Response to the FHFA's RFI on
Appraisal-Related Policies, Practices, and Processes

Junia Howell and Elizabeth Korver-Glenn

The Federal Housing Finance Agency's *Request for Information on Appraisal-Related Policies, Practices, and Processes* astutely outlines how modernizing appraisal procedures could address some of the industry's longstanding challenges. For ease of reader comprehension, the RFI organizes these plausible changes into four distinct sections: modernizing appraisals, updating forms and datasets, using AVMs and waivers, and reducing racial bias. However, in this response, we focus on how these opportunities and obstacles are interrelated and require solutions that are designed to simultaneously address the interconnected challenges. Specifically, **we argue that the systemic and individual racial and class biases observed within the industry are enabled by current appraisal forms, technology, priorities, and data policies.** Thus, the modernization of appraisal policies, practices, and processes needs to also address how these procedures can decrease racial and class inequality.

In what follows, we begin by providing an overview of racial and class biases within the appraisal industry and their detrimental effects on families' wellbeing and the economy. We then discuss how current appraisal policies, practices, and processes contribute to the observed inequality and what steps the FHFA can take to address these concerns. Given that we are deliberately drawing connections between the RFI subsections, most of our points intentionally answer multiple RFI questions. To highlight which questions each section addresses, we list the relevant question numbers in parenthesis at the close of each section.

Racial and Class Bias and Their Detrimental Effects

On average, homes in White neighborhoods are appraised three times higher than homes of comparable size, construction, and condition in Black, Latinx, and Indigenous communities. This is true even when the neighborhood's real estate demand, crime rates, school quality, local amenities, and socioeconomic status are held constant (Howell and Korver-Glenn 2018). Moreover, the inequality between White neighborhoods and communities of color has doubled since 1980 (Howell and Korver-Glenn 2020). Between 1980 and 2015, homes in White neighborhoods saw unprecedented appreciation rates, increasing on average $200,000 more than comparable communities of color. This growing inequality in appreciation rates exacerbated the racial wealth gap and the affordable housing crisis. [Question C1.4]

Racial Wealth Gap. Today, White families have 10 times the wealth of Black families. In the last 30 years, this gap has nearly tripled, with average White families now having $236,000 per family member more than Black families. Over half of this gap is explained by housing appreciation rates. The growing property appraisal gap directly affects families' ability to accumulate capital for starting businesses, save for retirement, assist with their children's education, and have critical safety nets for health emergencies or climate-related disasters. These direct impacts then have cascading implications on individual families as well as the economic and civil stability of the entire society. [Questions C1.4; C1.5]

Affordable Housing Crisis. Growing inequality in home appreciation rates also affects the amount of housing available. Overall, home appreciation rates have far outpaced inflation, incomes, and prices of other consumer goods. For those already owning homes, particularly those owning homes in White middle- and upper-class communities, the appreciation contributes to their wealth, enabling them to purchase additional or new homes of higher value. For everyone else, these appreciation rates make homeownership less obtainable and rents increasingly burdensome. Moreover, the inflated prices, combined with other economic and policy factors, has decreased incentives for housing market professionals to build and sell affordable housing. The diminishing stock of affordable housing has a multitude of negative implications on working families and our social service sectors. [Questions C1.4; C1.5]

Beginning to address the racial wealth gap and affordable housing crisis requires identifying and addressing the mechanisms within the appraisal industry that contribute to the ongoing systemic discrimination. Below we focus on the mechanisms that fall within the mandate of the FHFA.

Procedures Contributing to Inequality and Proposed Changes

Ethnographic observations and interviews with appraisers and other housing market professionals demonstrate that the appraisal industry's current policies, practices, and processes create, maintain, and enable the observed racial and class inequality (Howell and Korver-Glenn 2018; Korver-Glenn 2021). Five of these key procedures include: appraisers' evaluation of neighborhoods, implementation of the sales comparison approach, inconsistent assessments, limited data accessibility, and the ongoing legacy of the National Housing Act.

1. **Evaluation of Neighborhoods**

   A key factor in determining a home's worth is its location, specifically its neighborhood. However, neighborhood location has not always been so central. As part of the National Housing Act of 1934, the federal government—in partnership with industry actors—standardized the appraisal process. In doing so, they made a deliberate decision to use neighborhoods as the primary factor to determine value. Through the instructions laid out in the Underwriting Manual of 1936 and the Home Owners' Loan Corporation neighborhood rankings, appraisers were encouraged to evaluate White and middle- to upper-class neighborhoods as more valuable. A series of legislative acts and lawsuits from 1968 to 1977 outlawed the explicit use of racial demographics as a justification for value. However, via the Uniform Residential Appraisal Report, appraisers are still required to evaluate neighborhood boundaries, characteristics, and trends.

   Ethnographic observations, interviews, and quantitative analyses demonstrate that although appraisers do not formally report racial demographics, these demographics still play a central role in how appraisers define neighborhood boundaries, evaluate neighborhood characteristics, and perceive neighborhood trends (Howell and Korver-Glenn 2018; Korver-Glenn 2021). Since there is no uniform process for defining neighborhoods or establishing characteristics and trends, racial and class biases often shape appraisers' interpretations of neighborhoods.

In a recent study by CBC reporters, six different appraisers evaluated the same house in the same week. Not a single one of the appraisers classified the neighborhood the same. Some defined it as "urban," others "suburban;" some defined property values as "increasing," others "stable," each had a different value for the neighborhood's median housing age and property value and all differed in their written descriptions of the neighborhood. This is merely one illustrative example of the inconsistency. In aggregate, this inconsistency repeatedly results in appraisers providing less favorable evaluations and values to communities and individuals of color.

To address this inconsistency and its tendencies to perpetuate racial and class biases, we propose the FHFA consider including the following:

a. *Create standardized neighborhood boundaries*. Instead of allowing appraisers to determine neighborhood boundaries—a process that often results in appraisers grouping areas by racial composition (Korver-Glenn 2021)—the FHFA should require appraisers to used standardized definitions of neighborhoods. These could be census tracks, census block groups or other non-census defined boundaries. Yet, using preselected neighborhood boundaries would reduce appraiser bias. Additionally, to further ease standardization, the modernized data entry platforms could use location address to automatically populate neighborhood boundaries.

b. *Draw neighborhood characteristics and trends from uniform data sources*. In tandem to creating standardized neighborhood boundaries, the FHFA should select uniform, frequently updated data sources for determining neighborhood characteristics and trends. Data from the Census Bureau, the Uniform Appraisal Dataset itself and other non-governmental data (e.g. National Establishment Time Series) could be combined to create uniform and frequently updated information. Like neighborhood boundaries, modernized platforms could be programed to automatically populate neighborhood characteristics and trends once the location was identified. This standardization would also assist appraisers in rural or underserved areas who are serving larger regions and thus are unable to have detailed localized knowledge.

c. *Clarify how neighborhood characteristics should be evaluated*. Although neighborhood location remains critical in evaluating property worth, there are no outlined standards for how to translate the neighborhood characteristics on the uniform appraisal report into exact values. Much of this process occurs through the sales comparison approach which we discuss at more length below. Yet, beyond the needed reforms to the sales comparison approach, the FHFA should also create explicit guidelines for how appraisers should use neighborhood conditions in their evaluations of property. For neighborhood characteristics or trends that do not correspond with uniform or relevant evaluation standards, the FHFA should remove these attributes from the form to diminish implicit biases.

[Questions A1.2; A1.4; A1.6; B2.1; C1.3; C1.4; C1.5; C1.6]

2. **Sales Comparison Approach**

In addition to centralizing neighborhoods, the 1930s standardization process also elevated the sales comparison approach as the most common appraisal method. Unlike other methods (e.g. the cost approach that was most common in the 1920s), the sales comparison approach uses previous sales to derive appraised value. Specifically, appraisers select 3-5 nearby similar properties that have sold recently. Appraisers then determine the comparability between the subject property and the selected comparable sales to derive adjusted sale prices. These adjusted sale prices create a range of plausible values and the appraiser selects a value from within this range.

Conceptually, the appraiser is supposed to select comparable sales from within the same neighborhood. This is how neighborhood location becomes a foundation for setting the subject house value. However, appraisers have discretion on where and how to select comparable homes, especially when comparable homes have not sold recently within the defined neighborhood. Research has demonstrated appraisers often select previous sales in communities with racially similar demographics, even when the communities have distinct socioeconomic status, physical locations, amenities, or real estate demand (Howell and Korver-Glenn 2018). This perpetuates the process of evaluating homes according to a racial hierarchy. Additionally, using previous sales to determine value ensures contemporary values are shaped by past racial and class ranking systems. That is, even though HOLC's redlining maps were formally outlawed, appraisers continued to use the valued derived under this system to justify appraised values, bringing historical racialized and classed practices into the present (Howell and Korver-Glenn 2020).

Moreover, mirroring the inconsistencies in the evaluation of neighborhoods, appraisers inconsistently evaluate the comparability between properties. That is, even when appraisers are comparing the exact same properties, they routinely provide a different list of value adjustments, sometimes deriving drastically different adjusted sale prices. Once again, this inconsistency leaves room for racial and class biases to influence appraisers' decisions. Likewise, appraisers' discretion to select any value within the range of adjusted values also creates another opportunity for individual and systematic bias.

To address the aspects of the sales comparison approach that contribute to inequality, we propose the FHFA consider including the following:

a. *Switch to Appraised Ranges instead of Values*. The most immediate alteration FHFA can make to address the biases in the sales comparison approach is allow federally ensured mortgages to be granted for any value within the adjusted sale price range. That is, instead of requiring appraisers to provide one value from within the range they derived using their chosen comps, require appraisers to provide the bank with their range of adjusted sale prices. Banks would then be able to provide federally insured mortgages for any value within or under this range. This would eliminate any bias introduced by the appraisers' own selection of one value within this range. Although this bias is likely only a very small fraction of the overall observed inequality, it would begin to create a more equitable system, especially for refinancing.

b. *Standardize the Adjustment Process*. Currently, appraisers have substantial discretion in deciding what features need to be prioritized when calculating adjusted sale prices. Moreover, appraisers vary widely in how they price different updates or additions. Although these processes cannot be perfectly dictated for every possibility, the FHFA should work with the Appraisal Institute and Appraisal Foundation to create more precise guidelines outlining appropriate ways of calculating adjusted values for each specific factor. Additionally, the FHFA can work towards creating automated equations that use the selected comp to calculate adjusted prices. Using technology would be more precise and allow for multilayered comparisons between properties that are not feasible with hand calculations. This would be a particularly powerful tool if it used the uniform appraisal dataset information from the most recent sales to compare multiple aspects of property condition and construction.

c. *De-racialize Comp Selection*. Simply stating that racial composition is not an appraisal factor has not and will not decouple race from value unless the selection of comparable sales is conducted in a matter that addresses the inequality of past sales. Towards this end, the FHFA needs to introduce a process that resets and accounts for the historical ranking system and counterpart contemporary racialized processes. One possible approach would be to require that at least one comparable sale be a similar home in a neighborhood with a different racial composition. Another approach would include standardizing or automating the comparable sales selection process in a way that intentionally adjust for the inequities of the past.

d. *Creating and Institutionalizing a New Appraisal Method*. Long term, FHFA should work with industry actors and researchers to derive robust alternative approaches that intentionally combat the assumption that White communities and homes owned by White residents are more desirable, marketable, or valuable. One approach would include building upon the cost approach (homes valued based on the cost of recreating them in their exact conditions) to create a modernized method that is consistent and accurate. This would likely entail appraisers uploading multiple pictures and detailed information to a smart phone or tablet.

This detailed information could them be used to evaluate the cost of all materials and estimated devaluation based on use or damage. Approaches like this that are directly connected to the supply and demand of housing materials would ensure the market accurately reflects the needs for housing in the community and thereby increase incentives for builders to construct affordable housing. Using an open source platform would also enable homeowners making repairs and upgrades to access the financial and non-financial benefits of their investments. Finally, these alternative approaches need to be designed in collaboration with local communities and tribal nations to help create equitable evaluations of materials and the land itself.

[Questions A1.2; A1.4; A1.6; B2.1; C1.3; C1.4; C1.5; C1.6]

3. **Inconsistent Assessments**

In addition to the inconsistencies in appraisers' assessments of neighborhoods and comparable houses, data demonstrates that inconsistencies in assessments of the subject property also leaves room for racial and class biases to influences appraisers' evaluations of homes. Appraisers often have widely varying assessments of even seemingly objective property characteristics like square footage, land acreage, and number of rooms. A quantitative analysis done by Clear Capital found appraisers' estimates of square footage vary on average by 8 percent (Allen 2021). Inconsistencies in square footage alone alter appraised values by tens of thousands of dollars. Combined with other common inconsistencies regarding the foundation, amenities, condition, and "appeal," appraisers' micro impressions and decisions create and reinforce existing inequality. In addition to the evaluation of the property itself, appraisers also vary in the value they assign various amenities and characteristics.

Using new technologies could decrease the inconsistencies that enable inequality and provide more precise information to banks, landowners, and local municipalities. To foster standardization, we encourage the FHFA to consider the following:

a. *Foster the Adoption of Automated Floor Plan Technology*. Noting the inconsistencies in appraisers' gross living area estimates, technology companies have created smart phone applications that use the phone's camera to measure depth and create automated floor plans. An analysis by Clear Capital showed that when untrained homeowners and other users employed CubiCasa's application they produced more accurate and consistent measurements than trained appraisers using traditional methods (Allen 2021). FHFA should phase in requirements for appraisers to use more reliable measurement tools for gross living area as well as floorplans, number of rooms, and assessments of amenities.

b. *Standardize Guidelines for Evaluating Property Amenities*. In addition to consistent measurements, FHFA could foster consistency by creating monetizing standards. That is, provide specified guidelines for how a wide range of property characteristics should be assessed and valued. Eventually, these standards should be incorporated into the modernized uniform appraisal reports. That is, after the appraiser enters all the specified information, the form would populate specific value ranges to guide the appraiser in accessing the exact adjustments for each property feature.

[Questions A1.2; A1.4; A1.6; C1.3; C1.4; C1.5; C1.6]

4. Limited Data Accessibility

Another reason racialized and class inequality can persist is the lack of accessible data. Without democratic processes and information, it is difficult for individual homeowners and communities to determine whether they are receiving fair and equitable appraisals. Likewise, researchers and appraisal companies can also not examine the full extent of racial and class inequality and the specific mechanisms that shape these patterns. The Dodd-Frank legislation provided a critical first step in democratizing data by creating the Uniform Appraisal Dataset. For this to truly serve the broader public and the industry, this data needs to be made available. Granted, the distribution of such data needs to take into consideration privacy concerns by ensuring personalized information is not accessible to the broader public. Yet, the precautions are plausible and well established by other governmental agencies working with similarly sensitive data.

Increasing the accessibility of this data would also assist local governments attempting to update their tax assessment values, the FHFA to track whether implemented changes are increasing equity, accuracy, and consistency, and industry actors responding to the trends in housing supply and demand.

a. *Create Publicly Accessible Versions of the Uniform Appraisal Dataset*. Much like the U.S. Census Bureau, the FHFA should consider ways to make the UAD accessible at different levels of aggregation. To begin, the FHFA could work with the Census' Restricted Data Centers to make the complete UAD accessible to researchers with Special Sworn Status with projects approved by the FHFA. This immediate step could enable researchers to start partnering with the FHFA to further understand patterns within the data, derive evidence based solutions, and innovate ways to anonymize the data to make it available to the wider public.

b. *Track Changes Over Time*. The FHFA should partner with researchers to track racial and class inequality in appraisals over time. Tracking this data will assist government officials and the public to recognize what interventions and practices are fostering equity and how we can collectively ensure we are implementing changes that uphold fair housing legislation.

[Questions B2.1; C1.4; C1.5; C1.6]

5. Legacy of the National Housing Act

As discussed above, the National Housing Act of 1934 and the subsequent actions of the newly formed Federal Housing Administration and Home Owners' Loan Corporation institutionalized the practice of evaluating White and middle- and upper-class neighborhoods as more valuable simply because of the residents who dwelled in them. These decisions combined with other New Deal programs as well as the Servicemen's Readjustment Act of 1944 (colloquially called the G.I. Bill) enabled millions of White middle-class families to buy homes at federally subsidized prices. These homes appreciated in value, enabling many of these families to pass down generational wealth to their children and grandchildren (Jackson 1985; Rothstein 2017; Trounstine 2018).

No comparable programs have been available to Black, Indigenous, or Latinx Americans. This historical inequality still influences racial homeownership and wealth gaps. The Federal Housing Finance Agency should partner with other federal agencies and lawmakers to provide federal loans. Like federal educational loans, these loans would be available directly from the government to qualified borrowers. Like other federal programs whose qualifications are based on both income and wealth (e.g. SNAP), loan amounts and interest rates would be determined based on income and wealth. Applicants with less wealth and income would qualify for lower down payments and interest rates.

[Questions C1.5; C1.6]