory reforms for the industry to improve information flow at the federal and state levels and for industry practitioners and stakeholder organizations.

Additional Considerations

- *Appraiser Qualifications*- We believe instances of potentially sub-par or otherwise problematic appraisals could be mitigated by hiring highly qualified appraisers who also have market and geography competency at the outset. This is not always the case, as the turnaround times and price of the appraisal often are bigger factors in the appraisal assignment process. Beyond this, lender appraisal management could be strengthened by engaging qualified appraisal review staff, coupled with better communication with borrowers as to what level of review was completed and what was identified during that review in response to appeals.

- States issue several types of licenses and certifications for appraisers, and private organizations may confer professional designations that exceed these requirements. It's important to work with the most highly qualified appraisers such as Appraisal Institute Designated Members who have completed more rigorous training and are bound by a higher Code of Professional Ethics.

- *Automated Valuation Models* - The idea of technology and automated valuation models (AVMs) being used to resolve valuation bias concerns has been offered by many. The Action Plan includes an initiative to develop a long-awaited quality control standard for AVMs. We support the idea of including a component in the standard that addresses bias or discrimination, but the idea that policy might whisk away biases – some of which are systemic within the market – is potentially short-sighted and dangerous. One thing to be noted is that a good portion of the research that has been conducted has evaluated automated valuation model data – not appraisal data, including the contrasting research from the Brookings Institution and the American Enterprise Institute. We cannot overlook the Zillow CEO's statement in the 4th Quarter of 2021 concerning the "difficulty of accurately estimating market value" as a concern for AVM reliability.

- *Appraisers "making" the market* – a belief is held by some that appraisers control or set the market through their work. The thought process goes that the market starts with the appraiser "assigning" value to the property and buyers, sellers, agents, and the rest of the market responding to the appraisal. This view is not consistent with our experience. In our work, the market is driven by buyers and sellers, and their actions are reflected in sales data, which includes the terms of the sale, including any sales concessions or other considerations. Purchase price is a fact. Appraisers use the "facts," analyze this activity, and apply local market knowledge and professional judgment as an unbiased and independent actor to develop a credible and well-supported opinion of value (appraisal) for a specific property as of a single date in time. As an opinion, it is not a "fact" that can be found. Opinions require support. They should be logical and follow reasoning. Any formal appraisal review requires forensic analysis and understanding. These points are missing from today's conversation.

- Appraisers don't set the market, they reflect it. Think of appraisers as referees in a sporting event. They're a disinterested third party whose focus is on fairness for all parties involved and generating credible, reliable opinions of value.

- *The ecosystem and guidelines* - Appraisal is one piece of a larger ecosystem to look at when it comes to housing issues. Appraisal groups are working alongside consumer groups, real estate brokers and agents, banks, government agencies, think tanks and others to explore where housing inequities may stem from and what combination of solutions should be considered.

- The Action Plan touches upon the idea of interagency coordination around certain activities, including ROV policies. One step that we believe would benefit all parties involved is greater coordination on lender collateral valuation guidelines that are established by the agencies and enterprises and used by mortgage lenders and others in the review process. These guidelines drive much of the review process in today's mortgage ecosystem – automated review systems have been created based upon these rules to optically screen appraisals via computer to flag information that may be inconsistent or questionable. While these guidelines have a great deal of consistency, variations can be found as they relate to the acceptance or application of certain approaches to value. More to the point, we believe the agencies and enterprises could work with the appraisal profession, consumer groups and others to address challenging issues or topics. This would help bring focus and greater consistency to the approach by all parties within the mortgage ecosystem.

- *Uniform Appraisal Dataset/Forms Updat*e – Fannie Mae and Freddie Mac, overseen by the Federal Housing Finance Agency, have been working on an update to the Uniform Appraisal Dataset and uniform appraisal forms developed and maintained by the GSEs for many years, and this work is nearing the finish line. Much of the mortgage appraisal process today centers around the seller/servicing guidelines mentioned above and the UAD and the Uniform Residential Appraisal Report. The UAD defines all fields required for an appraisal submission for specific appraisal forms and standardizes definitions and responses for a key subset of fields. The update project aims to improve the quality and consistency of appraisal data for loans delivered to the GSEs and to move away from a form or guideline driven process to one relying on the analysis of the appraiser backed by more consistent and richer data. These projects are significant and could be transformational to the entire appraisal process. We urge that this work be allowed to proceed unabated.

- Data is the lifeblood of the appraisal profession, and our organization welcomes the opportunity to discuss how we can get better data in the hands of appraisers. This not only would add value to appraisal assignments, but result in more credible outcomes for consumers as well.

Legislative Proposal

The Action Plan calls for significant regulatory and oversight changes but does not outline specific plans. Transparency and accountability are important, but these goals should be balanced with maintaining industry independence and promoting entry into the profession. When The Appraisal Foundation was created as a private entity, it was intentional to prevent outside influences from Agencies and those with vested interests in the transactions, which was identified as a cause of the S&L crisis. While a reasonable construct then, lack of any oversight is not best practice. The proposal to create a new federal agency is not the right answer and is inconsistent with other industry standards-setting governing models. There are a wide variety of governance models in the marketplace that we can turn to for ideas to promote accountability, oversight, and transparency.

In closing, we must be careful to balance the proposals for increased regulatory requirements on appraisers and potentially significant additional work in the event value conclusions are challenged, with the efforts to make this an attractive, attainable, and diverse profession. We see the difficulties of attracting new individuals to the profession under the current appraisal business and regulatory environment. Increased regulation may be more unattractive and dissuade new entrants to the profession.

The proposed increased regulation, review and audit of appraiser files resulting from a complaint of undervaluation due to bias does not reference due process. Due process must remain a central part of any reform. We need better consumer appeals processes, but we also need to protect appraiser independence. This is a tough balance, but it is one that is necessary to protect the health of our banking and real estate markets.

Testimony of
David S. Bunton, President
The Appraisal Foundation

Devalued, Denied, and Disrespected: How Home Appraisal Bias and Discrimination Are Hurting Homeowners and Communities of Color

U.S. House of Representatives
Committee on Financial Services

March 29, 2022

The Appraisal FOUNDATION
Authorized by Congress as the Source of Appraisal Standards and Appraiser Qualifications

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INTRODUCTION

Madam Chair and members of the Committee, The Appraisal Foundation greatly appreciates the opportunity to appear before you today to offer our perspective on the regulation of real estate appraisers and combatting bias and discrimination in the profession.

There are many misconceptions about the Foundation and let me begin by stating that the Foundation is not:

- a government agency or regulatory body;
- created by Congress;
- an appraisal trade association.

Rather, the Foundation:

- is a non-profit 501(c)(3) educational organization;
- was founded by eight national appraisal organizations 35 years ago;
- sets standards of excellence, promotes education and upholds the public trust;
- serves as an umbrella organization comprised of approximately 100 organizations and government agencies with an interest in valuation (Attachment 1);
- was created to foster professionalism in appraising;
- strives for excellence, consistency, unity and trust in the valuation profession.

We provide private sector expertise in the real property appraiser regulatory system. The Foundation was given specific authority by Congress in 1989 (Title XI of FIRREA) regarding the real property appraiser regulatory system. The Foundation does not have any regulatory authority, but it provides tools for the regulatory community. Specifically:

- individuals seeking to become a trainee appraiser, supervisory appraiser, state-licensed or certified appraiser must meet the minimum qualification requirements established by the Foundation's Appraiser Qualifications Board (AQB);
- all states and territories must use licensing and certification examinations either issued or endorsed by the Foundation's AQB; and
- all state licensed and certified real estate appraisers must adhere to the *Uniform Standards of Professional Appraisal Practice* (standards of conduct) written by the Foundation's Appraisal Standards Board.

On behalf of the Foundation, as a fair, impartial, and objective resource on valuation-related issues, thank you for the opportunity to address the specific topics on which you are seeking our perspective.

OVERVIEW

The Uniform Standards of Professional Appraisal Practice, which lays out the professional standards appraisers must follow, has prohibited appraisers from acting with bias or discriminating against protected classes since Day One. This has been a cornerstone of the appraisal profession for over three decades, and even a single allegation of bias or discrimination is deeply concerning and undermines the public's trust in the appraisal profession.

The allegations of bias and discrimination we have seen in the press make it clear that more must be done to protect the public's trust in the appraisal profession. Even before these press reports were beginning to emerge, The Appraisal Foundation was taking action to address concerns of bias, discrimination and a lack of diversity in the appraisal profession.

We have undertaken a number of initiatives aimed at combatting bias and discrimination and promoting diversity, equity and inclusion in the profession.

The process through which The Appraisal Foundation's boards adopt standards and qualifications closely mirrors federal rulemaking. All changes are publicly exposed for a comment period, and boards will often go through multiple drafts of proposed changes before making them final. All meetings regarding these changes are held publicly with an opportunity for anyone to provide verbal or written comments. Boards adopt changes in a public vote, and all 55 jurisdictions are given ample notice, often as long as ten months to even two or three years before changes become effective. These changes are also always reviewed by a regulatory attorney. Upon receiving congressional authority, Standards 1-4, those covering real property appraisals, were published in the Federal Register.

As an additional measure, we have now retained the noted civil rights and fair housing firm Relman-Colfax. They will review any and all proposed changes to the standards and qualifications going forward to ensure that the public's trust is protected.

The Appraisal Standards Board is also currently undertaking a comprehensive review of the Ethics Rule. Bias and discrimination against protected classes have always been prohibited by our standards. But we want to ensure that is crystal clear to everyone. Following concerns raised by federal regulators, the standards board decided to undertake this review in conjunction with these regulators to ensure that the language of the Ethics Rule is in line with its intent.

This is just a small part of The Appraisal Foundation's broader efforts to promote public trust in the appraisal profession, combat bias and discrimination, and promote diversity equity and inclusion. Our boards look forward to continuing this work in conjunction with federal regulators and stakeholders, as we have for the last 33 years.

SPECIFIC TOPICS OF DISCUSSION REQUESTED BY THE COMMITTEE

The Appraisal Regulatory System

The appraisal regulatory system is unique. Under Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Congress authorized The Appraisal Foundation to write and maintain the standards and qualifications for real estate appraisals. These standards and qualifications are adopted by states and carry the force of law. The Appraisal Subcommittee is empowered to provide oversight for states and monitor and review The Appraisal Foundation.

Given its role developing standards and qualifications that will become state law, The Appraisal Foundation takes its responsibility as a standard setter seriously. Its boards follow a rulemaking process that closely mirrors federal rulemaking. All changes are exposed for public comment on multiple occasions before any changes are adopted in a public meeting. States and stakeholders often have at least ten months and sometimes as long as three years notice before any of these changes go into effect. From open meetings with public input, to review of thousands of comment letters, the ASB and AQB seriously consider every comment and suggestion.

The Appraisal Foundation does not have regulatory authority but provides the tools for regulators. Currently, the Appraisal Subcommittee conducts biennial reviews of a state's compliance with the Foundation's qualification criteria but does not determine if the appraisal standards are being applied correctly and consistently across the states. The standards can be as strong and clear as possible, but if the federal regulator authorized to make certain Title XI of FIRREA is being properly implemented does not check for proper application of the standards, then instances of bias and discrimination may be going unchecked.

The Appraisal Subcommittee's commissioned National Fair Housing Alliance study of appraisal standards and appraiser qualification criteria calls into question the actions of Congress in creating the current appraiser regulatory system. In addition, draft legislation publicly noticed for this hearing proposes to decimate the current system by removing functions of the private sector and the state appraiser regulatory bodies to an expanded Appraisal Subcommittee under a new agency name. Both appear to be based on limited or mistaken information and the Foundation encourages the authors to work with us and the broader valuation community to develop solutions that will not be damaging to consumers, to users of appraisal services, and to the public trust in valuation.

Recommendations:

- The Appraisal Subcommittee should determine if a state is applying appraisal standards correctly and consistently as part of their biennial review.

- The National Fair Housing Alliance, federal regulators, and others with an interest in valuation should collaborate with the Foundation and its 100+ affiliates in developing solutions to overcome issues of bias or discrimination in appraisals.
- Congress should retain and build upon the current appraiser regulatory system that is based on mutual respect and collaboration rather than decimate it.

Data on Bias and Discrimination Complaints

Even one allegation of bias and discrimination in an appraisal is one too many. Currently, there is no way for anyone to know or to track the number of complaints that have been received alleging bias or discrimination in the United States or how those complaints are adjudicated.

This lack of data derives from a couple of issues. The first being that there is no central point for consumers to submit appraisal complaints. The Appraisal Subcommittee is congressionally authorized to track appraisal complaints received by its national hotline but has not done so. This hotline operates as a referral service but does not intake any data on the consumers who call in.

This creates a data gap. The hotline might refer a consumer to a state appraiser board, civil rights commission or the U.S. Department of Housing and Urban Development, but it does not register the complaint or follow up to see how it was adjudicated.

The Appraisal Foundation believes that this data is critical to understanding the full scope of the issues facing the appraisal profession. It will also give the profession an initial benchmark to begin measuring progress as efforts to combat bias and discrimination continue.

Being able to track an appraisal complaint from start to finish also provides a unique learning opportunity for appraisers to learn to identify bias and avoid it in their appraisal practice. This data could be a powerful teaching tool in addition to a way to measure progress in eliminating bias from the profession.

Recommendation:

- The Appraisal Subcommittee should act on its congressional authorization to track appraisal complaints received by its national hotline, including how those complaints are resolved and share that data with regulators and stakeholders.

Promoting Diversity in the Appraisal Profession

As has been recognized in the PAVE action plan and in our own demographic research, the appraisal profession is predominantly white, male and over age 55. This is not reflective of the United States we live in today, and The Appraisal Foundation has been committed to promoting diversity in the appraisal profession.

The Appraiser Qualifications Board (AQB) takes seriously its efforts to establish appraiser qualification criteria to be the minimum needed for those doing appraisals to be qualified and have the necessary understanding to perform appraisal assignments. These Criteria are reviewed periodically against the findings of occupational analysis to make certain they meet the baseline.

As an example, in 2018 the AQB cut the experience hours in half for those seeking to become licensed or certified residential appraisers finding that the expanded education and technology available to aspiring appraisers were sufficient to warrant a lower experience requirement. That same year, the AQB reduced the college education requirements for licensed and certified residential appraisers – and developed a pathway from licensed or certified that requires no college education.

The AQB has also looked for more innovative ways to provide aspiring appraisers a path into the profession. After the passage of Dodd-Frank, it became much more difficult for aspiring appraisers to find a supervisor. To fill this growing need, the AQB has developed the Practical Applications of Real Estate Appraisal (PAREA). This alternative pathway for an aspiring appraiser to meet their experience requirements is a simulated training that allows participants to fulfill their experience hours in their home and includes interaction with experienced appraisers who are provided to the participant through the program.

There are currently eight PAREA programs in development, and we expect to see at least two publicly available to aspiring appraisers by the end of 2022. The arrival of this highly anticipated program will open up the profession to a whole new generation.

The AQB is responsible for setting the minimum qualification criteria for appraisers, but states and federal agencies can, and do, go beyond these minimum requirements in determining whether or not they consider an appraiser to be qualified.

For example, the Federal Housing Administration (FHA) will not accept licensed appraisers, the lowest credential level which does not require a college degree, following the passage of the Housing and Economic Recovery Act of 2008. This has caused the number of licensed appraisers in the United States to plunge from over 30,000 to under 8,000 in less than 15 years.

Licensed appraisers are permitted to appraise any residence under one million dollars, which makes them qualified to conduct FHA appraisals. Legislation should be considered to rescind the requirement for an appraiser to be certified rather than licensed to complete this work. Likewise, federal agencies should examine their requirements for appraisers and harmonize them with the AQB minimum criteria.

Recommendations:

- Federal agencies should harmonize their appraiser qualifications regulations to mirror Appraiser Qualifications Board minimums.
- Congress should pass legislation allowing licensed appraisers to perform FHA appraisals.
- States should accept the Practical Applications of Real Estate Appraisal for

100% of an aspiring appraiser's required experience hours.

Combatting Bias and Discrimination in the Appraisal Profession

There is no place for bias or discrimination in the appraisal profession. The Appraisal Foundation has been working tirelessly to root out any bias or discrimination in the profession.

Since the day the Uniform Standards of Professional Appraisal Practice were first adopted over thirty years ago, bias in an appraisal has been prohibited. But it is clear that more needs to be done to protect the public trust.

The Appraisal Foundation's efforts to combat bias and discrimination include:

- A comprehensive review of the Ethics Rule in the Uniform Standards of Professional Appraisal Practice (USPAP) to ensure it is clear that bias and discrimination are prohibited.
- Retaining the prominent fair housing firm Relman Colfax to review current standards, qualifications and courses as well as any future proposed changes to the standards and qualifications through a fair housing lens.
- Including bias as it relates to USPAP as a central component of required continuing education for all appraisers.
- Providing public notice, exposure drafts and opportunities for public participation for work products of the Appraisal Standards Board and Appraiser Qualifications Board.
- Publishing final Standards and *Qualification Criteria* at least 30 days prior to the effective date.
- Developing an alternative pathway for an appraiser to gain experience hours without a supervisory appraiser. The first modules adhering to this pathway, called the Practical Application of Real Estate Appraisal (PAREA), are expected to be available in the first half of this year.
- Monitoring the demographics of the profession and making that data publicly available.
- Reducing barriers to entry to the appraisal profession by creating a pathway from a licensed credential to certified residential credential without a college degree.

It is heartening that the PAVE Task Force echoes The Appraisal Foundation's commitment for clear guidance to appraisers and education for consumers. The Foundation looks forward to starting a dialogue with the Task Force on possible paths for collaboration to continue to advance these shared goals.

Recommendation:

- The PAVE Task Force should engage with The Appraisal Foundation to provide input on standards and qualifications and explore avenues for collaboration to combat bias and discrimination.

Promoting Diversity at the Foundation

The Appraisal Foundation's work to promote diversity, equity and inclusion has not just focused on the appraisal profession itself, and while Foundation staff demographics are 92% female and 50% Black or African American, the Foundation has also been working to increase the diversity of its boards and stakeholders.

In summer 2021, the Foundation hired Aubrey Blanche, a diversity consultant, to review the processes for selecting board members for the Foundation's management board and its two technical boards. Ms. Blanche's analysis revealed that the Foundation was following best practice for both its trustee nominating and board nominating cycles, but she recommended improvements to these systems.

These recommendations included a rubric scoring system as well as a blind scoring process that the Board of Trustees is now implementing. This process is still ongoing, but after the first round of application review, the Board is pleased to be considering its most diverse pool of candidates ever.

To measure the impact of these efforts, the Foundation surveyed our current boards for baseline demographic data. This data reveals gender and racial diversity at 40% female and 9% Black, African American, or American Indian with 3% preferring not to answer. These insights show there is room for growth.

The Appraisal Foundation is continuing to consider recommendations put forth by both the National Fair Housing Alliance's study of appraisal standards and appraiser qualifications and the PAVE task force.

Two recommendations the Board of Trustees is strongly considering are to enhance the participation of consumer advocates and civil rights organizations in the Foundation's rulemaking process.

The first of these recommendations is the establishment of an advisory council consisting of consumer advocates and civil rights organizations. Currently the Foundation has two advisory councils, the Industry Advisory Council and The Appraisal Foundation Advisory Council, consisting of industry partners and non-profit organizations respectively. Each of these councils provides guidance to the technical boards by offering comments on any proposed changes to the standards and qualifications and has the ability to appoint one trustee to serve on the Board of Trustees. This newly created council would have those same rights.

The Board of Trustees is also considering adding a public member to each of the two technical boards, the Appraisal Standards Board and Appraiser Qualifications Board. The Board of Trustees has a seat reserved for a consumer advocate and has, at times had more than one consumer advocate on the board, but this has not extended to the technical boards. These boards have historically required members be subject matter experts in the appraisal standards or appraiser qualifications. The National Fair Housing

Alliance study demonstrated the wisdom of having public members present throughout the development of proposed changes.

The Appraisal Foundation prides itself on being an open, transparent organization. The Foundation's boards will continue to seek ways to increase its accessibility to the public through partnership with regulators and stakeholders. The Foundation is well-respected as the umbrella for all with an interest in valuation, and we encourage the NFHA, the PAVE task force federal regulators, and all with an interest in valuation who have not yet done so to join with us and the broad array of stakeholders across the country working collaboratively to uphold the public trust.

Recommendations:

- The Foundation will begin tracking its board demographics and set goals for all three of its boards to maintain a more diverse membership.
- The Foundation will review its application and interview process for all three boards on an ongoing basis to ensure that the process is fair and equitable.
- The Foundation will establish an Advisory Council consisting of consumer advocates and civil rights organizations to provide input on all future changes to the standards and qualifications.
- The Foundation's Board of Trustees will explore adding a public seat to each of the Foundation's technical boards to ensure that the consumer perspective is always represented in any proposed changes to standards and qualifications.

Benefits and Limitations of Automated Valuation Models (AVMs)

Appraisers always welcome more and better data. Credible AVM data helps appraisers produce meaningful and robust analysis of the subject property, but not all AVM outputs are reliable. It is widely known that AVMs are very good at dealing with homogenous properties but are not able to provide accurate and reliable conclusions when a market is diverse or transitioning. AVMs can play a role in reducing bias only by having to adhere to regulatory standards and by operating in a transparent and testable manner. Additionally, it is paramount that users of AVMs, including lenders and consumers, understand what the model's output means and have a way to challenge the AVM output.

The Appraisal Foundation Industry Advisory Council has been studying the foundational requirements for AVM standards over the last 18 months. The IAC AVM Task Force comprised of industry leaders, academicians, algorithmic modelers, and analysts is nearing completion of a comprehensive report on the topic. The report will be shared with the federal banking regulatory agencies charged in Dodd Frank to develop AVM standards.

Recommendations:

- The Appraisal Foundation will share the report of the IAC AVM Task Force with the federal banking regulatory agencies to inform and aid them in their work.
- Federal banking regulatory agencies should develop AVM standards as set forth in Dodd Frank in consultation with the Appraisal Standards Board and ASC staff.

CONCLUSION

The Appraisal Foundation is committed to fostering an appraisal profession that maintains public trust and is reflective of the population of the United States. This goal is only attainable with the collaborative engagement of all stakeholders as Congress intended when it created the current model which has been fostered over the following three decades since FIRREA was enacted. The Foundation shares the concerns and goals of the Biden Administration's PAVE Task Force and hopes to partner with the task force to continue advancing their shared goals.

The Appraisal Foundation appreciates the opportunity to share our perspectives with you today and we urge this Committee and all members of Congress to continue to use the Foundation as a resource on valuation-related matters.

The Appraisal FOUNDATION

Authorized by Congress as the Source of Appraisal Standards and Appraiser Qualifications

The Appraisal Foundation Advisory Council:

ORGANIZATIONS OF APPRAISERS

American Society of Appraisers *
American Society of Farm Managers and Rural Appraisers *
Appraisers Association of America *
Association of Independent Mortgage Experts
Association of Machinery and Equipment Appraisers
Association of Texas Appraisers
Canadian National Association of Real Estate Appraisers
Columbia Society of Real Estate Appraisers
Equipment Appraisers Association of North America
Illinois Coalition of Appraiser Professionals
Instituto de Evaluadores de Puerto Rico *
International Association of Assessing Officers *
International Right of Way Association *
International Society of Appraisers *
Maryland Association of Appraisers
Massachusetts Board of Real Estate Appraisers *
Midwest Appraisers Association
National Association of Appraisers
National Society of Real Estate Appraisers
North Carolina Professional Appraisers Coalition *
North Carolina Real Estate Appraiser Association
Ohio Coalition of Appraiser Professionals
Real Estate Valuation Advocacy Association
Royal Institution of Chartered Surveyors *
South Carolina Professional Appraisers Coalition *
Virginia Coalition of Appraiser Professionals
West Virginia Council of Appraiser Professionals

USERS OF APPRAISALS

American Bankers Association
American Institute of Certified Public Accountants
Conference of State Bank Supervisors
Counselors of Real Estate
Farm Credit Council *
Federal Agricultural Mortgage Corporation
Institute for Professionals in Taxation
Mortgage Bankers Association
National Association of Federal Credit Unions
National Association of Home Builders
National Association of Jewelry Appraisers
National Association of Mortgage Brokers
National Association of Realtors *
National Auctioneers Association
National Council of Real Estate Investment Fiduciaries
Relocation Appraisers & Consultants
Worldwide ERC

GOVERNMENT AGENCIES AND ORGANIZATIONS

Association of Appraiser Regulatory Officials
Fannie Mae
Federal Highway Administration
Federal Transit Administration
Freddie Mac
General Services Administration
Internal Revenue Services
US Department of Agriculture, Farm Service Agency
US Department of Agriculture, Forest Service
US Department of Agriculture, Natural Resources Conservation Service
US Department of Agriculture, Rural Development
US Department of Energy, Bonneville Power Administration
US Department of Housing and Urban Development
US Department of Justice
US Department of the Army
US Department of the Interior, the Office of Valuation Services
US Department of the Navy
US Department of Veteran Affairs

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The Appraisal FOUNDATION

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The Appraisal Foundation Industry Advisory Council:

FOR-PROFIT ORGANIZATIONS

Allstate Appraisal
Amrock
AppraiserVendor.com
AVMetrics
Bank of America
BBG, Inc.
CBRE
Clarocity Corporation
Class Valuation
Clearcapital.com, Inc.
CoreLogic|FNC, Inc.
Cushman & Wakefield
Genworth Mortgage Insurance Corporation
Green Street Advisors
HouseCanary
J2C Valuation Services
JLL Valuation & Advisory, LLC
JPMorgan Chase
Lightbox
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LW Hospitality Advisors
Morgan Stanley Mortgage Capital
National Valuation Consultants
Newmark Knight Frank Valuation & Advisory
Opteon Appraisal
PCV Murcor Real Estate Services
PNC Bank
Property Sciences Group
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TrUnion Appraisal Services
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United States Appraisals
Valbridge Property Advisors
Veros Real Estate Solutions
Weichert Workforce Mobility
Wells Fargo Bank
Zillow Group

REVAA
Real Estate Valuation Advocacy Association

Testimony of Dean Kelker
Senior Vice President- Chief Risk Officer
SingleSource Property Solutions

On Behalf of the
Real Estate Valuation Advocacy Association (REVAA)

Before the
House Committee on Financial Services

Hearing on
"Devalued, Denied, and Disrespected: How Home Appraisal Bias and Discrimination Are Hurting Homeowners and Communities of Color."

Tuesday, March 29, 2022

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Introduction

Good morning Chairwoman Waters, Ranking Member McHenry, and distinguished Committee members. Thank you for the privilege to share with you the perspective of appraisal management companies (AMC) at this hearing.

Since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) nearly a decade ago, the appraisal industry has changed significantly as Congress intended to protect safety and soundness.

The following submitted testimony from the Real Estate Valuation Advocacy Association (REVAA) seeks to provide insight into the appraisal industry from the perspective of AMCs, many of which also serve as a lender valuation provider beyond residential appraisals. Specifically, this testimony addresses the items below:

- An overview of the role of AMCs in the residential mortgage process;
- The AMC state regulatory structure post Dodd-Frank Act;
- Valuation bias and the undervaluation of properties in minority neighborhoods;
- Support for the recruitment and training of the next generation of residential real estate appraisers;
- Integrating human capital, data and technological innovation as the appraisal industry modernizes,
- Support for the promulgation of Automated Valuation Model (AVM) quality control standards

About Appraisal Management Companies

AMCs are third party service providers engaged by bank/non-bank lenders to collaborate with appraisers on residential appraisals in compliance with federal appraisal independence requirements. AMCs have existed since the 1960's and were primarily utilized by the largest US financial institutions to reduce consumer costs by outsourcing the expenses that would be incurred through their internal management of the valuation process. AMCs grew in popularity among smaller and mid-size lenders following the 2007-08 financial crisis as their attention to efficiency, compliance and regulatory responsibilities helped ensure consumer protection. The outsourcing of the valuation process continued, extending to the largest financial institutions, who now rely upon AMCs for the valuations of residential mortgages. Today, there are an estimated 200-300 AMCs in the nation, ranging from small local businesses to large national corporations.

AMCs benefit consumers by ensuring that the residential property they are purchasing, refinancing, or otherwise using as collateral is properly evaluated and that the lender they are working with to secure their residential mortgage transaction will receive a quality, timely appraisal that is reasonably priced based on current market conditions, free from undue influence, and compliant with the *Uniform Standards of Professional Appraisal Practice* (USPAP). Among an AMC's core functions include:

- Maintaining a panel of qualified appraisers ready to execute lender valuation assignments.
- Ensuring appraiser independence by safeguarding against fraud and undue influence.
- Providing quality assurance processes in the delivery of final appraisal and valuation products.
- Supporting a smooth, timely and responsive mortgage process for consumers and lenders.
- Ensuring lender compliance with federal and state banking and mortgage regulations.

AMCs invest significantly in technology to support the above functions, including but not limited to developing proprietary ordering processes that can integrate with appraisal form provides and other real estate technology solutions and implementing automated quality control rule sets. It is important to underscore that the AMC's lender customer sets the expectations for how an AMC must manage its appraisal orders – this is critical as there is a misunderstanding amongst appraisers that AMCs set appraisal order turn times, delivery requirements, and other obligations.

In addition, many AMCs are more appropriately described as valuation providers that offer customers with a variety of valuation-related products and management services, including but not limited to evaluations, broker price opinions, automated valuation models, property data collection products, post-disaster property reviews, and data analytics. While a business may meet the definition of an AMC, they often provide many other services - this business model is beneficial to customers, borrowers, and helps to support a more healthy and cohesive process.

AMCs play a critical role in developing and supporting innovation that allows non-traditional valuation services to augment traditional appraisals. New and emerging technology places mobile tools in the hands of both appraisers and non-appraisers to perform onsite data collection, including obtaining photographs, video, floor plans, square footage calculations, 3D scanning, virtual property tours to obtain digital GLA measurements.

Lenders, mortgage companies, investors, government-sponsored entities and others seek different levels of service from a valuation company for several reasons, including:

- Valuation companies are experts in real estate property data. Customers seek to collaborate with companies that have expertise in all real estate collateral risk concepts.
- From a vendor management perspective, customers demand to work with one business that can support many needs, as opposed to working with an AMC, a valuation company, and data company. This helps banks and other regulated institutions more effectively provide oversight of their vendors.
- Valuation companies invest heavily in technology, product development tools, vendor panels to be able to adapt to shifts in the marketplace, which provides economies of scale and efficiencies to support customer needs for different transaction types.

Under federal law and regulation, lender clients may be held responsible for the actions or inactions of their third-party vendors, including AMCs. Therefore, AMCs are under continuous, vigorous, and extensive scrutiny by their lender clients through the lender client third-party oversight programs. AMCs are required to regularly submit to client audits to ensure compliance with federal banking regulations and lender policies and procedures. In addition, lender transactions with AMCs are regulated by state and federal banking regulators.

Fannie Mae, Freddie Mac and others have praised the role AMCs have played in improving appraisal quality and enforcing federal Appraisal Independence Requirements (AIR) since the Home Value Code of Conduct (HVCC) and Dodd-Frank were enacted. In addition, AMCs are actively involved in the non-profit and for-profit advisory councils of The Appraisal Foundation (“TAF”), many of their representatives have sat on the TAF Appraiser Qualifications Board and Appraisal Standards Board and participate in meetings hosted by The Association of Appraiser Regulatory Officials (“AARO”).

AMC Oversight Post Dodd-Frank Act

The Dodd-Frank Act was rooted in the objective to restore public trust in the safety and soundness of the financial industry. Specific to appraisal and AMCs, Dodd-Frank adopted several important consumer protections that REVAA supports, including but not limited to:

- The Truth in Lending Act (“TILA”) was amended to make it unlawful, in extending credit or in providing any services for a consumer credit transaction secured by the principal dwelling of the consumer, to engage in any act or practice that violates appraisal independence.
- The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (“FIRREA”) was amended to include AMCs within the scope of appraisal activity overseen by the Appraisal Subcommittee and applicable federal regulators.

Supporting Appraiser Independence Under TILA

- *Safeguard Appraiser Independence and Protecting Against* Fraud - AMCs help ensure that appraisals are completed in compliance with federal and state laws, as well as industry standards (USPAP), and that appraisers form their value opinions independently, without undue influence. Preventing coercion is critical to avoiding collusion in the valuation process and thereby reducing the potential for fraud.

- *Protect Public Safety* - Consumers are provided an extra layer of safety and protection as most AMCs are required to conduct background checks before appraisers are employed or empaneled. Further, AMCs continue to monitor appraisers on an ongoing basis to ensure that appraisers who are unqualified or may pose a threat to public trust or safety are removed.

- *Ensure Lender Compliance with State and Federal Banking and Mortgage Regulations* - AMCs are invaluable partners for lenders as they ensure efficiency and support lender compliance with the mortgage lending requirements of state and federal regulators (e.g., Fed, FDIC, OCC, CFPB).

- *Ensure Appraiser Independence* - Lenders (big banks, small banks, mortgage lenders, credit unions, etc.) use AMCs because they provide efficient solutions to establish and maintain the necessary firewalls to preserve appraiser independence. Lenders require that AMCs maintain processes to give appraisers a clear path to complain if they believe they are being unduly influenced.

- *Ensure Quality Essential to Consumers and the Secondary Market* - AMCs provide the quality assurance lenders need to ensure a valuation won't prevent a loan from being saleable in the secondary market. Federal agencies require lenders to provide thorough, accurate, and objective appraisal reports with reliable opinions of market value to support underwriting decisions.

FIRREA – Guidance for State Regulation of AMCs

The Dodd-Frank amendments to FIRREA and their subsequent regulations promulgated after Dodd-Frank's enactment created the path for States to register AMCs providing appraisal management services related to a federally related transaction. The Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection (collectively, "the Federal Banking Regulators") were tasked to jointly, by rule, establish minimum requirements to be applied by a State in the registration of appraisal management companies.

These minimum rules became effective on August 10, 2015. FIRREA provides that no appraisal management company may perform services related to a federally related transaction in a State after the date that is 36 months after their rules' effective date, unless such company is registered with such State or subject to oversight by a Federal financial institution regulatory agency. There was also an opportunity for States to obtain a one-year extension from the Appraisal Subcommittee - the firm deadline was August 10, 2019.

Pursuant to the minimum rules, at minimum a State registration program must include a requirement that AMCs:

- register with and be subject to supervision by a State appraiser certifying and licensing agency in each State in which such company operates;

- verify that only licensed or certified appraisers are used for federally related transactions;

- require that appraisals coordinated by an appraisal management company comply with the Uniform Standards of Professional Appraisal Practice; and

- require that appraisals be conducted independently and free from inappropriate influence and coercion pursuant to the appraisal independence standards established under section 129E of the Truth in Lending Act.

The Appraisal Subcommittee is authorized to review State AMC program compliance with the above requirements.

Seeking to ensure that there was appropriate oversight over AMCs, many States passed AMC registration programs – REVAA has been actively engaged in supporting the registration and oversight of AMCs in all States.

All 50 states and the District of Columbia have implemented AMC registration programs consistent with federal law and rules. The only U.S. jurisdictions to opt-out of enacting these important Dodd-Frank consumer protections are Puerto Rico, Guam, Virgin Islands and the Northern Marianas Islands.

As a result, AMCs are now state regulated and under significant regulatory scrutiny. They must comply with several important requirements, including but not limited to:

- Only engaging with appraisers who have an active appraiser credential in good standing;
- Requiring disclosure of its registration number to appraisers when ordering appraisals;
- Not employing persons who have had appraiser credentials revoked;
- Disclosing to customers fee information about completed appraisals;
- Maintaining a process to require that an appraiser comply with USPAP and state law;
- Paying appraisers within a defined period of time;
- Maintaining a process for reviewing the work of appraisers;
- Informing regulators of address changes or material changes in ownership
- Maintaining a surety bond;
- Being subject to audit by state regulators

Violations of any of these requirements may result in disciplinary action by the state regulators.

REVAA supports the Dodd-Frank amendments to FIRREA and believes that proper oversight by federal and state regulators over AMCs is critical to supporting a health valuation marketplace and ensuring safety and soundness of financial institutions. Therefore, we continue to support AMC registration by all 50 states and the five U.S. territories to strengthen and ensure consistent appraiser independence and consumer protections across the entire United States.

Industry Priorities

Appraisal Bias / Undervaluation of Properties in Minority Neighborhoods– REVAA condemns bias and discrimination. We've been an active participant in important industry discussions led by the Interagency Task Force on Property Appraisal & Valuation Equity (PAVE), the Appraisal Subcommittee (including the CLEAR report commissioned by the ASC to review appraisal standards and qualifications), Congress, The Appraisal Foundation, and other industry stakeholders. It is our intention to be an active part of the collective solution as the recommendations of the PAVE Task Force Final Report are further discussed and new policy revisions implemented.

AMCs are required to follow federal Fair Housing Law in its internal and external business practices (i.e., how it recruits staff appraisers, how assignments are placed, etc.). They must communicate Fair Housing rules and expectations to their vendor workforce, independent fee appraisers and real estate agents/brokers.

Furthermore, AMCs must manage complaints related to appraisal bias or discrimination. These complaints typically come from homebuyers through the lender, and AMCs are often directed not to communicate with a consumer directly regarding their concerns with a report. If an AMC is contacted by a consumer, the AMC typically refers them back to their lender. This is important because the consumer likely received the appraisal from the lender who may have engaged in our QC or review that the AMC has not seen.

AMC Quality Control (QC)

Any Appraisal Management Company (AMC) QC process must comply with two important components of appraiser independence under the Truth in Lending Act:

1. Ensure AMC complies with federal and state appraiser independence requirements, including not attempting to directly or indirectly causing an opinion of value to be influenced based on any factor other than the independent judgment of the person preparing the valuation.

2. Performing quality assurance review in compliance with appraiser independence which permits an AMC to ask an appraiser to:
   a. Consider additional, appropriate property information, including the consideration of additional comparable properties to make or support a valuation.
   b. Provide further detail, substantiation, or explanation for the valuation provider's value conclusion.
   c. Correct errors in the appraisal report.

FIRREA expects appraisals to be subject to appropriate review for compliance with USPAP. October 2019 federal banking regulators adopted regulations implementing this requirement, stating the Interagency Appraisal and Evaluation Guidelines provide more information to assist financial institutions in the appropriate review of appraisals.

AMCs have robust Quality Control (QC) programs in place to examine appraisal reports after the initial delivery by the appraiser. QC processes vary by AMC and client requirements. QC is a service provided by AMCs to aid their clients. These reviews are done to ensure compliance before the appraisal report or valuation is delivered to the lender and are not used to determine a lending decision.

- **AMC Quality Control Programs:** To best serve its lender clients, most AMCs have a quality control program built internally to review each appraisal and valuation before it is forwarded to the client as completed.

- **Lender Quality Control Requirements:** Federal Interagency Appraisal and Evaluation Guidelines mandate that lenders are responsible for safety and soundness of property valuations.

  XV. Reviewing Appraisals and Evaluations
  The Agencies' appraisal regulations specify that appraisals for federally related transactions must contain sufficient information and analysis to support an institution's decision to engage in the credit transaction. For certain transactions that do not require an appraisal, the Agencies' regulations require an institution to obtain an appropriate evaluation of real property collateral that is consistent with safe and sound banking practices. As part of the credit approval process and prior to a final credit decision, an institution should review appraisals and evaluations to ensure that they comply with the Agencies' appraisal regulations and are consistent with supervisory guidance and its own internal policies. This review also should ensure that an appraisal or evaluation contains sufficient information and analysis to support the decision to engage in the transaction. Through the review process, the institution should be able to assess the reasonableness of the appraisal or evaluation, including whether the valuation methods, assumptions, and data sources are appropriate and well-supported. An institution may use the review findings to monitor and evaluate the competency and ongoing performance of appraisers and persons who perform evaluations.

  As a result, most lender clients outline requirements for the AMCs they have hired to perform QC as part of the overall services performed on their behalf. These requirements vary by lender client and can range from nominal review to intensive review. In addition, some lenders have their own QC programs beyond or in lieu of what may be provided by the AMC. So while AMCs may have a base set of QC processes, they can be enhanced or changed by customers - most AMCs typically do not have the same QC process for all customers.

- **AMC QC Review of Independent Appraisers:** AMCs review their panel of independent fee appraisers to grade appraiser performance on past assignments, research state boards to determine if there is any disciplinary history, require background checks to determine if there is any criminal history. Their work is reviewed for quality, on-time delivery, customer service and professionalism, conformance with appraiser independence requirements, and USPAP compliance. Independent appraisers also need to agree to terms of use/agreement/code of conduct which outline specific expectations of the relationship, including compliance with applicable laws (i.e. fair lending requirements), and individual assignments include a letter of engagement that outlines assignment-specific criteria required by a client.

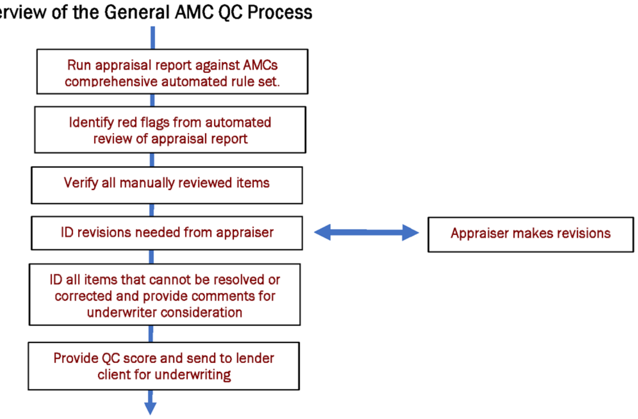
- **AMC QC Requirements Under Federal Law:** Federal law imposes requirements on lenders to implement controls to review appraisals, and AMCs as service providers work with lender customers to ensure their requirements are met.

- **AMC QC Requirements Under State Law:** State laws vary, but most have a requirement that AMCs must audit the work of appraisers on their panel, although the details of how many appraisals must be reviewed or the extent of the review can vary. Typically, AMCs are required to provide a general review for compliance with USPAP. Some have more restrictive requirements that require a detailed review in compliance with Standards 3 and 4 in USPAP, which is a full review of the appraisal and its value by another credentialed appraiser.

- **AMC Quality Control Programs Differ:** Each AMC has its own QC process that is largely dependent on the unique QC review requirements of its lender clients. Lender contracts with AMCs dictate the level of QC and specific guidelines for what is to be reviewed by the AMC. Often, AMCs will have their own unique branded QC to separate itself from competitors.

- **There are Different Levels of AMC QC Reviews:** AMCs review all appraisal reports for a base level of items as dictated by state and/or lender requirements.
  - Detailed (Big R) Review = <1% of reviews (USPAP Standards 3 and 4 full review of an appraisers work). In most cases, a detailed (Big R) review by an AMC would treat this like an appraisal assignment and use their appraiser panel to identify a geographically competent appraiser in the market in question to perform the review.
  - General (Little R) Review = 99% of reviews (QC for correct names and address, use of proper forms, report completion, compliance with standards such USPAP, Uniform Appraisal Dataset (UAD), the Uniform Collateral Data Portal (UCDP)). These reviews ensure compliance before the appraisal report or valuation is delivered to the lender and are not used to determine a lending decision.
    - Automated reviews utilize logic software with defined business rules to review text used in the appraisal report. The number of business rules used varies AMC to AMC based on lender client or state requirements (e.g., 100+ including USPAP, UAD, UCDP, FHA, USDA, etc. and lender-specific overlays). In addition, for some AMCs this may include a key word search to identify those words shared by Fannie Mae, Freddie Mac and other institutions which can be perceived as bias or discriminatory in nature. Flagged words would be sent back to the appraiser for removal.
    - There are some states that require AMCs to review a percentage (e.g. 2%) of appraisals each month that were performed in the state for quality control purposes. Typically, this requires a general review for compliance with USPAP. However, there are a few states that do require this review to be a more detailed Standards 3 and 4 review.

Overview of the General AMC QC Process



Lenders may request additional information after an appraisal has been submitted for a lending decision. The AMC would facilitate the information request with the appraiser who performed the assignment, within the guidelines of federal appraisal independence requirements.

- **Escalation.** If a red flag is identified through an automated or manual review of an appraisal, the concern is escalated to a more intensive review based on severity, including one or all of the tools outlined below. Any questions or issues identified are addressed with the appraiser who completed the appraisal.

    - Manual desk reviews are performed as required by AMC lender client contracts. It allows or consideration of unique attributes to the property and its potential impact on value.

    - AMCs may seek to evaluate an opinion of value via an automated valuation model (AVM) or other valuation tool) to determine if over or under value.

    - AMCs must manage complaints related to appraisal bias or discrimination. These complaints come from homebuyers through the lender, there is no direct contact between the consumer and AMC.

    - Reconsideration of value at the request of lender or borrower. Any questions or issues identified are addressed with the appraiser who completed the appraisal. It is important to note again that reconsiderations are routed through the lender because they may have conducted other QC or review for that file that the AMC has not been exposed to. A lender may opt not to forward a ROV to an AMC if they believe it doesn't have merit. An AMCs responsibility in the ROV process is to communicate the request to the appraiser, review the response to confirm it addresses the request, determine if there are any outstanding QC issues, and return to the lender for its review.

Alternatives for an Aging Appraiser Workforce / Trainees – REVAA supports a vibrant and diverse appraiser industry. The future of appraisal needs to retain a human component, which is why we support the recruitment of new appraisers to help revitalize the professional for the next generation. The reliance on appraisers and appraisal products creates an important need to help ensure the sustainability of the profession, and the safety and soundness of financial institutions. Consumers, residential mortgage lenders, secondary markets and AMCs rely on a plentiful supply of qualified appraisers to meet anticipated demand.

However, demographic data indicates there is a lack of appraisers to meet the future demand for traditional appraisals. According to the Bureau of Labor Statistics the median age of an appraiser in 2020 was 52. Further, 96.5% of appraisers are Caucasian and 70% are male.

Furthermore, the current experience and educational requirements of becoming an appraiser are overly burdensome, creating a roadblock for the recruitment and training of new appraisers. There is a shortage of young adults, graduates and those in career transition seeking to become appraisers. Supervisory appraisers are hesitant to take on the responsibility or economic burden of training. And, because trainees are not on the National Registry, many lender risk-management policies and procedures restrict, limit or prohibit the use of trainees.

REVAA supports immediately removing barriers in the recruitment and training of new appraisers. Modernization should incorporate innovative technologies and learning techniques to recruit and train future appraisers, just as they are used for other industries. This includes the nationwide adoption of innovative initiatives such as the Practical Applications of Real Estate Appraisal (PAREA) or other alternatives that are created to make it easier to recruit, train and retain a diverse future generation of appraisers at scale.

Valuation Modernization – The real estate valuation industry continues to innovate with modern technologies and products that meet the needs of America's consumers and lenders. Federal regulatory agencies are updating valuation-related policies to address concerns related to appraiser demographics and the rapidly evolving technology landscape (e.g., GSE move to desktop and hybrid appraisals to augment traditional appraisals). There were positive lessons learned during the COVID-19 pandemic when federal regulators enacted appraisal flexibilities to protect public health while not hindering the collection of property valuation information for the surge in lending volume.

REVAA strongly believes there is a need for new valuation solutions and/or increased use of existing alternative valuation solutions rooted in alternative labor forces and the use of innovative technologies to help make the collection of property data efficient, credible, consistent, and accurate.

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AMCs play a critical role in developing and supporting innovation that allows non-traditional valuation services to augment traditional appraisals. REVAA members and others are developing innovative technologies that supports the appraiser and valuation profession. New and emerging technology places mobile tools in the hands of both appraisers and non-appraisers to perform onsite data collection, including obtaining photographs, video, floor plans, square footage calculations, 3D scanning, virtual property tours to obtain digital GLA measurements.

As stated by the Bureau of Labor Statistics, the expectation of greater use in mobile technology will improve efficiencies and productivity.[1] REVAA members believe their investments in technology will transform the profession into a true 21st century expertise. For example:

- Mobile applications that allow an appraiser to more accurately measure property and develop a sketch of a residence;

- Scheduling applications that give the borrower better command over scheduling their appraiser/inspector visit which can reduce delays and improve communications between the appraiser and lender; and

- Continued integration of third-party real estate data available at an appraiser's fingertips.

Automated Valuation Model (AVM) Rulemaking - An automated valuation model ("AVM") is defined in FIRREA as "any computerized model used by mortgage originators and secondary market issuers to determine the collateral worth of a mortgage secured by a consumer's principal dwelling."[2]

AVMs are used in several different contexts, including but not limited, to: (1) assess collateral value before deciding what type of additional valuation is required; (2) valuing a portfolio; and (3) for lending decisions where an appraisal is not required (i.e., for home equity lending purposes). Federal guidelines define how an AVM can be used in lieu of an appraisal as prescribed by the Interagency Appraisal and Evaluation Guidelines.

Importantly, not all AVMs built the same. There are consumer-facing AVMs that provide value estimates for various non-lending purposes, and lending-grade AVMs that have sufficient data and analysis to support lending use.[3] Testing of AVMs can also vary.[4]

Federal Banking Regulators were tasked under the Dodd-Frank Act amendments to FIRREA to promulgate regulations to implement AVM quality control standards. The PAVE Task Force has prioritized passage of these quality control rules. REVAA welcomes AVM guidance that gives the rules of the road but still promotes competition, innovation and empowers users to tailor AVM use to their risk management practices consistent with current guidelines.

We are currently reviewing the CFPB's recent outline of proposals for its small business advisory review panel (SBREFA) for AVM rulemaking and intend to provide comment. Proposed AVM quality control standards are anticipated to be available in Summer 2022.

Conclusion

The Dodd-Frank Act enacted statutory and regulatory changes to implement new consumer protections. REVAA believes that the systems and structures that have been put in place across the country have largely helped achieve the goal of protecting safety and soundness. But the work isn't done. Despite the considerable progress that has been made in some areas but there continues to be a need for industry-wide focus on improvement regarding bias and diversity.

Congress, federal regulators and industry stakeholders must continue to have constructive dialogue to discuss the future of the industry including appraisal bias and diversity, the recruitment and training of a diverse future generation of appraisers and the appropriate role of modern technologies and data on residential appraisal and lender valuations.

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[1] Bureau of Labor Statistics, "Appraisers and Assessors of Real Estate: Occupational Outlook Handbook," https://www.bls.gov/ooh/business-and-financial/appraisers-and-assessors-of-real-estate.htm#tab-6.
[2] 12 U.S.C. 3354(c).
[3] Mortgage Bankers Association, "Real Estate Appraisals [RIN: 1557-AE57; 3064-AE87; 7100-AF30]," https://www.mba.org/Documents/MBA_Real_Estate_Appraisals_(0).pdf
[4] "A Lender's Guide to the Top 3 AVM Testing Methods," ClearCapital.com, Inc, June 06, 2019, https://www.clearcapital.com/blog-avm-testing-guide/.

Beyond additional dialogue and collaboration, and the action plan items from the PAVE Task Force report, REVAA believes that there are immediate activities that will foster more robust action related to the appraisal industry

More Data and Information is Essential – While there has recently been data released to show the occurrence and impact of appraisal bias, REVAA believes that more data is required to give a clearer understanding of the problem so cogent, targeted and impactful solutions can be implemented. The mortgage and appraisal industry can't fix this problem without understanding what is happening in the marketplace. Recently released data is interesting and concerning, but there are legitimate challenges to this data that raises questions. We believe this needs more review with a bipartisan commitment for collaboration.

Automated Valuation Model (AVM) Rulemaking - Federal Banking Regulators were tasked under the Dodd-Frank amendments to FIRREA to promulgate important AVM quality control standards. The PAVE Task Force report has reiterated the importance of these quality control standards.

REVAA welcomes AVM quality control standards guidance that gives the rules of the road but still promotes innovation and empowers users to tailor AVM use to their risk management practices consistent with current guidelines. We are reviewing the Consumer Financial Protection Bureau's (CFPB) recent outline of proposals for its small business advisory review panel (SBREFA) for AVM rulemaking.

Congressional Action - Congress can and should address appraisal issues. There are several appraisal related bills that would have a significant positive impact on our industry, as listed below, but appraisal legislation has largely stalled in both the House and Senate:

H.R. 2553 - Real Estate Valuation Fairness and Improvement Act of 2021 - Creates a task force of federal agencies; an advisory group of industry stakeholders; and a grant program at the Appraisal Subcommittee that will help recruit and train diverse new appraisers. H.R. 2553 has passed the House Financial Services Committee and will next be heard by the full House. A senate version of this bill has not yet been introduced.

H.R. 3008 - Bill to Allow Licensed Appraisers to Perform FHA Assignments – Amends the National Housing Act to authorize state-licensed appraisers to conduct appraisals for mortgages insured by the FHA and requires compliance with the existing appraiser education requirement. The bill has passed the House.

H.R. 5756 - The Portal for Appraisal Licensing Act – Intended to create a cloud-based licensing portal for AMCs and appraisers within the Appraisal Subcommittee; if implemented, state adoption would be voluntary.

H.R. 4155 - Green Neighborhoods Act of 2021 – Intended to encourage energy efficiency, conservation, and development of renewable energy sources for housing, and to create sustainable communities. It includes a component on home appraisals and requirements for appraisers to consider green aspects in their report.

Senate Appraisal Bill (Not Introduced Yet) – REVAA is working with the Senate Banking Committee on legislation to add trainees to the National Registry, allow the Appraisal Subcommittee to reduce the AMC National Registry Fee, and permit licensed appraisers to perform FHA assignments.

House Appraisal Bill (Not Introduced Yet) – REVAA is working with the House Financial Services Committee on reintroduction of legislation to add trainees to the appraiser registry, allowing ASC to lower AMC National Registry fee, and add the Veteran's Administration to Appraisal Subcommittee Board. Unlike the Senate version of this legislation, the FHA component has been incorporated separately into H.R. 3008.

House Financial Services Committee Bill (Not Introduced Yet) – This bill is in proposal stage and will seek to enact a new regulatory structure for real estate appraisal and property valuations.

About Dean Kelker, Sr. Vice President -Chief Risk Officer SingleSource Property Solutions

Dean Kelker is senior vice president and chief risk officer at SingleSource Property Solutions with responsibility for managing regulatory, compliance, and financial risks for the past ten years. Additionally, he manages the valuation policy oversight for SingleSource.

Prior to joining SingleSource, Dean has had diverse executive experience over the past 30 years in a wide range of real estate finance areas including real estate appraiser, managing collateral, credit and compliance risks for lenders, credit risks for a mortgage insurer, and mortgage default investigations for a due diligence firm.

Currently Dean serves on the Board of Directors of the Real Estate Valuation Advocacy Association (REVAA) and was the 2019 Treasurer and 2020 President. He has also worked as a volunteer and board member of Habitat for Humanity of Greater Pittsburgh.

About REVAA

REVAA is a trade association whose membership includes Appraisal Management Companies (AMC) and valuation providers that collectively provide residential real estate appraisals nationwide for mortgage lenders.

In addition, many REVAA members also create innovative technologies and provide other important lender valuation services such as Evaluations, Broker Price Opinions (BPO) and Automated Valuation Models (AVM).

Accurate Group	Class Valuation	Frisco Lender Services	Opteon	SingleSource
Amrock	Clear Capital	LRES	PCV Murcor	SWBC Lender Services
Applied Valuation Services	Core Logic	MountainSeed	Pro Teck	Valuation Connect
Appraiservendor.com	Equity Solutions	Nations Valuation	Service 1st	Valutrust
Axis AMC	First American	Nationwide	ServiceLink	Voxtur Valuation
				Wells Fargo REVS

Statement before the House Committee on Financial Services

Devalued, Denied, and Disrespected: How Home Appraisal Bias and Discrimination Are Hurting Homeowners and Communities of Color

Faulty Evidence and Misdiagnosed Solutions

Why centralizing appraisal standards and criteria under a new federal agency as proposed under the Fair Appraisal and Inequity Reform Act is not justified

Tobias J. Peter
Assistant Director, AEI Housing Center
Research Fellow, American Enterprise Institute (AEI)

March 29, 2022

Chairwoman Waters and Ranking Member McHenry, and distinguished Members of the Committee, thank you for the opportunity to testify today.

Executive Summary:

The case for centralizing appraisal standards and criteria under a new federal agency as proposed under the Fair Appraisal and Inequity Reform Act is not justified. It is based on unsubstantiated claims of systemic bias and racism in the housing finance sector and represents and unwarranted power grab by the federal government and one giant step towards the federal government setting fiat home values. Upending the appraisal process risks mis-valuating millions of properties, which could have serious repercussions for minority neighborhoods and rural areas, where home sales are sparser.

Last week's report by the Interagency Task Force on Property Appraisal and Valuation Equity (PAVE) alleged "inequities within current home lending and appraisal processes" for communities of color.

The work cited by PAVE contained serious red flags that were obvious from a cursory look. The work of the AEI Housing Center has also debunked the Brookings study and Freddie Mac exploratory note, which were both heavily relied on in the PAVE report and this hearing's memo. Most importantly, these studies conflate race with socio-economic status (SES), i.e. income, buying power, marriage rates, credit scores, etc. Once adjusted for differences in SES, race-based gaps found in these studies either entirely or substantially disappear, which raises serious questions regarding a race-based explanation.[1]

While individual appraiser bias certainly exists, the PAVE report admits that "the exact number of instances of valuation bias is difficult to assess." We have undertaken a study with over 240,000 loans for which we knew the race of the borrowers. Our statistical analysis found that racial bias by appraisers on refinance loans is uncommon and not systemic. These results and our methodology have been confirmed by other academic research.[2] All of this work was ignored by PAVE. Further, research by Fannie Mae, which directly contradicted Freddie Mac's preliminary findings, was so selectively cited this point was lost.

It is questionable how PAVE could arrive at its conclusions when its own report admits a lack of data.[3] Furthermore, this lack of data is the fault of the government. Two years ago, we outlined a statistical approach using existing data that would have allowed FHFA, Fannie Mae, and Freddie Mac to identify bad actors using existing data. This offer was ignored.

Now, two years later we are debating a task force report and draft bill based on cherry-picked data, discredited research, and flawed conclusions, suggesting a lack of interest in getting to the truth and an alternative motive to provide an excuse for centralizing appraisal valuation standards and appraiser criteria in the federal government.[4]

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[1] The same critique to the Brookings paper also applies to research by Howell and Korver-Glenn (2021) or a recent Redfin on the same topic.
[2] See Ambrose, Brent W., James Conklin, N. Edward Coulson, Moussa Diop, and Luis A. Lopez. "Does Appraiser and Borrower Race Affect Valuation?." Available at SSRN 3951587 (2021).
[3] In particular, the PAVE report states "lack of access to complete data has been a hindrance to research on appraisal disparities and on the impact of racial and ethnic bias in appraisals."
[4] For our detailed critique of the PAVE report, please see Appendix A1 on page 22.

Instead of this bill, agencies should get to work using existing data. These data should be anonymized and made available to independent researchers to verify as a bipartisan group of Senators agreed at last week's Senate Banking hearing.[5] This would allow bad actors, whether racially biased or incompetent, to be removed immediately from the profession, as they should.

Additionally, since PAVE has misdiagnosed the problem, its proposed agency actions will not address racial and ethnic differences in homeownership rate, financial returns of owning a home, or median wealth. Instead it will likely make these differences worse or divert attention from finding effective solutions.

Rather than discredited claims of systemic appraiser bias, homeowners and communities of color are being hurt by the combination of low SES, which certainly reflects a legacy of past racism and lingering racial bias, which leaves Blacks at a large income and wealth disadvantage relative to most Whites, and foreclosure-prone federal lending practices.

A recent paper out of the UC Berkley finds that Black and Hispanic homeowners experience lower returns than White homeowners, which it attributes almost entirely to the higher prevalence of distressed home sales – and not appraiser bias. The study finds that "The disparity [in distressed home sales] explains about 40% of the Black-white gap in housing wealth at retirement." The paper also notes that "[i]mportantly, absent financial distress, houses owned by minorities do not appreciate at slower rates than houses owned by non-minorities," which again directly contracts the PAVE report.

Foreclosure-prone affordable housing policies have been targeted at low-income and minority borrowers. These policies subsidize debt by providing excessive leverage and lower rates. Coupled with a supply shortage, the increased demand from additional leverage has fueled unforgiving boom-bust home price cycles. During the Financial Crisis, these policies contributed to over 10 million foreclosures and other forced dispositions, which were proportionally higher in low-income and minority neighborhoods. While higher SES individuals have the wherewithal to withstand economic or personal shocks, low SES individuals do not. Notwithstanding massive subsidies and lending, federal housing policies have not built generational wealth.

The PAVE report even acknowledged the importance of SES, stating that "Much of the gap in rates of homeownership can be traced to socio-economic factors that differ on average between Black and white homeowners." It then proceeded to ignore it in its 21 proposed agency actions, all of which related to appraiser bias. This could have unintended consequences similar to prior housing task forces such as the 1967 Presidential Task Force on Housing and Urban Development, which ended up destroying many American cities, especially Black neighborhoods, or the 1995 National Homeownership Strategy, which ended in millions of foreclosures. Mis-valuing millions of property could have similar consequences, with minorities once again being the victims.

Closing the racial wealth gap requires addressing differences in SES head-on. Housing solutions include a focus on generational wealth building through better mortgage products with more prudent underwriting, increasing supply, and opening up more areas of opportunity for lower-income

[5] Senators Toomey, Tester, Smith, and Brown stressed data transparency for independent researchers in the hearing of the Senate Banking Committee "Strengthening Oversight and Equity in the Appraisal Process" on March 24, 2022.

households. But policy also need to focus on closing gaps in educational attainment, stable families, and public investment relating to minority neighborhoods, among other things.

1) **Evidence on devaluation: A critique of the Brookings study and the Freddie Mac note**

Both the Brookings study and Freddie Mac exploratory note were heavily relied on by PAVE. However, they are fundamentally flawed in that they conflate race with socio-economic status (SES), i.e. income, buying power, marriage rates, credit scores, etc. Furthermore, our analyses show that Black, White or Hispanic households with similar SES all had similar results, raising serious questions regarding a race-based explanation.

In the **Brookings study "The Devaluation of Assets in Black Neighborhoods,"** Perry et al. claimed that:

- *"Homes of similar quality in neighborhoods with similar amenities are worth 23 percent less in majority Black neighborhoods, compared to those with very few or no Black residents."*
- *"Across all majority Black neighborhoods, owner-occupied homes are undervalued by $48,000 per home on average, amounting to $156 billion in cumulative losses." (p. 3)*

This conclusion rests on their claim to have completely controlled for structural characteristics and neighborhood amenities using 23 control variables, therefore, the remainder in the gap has to be due to racial bias.

AEI Housing Center Critique:

After having replicated Perry et al., we add just one additional SES control variable, the Equifax Risk Score for the neighborhood without removing any of their original 23 control variables.[6] We find that ERS alone is able to explain the entirety of the devaluation.[7]

Specification	% Devaluation	# of Tracts
23 control variables for all tracts	-22.0%	33,066
23 control variables (limited – new baseline)	-21.8%	32,998
23 control variables & ERS control variable	0.3%	32,998

By adding just one additional SES-related explanatory variables, the devaluation found by Perry et al. disappears. Thus, their approach did not fully adjust for structural characteristics and neighborhood

[6] We show that the Equifax Risk Score (ERS) is race neutral and suitable for use as a control variable. The Equifax Risk Score (ERS) is a compilation of Vantage credit scores from 2013, representing a summary metric of the stock of all individuals of any type in a neighborhood with a score. It includes over 220 million scored individuals. In its 2007 "Report to Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit," the Board of Governors of the Federal Reserve System stated that "credit characteristics included in credit history scoring models do not serve as substitutes, or proxies, for race, ethnicity, or sex" (S-1f). Vantage credit scores are one of two industry standard scores and they are race blind as confirmed by the Fed report.
Based on the above, we don't think Perry and Rothwell's (2021) critique of ERS holds. As we have shown in our initial critique and will also show below, ERS is highly predictive. The fact that the data are propriety credit scores is not disqualifying. Indeed, credit scores are used routinely in empirical work involving mortgage and housing markets. The ERS data are aggregated up from ZIP-7 to census tract and are from November 2021.

[7] Other SES variables such as the share one one-adult borrowers also significantly reduce the gap.

amenities as they claimed and their estimate of devaluation due to racial bias is, at a minimum, seriously overstated.[8]

Further evidence that refutes the Brookings study:

1) We demonstrate clear omitted variable bias in the Brookings study.
2) We show that similar devaluation gaps are present in majority White or White-only tracts across different SES levels.
3) We find that relatively few Black borrowers choose to buy in majority Black tracts. This is especially true for Black borrowers with higher incomes. If constant-quality prices in majority Black tracts were really 23% lower, then why are Black buyers not taking advantage of the price discount in majority Black tracts?
4) There has been progress in racial integration. If home values in majority Black neighborhoods were undervalued all else equal, Black homeowners would not have shifted to areas predominantly non-Black.

For details on these case studies, see pages 37-41 in appendix A2.

We also found that Perry and Rothwell's (2021) rebuttal to our critique supported our claim of omitted variable bias, failed to rebuke our methodology, and never addressed our case studies. We also presented solutions based on our findings.

For the full study, see appendix A2 (starting on page 26) and for our rebuttal to Perry and Rothwell, see appendix A3 (starting on page 53).

In **Freddie Mac's note on "Racial and Ethnic Valuation Gaps in Home Purchase Appraisals"**, Freddie Mac noted "substantial appraisal valuations gaps" for minority versus White tracts. While the note described the research as "exploratory" and "preliminary," the language in the press release that went along with the report was, however, stronger: it spoke of a "persistent problem" and implied causality, which Freddie Mac's note never claimed.

AEI Housing Center Critique:

Using a dataset that substantially replicated Freddie Mac's, we were able to demonstrate that rather than being due to racial discrimination by appraisers, we found Freddie's claim of an "appraisal gap" is much more likely the result of would-be first-time buyer inexperience, socio-economic status (SES), or government actions (in particular a concentration of FHA lending in certain census tracts) with a disparate impact on protected classes.

Our analysis, which goes well beyond Freddie Mac's "exploratory research" which used no control variables, concludes that:

[8] The same critique to the Brookings paper also applies to research by Howell and Korver-Glenn (2021) and a recent Redfin post on the same topic.

- We can explain around 85% for Black tracts and 29% for Latino tracts of the gap through differences in SES, leverage, and borrower characteristics. With the full set of control variables, the Black gap disappears entirely, while the Latino gap falls by half.
- The literature provides strong evidence that an appraiser is likely providing some would-be buyers a consumer benefit by providing an appraised value below the contract price, by alerting such buyer that he or she is overpaying on the home, which then usually triggers a renegotiation. This benefit is greater for borrowers with higher LTVs.[9]
- As noted earlier, high leverage federal programs (especially FHA) and suppressed interest rates tend to drive up prices during a seller's market, as they are quickly capitalized into higher prices. Minority FHA-insured borrowers have the most to gain from the consumer-protection benefits of a low appraisal that leads to a renegotiation. All of this was ignored by PAVE.

For the full study, see appendix A4 (starting on page 67).

Research by **Fannie Mae entitled "Appraising the Appraisal: A closer look at divergent appraisal values for Black and white borrowers refinancing their home"** provides a likely, non-race based explanation for the valuation discrepancy found by Freddie Mac.[10] It is worth noting that Fannie Mae's explanation castes a favorable light on the appraisal industry.

Fannie Mae concluded that for refinance applications "Black borrowers refinancing their home on average received a slightly lower appraisal value relative to automated valuation models" and that "the frequency of 'undervaluation' did not have a notable racial pattern."

Interestingly, Fannie Mae (2022) also rebuked the methodological approach in Freddie Mac's research note that was cited by PAVE as one of the three main studies.[11] Fannie Mae also offered an alternative explanation differences in appraisals such as gentrification, which they are still in the process of studying.

[9] Further, "when a low appraisal occurs, … the probability of downward renegotiation rises to 55.8% and continues steadily to rise as appraised value falls further short of contract, reaching 79.9% when appraised value is short of contract by seven to 8 %" or that "higher LTV borrowers renegotiate more often, in more than 93% of cases for applications with an LTV of 97 when the appraised value's shortfall from contract is greater than 2%. Renegotiation likelihood drops much lower for LTVs of 70 or less, where the low appraisal is less likely to jeopardize the loan". Finally, a low appraisal "sharply raises the probability of downward price renegotiation" and "shows that high LTV borrowers usually recapture the entire difference between contract and appraised value. Borrowers with lower LTV, including unconstrained borrowers, split this difference, giving up more to the seller as constraints loosen."

[10] Williamson, Jake and Mark Palim. "Appraising the Appraisal: A closer look at divergent appraisal values for Black and white borrowers refinancing their home." (2022).

[11] In particular, Fannie Mae wrote that "We chose to study refinance applications, as opposed to home purchase applications, because the appraiser in a refinance transaction typically interacts directly with the homeowner (i.e., the borrower), establishing a pathway for potential bias to influence the appraisal results. The race or ethnicity of the borrower is often disclosed in the loan data, making it possible to directly observe any correlation with value. On the other hand, in a purchase transaction, the appraiser typically does not interact with the buyer (i.e., the borrower) of the property but rather with the seller or the seller's agent. The availability of racial or ethnic data of sellers and real estate agents is limited, thereby making an analysis of valuation differences by different demographics for purchase transactions limited or incomplete relative to the analysis detailed below using refinance transactions." (p.3)

Research by FHA's Kevin Park (2022) found that "minority applicants are more likely to experience underappraisal, but also … that underappraisal has a small effect on the likelihood of endorsement…"[12]

Research by Kermani and Wong (2021) find that "Importantly, absent financial distress, houses owned by minorities do not appreciate at slower rates than houses owned by non-minorities," which again goes counter to the unsubstantiated assertion that underappraisals or appraiser bias are holding Black wealth back.[13] It is rather the role of the federal government's involvement in the housing market and housing finance that has created problem time and time again (more on this below).

Based on this evidence, it is premature and not justified to proceed with this draft bill which would centralize appraisal standards and criteria under a new federal agency.

2) **PAVE has provided no evidence from sources using rigorous analysis to support its assertion that there is a recurring pattern of appraiser discrimination**

Recent media stories have highlighted individual instances where a second appraisal came in an average of about $126,000 or 25% higher than the initial appraisal after the Black applicants disguised their race. The implication is that intentional and perhaps unintentional appraisal bias is commonplace and the valuation gaps are large. While the facts alleged may well be true, any policy response must be based on whether the cases are the result of "bad apple" appraisers or systemic racial bias. A literature search found no credible statistical analysis to support a claim systemic racial bias.

AEI Housing Center Critique:

To evaluate the claim of systemic racial bias, we assembled a unique dataset with over 240,000 loans for which we knew the race of the borrowers. We used two different approaches and many different robustness checks to see if on average there is a value difference (or a gap) between refinance loan appraisals for Blacks and Whites. Our approach and methodology have recently been validated by Ambrose et al. (2021). They concluded that "contrary to media allegations, our statistical analysis found that racial bias by appraisers on refinance loans is uncommon and not systemic."[14]

Contrary to the stories in the media, our statistical analysis found that racial bias by appraisers on refinance loans is uncommon and not systemic.

While there is no denying that there are individual cases of racial bias, a count of media reports is not a valid sample upon which to base a conclusion. There is likely selection bias and no ability to conclude the cases are representative of all instances.[15] Appraiser bias cases, such as those cited by the media,

[12] Park, Kevin A. "A Comparison of Mortgage Denial and Default Rates by Race, Ethnicity, and Gender." Ethnicity, and Gender (February 7, 2022) (2022).
[13] Kermani, Amir, and Francis Wong. Racial Disparities in Housing Returns. No. w29306. National Bureau of Economic Research, 2021.
[14] Ambrose, Brent W., James Conklin, N. Edward Coulson, Moussa Diop, and Luis A. Lopez. "Does Appraiser and Borrower Race Affect Valuation?" Available at SSRN 3951587 (2021).
[15] In particular, claims of bias should be set in relationship to the purchase price and an appropriate level of home price appreciation (HPA) for the area. In a story on CNN, a Black homeowner purchased "her home for about $100,000 three years ago and, given home price appreciation in her area, she expected her home's value to be about $185,000 when she applied to refinance." Absent any improvements, this implies an expected average

may well result from "bad apple" appraisers or incompetence on both minority and non-minority appraisals.[16]

Our recommendation to regulators and agencies continues to be that same as we suggested 2 years ago:

- Given that a number of regulators and agencies have access to appraiser names, we have suggested that they use our or similar statistical methods to identify, investigate, and root out both appraisers with racial animus and those that are just plain incompetent.

Our recommendation to stakeholders:

- Propose and implement robust apprenticeship and training programs.
- Work with historically Black colleges.
- Adopt much of the VA appraiser and appraisal process, including the VA appraisal management approach, appraiser vetting, the Tidewater initiative (PAVE did mention this initiative favorably), and appraisal preparation guidance.

For the full study, see appendix A5 (starting on page 88).

Other evidence

Fannie Mae (2022) also concluded that for refinance applications "Black borrowers refinancing their home on average received a slightly lower appraisal value relative to automated valuation models" and that "the frequency of 'undervaluation' did not have a notable racial pattern."[17]Interestingly, Fannie Mae (2022) also rebuked the methodological approach in Freddie Mac's research note that was cited by PAVE as one of the three main studies.[18]

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annual HPA of 23% per year, which is about twice the level of 11% HPA for homes in the low price tier in Indianapolis over the same time period. The first appraisal came in at $125,000 and the second at $115,000, which implies an average annual HPA of 8% and 5%, respectively. Eventually after removing all traces of her race from her home and having a White friend stand in, the third appraisal came in at $259,000, which implies an average annual HPA of 37%, an extraordinary level of appreciation absent substantial improvements or purchase at a bargain price.

[16] This shortcoming may be demonstrated by this simple thought experiment. Take 1000 appraisals and assume 100 (10%) are performed by incompetent appraisers. Further assume for simplicity that there are 800 White borrowers and 200 Black borrowers. Also assume that 80 (10%) of the White and 20 (10%) of the Black borrower appraisals were done by an incompetent appraiser. Now assume that 20 of the White and 5 of the Black borrowers with appraisals done incompetently complain to the media. The media find the stories of 5 Black borrowers to be newsworthy and the stories of the 20 White borrowers not to be of interest. A search of the resulting media reports would come up with 5 stories, all from Black borrowers and all done by incompetent appraisers. And the erroneous conclusion would be that this proves systemic racism by appraisers.

[17] Williamson, Jake and Mark Palim. "Appraising the Appraisal: A closer look at divergent appraisal values for Black and white borrowers refinancing their home." (2022).

[18] In particular, Fannie Mae wrote that "We chose to study refinance applications, as opposed to home purchase applications, because the appraiser in a refinance transaction typically interacts directly with the homeowner (i.e., the borrower), establishing a pathway for potential bias to influence the appraisal results. The race or ethnicity of the borrower is often disclosed in the loan data, making it possible to directly observe any correlation with value. On the other hand, in a purchase transaction, the appraiser typically does not interact with the buyer (i.e., the borrower) of the property but rather with the seller or the seller's agent. The availability of racial or ethnic data of

A FHFA blog post, which was prominently cited by PAVE as evidence of pervasive bias, stated that in their "review of appraisals, we have observed references to race and ethnicity in the 'Neighborhood Description' and other free-form text fields in the appraisal form." FHFA concluded that the use of such references is evidence of bias as the "racial and ethnic composition of the neighborhood should never be a factor that influences the value of a family's home" and released 16 specific examples.

While we all can agree with FHFA's statement that "racial and ethnic composition of the neighborhood should never be a factor that influences the value of a family's home", the blog post failed to provide any specifics as to the frequency of such occurrences. It only stated:

> From millions of appraisals submitted annually, a keyword search resulted in thousands of potential race-related flags. Individual review finds many instances of keywords to be false positives, but the following are [16] examples of references when the appraiser has clearly included race or other protected class references in the appraisal.

The blog post was conspicuous in failing to provide any information that would allow the reader (or PAVE) to determine the frequency of such occurrences. Did it occur 5 times per million (0.0005%) or 50,000 times per million (5%)? The policy solutions would be quite different for the first level of incidence versus the second.

We have outlined a statistical approach that would allow FHFA, Fannie Mae, and Freddie Mac to identify bad actors today, be they biased or incompetent. These data should be anonymized and made available to independent researchers to verify. Bad actors should be removed immediately from the profession by the appropriate regulator. A failure to proceed in this common sense fashion would confirm a lack of interest in getting to the truth and that the real goal is to provide of an excuse to centralize appraisal valuation standards and appraiser criteria in the federal government.

For the outline of this approach, please refer to page 104 in appendix A5.

3) Many housing task forces and congressional actions have contributed to the racial wealth gap we find ourselves in today. This might serve as a warning for many of today's proposed policies.

HUD, and its predecessors, have played a major role in perpetuating segregation and racial wealth disparities. As noted by PAVE throughout the 20th century, the "federal…government systematically implemented discriminatory policies that led to housing segregation." Not mentioned by PAVE were:

- the U.S. Commerce Department's role in implementing a zoning regime designed to keep Black and ethnic-minorities out of single-family detached neighborhoods (see Chapter 1, AEI Light Touch Density E-Book),
- the 1949 Housing Act which resulted in the high-rise public housing and urban renewal programs, both of which worked to the great detriment of Black households and neighborhoods,

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sellers and real estate agents is limited, thereby making an analysis of valuation differences by different demographics for purchase transactions limited or incomplete relative to the analysis detailed below using refinance transactions." (p.3)

- the 1967 Presidential Task Force on Housing and Urban Development (headed by HUD Secretary Weaver), which proposed a 10-year housing program to eliminate all substandard housing in the U.S., which program was enacted in the 1968 Housing and Urban Development Act, the consequences of which led to HUD and FHA destroying many American cities, especially Black neighborhoods (Cities Destroyed Cash: The FHA Scandal at HUD),
- the Tax Reform Act of 1986, which created the Low Income Housing Tax Credit, which has perpetuated racial segregation (Chicago tax credit program mostly produces affordable housing in poor black areas, March 15, 2021),
- the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, which granted HUD the authority to set affordable housing mandates for Fannie Mae and Freddie Mac, and
- HUD's 1995 National Homeownership Strategy: Partners in the American Dream, which led to over 10 million foreclosures and did much to create the wealth disparities Blacks now face. All of these failures may be traced to HUD, or its predecessor agencies responsible for federal housing policy.

Despite as PAVE claimed "extensive consultation with subject matter experts and leaders across industry, academia, trade and civil rights groups, and government," PAVE ignored a large body of research as outlined above.

And while the PAVE report openly admits that "the exact number of instances of valuation bias is difficult to assess," it arrives at a conclusions that "homeownership is often hindered by inequities within current home lending and appraisal processes, which research shows disproportionately impact people in communities of color." It is questionable at best how PAVE could arrive at its conclusions when its own report states that "lack of access to complete data has been a hindrance to research on appraisal disparities and on the impact of racial and ethnic bias in appraisals."

It seems to suggest that the Biden administration and the media had concluded even before the work of the task force began that there is systemic racial discrimination in the housing market, including systemic racism and bias in housing valuations and property appraisals.

This is clear when, on June 1, 2021, President Biden established the Property Appraisal and Valuation Equity (PAVE) Task Force to be directed by HUD Secretary Marcia Fudge:

> "The Administration will take action to address racial discrimination in the housing market, including by launching a first of-its-kind interagency effort to address inequity in home appraisals, and conducting rulemaking to aggressively combat housing discrimination...."[19]

Again from the readout from PAVE's first meeting held on August 5, 2021 stated:

> "Task Force members discussed how current appraisal practices are a significant contributor to the disparity in housing values. The practice of comparing properties within similar

[19] https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/01/fact-sheet-biden-harris-administration-announces-new-actions-to-build-black-wealth-and-narrow-the-racial-wealth-gap/

> neighborhoods can be a proxy for racial demographics, which leads to the perpetuation and exacerbation of the legacy of segregation and redlining."[20]

The above statements are not supported by credible data and research and making housing and valuation policy based upon such statements would likely do lasting harm to minority borrowers (and low-income borrowers generally).

Based on the debunked Brookings and Freddie Mac research and the data availabilities that currently exist, the federal government has not proven the need for a new centralized behemoth. It is highly questionable that PAVE's proposals will address racial and ethnic differences in homeownership rate, financial returns of owning a home, and median wealth. In some cases, they may make these differences worse or take the pressure off in finding effective solutions, which could ultimately end in disaster for minorities, just like many task forces and housing bills before.

4) The importance of socio-economic status (SES)

Rather than PAVE's finding of "inequities within current home lending and appraisal processes, which research shows disproportionately impact people in communities of color" the real culprit are inequities in SES, which PAVE acknowledges when it states that "[m]uch of the gap in rates of homeownership can be traced to socio-economic factors that differ on average between Black and white homeowners." While lower SES certainly reflects a legacy of past racism and lingering racial bias, which leaves Blacks at a large income and wealth disadvantage relative to most Whites, PAVE should have addressed this in its policy recommendations. Thus, the PAVE Action Plan, by misdiagnosing the causes of the racial gap, will likely lead to unintended consequences as the Action Plan does not address the root problem.

We agree with PAVE that we ought to support opportunities for income and wealth growth among lower-income households. PAVE proposed 21 agency actions. However none of them address the root cause of lower SES, and instead addressed unsubstantiated claims of systemic bias and racism in the housing finance sector.

Based on an objective diagnosis of symptoms and causes using rigorous data analysis, we propose the following solutions:

The housing policy solutions are:

- Building generational wealth through sustainable homeownership for low SES households by reducing leverage for aspiring low-income home buyers.
- Increasing supply and reducing income stratification through Light Touch Density.
- Promoting Walkable Oriented Development in existing neighborhoods with a mix of residential and commercial properties.

Other policy solutions, which might be explored, are:[21]

[20] https://www.whitehouse.gov/briefing-room/statements-releases/2021/08/05/readout-of-the-first-interagency-task-force-meeting-on-property-appraisal-and-valuation-equity-pave/

[21] Many thanks to our AEI colleagues Naomi Schaefer Riley and Angela Rachidi for many of these ideas. Please see their thoughtful analysis: https://reason.com/2021/02/24/fix-family-poverty-with-free-markets-for-once/

- Encouraging two parents in households with children (single-parent households have been found to be a significant SES factor by a wide ranch of academic researchers).
- Enacting occupational licensing reforms and allowing small businesses to be run out of one's home (this has been found to be a significant barrier to low SES households).
- More economical childcare by rolling back burdensome government regulations (childcare costs are a significant barrier to gainful employment by low SES households).
- Real school choice for access to quality elementary and secondary education (racial and ethnic minorities would benefit greatly from real school choice).
- Improving access to technical and apprenticeship training (this would open up access by low SES households to these well-paying jobs).
- Encouraging state and local governments to address public investment disparities relating to minority and lower income neighborhoods.

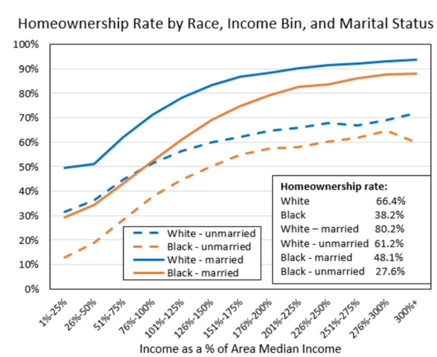
Recognizing the importance of SES factors is key to fashioning appropriate public and private responses. A misdiagnosis that focuses on other factors will not address the root problem and could potentially lead to unintended consequences. We must be mindful that many public policies aimed at addressing racial discrimination have had unintended consequences that have done substantial harm to low-income households generally, and minority households in particular.

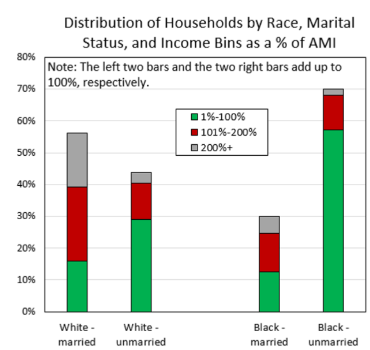
Marital Status and Income Are Key Drivers of the Homeownership Rate by Race

The Black homeownership (HO) rate is much lower than the White HO rate, but the difference gets smaller as income grows. The HO rate for White or Black married households (HH) is much higher than for unmarried White or Black HH (left panel).

There is a big disparity by marital status between Blacks and Whites. Unmarried Black HH comprise 70% of Black HH, and the vast majority are below area median income (right panel).

Policy challenge: Reduce income and marital status disparities between Black and White HH.





Note: Data are for urban household heads aged 25-65 and exclude widowed households.
Source: Census Bureau and AEI Housing Center, www.AEI.org/housing.

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For the full a lengthier discussion of the policy solutions, see appendix A2 (starting on page 26).

5) **Foreclosure-prone affordable housing policies have contributed to the racial wealth gap we find ourselves in today.**

Foreclosure-prone affordable housing policies for single-family lending have subsidized debt by providing excessive leverage. These policies have been primarily targeted at low-income and minority homebuyers and began in 1954, when Congress authorized the 30-year loan for use on existing FHA home loans. Congress also raised loan-to–value (LTV) limits around the same time. The average FHA loan term and LTV in 1954 was 21.4 years and 79.9%. These rose to 27 years and 90% by 1959.

Congress doubled down on this policy with the passage of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, which would have a devastating effect. During the Financial Crisis, these policies contributed to at least 10 million or more foreclosures, which were proportionally higher in low-income and minority neighborhoods. For example, the 27% foreclosure rate in low-income census tracts (defined as <80% of area median income) was 1.5 times as high as the 18% foreclosure rate in high-income census tracts (defined as ≥120% of area median income). Similarly, the foreclosure rate of 30% in census tracts with a Black and/or Hispanic share of households of at least 50% was twice as high as the 16% foreclosure rate in census tracts with a Black and/or Hispanic share of households of less than 10%.

Table: Foreclosure Rate by Neighborhood Type

Census Tract to Area Median Income Ratio	**Foreclosure Rate**
<80%	27%
80% - <120%	22%
≥120%	18%
All	22%

Census Tract Black and/or Hispanic share	**Foreclosure Rate**
≥50%	30%
20% - <50%	24%
10% - <20%	18%
<10%	16%

Note: Foreclosure rate is for loans originated between 2004 and 2008.
Source: LLMA and AEI Housing Center.

Yet, the homeownership rate in 2020:Q4 was 65.8%, only marginally higher than the rate of 63.0% in 1964:Q4.[22] Today, the federal government's twin legacy of racially-motivated zoning and poorly designed affordable housing policies continue to make the housing market separate and unequal.

This is the paradox of accessible lending: When supply is constrained, credit easing will make entry-level homes less, not more, affordable. Credit easing merely permits one borrower to bid up the price against another would be buyer for a scarce good.[23] Thus, much of the credit easing that these federal policies provided are quickly capitalized into higher home prices. This is especially pertinent for entry-level homes, which are perennially in short supply. This puts upward pressure on home prices, does not expand access, and is dangerous; concepts we have had to learn and relearn.

[22] Pinto, "Housing finance fact or fiction? FHA pioneered the 30-year fixed rate mortgage during the Great Depression?" June 2015, https://www.aei.org/economics/housing-finance/housing-finance-fact-or-fiction-fha-pioneered-the-30-year-fixed-rate-mortgage-during-the-great-depression/

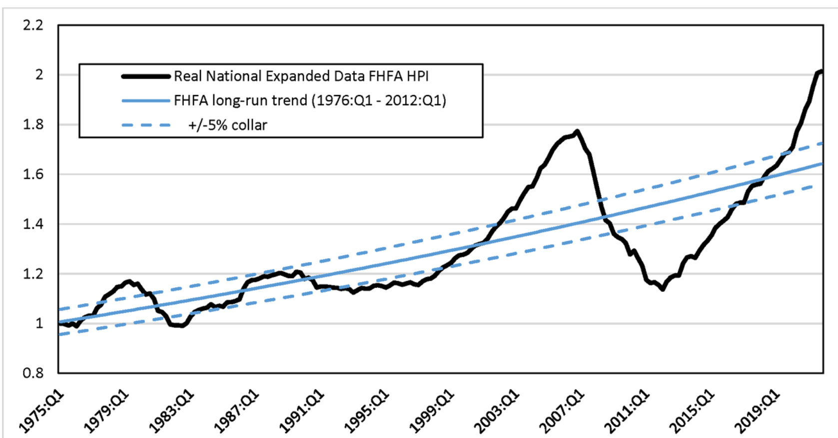
[23] Fed Chairman Marriner Eccles, Federal Reserve Bulletin, The Current Inflation Problem, 1947.

An NBER paper by Kermani and Wong (2021) has looked at the evidence in detail. It is worth quoting their abstract in full:[24]

> We document the existence of a racial gap in realized housing returns that is an order of magnitude larger than disparities arising from housing costs alone, and is driven almost entirely by differences in distressed home sales (i.e. foreclosures and short sales). Black and Hispanic homeowners are both more likely to experience a distressed sale and to live in neighborhoods where distressed sales erase more house value. Importantly, absent financial distress, houses owned by minorities do not appreciate at slower rates than houses owned by non-minorities. Racial differences in income stability and liquid wealth explain a large share of the differences in distress. We use quasi-experimental variation in loan modifications to show that policies that restructure mortgages for distressed minorities can increase housing returns and reduce the racial wealth gap.

Yet, merely a decade after the last housing crash, the country is in the midst of yet another housing boom already nine years in the making and which according to Nobel Laureate Robert Shiller was "already gigantic" by 2018.[25] The Federal Housing Finance Agency has developed a measure of the current state of the housing market in terms of the long-term inflation-adjusted home price trend. We are well above the long term trend and home prices are expected to continue to significantly increase in 2021 and likely 2022. An extended price boom not only makes homes unaffordable, but also promotes price volatility and unforgiving mean reversion.

Chart: Inflation-adjusted National Home Price Index with FHFA's Long-run Trend and Collar



Source: FHFA and AEI Housing Center.

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[24] Kermani, Amir, and Francis Wong. Racial Disparities in Housing Returns. No. w29306. National Bureau of Economic Research, 2021.

[25] Robert Shiller, "The Housing Boom Is Already Gigantic. How Long Can It Last?" NYT Dec. 7, 2018.

Based on an objective diagnosis of symptoms and causes using rigorous data analysis, we propose the following solutions:

- Eliminate demand boosters as they create unaffordability until balance between supply and demand has been restored:
  - Congress should task FHA, not the GSEs, with guaranteeing loans for high-risk, low-income borrowers.
    - FHA should limit mortgage default risk at loan origination through the use of shorter loan terms.
    - HUD should study how to increase borrower resiliency by examining the effectiveness of the residual income test, month's reserves at closing, the Massachusetts Housing Finance Agency unemployment program, and a loan with a reserve accumulation component. In all cases, the data should be made available to private researchers for independent study and evaluation.
  - FHFA should set a limit on mortgage default risk at loan origination.
    - The MDR is a comprehensive stressed default rate, which represents the worst-case scenario stress test similar to a car crash test or a hurricane safety rating. The NMDR has shown to be incredible predictive of loan defaults during the COVID- 19 pandemic.[26]
    - The MDR would also help end policies, especially risk layering, that have had a disparate impact on low-income households, especially ones of color, and would therefore affirmatively further fair housing under the Fair Housing Act.
- Shrink the government's footprint in the housing market.
- Do not relax underwriting standards in an overheated housing market
  - It has been tried many times since 1954 and has not worked.
  - There is a growing consensus that the way to make housing more affordable is to increase supply, not to ease credit, increase government subsidies, or suppress interest rates.
  - Yet, rather than shrinking the government's footprint or reducing risk, Fannie has already increased risk layering and FHFA has recently made policy changes that increases GSE competition with the private sector and will lead to greater risk-layering. Many other changes are being discussed such as:
    - June 2021: CFPB delayed the mandatory compliance data of the QM rule until Oct 1, 2022. The CFPB's 2020 replacement of the QM rule with a new standard based on the Average Prime Offer Rate) would similarly relax underwriting requirements and thus promote higher risk loans and unsustainable home price appreciation. The same applies to an expansive stand-alone DTI limit.
    - August 2021: FHA updated its student loan monthly payment calculations.
    - August 2021: FHFA proposed new benchmark level for minority & low-income tracts home purchase in 2022-24.
    - September 2021: Fannie and Freddie suspended limits on second homes and investment properties, and risk layering limits on loans due to higher risk characteristics

[26] https://www.aei.org/housing/mortgage-risk-index/

- September 2021: Fannie started to include rental payment history in its risk assessment processes.
- Possible for 2022:
    - Pressures on FHA are building to lower FHA's current level of mortgage insurance premiums (MIP). Secretary Fudge has for the moment ruled out a cut to the MIP, but if a cut were to be implemented during an overheated housing market, it would have similar consequences as the 2015 MIP cut, which drove up prices and did not materially expand homeownership.[27] A move such as this would restart a dangerous bidding war between FHA and the GSEs, who would be facing higher affordable housing goals for low-income and minority borrowers, which leads a race to the bottom in terms of lending standards.
    - Acting FHFA Director Thompson announced in September 2021 that "the agency is weighing changes to the loan-level price adjustments enacted in 2008 to help the government-sponsored enterprises manage risk."[28]

Each one of these proposals on its own seems innocuous. However, the accumulation and combination of them should raise alarms.

With new leadership at federal agencies and regulators, a concerted effort to lower underwriting standards again – as happened during the 1990s and 2000s – seems to be underway.

Raising the Affordable Housing Goals requires lessening criteria on risk layering, otherwise the goals could not achieve much. At the same time, the effort to bring in higher-risk borrowers requires larger cross-subsidies, which requires lower changes to the LLPAs.

While lower-income Americans are being crowded out of the housing market (more below), bringing them back by lowering underwriting standards through a concerted efforts by federal agencies and regulators is a recipe for disaster and risks creating more housing risk. This will put the exact people the policies are intended to help into harm's way.

[27] At the time, the FHA claimed that the premium drop would result in 250,000 new first-time buyers over the next three years, and save each FHA buyer $900 annually. Our research found that home prices went up by about 2.5% for FHA borrowers. These borrowers had to use part their new found "wealth" — obtained by paying lower FHA insurance premiums —to pay for the higher house price. Prices also went up for non-FHA buyers in neighborhoods with FHA insured sales. After all, it is one housing market, where borrowers, no matter the financing, compete for houses. This caused the non-FHA buyers, who did not receive the benefit of lower premiums, to largely offset the price increase by buying a home of lesser quality (perhaps a smaller home, a smaller lot, or in a different location) – they were the clear losers. We estimate that about 500,000 of these non-FHA borrowers were first-time homebuyers. Each of these non-FHA homebuyers paid approximately $6,200 extra per house, a total extra payment of about $3.1 billion. From a cost-benefit perspective, this averages to an incredible $180,000 for each of the roughly 17,000 new FHA first-time buyers! The big winners were the realtors who received hundreds of millions of dollars in higher commissions from higher prices. For more, see Davis, Oliner, Peter, and Pinto, The impact of federal housing policy on housing demand and homeownership: Evidence from a quasi-experiment, http://www.aei.org/wp-content/uploads/2018/01/Oliner-homeownership-WP-Update.pdf?x91208

[28] https://www.americanbanker.com/news/fhfa-weighs-cutting-price-adjustment-fees-on-fannie-and-freddie-loans

Equally worrisome are increases to the GSEs appraisal waiver practices, particularly purchase loans. In the past, human appraisals have successfully alerted lower-income and minority borrowers when they were overpaying. An appraisal waiver may simply confirm the negotiated sale price, while the competition between Fannie and Freddie for market share may create a race to the bottom on standards – not to mention that these processes can be gamed, which was commonplace with respect to the GSEs automated underwriting systems in the lead up to the Financial Crisis.

6) The crowding out of low- and moderate-income and minority borrowers

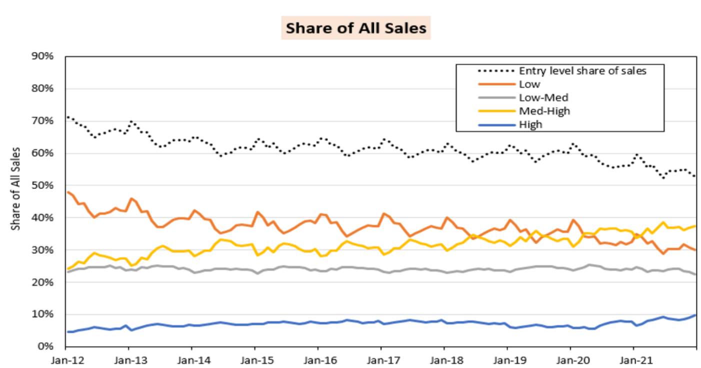
These federal housing policies, including the Fed's role in artificially lowering interest rates through its easy monetary policy during a seller's market, have contributed to rapidly rising home prices. These high prices are having the effect of increasingly crowding out lower-income and minority would-be homebuyers out of the housing market. It begs the question how these individuals should ever be able to accumulate wealth if they cannot get on the first rung of the housing ladder.

Here is a list of data on the recent single-family housing boom, which started in 2012:

- Uninterrupted seller's market since 2012, which is now the longest ever recorded.
- Housing supply is currently at its lowest level ever. In December 2022 the months' supply of low- and low-median price tiers was 0.9 and 1.0 months respectively. Traditionally about 75% of homes at these price points are first-time buyers.
- Since 2012, home price appreciation has far outpaced the growth in market fundamentals (wages, construction cost, rents).
- Since 2012, home prices have appreciated 102%. Entry-level prices are up even more (118%).
- Home price appreciation (HPA) has further accelerated in the aftermath of the pandemic.
    - Since Jan. 2020 prices are up 27%.

Example 1:

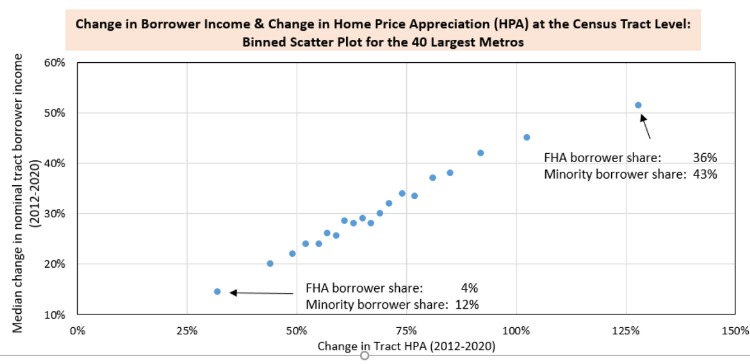
The entry-level share of home sales has been declining from 71% in Jan. 2012 to 53% in Dec. 2021.



Source: AEI Housing Center.

Example 2:

- For census tracts with the fastest HPA (+125% since 2012), we observe borrower income growth (+50%) twice the rate of the national income growth (~27%).
    - Unfortunately, it is highly implausible that the incomes for this group of borrowers has gone up that fast.
    - What is more likely happening is that due to the rapid price spiral, a different mix of buyers is buying in these neighborhoods.
    - For example:
        - In 2012, the borrowers purchasing in census tract A had a median income of $40,000.
        - By 2020, these borrowers should be making $51,000 according to wage statistics from the Atlanta Fed.
        - However in 2020, we observe that the borrowers now purchasing in census tract A have a median income of $61,000.
        - Had the borrowers from 2012 not purchased in 2012, but rather tried to purchase in 2020, their income would not have sufficed to compete with the higher income borrowers that actually purchased in 2020.
- The census tracts with the fastest HPA also had the highest share of FHA purchase loans (an indicator for lower-income) and minority borrowers.



Note: Tracts are weighted by their respective loan counts. Binned scatter plot accounts for differences in metros. FHA and minority borrower shares are for 2020. HPA stands for constant-quality home price appreciation
Source: HMDA and AEI Housing Center, www.AEI.org/housing.

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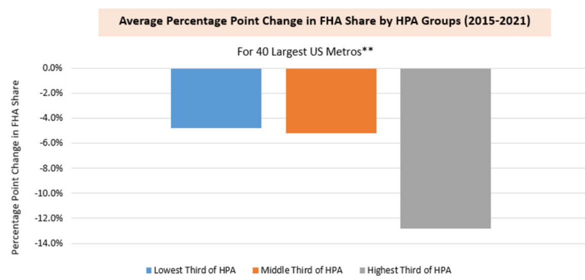
Example 3:

- The top one-third of large metros with the highest growth in HPA have seen a 13 percentage point reduction in FHA purchase loan share compared to a 6 percentage point reduction for the two-thirds of metros with lower levels of HPA.
- Since FHA is a proxy for lower-income and minority borrowers, this trend is indicative of substantial crowding out of low income and minority potential home buyers.



* FHA purchase share is used as a proxy for lower income, minority, first-time, and first-generation borrowers
****Metro Cities in Lowest Third HPA Category**: Baltimore, MD; Chicago, IL; Cincinnati, OH; Cleveland, OH; Houston, TX; Kansas City, MO; New York, NY; Philadelphia, PA; Pittsburgh, PA; Raleigh, NC; San Antonio, TX; St. Louis, MO; Virginia Beach, VA; Washington, DC.
Metro Cities in the Middle Third HPA Category: Austin, TX; Boston, MA; Cape Coral, FL; Charlotte, NC; Columbus, OH; Dallas, TX; Detroit, MI; Indianapolis, IN; Jacksonville, FL; Los Angeles, CA; Miami, FL; Minneapolis, MN; North Port, FL.
Metro Cities in Highest Third HPA Category: Atlanta, GA; Denver, CO; Las Vegas, NV; Nashville, TN; Orlando, FL; Phoenix, AZ; Portland, OR; Riverside, CA; Sacramento, CA; San Diego, CA; San Francisco, CA; Seattle, WA; Tampa, FL.

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Source: American Community Survey, Public Records, and AEI Housing Center, www.AEI.org/housing.

The conclusion is that because of an out of control price spiral there is increased competition for fewer and fewer affordable homes. Potential entry-level buyers are increasingly pushed to the sidelines as they cannot compete with more deep pocketed individuals, who experience the same competition only higher up the price spectrum, and so on. As home prices rise faster than incomes, it will permanently price low-income and minority households out of areas of opportunity. These trends are indicative of the crowding out of low income and minority potential home buyers, which results from the house price boom due to federal monetary and housing policies. It is a violation of the Fair Housing Act.

Appendices:

AEI Housing Center

Comments on PAVE's "Action Plan to Advance Property Appraisal and Valuation Equity: Closing the Racial Wealth Gap by Addressing Mis-valuations for Families and Communities of Color"

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March 2022

On March 23rd, the Interagency Task Force on Property Appraisal and Valuation Equity and, which is composed of thirteen federal agencies and offices, released its report entitled "Action Plan to Advance Property Appraisal and Valuation Equity: Closing the Racial Wealth Gap by Addressing Mis-valuations for Families and Communities of Color."

Commentary on PAVE's conclusion:

PAVE concluded that "Homeownership is often hindered by inequities within current home lending and appraisal processes, which research shows disproportionately impact people in communities of color."

As noted in the Executive Summary, the report largely rests on three studies for its conclusion: (i) a report by the Brookings Institution, (ii) a note by Freddie Mac, and (iii) a blog post by FHFA.[1] In our work, we have issued lengthy critiques that discredit the first two studies (see our rebuttal to Brookings and to Freddie Mac) and now take the opportunity to respond to the FHFA study.[2] Here is a summary of our findings:

The Brookings and Freddie Mac studies are not based on rigorous data analysis. Most importantly, they conflate race with socio-economic status (SES), i.e. income, buying power, marriage rates, credit scores, etc. **Race-based gaps found in the Brookings and Freddie Mac studies either entirely or substantially disappear when adjusting for differences in SES.** Furthermore, our analyses show that similar gaps are present in majority White or White-only tracts across different SES levels, raising serious questions regarding a race-based explanation.[3] We also addressed a rebuttal from the Brookings authors to our critique. We found that Perry and Rothwell's (2021) rebuttal to our critique supported our claim of omitted variable bias, failed to rebuke our methodology, and never addressed our case studies. We also presented solutions based on our findings. The Freddie Mac study took pains to state that its research was both "exploratory" and "preliminary". Yet PAVE accepted Freddie Mac's findings at face value, even

[1] Interagency Task Force on Property Appraisal and Valuation Equity (PAVE), *Action Plan to Advance Property Appraisal and Valuation Equity: Closing the Racial Wealth Gap by Addressing Mis-valuations for Families and Communities of Color*, March 24, 2022, pp. 2-3.
[2] Despite the AEI Housing Center having undertaken a significant body of research on the topic of racial bias in housing finance over a course of years and notwithstanding efforts to engage with PAVE and some of its members, we were unable to engage with PAVE and our work was not mentioned in the report. Yet, PAVE stated that "[o]ver the past 180 days, the Task Force has undertaken a collaborative and comprehensive approach toward identifying actions to address appraisal bias. This approach involved extensive consultation with subject matter experts and leaders across industry, academia, trade and civil rights groups, and government."
[3] The same critique to the Brookings paper also applies to research by Howell and Korver-Glenn (2021) and a recent Redfin post on the same topic.

though research by Fannie Mae provides a likely, non-race based explanation for the valuation discrepancy found by Freddie Mac. It is worth noting that Fannie Mae's explanation casts a favorable light on the appraisal industry.

This conflation by both Brookings and Freddie Mac is of critical importance. While there is agreement regarding the symptoms observed by PAVE--racial and ethnic differences in the homeownership rate, the financial returns of owning a home, and median wealth levels--ascertaining the causes and workable solutions requires a competition of ideas.[4] PAVE excluded research that was inconvenient or inconsistent with the desired narrative and conclusion.[5]

The FHFA blog post, which we have not addressed until now, stated that in their "review of appraisals, we have observed references to race and ethnicity in the 'Neighborhood Description' and other free-form text fields in the appraisal form." FHFA concluded that the use of such references is evidence of bias as the "racial and ethnic composition of the neighborhood should never be a factor that influences the value of a family's home" and released 16 specific examples.

While we all can agree with FHFA's statement that "racial and ethnic composition of the neighborhood should never be a factor that influences the value of a family's home", the blog post failed to provide any specifics as to the frequency of such occurrences. It only stated:

> From millions of appraisals submitted annually, a keyword search resulted in thousands of potential race-related flags. Individual review finds many instances of keywords to be false positives, but the following are [16] examples of references when the appraiser has clearly included race or other protected class references in the appraisal.

Without more information, one is unable to discern whether this is evidence of a few bad apples or systemic behavior. This is made all the more problematic given that there is other evidence showing no systemic appraisal bias. Unfortunately, PAVE ignored that body of research, to wit:

- AEI Housing Center (2021) found that racial bias by appraisers on refinance loans is uncommon and not systemic. To evaluate the existence of bias, the AEI Housing Center assembled a unique dataset with over 240,000 loans for which we knew the race of the borrowers.
- Ambrose et al. (2021) concluded that "contrary to media allegations, our statistical analysis found that racial bias by appraisers on refinance loans is uncommon and not systemic."[6]
- Fannie Mae (2022) concluded that for refinance applications "Black borrowers refinancing their home on average received a slightly lower appraisal value relative to automated valuation

[4] The University of Wisconsin Board of Regents stated this concept best over 125 years ago: *"Whatever may be the limitations which trammel inquiry elsewhere, we believe that the great state University of Wisconsin should ever encourage that continual and fearless sifting and winnowing by which alone the truth can be found."* https://news.wisc.edu/sifting-and-winnowing-turns-125/

[5] This goes back to when President Biden in his January 26, 2021 "Memorandum on Redressing Our Nation's and the Federal Government's History of Discriminatory Housing Practices and Policies" for the Secretary of HUD cited as fact "a persistent undervaluation of properties owned by families of color." Thus, PAVE would need to conform to the President's stated narrative, notwithstanding strong evidence to the contrary. https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/26/memorandum-on-redressing-our-nations-and-the-federal-governments-history-of-discriminatory-housing-practices-and-policies/

[6] Ambrose, Brent W., James Conklin, N. Edward Coulson, Moussa Diop, and Luis A. Lopez. "Does Appraiser and Borrower Race Affect Valuation?" Available at SSRN 3951587 (2021).

> models" and that "the frequency of 'undervaluation' did not have a notable racial pattern."[7]Interestingly, Fannie Mae (2022) also rebuked the methodological approach in Freddie Mac's research note that was cited by PAVE as one of the three main studies.[8]

Our conclusion is that PAVE has misdiagnosed the problem.[9] PAVE proposed 21 agency actions. It is highly questionable that these will address racial and ethnic differences in the homeownership rate, the financial returns of owning a home, or median wealth levels. In some cases, they may make these differences worse or take the pressure off in finding effective solutions. It also must be noted that HUD and its predecessors have played a major role in perpetuating segregation and racial wealth disparities.[10] This alone should give pause to any objective reader of the PAVE report.

Rather than PAVE's finding of "inequities within current home lending and appraisal processes, which research shows disproportionately impact people in communities of color," the real culprit is inequities in SES, which PAVE acknowledges when it states that "[m]uch of the gap in rates of homeownership can be traced to socio-economic factors that differ on average between Black and white homeowners." While lower SES certainly reflects a legacy of past racism and lingering racial bias, which leaves Blacks at a large income and wealth disadvantage relative to most Whites, PAVE should have addressed this in its

[7] Williamson, Jake and Mark Palim. "Appraising the Appraisal: A closer look at divergent appraisal values for Black and white borrowers refinancing their home." (2022).

[8] In particular, Fannie Mae wrote that "[w]e chose to study refinance applications, as opposed to home purchase applications, because the appraiser in a refinance transaction typically interacts directly with the homeowner (i.e., the borrower), establishing a pathway for potential bias to influence the appraisal results. The race or ethnicity of the borrower is often disclosed in the loan data, making it possible to directly observe any correlation with value. On the other hand, in a purchase transaction, the appraiser typically does not interact with the buyer (i.e., the borrower) of the property but rather with the seller or the seller's agent. The availability of racial or ethnic data of sellers and real estate agents is limited, thereby making an analysis of valuation differences by different demographics for purchase transactions limited or incomplete relative to the analysis detailed below using refinance transactions." (p.3)

[9] At times, PAVE tried to have it both ways. On the topic of undervaluation, which is the main focus in the Freddie Mac analysis because of the negative impact on minority home buyers, the PAVE report stated that a lower appraisal can be beneficial to the buyer but hurtful to the seller as "it limits the seller's realized home equity gains and therefore impacts the seller's wealth." (p.15)

[10] As noted by PAVE, throughout the 20th century the "federal…government systematically implemented discriminatory policies that led to housing segregation." Not mentioned by PAVE was the U.S. Commerce Department's role in implementing a zoning regime designed to keep Black and ethnic-minorities out of single-family detached neighborhoods (see Chapter 1, AEI Light Touch Density E-Book), the 1949 Housing Act which resulted in the high-rise public housing and urban renewal programs, both of which worked to the great detriment of Black households and neighborhoods, the 1967 Presidential Task Force on Housing and Urban Development (headed by HUD Secretary Weaver), which proposed a 10-year housing program to eliminate all substandard housing in the U.S. (source: Lyndon Johnson Library), that was enacted in the 1968 Housing and Urban Development Act, the consequences of which led to HUD and FHA destroying many American cities, especially Black neighborhoods (Cities Destroyed Cash: The FHA Scandal at HUD), the Tax Reform Act of 1986, which created the Low Income Housing Tax Credit, which has perpetuated racial segregation (Chicago tax credit program mostly produces affordable housing in poor black areas, March 15, 2021), the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, which granted HUD the authority to set affordable housing mandates for Fannie Mae and Freddie Mac, and HUD's 1995 National Homeownership Strategy: Partners in the American Dream, which led to over 10 million foreclosures and did much to create the wealth disparities Blacks now face. All of these failures may be traced to HUD, or its predecessor agencies responsible for federal housing policy.

policy recommendations. Thus, the PAVE Action Plan, by misdiagnosing the causes of the racial gap, will likely lead to unintended consequences as the Action Plan does not address the root problem.

We agree with PAVE that we ought to support opportunities for income and wealth growth among lower-income households. However, we should address the root cause for lower SES instead of unsubstantiated claims of systemic bias and racism in the housing finance sector.

Based on an objective diagnosis of symptoms and causes using rigorous data analysis, we propose the following solutions:

The housing policy solutions are:

- Building generational wealth through sustainable homeownership for low SES households by reducing leverage for aspiring low-income home buyers.
- Increasing supply and reducing income stratification through Light Touch Density.
- Promoting Walkable Oriented Development in existing neighborhoods with a mix of residential and commercial properties.

Other policy solutions, which might be explored, are:[11]

- Encouraging two parents in households with children (single-parent households have been found to be a significant SES factor by a wide ranch of academic researchers).
- Enacting occupational licensing reforms and allowing small businesses to be run out of one's home (this has been found to be a significant barrier to low SES households).
- More economical childcare by rolling back burdensome government regulations (childcare costs are a significant barrier to gainful employment by low SES households).
- Real school choice for access to quality elementary and secondary education (racial and ethnic minorities would benefit greatly from real school choice).
- Improving access to technical and apprenticeship training (this would open up access by low SES households to these well-paying jobs).
- Encouraging state and local governments to address public investment disparities relating to minority and lower income neighborhoods.

Recognizing the importance of SES factors is key to fashioning appropriate public and private responses. A misdiagnosis that focuses on other factors will not address the root problem and could potentially lead to unintended consequences. We must be mindful that many public policies aimed at addressing racial discrimination have had unintended consequences that have done substantial harm to low-income households generally, and minority households in particular.

[11] Many thanks to our AEI colleagues Naomi Schaefer Riley and Angela Rachidi for many of these ideas. Please see their thoughtful analysis: https://reason.com/2021/02/24/fix-family-poverty-with-free-markets-for-once/.

The Impact of Race and Socio-Economic Status on the Value of Homes by Neighborhood

A Critique of the Brookings Institution's "The Devaluation of Assets in Black Neighborhoods"

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Synopsis

Perry et al.'s "The Devaluation of Assets in Black Neighborhoods" finds a value difference of 23% between <1% Black and majority Black neighborhoods or $156 billion in cumulative losses, which the authors attribute in its entirety to racial bias. Using 23 controls in a regression, they state that these controls account for all differences in structural and neighborhood amenities between neighborhoods (census tracts) with various percentages of Black residents. The authors graciously provided their data and regression code for our test.

While measuring the lingering effects of racism on disparity in home values is impervious to scientific exactitude, the authors' hypothesis and methodology can be tested to determine whether they are in error. We did not find small, inconsequential errors, but rather a massive over-estimate of the disparity attributed exclusively to race.

Our test had three parts. First, we added 1 control to the original 23 and found that this small change reduced the value difference substantially. Second, we applied the authors' regression methodology to just the tracts with a Black share of <1%. There can be no devaluation due to racial bias in this sample. We found a substantial value difference due to omitted socio-economic status (SES) factors such as income and credit score. Third, we confirmed this using 6 variables that proxy for aspects of SES, and found differences up to 51%, including 3 larger than the 23% devaluation the authors found when comparing tracts with Black shares of 50% and 0%. We conclude that what the authors characterize as race-based differences in home values are actually due, in large part, to SES differences. Lower SES certainly reflects a legacy of past racism and lingering racial bias, leaving Blacks at a large income and wealth disadvantage relative to most Whites.

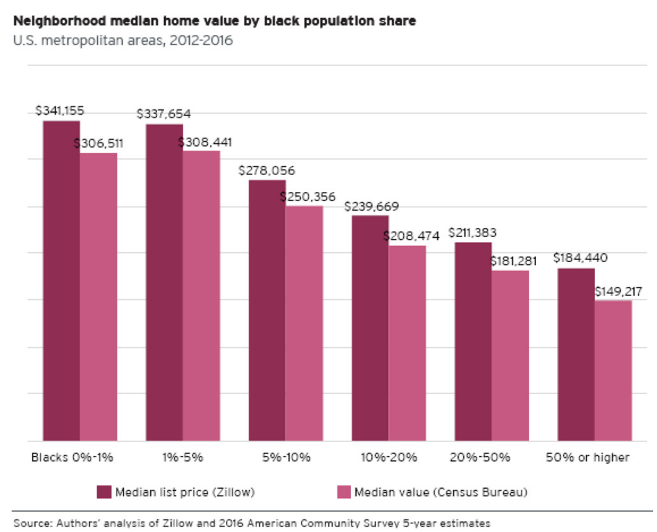
Recognizing the importance of SES factors is key to fashioning appropriate public and private responses. The overarching goal is to promote sustainable access to housing finance and support opportunities for income and wealth growth among lower income households. In so doing, we must be mindful that many past and continuing housing and other policy actions to address racial discrimination have had unintended consequences that have done substantial harm to low-income households generally, and minority households in particular.

Key Takeaways

- Perry et al.'s "The Devaluation of Assets in Black Neighborhoods" has garnered much attention. The study aims to quantify the financial cost of racial discrimination. It finds a value difference of 23% between <1% Black and majority Black neighborhoods or $156 billion in cumulative losses, which the authors attribute in its entirety to racial bias.
- We point out shortcomings in Perry et al.'s methodology and conclude that it is a serious overstatement to attribute a 23% gap in valuations solely to racial bias.
- We are not aiming to provide an alternative point estimate, but rather to show that the current approach has serious shortcomings.
- Our work finds that what Perry et al. characterize as race-based differences in home values are actually, in large part, SES-based differences.
  - Lower SES certainly reflects a legacy of past racism and lingering racial bias, leaving Blacks at a large income (and wealth) disadvantage relative to most Whites.
  - However, if largely SES based, the primary remedy would be policies that work to address the income and wealth gap.
- Our work finds that while much work remains to be done, the focus should be on increasing financial security, creating generational wealth, and shrinking the SES gap through sustainable home ownership. This is largely a buying power issue, not a valuation one. To do otherwise risks repeating the mistakes of the past.
- We also point out that while the country has been making progress in racial integration, stratification along income and SES has been increasing.
- We propose several policy solutions to address this increasing stratification.

Devaluation of Assets in Black Neighborhoods*

"In the average U.S. metropolitan area, homes in neighborhoods where the share of the population is 50 percent Black are valued at roughly half the price as homes in neighborhoods with no Black residents. There is a strong and powerful statistical relationship between the share of the population that is Black and the market value of owner-occupied homes." (p.2)



* Andre Perry, Jonathan Rothwell, and David Harshbarger, The Brookings Institution, *The Devaluation of Assets in Black Neighborhoods*, https://www.brookings.edu/research/devaluation-of-assets-in-black-neighborhoods/, 2018
Note that Perry et al. refer to census tracts as neighborhoods. We generally refer to them as tracts.

Devaluation of Assets in Black Neighborhoods (Cont.)

"Homes of similar quality in neighborhoods with similar amenities are worth 23 percent less in majority Black neighborhoods, compared to those with very few or no Black residents."

Perry et al. attribute this gap entirely to racial discrimination.*

"Across all majority Black neighborhoods, owner-occupied homes are undervalued by $48,000 per home on average, amounting to $156 billion in cumulative losses." (p. 3)

Average devaluation of homes due to location in a neighborhood that is 50% black compared to 0% black

Owner-occupied units in U.S. metropolitan areas, 2012-2016

	Actual price comparison	Adjustments for structural characteristics of home	Adjustments for structural characteristics of home and neighborhood amenities
Census median home value	-55%	-42%	-23%
Zillow median list price of houses per square foot	-35%	-40%	-23%
Zillow median list price of houses	-51%	-44%	-22%

Source: Authors' analysis of 2016 American Community Survey 5-year estimates and median values from Zillow averaged from 2012-2016. See text for list of structural characteristics and neighborhood amenities

Source: Perry et al.

* Howell and Korver-Glenn arrive at a devaluation estimate of 32% for Black and Hispanic neighborhoods after controlling for house and neighborhood characteristics, which is similar to the results in Perry et al. "The Price of Racial Bias" by Redfin arrives at a devaluation estimate of $46,000 after controlling for house and neighborhood characteristics, which is similar to the results in Perry et al. We believe that the same critique outlined herein would apply to Howell and Korver-Glenn and the Redfin study. In the appendix we demonstrate that the 2 specific examples cited in the Redfin study do not withstand close examination.

Devaluation of Assets in Black Neighborhoods (Cont.)

Perry et al. claim to have completely controlled for structural characteristics and neighborhood (tract) amenities using 23 control variables, leaving the black population share to measure racial bias. Of the 23 controls, 16 are statistically significant at the 5% level, 7 are not.

Perry et al.'s framework may be expressed by the following equation:

Home Value = Structural Characteristics + Neighborhood Amenities + Racial Bias

And alternatively:

Racial Bias = Home Value - Structural Characteristics - Neighborhood Amenities

#	Variable	Source	Significant at 5% level?
	Structural Characteristics		
1.	Median rooms	ACS 2012-2016	Y
2.	Median year built		N
3.	Single-family detached share of owner-occupied units		Y
4.	Single-family attached share of owner-occupied units		Y
5.	Mobile homes share of owner-occupied units		Y
6.	Homes with no vehicle availability		N
7.	Homes with gas or electric heating		N
8.	Homes with complete kitchen facilities		Y
	Neighborhood Amenities		
9.	Mean commute of adult workers	ACS 2012-2016	Y
10.	Percent of working adults who carpool to work		Y
11.	Percent of working adults who use public transport		Y
12.	Percent owner-occupied units		N
13.	Population (natural log)		N
14.	Percent of households with children under 18		N
15.	Percent households headed by single mothers with children under 18		Y
16.	Median age of the population		N
17.	EPA Walkability Index	EPA	Y
18.	Number of professional service businesses	County Business Patterns	Y
19.	Number of libraries		Y
20.	Number of museums and historical sites		Y
21.	Number of food and drinking places		Y
22.	Number of gas stations		Y
23.	Proficiency rate of 4^{th}-8^{th} grade public school students	Perry et al.'s Calculations	Y

Source: Perry et al., as replicated by the AEI Housing Center, www.AEI.org/housing. We are grateful to the authors' for providing both their data set and code.

The AEI Housing Center Approach

- Establish a baseline by replicating Perry et al.'s approach using the 23 controls along with the Black population share. We are grateful to the authors for providing both their data set and code.
- Identify and test additional controls that might improve upon Perry et al.'s 23 control approach.
- Conduct a series of case studies, thought experiments and robustness checks to further evaluate both Perry et al.'s and our approaches.
- Analyze the results in a manner that accounts for socio-economic status (SES), which can explain differences in neighborhood home values, thereby expressing our framework as follows:

  Home Value = Structure Characteristics + Neighborhood Amenities + SES + Racial Bias

And alternatively:

  Racial Bias = Home Value - Structural Characteristics - Neighborhood Amenities – SES

- Develop policy recommendations based upon our findings.

Identifying and Testing Additional Controls that Might Improve upon Perry et al.'s 23 Control Approach

- With 23 control variables, adding two more should be noncontroversial. We add:
  - **One adult borrower share (vs. two or more borrowers)*:**
    - Perry et al. include the shares of single mothers with children under 18 and are home owners.
    - One adult borrower share is similar in kind to single mothers and home owners in that all of these variables are SES proxies.
  - **Average 2013 Equifax Risk Score (ERS)**:**
    - ERS is a credit score code, representing a summary metric of the stock of all residents of any type in a neighborhood with a score.
    - It is another SES proxy.
- Similar to many of the original 23 controls, one adult borrower share and ERS are both highly correlated with income.
- These new SES variables are significant at the 1% level and add new explanatory power.
  - The percentage with kitchen and carpool control variables are now statistically insignificant, increasing the insignificant total to 9 of the 23.

* One adult borrower share comes from 2012-2016 HMDA home purchase loans. Since the source is HMDA, it is a near complete census and highly accurate. This metric is a flow measure as opposed to shares of single mothers with children under 18 and home owners, which are both stock measures.

** The ERS source data are at the ZIP code level and are translated to the neighborhood level using a HUD crosswalk file. We also tested tree canopy coverage and air pollution, but found these variables not to be statistically significant. In terms of tree coverage, there may be too little discernment between neighborhoods and in the case of air pollution, the data are interpolated from a much larger area to the neighborhood level, which may introduce noise.

Housing Center Results (Zillow Data and ZIP-7 ERS)

- We replicate Perry et al. using Zillow's median list price of houses per square foot as the dependent variable (Perry et al.'s preferred specification).
  - We find an initial devaluation of 22.0%.[1] After deleting 68 tracts (0.2% of all tracts) for which ERS or the one adult borrower share are not available, we find a baseline devaluation of 21.8%.
  - Adding ERS as a control reduces the devaluation to -0.3%, a 100% reduction. This devaluation is not significantly different than zero.
- **Conclusion**: By adding just the Equifax Risk Score*, which is an SES-related explanatory variable, the devaluation found by Perry et al. disappears. As a result:
  - Their approach did not, as asserted, fully adjust for structure characteristics and neighborhood amenities.
  - Their estimate of devaluation due to racial bias is, at a minimum, seriously overstated.

Dependent Variable	Specification	% Devaluation	95% Confidence Band	# of Tracts
Zillow median list price of houses per square foot	23 controls for all tracts	-22.0% **	-17.4% to -26.6%	33,066
	23 controls (limited – new baseline)	-21.8% **	-17.2% to -26.4%	32,998
	23 controls & ERS control	0.3%	-0.1% to -10.1%	32,998

[1] When we run the regression using Perry et al.'s data and code, we get 22%, rather than 23%. We have followed up on this minor discrepancy and hinges on slight differences in data that were provided to us.

* For this slide we use the November 2021 Equifax Risk Score (ERS) at the ZIP-7 level. We then aggregate the roughly 700,000 scores up to the tract level. The following slides use the July 2013 ERS at the ZIP-5 level. We then crosswalk the roughly 40,000 scores to the tract level. The ZIP-7 score is much more granular and hence better. We find that it explain the devaluation entirely, while the less granular ZIP-5 ERS leaves some variation unexplained. In future work, we will update the rest of the presentation to the ZIP-7 ERS. Thus, the following slides present likely an overestimate of the true devaluation.

Source: Perry et al. and AEI Housing Center, www.AEI.org/housing.

Housing Center Results (Zillow Data)

- We replicate Perry et al. using Zillow's median list price of houses per square foot as the dependent variable (Perry et al.'s preferred specification).
  - We find an initial devaluation of 22.0%.[1] After deleting 66 tracts (0.2% of all tracts) for which ERS or the one adult borrower share are not available, we find a baseline devaluation of 21.8%.
  - Adding ERS as a control reduces the devaluation to 5.1%, a 76% reduction.
  - Adding one adult borrower share (vs. two or more borrowers) as a control reduces the devaluation to 14.6%, a 33% reduction.
  - Adding both ERS and one adult borrower share yields a devaluation of 1.9%. This devaluation is not significantly different than zero.
- **Conclusion**: By adding just one or two additional SES-related explanatory variables, the devaluation found by Perry et al. drops substantially. As a result:
  - Their approach did not, as asserted, fully adjust for structure characteristics and neighborhood amenities.
  - Their estimate of devaluation due to racial bias is, at a minimum, seriously overstated.

Dependent Variable	Specification	% Devaluation	95% Confidence Band	# of Tracts
Zillow median list price of houses per square foot	23 controls for all tracts	-22.0% **	-17.4% to -26.6%	33,066
	23 controls (limited – new baseline)	-21.8% **	-17.2% to -26.4%	33,000
	23 controls & ERS	-5.1% *	-0.1% to -10.1%	33,000
	23 controls & one adult borrower share	-14.6% **	-10.3% to -18.9%	33,000
	23 controls & ERS & one adult borrower share	-1.9%	3.0% to -6.8%	33,000

[1] When we run the regression using Perry et al.'s data and code, we get 22%, rather than 23%. We are following up on this minor discrepancy.
** denotes significance at the 1% level and * denotes significance at the 5% level.

Source: Perry et al. and AEI Housing Center, www.AEI.org/housing.

Housing Center Results (ACS Data)

- We replicate Perry et al. using the ACS median home value as the dependent variable.
  - We start with a devaluation for 23.2%, which becomes 22.3% after deleting 197 tracts (0.5% of all tracts), which data for our added controls.
  - Adding ERS as a control reduces the devaluation to 12.8%, a 43% reduction.
  - Adding one adult borrower share (vs. two or more borrowers) as a control reduces the devaluation to 13.7%, a 39% reduction.
  - Adding ERS & one adult borrower share as controls reduces the devaluation to 7.6%, a 66% reduction.
  - Adding income bins (to control for differences in buying power) and limiting the sample to 60-110% Area Median Income (AMI) using 10ppt. increments, so as to create more similar treatment and control groups, reduces the devaluation to 15.8%, a 29% reduction (see slide 15 for our reasoning for doing so).
  - Adding ERS, one adult borrower share , and income bins as controls, and limiting the sample to 60-110% AMI reduces the devaluation to 3.8%. This devaluation is not significantly different than zero.
- **Conclusion**: As with Zillow data, adding 1 or 2 additional SES-related explanatory variables results in a significant reduction in devaluation as found by Perry et al. A further reduction occurs with the addition of income bins and limiting sample to 60-110% AMI (both SES).

Dependent Variable	Specification	% Devaluation	95% Confidence Band	# of Tracts
ACS median home value	23 controls for all tracts	-23.2% **	-18.5% to -27.9%	38,303
	23 controls (limited – new baseline)	-22.3% **	-18% to -26.7%	38,106
	23 controls & ERS	-12.8% **	-8.1% to -17.5%	38,106
	23 controls & one adult borrower share	-13.7% **	-9.7% to -17.7%	38,106
	23 controls & ERS & one adult borrower share	-7.6% **	-3.4% to -11.9%	38,106
	23 controls & income bins & 60-110% of AMI	-15.8% **	-11.3% to -20.2%	16,677
	23 controls & income bins & 60-110% of AMI & ERS & one borrower share	-3.8%	0.5% to -8.0%	16,677

** denotes significance at the 1% level.
Source: Perry et al. and AEI Housing Center, www.AEI.org/housing.

Case Study #1: Evidence that the 23 Controls Do Not Work as Intended

- Perry et al. point out that differences in neighborhood (tract) home values are due to structural characteristics, tract amenities, and/or racial bias, yielding:

  Home Value – Structural characteristics – Neighborhood amenities = Racial Bias

- For <1% Black tracts racial bias must be zero, therefore simplifying to:

  Home Value - Structural characteristics - Neighborhood amenities = 0

This simplification allows us to test if Perry et al.'s 23 controls, in actuality, control for all differences in structural characteristics and neighborhood amenities.

If the 23 controls fully account for differences in structural characteristics and neighborhood amenities, there should be little unexplained residual variation across the tracts with less than 1% Black residents.

As the histogram shows, residuals from the regression for these tracts have a mean absolute error (MAE) of 16.2%, which is not near 0% and is about 2/3 of the 23.7% of the within metro variation in value present prior to the application of the 23 controls.

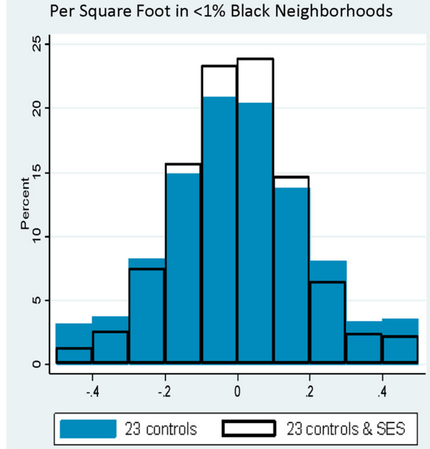
In addition, we test whether the addition of the SES controls improves the fit of the regression by further reducing the MAE. We find that the MAE drops from 16.2% to 13.6%, which is a statistically significant drop at the 1% level.

Conclusions:

1) **The 23 controls fail to capture 2/3 of the value differences in tracts with virtually no Black residents.**
2) **The additional SES control variables have explanatory power beyond the original 23.**

This case study confirms omitted variable bias and raises serious questions about Perry et al.'s overall approach.

Regression Residuals In Log Zillow Median List Price Per Square Foot in <1% Black Neighborhoods



Note: Regression controls for 23 variables and metro fixed effects. Additional SES control variables are Average ERS, share of one adult borrowers, and income bins based on 10ppt. Increments are of Area Median Income (AMI).
Source: Perry et al. and AEI Housing Center, www.AEI.org/housing.

Case Study #2a: An Alternative Explanation

- We have posited that SES plays a far more important role in the value of homes purchased than racial bias in determining the valuation of such homes. We can further demonstrate that based on a simple case study applied to entirely non-Black tracts (<1% Black).
- Since there are no Black residents, there can be no racial discrimination. We substitute the following non-race variables for the Black population share of the tract.
  - Median income (as a % of Area Median Income (AMI))
  - Average Equifax Risk Score (ERS)
  - One adult borrower share
  - Share without a bachelors degree
  - Share not in the labor force
  - Share receiving SNAP (food stamp) benefit
- We measure the devaluation for each of these variables after controlling for Perry et al.'s 23 variables.
- **Conclusion:** In each instance we find a large devaluation based on non-race variables within tracts with <1% Black census tracts. Since the residents of these tracts do not face racial animus, the large devaluations must reflect the fact that lower-SES households end up in less expensive neighborhoods.

Dependent Variable	Replacement Variable	Comparison values[1]	% Devaluation	# of Tracts
Zillow median list price of houses per square foot	Median income (as a % of AMI)	75% vs 200%	-35.4% **	5,340
	Average ERS	675 vs 750	-51.4% **	5,342
	One adult borrower share	70% vs 36%	-20.6% **	5,340
	Share without a bachelors degree	77% vs 32%	-33.5% **	5,342
	Share not in the labor force	33% vs 25%	-2.5%	5,342
	Share receiving SNAP benefits	20% vs 0%	-20.3% **	5,342

[1] Shows the values for each variable used to calculate the devaluation. For example, in the first row, we measure the devaluation of tracts with 30% of residents without a bachelors degree to tracts where all residents have a bachelors degree. The comparison values are chosen to roughly reflect the same percentiles as tracts with no and 50% Black residents.

Note: Regressions control for 23 variables and metro fixed effects in census tracts with < 1% Black residents. The 5,342 tracts are in 118 metros.

** denotes significance at the 1% level and * denotes significance at the 5% level.

Source: Perry et al. and AEI Housing Center, www.AEI.org/housing.

Case Study #2b: An Alternative Explanation

- We have posited that SES plays a far more important role in the value of homes purchased than racial bias in determining the valuation of such homes. We can further demonstrate that based on a simple case study applied to entirely White tracts (≥97.5% White).
- Since there are no Black residents, there can be no racial discrimination. We substitute the following non-race variables for the Black population share of the tract.
  - Median income (as a % of Area Median Income (AMI))
  - Average Equifax Risk Score (ERS)
  - One adult borrower share
  - Share without a bachelors degree
  - Share not in the labor force
  - Share receiving SNAP (food stamp) benefit
- We measure the devaluation for each of these variables after controlling for Perry et al.'s 23 variables.
- **Conclusion:** In each instance we find a large devaluation based on non-race variables within tracts with ≥97.5% White census tracts. Since the residents of these tracts do not face racial animus, the large devaluations must reflect the fact that lower-SES households end up in less expensive neighborhoods.

Dependent Variable	Replacement Variable	Comparison values[1]	% Devaluation	# of Tracts
Zillow median list price of houses per square foot	Median income (as a % of AMI)	75% vs 200%	-33.8% **	465
	Average ERS	675 vs 750	-28.6% **	465
	One adult borrower share	70% vs 36%	-29.4% **	465
	Share without a bachelors degree	77% vs 32%	-34.1% **	465
	Share not in the labor force	33% vs 25%	-5.6% *	465
	Share receiving SNAP benefits	20% vs 0%	-16.4%	465

[1] Shows the values for each variable used to calculate the devaluation. For example, in the first row, we measure the devaluation of tracts with 30% of residents without a bachelors degree to tracts where all residents have a bachelors degree. The comparison values are chosen to roughly reflect the same percentiles as tracts with no and 50% Black residents.
Note: Regressions control for 23 variables and metro fixed effects in census tracts with < 1% Black residents. The 465 tracts are in 76 metros.
** denotes significance at the 1% level and * denotes significance at the 5% level.
Source: Perry et al. and AEI Housing Center, www.AEI.org/housing.

Case Study #3: Analysis of Black Home Buyers

- How can a 23% price gap exist in the marketplace between two goods that Perry et al. claim are identical?
  - Economic theory suggests that if this were really a constant-quality price gap, it should prompt Black households to buy homes almost exclusively in majority Black neighborhoods to take advantage of the discount.
    - This is not what Black buyers are doing as racial integration is increasing (next slide).
    - Are the purportedly identical homes and neighborhoods really identical?
- We find that relatively few Black borrowers choose to buy in majority Black tracts. This is especially true for Black borrowers with higher incomes.
- If constant-quality prices in majority Black tracts were really 23% lower than in <1% Black tracts, then why are Black buyers not taking advantage of the price discount in majority Black tracts?
- **Conclusion:**
  - Black buyers must understand that the non-Black neighborhoods, in fact, have more amenities and, as a result, there is no "discount" or "undervaluation" on homes in Black neighborhoods of the magnitude found by Perry et al.
  - This real world evidence is consistent with the fact that the country has been making progress in racial integration.

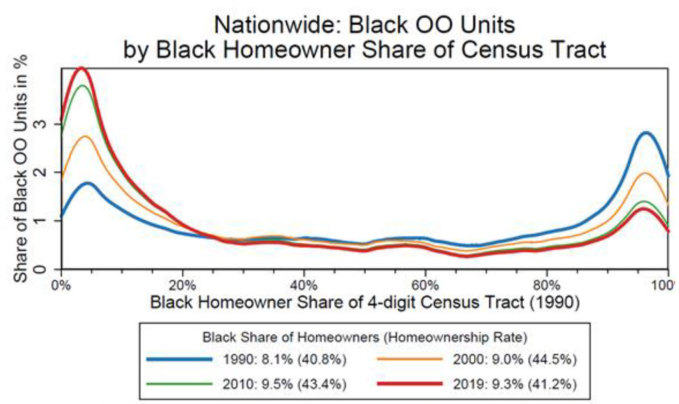
Loans to Black Borrowers (2019): by % of Area Median Income (AMI)		
By share of Black Residents	>60% & ≤120% AMI Borrowers	>120% AMI Borrowers
< 1%	4%	7%
1% - <5%	11%	18%
5% - <10%	13%	17%
10% - <20%	19%	21%
20% - <50%	30%	24%
≥50%	23%	13%
Total	100%	100%
# of Black Loans	154,000	93,000

Note: To test this we evaluated around 300,000 loans originated in 2019 to Black homebuyers. The loan level data come from the Home Mortgage Disclosure Act (HMDA), which is a near census of loans. We first assign each loan its tract's share of Black residents from the 5-year 2016 ACS data. We then focus on Black borrowers with incomes greater than 60% Area Median Income (AMI).
Source: HMDA and AEI Housing Center, www.AEI.org/housing.

Case Study #4: There Has Been Progress in Racial Integration

While the Black homeownership rate in 2019 is about the same rate as in 1990, the stock of Black homeowners has increasingly shifted to areas that were predominantly non-Black in 1990, with the same pattern for renters (not shown).

- In 1990, about 32% of housing units with a Black householder were in tracts with 80% or more Black residents; in 2019 about 17% remained in such tracts.
- **If home values in majority Black neighborhoods were undervalued all else equal, Black homeowners would not have shifted to areas predominantly non-Black.**



Note: OO denotes 'owner occupied.' Share of black OO units (y-axis) and tract-level black Homeowner share (x-axis) are from the Census. Kernel bandwidth is set to 2.5%. Numbers in legend denote the black share of homeowners (homeownership rate). Census tracts are abbreviated to 4 digits to account for changes in census tract definitions between decennial censuses.

<u>Dissimilarity Score</u>*
(largest 100 metros):
1990: 70%
2000: 66%
2010: 61%
2019: 59%

*The dissimilarity index measures the share of Black residents (owners and renters) that would have to move to produce a distribution that matches that of the larger area.

Source: Census Bureau and AEI Housing Center, www.AEI.org/housing.

A Final Concern: Creating More Similar Treatment and Control Groups

As demonstrated below, income levels vary significantly across tracts. The greater the income differences, the harder it becomes to render tracts comparable through any combination or variety of control variables.

- For example, the median income of <1% Black tracts is 121% of Area Median Income (AMI), while the median income of 50% or higher Black tracts is 58%.

Our enhancements include:

- We bin tracts by income (in 10 ppts. intervals*), which greatly helps standardize buying power.
- We focus on the 60-110% area median income range. This captures around half of the <1% Black and about half of 50% or higher tracts (see table).

This approach generates similar comparison groups in terms of buying power.

Black population Share	Relative income percentile				
	5th	25th	50th	75th	95th
0%-1%	64%	95%	121%	156%	230%
1%-5%	61%	92%	119%	154%	225%
5%-10%	54%	84%	108%	139%	202%
10%-20%	47%	72%	94%	122%	171%
20%-50%	36%	59%	78%	101%	144%
50% or higher	28%	44%	58%	76%	114%

Note: Relative income is the ratio of tract income to median CBSA income.

* We bin income in 10 ppts. bins starting with 0% to <10% of area median income. We also use 5 ppts. and 20 ppts. bins as robustness checks. The results are robust.

Source: Perry et al. and AEI Housing Center, www.AEI.org/housing.

A Final Concern: Creating More Similar Treatment and Control Groups (cont.)

A glance at a map can quickly reveal why it is important to account for income or SES.

Jacksonville for example, which according to Perry et al. has one of the highest devaluations (-47%) of Black assets in the country, has 80% of the less than 1% Black tracts situated at or near the water. Majority Black tracts are largely found in the inner city part of the metro.

It is therefore plausible that some of the devaluation may be due to this natural amenity, for which Perry et. al.'s model does not control, rather than racial bias. Other metros in the study have similar types of natural amenity dissimilarities.

Natural amenities, to the extent reflected in the higher home prices, would be captured to some extent by higher incomes or SES of residents in a tract.

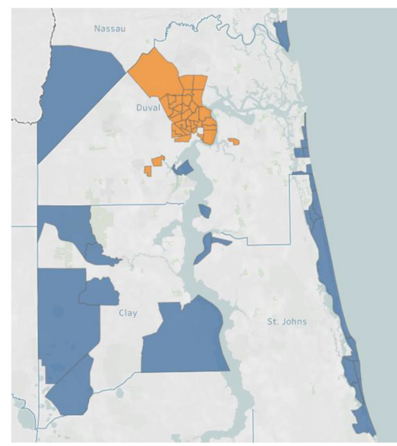
Jacksonville, FL example

% of black pop. in census tract
< 1%
>= 50%

Waterfront & exurban control tracts

vs.

mostly inner-city treatment tracts



Source: Perry et al. and AEI Housing Center, www.AEI.org/housing.

We Now Turn to Policy Solutions Aimed at Addressing SES

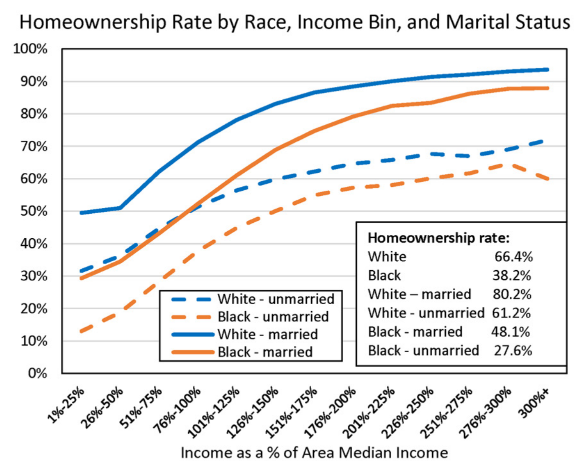
- While much work remains to be done, our study strongly suggests that the focus should be on increasing financial security, creating generational wealth, and shrinking the SES gap through sustainable home ownership. This is largely a buying power issue, not a valuation one. To do otherwise risks repeating the mistakes of the past.
- We also point out that while the country has been making progress in racial integration, stratification along income and SES has been increasing.
- Ultimately, the overarching policy goal should be to provide and support economically sound opportunities for income and wealth growth for lower income people. We propose several such policy solutions.

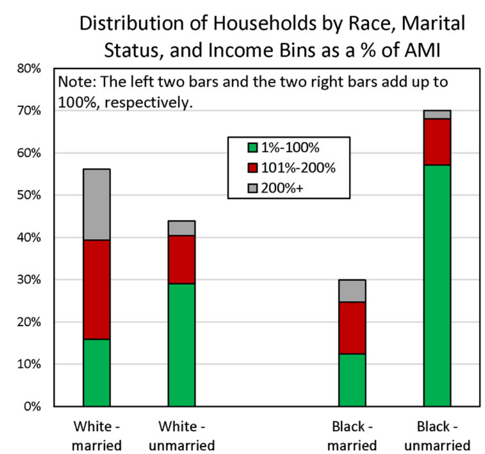
Marital Status and Income Are Key Drivers of the Homeownership Rate by Race

The Black homeownership (HO) rate is much lower than the White HO rate, but the difference gets smaller as income grows. The HO rate for White or Black married households (HH) is much higher than for unmarried White or Black HH (left panel).

There is a big disparity by marital status between Blacks and Whites. Unmarried Black HH comprise 70% of Black HH, and the vast majority are below area median income (right panel).

Policy challenge: Reduce income and marital status disparities between Black and White HH.

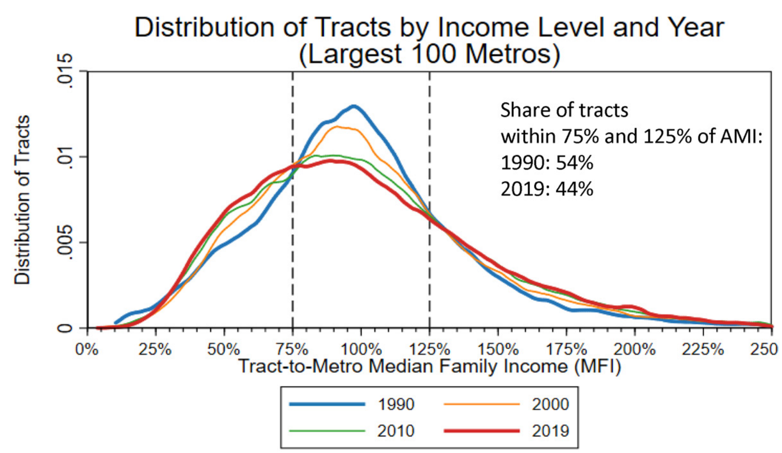




Note: Data are for urban household heads aged 25-65 and exclude widowed households.
Source: Census Bureau and AEI Housing Center, www.AEI.org/housing.

There Has Been an Increase in Stratification along Income and Socio-Economic Status

The share of tracts within 75% and 125% of area median income has decreased drastically over time. By this simple measure 54% of tracts in 1990 were within this range, compared to 44% in 2019.

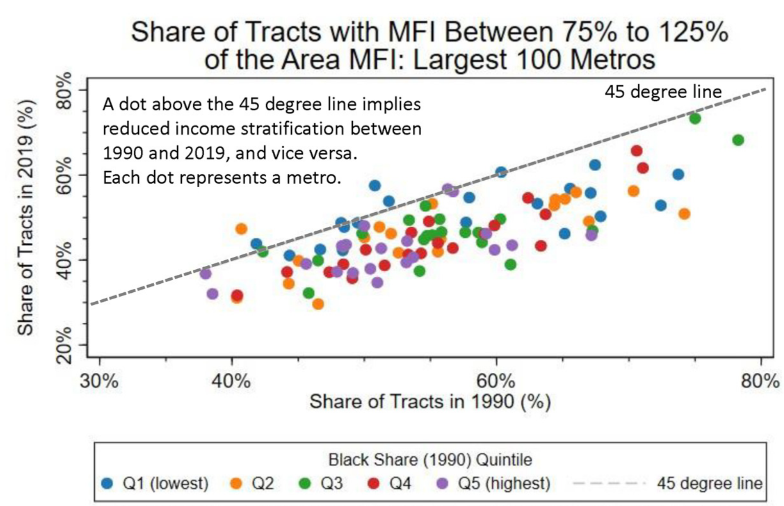


Notes: Largest 100 metros are determined by total sales over 2012-2019 from public records. Sample of tracts is limited to tracts with nonmissing income data and below 250% of the area MFI. Dashed lines indicate income levels at 75% and 125% of the area MFI. Kernel bandwidth is 2.5%.

Note: MFI stands for Median Family Income and AMI stands for Area Median Income.
Source: Census Bureau, FFIEC, and AEI Housing Center, www.AEI.org/housing.

Increasing Stratification along Income/Socio-Economic Status

Since 1990, income stratification has grown in virtually all of the largest 100 metros. This trend is not correlated with the Black share of households in the metro.



Notes: Each dot represents a metro area. Figure only plots tracts with nonmissing income data. Top 100 metros are determined by total sales over 2012-2019 from public records.

Note: MFI stands for Median Family Income.
Source: Census Bureau, FFIEC, and AEI Housing Center, www.AEI.org/housing.

Guiding Reform Principles & Past Mistakes

There is an important place for policies that assist low-income families to become homeowners, but these policies must balance the interest in low-income lending against the risks to the borrowers and the interests of the taxpayers.

- In the past, "affordable housing" policies that sought to increase homeownership turned out to escalate the risks for both borrowers and taxpayers.
- Instead such policies must promote sustainable access to housing finance and support opportunities for income and wealth growth among lower income households.
- Any efforts to subsidize low and moderate income home buyers must be on-budget, transparent and sustainable, and must meet the "do no harm" test.

Learning from the past.

- Many past and continuing housing and other policy actions to address racial discrimination have had unintended consequences that have done substantial harm to low-income households.
  - Public housing: fails to build wealth and perpetrates segregation.
  - Inclusionary zoning & transit oriented development is expensive and helps only a few.
  - LIHTC: perpetrates segregation and is incredibly expensive and crowds out unsubsidized supply.
  - Longer loan terms and looser underwriting: builds wealth much more slowly and, when combined with other forms of risk layering, leads to high defaults.
  - Low interest rates: has led to a permanent increase to prices.
    - We would be remiss if we failed to point out that the task of increasing the homeownership rate for lower-income people has been made immeasurably more difficult due to the failure of the Federal Reserve to recognize the harm its interest rate and quantitative easing policies have done by needlessly driving up home prices for current and future cohorts of aspiring low-income and minority homebuyers.

A focus on fixing the valuation process to account for race could do more harm than good.

- It is not supported by our research.
- It will likely lead to mispricing and put homeownership out of reach for low-income households.
- It would result in a wealth redistribution to owners from first-time buyers.

Housing Related Policy Solutions Based on Our Findings

Diagnosing the causes of the home value gap, along with a recognition of decreasing racial and ethnic segregation and increasing Socio-Economic Status (SES) stratification, helps in the consideration of appropriate policy solutions that will increase financial security and shrink the SES gap through sustainable home ownership. Several such policy solutions are:

- **Building generational wealth through sustainable homeownership for low SES households by reducing leverage for aspiring low-income home buyers.**
  - Lower-Income First Generation Homebuyer (LIFT Home) assistance used to buy down the interest rate on a 20-year term loan would subsidize wealth building, rather than debt.
  - Shorter terms lower default risk to sustainable levels.
    - Default propensity is a key contributor to neighborhood blight.
  - HMDA denial reasons suggest 2 main impediments for Black potential buyers*:
    - Credit score → overcoming this impediment requires the safe expansion of the credit box, which is possible with a 20-yr loan term.
    - DTI → overcoming this impediment requires the growth of incomes and the slowing of unsustainable home price appreciation. The latter may be done through the addition of more supply.
- **Increasing supply and reducing income stratification through Light Touch Density.**
  - Making 2, 3, and 4 unit housing legal in 1-unit neighborhoods.
  - Allow extra rooms in homes to be rented out.
- **Promote Walkable Oriented Development in existing neighborhoods with a mix of residential and commercial properties.**
  - These neighborhoods have job and education opportunities.

* Data from Ellie Mae confirm this. According to data from Feb. 2016 (the last time these data were available), closed FHA purchase loans had an average credit score of 686 and a backend DTI of 41, while denied FHA purchase loans for Black borrowers had an average credit score of 628 and a backend DTI of 50. We believe these data are still representative today.
Source: AEI Housing Center, www.AEI.org/housing.

Other Policy Solutions Based on Our Findings*

Ultimately, the overarching policy goal should be to provide and support economically sound opportunities for income and wealth growth for lower income households. Several such policy solutions which might be explored are:

- **Encouraging 2 parents in households with children**
  - Child tax credits should focus on low income households and should reward having two parents in the household.
- **Enact occupational licensing reforms and allow small businesses to be run out of one's home**
  - This would give families another path to upward mobility.
- **More economical childcare by rolling back burdensome government regulations**
  - This would allow parents to decide whom they trust with their children.
- **Real school choice for access to quality elementary and secondary education**
  - Expand charter schools and voucher programs.
  - Parents would not have to buy a more expensive home to get access to a better education.
- **Improving access to technical and apprenticeship training**
  - Public-private partnerships to promote training and skill development.
  - Provide flexible vouchers to low-income students, thereby letting them spend the money in a way to quickly and efficiently gain job skills.
- **Encouraging state and local governments to address public investment disparities relating to minority and lower income neighborhoods**

* Many thanks to our AEI colleagues Naomi Schaefer Riley and Angela Rachidi for many of these ideas. Please see their thoughtful analysis: https://reason.com/2021/02/24/fix-family-poverty-with-free-markets-for-once/

Appendix

Appendix - Redfin's "Price of Racial Bias": We Found Compelling Evidence that the Case Studies Cited Are Fatally Flawed

- The Redfin study, like Perry et al. maintains that it "rules out all the factors that are typically associated with home value" and that any residual difference is due to "bias and systemic racism", thus yielding the same formula as Perry et al.* This study defined a neighborhood as a ZIP code.

  Home Value – Structural characteristics – Neighborhood amenities = Racial Bias

- Two specific case studies are provided, one in Atlanta, the other in Chicago. In each case, it was asserted that two "similar homes in similar neighborhoods" were found, the only difference being racial makeup.
- The study's two flaws are that it insufficiently controls for Socio Economic Status and ZIP code is not granular enough.
- The former becomes clear in the case of Chicago, where an examination of both zip code and Census data reveal wide pair variances in SES indicators (see green shading).
- The latter becomes clear in the case of Atlanta, where the purported majority Black neighborhood at the zip code level (used for mail delivery) has, on the census tract level, only slightly more Black residents than the White neighborhood. Census tract is the Census Bureau's proxy for neighborhood. The much large ZIP with 56,000 population compares to much finer census tracts, with around 5,000 people (see orange shading.)

	ZIP Code				Census Tract			
	Chicago	Chicago	Atlanta	Atlanta	Chicago	Chicago	Atlanta	Atlanta
	60655	60620	30329	30318	17031720400	17031700501	13089021603	13121008800
Sale price of case study home ($)	217,500	172,000	412,000	300,000	217,500	172,000	412,000	300,000
Sale date of case study home	Jul-16	Nov-17	Jun-20	May-19	Jul-16	Nov-17	Jun-20	May-19
Total population	28,741	69,299	28,383	56,109	1,957	7,645	4,943	5,430
Black %	6.5%	96.6%	17.1%	54.1%	1.7%	86.1%	18.5%	23.6%
Land Area (sq. miles)	4.4	7.1	5.4	20.4	0.3	0.6	1.5	3.7
Total housing units/square mile	2,440	4,262	2,425	1,314	2,433	4,268	1,859	671
Median Household Income - $ (ACS)	$91,102	$32,401	$58,658	$52,245	$90,721	$67,665	$66,425	$103,385
% single mothers with children under 18	3.9%	14.3%	4.7%	7.6%	2.9%	5.5%	3.0%	7.6%
Equifax Risk Score	722.0	623.0	688.1	650.0	721.7	658.6	688.8	650.0
% one borrower loans (2012-2017)	NA	NA	NA	NA	62.9%	85.7%	61.6%	61.6%
Mortgage Default Rate (2012-2020)	12.9%	23.3%	7.6%	9.8%	11.6%	21.5%	7.8%	10.7%

* Dana Anderson, "The Price of Racial Bias", Redfin, May 3, 2021, https://www.redfin.com/news/undervaluation-homes-black-versus-white-neighborhoods/

AEI Housing Center

AEI Housing Center Response to Perry and Rothwell (2021)

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December 2021[1]

The Brookings Institution and the American Enterprise Institute, two of the nation's oldest think tanks, have long engaged in a competition of ideas. That spirit has infused the discussion and commentary between scholars at both institutions with respect to *The Devaluation of Assets in Black Neighborhoods* (Perry et al. (2018)).[2] We issued a revised critique of *The Devaluation of Assets in Black Neighborhoods* on August 5, 2021 (Pinto and Peter (2021)) and Perry and Rothwell issued a rebuttal on November 17, 2021 (Perry and Rothwell (2021)). In the spirit of this competition of ideas, we welcome their engagement with us on this important topic and thank them again for providing us their data and code.

Our key takeaways are:

- In reviewing Perry and Rothwell (2021), we find that their concerns only confirm our findings.
    - In Pinto and Peter (2021) we showed that Perry et al.'s (2018) methodology has serious shortcomings, including omitted variable bias, and that their conclusion that a 23% gap in valuations of homes in majority black neighborhoods is attributable solely to racial bias is a serious overstatement.
    - Perry and Rothwell's (2021) rebuttal to our critique supports our claim of omitted variable bias, as their results in Table 1 seem to confirm that adding additional controls can significantly lower the devaluation estimate.
    - Perry and Rothwell (2021) in particular object to our two additional controls in addition to their original 23 controls in Perry et al. (2018). We show that the Equifax Risk Score (ERS) is race neutral and suitable for use as a control. We demonstrate that the one-adult borrower share on home purchase loans is no more a proxy variable for race than some of their original 23 controls are. (I.e. one-adult borrower share has the same correlation to race as the percent of households headed by single mothers with children under 18). Most importantly, both of these additional controls have significant explanatory power.
    - Finally, Perry and Rothwell (2021) also object to our case studies, where – in order to eliminate race from the equation – we examine non-Black tracts. Perry and Rothwell

[1] The views expressed are those of the authors alone and do not necessarily represent those of the American Enterprise Institute or of any individual who provided comments. The authors would like to thank Steve Oliner for his helpful comments.

[2] Andre Perry, Jonathan Rothwell, and David Harshbarger, The Brookings Institution, *The Devaluation of Assets in Black Neighborhoods*, https://www.brookings.edu/research/devaluation-of-assets-in-black-neighborhoods/, 2018

point out that these tracts could include not only White residents but also Hispanic residents, who could face racial bias just like Black residents. To address this point, we show that when we limit the sample to areas where White residents account for more than 97.5% of tract population, we find the same shortcomings in their results.

- We found and continue to assert that what Perry and Rothwell characterize as race-based differences in home values are, in large part, likely due to socio-economic status (SES) differences. Lower SES certainly reflects a legacy of past racism and lingering racial bias, leaving Blacks at a large income (and wealth) disadvantage relative to most Whites. Recognizing the importance of SES factors is key to fashioning appropriate public and private responses. For if largely SES based, the primary remedy would be policies that work to address the income and wealth gap.
- Our overarching goal in providing our critiques is to promote sustainable access to housing finance and support opportunities for income and wealth growth among lower income households. In so doing, we must be mindful that many past and continuing housing and other policy actions to address racial discrimination have had unintended consequences that have done substantial harm to low-income households generally, and minority households in particular.

Recap and what's new?

In the original paper, Perry et al. (2018) presented their key finding:

> "Homes of similar quality in neighborhoods with similar amenities are worth 23 percent less in majority black neighborhoods, compared to those with very few or no black residents.… Across all majority Black neighborhoods, owner-occupied homes are undervalued by $48,000 per home on average, amounting to $156 billion in cumulative losses.…
>
> We believe **anti-black bias is the reason this undervaluation happens**, and we hope to better understand the precise beliefs and behaviors that drive this process in future research." (p. 3) (emphasis added)

As we pointed out in our critique, by this first quote along with similar ones on pages 6 and 15, Perry et al. (2018) claim to have completely controlled for structural characteristics and neighborhood amenities using 23 control variables (see appendix for a replication of the 23 controls in Perry et al. 2018). Therefore, the remainder in the gap has to be due to racial bias.

The second quote above states causality, namely that racial bias is the reason for the 23% devaluation of Black neighborhoods. There are many other instances where causality was implied or explicitly stated by the authors.

For example:

> "Perry testified that while overt discrimination in U.S. housing policy has been outlawed, systemic racism in the housing ecosystem still impacts Black families, both through the actions of individual appraisers as well as the broader industry's devaluation of majority-Black communities. This is evidenced by such factors as the Black homeownership rate (which

> has barely budged past its 1966 rate of 46%) and the lower valuation of homes in Black neighborhoods regardless of their quality (23% lower than homes in white neighborhoods, or $48,000 less per home on average)."[3]

In our critique of Perry et al. (2018), we demonstrated that the gaps in value that Perry et al. (2018) attribute solely to racism may be significantly reduced by adding two additional controls while keeping their 23 controls: the Equifax Risk Score (ERS) and the single-borrower share. We emphasized that we did not remove any of Perry et al.'s 23 control variables. We simply built upon their model by adding two additional controls.

Based on this result, we concluded that "their approach did not, as asserted, fully adjust for structure characteristics and neighborhood amenities" and that "their estimate of devaluation due to racial bias is, at a minimum, seriously overstated." In short, their approach suffered from omitted variable bias.

Significantly Perry and Rothwell (2021) contains a shift in the key finding of Perry et al. (2018)

In their rebuttal to our critique of their original paper, Perry and Rothwell (2021) wrote:

> "The results of our original research are robust to many alternative modeling strategies and theoretical concerns about omitted variables bias. **We cannot say if the best possible estimate is -23% or somewhat higher or lower, but we are confident that housing is valued differently in Black neighborhoods, and racial discrimination—in some form or forms—is the best explanation available given current information."** (Emphasis added)

From this response, it seems clear that their position has shifted. Perry and Rothwell (2021) are now admitting that the 23% devaluation estimate could be different, which would also change the extent of racial bias. In fact, in Table 1 (replicated in the appendix) they confirm that their estimates of racial bias could be substantially reduced when they control for additional SES factors beyond those included in their list of original 23 controls.[4]

Most importantly, Perry and Rothwell (2021) no longer claim causality for the devaluation.

> "The question is: **What explains this? We don't know with any precision.** In our paper, we reviewed literature on racial bias and pointed to its potential as an explanation, writing: "Our findings are generally consistent with the widespread presence of anti-Black bias." We left it for future work to explore some of the relevant mechanisms that link bias to valuations and quantify their importance." (Emphasis added)

However, the precise mechanism for the devaluation is of utmost importance. If neighborhood values are substantially lower as originally alleged due to racial bias based on the share of Black residents, this would call for certain policy approaches to address this bias. If neighborhood values are lower because of other reasons, such as systematic differences in SES, then the policy solutions would need to focus on

[3] See https://www.brookings.edu/testimonies/how-racial-disparities-in-home-prices-reveal-widespread-discrimination/.

[4] Perry and Rothwell (2021) state that they "created a more comprehensive measure of socio-economic status using factor analysis, with variables for median household income, the bachelor's degree or higher education attainment rate, mean capital income, and the loan-to-value ratio."

the root causes of the issue, and approaches addressing bias could do lasting harm to communities of color.

Our Responses to Perry and Rothwell's (2021) rebuttal[5]:

Rebuttal critique #1: Omitted variable bias

Perry and Rothwell's (2021) rebuttal to our critique supports our claim of omitted variable bias as shown in their Table 1 (replicated in our appendix below):

> "Table 1 reports devaluation estimates from six different models, both run using Census home values and Zillow price per square foot values. The first shows our original estimates. The second adds the loan to value ratio. The third uses the SES index from our factor analysis. The fourth omits a variable from our original model used to measure SES (single-mother households) and replaces it with our index. The fifth omits the single-mother variable from our original model, and the sixth includes our original model, the single-applicant share, and the loan-to-value ratio. The effects range from -15% to -29%."

The prior paragraph contrasts with the original statement in Perry et al. (2018) that "differences in home and neighborhood quality do not fully explain the devaluation of homes in black neighborhoods." In other words, Perry et al. (2018) claim that differences in home values have to be due to racial bias as they have completely controlled for differences in structural characteristics and neighborhood amenities using 23 control variables.

In Perry and Rothwell (2021) Table 1, they not only add an additional four SES variables in the form of an SES index, which noticeably reduces their estimates of devaluation, but they also remove the single mother with children under 18 variable, a strong SES factor. This approach is highly problematic as it directly contradicts their position in Perry et al. (2018), where they assert that the original 23 controls account for all structural and neighborhood differences. Models 4 and 5 in Table 1 each removes the "single-mother with children under 18" as a control. Therefore, judged against their own standard, they are not valid models. In our critique of their work, we start with, as a baseline, their standard, that is all of their 23 controls and then only add to this list.

Thus the key takeaway from Perry and Rothwell's (2021) results in Table 1 is a confirmation that adding additional controls can significantly lower the devaluation estimate, clearly supporting our claim of omitted variable bias.

Perry and Rothwell (2021) then inexplicably reach this conclusion:

[5] We do not respond to the first part of Perry and Rothwell's (2021) critique, which was based on our effort to independently replicate their data set. Perry and Rothwell (2021) concluded that our initial critique "fails empirically once you include rich and poor neighborhoods." Perry et al. (2018) objected to taking buying power into consideration. We attempted to overcome their objection by creating and comparing groupings of census tracts with similar buying power. We have completely replaced our first critique of their work, which was based on our effort to independently replicate their data set. We are grateful to Perry & Rothwell to have provided the complete data set and code so that we can focus on their methodology.

> "To summarize, there is no compelling evidence that bias from omitted measures of socio-economic status, purchasing power, or even non-real estate wealth have inflated our original estimate of devaluation."

As we have pointed out in our critique "the gaps in value that the Perry model attributes solely to racism may be significantly reduced by adding an additional two controls." Their analysis confirms this and furthermore leaves the option of other omitted variables that could further explain the difference they find such as the Equifax Risk Score or others.[6]

Yet, even in their original paper – albeit buried in the later pages - Perry et al. (2018) always acknowledge the potential shortcomings of their analysis:

> "It is certainly possible that our analysis has omitted variables that are correlated with both the black-population share and the value of housing and that could go further in explaining the gaps we observe in value. Yet, we believe it is unlikely that any such factors would explain the gap entirely." (p. 15)

As we pointed out in our initial critique and as Perry and Rothwell (2021) have now confirmed, there are omitted variables that lower the devaluation that Perry et al. attributed to their belief that "anti-black bias is the reason this undervaluation happens".

Thus, it was always premature and likely an overstatement to attribute all differences in value on racial bias. To simply state that "it is unlikely that any such factors would explain the gap entirely" and to make claims like the ones mentioned above is simply irresponsible in any policy debate, much less one as important as this one.

<u>Rebuttal critique #2: The inclusion of the Equifax Risk Score (ERS) and one adult borrower share as additional controls</u>

Perry and Rothwell (2021) state that we "claim that the inclusion of the ERS score lowers the devaluation estimate from 23% to 13% and it falls to 8% when including the ERS score and the individual adult borrower share."

This is correct. However, when using Perry et al.'s (2018) preferred specification, which is the Zillow list price per square foot, the devaluation falls even more and is no longer statistically significant with ERS and one adult borrower share.

Specification	**% Devaluation**	**# of Tracts**
23 controls for all tracts	-22.0% **	33,066
23 controls (limited – new baseline)	-21.8% **	33,000
23 controls & ERS	-5.1% *	33,000
23 controls & one adult borrower share	-14.6% **	33,000
23 controls & ERS & one adult borrower share	-1.9%	33,000

** denotes significance at the 1% level and * denotes significance at the 5% level.

[6] It is entirely plausible that non-SES variables on property maintenance, tax rates, nearness to natural amenities, etc. could influence home values. These factors are hard to measure and even harder to find reliable data. We think that SES to some extent incorporates these factors.

Perry and Rothwell (2021) object to using these additional two controls.

> "First, the ERS index is a proprietary model-derived measure that is methodologically opaque. Not only do scholars not know what model creates the index, we do not even know whether it includes the Black population share as a control. If so, it can hardly be used in our model."

The Equifax Risk Score (ERS) is a compilation of Vantage credit scores from 2013, representing a summary metric of the stock of all individuals of any type in a neighborhood with a score. It includes over 220 million scored individuals. In its 2007 "Report to Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit," the Board of Governors of the Federal Reserve System stated that "credit characteristics included in credit history scoring models do not serve as substitutes, or proxies, for race, ethnicity, or sex" (S-1f). Vantage credit scores are one of two industry standard scores and they are race blind as confirmed by the Fed report.

Based on the above, we don't think Perry and Rothwell's (2021) critique of ERS holds. As we have shown in our initial critique and will also show below, ERS is highly predictive. The fact that the data are propriety credit scores is not disqualifying. Indeed, credit scores are used routinely in empirical work involving mortgage and housing markets.

Perry and Rothwell (2021) also criticize our use of the one-adult borrower share.

> "Second the single-applicant share is itself a proxy variable for race. In the HMDA database, 70% of approved Black loan applicants do not have a co-applicant compared to only 50% of approved white applicants. The correlation between the Black population share and the percentage of 2016 applicants who are single-applicants is 0.50."

While this is certainly true, other variables, including ones from Perry et al.'s (2018) original 23 controls, such as the share of single mothers with children under 18, are also highly correlated with race. The following table shows some of these correlations:

Correlation with the share of Black residents	
Equifax Risk Score (ERS)	-67%
Percent households headed by single mothers with children under 18	58%
One-adult borrower share	57%
Proficiency rate of 4th-8th grade public school students	-41%
Median household income	-41%
Percent owner-occupied units	-37%
Percent with a bachelor's degree	-35%

More importantly though, the high correlations between race and the share of one-adult borrower (and other variables for that matter) is the reason why we want to include all of these control variables in the regression. In any regression analysis, explanatory variables will, to some degree, be correlated with other explanatory variables. The regression takes all of these correlations into account in order to determine the relationship between each explanatory variable and the dependent variable, all else equal. This is Econometrics 101. If ERS has little to no explanatory power beyond race, then the coefficient on ERS will be small and insignificant, while the coefficient on race will be strong and significant. If, however, ERS has explanatory power beyond race, then the coefficient on ERS will be large and significant, while it will reduce the coefficient on race, which is exactly what we are finding.

The regression approach works well unless all explanatory variables are highly correlated with each other (multicollinearity). To say otherwise would in fact invalidate almost all regression research.

Perry and Rothwell (2021) also raise concerns about multicollinearity when we include other control variables such as the one-adult borrower share.

> "Multicollinearity occurs when variables that are highly correlated with each other are used in the same model and the result is usually that the effects are attenuated (or weakened). This is the predictable result of including the single co-applicant share."

However, the direction of the bias introduced by the multicollinearity cannot be known. In fact, the bias could go in either direction, so it is not correct to state that it would attenuate or weaken the effects since it could also enhance or strengthen them. We also do not find that multicollinearity is particularly high. The variance inflation factor (VIF) measures how much the variance of an explanatory variable is influenced, or inflated, by its correlation with the other explanatory variables. Including our two additional controls merely raises the variance inflation factor for the entire regression by 5% - from an average of 2.19 to 2.30. Furthermore, our analysis of the individual controls does not suggest a particularly high VIF for our two additional controls – and there are other controls that have higher VIFs. The VIF for both ERS (3.17) and one-adult borrower share (2.47) are far below a level of 10, which is generally considered to merit further investigation.

Perry and Rothwell (2021) then state the following:

> "Pinto and Peter justify [the inclusion of single-applicant share] by saying that it measures neighborhood socio-economic status, but they do not say why it is a better measure than school test scores, commuting times to work, access to stores, the college attainment rate, median household income, or the percentage of households headed by single mothers, all of which we already analyzed."
>
> "An alternative rationale for including the single-applicant share of loan applications is to measure the buying power of residents. Again, median household income would be more relevant, but one could also use the income data from the HMDA database, which has a much stronger correlation with loan value in the HMDA microdata than the number of co-applicants on the loan."

The point is not that one-adult borrower share is a better measure of SES, but that it is another possible factor that can affect property values. It is entirely plausible that one-adult borrower share captures something slightly different than income, such as a household's resiliency to withstanding a personal (i.e. medical emergency) or economic (i.e. unemployment) shock event, which may be mitigated by the presence of a second adult borrower on the note.

The same logic applies to the inclusion of the loan-to-income ratio[7], which Perry and Rothwell (2021) appear to prefer over our ERS metric. The loan-to-income ratio likely captures the leverage borrowers are taking on. The greater the ratio is, the greater the debt is and the ratio may thus proxy an inverse of a buying power. It may also capture lending risks. However in this regard, it is far less comprehensive than ERS, which may capture employment history, past hardships, etc. We are not opposed to including the loan-to-income ratio in the regression, but we think that the regression should also include other variables such as ERS and the one-borrower share, which have additional explanatory power.[8]

As discussed above, the regression methodology will tease out if the one-adult borrower variable (or any other variable) has explanatory power. In our initial critique, we pointed out that the original Perry et al. (2018) regression was already doing this: of the 23 controls used, 16 are statistically significant at the 5% level, but 7 are not.

Adding just two additional controls (ERS and one-adult borrower share), both of which are highly statistically significant, renders the Black share no longer statistically significant at the 5% level, but also leads to 2 more controls no longer being so, bringing the total to 9 of 23. This implies that our additional control variables are indeed better predictors than some of the original 23 controls. In case study 1 below, we present further evidence why the original 23 controls in Perry et al. (2018) do not work as intended and demonstrate that our additional SES control variables have explanatory power beyond the original 23 controls.

Rebuttal critique #3: Our case studies

Case study 1: Evidence that Perry et al.'s (2018) 23 controls do not work as intended

We think focusing on areas with entirely White populations provides a clear case study. Since the residents of these tracts do not face racial animus, we can test whether the 23 controls work as intended since we do not need to worry about racial bias.

Perry and Rothwell (2021) argue that:

> "It also does not follow that America's racial politics and history disappear in neighborhoods with no Black residents. Our modelling shows that these neighborhoods are over-valued relative to Black neighborhoods, and we argue that one reason is that Black people have not historically lived in these neighborhoods. Discrimination creates losses and gains when it comes to competitive markets, like housing and restaurants."

However, it is unclear why the relative valuations across all-White tracts should be affected by any estimated devaluation in majority-Black tracts especially given that Perry and Rothwell (2021) acknowledge a competitive market, in which the extra demand will not distort the relative price ratios.

[7] Perry & Rothwell (2021) also refer to the loan-to-income ratio as loan-to-value ratio. However, since HMDA 2016 does not include the LTV or the sale price, we assume that they mean loan-to-income ratio.
[8] We have included this variable in our regression next to the ERS and one-adult borrower share. We find that the loan-to-income ratio is highly statistically significant. The inclusion further reduces the devaluation for majority Black neighborhoods using the Zillow median list price of houses per square foot from 1.9% to 0.7%, which are both not significantly different than zero. Importantly, the coefficients on ERS and the one-adult borrower share are little changed implying that these variables have explanatory power beyond the loan-to-income ratio In the case of the ACS data, the inclusion reduces the devaluation from 7.6% to 5.7%.

Perry and Rothwell then use a Lasso (Least Absolute Shrinkage and Selection Operator) regression to purportedly show that this statistical tool "selected a nearly identical model to our original model and reported the same result." They then continue that "The only way to get devaluation estimates as low as those reported by Pinto and Peter is to throw away information." To reiterate the point from above, we do not discard any variables from Perry et al.'s (2018) original list. We are simply building on their model by adding two additional controls for SES. Perry and Rothwell concede that SES controls are appropriate since they themselves estimate models with added SES variables.[9]

When we tested the original 23 controls with the addition of our 2 additional SES variables (ERS and one-adult borrowers) using a Lasso regression, the Lasso ranked the model with all 25 controls as the model with the highest predictive value. Furthermore, the Lasso regression also ranked the ERS and one-adult borrower share as the most and third most predictive variables out of the full list of the 25 explanatory variables. (Out of the original 23 controls, the number of professional service businesses was ranked second highest by the Lasso model.) This suggests that SES, and in particular ERS and one-adult borrower share, are in fact highly predictive of home valuations and should therefore be included in the model as we do.

Furthermore, it's not clear that Lasso is even appropriate for the regression at hand. In contrast to the current case in which a sizable number of variables have explanatory power, Lasso is designed for situations where only a few variables out of many possible candidates actually belong in the regression. Stata, the statistical software tool used for this analysis, states as much:

> "The lasso is most useful when a few out of many potential covariates affect the outcome and it is important to include only the covariates [explanatory variables] that have an affect… Given that only a few of the many covariates affect the outcome, the problem is now that we don't know which covariates are important and which are not. The lasso produces estimates of the coefficients and solves this covariate-selection problem."[10]

Furthermore, Perry and Rothwell (2021) state that:

> "Moreover, it is unclear theoretically why the socio-economic status of residents should matter to the valuation of homes, after adjusting for things that people say they care about, such as school quality, walkability, and crime."

We would respond that SES variables are proxies for hard to quantify items such as neighborhood and structure condition, deferred maintenance, proximity to water, view, air quality, noise levels, etc. Focusing on entirely White tracts (≥97.5% White) provides further evidence of the limits of Perry et al.'s original 23 controls and the value of our additional SES variables. If the 23 controls fully account for differences in structural characteristics and neighborhood amenities, there should be little unexplained residual variation across the tracts with at least 97.5% White residents. As the table below shows, residuals from the regression for these tracts have a mean absolute error (MAE) of 12.0%, which is not near 0% and leaves unexplained about ¾ of the 16.1% within-metro variation in value.

[9] What is curious in Table 2 is that results for Perry et al.'s (2018) preferred specification (Zillow price per square foot) are not shown. It may be possible that Zillow home values refer to the preferred specification or it could refer to the Zillow median list price.
[10] See for example, https://blog.stata.com/2019/09/09/an-introduction-to-the-lasso-in-stata/.

When we then test whether the addition of two SES controls (ERS and one-adult borrower share) improves the fit of the regression by further reducing the MAE, we find that the MAE drops from 12.0% to 11.0%, which is a statistically significant drop at the 5% level. When we test whether the addition of three SES controls (ERS, one-adult borrower share, and income bins) improves the fit of the regression, we find that the MAE drops from 12.0% to 10.2%, which is a statistically significant drop at the 1% level. This tweaked case study confirms that Perry et al. omitted relevant variables and raises serious questions about their overall approach.

Mean Absolute Error (MAE) for Entirely White Tracts (≥97.5% White)	
Metro controls only	16.1%
23 controls & metro controls (baseline)	12.0%
23 controls plus 2 SES controls & metro controls	11.0%*
23 controls plus 3 SES controls & metro controls	10.2%**

Note: Additional 2 SES control variables are the Average ERS and the share of one adult borrowers. The third additional SES control are income bins based on 10ppt. increments of area median income (AMI). N-count is 465 tracts.
* and ** represents a statistically significant reduction at the 5% and 1% level from the baseline, respectively.

Case study 2: SES as an alternative explanation to value differences

As discussed above, we dismiss Perry and Rothwell's (2021) point about relative value differences between White neighborhoods due to racial bias. However, we acknowledge their point about Hispanic residents. We therefore tweak our case study 2, which previously was limited to tracts with fewer than 1% Black residents and which could include a large share of Hispanic residents.

We find a large devaluation based on non-race variables within entirely White tracts (≥97.5% White). In each instance we find a large devaluation based on non-race variables within these tracts. Since the residents of these tracts do not face racial animus, the large devaluations must reflect the fact that lower-SES households end up in less expensive neighborhoods.

Replacement variable for the Black population share	**Comparison values[1]**	**% Devaluation**
Median income (as a % of AMI)	75% vs 200%	-33.8% **
Average ERS	675 vs 750	-28.6% **
One adult borrower share	70% vs 36%	-29.4% **
Share without a bachelor's degree	77% vs 32%	-34.1% **
Share not in the labor force	33% vs 25%	-5.6% *
Share receiving SNAP benefits	20% vs 0%	-16.4%

** denotes significance at the 1% level and * denotes significance at the 5% level.
[1] Shows the values for each variable used to calculate the devaluation. For example, in the first row, we measure the devaluation of tracts with an area median income (AMI) of 75% to tracts with an AMI of 200%. The comparison values are chosen to roughly reflect the same percentiles as tracts with no and 50% Black residents.
Note: Regressions control for 23 variables and metro fixed effects in census tracts with < 1% Black residents. Dependent variable is the Zillow median list price of houses per square foot. The 465 tracts are in 76 metros.

Perry and Rothwell (2021) also state:

> "When we run our original model but include the Latino or Hispanic population share for the census tract, our devaluation estimates for majority Black neighborhoods actually increases in absolute value from -23% to -28%. The Latino or Hispanic devaluation estimate is -15%. When we include median household income and college education, the Black devaluation estimate is -23% but the Latino or Hispanic estimate falls to -3%. In other words, socio-economic status appears to be playing a much larger role in determining home prices in Latino or Hispanic neighborhoods than in Black neighborhoods. This suggests a potentially large role for anti-Black racial discrimination."

When we include Hispanic share in addition to the 23 controls and ERS and one-adult borrower, both Black and Hispanic variables are not statistically different than White. [11]

Case study 3: Progress in racial integration

Perry and Rothwell (2021) do not address our point about racial integration. There has been progress in racial integration, which runs counter to the fact of a "discount" or "undervaluation" on homes in Black neighborhoods of the magnitude found by Perry et al. (2018). This must mean that Black buyers understand that non-Black neighborhoods, in fact, have more amenities and, as a result, there is no "discount" or "undervaluation" on homes in Black neighborhoods of the magnitude found by Perry et al. (2018).

Further comments on Perry and Rothwell (2021)

Perry and Rothwell (2021) at the end of their report pivot to a Freddie Mac study claiming racial discrimination by appraisers. In a recent study, we have raised serious questions about this study. As we have pointed out, it was premature to publish a note based only on "exploratory research" limited to a single race-based correlation, with no attempt to present a rigorous analysis regarding other potential explanations. Merely stating that low appraisals resulted in "substantial appraisal valuations gaps" for minority versus White tracts provided an ominous sounding headline, but sheds little light on whether the gaps support a claim of systemic racism, which the note likely cannot substantiate.

Perry and Rothwell (2021) also state:

[11] Perry & Rothwell (2021) also state that "While this group has faced less discrimination, Latino or Hispanic Americans have similar socio-economic status as Black Americans, in that Latino or Hispanic adults have a somewhat lower rate of college education than Black adults but slightly higher median income." We would counter that it is not entirely adequate to conclude that Hispanic and Black Americans have similar SES simply based on educational attainment and income levels. Hispanic and Black Americans are quite different in terms of family structure or employment, which can all affect the demand for housing and thus home values. See for example: https://www.pewresearch.org/social-trends/2016/06/27/1-demographic-trends-and-economic-well-being/.

> "We would like to see more research along the lines of the new Freddie Mac paper. Measuring bias in appraisals is only one piece of the puzzle. Similar work needs to be done for lending and underwriting. Unfortunately, the institutions most suited to provide the data needed to conduct that analysis—Freddie Mac and Fannie Mae—do not have a culture of creating and sharing data for public research."

We would encourage them to take a look at our study on our recent work on "How Common Is Mortgage Lending Discrimination (Disparate Impact) with respect to Protected Classes? - A Critique of the Associated Press/Markup's "The Secret Bias Hidden in Mortgages." We find that on aggregate, there is no evidence of systemic bias by mortgage lenders. We cannot rule it out definitively, but we did not find any evidence of bias.

Conclusion:

In our initial critique we stated that "Lower SES certainly reflects a legacy of past racism and lingering racial bias, leaving Blacks at a large income and wealth disadvantage relative to most Whites" and that "Recognizing the importance of SES factors is key to fashioning appropriate public and private responses. We noted that "We must be mindful that many past and continuing housing and other policy actions to address racial discrimination have had unintended consequences that have done substantial harm to low-income households generally, and minority households in particular."

We thank Perry and Rothwell (2021) for their comments, cooperation, and spirit of collegiality. We find that their concerns only confirm our findings. We are not aiming to provide an alternative point estimate, but rather to show that the current approach has serious shortcomings. Therefore, we stand by our assessment that what Perry et al. (2018) characterize as race-based differences in home values are in large part, due to SES-based differences. The primary remedy should be policies that address the income and wealth gap. The focus should be on increasing financial security, creating generational wealth, and shrinking the SES gap through sustainable home ownership. This is largely a buying power issue, not a valuation one. To do otherwise risks repeating the mistakes of the past.

Appendix:

List of the Perry et al. (2018) 23 control variables:

#	Variable	Source
	Structural Characteristics	
1.	Median rooms	ACS 2012-2016
2.	Median year built	
3.	Single-family detached share of owner-occupied units	
4.	Single-family attached share of owner-occupied units	
5.	Mobile homes share of owner-occupied units	
6.	Homes with no vehicle availability	
7.	Homes with gas or electric heating	
8.	Homes with complete kitchen facilities	
	Neighborhood Amenities	
9.	Mean commute of adult workers	ACS 2012-2016
10.	Percent of working adults who carpool to work	
11.	Percent of working adults who use public transport	
12.	Percent owner-occupied units	
13.	Population (natural log)	
14.	Percent of households with children under 18	
15.	Percent households headed by single mothers with children under 18	
16.	Median age of the population	
17.	EPA Walkability Index	EPA
18.	Number of professional service businesses	County Business Patterns
19.	Number of libraries	
20.	Number of museums and historical sites	
21.	Number of food and drinking places	
22.	Number of gas stations	
23.	Proficiency rate of 4^{th}-8^{th} grade public school students	Perry et al.'s (2018) calculations

Table 1 from Perry and Rothwell (2021):

Table 1. Estimates of the devaluation of housing in majority Black neighborhoods using different modelling strategies

		Census home value			Zillow price per square foot		
		Devaluation on estimate	Number of census tracts in analysis	Adj R-squared	Devaluation on estimate	Number of census tracts in analysis	Adj R-squared
Model 1	original	−23%	38,303	0.8560	−22%	33,066	0.8350
Model 2	original + loan to value ratio	−20%	37,869	0.8660	−20%	32,866	0.8438
Model 3	original + SES index	−20%	37,851	0.8846	−21%	32,855	0.8548
Model 4	original omitting single mother variable + SES index	−23%	37,851	0.8839	−23%	32,855	0.8542
Model 5	original omitting single mother variable	−29%	38,303	0.8530	−27%	33,066	0.8324
Model 6	original + single applicants + loan to value ratio	−15%	37,869	0.8743	−16%	32,866	0.8491

Note: Original model refers to full list of controls described in Perry, Rothwell, and Harshbarger (2018), with percent of households headed by single-mothers omitted where noted (Models 4-5). SES index is first component of factor analysis using median household income, the bachelor's degree or higher attainment rate, the mean loan to value ratio and mean level of non-labor income.

Source: Perry-Rothwell-Harshbarger Housing Devaluation Data. Tract data on loan-to-income ratio and share of loans to individual applicants are from the Consumer Financial Protection Bureau (https://www.consumerfinance.gov/data-research/hmda/historic-data/) Capital income data are from the IRS, https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-statistics-2015-zip-code-data-soi

B Brookings Metro

AEI Housing Center

AEI Housing Center Critique of Freddie Mac's Note on "Racial and Ethnic Valuation Gaps in Home Purchase Appraisals"

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January 2022 (This version replaces an earlier version from November 2021.)[1]

Executive Summary

While we applaud Freddie Mac for having undertaken an effort to assemble relevant data to investigate the topic of appraisal discrimination, it was premature to publish a note based only on "exploratory research" limited to a single race-based correlation, with no attempt to present a rigorous analysis regarding other potential explanations. Merely stating that low appraisals resulted in "substantial appraisal valuations gaps" for minority versus White tracts provides an ominous sounding headline, but sheds little light on whether the gaps support a claim of systemic racism. Even worse, Freddie Mac's research note was quickly seized by policymakers and the media as evidence of systemic racism.[2]

Rather than being due to racial discrimination by appraisers, we found Freddie's claim of an "appraisal gap" is much more likely the result of would-be first-time buyer inexperience, socio-economic status (SES), or government actions (in particular a concentration of FHA lending in certain census tracts) with a disparate impact on protected classes.

Our analysis, which goes well beyond Freddie Mac's "exploratory research", can explain around 85% for Black tracts and 29% for Latino tracts of the gap through differences in socio-economic status (SES), leverage, and borrower characteristics. With the full set of controls, the Black gap disappears entirely, while the Latino gap falls by almost half.

[1] In this version, we have slightly updated our dataset to have it match Freddie Mac's cleaning process. The results are about the same as in the prior version. The views expressed are those of the authors alone and do not necessarily represent those of the American Enterprise Institute or of any individual who provided comments. The authors would like to thank Salim Furth, Mark Palim, and Steve Oliner for their helpful comments.

[2] FHFA acting director Sandra Thompson stated at the 2021 National Housing Conference that Freddie Mac found "substantial appraisal valuation gaps for minority versus White tracts." Money.com's headline stated "Freddie Mac Confirms There's a Major Racial Gap in Home Appraisals", Inman's "Landmark study confirms troubling 'appraisal gap' in minority enclaves", Bloomberg's "Freddie Mac Finds 'Pervasive' Bias in Home Appraisal Industry", CBS News' "There's a big "appraisal gap" between Black and White homeowners", and the WSJ's "Freddie Mac Finds Home Appraisals in Black, Latino Areas More Likely to Fall Short."

In a robustness test, we found a sizeable FHA effect for majority White or White-only tracts. Thus, FHA lending, but also Equifax Risk Factor (ERS) and the one adult borrower share, is not simply substituting for minority borrowers.

Finally, research ignored by Freddie Mac has found a substantial consumer benefit to low appraisals:

> Low appraisals provide enormous leverage to renegotiate the contract to a lower price. When buyers do renegotiate, subsequent to a low appraisal, they usually lower price by a significant share of the difference between contract price and appraised value. The new lower price reduces credit risk, costs to the borrower, and ultimately results in greater wealth for the buyer.[3]

If the differences found by Freddie Mac are in fact, as our research indicates, largely due to factors such as differing rates of FHA financing and SES in the grouped census tracts, then addressing wealth inequities through the use of easier lending criteria and accommodative monetary policy create a systemic barrier to sustainable homeownership and wealth creation by subjecting protected class households to risky lending, unsustainable price boosts, speculation in land, and home price volatility as other AEI Housing Center research has shown.[4] These polices are a violation of the FHFA's (and HUD's and the CFPB's) obligation to Affirmatively Further the Goal of Fair Housing. Thus, instead of Freddie Mac's correlation being the result of systemic appraiser racism, it may well have been the result of government policies and actions which have a disparate impact on protected classes.

We respectfully submit the following comments in an effort to highlight the above deficiencies and report on our research into other explanatory factors. We believe that our research could be quickly confirmed. We trust that this critique will help inform Freddie Mac, FHFA, policy makers and the public on this important topic.[5]

Replicating Freddie Mac's Data

The main data on the "appraisal gap" presented by Freddie Mac are summarized in Exhibit 1 of their note, which shows that appraisals come in below the contract price more often in census tracts (or neighborhoods as Freddie Mac refers to them) with a majority of Latino or Black residents. Per Freddie Mac, the appraisal gap increases with the share of the Latino and Black residents in the tract. From these data, Freddie Mac, while calling its note "exploratory research", states that there are "substantial appraisal valuation gaps for minority versus White tracts". As noted, publishing with only this single race-based correlation was inappropriate and premature. Given that the rest of the note is largely based on this single correlation, the entire note suffers from the same shortcoming.

[3] Fout, Hamilton, Nuno Mota, and Eric Rosenblatt. "When Appraisers Go Low, Contracts Go Lower: The Impact of Expert Opinions on Transaction Prices." The Journal of Real Estate Finance and Economics (2021): 1-41. and Fout, Hamilton, and Vincent Yao. Housing market effects of appraising below contract. Working paper, available at: http://www.fanniemae.com/resources/file/research/datanotes/pdf/fannie-mae-whitepaper-060716.pdf, 2016.
[4] See for example "The paradox of accessible lending" or "How the federal government's policies have helped to make housing outcomes separate and unequal."
[5] We also provide additional research questions in Appendix 2 and questions about the note in Appendix 3.

Freddie Mac's data set contains 13 million appraisals from 2015 to 2020. We first replicate Freddie Mac's Exhibit 1 in an effort to determine the validity of the data (Table 1). Our data set includes over 4.9 million appraisals or about 38% of Freddie Mac's data.[6] Both data sets rely on Census data at the tract level to identify the racial and ethnic composition of the tracts.[7] Neither data set includes the race or ethnicity of the individual loan applicants. Neither data set includes information as to the final disposition of the loan application (i.e. did the purchase and loan transaction proceed with the original applicant and was the purchase price adjusted based on the lower valuation provided by the appraiser).

We find that when comparing the results between Freddie Mac and AEI side by side (see Table 1), we find similar "appraisal gap" correlations for minority versus White tracts. For example, our gap for majority Black tracts is similar to Freddie Mac's gap (6.6 ppts versus 5.2 ppts), while the gap for majority Latino tracts is very close (8.3 ppts versus 8.0 ppts).

We conclude that our data are robust and representative and we will leverage them to go far beyond Freddie Mac's "exploratory research" and dive deeply into an examination of many other correlations and their explanatory power.

Table 1: Freddie Mac's Exhibit 1 and AEI's Replication of Exhibit 1
Appraisals for the purchase of single-family one-unit homes, Jan. 1, 2015-Dec. 31, 2020

	Freddie Mac Note			AEI results		
Property Tract	**Count**	**% Lower Than Contract Price**	**Gap vs. White**	**Count**	**% Lower Than Contract Price**	**Gap vs. White**
Overall	12,752,779	8.3%		4,948,772	9.1%	
White [50%-100%]	10,632,616	7.4%		3,926,787	7.9%	
Latino [50%-100%]	**553,470**	**15.4%**	**8.0 ppts**	**238,064**	**16.2%**	**8.3 ppts**
Latino [50%-80%]		15.0%	7.7 ppts	194,630	15.7%	6.8 ppts
Latino [80%-100%]		16.7%	9.4 ppts	43,434	18.7%	11.7 ppts
Black [50%-100%]	**373,747**	**12.5%**	**5.2 ppts**	**141,206**	**14.6%**	**6.6 ppts**
Black [50%-80%]		12.10%	4.8 ppts	106,577	14.00%	5.1 ppts
Black [80%-100%]		13.30%	5.9 ppts	34,632	16.40%	9.4 ppts

Source: Freddie Mac and AEI Housing Center.

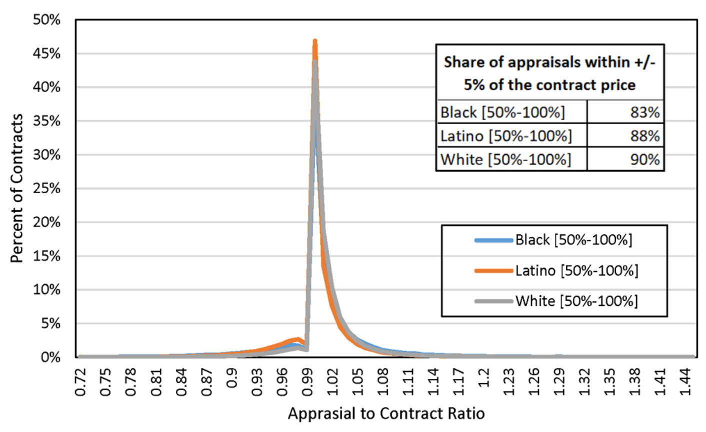
Initial observations about Freddie Mac's "Exploratory Research"

What was omitted from the Freddie Mac note is the extent of the "appraisal gap," meaning by how much appraisers are coming in below the contract price or the severity of the gap. Figure 1 first presents the distribution of the ratios of appraisal to contract price for three groups. There is a large amount of anchoring to the contract price as shown by the large spikes at a ratio of 1. Between 83% of appraisals in

[6] Unlike in a prior version of this paper, we have now excluded appraisals where it involved a non-arm length transaction and a seller concession exceeding 3%. The new data set now uses the same cleaning steps as outlined in the Freddie Mac note.
[7] We use the 5-year 2015-2019 American Community Survey data to classify tracts while Freddie uses 2010 Census data.

Black tracts and 90% in White tracts fall within +/- 5% of the contract price. From the chart, it is hard to make out a meaningful difference between the 3 lines. Importantly research has shown that "[L]ow appraisals provide enormous leverage to renegotiate the contract to a lower price."[8] Thus, they can be an important consumer protection.

Figure 1: Appraisal to Contract Ratio



Source: AEI Housing Center.

Table 2 displays a measure of the severity of the "appraisal gap," which was not reported by Freddie Mac. Severity is, however, an important part in establishing the magnitude of appraiser bias. The table provides median gaps, which are generally around 4-6% of the contract price depending on the group for appraisals that came in below contract price. Within this narrow range, the gap in percent is negligible between Latino tracts and White ones (0.3%) and the gap between Black tracts and White ones is 1.5%. (See Figure A1 in the appendix for a distribution of the differences.)

What is interesting is that for the appraisals that came in below contract price, there appears to be no gap relative to White tracts for Latino tracts and a relatively small gap of 1-2% for Black tracts. Rather than racial bias, this seems to suggest that tracts which a higher share of appraisals below contract price have certain characteristics that make them likelier to do so. We explore this explanation in our analysis which begins following the end of this section.

[8] Fout et al. (2021)

Table 2: Insights on Freddie Mac's Omitted Results

	Median contract price	Median Difference btw. appraisal and contract price		Gap vs White	
		%	$	%	$
White [50%-100%]	$265,000	3.6%	-$10,000		
Latino [50%-100%]	$246,000	3.9%	-$10,000	0.3%	$0
Latino [50%-80%]	$243,500	3.8%	-$10,000	0.3%	$0
Latino [80%-100%]	$260,000	4.2%	-$10,000	0.7%	$0
Black [50%-100%]	$182,000	5.1%	-$10,000	1.5%	$0
Black [50%-80%]	$185,000	4.8%	-$9,950	1.3%	$50
Black [80%-100%]	$175,000	5.7%	-$10,000	2.2%	$0

Source: AEI Housing Center.

We also point to research by Fout et al. (2021), which uses home purchase loan application data, and builds on earlier research by Fout and Yao (2016). Fout studies "buyer responses to the uncommon occurrence of the appraised value coming in below the contract price (i.e. a low appraisal)."[9] The study has two significant findings:

1) "Furthermore, the study finds that "when a low appraisal occurs, … the probability of downward renegotiation rises to 55.8% and continues steadily to rise as appraised value falls further short of contract, reaching 79.9% when appraised value is short of contract by seven to 8 %" or that "higher LTV borrowers renegotiate more often, in more than 93% of cases for applications with an LTV of 97 when the appraised value's shortfall from contract is greater than 2%. Renegotiation likelihood drops much lower for LTVs of 70 or less, where the low appraisal is less likely to jeopardize the loan" and
2) a low appraisal "sharply raises the probability of downward price renegotiation"[10] and "Fig. 5 [reproduced below] shows that high LTV borrowers usually recapture the entire difference between contract and appraised value. Borrowers with lower LTV, including unconstrained borrowers, split this difference, giving up more to the seller as constraints loosen."[11]

[9] Fout et al. (2021)
[10] Ibid.
[11] Fout et al. (2021) explain that "downward renegotiation given a low appraisal is more common among borrowers that are deemed financially constrained, for whom the low appraisal, absent a renegotiation, would imply higher financing costs or difficulties in closing the loan. Nonetheless, even borrowers that are entirely unconstrained from a financing perspective, still exhibit substantial renegotiation rates when facing low appraisals. This suggests that the news or information effect of receiving an expert opinion on the property valuation (by the appraiser) has a significant implication for the renegotiation likelihood. Together, these results suggest there is both a liquidity effect and an information effect that impact the likelihood of renegotiation when facing a low appraisal, a novel finding in the literature."

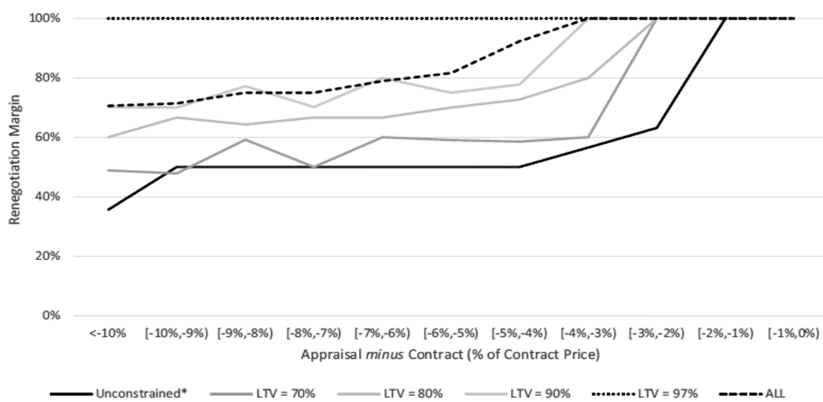


Fig. 5 Median percent of difference between contract and appraised value recaptured by buyers who renegotiate in cases where downward renegotiation occurs.* "Unconstrained" borrowers defined as those with a post-appraisal LTV below 60% and FICO of 740 or higher

Figure 5 reproduced from Fout et al. (2021)

While Fout et al. (2021) did not investigate the impact on race, the higher shares of FHA lending in Black and Latino tracts, which likely means LTVs of 96.5% or more, seem to suggest that borrowers in these tracts end up mostly benefiting from lower appraisals because the "buyer gains substantial bargaining power because the buyer can dissolve the contract by simply failing to pursue the mortgage, getting all earnest money back and avoiding most financing costs."

Thus, the slightly larger share of appraisals below contract price in Black tracts and their slightly higher differences to the appraisal price may actually provide a larger consumer benefit to these tract – quite the opposite of what Freddie Mac alleges. Crucially, this study was published on February 23, 2021, well before Freddie Mac's note was released.[12]

In footnote 8 to its note, Freddie Mac cites a paper by Calem, Lambie-Hanson, and Nakamura (2017). The footnote states:

> We acknowledge that the sale price is not always equal to market value, and we expect that in all areas some appraisals will report values lower than the contract price. However, research

[12] Fout et al. (2021) also state that "Low appraisals provide enormous leverage to renegotiate the contract to a lower price. When buyers do renegotiate, subsequent to a low appraisal, they usually lower price by a significant share of the difference between contract price and appraised value. The new lower price reduces credit risk, costs to the borrower, and ultimately results in greater wealth for the buyer" or "the ability to renegotiate sales price to more accurately reflect the value of the underlying collateral potentially puts the borrower in a better position to sustain homeownership and allow for more effective management of the associated mortgage risk. A low appraisal gives buyers an opportunity to carry out such a renegotiation. As such, more accurate appraisals in the case of evidence of buyer overbidding support better decision making and more effective assessment of mortgage credit risk and pricing."

data indicate that a high percentage of appraisals are at or above the purchase contract price (Calem, Lambie-Hanson, and Nakamura, 2017).

Interestingly, the Calem et al. paper has in the abstract the following statement: “An important benefit of appraisals reported below the contract price is that they help borrowers renegotiate prices with sellers.” This sentence is based on Fout and Yao (2016).

Freddie Mac failed to mention this fact or the updated 2021 Fout study anywhere in its note on low appraisals, which noted “substantial appraisal valuation gaps for minority versus White tracts”.

Methodology to Analyze Correlations: An aspect of American life is that Blacks and Latinos, on average, have a lower SES than Whites.[13] This opens up the question: Do borrowers who receive an appraisal below contract price have certain characteristics that make them more likely to do so? We are informed in this approach by having undertaken many studies on alleged racial bias in housing.[14]

Equation (1): Using our appraisal dataset and without any control variables, we first construct the following logistic regression to determine a baseline:

$$(1)\quad Below_i = a + b_1\, White_{i,x} + b_2\, Latino_{i,x} + b_3\, Black_{i,x} + Year\ FE + MSA\ FE + e_i$$

where Below is a dummy (or binary) variable for whether the appraisal came in below the contract price or not, which is indicated by the i subscript for appraisal level. White, Black, and Latino measure each group’s share of the residents within a census tract, which is indicated by the x subscript for tract level. We also control for differences across metro areas through metro fixed effects and for differences across years through year fixed effects.

We report the detailed regression coefficients in the appendix. We then “translate” the regression coefficients from the logistical regression to a marginal effect for each observation, which predict the effect on outcomes (namely the share of appraisals below contract price). We then calculate average marginal effects, which is the simple average of the marginal effect across all observations for the 3

[13] However, given Whites’ sizable share of the nation’s population, they constitute a sizable proportion of low-SES individuals. For example, of the estimated 11 million children in poverty in 2019, 28% are Black, 39% are Hispanic or Latino, and 33% are non–Hispanic White. https://datacenter.kidscount.org/data#USA/1/0/char/5

[14] See for example: What is the Impact of Race and Socio-Economic Status on the Valuation of Homes by Neighborhood?, How Common Is Appraiser Racial Bias?, or How Common Is Disparate Impact in Mortgage Lending?

groups of interest.[15] Lastly, we calculate the gap in appraisals below contract price for minority tracts relative to White ones.[16]

Equation (2): Next, we introduce a limited set of control variables aimed at socio-economic status and buyer characteristics to test if non-race related factors may help explain the correlation found by Freddie Mac of "substantial appraisal valuation gaps for minority versus White tracts." We select these variables because of our prior research, which found them to be a significant explanatory factors in evaluating valuation differences across tracts of difference racial make-up.[17] We then repeat the steps from above.

We construct the following regression, which builds on equation (1) but adds a limited set of new control variables:

$$(2)\quad Below_i = a + b_1\, White_{i,x} + b_2\, Latino_{i,x} + b_3\, Black_{i,x} + b_4\, FHA_x + b_5\, ERS_x + \\ + b_6\, OneAdult_x + Year\ FE + MSA\ FE + e_i$$

The additional controls in equation (2) relative to equation (1) are:

- *FHA* is a continuous variable for the FHA share of purchase loans originated in each tract in 2020 per HMDA data,
- *ERS* is a set of dummy variables for the tract's 2013 Equifax Risk Score decile (ranking from low 0 to high 9), which encompasses the credit scores of all individuals in a tract with a credit score and as such it is a much broader measure of credit than the scores of individuals taking out mortgage loans,
- *OneAdult* is the share of one adult (as opposed to two adult) borrowers in 2020 per HMDA data.

Equation (3). We build on equation (1) and (2) by adding a full set of control variables:

$$(3)\quad Below_i = a + b_1\, White_{i,x} + b_2\, Latino_{i,x} + b_3\, Black_{i,x} + b_4\, FHA_x + b_5\, ERS_x + \\ + b_6\, OneAdult_x + b_7\, HPA_x + b_8\, Sales_x + b_9\, Tier_{i,x} + b_{10}\, New_{i,x} + \\ + b_{11}\, Poor_{i,x} + b_{12}\, Owner_x + b_{13}\, Income_x + Year\ FE + MSA\ FE + e_i$$

The additional controls in equation (3) relative to equation (2) are:

[15] Freddie Mac defines a majority tract as having a resident share of at least 50% for one of the three groups (White, Latino, and Black). In the regression, we include a continuous variable ranging from 0 to 100 percent for each of the three groups. When we estimate the implied appraisal gap, we assume an 80% share for each group in the marginal effects, which represents the point which Freddie Mac uses to distinguish as the share of minority people increases. At the same time, we reduce the shares for the other groups. In the case of majority Black tracts, we thus assume an 80% Black and 20% White split, in the case of majority Latino, we assume an 80% Latino and 20% White split, and for majority White, we assume an 80% White and 10% Black and Latino respectively.
[16] For the margin effects we use average predictions using SAS's Proc QLIM (Qualitative and Limited Dependent Variable Model) program.
[17] See What is the Impact of Race and Socio-Economic Status on the Valuation of Homes by Neighborhood? For details.

- *HPA* is the FHFA annual year-over-year home price appreciation. Faster HPA may introduce errors on the appraisal, including time adjustments, especially if there is a large gap to the metro median HPA, which is most likely what the appraiser is observing.
- *Sales* measures the quarterly number of appraisals (in logarithmic terms). A lower number of appraisals may make it harder to for the appraiser to find comps, which then also require a larger sale price time adjustment.
- *Tier* is a set of dummy variables for the low, middle (omitted), or high price third of the contract property's price in a given quarter relative to all other sales in the metro area. Lower priced home may be a proxy for first-time and less experienced buyers.
- *New* is a dummy variable for whether the 1004 appraisal form indicates a new home condition (Condition of C1) or not. Newer homes may be easier to appraise than older ones.
- *Poor* is dummy variable for whether the 1004 appraisal form indicates "deferred maintenance" (C5) or "substantial damage" (C6).
- *Owner* measures the owner-occupied share of homes in the tract, and
- *Income* is the ratio of the tract's income to the metro area median income, which is a component of tract SES.

Results

Equation (1): Without using any controls, we find that the gap relative to Whites for appraisals below contract price is 5.4 ppts for Black tracts and 7.8 ppts for Latino tracts. While these results are regression based, they are very similar to our results from our replication of Freddie Mac's Exhibit 1 (6.6 ppts and 8.3 ppts, respectively). They are also fairly similar to Freddie Mac's results of 5.2 ppts and 8.0 ppts, respectively.

Equation (2): After introducing the limited set of additional controls, the gap relative to White tracts for appraisals below contract price is 0.8 ppt for Black tracts (down from 5.4 ppts) and 5.5 ppts for Latino tracts (down from 7.8 ppts).

These results with the limited set of additional controls are interesting as the implied gaps in the share of appraisals below contract price are much lower than without any controls. In fact, the gap for Black tracts falls by seven-eighths and the gap for Latino tracts falls by about one-third. This presents evidence that the socio-economic factors, FHA lending, or borrower characteristics can account almost entirely (in the case of Black tracts) or for over a third (in the case of Latino tracts) of the "appraisal gap" as identified by Freddie Mac.

Equation (3): After introducing the full set of additional controls, the gap for Black tract disappears entirely (-0.3 ppt vs. 6.6 ppts) and the gap for Latino tracts falls by almost half (4.6 ppts vs 8.3 ppts). For the regression results, please refer to the appendix.

Table 3: Summary of Results	Gap vs. White				
	Freddie Mac results	Table 1 AEI results	Equation (1) no controls	Equation (2) with limited controls	Equation (3) with full controls
White					
Latino	8.0 ppts	8.3 ppts	7.8 ppts	5.5 ppts	4.6 ppts
Black	5.2 ppts	6.6 ppts	5.4 ppts	0.8 ppt	-0.3 ppt

FHA lending at the tract level is a powerful predictor: Among the controls, we particularly find that the presence of FHA lending is a powerful predictor. For a 10 ppts increase in the FHA share of lending in the tract, we find that the share of appraisals below contract price increases by 0.5 ppts. Given that Black tracts have on average an FHA share of 34%, Latino tracts of 32% and White tracts of 15% (see Table 4), this variable alone accounts for about one-quarter and about four-third of the reduction in the appraisal gap for Black and Latino tracts, respectively.[18] As we discuss below, the presence of FHA lending continues as a powerful predictor even when comparing the share of appraisals below purchase price among largely White tracts with varying levels of FHA lending.

Three hypothesis come to mind for the outsized effect of FHA lending:

1) FHA borrowers are likely more inexperienced and likely have less financial literacy. FHA purchase borrowers tend to be lower income, with 83% being first-time homebuyers (and likely often first-generation buyers) and 40% of purchasers being minority.[19] They have much lower credit scores (median of 671 over the sample period) than the average for all agency-guaranteed homebuyers (median of 733 over the sample period). This gap in credit scores may also be an indication of less financial literacy and experience, which may translate into a lower skill to negotiate on price.

   One study by FHFA researchers found that first time buyers (FTBs) have a tendency to overpay for their homes when compared to their more experienced, repeat buyer counterparts.[20] After adjusting for housing characteristics, the FHFA study found that over 2012-2016 first time home buyers overpaid on average by 1.04%. Given the $275,021 price for the average home in the study sample, this suggests that FTBs overpay by as much as $2,860. Possible explanations for this discrepancy offered are lack of buyer experience, the failure to negotiate, or haste in closing on a contract.

2) FHA borrowers could be outbidding other buyers with leverage readily provided by FHA. (FHA's median DTI is 44 percent over the sample period compared to 37 percent for all non-FHA

[18] For these estimates, we first multiply the marginal effect by the difference in FHA lending between White and Latino and Black tracts as provided in Table 4. We then compute the reduction in the gap relative to White tracts from equation 2 from equation 1, which in the case of Black tracts is 3.1 ppts. We then divide the numbers to arrive at a rough estimate of the effect of FHA lending in reducing the gap. We later repeat the procedure for ERS bin and one adult borrower share.
[19] First-time buyer and minority statistics is for FY 2018. Minority share is based on the 92% with a reported race or ethnicity. https://www.hud.gov/sites/dfiles/Housing/documents/FHAProdReport_Sep2018.pdf
[20] Shui, Jessica, and Shriya Murthy. "Under what circumstances do first-time homebuyers overpay?—An empirical analysis using mortgage and appraisal data." Journal of Real Estate Research 41, no. 1 (2019): 107-146.

agency-guaranteed homebuyers). They could be overpaying because of their inexperience in working with realtors (who are paid by the seller) or because their interests are not necessarily aligned with realtors or mortgage bankers, who get paid based on the sale price or loan amount.[21]

3) FHA loans use the same Uniform Residential Appraisal Report (Form 1004) as conventional lending. The one substantive difference in the appraisal standard for an FHA loan relative to a conventional loan is that HUD establishes Minimum Property Standards (MPS) setting certain minimum standards for buildings constructed under HUD housing programs, including FHA insured single family homes. MPS includes "durability of such items as doors, windows, gutters and downspouts, painting and wall coverings, kitchen cabinets and carpeting. The MPS includes minimum standards for these, and other items, to ensure that the value of an FHA-insured home is not reduced by the deterioration of these components." As a result, a real estate agent familiar with MPS may advise a seller, when considering an FHA insured loan applicant, to hold out for a higher contract price to offset all or part of that cost, in an attempt to shift the cost of the repairs from the seller to the buyer.[22]

Equifax Risk Score Decile: We also found Equifax Risk Score decile to be another very powerful predictor of the share of appraisals below contract price. For a tract in the lowest ERS decile, we find that the share of appraisals below contract price is about 2.4 ppts greater than in the highest ERS decile. Given that Black tracts have on average an ERS decile of 0.7, Latino tracts of 1.5, but White ones of 5.2 (see Table 4), ERS can perhaps explain about one-third of the reduction appraisal gap for Black and Latino tracts, respectively. ERS measures past payment behavior but it may also be a close proxy for financial literacy and socio-economic status. Crucially, the ERS is also color blind, meaning no race or ethnicity variables are reported to the credit bureau.

Share of One Adult Borrowers: We also found the share of purchase loans with one adult borrower to be another very powerful predictor of the share of appraisals below contract price. For a 10 ppts increase in the share of one adult borrower in the tract, we find that the share of appraisals below contract price increases by 0.7 ppt. Given that Black tracts have a median one adult borrower share of 77%, Latino tracts of 64%, and White tracts of 53% (see Table 4), this variable alone accounts for about four-tenths and about one-third of the reduction in the appraisal gap for Black and Latino tracts, respectively. Similar to the FHA share, this variable likely captures first-time, first-generation, inexperienced prospective buyers with lots of access to leverage.

When taken together, the limited set of control variables of ERS, FHA lending, and one adult borrower share – which are all highly statistically significant – reduce the "appraisal gap" for Black tracts by 85% and for Latino tracts by 29%.

With the full set of controls, the Black gap disappears entirely, while the Latino gap falls by half. The detailed regression results are summarized in the appendix.

[21] For mortgage bankers, the mechanism may work through the preapproval process based on FHA's underwriting guidelines, where the applicant is pre-approved for the maximum allowable purchase price based on income.
[22] https://www.hud.gov/program_offices/housing/ramh/mps/mhsmpsp

Robustness Test

FHA lending skews heavily to FTBs. Per FHA data, around 82.5% of its home purchase loans between Jan. 2015 and Dec. 2020 were to first-time buyers.[23] According to AEI estimates, around 16% and 22% of these FHA FTB home purchase loans were to Black and Latino borrowers, respectively. To test whether the FHA share is simply a proxy for minority borrowers and thus diminishing the size of the "appraisal gap" on the Black and Latino estimates, we limit the sample to White tracts (those with 50+% White share of residents), thus largely removing the effect from minority tracts.[24]

For these majority White tracts, we then test if the FHA purchase loan share by itself has an effect on the share of appraisals below contract price. We find that a 10 ppts increase in the FHA loan share is associated with a 1.2 ppts increase in the share of appraisals below contract price. When we control for ERS bin and the share of one adult borrowers, a 10 ppts increase in FHA lending is associated with a 0.5 ppt increase in the share of appraisals below contract price. Just like the FHA loan share, ERS decile and one adult borrower share are highly statically significant. These results also hold for tracts with even higher White resident shares.

We therefore conclude that there is a sizeable FHA effect for majority White or White-only tracts. Thus, FHA lending, but also ERS and the one adult borrower share, is not simply substituting for minority borrowers.

Discussion

The “appraisal gap” found by Freddie Mac is more likely due to SES, FHA lending, and borrower characteristics than systemic racism. From the start of 2015 to the end of 2020, we can document the following relationships to these characteristics (see table 4):

- Home price appreciation (HPA) in minority tracts has far exceeded HPA in White tracts,
- Access to looser underwriting (as measured by the mortgage default rate (MDR), a proxy for lending standards at loan origination) has been far greater in minority tracts than in White tracts,
- FHA lending has a far greater footprint in minority tracts than White ones,
- Shares of one adult borrower are much greater, and
- Credit score profiles are much lower for individual with scores in minority tracts than White ones.

[23] Supra. https://www.hud.gov/sites/dfiles/Housing/documents/FHAProdReport_Sep2018.pdf
[24] See the appendix for a detailed table on FHA shares by majority White, Latino, and Black tracts.

Table 4: Summary Statistics for Majority White, Latino, and Black Tracts	Median Cumulative HPA (2015-2020)	MDR	% FHA lending	% one adult borrower	Average ERS	Average ERS Decile
White [50%-100%]	**26.5%**	**12.4%**	**15.0%**	**52.8%**	**706**	**5.2**
Latino [50%-100%]	**33.9%**	**17.4%**	**32.3%**	**63.8%**	**665**	**1.5**
Latino [50%-80%]	37.4%	17.2%	32.0%	63.9%	667	1.6
Latino [80%-100%]	25.8%	18.1%	33.3%	63.4%	658	0.9
Black [50%-100%]	**36.6%**	**19.2%**	**34.4%**	**77.1%**	**647**	**0.7**
Black [50%-80%]	34.9%	18.5%	32.1%	74.9%	653	0.8
Black [80%-100%]	41.6%	21.2%	41.4%	83.7%	629	0.2

Note: Cells are weighted by 2020 HMDA purchase counts.

Freddie's claim of an "appraisal gap" seemingly due to systemic racism looks more to be the result of would-be first-time buyer inexperience, SES, or government actions (in particular FHA) with a disparate impact on protected classes.

FHA equips many lower income, lower SES potential homebuyers with lots of spending power in the form of leverage. Given this leverage and the "seal of a qualified mortgage underwriting approval" by a government agency, these FHA homebuyers (especially less experienced first-time/first generation buyers) have less ability to gauge what the right price is and are lulled into thinking they are able to afford the price needed to win the bidding contest.[25] For particularly inexperienced borrowers, an appraiser may be providing a consumer benefit with an appraisal below contract price by alerting the would-be buyer that he or she is overpaying on the home.

While this research cannot rule out instances of individual appraiser bias, our aggregate results either eliminate or sharply narrow the "appraisal gap" measured in Freddie Mac's research note, undercutting explanations based on systemic bias. Given these findings, we think that this framework could also explain the differences for the 934 appraisers who submitted a sufficient number of appraisals in both Black or Latino and White tracts and for which Freddie Mac presented evidence of an "appraisal gap." Freddie Mac should redo their research of these individual appraisers incorporating the additional controls that we outlined in this critique.

Conclusion

- Freddie found an "appraisal gap" between White and minorities in the share of appraisals which come in below contract price.
- We can explain around 85% for Black tracts and 29% for Latino tracts of the gap through differences in SES, leverage, and borrower characteristics. With the full set of controls, the Black gap disappears entirely, while the Latino gap falls by half.

[25] See for example, Davis, Morris A., Stephen D. Oliner, Tobias J. Peter, and Edward J. Pinto. "The impact of federal housing policy on housing demand and homeownership: evidence from a quasi-experiment." Journal of Housing Economics 48 (2020).

- The literature suggests that an appraiser may be providing some would-be buyers a consumer benefit by providing an appraised value below the contract price, thus alerting such buyer that he or she is overpaying on the home, which then triggers a renegotiation.

The United States was founded on the ideals of freedom, equality, and self-governance. While there is a legacy of past racism and lingering racial bias, progress has been made in living up to these ideals. In order to stamp out lingering racial bias, claims of systemic racism must be subjected to rigorous, fact-based research and analysis. This is fundamental to fashioning appropriate and successful public and private responses. The overarching goal must be to promote sustainable access to housing finance and support opportunities for income and wealth growth among lower income households. We must be mindful that many past and continuing housing and other policy actions to address racial discrimination have had unintended consequences that have done substantial harm to low-income households generally, and minority households in particular.

For more on this general topic by the AEI Housing Center, see:

- *What is the Impact of Race and Socio-Economic Status on the Valuation of Homes by Neighborhood?*
- *How Common Is Appraiser Racial Bias?*
- *How Common Is Disparate Impact in Mortgage Lending?*

Appendix 1:

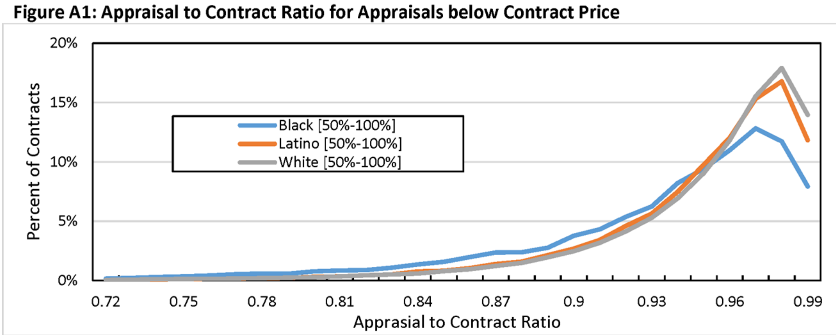
The higher the share of FHA lending is, the higher the cumulative level of HPA over 2015-2020 has been. Many majority Latino and Black tracts have very high shares of FHA lending. Thus borrowers in these areas likely have access to more leverage to bid up prices or they have certain unobservable factors that make them more likely to opt for FHA financing and to negotiate contracts that end up above the appraisal. For example, 82% of FHA home purchase loans are to first time buyers and 40% are minority respectively.[26] As a result, a disproportionate percentage of Black and Latino FHA purchasers are first-time and likely first-generation home buyers, placing them at a possible disadvantage in negotiating a home purchase.

Table A1: Distribution of tracts that are majority White, Latino, and Black by the FHA lending decile

FHA lending decile	% FHA lending	Median Cumulative HPA (2015-2020)	Distribution of tracts that are majority (columns add to 100%)		
			White	Latino	Black
1 - lowest	0%	22.8%	10%	8%	5%
2	3%	24.3%	12%	2%	2%
3	7%	24.6%	11%	3%	3%
4	10%	25.9%	12%	5%	4%
5	13%	27.0%	11%	5%	5%
6	17%	27.2%	11%	6%	5%
7	21%	28.2%	11%	7%	7%
8	25%	29.5%	10%	10%	10%
9	32%	33.1%	8%	17%	19%
10 - highest	44%	39.8%	5%	36%	41%

Note: Cells are weighted by 2020 HMDA purchase counts.
Majority tracts are defined as having at least a 50% share of the respective group of residents.

Figure A1: Appraisal to Contract Ratio for Appraisals below Contract Price



[26] Supra. https://www.hud.gov/sites/dfiles/Housing/documents/FHAProdReport_Sep2018.pdf

Detailed Regression results

	Equation 1	Equation 2	Equation 3
Intercept	-2.14	-2.11	-3.16
	(-144.81)	(-109.26)	(-111.47)
White	-0.006	-0.009	-0.007
	(-34.94)	(-53.65)	(-33.81)
	[-0.0005]	[-0.0007]	[-0.0006]
Latino	0.0097	0.001	0.001
	(53.99)	(5.94)	(5.13)
	[0.0008]	[0.0001]	[0.0001]
Black	0.006	-0.006	-0.006
	(33.03)	(-28.41)	(-24.52)
	[0.0005]	[-0.0005]	[-0.0005]
FHA		0.66	0.80
		(42.47)	(41.07)
		[0.05]	[0.06]
ERS		-0.03	-0.05
		(-34.88)	(-45.57)
		[-0.003]	[-0.004]
One Adult		0.88	0.75
		(49.97)	(33.92)
		[0.07]	[0.06]
HPA			1.56
			(51.04)
			[0.13]
Sales			0.11
			(83.29)
			[0.009]
Low			-0.23
			(-44.24)
			[-0.02]
High			0.12
			(27.52)
			[0.01]

New			-0.55 (-86.09) [-0.04]
Poor			0.78 (22.24) [0.06]
Owner			0.002 (12.5) [0.0001]
Income			-0.001 (-12.99) [-0.0001]
Year and Metro Fixed Effects	Yes	Yes	Yes

t statistics in parentheses, calculated marginal effects in brackets

Appendix 2:The AEI Housing Center respectfully requests that Freddie Mac use the suggested method below or another similar method to establish additional facts so as to determine the percentage of instances where the contract price vs. the appraised value is "correct".

The following section sets out to establish a framework for evaluating appraisals that come in below contract price. Within this framework, we then suggest various steps that Freddie Mac might undertake to test the various outcomes of the framework, in an effort to shed light on the appraiser's motivation and whether the applicant/homebuyer is a beneficiary of the gap between the sales contract price and the appraised value.

What transpired during the sales negotiation process preceding the preparation of a below contract price appraisal?

Many studies, including ones on home purchases and loans, have shown that shopping behavior can reduce price.[27] Imagine the following scenario where a buyer either negotiates or does not on the listing price:

	Buyer	
	negotiates	does not negotiate
List price	$100k	$100k
Contract price	$95k	$100k
Appraisal	$95k	$95k
Gap btw. contract price and appraisal	0%	-5%

The appraiser may assess the home at exactly the same price, but because the buyer did not negotiate, it appears as if the appraiser may be biased against the buyer, while in fact the appraiser's value may be a signal to the buyer that he may well be overpaying, thus providing a consumer benefit.

There are a number of potential outcomes, all of which require post-appraisal data:

1) Buyer renegotiates and price paid is reduced, saving the buyer some money. This implies that
    a. the appraiser was correct and actually helped the buyer.
        i. Comparison to a data set such as the public records would allow the frequency of this circumstance to be determined.
2) Buyer attempts to renegotiate but seller has market power and buyer pays the same price. This implies that
    a. the appraiser was correct, but it is difficult to know for sure.
        i. Supply/ demand data might shed light on this circumstance.
3) Buyer does nothing and pays the negotiated price. This implies that
    a. the appraiser was wrong but not necessarily biased, or
    b. the appraiser was biased, or

[27] See for example: Bhutta, N., A. Fuster and A. Hizmo. 2019. Paying Too Much? Price Dispersion in the US Mortgage Market. Working Paper, February. https://areuea.org/conferences/papers/download.phtml?id=5551, or Alexandrov, A. and S. Koulayev. 2018. No Shopping in the U.S. Mortgage Market: Direct and Strategic Effects of Providing Information. Working Paper, May. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2948491, or Malliaris, S., D. Rettl, and R. Singh. 2020. Is Competition a Cure for Confusion? Evidence From the Residential Mortgage Market. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3429267.

c. the buyer was inexperienced or was not properly advised that the price could or even should be renegotiated, or
d. the buyer chooses to forgo the hassle of renegotiating or is willing to pay the higher price and comes up with the extra cash or opts for a higher LTV.
e. In the latter two instances, an Automated Valuation Model (AVM) might be used as a "yardstick" to determine the correct (or more correct value).

4) Sale falls through because the potential buyer cannot come up with more cash or was unwilling to increase the LTV. This implies that
   a. the appraiser was correct, or
   b. the appraiser was wrong but not necessarily biased, or
   c. the appraiser was biased.
      i. In the latter two instances, an Automated Valuation Model (AVM) might be used as a "yardstick" to determine the correct (or more correct value).

We understand that Freddie Mac's current dataset is insufficient to determine the frequencies of

a. whether the buyer negotiated <u>before</u> the appraisal came in below contract price, and
b. whether the sale fell through or whether the buyer negotiated <u>after</u> the appraisal came in below contract price.

However, with what we believe would be straightforward matching against the public record data set, it would be possible to determine these frequencies and thus shed light on post-appraisal events. We say straightforward because the appraisal itself contains a number of potentially useful data fields, starting with the parcel ID, seller's name, and buyer's name. As we will demonstrate, once this matching is done, a number of other metrics become available from the public record data set, such as the presence of FHA insurance, a VA guaranty, and the recorded sales price, and is useful in determining whether the actual buyer matches the buyer name on the appraisal.

Action items for Freddie Mac:

Freddie Mac should match its appraisal data to both home listing data and the public records. The match is straightforward as the appraisal data can easily be linked to the other datasets using the property's parcel ID or address, along with seller's and buyer's names.[28] Matching to home listings data would provide the initial listing price and the negotiated price. Matching to public record would provide the sales price and whether the buyer listed on the appraisal went through with the purchase and the sales price. The appraisal also includes many other data fields that could be potentially useful once this matching is done.

<u>Listings data match to see if certain groups are better at negotiating price than others:</u>

[28] This analysis should however heavily discount post-pandemic results when a red hot housing market enticed shrewd sellers to list their homes below market to start bidding wars. Nevertheless, data from 2015-2020:Q1 will provide ample data.

While not all appraisals will match to listings, due to coverage issues in the listings data, the resulting matches should be more than ample to provide insights as to the extent that borrowers did or did not negotiate the contract price as it relates to the listing price (or prices). Days on market would also be a useful metric available from the listings data. This analysis should identify differences in the relationship of the list price to the contract price by:

a. the racial make-up of the census tract,
b. the income level of the census tract,
c. the educational attainment level of the census tract,
d. the average credit score of the census tract,
e. the homeownership rate of the census tract, etc.

Financial literacy, while hard to gauge, may be different for people of different socio-economic or racial backgrounds. First-time homebuyers may not be aware of many pitfalls and opportunities in the home buying process. Similarly, first-generation home buyers will not have access to the experience of home owning parents, who have negotiated home purchases before. Or a lower homeownership rate for minorities or in certain neighborhoods may work to their detriment as the pool of experienced home buyers in a group of friends, neighbors, or associates may smaller.

If Freddie Mac were to find systematically lower contract prices than list prices depending on the neighborhood type (particularly between higher and lower average credit score tracts), then this could be indicative of negotiating behavior (or lack thereof) by certain buyers. Thus, an appraisal below contract price may signal an appraiser trying to alert the buyer that she is overpaying. As we note below, these tentative insights might then be tested by matching to a public record data set.

Freddie Mac could also look at the same issue more directly by utilizing its smaller dataset, which already includes the borrower's race or first-time buyer status flag. It might be interesting to see whether minority or first-time buyers are less skilled home price negotiators than repeat buyers. The test should limit the sample to buyers that are White to establish a baseline without a racial context. Only as a second step should Freddie Mac then look at differences between minority and White repeat and first-time buyers.

Freddie Mac should disclose the results for each test, ideally by year, as well as the median ratios, percentages, dollar values, and confidence bands for each contract price to list price comparison.

Public records match to see how many sales fall through and if buyers use the lower appraisal to renegotiate the price:[29]

1) If no match of the appraised property to the public records data around the time of the appraisal can be found, then we can assume that the appraisal did not result in an actual sale.
2) If an actual match around the time of the appraisal is found, then Freddie Mac should ascertain that the buyer name in the public records matches with the borrower's name from the 1004 appraisal form.

[29] An FHFA paper (done jointly by FHFA's Will Larsen and AEI's Steve Oliner and Morris Davis) on land valuations has already matched appraisal data to public records data with a high success rate.

a. In this case, Freddie Mac should compare the sale price in the public records (with the exception of non-disclosure states for which the exact sale price is not publicly disclosed) to the appraised value from the 1004 form.

Knowing the frequencies for each outcome is important to understand the motivation of the appraiser. For example, an appraisal below contract price may not necessarily reflect bias if it alerts the buyer to renegotiate the contract price as this would work to the benefit of the buyer.

Freddie Mac should disclose the results for each instance, ideally by year, as well as the median ratio percentages, dollar values, and confidence bands for the comparison between appraisal amount and eventual sale price as described in 2a above.

Side note: A further advantage of matching the appraisal data to the public records would be to learn additional details about the borrower, which would allow for additional robustness checks.

1) Freddie Mac could identify VA loans and therefore VA appraisals; VA appraisers are randomly assigned. Do the Freddie Mac results hold for VA loans?
2) Freddie Mac could identify FHA loans. Over 80 percent of FHA borrowers are first time buyers (FTB). Thus it serves as an FTB proxy. Also, with FHA loans, the borrower's ability to increase the LTV is generally limited because most FHA loans are already at the statutory LTV limit.
3) Freddie Mac will learn the LTV of the loan, which should be used as an additional control variable.

Appendix 3: Additional AEI Housing Center questions and comments on Freddie Mac's note

This section provides one additional robustness check and a couple questions that Freddie Mac should explore in order to add more color to its note and also our findings from above.

Additional proposed robustness check:

For its appraisal waiver product, Freddie Mac already computes an acceptable range for a self-appraisal in lieu of a human appraisal. How do the under-appraised properties fall within the range of Freddie Mac's own Home Value Explorer (HVE) model? What about the over-appraised properties? Are there differences by a neighborhood's racial makeup or by SES?

Miscellaneous questions and comments:

- Latino tracts have a higher percentage of appraisals below contract price than Black tracts. These results also hold in our regression. What might explain this?
- What is the median time lag between comps and appraisals in majority White, Latino, and Black tract. This is an important question as longer time lags between the comp and the actual appraisal can introduce adjustment errors on the part of the appraiser. These errors can be larger if tracts experience much faster home price appreciation relative to the metro average.

How Common Is Appraiser Racial Bias?

An Analysis Using Big Data to Inform as to Whether It Is Common or Uncommon that an Appraiser's Knowledge of an Applicant's Race Results in Valuation Bias

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AEI Housing Center

Working Report – Preliminary Results
AEI.org/housing

January 19, 2021

Link to AEI HMIs:
https://www.aei.org/housing/housing-market-indicators/

Recent Reports Alleging Racial Bias by Appraisers on Mortgage Loans

- New York Times examples*
  - $135,000 or 29% difference (Jacksonville FL - appraisal 1: $330,000, appraisal 2: $465,000)
  - $40,000 (% unknown) difference (Hartford, CT suburb)
  - $160,000 or 24% difference (Los Angeles - appraisal 1: $500,000, appraisal 2: $660,000)
- Denver News Channel 7 example**
  - $145,000 or 26% (Denver, CO – appraisal 1: $405,000, appraisal 2: $550,000)
- Chicago Sun Times example***
  - $62,000 or (Chicago, IL – appraisal 1: $278,000, appraisal 2: $340,000)
- Of four examples with sufficient data, appraisal 1 came in an average of about $126,000 or 25% lower than appraisal 2.
- Claims of bias were based on an allegation that a human appraiser was aware of the applicant(s)' race either from a meeting or photos or other items in the home which indicated race, and as a result, the appraiser underestimated the property's value.
- Allegations commonly occurred in predominantly White neighborhoods.
- The implication is that intentional and perhaps unintentional appraisal bias is commonplace and the valuation gaps are large.
- While the facts alleged may well be true, any policy response must be based on whether the cases are the result of "bad apple" appraisers or systemic racial bias.
- A literature search found no statistical analysis of this type of claim.
- Using big data we conduct the first analysis into whether the alleged practices of intentional racial bias, along with unintentional bias, are common or uncommon.

* https://www.nytimes.com/2020/08/25/realestate/blacks-minorities-appraisals-discrimination.html
** https://www.thedenverchannel.com/news/local-news/an-unconscious-bias-biracial-denver-couple-says-they-faced-discrimination-on-home-appraisa
*** https://chicago.suntimes.com/2020/10/7/21493755/chicago-home-appraisal-black-race-homeowners

We Asked the Collateral Risk Network (CRN) to Survey Appraisal Management Companies and Lenders

- Why: our data consist of appraisals on transactions that actually closed, thus we need to evaluate whether our set suffers from selection bias as discrimination might occur with respect to appraisals not used in loan closings.
- The question is: how likely is that Review of Valuation (ROV) requests are received and what happens after an ROV is made? Here are relevant results:

		AMC	Lenders
Frequency of Review of Valuation (ROV) requests:		Insufficient data (only 1 response, as AMCs generally do not see ROV requests)	1st survey- 2.5% (median for 12 responses) 2nd survey- 3% (median for 8 responses)
Most common reasons for a ROV (where one is given):		1. Poor selection of comps 2. Recent Improvements not noted 3. Sq. Ft. incorrect	1. Poor selection of comps 2. Sq. Ft. incorrect 3. Recent Improvements not noted
Regarding ROVs involving racial or ethnic bias:	**Never**	58%	63%
	<10%	42%	37%
When you do get an ROV, how many get escalated to a second appraisal?	**Never**	0 (0%)	2 (25%)
	<10%	17 (89%)	4 (50%)
	10-30%	2 (11%)	2 (25%)
	>30%	0 (0%)	0 (0%)
How many contracts get renegotiated?	**Never**	3 (17%)	0 (%)
	<10%	9 (50%)	5 (71%)
	10-30%	5 (28%)	1 (14%)
	>30-60%	0 (0%)	1 (14%)
	>60%	1 (6%)	0 (0%)
Are ROVs more common on refinance or purchases?		68% refi	63% refi

- Conclusions:
  - Items noted in red are not unique to claims of racial or ethnic bias, but are common to all ROVs.
  - An ROV is rare (2.5%-3% incidence), ROVs are related to race or ethnic bias are also rare, and an ROV is a condition precedent to a second appraisal, which itself is relatively rare (about 10%-20% incidence).
  - Based on the survey, we may conclude that our data set, consisting entirely of closed loans, does not suffer from a significant level of selection bias.

Home Mortgage Disclosure Act Data for 2018-2019 (HMDA) and HUD Data for 2019-2020 Seemingly Confirm That Selection Bias Is Low

- HMDA, a virtual census of institutional loan app data, covered >8 million applicants.

		White	Black
Refi	Total Applications	4,995,603	614,394
	% of Application Denied	16%	26%
	% Denial Reason is Collateral	17%	14%
	% Denial Reason is DTI or Credit History	49%	54%
Purchase	Total Applications	6,065,075	782,255
	% of Application Denied	8%	17%
	% Denial Reason is Collateral	13%	8%
	% Denial Reason is DTI or Credit History	56%	66%

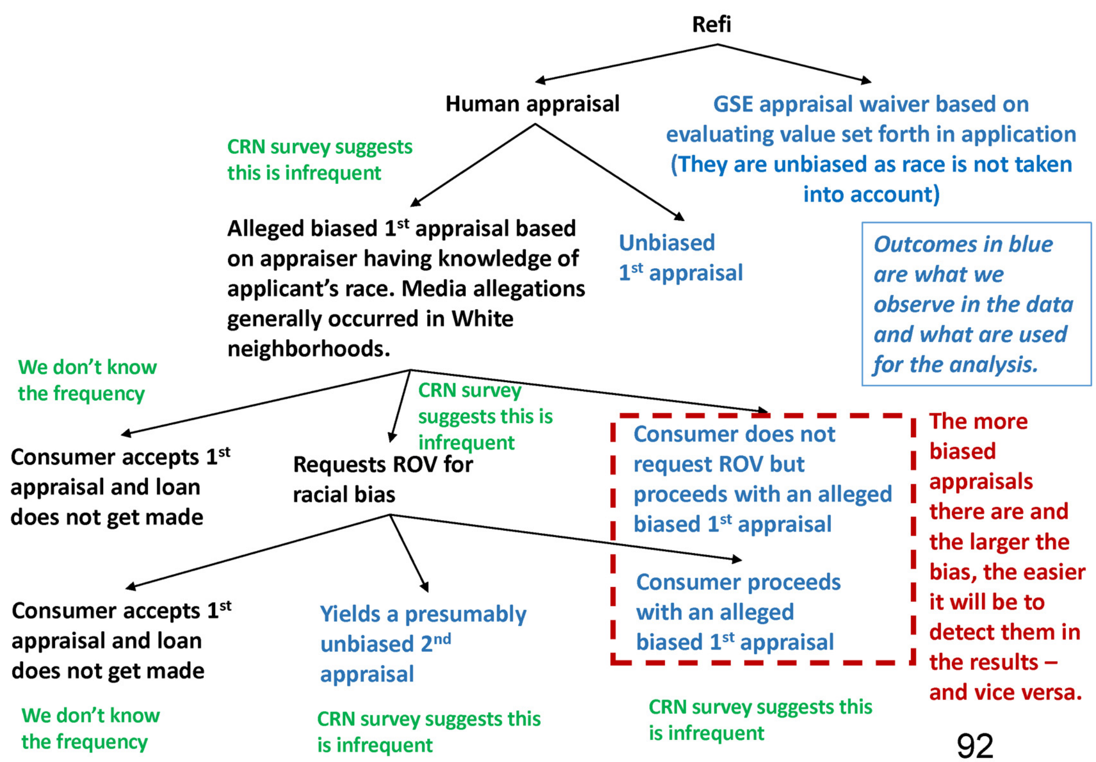
Note: Data for 1st lien, 1-unit, owner-occupied homes only. Excludes I/O, balloons, or neg. am. loans. "Denial "for principal denial reason only.

Source: HMDA 2018 & 2019

- HUD data:
  - There is no national appraisal discrimination complaint database. Given HUD's fair housing role, it does receive appraisal bias complaints. In 2019 and 2020 there were 3 and 6 respectively.
- Conclusions:
  - HMDA loan denial rate on refis is 16% for White applicants and 26% for Black applicants; denial rate on purchase loans is lower for both White and Black applicants.
    - The main reasons for Black denials are credit history and DTI.
    - Collateral is noted as a denial reason less for Black applicants than White ones and perceived or alleged bias would be one of a number of potential reasons for a collateral denial.
    - Based on HMDA data, the potential for bias by an appraiser is small, since it would be a percentage of a percentage of a percentage.
  - Since HMDA is consistent with the results of the CRN survey and since HUD receives relatively few complaints, notwithstanding media coverage of appraiser bias, we may conclude that our data set, consisting entirely of closed loans, does not suffer from a significant level of selection bias.

* https://www.washingtonpost.com/realestate/for-black-homeowners-a-common-conundrum-with-appraisals/2021/01/20/80fbfb50-5431-11eb-a817-e5e7f8a406d6_story.html

Analytical Framework



We Use Big Data to Evaluate the Likelihood of Racial Bias by an Appraiser

- The AEI Housing Center has assembled the National Housing Market Database (NHMDB), which uses and connects many different datasets.
  - Most in-depth resource for key housing data and trends.
  - Accurate, timely, and in-depth coverage of purchase trends.
  - Connects the dots for many housing indicators, yielding the most comprehensive analysis of the housing market.
  - Its integrated structure is uniquely suited to study countless questions.
  - Here we apply the NHMDB to help shed light on the question: Is there intentional or unintentional racial bias by appraisers?
    - We are able to identify whether the transaction had a human appraiser or a GSE appraisal waiver using a computer generated value.
      - The waiver value is unbiased, as neither race nor any other borrower characteristic is used that could be correlated with race is used in generating the value.
    - We use the race neutral Automated Valuation Model (AVM), where neither race nor any other borrower characteristic is used that could be correlated with race is used in generating the value.
    - The AVM controls for non-racial factors that affect home value, leaving the race dummies to pick up any racial effects.
    - AVMs allow us to statistically test bias assertions by objectively assessing previously performed human appraisals and appraisal waivers.
  - A literature search found no statistical analysis of this type.
    - This study is based on 243,000 appraisals (of which 59,000 are GSE appraisal waiver cases & 22,000 GSE human appraisals), & 2,600 group match cases originated in 2018 & 2019.
  - Unintentional bias may have a disparate impact, but it must be demonstrated that a challenged practice involving racial bias is the substantial cause of the disparate impact.
  - Using computer generated property values, we used big data to look for bias of the type alleged in the media and racial bias that might result in a disparate impact allegation.
- This Working Report presents preliminary results and we welcome comments.

Using Big Data to Evaluate the Presence of Appraiser Bias

- NHMDB data used in performing this analysis include:
  - Public records
  - Automated Valuation Models (AVM)
  - National Mortgage Risk Index using agency loan data, including use of appraisal waivers
  - Home Mortgage Disclosure Act (HMDA) data
- Our main focus is on refinance loans:
  - Refinance loans lack an arm's length transaction, potentially providing more of an opportunity to exercise racial bias.
  - Purchase loan appraisals are highly anchored to the sales price and therefore tend to not come in below the sales price.* This makes them useful as a check, since they provide less of an opportunity and potential to exercise racial bias.
  - Thus, deviations due to bias, if present, should be larger for unanchored refi valuations compared to anchored purchase valuations.
  - FHA purchase loans have a unique double anchor, which is useful for a natural experiment:
    - The 1st anchor is to sales price and the 2nd to a statutory maximum LTV of 96.5%.
    - Also, an average LTV of around 95% for groups being compared, which means even a small gap between the sales price and appraised value would require a price renegotiation with the seller.

* Contract Price Confirmation Bias: Evidence from Repeat Appraisals

Methodology

We use 2 different approaches, to see if on average there is a value difference (or a gap) between refinance loan appraisals for Blacks and Whites, in order to evaluate the existence of bias, especially as it relates to the alleged practices.

- Automated Valuation Model (AVM) approach (N-count = 243,000 loans)
  - We regress the Dec-2017 AVM, month of origination dummies, census tract fixed effects, and a dummy variable for minority status on the log property value.
    - An AVM provides a neutral control for neighborhood and home characteristics.
    - Lacks "knowledge" of applicant's race.
    - We filter out properties with extreme outliers in home characteristics.
  - Our analysis is enhanced by running it separately for loans using human generated appraisals vs. a waiver with a computer generated value (the AVM noted above is independent of this waiver value).
    - The goal is to determine whether an alleged practice (such as racial bias based on knowing whether an applicant is Black from a meeting or interior items (i.e. photos, art, or books) occurs more frequently on Black refi valuations by humans.
    - A second goal is to test for unintentional racial bias against Blacks on refi valuations by humans that has a disparate impact and is the substantial cause of the disparate impact.
  - Hedonic approach is used to check the AVM approach:
    - We replace the AVM with house characteristics (sq. footage, lot size, year built, and census tract).
- Group approach (N-count totaled 2,600 groups):
  - Identify groups of homes that are identical based on external characteristics (same census tract, home type, sq. footage, lot size, year built, # of baths, and land use code), within 1,650 ft of each other (median: 200 ft), and owned by households of different racial backgrounds.
    - Rules out challenged practices such as comp selection and neighborhood effects as an explanation.
  - We regress a set of dummies for minority status and month of origination on the log property value. The group of homes are treated as fixed effects.
- We define the following non-overlapping groups (N-counts):

	AVM/Hedonic	GSE Human	GSE Waiver	Group
White (defined as non-Hispanic White)	212,935	53,397	21,539	3,563
Black (defined as non-Hispanic Black)	30,435	5,393	1,391	2,810

Note: 2% of Hispanics identify as Black Hispanic. These loans are excluded from this analysis.

Note on Interpreting the Results

- Purchase loans are arm's length transactions between consumers. Due to anchoring to the sale price, the opportunity for racial bias from appraisers is low to non-existent.
  - The consumers establish the true price of the asset, including quantifying the impact on price of the current state of improvements, upkeep, or decoration (unobservable factors). A computer model can only approximate these items, as it is limited by data availability.
- We use a computer generated AVM as a control for home quality, thus unobservable factors will be present in both our purchase and refi analysis. Due to anchoring, purchase results can serve as benchmark on the magnitude of these unobservable factors.
- Results for both approaches found similar gaps for both refinance and purchase loans, thus we are able to attribute the refi loan gaps to unobservable factors rather than bias.
- Below we compare results for refi and purchase loans using the AVM approach. While there is a modest gap between Blacks and Whites for refis, a slightly larger gap exists for purchase loans. As noted, we compare refis to purchase loans to account for unobservable factors. It appears Blacks on average receive slightly higher appraisals than Whites.

AVM Approach	Gap between Blacks and Whites	Gap between Blacks and Whites after accounting for unobservable factors
1. For refinance loans only	-0.7%***	0.0 ppt.
2. For purchase loans only	-0.7%***	

Note: The results are differences in property value relative to Whites. ***** denotes significance at the 1% level**. Data for this approach are limited to property value $100,000-$1,000,000, Year built between 2000-2019, Lot sizes of 2,000-20,000 sq. ft., and Building area of 800-3600 sq. ft.

- The Group approach, by its design, also provides a compelling means to determine whether racial bias exists. However, it also cannot fully eliminate all unobservable factors.
  - Due to small n-sizes, we report these findings second. (By mid-2021 we expect to be able to add another year of data, growing our n-sizes. This will add to the utility of this approach.)
- Due to space concerns, the following slides do not explicitly report the gap between Blacks and Whites refinance loan appraisals after accounting for unobservable factors (red) leaving readers to do so on their own.

AVM Approach Results for Refinance Loans

- The media reports all had a common challenged practice: the human appraiser knew the applicant was Black by having met the applicant or from photos in the home and rendered a biased opinion of value that was below the property's correct value.
- The race neutral AVM approach was applied to valuations on: 1. refinance loans generally, 2. purchase loans, and 3. refinance loans with either a human appraisal or a waiver.
  - #1 (refinance loans only) includes instances where biased refi valuations have been rendered.
  - #2 (purchase loans only) would be much less influenced by bias due to anchoring to the sale price by human appraisers.
  - #3. a. (waiver only) has lack of "knowledge" of race and interior condition, or the potential for bias in the selection of comps and should be free of racial bias due to the common practice noted above.
- Our results indicate that for #2 (purchase loans) and #3.a. (non-human valuations), Blacks had nearly identical valuation gaps as Whites (-0.8% and -0.5% respectively), as #1 (-0.7%).
- Thus we conclude allegation that knowing the race of the applicant results in racial bias by appraisers on refinance loans is uncommon and not systemic. This same analysis supports the conclusion that unintentional bias based on race is also uncommon and not systemic.

AVM Approach	Gap between Blacks and Whites
1. For refinance loans only	-0.7%***
2. For purchase loans only	-0.7%***
3. Limited to refinance loans with an Appraisal/Waiver Flag (GSE only)	-0.7%***
a. Waiver only	-0.5%
b. Appraisal only	-0.8%***

Note: The results are differences in property value relative to Whites. *** **denotes significance at the 1% level**. Data for this approach are limited to property value $100,000-$1,000,000, Year built between 2000-2019, Lot sizes of 2,000-20,000 sq. ft., and Building area of 800-3600 sq. ft.

AVM Approach: Robustness Checks

	Gap btw. Blacks and Whites
AVM Approach for refinance loans	-0.7%***
Check 1. AVM Approach for refinance loans but using quantile regression (median value)	-0.7%
Check 2. AVM Approach for refinance loans but limiting to properties with values between the 20th and 80th percentile at the census tract level	-0.4%***
Check 3. AVM Approach for refinance loans but adding controls for FICO bucket, income, CLTV bucket, and the # of borrowers	0.4%**
Check 4. Hedonic approach for refinance loans	-2.3%***
Check 5. Hedonic approach for purchase loans	-2.4%***

Note: The results are differences in property value relative to Whites. **** denotes significance at the 5% level and *** at the 1% level**. Data for these approaches are limited to property value $100,000-$1,000,000, Year built between 2000-2019, Lot sizes of 2,000-20,000 sq. ft., and Building area of 800-3,600 sq. ft.

- Checks 1 &2 focus on the impact of outliers, as the anecdotal value gaps averaged 25% and indicate that the AVM Approach results are very robust (that is, remain valid under different assumptions, parameters and initial conditions).
- Check 3, which controls for certain borrower characteristics, eliminates the small gap between Blacks to Whites (now a small positive gap).
  - Generally, higher income, higher FICO, lower CLTV, and 2 borrowers mean a slightly higher appraisal.
  - The results are also generally robust for different states, but n-counts are often too small for a systematic analysis.
- Checks 1-3: the gaps for refinance loans likely reflect unobserved property or location characteristics that are not captured in the AVM.
- Checks 4 and 5 yields a Black-White gap of -2.3% on refinance and -2.4% on purchase loans. Racial discrimination is unlikely on purchase loans due to sale price anchoring.
- Checks 1-5 support our conclusion that the common challenged practice of knowing the race of the applicant results in racial bias by appraisers on refinance loans is uncommon and not systemic. They also support the conclusion that unintentional bias based on race is also uncommon and not systemic.
- More robustness checks are provided in the appendix.

Group Approach Results

Group Approach	Gap between Blacks and Whites
1. For refinance loans only	-0.4%
2. For purchase loans only	0.0%

Note: The results are differences in property value relative to Whites. **The results are not statistically significant**. Data for this Approach are limited to homes built between 1950 and 2019 and 1-unit SF, condos, townhomes, or PUDs within 500m of each other (median is 200 ft).

- This approach looks at two or more identical homes, so as to reduce the possibility for variation between the groups.
  - This reduces the likelihood that variation in selected comparable sales, differences in racial make-up of comparable locations, & location within a neighborhood affect the result.
- The Group approach, by its design, provides the most compelling evidence regarding the existence of racial bias.
- The Group approach has results that are quite close to the AVM approach for refinance loans and there is only a small difference to purchase loans, for which biased appraisals are unlikely. It also supports our earlier conclusions that intentional and unintentional appraiser bias based on race is uncommon and not systemic.
  - We ended up with around 2,600 home groups with owners of a different race.
  - The results seem to hold for townhomes or condos only, but n-counts are fairly small.
  - There is no statistically detectable difference between Waivers and Appraisals for identical homes, but n-counts again are fairly small.

Refi Waiver-Appraisal Gap between Whites (Control Group) and Blacks

The Gap of a Human Appraisal Relative to a Waiver	Using AVM Approach to Measure Gap	N-Count (Appraisal)	N-Count (Waiver)
White (control group as presumably unbiased on race)	-0.8%***	45,155	19,987
Black	-1.4%	4,422	1,271

Note: Borrower controls are FICO and LTV buckets, the number of borrowers, and income. *** **denotes significance at the 1% level**. Data are limited to property value $100,000-$1,000,000, Year built between 2000-2019, Lot sizes of 2,000-20,000 sq. ft., and Building area of 800-3,600 sq. ft. They are also limited to GSE borrowers with CLTVs <= 80% since waivers have an eligibility criterion.

- Here we examine the gap within the each group between the Refi human appraisal and the Waiver.
  - Whites with a human appraisal get 0.8% lower value than Whites with a refi waiver and this result is highly statistically significant (at 1% level).
    - Whites serve as the control group because their appraisals should not be biased and the Waiver is in theory color blind.
  - Blacks with a Refi human appraisal get 1.4% lower value than Blacks with a refi waiver appraiser. However, this result is not statistically significant at the 5% level, with a confidence range of +0.3% to -3.2%.
  - The difference between the White and Black groups is 0.6%, basically the same as for the AVM and the Group approaches.
- This result further supports our conclusion that intentional and unintentional racial bias by appraisers on refinance loans is uncommon and not systemic.

FHA Purchase Transactions: A Unique Natural Experiment to Evaluate Bias

- FHA purchase appraisals are helpful as a check because they are prone to anchoring in two ways:
  - Sales price as usual.
  - Also prone to LTV anchoring due to the statutory LTV limit of 96.5%.
- There is another helpful characteristic: an average LTV of 95.23%, only slightly below the statutory maximum 96.5%.
- As the chart below demonstrates:
  - FHA purchase loan median LTV equals 96.5% for all listed groups.
    - Since 73% of FHA loans are at the cap, the median LTV equals the cap.
  - FHA purchase loan mean LTVs are all in a tight range relative to median LTVs (White and Black applicants have a 0.48% mean LTV difference).

	LTV of FHA Purchase Loans		
	# of obs.	Median	Mean
White	375,508	96.50	95.04
Black	92,985	96.50	95.52

Note: Data cover an estimated 99% of the agency market.
Source: AEI Housing Center National Mortgage Risk Index.

FHA Purchase Transactions: a Natural Experiment to Evaluate Bias (Cont'd)

		Gap btw. Blacks and Whites	# of observations
Purchase	AVM Approach (all loan types)	-0.7%***	299,930
	FHA only	1.0%***	35,070
Refi	AVM Approach (all loan types)	-0.7%***	243,370
	FHA only	-0.4%	30,992

Note: The results are differences in property value relative to Whites. *** **denotes significance at the 1% level**. Data for this Approach are limited to property value $100,000-$1,000,000, Year built between 2000-2019, Lot sizes of 2,000-20,000 sq. ft., and Building area of 800-3600 sq. ft.

- The results for FHA purchase loan appraisals, which involve substantial numbers of Black applicants, provide additional support for the existence of small appraisal valuation gaps, which cannot be attributed to racial bias (the positive gap for FHA purchase loans to Blacks may be due to the larger seller concessions allowed under the FHA program compared to conventional loans and which tend to be used more in low-income areas. Such concessions are absent on refis).
  - As noted earlier, there is minimal to no difference between White and Black LTV levels.
  - There are two outcomes that would result from bias, both of which are unlikely to occur.
    - A biased lower valuation for Blacks, which if present in practice, would result in the frequent renegotiation of purchase contracts to a lower price, since the value does not support the loan amount and there is little LTV room. However, this would work to the benefit of the home buyer; and the CRN survey indicates renegotiations are infrequent.
    - To display a bias, the appraiser abandons the tendency to anchor to both the purchase price and a key LTV level, yet the dollar difference here is so small that it itself would be red flag and would create a notable headache for the appraiser over the small amount.
- The results for refinance loans are fairly similar to purchase loans, and as noted above, the results for purchase loans more or less rule out significant bias.
- Therefore this experiment also supports our conclusions.

A Further Robustness Test: Refi Appraisal Gap by Neighborhood

- Under this test, we create census tract groups based on shares of Black residents and then compare gaps for tracts with <=25% and >25% Black residents.
- This is an important test as the media allegations of racial bias commonly occurred in predominantly White neighborhoods.
- The gaps for tracts with <=25% and >25% Black residents are virtually identical (-0.6% and -0.7% respectively), both of which are nearly the same gap as shown on Slide 9: -0.7%).
- This result adds further support to our conclusion that the alleged practice of knowing the applicant's race results in racial bias by appraisers on refinance loans is uncommon and not systemic.
- It also supports the conclusion that unintentional appraiser bias based on race is also uncommon and not systemic.

Black resident share of census tract	Gap btw. Blacks and Whites	# of White observations	# of Black observations
All	-0.7%***	212,935	30,435
<= 25%	-0.6%***	205,480	19,639
> 25%	-0.7%**	7,198	10,774

Note: Regression is the AVM refi approach and data are limited to property value $100,000-$1,000,000, Year built between 2000-2019, Lot sizes of 2,000-20,000 sq. ft., Building area of 800-3600 sq. ft. We only use human appraisals, waivers are excluded. Minority share of census tract is defined as the share of Black people residing in a tract. **** denotes significance at the 5% level and *** at the 1% level.**

Pro-actively Identifying or Defending against Appraiser Bias

Regulators, Appraiser Management Companies (AMCs), appraisal firms and mortgage lenders would be able to replicate our methodology and use it to pro-actively identify and root out cases of appraiser racial or ethnic bias. It could also be used to defend against claims of appraiser racial or ethnic bias.

Using our methodology one would be able to confirm the presence or lack of a statistically significant pattern of bias being experienced by the protected class, by rendering outcomes directly comparable between the protected and non-protected classes.* Should the result show no statistically significant difference in the valuation outcomes between a protected class and a non-protected class, one could conclude there was a lack of statistically significant racial bias. These results would also be usable as a valid defense to any disparate impact liability.

Regulators and individual firms may have access to even more data than was used in our analysis:

- Access to the appraiser and appraisal firm's name,
- Access to all loan applications, regardless of disposition,
- Access to all complaints and review of valuation requests and their disposition, regardless of race or ethnic origin.

* See Comment Letter on HUD's Implementation of the Fair Housing Act's Disparate Impact Standard

Conclusion

We set out to statistically examine the level of racial bias in human performed appraisals.

The CRN survey of lenders and AMCs suggest that Reconsiderations of Value (ROVs) are infrequent, as are reappraisals based on an ROV. Further, ROVs with an allegation of racial bias on 1st appraisal are also infrequent.

The CRN survey and HMDA data both support the conclusion that our data set, consisting entirely of closed loans, does not suffer from a significant level of selection bias.

Thus, statistically analyzing big data on closed loans can contribute to determining the presence and levels of racial bias by appraisers.

The more biased appraisals there are and the larger the under-valuation, the easier it would be to detect them in the results – and vice versa.

While a claim of disparate impact does not need to demonstrate intent or knowledge, any challenged practice must be shown to be the substantial cause of the disparate impact.

Our analysis looked for evidence of either intentional or unintentional racial bias.

Conclusions: (i) contrary to media allegations, racial bias by appraisers on refinance loans is uncommon and not systemic (ii) a claim of unintentional bias on refinance loans, if to be used as the basis of a disparate impact claim, was also found to be uncommon and not systemic, (iii) appraiser bias cases, such as cited by the media, may well result from "bad apple" appraisers or incompetence. Industry members with access to appraiser names should use our statistical methods to identify, investigate, and discipline as appropriate.

Appendix

Detailed Model Specification

We estimate the gap between Whites and each minority group on property value with the following regressions, which are run separately for each minority group by partitioning the sample. We also run separate regressions for refinance and purchase loans.

AVM Approach

$$ln(price) = b_0 + b_1\,Minority + b_2 AVM + b_3\,Tract + b_4 Month + e \qquad (1)$$

where *Price* represents the property value of the refinance/purchase loan. *Minority* is a dummy variable which indicates whether the borrower is either Black, Hispanic, or Asian. It is our variable of interest and measures that gap or value difference between each respective minority group and Whites. *AVM* is a control for home quality as provided by the Dec. 2017 Automated Valuation Model (AVM), *Tract* is a set of dummy variables for census tracts, and *Month* is a set of monthly dummy variables for the period of Feb. 2018 to Dec. 2019, with Jan. 2018 being the omitted variable.

Hedonic Approach

$$ln(price) = b_0 + b_1\,Minority + b_2 Area + b_3 LotSize + b_4 YearBuilt + b_5\,Tract + b_6 Month + e \qquad (2)$$

where *Area* is the building area and *LotSize* the lot size of the property, both measured in square feet. *YearBuilt* is a set of dummy variables for the year each home was built. Equation 2 is identical to equation 1 except that we use a combination of building area, lot size, and year built, instead of the Dec. 2017 AVM, to control for home quality.

Group Approach

$$ln(price) = b_0 + b_1\,Minority + b_2 Group + b_3 Month + e \qquad (3)$$

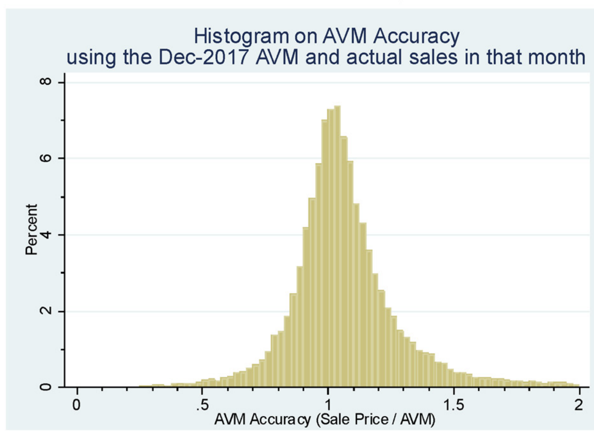
where *Group* is a set of dummy variables for identical home groups, defined as homes that have exact same building area, lot size, year built, number of bathrooms, land use code, lie in the same census tract, are no more than 500m away from each other, and are owned by at least one White and one minority individual. Home groups can consist of more than just 2 identical homes.

Appendix – Dec. 2017 AVM Evaluation

We assess the accuracy of the December 2017 AVMs by comparing AVM values to reported sale prices for properties that sold in that month. Due to data reporting and collection lags, sales in December 2017 are not known until a subsequent month. Hence, the December 2017 AVM value is calculated independently of the actual December 2017 sale price

For the roughly 37,500 homes that sold in December 2017, the histogram displays the ratio of the home's sales price to its December 2017 AVM value. The sale price was equal to 105% of the AVM, and 47% of the sale prices fell within +/-10% of the AVM (PPE 10).

As the table indicates there are differences in the AVM's accuracy by price point, we undertake several robustness checks, which are described on the next page.



Price Quintile	Median AVM Accuracy
All	105%
1 - lowest	122%
2	107%
3	104%
4	102%
5 - highest	98%

Note: AVM accuracy is defined as the ratio of actual sale price for sales in Dec. 2017 to the Dec. 2017 AVM. Price quintiles are based on the Dec. 2017 AVM and are created at the metro level and rest of state level, if outside a metro.
Data are limited to property value $100,000-$1,000,000, Year built between 2000-2019, Lot sizes of 2,000-20,000 sq. ft., and Building area of 800-3,600 sq. ft.

Appendix: Additional Robustness Checks

Gap between Blacks and Whites using …			
AVM Approach for	**Dec-2017 AVM**	**Dec-2019 AVM**	**Jun-2020 AVM**
Refinance Loans	-0.7%***	-0.9%***	-0.9%***
Purchase Loans	-0.8%***	-0.4%***	-0.6%***
PPE 10	47%	78%	81%
Median AVM Accuracy	105%	101%	101%

Gap between Blacks and Whites for loans in the lowest price quintile only		
	AVM Approach (using the Dec-2017 AVM)	**Hedonic Approach**
Refinance Loans	0.3%	-1.1%***
Purchase Loans	0.5%	-1.1%***

Note: The results are differences in property value relative to Whites. *** **denotes significance at the 1% level**. Data for these approaches are limited to property value $100,000-$1,000,000, Year built between 2000-2019, Lot sizes of 2,000-20,000 sq. ft., and Building area of 800-3,600 sq. ft. PPE 10 is the share of sale prices that fall within +/-10% of the respective AVM. AVM accuracy is defined as the ratio of actual sale price for sales in the AVM month to the respective AVM.

- The first table focuses on the impact from using different AVMs, which is fairly small. We use the December 2017 AVM as our pre-event “stake in the ground”, which allows us to compare actual appraisals and sales to an unbiased estimate of home value, since the Dec. 2017 AVM predates the subject sales in our test. While the Dec. 2017 AVM scores lowest on PPE 10 and on AVM accuracy, the results are only slightly different using more recent AVMs with higher PPE 10s and greater AVM accuracy.
- The second table presents results for the lowest price quintile. Here too, the AVM results using the Dec-2017 AVM, especially when compared to purchase loans, are not materially different from our baseline results presented in the main part. Since the Dec. 2017 AVM’s performance is weaker for lower priced homes, we compare the results to a hedonic approach for the same set of loans. As described in the methodology, the hedonic approach is a substitute for the AVM.
- The robustness checks on this page confirm that the results are robust for different AVM periods and also for lower priced homes.

Appendix – Results for Hispanics and Asians

The results for Hispanics and Asians are similar to the ones for Blacks.

		Gap between Whites and …		
		Blacks	**Hispanics**	**Asians**
AVM Approach	1. For refinance loans only	-0.7%***	-1.2%***	0.0%
	2. For purchase loans only	-0.7%***	-2.7%***	-0.5%***
	3. Limited to refinance loans with an Appraisal/Waiver Flag (GSE only)	-0.7%***	-1.3%***	-0.2%
	a. Waiver only	-0.3%	-0.8%**	-0.6%
	b. Appraisal only	-0.8%***	-1.3%***	-0.1%
	4. For FHA refinance loans only	-0.3%	-0.6%**	0.0%
	5. For FHA purchase loans only	1.0%***	-1.3%***	0.2%
	6. For refinance loans with $100-250k	0.0%	-0.2%	0.5%**
	7. For refinance loans with $250-500k	-0.4%***	-0.1%***	0.2%**
	8. For refinance loans with $500-1,000k	-0.4%*	-0.8%***	-0.5%***
Hedonic Approach	1. For refinance loans only	-2.3%***	-1.6%***	-1.8%***
	2. For purchase loans only	-2.4%***	-2.5%***	-1.8%***
Group Approach	1. For refinance loans only	-0.4%	0.2%	-0.2%
	2. For purchase loans only	0.0%	-0.4%***	-0.2%*

Note: The results are differences in property value relative to Whites. * denotes significance at the 10% level, ** at the 5% level and *** at the 1% level. Data for AVM Approach are limited to property value $100,000-$1,000,000, Year built between 2000-2019, Lot sizes of 2,000-20,000 sq. ft., and Building area of 800-3,600 sq. ft.
Data for Group Approach are limited to homes built between 1950 and 2019 and 1-unit SF, condos, townhomes, or PUDs within 500m of each other (median is 200 ft).

Appendix– Results for Hispanics and Asians (cont.)

The Gap of a Human Appraisal Relative to a Waiver	Using AVM Approach to Measure Gap	N-Count (Appraisal)	N-Count (Waiver)
White (control group as presumably unbiased on race)	-0.8%***	45,155	19,987
Black	-1.4%	4,422	1,271
Hispanic	-0.9%**	7,404	2,436
Asian	-0.7%	4,589	3,742

Note: Borrower controls are FICO and LTV buckets, the number of borrowers, and income. ** denotes significance at the 5% level and *** at the 1% level. Data are limited to property value $100,000-$1,000,000, Year built between 2000-2019, Lot sizes of 2,000-20,000 sq. ft., and Building area of 800-3,600 sq. ft. They are also limited to GSE borrowers with CLTVs <= 80% since waivers have an eligibility criterion.

Sample sizes:

	AVM/ Hedonic	GSE Human	GSE Waiver	Group: White-Black	Group: White-Hispanic	Group: White-Asian
White (defined as non-Hispanic White)	212,935	53,397	21,539	3,566	6,530	6,645
Black (defined as non-Hispanic Black)	30,435	5,393	1,391	2,813	\	\
Hispanic	33,323	8,699	2,608	\	5,233	\
Asian (defined as non-Hispanic Asian)	22,292	5,613	3,952	\	\	5,747

Note: 2% of Hispanics identify as Black Hispanic. These loans are excluded from this analysis.

Appendix – AVM Approach Results for Refinance Loans by State

	Refi	Purchase	Refi	Purchase
	Gap between Whites and Blacks		N-Counts for Blacks	
Arizona	-0.5%	-0.4%	1,580	2,027
California	-0.2%	-0.5%*	3,599	2,116
Colorado	-0.2%	0.8%	1,061	842
Florida	-0.6%**	-1.5%***	3,778	8,047
Georgia	-0.8%	-0.4%	3,823	6,578
Maryland	-0.3%	0.1%	1,544	1,900
North Carolina	-1.5%***	-0.9%**	3,154	4,059
Nevada	-0.4%	-1.4%***	1,237	1,294
South Carolina	-4.1%***	-1.8%***	1,259	2,926
Texas	-0.7%**	-0.6%**	4,741	5,857
Virginia	0.4%	-0.3%	1,915	2,571
	Gap between Whites and Hispanics		N-Counts for Hispanics	
Arizona	-0.6%***	-1.4%***	5,071	8,503
California	-0.5%***	-1.7%***	9,324	9,382
Colorado	-1.0%***	-1.3%***	2,285	2,569
Florida	-0.8%***	-2.6%***	4,651	13,103
Nevada	-0.9%***	-2.4%***	1,697	2,523
Texas	-1.5%***	-3.0%***	7,565	14,751
	Gap between Whites and Asians		N-Counts for Asians	
Arizona	-1.1%***	-1.1%***	1,112	1,968
California	-0.1%	-0.9%***	7,478	6,352
Florida	-0.9%*	-1.4%***	1,072	3,046
Nevada	-1.2%***	-1.7%***	1,679	2,202
Texas	0.7%*	0.2%	2,926	6,157
Washington	0.1%	0.0%	2,214	3,109

Note: The results are differences in property value relative to Whites. * denotes significance at the 10% level, ** at the 5% level and *** at the 1% level. Data are limited to property value $100,000-$1,000,000, Year built between 2000-2019, Lot sizes of 2,000-20,000 sq. ft., Building area of 800-3,600 sq. ft., and **states with at least 1,000 Refi loans for the minority group.**

Appendix – AVM Approach Results for Refinance Loans by Metro

	Refi	Purchase	Refi	Purchase
	Gap between Whites and Blacks		**N-Counts**	
Atlanta, GA	-1.1%*	-0.5%	3,249	5,195
Charlotte, NC	-0.5%	-1.2%**	1,305	1,583
Dallas, TX	-0.8%*	-0.6%	2,172	2,206
Houston, TX	-1.5%***	-0.7%*	1,495	2,346
Las Vegas, NV	-0.5%	-1.4%***	1,171	1,228
Phoenix, AZ	-0.6%*	-0.5%	1,430	1,836
Riverside-SB, CA	-0.4%	0.0%	1,308	704
Washington, DC	0.9%**	0.3%	1,891	1,851
	Gap between Whites and Hispanics		**N-Counts**	
Dallas, TX	-1.1%***	-2.3%***	1,630	2,485
Denver, CO	-1.3%***	-1.3%***	1,236	1,285
Houston, TX	-1.2%**	-2.8%***	1,655	4,179
Las Vegas, NV	-0.4%	-2.4%***	1,411	2,176
Orlando, FL	-0.7%	-2.8%***	1,227	2,893
Phoenix, AZ	-0.7%***	-1.3%***	3,983	6,743
Riverside_SB, CA	-0.7%***	-1.1%***	3,603	3,018
San Antonio, TX	-1.0%	-3.7%***	1,272	2,224
	Gap between Whites and Asians		**N-Counts**	
Dallas, TX	1.4%***	-0.2%	1,320	2,410
Las Vegas, NV	-1.2%***	-2.1%***	1,539	2,003
Phoenix, AZ	-1.0%***	-1.1%***	1,002	1,746
Riverside-SB, CA	-0.8%**	-0.8%*	1,301	866
Sacramento, CA	0.2%	-1.2%**	1,741	1,755
Seattle, WA	0.2%	0.0%	1,803	2,346

Note: The results are differences in property value relative to Whites. * denotes significance at the 10% level, ** at the 5% level and *** at the 1% level. Data are limited to property value $100,000-$1,000,000, Year built between 2000-2019, Lot sizes of 2,000-20,000 sq. ft., Building area of 800-3,600 sq. ft., and **metros with at least 1,000 Refi loans for the minority group.**

Appendix – AVM Approach Results for Refinance Loans by Region

	Refi	Purchase	Refi	Purchase
	Gap between Whites and Blacks		N-Counts	
Midwest	-0.4%	-0.6%*	2,933	4,209
Mountain West	-0.2%	-0.7%**	2,411	2,264
Northeast	-1.3%***	-0.5%	2,456	3,885
South	-1.0%***	-0.8%***	16,051	28,572
Southwest	-0.7%***	-0.5%**	6,514	8,364
West	-0.2%	-0.3%	4,603	3,209
	Gap between Whites and Hispanics		N-Counts	
Midwest	-1.8%***	-2.4%***	1,573	2,965
Mountain West	-1.4%***	-2.4%***	4,794	6,239
Northeast	-1.0%	-3.1%***	450	1,403
South	-1.1%***	-3.0%***	6,608	19,293
Southwest	-1.2%***	-2.5%***	13,136	24,415
West	-0.8%***	-2.0%***	10,686	11,629
	Gap between Whites and Asians		N-Counts	
Midwest	0.5%	-0.6%*	2,659	4,645
Mountain West	-1.0%***	-1.7%***	2,967	4,134
Northeast	1.1%*	1.1%**	1,727	3,140
South	-0.3%	-0.3%	4,031	10,399
Southwest	0.1%	-0.3%	4,137	8,716
West	0.0%	-0.6%***	10,751	10,979

Note: The results are differences in property value relative to Whites. * denotes significance at the 10% level, ** at the 5% level and *** at the 1% level. Data are limited to property value $100,000-$1,000,000, Year built between 2000-2019, Lot sizes of 2,000-20,000 sq. ft., and Building area of 800-3,600 sq. ft.

Devalued, Denied, and Disrespected: How Home Appraisal Bias and Discrimination Are Hurting Homeowners and Communities of Color

Testimony of Lisa Rice
President and CEO, National Fair Housing Alliance

Before the
U.S. House Committee on Financial Services
Tuesday, March 29, 2022

I. Introduction

Chairwoman Waters, Ranking Member McHenry, and other distinguished members of the United States House Financial Services Committee,

Thank you for inviting the National Fair Housing Alliance to testify today on the extremely important issue of appraisal bias and reform, which affects millions of people across the country.

My name is Lisa Rice and I am the President and CEO of the National Fair Housing Alliance ("NFHA"). NFHA is the country's only national non-profit civil rights agency solely dedicated to eliminating all forms of housing discrimination and ensuring equitable housing opportunities for all people and communities. We do this through the provision of our education and outreach, member services, public policy, advocacy, housing and community development, tech equity, enforcement and consulting and compliance programs. NFHA is also the trade association for more than 170 fair housing organizations throughout the U.S.

An appraiser has the unique power to determine the value of a home, which for most Americans, is their single most important financial asset and holds the key to wealth, stability, and opportunity for their family and generations to come. In addition, home values affect the tax base, school funding, and community investments. Moreover, time and again, our nation's economy and financial markets have been significantly impacted by home valuations, with communities of color often bearing the brunt of failings in the mortgage market and the home appraisal process. Given the importance of homeownership to American families, particularly families of color, governmental and private organizations have called for reforms and a comprehensive examination of the structure and governance of the appraisal industry.

Several organizations have answered this urgent call to action. In January 2022, the National Fair Housing Alliance along with its partners, Dane Law and the Christensen Law firm, released a report commissioned by the Appraisal Subcommittee and managed by the Council on Licensure, Enforcement and Regulation (NFHA Report).[1] We conducted an independent review of the Uniform Standards of Professional Appraisal Practice ("USPAP Standards") and the Real Property Appraiser Qualification Criteria ("Qualification Criteria"). The goal of the review was to "ensure that the USPAP Standards and the Appraiser Criteria do not encourage or systematize bias, and that the standards and criteria consistently support or promote fairness, equity, objectivity, and diversity in both appraisals and the training and credentialing of appraisers." This groundbreaking report presented a roadmap for Congress, regulators, advocates, and

[1] NFHA, Dane Law LLC, Christensen Law Firm, *Identifying Bias and Barriers, Promoting Equity: An Analysis of the USPAP Standards and Appraiser Qualification Criteria* (Jan. 2022), https://nationalfairhousing.org/wp-content/uploads/2022/02/2022-01-28-NFHA-et-al_Analysis-of-Appraisal-Standards-and-Appraiser-Criteria_FINAL.pdf.

the industry to address the nation's long legacy of bias in real estate valuations and build a future in which a family's most valuable asset is treated fairly. Congress, federal regulators, and The Appraisal Foundation have already taken concrete actions to address the findings in the NFHA Report.

Just recently, on March 23, 2022, the Property Appraisal and Valuation Equity ("PAVE") Task Force released an Action Plan, which announced a transformative set of bold agency and legislative actions designed to root out racial and ethnic bias in home valuations.[2] The PAVE Task Force is made up of 13 agency members and is co-chaired by the Department of Housing and Urban Development Secretary Marcia Fudge and Ambassador Susan Rice, White House Domestic Policy Advisor. The Task Force was created in response to President Biden's directive to launch an interagency initiative to combat bias in home appraisals.

To understand the challenges and solutions for appraisal reform, following is:

- A summary of the established history of appraisal bias to understand how we got to where we are today;
- An overview of the civil rights laws that provide a robust legal framework designed to address appraisal discrimination;
- An explanation of how the promise of the Fair Housing Act remains unfulfilled as appraisal discrimination continues today on an individual and systemic basis;
- Recommendations for congressional action that can ensure a fair, transparent, and consistent valuation process that benefits all borrowers, including borrowers of color; and
- An appendix with a one-page summary of recommendations.

II. There Is an Established History of Appraisal Bias

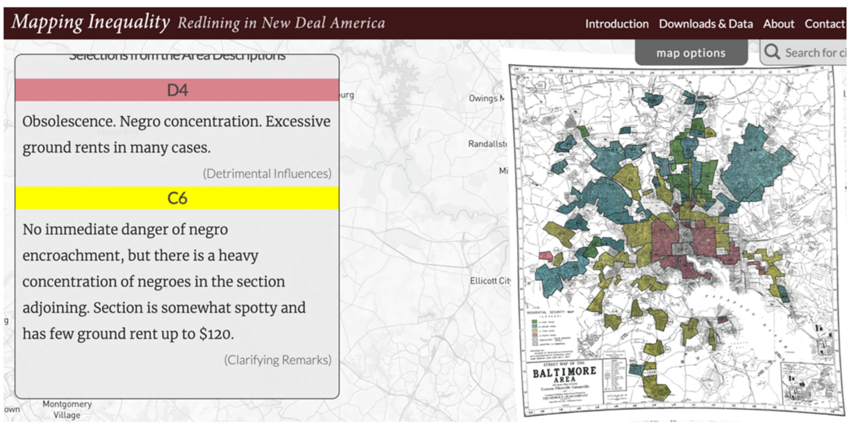
The Appraisal System Historically Undervalued Homes in Communities of Color

For centuries, laws and policies enacted to create land, housing, and credit opportunities were race-based, denying critical opportunities to Black, Latino, Asian American and Pacific Islander ("AAPI"), and Native American individuals. Despite our founding principles of liberty and justice for all, these policies were developed and implemented in a racially discriminatory manner.[3]

In particular, the New Deal's federal Home Owners Loan Corporation ("HOLC") developed one of the most harmful policy decisions in the housing and financial

[2] PAVE Interagency Task Force, *Action Plan to Advance Property Appraisal and Valuation Equity* (March 2022), https://pave.hud.gov/sites/pave.hud.gov/files/documents/PAVEActionPlan.pdf.
[3] *See* Lisa Rice, *The Fair Housing Act: A Tool for Expanding Access to Quality Credit,* The Fight for Fair Housing: Causes, Consequences, and Future Implications of the 1968 Federal Fair Housing Act (Gregory Squires, 1st ed. 2017) (providing a detailed explanation of how federal race-based housing and credit policies promoted inequality).

services markets by perpetuating a system that included race as a fundamental factor in determining the desirability and value of neighborhoods.[4] As shown in the graphic below, the HOLC created appraisal maps that were color-coded to evaluate, grade, and indicate the value of neighborhoods. Communities of color – and even neighborhoods with small numbers of Black residents – were coded as "hazardous" as signified by red shading on the map and were assigned the lowest value despite the reality that families who could afford mortgage loans resided within those communities. Moreover, areas that were adjacent to communities with Black residents could be downgraded simply based on their proximity to a community of color. Notably, the data used to create the maps were not just collected randomly, but were based on the opinions of the leading real estate professionals at the time, including appraisers. Later, the Federal Housing Administration adopted these maps and race-based policies as the basis for its mortgage insurance underwriting decisions. Thus, these policies and procedures helped systematize redlining as well as the unfounded association between race and risk in the U.S. housing and financial services markets.



HOLC Map of Baltimore. Source: Mapping Inequality[5]

[4] The Home Owners' Loan Act of 1933 established the HOLC as an emergency agency under the Federal Home Loan Bank Board. 12 U.S.C. § 1461 *et seq.*

[5] *See* University of Richmond, Virginia Tech, University of Maryland, and Johns Hopkins University, *Mapping Inequality* (documenting the maps and area descriptions created by the HOLC between 1935 and 1940), https://dsl.richmond.edu/panorama/redlining/#loc=3/41.245/-105.469&text=intro.

Appraisal Principles and Practices Further Perpetuated an Unfounded Association between Race and Risk

In addition to the mapping system, explicitly discriminatory principles and practices further perpetuated an unfounded association between race and risk. These practices promoted the idea that a home should be valued based on its neighborhood and that a homogeneous, all-White neighborhood held the highest value. Following are excerpts from a few appraisal texts and manuals.

1932: Valuation of Real Estate –
"There is one difference in people, namely race, which can result in very rapid decline [in real estate values]."

1935: American Institute of Real Estate Appraisers Manual, Real Estate Appraisal –
"To have the attributes of a good residential area, it is essential that protection be afforded against the infiltration of inharmonious racial groups…."

1938: Federal Housing Administration Underwriting Manual –
"Areas surrounding a location are investigated to determine whether incompatible racial and social groups are present, for the purpose of making a prediction regarding the probability of the locations being invaded by such groups. If a neighborhood is to retain stability, it is necessary that properties continue to be occupied by the same social and racial classes. A change in social or racial occupancy generally contributes to instability and a decline in values."

1946: McMichael's Appraising Manual, Third Edition –
"Those nationalities and races having the most favorable influence [in Chicago] come first in the list and those exerting detrimental effects come last:

1. English, Germans, Scotch, Irish, Scandinavians.
2. North Italians.
3. Bohemians or Czechs.
4. Poles.
5. Lithuanians.
6. Greeks.
7. Russian, Jews (lower class).
8. South Italians.
9. Negroes.
10. Mexicans."

1967: American Institute of Real Estate Appraisers Textbook, The Appraisal of Real Estate –
"The causes of racial and ethnic conflicts are not the appraiser's responsibility. However, he must recognize the fact that values change when people who are different from those presently occupying an area advance into and infiltrate a neighborhood."

In sum, these historical maps and policies resulted in homes in neighborhoods with similar amenities being systematically undervalued primarily on the basis of race and ethnicity. Discriminatory valuation systems and policies developed by the HOLC, the Federal Housing Administration, the American Institute of Real Estate Appraisers, and other entities also helped create, entrench, and perpetuate residential segregation. Real estate professionals used the redlining maps to racially steer people of color into red-coded or "hazardous" areas and to establish racially restrictive covenants to keep areas racially homogeneous. To this day, racial disparities in homeownership, wealth, health, education, and other key factors of success continue to follow the harmful redlining patterns set forth in these historical maps, policies, and practices.

III. The Civil Rights Laws Provide a Robust Framework for Addressing Appraisal Discrimination

The civil rights laws established a robust legal framework for addressing appraisal discrimination. Indeed, courts have long held that appraisal discrimination on the basis of race, color, religion, national origin, sex, disability, familial status, and other protected classes violates federal and state civil rights laws.[6]

The Civil Rights Act of 1866

Racial discrimination in the appraisal of housing violates the Civil Rights Act of 1866.[7] Section 1981 of this law, among other things, guarantees to all persons within the jurisdiction of the United States the same right as White citizens to make and enforce contracts. Section 1982 of this law provides all citizens with the same right as is enjoyed by White citizens to purchase, lease, sell, hold, and convey real and personal property. The Civil Rights Act of 1866 generally applies only to intentional racial discrimination, but the Supreme Court has expanded the scope of the Act to include certain types of ethnic discrimination. In conjunction with the Fair Housing Act, this law has been used in the courts to challenge appraisal discrimination.

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[6] *See, e.g., Steptoe v. Savings of America*, 800 F. Supp. 1542 (N.D. Ohio 1992). *See also*, DOJ Statement of Interest, *Austin, et al., v. Miller, et al.,* Case 3:21-cv-09319-MMC (N.D. Cal. Filed Feb. 14, 2022) (explaining that the Fair Housing Act prohibits discrimination in home appraisals), https://www.justice.gov/crt/case/statement-interest-austin-et-al-v-miller-et-al.
[7] 42 U.S.C. §§ 1981-1982.

The Fair Housing Act of 1968 and HUD's Regulation

The principal federal statute that prohibits appraisal discrimination is Title VIII of the Civil Rights Act of 1968 as amended by the Fair Housing Amendments Act of 1988 (the "Fair Housing Act"), which bars discrimination in home appraisals and other housing-related transactions on the basis of race, color, religion, national origin, sex, disability, and familial status (known as "prohibited bases," "protected classes," or "protected characteristics").[8]

The Fair Housing Act makes it unlawful for "any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction or in the terms or conditions of such transaction" on the basis of any protected class under the statute.[9] The term "residential real estate-related transaction" is defined in the statute to include "the appraising of residential real property."[10]

Courts have relied on other provisions of the Fair Housing Act to prohibit discrimination in the appraisal industry, including provisions associated with housing-related services that "otherwise make unavailable...a dwelling" or that discriminate in the "terms, conditions, or privileges of sale or rental of a dwelling."[11] Courts have observed that "an appraisal sufficient to support a loan request is a necessary condition precedent to a lending institution making a home loan."[12] Because an appraisal is a critical service associated with securing a home loan, a discriminatory appraisal may lead to the denial of a home, thereby making housing "unavailable." Appraisals may be regarded as a service provided in connection with the sale of a home, such that discriminatory appraisal practices may result in unlawful differences in treatment.

Implementing regulations under the Fair Housing Act, promulgated by HUD, broadly define the term "appraisal" to mean "an estimate or opinion of the value of a specified residential real property made in a business context in connection with the sale, rental, financing or refinancing of a dwelling or in connection with any activity that otherwise affects the availability of a residential real estate-related transaction, whether the appraisal is oral or written, or transmitted formally or informally. The appraisal includes all written comments and other documents submitted as support for the estimate or opinion of value."[13]

According to these regulations, the Fair Housing Act squarely bars any person or entity engaged in appraising residential real property from discriminating against any person "in making available such services, or in the performance of such services, because of

[8] 42 U.S.C. § 3601, *et seq.*
[9] *Id.* at § 3605(a).
[10] *Id.* at § 3605(b).
[11] *Id.* at § 3604(a) and § 3604(b).
[12] *Steptoe v. Savings of America*, 800 F. Supp. 1542, 1546 (N.D. Ohio 1992).
[13] 24 C.F.R. § 100.135(b).

race, color, religion, sex, handicap, familial status, or national origin."[14] The regulation also states that prohibited practices include "[u]sing an appraisal of residential real property in connection with the sale, rental, or financing of any dwelling where the person knows or reasonably should know that the appraisal improperly takes into consideration race, color, religion, sex, handicap, familial status, or national origin."[15]

This prohibition against discrimination as it expressly applies to appraisal services was added to the Fair Housing Act in 1988, essentially clarifying the existing scope of the Fair Housing Act as the courts had come to interpret its application in the appraisal industry.[16] The update also included a section titled "Appraisal Exemption," which notes that nothing in these mandates prohibits a person "engaged in the business of furnishing appraisals of real property to take into consideration factors other than race, color, religion, national origin, sex handicap, or familial status."[17]

The Equal Credit Opportunity Act of 1974 and the CFPB's Regulation B

Appraisal-related services are necessary in the provision of housing-related credit services. Accordingly, a discriminatory appraisal that results in the denial of home financing may also violate the Equal Credit Opportunity Act of 1974 ("ECOA"), which prohibits creditors from discriminating on the basis of race, color, religion, national origin, sex, marital status, age, and source of income (known as "prohibited bases," "protected classes," or "protected characteristics").[18] In 2013, the Consumer Financial Protection Bureau ("CFPB") amended Regulation B, which implements the ECOA, by requiring creditors to provide to applicants free copies of all appraisals and other written valuations developed in connection with an application for a loan to be secured by a first lien on a dwelling, and to notify applicants in writing that copies of appraisals will be provided to them promptly.[19] Notably, these provisions of ECOA and Regulation B only apply to the "creditor" and only if the appraisal was conducted in connection with the issuance of credit.

[14] 24 C.F.R. § 100.135(a).
[15] 24 C.F.R. § 100.135(d)(1).
[16] Robert Schwemm, *Housing Discrimination and the Appraisal Industry*, in Mortgage, Lending, Racial Discrimination, and Federal Policy (John Goering and Ron Wienk eds., 1996), https://www.fhcci.org/wp-content/uploads/2021/05/Schwemm-Housing-Discrimination-Appraisal-1996.pdf.
[17] 42 U.S.C. § 3605(c).
[18] 15 U.S.C. § 1619(a); *see e.g.*, *Cartwright v. American Savings & Loan Ass'n*, 880 F.2d 912, 925-27 (7th Cir. 1989).
[19] CFPB, *Disclosure and Delivery Requirements for Copies of Appraisals and Other Written Valuations Under the Equal Credit Opportunity Act (Regulation B)*, 78 Fed. Reg. 7215 (Jan. 31, 2013) (codified at 12 C.F.R. § 1002).

Federal Housing Enterprises Financial Safety and Soundness Act of 1992 and HUD's Regulation

The Federal Housing Enterprises Financial Safety and Soundness Act ("FHEFSSA") of 1992 detailed Congress' expectations that Fannie Mae and Freddie Mac (collectively, the "Government-Sponsored Enterprises" or "GSEs") would adhere to the requirements of the fair housing and fair lending laws.[20] The implementing regulations promulgated by HUD state that "[n]either [GSE] shall discriminate in any manner in making any mortgage purchases because of race, color, religion, sex, handicap, familial status, age, or national origin, including any consideration of the age or location of the dwelling or the age of the neighborhood or census tract where the dwelling is located in a manner that has a discriminatory effect."[21]

State Laws and Other Prohibited Bases

In addition to these federal laws, most states and many localities have statutes prohibiting discrimination in housing-related transactions, including home appraisals.[22] Moreover, compliance with federal and state fair housing laws requires understanding the prohibited bases, which may be broader than federal law. For example, the state of California prohibits discrimination in appraisals on the basis of gender expression and military status.[23] Similarly, while rare, the interpretation of a prohibited basis under federal law may evolve. For example, based on a recent Supreme Court holding in the employment context, the CFPB and HUD have interpreted the ECOA and the Fair Housing Act's prohibition on discrimination on the basis of "sex" to include discrimination on the basis of sexual orientation and gender identity.[24]

IV. The Promise of the Fair Housing Act Remains Unfulfilled: Appraisal Discrimination Continues on an Individual and Systemic Basis

Although the establishment of the robust legal framework of civil rights laws designed to combat appraisal discrimination was a critically-important development, these laws did not immediately change policies, practices, and attitudes. For example, although the Fair Housing Act passed in 1968, the explicitly discriminatory appraisal guidance continued. As late as the 1970s, the appraiser course material still contained the following explicitly race-based guidance:

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[20] 12 U.S.C. 4545.
[21] 24 C.F.R. 81.42.
[22] A recent survey of state fair housing laws is available here: http://lawatlas.org/datasets/state-fair-housing-protections-1498143743.
[23] Cal. Business and Professions Code § 11424(a).
[24] *See* CFPB, *Equal Credit Opportunity (Regulation B); Discrimination on the Bases of Sexual Orientation and Gender Identity, Interpretive Rule*, 86 Fed. Reg. 14363 (March 16, 2021), https://www.govinfo.gov/content/pkg/FR-2021-03-16/pdf/2021-05233.pdf; HUD, *Implementation of Executive Order 13988 on the Enforcement of the Fair Housing Act* (Feb. 11, 2021), https://www.hud.gov/sites/dfiles/PA/documents/HUD_Memo_EO13988.pdf.

"Ethnological information also is significant to real estate analysis. As a general rule, homogeneity of the population contributes to stability of real estate values. Information on the percentage of native-born whites, foreign whites, and non-white population is important, and the changes in this composition have a significance…. As a general rule, minority groups are found at the bottom of the socio-economic ladder, and problems associated with minority group segments of the population can hinder community growth."
-American Institute of Real Estate Appraisers Course Material (1973)

In 1976, the U.S. Department of Justice ("DOJ") filed suit against the American Institute of Real Estate Appraisers and three other defendants for alleged violations of the Fair Housing Act.[25] The DOJ alleged that the four defendants had engaged in unlawful discriminatory practices by promulgating standards and offering educational materials which had caused appraisers and lenders to treat race and national origin as negative factors in determining the value of dwellings and in evaluating the soundness of home loans, and by failing to take adequate steps to correct the continuing effect of past discrimination and ensure non-discrimination by appraisers and lenders whose practices were subject to the influence or authority of the four organizations. The parties eventually entered into a settlement agreement in which the American Institute of Real Estate Appraisers agreed to adopt the following policy statements:

1. It is improper to base a conclusion or opinion of value upon the premise that the racial, ethnic, or religious homogeneity of the inhabitants of an area or of a property is necessary for maximum value.

2. Racial, religious, or ethnic factors are deemed unreliable predictors of value trends or price variance.

3. It is improper to base a conclusion or opinion of value, or a conclusion with respect to neighborhood trends, upon stereotyped or biased presumptions relating to race, color, religion, sex, or national origin or upon unsupported presumptions relating to the effective age or remaining life of the property being appraised or the life expectancy of the neighborhood in which it is located.

As Currently Structured, the Sales Comparison Approach Allows Discretion to Perpetuate the Unfounded Association between Race and Risk

Although explicitly race-based policies have been removed from written guidance, valuation methods still provide appraisers with broad discretion, which has long been recognized as a key fair lending risk factor often leading to adverse outcomes for

[25] *United States v. American Institute of Real Estate Appraisers*, 442 F. Supp. 1072 (N.D. Ill. 1977).

borrowers of color.[26] While there are several possible methods of valuation, the GSEs generally require the use of the sales comparison approach, which means that most residential real estate appraisals use this approach.

On its face, the sales comparison approach is not necessarily discriminatory. According to the Fannie Mae Single Family Selling Guide ("Selling Guide"): "The sales comparison approach to value is an analysis of comparable sales, contract sales, and listings of properties that are the most comparable to the subject property."[27] The Selling Guide further states: "The appraiser is responsible for determining which comparables are the best and most appropriate for the assignment.... Comparable sales from within the same neighborhood (including subdivision or project) as the subject property should be used when possible."[28] Again, on its face, this is a race-neutral approach, but it must be understood in the context of historical discrimination.

Although guidance on the sales comparison approach no longer contains explicit race-based references, the historical undervaluation of communities of color as well as the broad discretion leaves open the opportunity for appraisers to perpetuate bias on a passive or active basis. That is, appraisers may passively or unwittingly perpetuate bias by continuing to use the undervalued comparable sales in neighborhoods of color. This undervaluation began in the 1930s and was never rectified. Under the current structure of the sales comparison approach, appraisers are instructed to limit the comparable sales to homes within the same undervalued neighborhood of color, even if there are similar homes with higher values in comparable White neighborhoods. Thus, appraisers must rely on biased data, which further perpetuates the bias.

In some instances, appraisers may be more active participants in perpetuating discrimination. For example, the qualitative research conducted by Dr. Elizabeth Korver-Glenn raises concerns about the extent to which appraisers may be active participants in a race-based market distortion using the sales comparison approach. Many of the appraisers in the study "assumed that White buyers were the standard for determining an area's desirability, with White areas meeting this standard and receiving the highest values and non-White areas falling below the standard."[29] Following is a sample of the feedback from some of the appraisers in the study:

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[26] *See, e.g.,* FFIEC, *Interagency Fair Lending Examination Procedures* (2009), https://www.ffiec.gov/PDF/fairlend.pdf.

[27] Fannie Mae Single Family Selling Guide, *Sales Comparison Approach Section of the Appraisal Report*, B4-1.3-07 (April 15, 2014), https://selling-guide.fanniemae.com/Selling-Guide/Origination-thru-Closing/Subpart-B4-Underwriting-Property/Chapter-B4-1-Appraisal-Requirements/Section-B4-1-3-Appraisal-Report-Assessment/1032992461/B4-1-3-07-Sales-Comparison-Approach-Section-of-the-Appraisal-Report-04-15-2014.htm.

[28] *See id.* at *Comparable Sales*, B4-1.3-08 (Oct 2, 2018).

[29] Dr. Elizabeth Korver-Glenn, "Appraising Value," *Race Brokers: Housing Markets and Segregation in 21st Century Urban America*, at 116-143 (2021).

- Allan, a White appraiser, assumed that neighborhoods of color were low-income and poorly maintained, stating: "It's kind of generalizing, but it seems to me that neighborhoods where I go to [appraise] where there are pockets where they're very strictly one ethnicity – it just seems like they're generally lower priced, and overall the properties aren't as well kept."[30]

- Allan also assumed that values would rise as a neighborhood became more homogeneous and Whiter, stating: "And then up here [north of Montrose] it's getting better because of all the Mexican people moving out...."[31]

- Larry, a White appraiser, stated that an "influx of minorities" to a neighborhood would be perceived by White homeowners as having a "negative impact," which would cause White homeowners to leave, which would lower home values.[32]

- Carl, a White appraiser, stated: "I think people want to be near their own kind. And I feel 100 percent about that. And I think it's factual when you look at the racial makeup of neighborhoods."[33]

- Diego, a Latino appraiser, described a majority Black and majority Latino neighborhood as follows: "The demographics are completely different, and I don't think that they directly compete because of that."[34]

It seemed that the appraisers in this study did not necessarily feel that they were injecting their own biases into the valuation, but felt that, under the sales comparison approach, their valuation should reflect the market's biased perception of certain neighborhoods, based on that neighborhood's dominant race or ethnicity. As further evidence of this, note the perceptions these appraisers had about the value of a neighborhood based on who was moving into and out of the area. According to Allan, neighborhoods were "getting better" and presumably housing values were increasing because of all the Mexican people moving out" while Larry opined that an "influx of minorities" into an area would lower values.

This research also suggests that appraisers may be using their discretion to establish neighborhood boundaries and, in this way, arbitrarily restricting which comparable sales are used to establish a property's value. The high levels of segregation in many communities likely contribute to perceptions about neighborhood boundaries. But those boundaries are not objective and fixed, and, in some instances, perceptions of the boundaries can change when the race of local homeowners changes. With little guidance and unfettered discretion, appraisers may believe that the sales comparison

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[30] *Id.* at 126.
[31] *Id.* at 131.
[32] *Id.* at 128.
[33] *Id.* at 129.
[34] *Id.* at 137.

approach requires incorporating their perception of the market's racial bias into the valuation.

Appraisal Discrimination Continues on an Individual and Systemic Basis

Given the broad discretion and lack of guidance, it is not surprising that the appraisal process continues to suffer from bias on an individual and systemic basis. Recent news stories from across the country have highlighted anecdotal evidence on an individual basis. In many instances, Black homeowners have had to "whitewash" their homes and remove all evidence of their racial identity in order to receive a fair valuation. A few of these stories are highlighted below.

California. A Black couple in Marin City, California, seeking to refinance received an initial appraisal of $995,000.[35] Suspecting that the valuation of their home was unjustifiably low, they removed all evidence of their racial identity and asked a White friend to pose as the homeowner and then received an appraisal of $1,482,500, which was almost $500,000 more than the appraisal conducted just weeks earlier. The homeowner said, "There are implications to our ability to create generational wealth or passing things on if our houses appraise for 50 percent less than its value."

[35] Fair Housing Advocates of Northern California, Discrimination Lawsuits Filed Alleging Discrimination in Home Appraisal Process, Press Release (Dec. 2, 2021), https://www.fairhousingnorcal.org/uploads/1/7/0/5/17051262/press_release_-_austin_case.final.pdf; Julian Glover, Black California Couple Lowballed by $500K in Home Appraisal, Believe Race Was a Factor, ABC7News (Feb. 12, 2021), https://abc7news.com/black-homeowner-problems-sf-bay-area-housing-discrimination-minority-homeownership-anti-black-policy/10331076/.

Indiana. After receiving an initial appraisal of $110,000, a Black woman in Indianapolis, Indiana, removed all family photos, Black art and books; declined to identify her race on the refinancing application; communicated with the appraiser by email only; and asked a White friend to pose as her brother and meet the appraiser.[36] This time, the home appraised for $259,000. Upon seeing that amount, the homeowner was first overcome with joy, but then felt hurt that she had had to erase herself from her home in order to get a value that was fair and accurate.

Colorado. A mixed-race couple in Denver, Colorado, scheduled an appraisal in connection with a home equity loan.[37] When the Black husband greeted the appraiser, the home was valued at $405,000 based on comparison to homes selected by the appraiser in a Black neighborhood in a different location. When the White wife greeted the second appraiser, the home was valued at $550,000, which was an increase of $145,000. The wife stated, "Race obviously played a role in how we were treated. But what's deflating is that this experience put a dollar figure on it."

Connecticut. After receiving an initial appraisal of $340,000, a Black family in Bloomfield, Connecticut, removed all family photos and asked a White neighbor to pose as the homeowner.[38] This time, the home appraised for just over $400,000. The homeowner stated, "[T]his kind of experience not only robs you of the ability to refinance, but also affects opportunities at building generational wealth."

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[36] Fair Housing Center of Central Indiana ("FHCCI"), FHCCI Announces HUD Complaints Alleging Discrimination in Home Appraisals, Press Release (May 4, 2021), https://www.fhcci.org/wp-content/uploads/2021/05/5-4-21-HUD-Appraisal-Filings-Revised.pdf.
[37] Troy McMullen, For Black Homeowners, A Common Conundrum with Appraisers, Washington Post (Jan. 21, 2021), https://www.washingtonpost.com/realestate/for-black-homeowners-a-common-conundrum-with-appraisals/2021/01/20/80fbfb50-543c-11eb-a817-e5e7f8a406d6_story.html.
[38] *Id.*

Florida. After receiving an initial appraisal of $330,000, a mixed-race couple in Jacksonville, Florida, removed all photos of the Black wife and her side of the family, books by Black authors, and holiday cards from Black friends.[39] When the White husband greeted the second appraiser, the home appraised at $465,000, which was an increase of more than 40 percent. After posting the story on Facebook, the homeowners received over 2,000 comments, many of which were from Black homeowners saying that they had a similar experience. The wife stated, "[I]n the Black community, it's just common knowledge that you take your pictures down when you're selling your house."

Ohio. A Black family in a suburb of Cincinnati, Ohio were elated to learn that they received an offer from a buyer to purchase their home.[40] The offer of $507,500 came in even before the family had an opportunity to formally list their home. But their hopes were dashed when the appraiser valued their home at $465,000, which was $42,500 lower than the sales price. The purchasers asked the couple to lower the sales price to comport with the appraisal. But the sellers believed they were being low-balled. Even after the couple requested a reconsideration of value, the appraiser refused to conduct another appraisal and the lender also refused to order a second appraisal. The family then "white-washed" their home, removing photos and images of themselves and replacing them with photos and images from their White neighbors. The family's real estate agent, who was White, agreed to be present for a second, independent appraisal - which the family secured on their own. The second appraisal came in $92,000 higher than the first appraisal and roughly $50,000 higher than the sales price.

While the individual stories of discrimination in appraisals are alarming, the analyses of systemic bias are even more stunning and disturbing. Recent studies contain the following findings:

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[39] Debra Kamin, Black Homeowners Face Discrimination in Appraisals, The New York Times (Aug. 25, 2020), https://www.nytimes.com/2020/08/25/realestate/blacks-minorities-appraisals-discrimination.html.
[40] Lucy May,*This Black Family's Their Race*, ABC-WCPO (Aug. 19, 2021), https://www.wcpo.com/news/our-community/this-black-familys-home-appraisal-grew-by-92-000-after-they-removed-all-signs-of-their-race.

Appraisal Reports: Federal Housing Finance Agency ("FHFA"). FHFA recently analyzed appraisal reports and found that thousands of the reports contained descriptions based on race, ethnicity, and religion in the "Neighborhood Description" and other free-form text fields.[41] Some examples include:

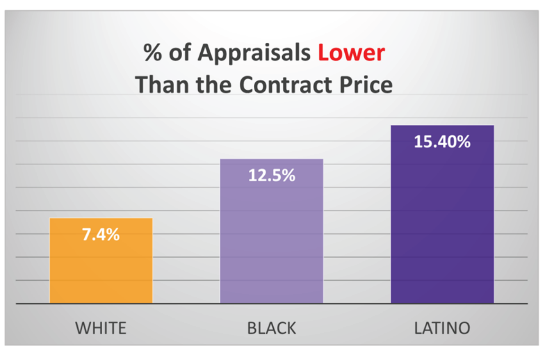
- A town was described as having a "**Black race population** above state average."
- A neighborhood was described as "**predominately Hispanic**" and that the residents have "assimilated their cultural heritage" into the neighborhood.
- It was noted that "there is more **Asian influence** of late" buying the market.
- Amenities were described as a "commercial strip featuring storefronts supplying **Jewish households**."
- A neighborhood was described as a "**homogeneous** neighborhood with good schools."

[41] FHFA, Reducing Valuation Bias by Addressing Appraiser and Property Valuation Commentary, FHFA Insights Blog (Dec. 14, 2021), https://www.fhfa.gov/Media/Blog/Pages/Reducing-Valuation-Bias-by-Addressing-Appraiser-and-Property-Valuation-Commentary.aspx.

<u>Purchases: Freddie Mac</u>. In a groundbreaking study, researchers at Freddie Mac analyzed more than 12 million appraisals submitted for purchase transactions and found unexplained racial disparities in the percentage of properties that received an appraisal value lower than the contract price (the "appraisal gap").[42] More specifically, the research showed that:

- *For Black/Latino neighborhoods*. An appraisal gap is more likely to occur in Black or Latino census tracts than White census tracts.
- *For Black/Latino individuals*. Similarly, an appraisal gap is more likely to occur for Black or Latino mortgage applicants than White mortgage applicants, regardless of the neighborhood where the property is located.
- *Across appraisers*. The majority of appraisers reviewed showed an appraisal gap. (That is, the issue was not limited to just "a few bad apples," but rather the majority of appraisers reviewed were more likely to show an appraisal gap for properties in Black or Latino census tracts than for properties in White census tracts.)

In other words, even when a buyer and seller agreed upon a value in an arms-length market transaction, the appraiser was less likely to support and validate that market value in neighborhoods of color than in White neighborhoods. This raises the question of whether these appraisers were actively distorting the market and thus further depressing the value of homes that were already undervalued because they were located in historically-redlined neighborhoods of color. That is, it may be difficult to rely on market forces to increase the values of the homes in these neighborhoods of color to match the value of homes in comparable White neighborhoods, because some appraisers may be actively distorting the market and keeping the values lower based on unfounded associations between race and risk.



[42] Melissa Narragon, et al., *Racial and Ethnic Valuation Gaps in Home Purchase Appraisals*, Freddie Mac Economic and Housing Research Note (Sept. 2021), http://www.freddiemac.com/fmac-resources/research/pdf/202109-Note-Appraisal-Gap.pdf.

Refinancings: Fannie Mae. In another groundbreaking study, researchers at Fannie Mae analyzed 1.8 million appraisals submitted for refinancing transactions and found that appraisers were more likely to overvalue White-owned homes in majority-Black neighborhoods.[43] Moreover, the overvaluation could be attributed to appraisers relying on comparable sales from outside of the subject property's immediate area (i.e., the majority-Black neighborhood) even though potentially more appropriate comparable properties were available closer to the subject property.

White borrowers in Black neighborhoods	
CU overvaluation reason codes	**%**
Multiple factors	36.4%
Comparable location	16.5%
Market adjustments	8.3%
Comparable selection	4.1%
Room count GLA adjustments	5.8%
All other	28.9%
Total	**100.0%**

Data: Refinance loan acquisitions from July – September 2021

[43] Jake Williamson and Mark Palim, *Appraising the Appraisal*, Fannie Mae Working Paper (Feb. 2022), https://www.fanniemae.com/media/42541/display.

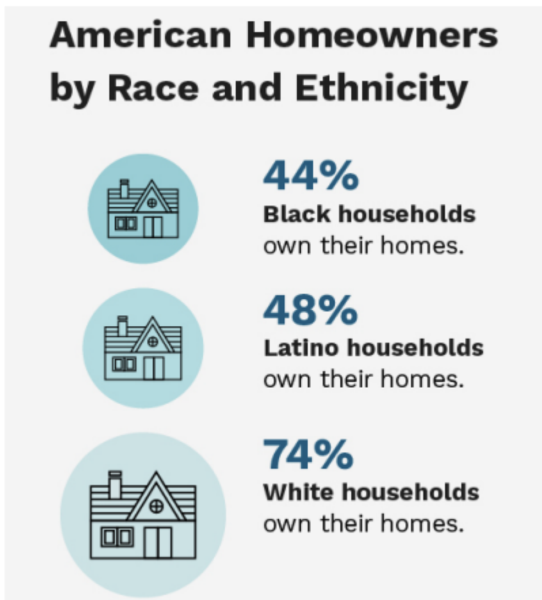
Cumulative Cost: The Brookings Institution. A 2018 Brookings Institution study of 2016 American Community Survey homeowner estimates and 2012-2016 Zillow data found that homes in majority Black neighborhoods had values that were 23 percent less than properties in mostly White neighborhoods, even after controlling for home features and neighborhood amenities.[44] That is, differences in home and neighborhood quality could not fully explain the devaluation of homes in Black neighborhoods, raising questions about whether discrimination was the determining factor. The study estimated that homes in majority-Black neighborhoods were undervalued by $48,000 per home on average, leading to a $156 billion cumulative loss in value nationwide.

Source: Brookings Institution

[44] Andre M. Perry, Jonathan Rothwell, and David Harshbarger, The Devaluation of Assets in Black Neighborhoods, The Brookings Institution Metropolitan Policy Program (Nov. 2018), https://www.brookings.edu/wp-content/uploads/2018/11/2018.11_Brookings-Metro_Devaluation-Assets-Black-Neighborhoods_final.pdf. See also Junia Howell and Elizabeth Korver-Glen, Neighborhoods, Race, and the Twenty-first Century Housing Appraisal Industry, 4 Sociology of Race and Ethnicity 473 (2018), https://journals.sagepub.com/doi/abs/10.1177/2332649218755178?journalCode=srea (finding substantial differences in home values in communities of color even after controlling for home features, neighborhood amenities, socioeconomic status and consumer demand).

Today, Appraisal Bias Remains One of the Key Drivers of the Wealth Gap

Given these circumstances, it is not surprising that the homeownership and wealth gaps remain large and persistent, and are, in part, driven by bias in home valuations. As a result of this troubled history of inequity and continuing discrimination, Black homeownership, the primary asset of Black families, is at levels similar to when the Fair Housing Act was passed in 1968.[45] Currently, the White homeownership rate is 74.1 percent, compared to 44.2 percent for Black households and 48.4 percent for Latino households.[46]



Source: PAVE Action Plan

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[45] Alanna McCargo and Jung Hyun Choi, *Closing the Gaps: Building Black Wealth Through Homeownership*, Urban Institute (November 2020), https://www.urban.org/sites/default/files/publication/103267/closing-the-gaps-building-black-wealth-through-homeownership_0.pdf. *See also* Laurie Goodman, Jun Zhu, and Rolf Pendall, *Are Gains in Black Homeownership History?*, Urban Institute (Feb. 14, 2017), https://www.urban.org/urbanwire/are-gains-black-homeownership-history.

[46] US Census Bureau, *Homeownership Rates by Race and Ethnicity of Householder*, Annual Statistics: 2021 (2021).

In addition, because home value has been the cornerstone of intergenerational wealth in the United States, the historical appraisal practices have had long-term effects in creating some of the current wealth inequalities. White wealth has soared while Black wealth has remained stagnant. In 2019, White household wealth sat at $188,200 (median) and $983,400 (mean).[47] In contrast, Black households' median and mean net worth were $24,100 and $142,500, respectively.[48] Moreover, overall White households held 10 times more wealth than Black households and seven times more than Latino households in 2016[49] with one study finding that homeownership accounted for 27 percent of the Black-White wealth gap.[50] These wealth disparities, in turn, reflect intergenerational transfer disparities: 29.9 percent of White households have received an inheritance, compared with only 10.1 percent of Black households.[51]

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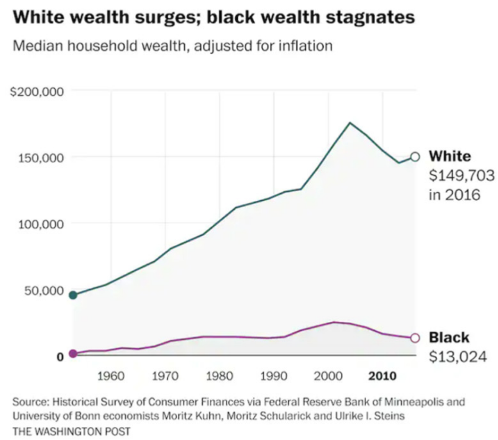
[47] Neil Bhutta, Jesse Bricker, Andrew Chang, et al., *Changes in U.S. family Finances from 2016 to 2019: Evidence from the Survey of Consumer Finances,* 106(5) Fed. Res. Bulletin (Sept. 2020), https://www.federalreserve.gov/publications/files/scf20.pdf.
[48] *Id.*
[49] Rakesh Kochhar and Anthony Cilluffo, *How Wealth Inequality Has Changed in the U.S. since the Great Recession, by Race, Ethnicity and Income* (Nov. 1, 2017), https://www.pewresearch.org/fact-tank/2017/11/01/how-wealth-inequality-has-changed-in-the-u-s-since-the-great-recession-by-race-ethnicity-and-income/.
[50] Thomas Shapiro, Tatjana Meschede, and Sam Osoro, *The Roots of the Widening Racial Wealth Gap: Explaining the Black-White Economic Divide*, Institute on Assets and Social Policy, Brandeis University (Feb. 2013), https://community-wealth.org/content/roots-widening-racial-wealth-gap-explaining-black-white-economic-divide.
[51] Neil Bhutta, et al., *Disparities in Wealth by Race and Ethnicity in the 2019 Survey of Consumer Finances,* FEDS Notes, Board of Governors of the Federal Reserve System (Sept. 2020), https://www.federalreserve.gov/econres/notes/feds-notes/disparities-in-wealth-by-race-and-ethnicity-in-the-2019-survey-of-consumer-finances-20200928.htm.



When the wealth of households with children is assessed, the gaps get even larger. A recent analysis found that White households with children have over 100 times the wealth as Black households with children.[52] At the median, Black households with children had roughly one cent for every dollar held by White households. Moreover, Latino households with children had eight cents for every dollar held by a White household. The researchers for this study noted that homeownership levels, segregation, and housing values were significant contributing factors explaining the wealth gaps.[53]

In addition to the wealth gap, undervalued home appraisals can have other significant consequences. Inaccurate appraisals can result in distortions in the loan-to-value ratio and in canceled home sales contracts or refinancing offers. Finally, low appraisals can pose significant challenges for using home equity for advancement opportunities, such as payment for college tuition or security for small business loans. Accurate home valuations are critically important to the advancement and security of people and communities of color.

The Promise of the Fair Housing Act Has Been Left Unfulfilled

The Fair Housing Act's promise of fair and equitable housing transactions is unfulfilled as shown by the well-documented evidence of appraisal bias on an individual and systemic basis. The current system unfairly limits the ability of many borrowers and communities of color to receive a fair valuation of their biggest financial asset and to

[52] Christine Percheski and Christina Gibson-Davis, *A Penny on the Dollar: Racial Inequalities in Wealth among Households with Children*, SAGE Journal (June 1, 2020), https://journals.sagepub.com/doi/full/10.1177/2378023120916616.
[53] *Id.*

build wealth and opportunities. Moreover, while many appraisers determine a home's value in a fair and unbiased manner, without rectifying previous historical undervaluation, controlling for discretion, and conducting robust compliance oversight, the opportunity remains for the appraiser to perpetuate discrimination in an active or passive manner. Given the continued bias, the appraisal industry would benefit from reform of the current structure, appraisal standards, and appraiser criteria as well as a comprehensive review of the current approach, policies, and practices.

Finally, one reason individual and systemic bias are still so prevalent, is the failure of broadscale enforcement of anti-discrimination laws. Indeed, the PAVE Action Plan acknowledges that federal regulators do not even have examination procedures to identify appraisal bias.[54] Federal and state regulatory and enforcement agencies must take action to provide effective oversight and to ensure compliance with fair housing and lending laws. These agencies must also engage in enforcement measures to help provide compensation to individuals and communities that have been impacted by discrimination. Furthermore, Congress must ensure private fair housing organizations, who have historically led the way in addressing appraisal bias issues, are adequately funded through the Fair Housing Initiatives Program.

V. Congressional Action Can Ensure a Fair, Transparent, and Consistent Valuation Process that Benefits All Borrowers, including Borrowers of Color

Congress Is in a Unique Position to Ensure a Fair, Transparent, and Consistent Valuation Process

Through oversight and legislation, Congress is in a unique position to address the bias in the appraisal and valuation process. We applaud the Committee's leadership in convening this hearing and developing a discussion draft of legislation. The "Fair Appraisal and Inequity Reform Act" ("Discussion Draft") is responsive to many of the concerns highlighted in the NFHA Report and the PAVE Action Plan.[55] While there are several areas meriting discussion, today we will focus on five key issues:

1. Accountable, efficient governance
2. Fair, transparent, and consistent processes
3. Fair algorithms and other appraisal alternatives
4. Reasonable qualification criteria for valuation professionals
5. Transparent, public valuation database

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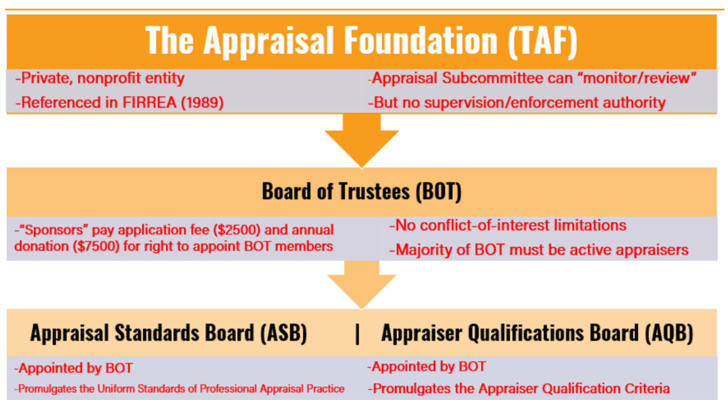
[54] *See* PAVE Action Plan at 29.
[55] House Financial Services Committee Discussion Draft, H.R. ___, "Fair Appraisal and Inequity Reform Act of 2022," https://financialservices.house.gov/uploadedfiles/bills-117pih-endingappraisaldiscriminationactof2022.pdf.

1 Congress Should Ensure Accountable, Efficient Governance of the Appraisal Industry

Problem: The Appraisal Foundation Is an Inefficient Governance Structure That Is Not Responsive to Small Businesses and Consumers, Particularly Consumers of Color

The current appraiser regulatory system is fundamentally broken for all consumers and for the small businesses that participate in the process, namely the appraisers and the Appraisal Management Companies ("AMCs"). The PAVE Action Plan covers several areas of concern with accountability and oversight, but we will focus on the issues raised by the structure of The Appraisal Foundation ("TAF").[56] As depicted in the graphic below, TAF is a private, nonprofit entity, which is referenced in the Financial Institution Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"),[57] but whose legal authority is not clear. TAF's boards set the baseline appraisal standards through the Uniform Standards for Professional Appraisal Practice ("USPAP") and the baseline criteria for professional qualification through the Real Property Appraiser Qualification Criteria ("Qualification Criteria"), which are then adopted by the states. TAF's main source of income is the sale of USPAP and the accompanying Advisory Opinions, which are largely behind a paywall.



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[56] For more details about the governance of the appraisal industry, *see* NFHA Report at page 34-48, PAVE Action Report at page 27.
[57] 12 U.S.C. §§ 3331-3356, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), and the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018.

The Appraisal Subcommittee is a subcommittee of the Federal Financial Institutions Examination Council ("FFIEC"). The Appraisal Subcommittee was established in FIRREA and is a federal agency with the authority to "review" and "monitor" TAF, but with no supervision or enforcement authority.[58] Likewise, Congress has no authority to oversee TAF's functions.

TAF is governed by a Board of Trustees. Industry organizations pay an upfront fee and annual donation for the right to appoint trustees. There are no conflict of interest rules for the trustees. Indeed, TAF's bylaws require a majority of the Board of Trustees to be appraisers employed in the industry.[59] From there, the Board of Trustees then appoints the members of the Appraisal Standards Board, which promulgates USPAP; and the Appraiser Qualifications Board, which promulgates the Qualification Criteria. Typically, these individuals are also appraisers employed in the industry.

Moreover, although the nonprofits on The Appraisal Foundation Advisory Council can participate in the appointment process without making a donation, they are comprised of 60 organizations with the right to appoint only one trustee. Also, none of the current nonprofits are civil rights or consumer advocates; they are all industry trade associations or governmental agencies. But even if a few civil rights and consumer advocates were to join the advisory council, their voices would be easily diluted and outnumbered.

It's hard to imagine Congress accepting a similar structure for the CFPB, with the rulemaking staff picked by industry creditors and the rules hidden behind a paywall. It's not clear why Congress feels that this structure is appropriate for appraisers, who have the critical responsibility of valuing collateral to protect the safety and soundness of a financial institution and to protect a consumer's most important financial asset.

TAF's structure raises several concerns:

<u>Out of step with the mortgage market</u>. There is no other facet of the housing finance market that is governed in the same manner as the appraisal industry. That is, because the mortgage market is recognized as complex, risky, and high-stakes for consumers as well as financial institutions and the American economy, it is highly regulated by specialized experts who are employed to serve the public, not solely the industry. In part because of this closed-loop, self-regulated structure, TAF has not been effective at addressing the complexities of a myriad of concerns raised by housing finance stakeholders over the years, including concerns regarding the deep-rooted inequities in the appraisal process.

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[58] 12 U.S.C. § 3332.
[59] The Appraisal Foundation, Restated Bylaws, § 6.02(b)(viii) (Nov. 16, 2019) (emphasis added) , https://appraisalfoundation.sharefile.com/share/view/s11d4d879051545738887fa0015cad511 ("Bylaws").

Undemocratic.TAF's staff selection and standard-setting processes do not follow core principles of democracy and good government. The selection process seems to be designed as a pay-to-play structure that embeds rather than avoids conflicts of interest. Moreover, while TAF was historically funded through grants from the Appraisal Subcommittee, the majority of its funding is now generated by proceeds from the sale of USPAP. This approach prevents the Appraisal Subcommittee from adding a mechanism of accountability through the grantmaking process.

Viewpoints are too broad and too narrow. The viewpoints of the TAF boards are both too broad and too narrow. With respect to real property, the viewpoints are too broad because USPAP Standards 1-4 for real property cover all types of appraising, not just those related to mortgage transactions. So, appraisers end up with high-level guidance that does not provide the much-needed guardrails specific to the valuation of residential real estate in connection with mortgage transactions. Instead, appraisers often rely on Fannie Mae and Freddie Mac for specific guidance. At the same time, the viewpoints of TAF's boards are too narrow because they are not structured to consider the public interest, including the consumer and civil rights perspective. TAF's processes make it difficult to yield candidates who would be ready to address the complex challenges of appraisal bias and lack of appraiser diversity and seek solutions that would benefit the whole of the housing market, including consumers of color.

Inefficient. We applaud the incredible efforts of the PAVE Task Force and the proposed actions that the federal agencies will undertake to address inefficiencies and challenges in the appraisal industry. There are some who may criticize efforts at appraisal reform as federal government "overreach." Nothing could be further from the truth. It is, rather, an overreach for a single private entity to set standards for a whole industry with little accountability to policymakers and consumers for the outcomes. It is difficult to imagine any other industry nonprofit or advocate nonprofit with similar authority to set standards for such high-stakes operations.

Unfair to consumers. It seems unfair to have the standards for valuing a consumer's most significant financial asset be set by a private entity with no accountability to those consumers, their elected representatives, or regulators. This unfairness is amplified for consumers of color, who face special challenges and risks in the current appraisal process that have been far too long ignored.

Burdensome to small business. While TAF's structure favors industry, it tends to favor those who are well-resourced and well-connected. In addition, the TAF board's frequent changes to USPAP are particularly burdensome to small businesses, such as appraisers and AMCs who must expend resources adapting their policies and practices to comply with new USPAP standards. In fact, the changes are so frequent that some portions of the TAF training now simply reference where to find the standards, rather than provide training on the specific standards.

Recommendation for Congressional Action

Immediate action. Congress should encourage TAF to revise its bylaws to ensure accountable and democratic procedural standards and board member selection processes. For example, TAF should be encouraged to repeal the requirement that a majority of trustees be industry appraisers and that financial donations are necessary to appoint board members.

Legislative action. We applaud the Committee for its bold leadership in proposing to elevate the Appraisal Subcommittee to become the Federal Valuation Agency with enhanced authority, including rulemaking authority for USPAP and Qualification Criteria. *See* Section 2(a) of the Discussion Draft. We believe that this structure would promote a much more accountable, efficient governance structure for the appraisal industry. For example, as a federal agency, the Federal Valuation Agency would be subject to the normal procedural guardrails of the Administrative Procedures Act, the Freedom of Information Act, conflict of interest rules, and congressional oversight. In addition, we recommend that the Federal Valuation Agency have jurisdiction over all real estate (both residential and commercial) valuations in connection with mortgage transactions, have a dual mandate for both safety and soundness and civil rights/consumer protection, and be comprised of a highly specialized workforce with expertise in real estate valuation, including valuation for rural areas, manufactured homes, and communities of color. Finally, we applaud the Committee for requiring an Office of Fair Lending, which would report directly to the head of the agency. *See* Section 2(b) of the Discussion Draft. This agency structure would be well-equipped to tackle the complex challenges facing the appraisal profession.

2 *Congress Should Ensure Appraisal and Valuation Standards Promote a Fair, Transparent, and Consistent Process*

Problem: The Current Sales Comparison Approach Provides Appraisers with Broad Discretion, which Can Result in Unfair and Inconsistent Outcomes, Particularly for Consumers of Color

Although the USPAP Standards' Ethics Rules require an appraiser to perform assignments with "impartiality [and] objectivity,"[60] appraisers can use their discretion to make many choices that can affect the valuation of a home.[61] For example, the appraiser can choose the neighborhood boundaries, the comparable sales, and the value adjustments. Since the 1990s when the DOJ first began filing fair lending lawsuits, discretion has been recognized as one of the key risk factors that can lead to fair

[60] USPAP Ethics Rule: Conduct, page 7, lines 185-186.
[61] For more details about the risks of discretion in the appraisal process, *see* NFHA Report at pages 21-24.

lending violations and consumer harm.[62] Just as lenders came to understand the risk of discretion in underwriting and pricing mortgage loans, appraisers will similarly need to understand the fair lending risk inherent in each discretionary decision and understand how to manage that risk appropriately. The current USPAP Standards provide almost no guidance on how to identify discretionary decisions and manage the fair lending risk.

Furthermore, private fair housing organizations, who have historically led the way in addressing appraisal bias issues, have been under-funded and are not sufficiently resourced to provide support and services to all consumers who experience discrimination in the appraisal market. Appraisal bias cases are highly complex and difficult to investigate. Qualified Fair Housing Enforcement Organizations[63] should receive adequate funding under the Fair Housing Initiatives Program[64] to enable them to provide a wide range of investigative and supportive services for consumers and communities impacted by appraisal bias.

Recommendation for Congressional Action

Immediate action. Congress should encourage TAF's Appraisal Standards Board to revise USPAP to minimize discretion and ensure a fair, transparent, and consistent appraisal process.[65]

Legislative Action. We applaud the Committee for proposing to provide the Federal Valuation Agency with the authority to promulgate rules for appraisal standards. *See* Section 2(c) of the Discussion Draft. We believe this structure would be responsive to the concerns of small businesses and consumers, including consumers of color, because historical and current versions of rules and interpretations would be provided for free, proposals would be published in the Federal Register, and the rulemaking agenda and process would be more transparent and responsive to stakeholders and

[62] *See* HUD, DOJ, Office of the Comptroller of the Currency ("OCC"), Office of Thrift Supervision, Board of Governors of the Federal Reserve System ("Federal Reserve"), Federal Deposit Insurance Corporation ("FDIC"), Federal Housing Finance Board, Federal Trade Commission, and National Credit Union Administration ("NCUA"), *Policy Statement on Discrimination in Lending*, 59 Fed. Reg. 73 (Apr. 15, 1994), https://www.govinfo.gov/content/pkg/FR-1994-04-15/html/94-9214.htm.
[63] As per 24 CFR 125.103, Qualified Fair Housing Enforcement Organizations are private, non-profit, tax-exempt, charitable agencies that 1) Have at least 2 years experience in complaint intake, complaint investigation, testing for fair housing violations and enforcement of meritorious claims; and 2) Are engaged in complaint intake, complaint investigation, testing for fair housing violations and enforcement of meritorious claims at the time of application for FHIP assistance.
[64] *See*, Fair Housing Initiatives Program, https://www.hud.gov/program_offices/fair_housing_equal_opp/partners/FHIP#:~:text=Search%20FHIP%20Organizations-,What%20Is%20the%20Fair%20Housing%20Initiatives%20Program%3F,been%20victims%20of%20housing%20discrimination.
[65] On February 4, 2022, the CFPB, HUD, DOJ, FHFA, Federal Reserve, OCC, FDIC, and NCUA sent a comment letter to TAF's Appraisal Standards Board regarding the current draft of USPAP and advocating for consistency with all applicable nondiscrimination standards provided in federal law. https://files.consumerfinance.gov/f/documents/cfpb_appraisal-discrimination_federal-interagency_comment_letter_2022-02.pdf.

their needs. We further commend the Committee for seeking increased funding for FHIP and FHAP programs to ensure private fair housing organizations are sufficiently resourced to provide support and services to all consumers who experience discrimination in the appraisal market. *See* Section 6 of the Discussion Draft.

3 Congress Should Ensure Valuation Standards Promote Fairness in Algorithms and Other Appraisal Alternatives

Problem: There Are No Federal Standards to Ensure Fairness in Algorithms or Other Appraisal Alternatives

At this point, it appears that changes to the traditional appraisal business model are inevitable. In all aspects of the mortgage market, investors, lenders and consumers are demanding faster, economical, more streamlined processes that produce accurate, reliable, and fair valuations. Moreover, the appraisal industry is experiencing a unique stress in workforce retention and recruitment as older and more experienced professionals exit the industry while new professionals find the credentialing requirements and fee pressures ever more challenging.

As an alternative to more costly and time-intensive traditional appraisals, many mortgage industry stakeholders are turning to Automated Valuation Models ("AVMs") for valuations or quality control. An AVM is defined in FIRREA as "any computerized model used by mortgage originators and secondary market issuers to determine the collateral worth of a mortgage secured by a consumer's principal dwelling."[66]

AVMs mainly rely on large datasets and algorithmic models to generate outcomes, which has benefits as well as risks.[67] Because of their data-driven nature, they tend to be held up as a more objective, bias-free form of valuation. But the reality is more complex. The long history of unfair, race-based policies means that the data used to power and train the model may be imbued with bias. Also, AVMs are dependent on large datasets that are more prevalent in newer, suburban neighborhoods where homes are more uniform, but not in rural or urban areas where the housing stock is varied. AVMs may also be less reliable for certain types of housing, such as manufactured homes.

[66] 12 U.S.C. § 3354.
[67] For more details about the risks of certain appraisal alternatives, *see* NFHA Comment Letter, *FHFA Request for Information on Appraisal-Related Policies, Practices, and Processes* (Feb 26, 2021), https://nationalfairhousing.org/wp-content/uploads/2021/04/NFHA-Comments_FHFA-RFI-re-Appraisals_02-26-2021_FINAL.pdf. *See also* PAVE Action Plan at pages 26-27, 43-44.

The AVM model itself may also suffer from discriminatory bias. As some data scientists have remarked, "Algorithms are just opinions embedded in code."[68] For example, a study by the Urban Institute found that AVMs in majority-Black neighborhoods produced a larger percentage magnitude of inaccuracies, relative to the underlying sales price, than AVMs in majority-White neighborhoods.[69] Even after controlling for certain neighborhood and income characteristics, the predominant race of the neighborhood still played a statistically significant role in the determination of the percentage AVM inaccuracy gap. These observations raise questions that warrant further review.

Other alternatives to traditional appraisals also warrant careful scrutiny, including desktop appraisals, evaluations, broker price opinions, and appraisal waivers. In particular, these concerns may raise the same issues pervasive in the dual credit market.[70] That is, appraisal alternatives may turn out to be more efficient and less costly, but the nature of such alternatives may make it less likely that they are commonly available for homes located in communities of color, which may result in a bifurcated valuation system.

The key to successfully improving the valuation business model is managing the changes to mitigate the fair lending risk and the risk of harm to consumers and communities, particularly those of color. Congress has the opportunity to play a central role in deconstructing decades of discrimination that undervalued homes in communities of color, which in turn unfairly stifled opportunities for advancement. It will be critically important to consider all changes in the valuation business model with an equity lens, carefully reviewing all processes for fair lending risk, testing outcomes for their effect and impact on people and communities of color, and seeking opportunities to construct a fair and transparent valuation system.

Recommendation for Congressional Action

Immediate action. Since 2010, FIRREA has provided the federal financial regulators with the authority to issue quality control standards for AVMs.[71] Recently, the CFPB issued an

[68] *See, e.g.,* Cathy O'Neil, Weapons of Math Destruction: How Big Data Increases Inequality and Threatens Democracy (New York: Crown Publishers, 2016).

[69] Michael Neal, Sara Strochak, Linna Zhu, and Caitlin Young, *How Automated Valuation Models Can Disproportionately Affect Majority-Black Neighborhoods*, Urban Institute (Dec. 2020), https://www.urban.org/research/publication/how-automated-valuation-models-can-disproportionately-affect-majority-black-neighborhoods.

[70] There is a dual credit market in the United States where fringe financial services, such as payday lenders, are more often available in communities of color and lower-income communities, while mainstream lenders, such as banks, are more prevalent in White, middle-income, and high-income communities. *See*, Testimony of Nikitra Bailey, Senior Vice President of Public Policy, NFHA, *Hearing: Promoting Economic Prosperity and Fair Growth through Access to Affordable and Stable Housing*, U.S. House Select Committee on Economic Disparity and Fairness in Growth (March 1, 2022), https://fairgrowth.house.gov/sites/democrats.fairgrowth.house.gov/files/documents/Nikitra%20%20Bailey%20House%20Select%20Committee%20EDFG_Testimony%20%28FINAL%29.pdf.

[71] 12 U.S.C. § 3354.

outline for an AVM rule, which would include a "fifth factor" (in addition to the statute's enumerated four factors) requiring "nondiscrimination" be part of the quality control standards.[72] Congress should encourage all of the applicable agencies to quickly issue the proposed and final rules to ensure that the proliferation of AVMs does not result in the perpetuation of discriminatory patterns.

Legislative action. We recommend that the Committee add to the Discussion Draft the authority for the Federal Valuation Agency to promulgate rules that will ensure that alternatives to traditional appraisals are fair and non-discriminatory and protect the value of the collateral for the financial institution as well as the consumer, including consumers of color. We further recommend that the rules for AVMs require guidance on the role of model risk management and fairness frameworks, such as NFHA's Purpose, Process, and Monitoring framework.[73]

4 *To Address Shortages and Lack of Diversity, Congress Should Ensure There Are Reasonable Qualification Criteria for Valuation Professionals*

Problem: The Current Appraiser Qualification Criteria Contain Stringent Barriers to Entry, Which Have Resulted in an Acute Appraiser Shortage and an Extreme Lack of Diversity

Unlike comparable professions, the path to becoming a certified residential appraiser consists of multiple barriers to entry, including:

- A college degree or equivalent,
- 200 appraiser education hours,
- 1,500 experience hours with a supervisory appraiser, and
- Passing a standardized test.[74]

Even after completing the required education and training, only about 55-65 percent of individuals pass the standardized test on the first try.[75] This raises concerns about

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[72] CFPB, *Small Business Advisory Panel Review Panel for Automated Valuation Model Rulemaking* (Feb. 23, 2022), https://files.consumerfinance.gov/f/documents/cfpb_avm_outline-of-proposals_2022-02.pdf.
[73] *See*, NFHA, *Purpose, Process, and Monitoring: A New Framework for Auditing Algorithmic Bias in Housing and Lending* (Feb. 17, 2022), https://nationalfairhousing.org/wp-content/uploads/2022/02/PPM_Framework_02_17_2022.pdf.
[74] For more details about barriers to entry for the appraisal profession, *see* NFHA Report at page 64-69, PAVE Action Plan at pages 30-34..
[75] *See* The Appraisal Foundation, *https://www.appraisalfoundation.org/imis/TAF/Standards/Qualification_Criteria/National_Uniform_Licensing_and_Certification_Exam_for_Real_Property_Appraisers_/TAF/AQB_National_Exam.aspx?hkey=50cf1d9e-6430-4e5d-ac6e-2fe92352cbdf*.

whether these criteria are effectively designed to set the candidates up for success as a qualified appraiser.

TAF's Appraiser Qualifications Board sets these Qualification Criteria, which have resulted in an acute shortage, particularly in rural areas,[76] and an extreme lack of diversity. At this time, the appraiser profession is 97 percent White and 70 percent male.[77] Extensive efforts have been made to attempt to meet TAF's criteria and increase the pipeline of appraisers, including appraisers of color, but the criteria would benefit from a fresh look to determine whether certain criteria may be discriminatory or unnecessary.

Despite these extensive criteria, TAF's Appraiser Qualifications Board has not yet required comprehensive fair housing training for initial credentialing and renewals.[78] Moreover, TAF's continuing education course regarding fair housing training provides content that is inaccurate and misleading. In effect, appraisers are required to pay TAF for training that may mislead them about the extent of their liability under the federal fair lending laws. The persistence of bias in appraisal markets suggests that fair housing training programs for appraisers have not been as comprehensive or effective as they could be, exposing consumers to harm and appraisers to liability.

Recommendation for Congressional Action

Immediate action. Congress should encourage TAF's Appraiser Qualification Board to revise the Qualification Criteria to reduce the barriers to entry for appraisers and ensure comprehensive and accurate fair housing training.[79]

Legislative action. We commend the Committee for proposing to provide the Federal Valuation Agency with authority to promulgate rules to ensure reasonable and appropriate qualification criteria. *See* Section 2(c) of the Discussion Draft. We further

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[76] In 2015, U.S. Senators Mike Rounds and John Thune sent a letter to TAF expressing concern about the decreasing number of real estate appraisers, particularly in rural and underserved areas. https://www.rounds.senate.gov/newsroom/press-releases/rounds-thune-send-letter-to-appraisal-foundation-chair-regarding-decrease-in-real-estate-appraisers-.

[77] According to the U.S. Bureau of Labor Statistics, the category of "Property appraisers and assessors" is 96.5% White, 2.3% Black, and 1.2% Asian. Six percent are classified as Hispanic and 29.7% were classified as female. See U.S. Bureau of Labor Statistics, Labor Force Statistics from the Current Population Survey, (Jan. 22, 2021), https://www.bls.gov/cps/cpsaat11.htm.

[78] For more details about the lack of specific fair housing training requirements and lack of comprehensive and accurate content, *see* NFHA Report at pages 56-63.

[79] In a recent blogpost, the CFPB raised concerns about TAF's fair housing training: "We have also seen the organization that sets the standards for appraisers, The Appraisal Foundation (TAF), fail to include clear warnings about the requirements of federal law in the standards it sets, and in the training it provides for appraisers…These actions undermine a fair and competitive market free of bias and discrimination." CFPB Blogpost, Appraisal Discrimination Is Illegal Under Federal Law (Feb. 4, 2022), https://www.consumerfinance.gov/about-us/blog/appraisal-discrimination-illegal-under-federal-law/.

commend the Committee for requiring comprehensive fair housing training, including the following topics:

- History of housing and appraisal discrimination,
- Federal laws that prohibit appraisal discrimination,
- An appraiser's legal duty not to discriminate and the legal penalties associated with violating such duties,
- Examples of discrimination violations and the harmful consequences of such discrimination on consumers and the market, and
- Best practices.

See Section 3 of the Discussion Draft. We also support requiring appraisers to enroll in a national registry and obtain a unique identifier, which may enable the lenders and AMCs to identify problem appraisers. *See* Section 3 of Discussion Draft.

5 Congress Should Promote the Development of a Transparent Public Valuation Database

Problem: The GSEs Maintain a Comprehensive Database of Millions of Appraisal Reports, but It Is Not Available for Research, Compliance, Supervision, or Enforcement

The Uniform Appraisal Dataset, which is maintained by the GSEs, contains millions of appraisal reports and rich data on valuations across the country.[80] Moreover, the FHA, Veterans Administration, and U.S. Department of Agriculture also maintain appraisal databases. Providing the public, including trusted researchers, with access to these databases could revolutionize research, risk management, efficiency, enforcement, and compliance, particularly with regard to the sources and solutions for appraisal discrimination. Under the PAVE Action Plan, the relevant federal regulators have pledged to enter an agreement to share data among each other and study a proposal for a public database.[81]

Recommendation for Congressional Action

Immediate action. Congress should encourage the appropriate federal regulators to move quickly to enter into an agreement to share with each other valuation data for the purposes of research, supervision, and enforcement. Congress should also require the agencies to establish a trusted researcher program. Congress should request a timeline and regular updates on their progress.

[80] For more details about the importance of appraisal datasets, *see* NFHA Report at pages 71-72 and PAVE Action Plan at pages 25-26, 38-42, 44.
[81] PAVE Action Plan at pages 39-40, 44.

Legislative action. We commend the Committee for proposing that the CFPB lead development of a publicly available database of residential real estate valuation information. *See* Section 4 of the Discussion Draft. Much like HMDA, public release of the data will provide much-needed transparency, and further understanding of the sources and solutions for appraisal bias.

VI. Conclusion

In conclusion, we thank the Committee for its bold leadership on the important issue of appraisal reform. We want to acknowledge that during the course of our research, we spoke to many appraisers and appraisal organizations who recognize the challenges the industry faces and are dedicated to developing solutions. We thank them for their insights and applaud them for their earnest efforts for change. We hope that NFHA's research, the PAVE Action Plan, and congressional hearings will encourage conversations and action among key stakeholders to seek and implement workable, sustainable solutions that benefit the whole of the housing market, including borrowers of color.

APPENDIX - SUMMARY OF RECOMMENDATIONS

ISSUE	IMMEDIATE ACTION	LEGISLATIVE ACTION
1-Accountable, Efficient Governance	Encourage The Appraisal Foundation (TAF) to revise its bylaws to ensure accountable and democratic procedural standards and board member selection processes.	Elevate the Appraisal Subcommittee to a new Federal Valuation Agency subject to normal federal procedural safeguards (Congressional oversight, APA, FOIA, conflict of interest rules, no pay to play).
2-Fair, Transparent, Consistent Process	Encourage TAF's Appraisal Standards Board to revise the Uniform Standards of Professional Appraisal Practice (USPAP) to minimize discretion and ensure a fair, transparent, consistent appraisal process.	Provide the Federal Valuation Agency with rulemaking authority to ensure that all real estate valuations are subject to a fair, transparent, consistent process. Ensure adequate funding under the Fair Housing Initiatives Program to enable Qualified Fair Housing Enforcement Agencies to effectively support consumers and communities impacted by appraisal bias.
3-Fair Algorithms and Other Appraisal Alternatives	Encourage the appropriate federal regulators to promulgate the Automated Valuation Model (AVM) rule, including the addition of nondiscrimination as a "fifth factor" for quality control.	Provide the Federal Valuation Agency with rulemaking authority to ensure that all valuation methods (including AVMs) result in a fair, transparent, and consistent valuation process. Set a deadline for the rulemaking.
4-Reasonable Qualification Criteria For Valuation Professionals	Encourage TAF's Appraiser Qualification Board to revise the Real Property Appraiser Qualification Criteria (Qualification Criteria) to reduce the barriers to entry for appraisers and ensure appropriate training.	Provide the Federal Valuation Agency with rulemaking authority to set reasonable qualification criteria for all valuation professionals; ensure that they receive appropriate training, including comprehensive fair housing training; and ensure that they are registered with a unique identifier.
5-Transparent Public Valuation Database	Encourage the appropriate federal regulators to enter into an agreement to share with each other valuation data for the purposes of research, supervision, and enforcement. Also encourage the regulators to develop a trusted researcher program.	Provide the CFPB with rulemaking authority to develop and implement a public HMDA-like database of valuation data for the purposes of research, compliance, supervision, and enforcement.

Questions for the Record from Chairwoman Maxine Waters
Full Committee Hearing, entitled "Devalued, Denied, and Disrespected: How Home Appraisal Bias and Discrimination Are Hurting Homeowners and Communities of Color"
Responses from Jody Bishop

Industry Governance

1. **Ms. Rice**, based on the National Fair Housing Alliance's review of the appraisal industry in the Appraisal Subcommittee's recently commissioned report, do you believe the current oversight and governance structure of the appraisal industry, including that of the Appraisal Foundation, is adequate or appropriate? What are your thoughts with regard to creating an independent office or agency to provide additional oversight, as envisioned in Chairwoman Waters' bill, the Fair Appraisal and Inequity Reform Act, or FAIR Act?

2. **Ms. Rice**, the FAIR Act would require that every licensed and certified appraiser take fair housing training for both initial credentialing and continuing education that is developed by the Office of Fair Housing and Equal Opportunity at HUD in coordination with the new Federal Valuation Agency. While the FAIR Act does not stipulate a set number of hours for this training, should it?

Uniform Standards for Professional Appraisal Practice (USPAP)

1. **Mr. Bishop and Ms. Rice**, what are some ways in which USPAP should be reformed to help prevent the systemic undervaluation of homes in communities of color and of those owned by people of color?
   - *USPAP already requires appraisers to act without bias, but we see ways in which antidiscrimination could be emphasized within USPAP. Establishment of a separate ethics rule on antidiscrimination would be one way of accomplishing that. We understand the Appraisal Standards Board has consulted with numerous agency and industry stakeholders on this topic and is expected to release a proposed change to USPAP that would reinforce antidiscrimination requirements for appraisers.*

2. **Mr. Bunton**, how can the Uniform Standards of Professional Appraisal Practice (USPAP) be improved to limit appraiser discretion based on discrimination or bias and mitigate fair lending risk?

Recruitment

1. **Mr. Kelker**, how are appraisal management companies (AMCs) engaging in diversity and inclusion work in the industry, especially to help diversify AMC appraiser panels and to grow and support minority and women owned AMCs?

2. **Mr. Bunton**, how might appraiser qualification standards set by the Appraisal Foundation be amended to reduce barriers to entry for real estate agents who may be interested in becoming appraisers?

3. **All Witnesses**, it has been suggested that eliminating supervisor-trainee requirements altogether would help reduce barriers to entry and more properly reflect other professions, such as the legal and accountancy professions, where experience is gained once the professional passes their exam requirements. Are you supportive of this type of proposal? Why or why not?

    - We maintain our support for experience requirements for appraisers because real estate and real estate valuation is complex and unique – situations encountered in the classroom vary differently than in practice and in the field. There is a saying in appraisal that for every rule there is an exception.
    - We note that experience requirements are found in a broad range of professions, including many trades, but also professional services such as education/teaching, architecture, and engineering. Each profession is unique in its needs and propositions; we believe this to be true of appraisal, which is an applied science involving complex issues and situations.
    - We do enthusiastically support alternative pathways to earning experience credit. The Practical Application of Real Estate Appraisal (PAREA) is one such pathway that is available and under development by the Appraisal Institute and several other private sector organizations. This will provide an additional pathway for aspiring appraisers to enter the field through a simulated environment and in addition to the traditional supervisory appraiser-trainee model.

Appraisal Management Companies (AMCs)

1. **Mr. Kelker**, what happens if an AMC flags an appraisal for potential bias in its quality control process? How is it reported and addressed?

2. **Mr. Rice**, through Dodd-Frank, the federal government establishes minimum federal AMC requirements. Do those requirements currently include fair lending or fair housing related requirements? How should those requirements be improved to adequately account for fair housing and fair lending obligations?

3. **Mr. Kelker**, what are appraiser blacklists—also referred to as "do not use lists"? Who creates and maintains them? Who has access to these lists?

4. **Mr. Kelker**, if an AMC wants to remove an appraiser from its panel, what processes must an AMC go through to do that? Can a state deny an AMC's request to remove an appraiser from its panel? In these instances, is USPAP enforced evenly across states?

Appraisal Waivers

1. **Ms. Rice**, while some industry stakeholders are supportive of greater appraisal waiver authorities to make it easier to do business, what fair lending implications should be considered as it relates to increasing waivers?

Questions for the Record from Chairwoman Maxine Waters
Full Committee Hearing, entitled "Devalued, Denied, and Disrespected: How Home Appraisal Bias and Discrimination Are Hurting Homeowners and Communities of Color"
Tuesday, March 29, 2022 at 10 a.m. ET

Responses from David Bunton

Industry Governance

1. **Ms. Rice**, based on the National Fair Housing Alliance's review of the appraisal industry in the Appraisal Subcommittee's recently commissioned report, do you believe the current oversight and governance structure of the appraisal industry, including that of the Appraisal Foundation, is adequate or appropriate? What are your thoughts with regard to creating an independent office or agency to provide additional oversight, as envisioned in Chairwoman Waters' bill, the Fair Appraisal and Inequity Reform Act, or FAIR Act?

2. **Ms. Rice**, the FAIR Act would require that every licensed and certified appraiser take fair housing training for both initial credentialing and continuing education that is developed by the Office of Fair Housing and Equal Opportunity at HUD in coordination with the new Federal Valuation Agency. While the FAIR Act does not stipulate a set number of hours for this training, should it?

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1. **Mr. Bishop and Ms. Rice**, what are some ways in which USPAP should be reformed to help prevent the systemic undervaluation of homes in communities of color and of those owned by people of color?

2. **Mr. Bunton**, how can the Uniform Standards of Professional Appraisal Practice (USPAP) be improved to limit appraiser discretion based on discrimination or bias and mitigate fair lending risk?

The Uniform Standards of Professional Appraisal Practice have always prohibited bias and discrimination, but federal regulators have raised concerns that this might not be clear to everyone. The Appraisal Standards Board has acted swiftly to address these concerns, launching a comprehensive review of the Ethics Rule and retaining leading fair housing firm Relman Colfax to assist in these efforts. With the guidance of Relman Colfax, the ASB is currently drafting a new version of the Ethics Rule which will be open for public comment and review by federal regulators. Going forward, all changes to the standards and qualifications will be reviewed by Relman Colfax through a fair housing lens.

Recruitment

1. **Mr. Kelker**, how are appraisal management companies (AMCs) engaging in diversity and inclusion work in the industry, especially to help diversify AMC appraiser panels and to grow and support minority and women owned AMCs?

2. **Mr. Bunton**, how might appraiser qualification standards set by the Appraisal Foundation be amended to reduce barriers to entry for real estate agents who may be interested in becoming appraisers?

The Appraiser Qualifications Board is committed to ensuring that all aspiring appraisers receive the requisite training they need to succeed as new appraisers while also safeguarding against unnecessary barriers to entry. The AQB periodically reviews the Criteria and, in 2018, reduced the experience requirements for all three classifications and the college course requirements for state licensed and certified residential credentials. This careful consideration also led to the creation of the Practical Application of Real Estate Appraisal (PAREA) which will provide aspiring appraisers an alternative to the supervisor-trainee model for fulfilling their experience requirements. The AQB is committed to continuing to pursue innovative solutions to help aspiring appraisers obtain their credentials.

3. **All Witnesses**, it has been suggested that eliminating supervisor-trainee requirements altogether would help reduce barriers to entry and more properly reflect other professions, such as the legal and accountancy professions, where experience is gained once the professional passes their exam requirements. Are you supportive of this type of proposal? Why or why not?

PAREA offers aspiring appraisers with an alternative path to fulfill their experience requirements without relying on the supervisor-trainee model. We believe this alternative will help aspiring appraisers earn their credential without experiencing unnecessary barriers to entry. At the same time, the current supervisor-trainee model should still be left available to those aspiring appraisers who do wish to fulfill their experience requirements using that pathway to entering the profession.

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Appraisal Waivers

1. **Ms. Rice**, while some industry stakeholders are supportive of greater appraisal waiver authorities to make it easier to do business, what fair lending implications should be considered as it relates to increasing waivers?

MEMORANDUM

To: Terrie Allison. Committee Editor, Committee on Financial Services

From: Dean Kelker (REVAA Board of Directors) and Mark Schiffman (REVAA Executive Director)

Date: May 17, 2022

Re: Responses to the follow-up questions from Chairwoman Waters to REVAA representative Dean Kelker.

Submitted by Email: Terrie.Allison@mail.house.gov

Appraisal Management Company (AMC) Efforts at Diversity, Equity and Inclusion
As businesses, AMCs are required to follow federal Fair Housing Law and applicable state laws where required in all internal and external business practices. This includes the engagement of independent fee appraisers or staff member recruitment, employment, training and business operations. In addition:

- AMCs support the removal of barriers to entry for new appraisal trainees and enhance the recruitment of diverse candidates through the traditional higher education system or through new venues to access the profession.

- The current burdensome trainee/supervisor model for gaining experience to become an appraiser has discouraged new entrants to the profession. In addition to being difficult, the current model doesn't tie the trainee into an opportunity for future employment. It has also discouraged AMCs from a more active role of recruitment and training of a new generation of appraisers. We support the creation of the Practical Applications of Real Estate Appraisal (PAREA) and other potential alternatives to the current trainee/supervisor model.

- The Real Estate Valuation Advocacy Association (REVAA), and individually several AMCs, are active participants in the Appraiser Diversity Initiative (ADI) created by Fannie Mae, Appraisal Institute, National Urban League and Chase.

- Lenders, the clients of AMCs can also mandate burdensome experience requirements on the use of trainees. These limitations currently preclude the use of trainees in the preparation of an appraisal. Additionally, trainees are not currently listed as part the Appraisal Subcommittee National Appraiser Registry, which further limits the ability of AMC's to use them in assignments. Lenders are slowly changing credit policies to allow trainees and appraisal students to be further integrated into appraisal practice likely increasing the diversity and inclusion in the profession. In addition, REVAA is working on a bill in Congress to add trainees to the National Appraiser Registry.

Appraisal Management Company (AMC) Bias Flagging / Quality Control
AMCs are third-party service providers engaged by bank and non-bank lenders to work with appraisers to complete residential assignments in compliance with federal appraisal independence requirements. Since the 1960's, U.S. financial institutions have outsourced services to AMCs due to their expertise, efficiency, and focus on federal and state regulatory compliance.

AMCs have robust Quality Control (QC) programs in place to examine appraisal reports after the initial delivery by the appraiser. QC processes vary by AMC and client requirement. QC is a service provided by AMCs to aid their clients. These reviews are done to ensure compliance before the appraisal report or valuation is delivered to the lender and are not used to determine a lending decision.

Each AMC has its own QC process that is largely dependent on the unique QC review requirements of its lender clients. Lender contracts with AMCs dictate the level of QC and specific guidelines for what is to be reviewed by the AMC. Often, AMCs will have their own unique branded QC to separate itself from competitors.

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Federal law imposes requirements on lenders to implement controls to review appraisals, and AMCs as service providers work with lender customers to ensure their requirements are met.

State laws vary, but most have a requirement that AMCs must audit the work of appraisers on their panel, although the details of how many appraisals must be reviewed or the extent of the review can vary. Typically, AMCs are required to provide a general review for compliance with USPAP. Some have more restrictive requirements that require a detailed review in compliance with Standards 3 and 4 in USPAP, which is a full review of the appraisal and its value by another credentialed appraiser.

AMCs review all appraisal reports for a base level of items as dictated by state and/or lender requirements.

- Detailed (Big R) Review = >1% of reviews (USPAP Standards 3 and 4 full review of an appraisers work). In most cases, a detailed (Big R) review by an AMC would treat this like an appraisal assignment and use their appraiser panel to identify a geographically competent appraiser in the market in question to perform the review.

- General (Little R) Review = 99% of reviews (QC for correct names and address, use of proper forms, report completion, compliance with standards such as Uniform Standards of Professional Appraisal Practice (USPAP), Uniform Appraisal Dataset (UAD), the Uniform Collateral Data Portal (UCDP)). There is no review of appraisal value. These reviews ensure compliance before the appraisal report or valuation is delivered to the lender and are not used to determine a lending decision.

    - Automated reviews utilize logic software with defined business rules to review text used in the appraisal report. The number of business rules used varies AMC to AMC based on lender client or state requirements (e.g., 100+ including USPAP, UAD, UCDP, FHA, USDA, etc. and lender-specific overlays). In addition, for some AMCs this may include a key word search to identify those words shared by Fannie Mae, Freddie Mac and other institutions which can be perceived as bias or discriminatory in nature. Flagged words would be sent back to the appraiser for removal.

    - There are some states that require AMCs to review a percentage (e.g. 2%) of appraisals each month that were performed in the state for quality control purposes. Typically, this requires a general review for compliance with USPAP. However, there are a few states that do require this review to be a more detailed Standards 3 and 4 review, which is a full review of the appraisal and its value by another credentialed appraiser.

If a red flag for bias is identified through an automated or manual review of an appraisal, the concern is escalated to a more intensive review based on severity. Any questions or issues identified are addressed with the appraiser who completed the appraisal.

- Manual desk reviews are performed as required by AMC lender client contracts. It allows or consideration of unique attributes to the property and its potential impact on value.

- Much would depend on the nature of the suspected bias contained in the report. If bias was associated with inappropriate terminology or descriptions, the appraiser would be contacted by the AMC to remove the objectionable language. If the bias was due to the application of inappropriate or incorrect valuation methodology, again the appraiser would be contacted to make whatever corrections were warranted.

- In a case where there appeared to be intentional bias in the appraisal report, the appropriate process would be to reorder the appraisal report from another appraiser, notify the client that the initial appraisal report was defective, and that the property would need to be re-appraised. The initial appraisal report would then be sent to the appraiser's state regulator for an independent review and consideration for disciplinary action.

- AMCs may order a new appraisal, seek to evaluate an opinion of value via an automated valuation model (AVM) or other valuation tool) to determine if over or under value.

- AMCs must manage complaints related to appraisal bias or discrimination. These complaints come from homebuyers through the lender, there is no direct contact between the consumer and AMC. If contacted by a consumer, AMCs typically refer them back to their lender. This is important because the consumer likely received the appraisal from the lender who may have engaged in our quality control or review that the AMC has not seen.

- Reconsideration of value at the request of lender or borrower. Any questions or issues identified are addressed with the appraiser who completed the appraisal. It is important to note again that reconsiderations are routed through the lender because they have conducted other QC or review for that file that the AMC has not been exposed to. A lender may opt not to forward a ROV to an AMC if they believe it doesn't have merit. Our responsibility in the ROV process is to communicate the request to the appraiser, review the response to confirm it addresses the request, determine if there are any outstanding QC issues, and return to the lender for its review.

<u>Appraiser "Do Not Use/Blacklists"</u>
AMCs, lenders, appraisal firms and any other employer review their panel of independent fee appraisers to grade appraiser performance on past assignments, research state boards to determine if there is any disciplinary history, require background checks to determine if there is any criminal history.

Speaking from the AMC perspective, an appraiser's work is continually reviewed for quality, on-time delivery, customer service and professionalism, conformance with appraiser independence requirements, and USPAP compliance. Independent appraisers also need to agree to terms of use/agreement/code of conduct which outline specific expectations of the relationship, including compliance with applicable laws (i.e. fair lending requirements), and individual assignments include a letter of engagement that outlines assignment-specific criteria required by a client.

An appraiser can end up on a "do not use/blacklist" for a variety of reasons. AMC's are service businesses so when an appraiser is graded poorly for their work product or customer service (e.g., technical quality, lateness, errors, poor communication, etc.) it is noted and the AMC works with the appraiser to remedy the behavior. If that behavior cannot be remedied through counselling of the appraiser, they likely end up on a "do not use list."

With respect to AMC's, state AMC law and administrative rules governing when and how an appraiser is removed from an AMC panel. They also require an AMC to notify the state and appraiser who is to be excluded from the panel so they have an opportunity to appeal that decision. The AMC will hear the appeal and decide to either sustain the decision or allow the appraiser to continue his or her status as an approved appraiser.

AMC "do not use/blacklists" are not shared outside of the individual AMC with other AMCs and access to this information within the company is extremely limited. Do not use lists managed by lenders are generally only available to people within that company and the AMC's that provide appraisal services for them. The lists are not published or available to the public.

<u>Appraisal Management Company (AMC) Removal of an Appraiser from its Panel</u>
The process that AMC's follow to remove an appraiser from their panel state is outlined in each state AMC law and administrative rules. They also require an AMC to notify the state and appraiser who is to be excluded from the panel so they have an opportunity to appeal the decision.

This notice includes the reasoning supporting that decision and then outlines what the appeal process is to attempt to overturn the decision. The appeal process will have a defined time duration for example, the appraiser will have 30 days to submit and appeal and the AMC with then have a defined time-period, say 30 days to provide a decision on the appeal back to the appraiser.

The appraiser can appeal to the state regulator that they were being removed from the panel for an inappropriate reason. While the state could not directly prevent the AMC from removing an appraiser from their panel, they could perform an investigation into the AMC regarding their policies for appraisal removal and if necessary, direct the AMC to modify their policies.

The Uniform Standards of Professional Appraisal Practice (USPAP) is a basic framework for appraisal practice, but significant elements of these standards are subject to specific interpretation at the state level. Some states have more rigid standards than the federal minimum requirements. Additionally, as was previously stated, an appraiser could be removed from a panel for non-USPAP reasons such as poor communications or inadequate customer service.

Thank you for the opportunity to share information with the Committee on Financial Services. Please contact us with additional questions.

Sincerely,

Dean Kelker
REVAA Board of Directors

Mark Schiffman
REVAA Executive Director

Better

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Testimony Submitted to U.S. House of Representatives

Committee on Financial Services regarding:

“Devalued, Denied, and Disrespected: How Home Appraisal Bias and Discrimination Are Hurting Homeowners and Communities of Color”

Written testimony of Jillian White

Head of Better+ at Better

March 29, 2022

INTRODUCTION

Chairwoman Waters, Ranking Member McHenry, and distinguished members of the Committee, thank you for the opportunity to provide a written statement for the record regarding home appraisal bias and discrimination. My name is Jillian White. I am a 19-year veteran of the appraisal industry, and I am one of only 600 Black women in this country to hold a real estate appraiser license. This is my story.

I began my career in appraising as the founder and CEO of my own residential appraisal company based in New York State. I am currently the Head of Better+ at Better—a digital-first homeownership company committed to helping families realize the dream of homeownership by making the entire homeownership process easier, more affordable, and more accessible.

HOME APPRAISAL BIAS

Homeownership in the United States has historically been one of the most significant determinants of intergenerational wealth, but the degree to which different communities—especially communities of color—can benefit from property appreciation is deeply inequitable.

Appraising a home is both an art and science. Using “science,” appraisers can add value based on the addition of a bathroom. The “art” is deciding whether the new bathroom is worth $10,000 or

$30,000. Over the last several months, a deluge of reports has brought to light stark disparities in the real estate home valuations of homeowners of color.

A growing body of research has found that racism in the appraisal industry is undervaluing the homes of Black and Latino Americans compared to homes owned by white people. In a September 2021 study[1] of more than 12 million housing appraisals, Freddie Mac researchers found that "pervasive" bias exists in the home appraisal industry, lowering home value determinations in Black and Latino neighborhoods. A similar study[2] reported that homes in Black neighborhoods sold for, on average, 23% less than similar homes in white neighborhoods and that the appraisal gap is now wider than it was in the 1980s.

A Black homeowner in Indianapolis found her home's appraised value had more than doubled[3] from $125,000 to $259,000 after removing all family photos and Black art from her home and asking a white friend to stand in for her during the appraiser's visit. A Jacksonville, Florida, couple saw their home appraisal jump 40%[4]—more than $100,000—after they "whitewashed" their home, taking down family pictures of Black relatives and removing pictures of Black greats, like Nobel Prize winner Toni Morrison, that they had hung on walls to inspire their son.

This practice of "whitewashing"— nonwhite homeowners erasing themselves and their personal effects from their home so that a white family is assumed to live there—is common among Black homeowners and is a symptom of ongoing inequities in real estate that are rooted in this country's history of racism.

I know firsthand the practice of whitewashing. When my aunt and uncle listed their home for sale, homes in their neighborhood with a floor plan identical to theirs sold within 30 days. My aunt and uncle's house sat unsold for 110 days when their realtor advised them to whitewash their home. Within weeks of erasing their identity as a Black family, my aunt and uncle's house

[1] Freddie Mac: Racial and Ethnic Valuation Gaps In Home Purchase Appraisals
[2] Brookings: Racial Disparities in Home Prices Reveal Widespread Discrimination
[3] IndyStar: Black homeowner had a white friend stand in for third appraisal. Her home value doubled.
[4] First Coast News: Jacksonville couple sees home appraisal jump 40 percent after they remove all traces of "Blackness"

finally sold. It is gut-wrenching to wonder if my college graduation photo—a photo I was so proud of and sat on their mantel—was directly responsible for delaying the sale of their home.

Years later, when my parents sought to sell their home, we also made the painful decision to remove all family pictures—of deceased relatives, prom photos, family portraits—as well as art, figurines, and Black literature to conceal our identity from the appraiser. The most excruciating moment was taking down my baby brother's kindergarten graduation photo. A big lump developed in my throat, and my eyes filled up with tears as I put his photo into a box. What if my baby brother caught me taking down his photo? Can you imagine explaining to a five-year-old why you're hiding his school picture? Do you tell him the truth—that his photo might somehow make his parents' house worth less?

When my parents refinanced their home and the appraisal report came back, I immediately identified several flaws leading to a severe undervaluation of their home. As a seasoned appraiser, I wrote a rebuttal and requested a revised appraisal. The revised appraisal came in $100,000 higher, and the appraiser admitted to making an egregious mistake in his original valuation—a mistake that would have gone unrefuted if not for my knowledge as a certified appraiser. My parents didn't need the higher valuation for the loan to go through, but who among us can afford to miss out on $100,000 of equity in their largest asset? Many of the photographs we took down that year never made it back up onto the walls. They bring up too many painful memories about what it means to whitewash your home.

On another occasion, I was on the phone with an appraiser I had not yet met in person. The appraiser presumably did not know my skin color when he said, "the people you expect to be clean are dirty, and the people you expect to be dirty are clean. I appraised the house of a young Black woman, and her house was spotless. So, you never know about people."

Even though redlining was outlawed in 1968, Black families today still suffer from its effects. Layer on the compounding effect of individual biases of appraisers, and that, in part, explains how our systems are chiseling away at Black wealth.

I don't believe that appraisers deliberately try to undervalue communities of color. We all have unconscious bias. But the current valuation process, and the resulting undervaluation of communities of color, is destroying Black homeowners' accumulation of home equity and exacerbating the racial wealth gap.

BETTER'S WORK TO ELIMINATE BIAS:

Here at Better, we believe every homeowner is entitled to an unbiased, fair valuation of their home—and that starts with a diverse and inclusive appraisal workforce. That's why Better is working to combat discrimination through several initiatives, including unconscious bias training, eliminating barriers to entry for new trainees looking to join the appraiser profession, and advancing diversity hiring and recruitment efforts to make the profession more inclusive and representative of the general population.

Broken appraisal policies and practices have severely limited diversity and prevented women and people of color from entering the industry. Of the approximately 75,000 appraisers who currently make up the appraisal profession, 97% are white,[5] 70% are male, and the vast majority are at or near retirement age. I am one of only 600 Black women in the entire country to be a real estate appraiser, and I am one of only 300 Black women to be an appraiser under retirement age.

Under current regulations, a prospective appraiser looking to earn their certification must: (1) complete qualifying education and coursework and (2) complete a minimum number of field experience hours (set by the Appraiser Qualifications Board and each state, usually ranging from 1,000 to 2,000 hours) working under a supervisory appraiser.

For me and many other people of color, finding a supervisor to fulfill field experience hours is often the biggest hurdle to breaking into the field. When I was looking to become an appraiser, I sent out hundreds of resumes before receiving a response. Then, to conceal my identity as a woman, I changed my name from Jillian White to J. White and began to receive interviews. However, once those supervisory appraisers saw me, I was rejected again. One appraiser was so taken aback when I entered the room that he never invited me to sit down. He conducted the

[5] U.S. Bureau of Labor Statistics: Labor Force Statistics from the Current Population Survey

entire interview from the doorway and kept saying, “You are too qualified to be an appraiser.” I could only wonder, then, why he ever even asked me to come in for an interview.

Once I started a job as an appraisal trainee, I introduced myself to the CEO of the company for which I was working. He barely said hello to me before asking if I had completed “a math test.” I was confused by his question—no one had warned me there would be a math test. After asking what math test he was referring to, the CEO told me that I have to be good at math to be an appraiser. Then the CEO asked me if I had taken a “written exam.” At this point, I realized the CEO was simply looking for reasons to disqualify me from keeping my new job as an appraiser trainee. I mustered the courage to tell the CEO that my degree in neuroscience from Columbia University had more than prepared me with the necessary math and writing skills, and I left that company a few weeks later. I was, once again, on the search for a supervisory appraiser to help me earn my license.

To eliminate these barriers to education, training, and experience, Better launched the Better Appraiser Program in 2022—the initiative is designed to address the severe lack of diversity in the appraisal profession and empower the next generation of appraisers. In the next year, Better will hire dozens of appraisers to equip trainees with the coursework, appraisal orders, and field experience they need to become licensed appraisers. Better will provide trainees—at no cost—with their qualifying education and coursework, match trainees with supervisors so they are guaranteed to complete their field experience hours, and prepare trainees and supervisors with tools to navigate bias in the industry. By launching the Better Appraiser Program in counties across the U.S., Better aims to foster a younger, more diverse pool of appraisers who represent the communities they serve.

Better is also proud to support a multitude of other initiatives that eliminate barriers to entry into the field that disproportionately impact minorities and women. Better is a sponsor of the Appraiser Diversity Initiative, a partnership spearheaded by The Appraisal Institute, Fannie Mae, Freddie Mac, and the National Urban League intended to provide trainees of color with their qualifying appraisal education.

RECOMMENDATIONS FOR CONGRESS:

As a Black appraiser, I understand both sides of the conversation. I know how it feels to remove my family's photos from the walls to facilitate the sale of my parents' house. I also know how it feels to receive hate mail from a homeowner who believes you undervalued their home.

Congress must take immediate action to stop the persistent devaluation of communities of color and foster equity in appraisal practices. Congressional actions should include:

- **Requiring bias training:** Congress should work with the administration and industry leaders to support the development of implicit bias training and fair housing continuing education requirements for real estate professionals.
- **Establishing a complaint reporting system:** Individual homeowners have illustrated that discriminatory bias continues to plague the appraisal industry. Because no single lender, Appraisal Management Company, or investor can police a single appraiser or group of appraisers, Congress should direct federal agencies to coordinate and track homeowner complaints against individual appraisers to be aggregated, investigated, and appropriately acted upon.
- **Foster diversity:** To foster diversity in the appraisal profession, Congress should encourage federal agencies and industry stakeholders to eliminate the requirement for trainees to work under a supervisory appraiser. These requirements have a disparate impact on people of color. Congress should also support the widespread adoption of the Practical Applications of Real Estate Appraisal (PAREA)—a pathway for aspiring appraisers to fulfill their experience requirements in a virtual environment, combining appraisal theory and methodology in real-world simulations.
- **Support appraisal modernization:** Congress should support the Government-Sponsored Enterprises in accepting alternative methods for appraisals. The update to permanently accept desktop appraisals for certain purchases starting in 2022 is a step in the right direction, although loan-to-value maximums could impact which borrower segments will benefit from this policy change. Desktop appraisals should also be considered for certain refinance transactions (e.g., Fannie Mae-to-Fannie Mae or Freddie Mac-to-Freddie Mac rate-term refinances) to further mitigate risk of bias in those transactions. The COVID-19

pandemic allowed the industry to illustrate how alternative methods can be just as reliable. Alternatives to a traditional, in-person inspection by the appraiser may mitigate bias to some degree by separating the appraiser from the borrower/occupant of the property.

The appraisal industry—unlike the vast majority of other sectors of the U.S. housing finance industry—has been allowed to "operat[e] in a relatively closed, self-regulated framework"[6] for too long. As a result, the industry has remained misaligned with consumers and left marginalized communities at a disadvantage. It is time for Congress to hold the industry accountable. Enacting meaningful legislation to foster diversity and eliminate discrimination within the profession is an important first step.

Thank you for the opportunity to offer input on this pressing matter. Better is encouraged by the Committee's commitment to addressing this issue, and we look forward to continuing to work with you to foster a more equitable homeownership process for all Americans. We welcome your questions and comments, and please do follow up if you need more information.

Sincerely,

Jillian White

Jillian White, SRA
Head of Better+, Better

[6] National Fair Housing Alliance, Dane Law LLC, Christensen Law Firm: Identifying Bias and Barriers, Promoting Equity: An Analysis of the USPAP Standards and Appraisal Qualifications Criteria

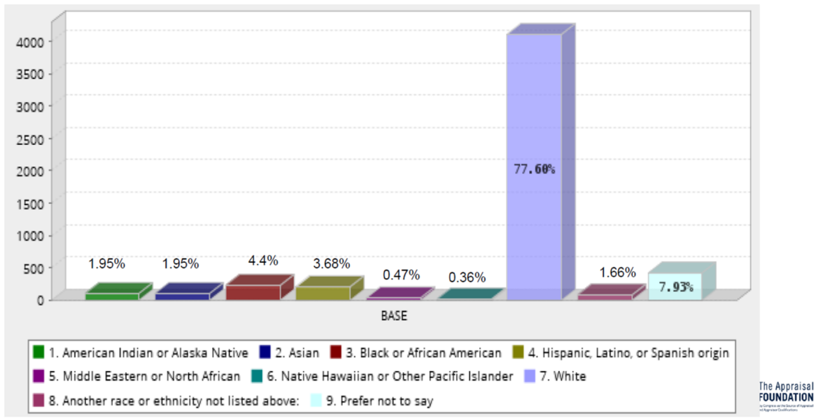
Questions For the Record from
Rep. French Hill April 1, 2022

Responses from Jody Bishop

Devalued, Denied, and Disrespected: How Home Appraisal Bias and Discrimination Are Hurting Homeowners and Communities of Color

- Mr. Bishop, the Bureau of Labor Statistics reports that the appraisal profession is predominately white. Are you aware of what information was used to conduct this study? Was the survey strictly limited to just appraisers or was it more broad?
  - Yes, I believe the study cited during today's hearing comes from the Bureau of Labor Statistics (BLS). One thing to note about the BLS survey is that it focuses broadly on "Property Appraisers and Assessors" which includes personal property and business appraisers, as well as real property assessors, which are typically employees within units of local government. The inclusion of these additional professional subsets may skew the BLS data.
  - More focused surveys of the real property appraisal profession – eligible to do mortgage finance appraisals – show slightly more diverse findings. The Appraisal Foundation conducted a survey in 2021 that was assisted by the Appraisal Institute, and it reported 78 percent white and 64 percent male, as cited below.
  - This is not to say the appraisal professional does not have work to do to improve diversity within its ranks. This is a priority to the Appraisal Institute and other industry leaders, tackled through projects like the Appraiser Diversity Initiative and the Practical Applications of Real Estate Appraisal (PAREA).
  - Lastly, the Appraisal Subcommittee is undertaking a Census/Survey of the profession to undertake a closer examination of industry diversity and demographics. The project – expected to be released later this year - will lean heavily on ASC National Registry data in completing its work.

With which racial and ethnic groups do you identify? (Mark all that apply)



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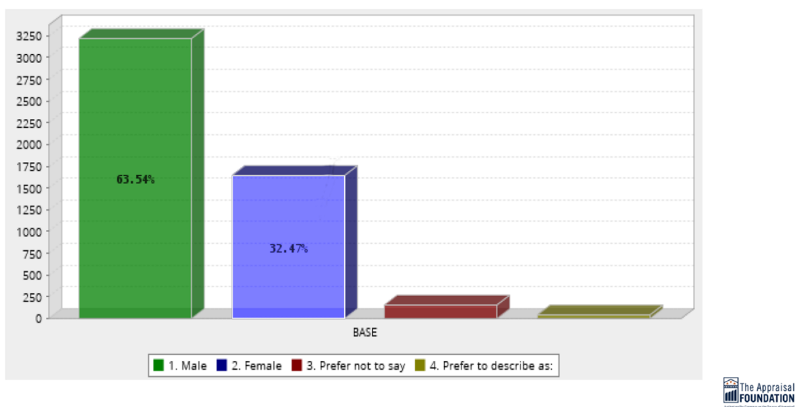
With which gender do you identify?



- Mr. Bishop, is there a formal process for federal agencies or the GSEs to report research findings with industry? Specifically in regards to the Fannie Mae report on confirmation bias – was any research on confirmation bias shared with the industry to absorb, understand or act upon?

- We are not aware of any formal process to engage with or involve the appraisal profession in research development or analysis. Most data on appraisal information is proprietary, and while broad issues or findings of end users of appraisals reports may be shared with the industry at industry meetings and conferences, typically, there is a wide gap in understanding the data inputs, research framework, and analysis and conclusions.
- It was implied earlier in the hearing the appraisal profession should have been more responsive to concerns expressed about confirmation bias by appraisers, even developing a specific standard of conduct to avoid confirmation bias. We are not aware of any instance where such a recommendation was made by a researching entity. Such a feedback mechanism could exist through the industry's standards setting process, but that would require researchers to involve and share in greater detail their research work with appropriate parties.

THE CITY
REPORTING FOR NEW YORKERS

HOUSING

With Pandemic Pause Over, NYC's Black Neighborhoods Brace for Foreclosures

New numbers from the Center for New York City Neighborhoods show more than 8% of homeowners in majority-Black communities were behind on payments last September.

BY GEORGE JOSEPH | MAR 22, 2022, 8:28PM EDT

Michelle Lopez, a homeowner in Canarsie, Brooklyn facing foreclosure, has sought a loan modification for more than a year without success. | George Joseph/THE CITY

The fate of 302 Berriman Street, a pink, two-family home in East New York, Brooklyn, was decided on in a matter of minutes.

On a drizzly March morning, a dozen people, mostly men in black rain coats, huddled together on the steps of Brooklyn's Supreme Court building, shouting out their bids for the foreclosed property: "SEVEN TWENTY!"... "SEVEN TWENTY-ONE!"..."SEVEN TWENTY-THREE!"

Soon, a clean-shaven man with black glasses was handing an envelope to the auctioneer. He had secured the house for $775,000. The family, which had fought to stave off the sale of their home since 2012, did not attend.

In the coming months, foreclosures like this one in East New York are likely to ramp up across the five boroughs. During the height of the COVID-19 pandemic, struggling homeowners were temporarily shielded by New York's foreclosure moratorium. But in January, state officials let the last of those protections expire.

Now, with foreclosure courts and mortgage servicers ramping back up to full capacity, data suggests that the city's Black neighborhoods, devastated by the economic shocks of the pandemic and decades of prior predatory lending, are most at risk.

According to mortgage delinquency numbers compiled by the Center for New York City Neighborhoods, an affordable homeownership advocacy group, as of last September, the city's majority-Black ZIP codes had an average of 8.48% of homeowners who had fallen behind on their payments for more than 30 days.

That percentage is four times that of the majority white ZIP code average and one-and-a-half times that of the majority Hispanic ZIP code average from September.

Those city figures echo racial disparities across the state. According to the latest U.S. Census Household Pulse Survey, 3.4% of white homeowners in New York said they were very likely to leave their homes due to foreclosure in the next two months and 4.4% said they were not at all confident or only slightly confident that they could make next month's mortgage payment.

By contrast, 9.4% of Black homeowners expressed fears of being kicked out of their homes and 17.4% voiced the same mortgage payment concerns.

Elected officials and homeowner advocates say the numbers point to a crisis on the horizon.

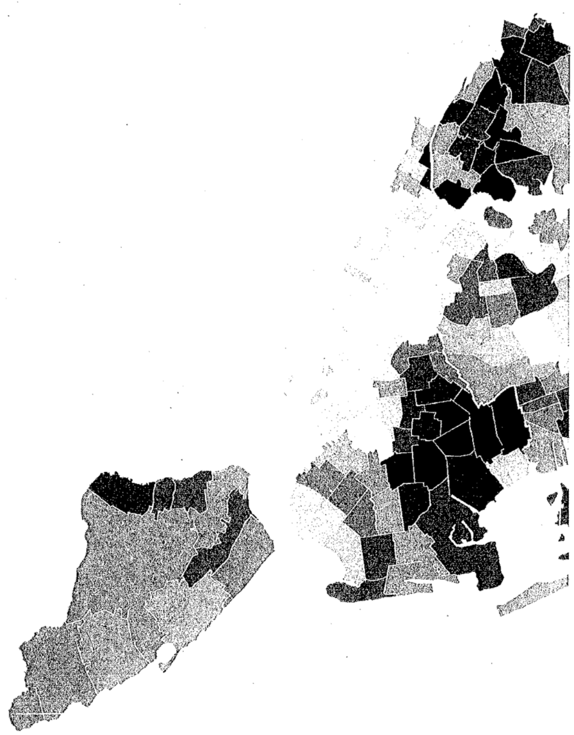
"The numbers are clear, many Black homeowners across New York City are once again facing an uncertain housing future," said City Councilmember Mercedes Narcisse, who represents Canarsie, one of the majority Black neighborhoods suffering high levels of mortgage distress. "All levels of government must do all they can to intervene and help preserve Black home ownership."

NYC's Black Neighborhoods Suffer From Higher Rates of Mortgage Distress

Data as of September 2021

Percentage of Homeowners Not Making Payments for 30+ Days

0% 17%



Map: George Joseph • Source: The Center for NYC Neighborhoods • Embed • Created with

Christina Wiley, executive director of the New York Mortgage Bankers Association, argued that the resumption of foreclosure proceedings could actually help some struggling homeowners.

"Some folks need to move forward," she said, noting that foreclosure sales could help distressed residents "get out from underneath the situation that they're in."

While the mortgage industry is concerned about the heightened potential for foreclosures, Wiley said, it does not anticipate a sudden surge in displacement because foreclosure courts take months to process cases.

"We don't see any crisis looming in the foreseeable future," she said.

Job Losses and Historic Burdens

Ivy Perez, senior policy and research manager for the Center for New York City Neighborhoods, argues the disparate numbers are, in part, a reflection of the disproportionate job losses Black and other non-white commmunities faced during the pandemic.

"The mortgage distress numbers are absolutely connected to the effects of the pandemic," she said. "We're seeing high levels of mortgage distress in the same areas that we know have high unemployment rates and we know that homeowners in many of these areas were already perhaps struggling to pay their mortgages."

But the distress concentrations also point to longer histories of segregation and racist exploitation going back generations. Most of the Black neighborhoods with high concentrations of struggling homeowners are in eastern Brooklyn and southeast Queens, areas that lenders had previously targeted with subprime loans in the run up to the 2008 financial crisis.

After the Great Recession, some homeowners in these areas benefited from an Obama-era program that encouraged loan modifications, but most did not receive large-scale principal reductions and remained in precarious positions, noted Shabnam Faruki, director of the Neighborhood Economic Justice Project at Brooklyn Legal Services.

"These are neighborhoods that have never really been compensated for the kinds of financial discrimination that they faced, and continue to face," she said.

In January, the same month that the home foreclosure moratorium ended, Gov. Kathy Hochul announced the launch of the Homeowner Assistance Fund, a federally funded program that is supposed to disburse $539 million to homeowners struggling due to hardships caused by the pandemic. The funds are going to residents behind on their mortgages as well as those who have struggled to keep up with property taxes, water bills, and condo fees.

Successful applicants can receive as much as $50,000 in the form of a no-interest loan, which will be forgiven for those who manage to stay in their homes for five years.

An East New York building in a rezoned area advertises foreclosure help. | Ben Fractenberg/THE CITY

Fifty thousand dollars could go a long way for Emerson and Maria Ison, who have lived in their elegant, one-story brick home in Canarsie, a majority-Black neighborhood in Brooklyn, for more than a decade. In February, Pale Horse Realty, an asset management company, launched a foreclosure proceeding against the family alleging they had failed to make their monthly payments for years. But the principal the Isons owe is relatively small, just shy of $58,000, according to the company's court complaint.

In a brief conversation on the Ison's porch, an elderly Caribbean woman told THE CITY that the family had applied to the Homeowner Assistance Fund, but was still waiting to hear back.

After the launch of the program, the Division of Homes and Community Renewal, the state agency in charge of the money, received over 13,000 applications from New York City residents. Thus far, 5,057 have been conditionally approved for the program, according to the agency.

But housing attorneys and mortgage industry representatives note that the fund may not be enough for many struggling homeowners in New York City, who tend to have far larger arrears than their upstate counterparts due to the city's higher property values.

Because of this, advocates argue that what many city homeowners need in the short term are loan modifications from mortgage servicers, who could reduce interest rates and lengthen loan terms to make residents' monthly installments more feasible. Officials from DHCR and the Office of the Attorney General say they are pushing servicers to agree to loan modifications, but their leverage is limited, especially for loans not backed by the federal government.

"Although negotiations have gone better than expected, they're still not perfect," said Dina Levy, senior vice president of Single Family and Community Development at DHCR.

Wiley, the industry representative, said that servicers, who manage loans on behalf of lenders and collect fees when borrowers fall behind on payments, are not the problem. "They're doing what they can to help New Yorkers stay in their homes," she said.

Michelle Lopez, another Black homeowner facing foreclosure in Canarsie, has sought a loan modification for more than a year without success.

Lopez and her two siblings bought their two-story, wood-paneled house more than two decades ago. They liked the giant park next door, and the neighborhood was far quieter than their native Flatbush, so far east you could feel the breeze from Jamaica Bay.

Her son and niece had fun growing up there, she says, running around the house making noise and shooting videos of their WWE toys fighting before Sunday dinners.

But some things were out of their control.

In 2012, the house, close to the coastline, was pummeled by Superstorm Sandy. She and her sister fled for their mother's in Flatbush, but her brother stayed behind on the top floor to protect the home.

When the family returned, the basement where her sister lived was destroyed. Insurance covered most of the remodeling and lost appliances, Lopez said, but the family had to pay out of pocket for the mold and her sister's clothes and other belongings.

In the years that followed, the family saw its income streams dry up one by one. In 2014, Lopez was laid off from her underwriter position at an insurance company. It took her two years to get another job — at far lower pay. Around the same time, her brother, a former Marine, lost his security gig and started driving for Uber. They started to fall behind on their payments.

One day in 2018, a package arrived at their house with court papers attached. The loan servicing company was initiating foreclosure proceedings, noting that the family owed more than $300,000 on the house.

Lopez tried to negotiate for a loan modification with little success. One time, she recalls, she called the company explaining she had collected her brother's paystubs in the hopes that it might improve her chances. But the company representative on the line brushed her off, she remembers.

"She just didn't even hear," Lopez said. "She says, 'It's not like it's going to make much of a difference.' I just didn't even know what to say. You just felt helpless."

The company listed as the official plaintiff in the case against Lopez filed for bankruptcy a year after the proceedings began. Thus far, the new mortgage servicer handling Lopez's loan has been unwilling to grant her a modification. It did not respond to repeated requests for comment.

Hopes for Relief

Despite homeowner advocates' concerns, some industry experts argue the flurry of post-pandemic foreclosure filings won't be nearly as damaging as they were in the years after the 2008 recession. Today's high home prices mean that even many of those struggling will have built up equity over the years, shielding them from financial disaster.

Perez points out, however, that when residents are forced to sell out of desperation, they often get a raw deal.

Recent research suggests that a significant part of the country's racial wealth gap can be attributed to the smaller returns on home sales that Black residents receive due to elevated rates of foreclosures and short sales, compelled by bouts of economic distress.

And advocates note that any homeowner displacement, even if on relatively favorable financial terms, could have ripple effects on non-owners, exacerbating gentrification.

"The new buyer who probably bought the home at an inflated price or at a higher price than the existing homeowner landlord is going to want to raise the rents on the tenant," said Perez. "So if you have a huge turnover of the homeowners in the neighborhood, you're actually also having a huge turnover in the tenants in the neighborhood because homeowner landlords are a huge source of affordable rent."

More relief could be on the way, though. Democrats in the state legislature are pushing for hundreds of millions more in funding in the upcoming state budget, due April 1, to supplement the Homeowner Assistance Fund.

"We need to do everything we can to keep people in their homes and help protect the wealth they've built, sometimes over generations," said State Sen. Zellnor Myrie (D-Brooklyn). "Homeowners in my district have been hit hard by the pandemic — our budget needs to provide real relief."

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