Recommendations for Appraisal Bias Risk Management

Public Briefing: March 5, 2024

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Opening Remarks

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Agenda

1 Background

2 Higher Valuations

3 Appraisal Reports

4 Business Processes

5 Compliance Management Systems

6 Statistical Analysis

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1 | Background

Why? The recommendations can reduce risk for all stakeholders in the housing market

Consumer and Communities

Lenders, AMCs, and Appraisers

American Economy

Source: Dr. Junia Howell and Dr. Elizabeth Korver-Glenn, Appraised (Nov. 2022)

What? The recommendations focus on the fair housing and fair lending laws that prohibit appraisal discrimination

	Fair Housing Act	Equal Credit Opportunity Act	Civil Rights Act of 1866
Who Covered	"Any person or other entity"	"Any creditor"	Any party
What Covered	Residential real property	"Any aspect of a credit transaction"	"Real and personal property"
Who Protected	Race, color, national origin, religion, disability, familial status, sex (sexual orientation, gender identity)	Race, color, national origin, religion, age, marital status, source of income, sex (sexual orientation, gender identity)	Race, color, national origin
Who Can Enforce	DOJ, HUD, financial regulators (but not CFPB), fair housing organization, tester, individual	DOJ, FTC, financial regulators (CFPB), fair housing organization, individual	Fair housing organization, individual

What? The recommendations contain risk factors based on current cases and risk management techniques based on supervisory expectations and best practices

Risk Factors

- Higher Valuations
- Appraisal Reports
  - Overt statements
  - Subject property
  - Comparable sales
  - Value adjustments
  - Reconciliation
- Business Processes
  - Consumer interaction
  - Reconsideration of Value
- Compliance Management System
- Statistical Analysis

Risk Management

- Board/Senior Management/Leadership Oversight
  - Third Party Risk Management
- Policies and Procedures
- Fair Housing Training
- Complaint Process and Tracking
- Audits and Monitoring

What? The recommendations explain each risk factor as follows:

1. Overview and explanation of the risk factor
2. Common standards for this risk factor; deviations from standards can be viewed as evidence of discrimination
3. Examples of this risk factor from federal cases, HUD complaints, GSE experience, research
4. Risk management techniques for this risk factor; framed as advice for the appraiser but can be used by others to manage risk or to detect the absence of risk management

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Who? The recommendations can empower:

- ✓ Appraisers
- ✓ AMCs
- ✓ Lenders
- ✓ GSEs
- ✓ Government investigators

- ✓ Government examiners
- ✓ State licensing boards
- ✓ Fair housing groups
- ✓ Consumers
- ✓ Researchers

**To identify appraisal bias risk, take action,
and help close the racial homeownership and wealth gaps**

Let's get started!

2 | Higher Valuations

A higher valuation may indicate the risk of discrimination

- **Overview**: Many allegations start when the consumer discovers a **valuation** that is significantly **higher** than the one received from the first appraisal

- **Example - Subsequent Appraisal**:
  - In a predominately White county in California, a Black couple applied for a refinancing and received an appraisal of **$995,000**
  - The homeowners "**whitewashed**" the home, replacing items indicating Black homeownership with items suggesting White homeownership
  - The second appraisal came in at **$1,482,500**, which was nearly **50%** higher than the first appraisal

- **Other Sources**:
  - Loan officer estimate
  - Real estate agent
  - Tax assessment
  - Zillow/Redfin
  - Contract value

Source: *Austin v. Miller*, Case 3:21-cv-09319-JCS (N.D. Cal. Complaint filed Dec. 2, 2021)

The risk can be managed by…

Reviewing Public Sources

- Before completing the opinion of value, the appraiser can review **public sources**, such as **tax assessments** and **online estimates**, as well as the contract price
- If those values are higher, the appraiser should understand **why**

Conducting Error Reviews

- The appraiser can review the work carefully for any **errors** or **departures from standard practice**, especially if other sources indicate a higher value

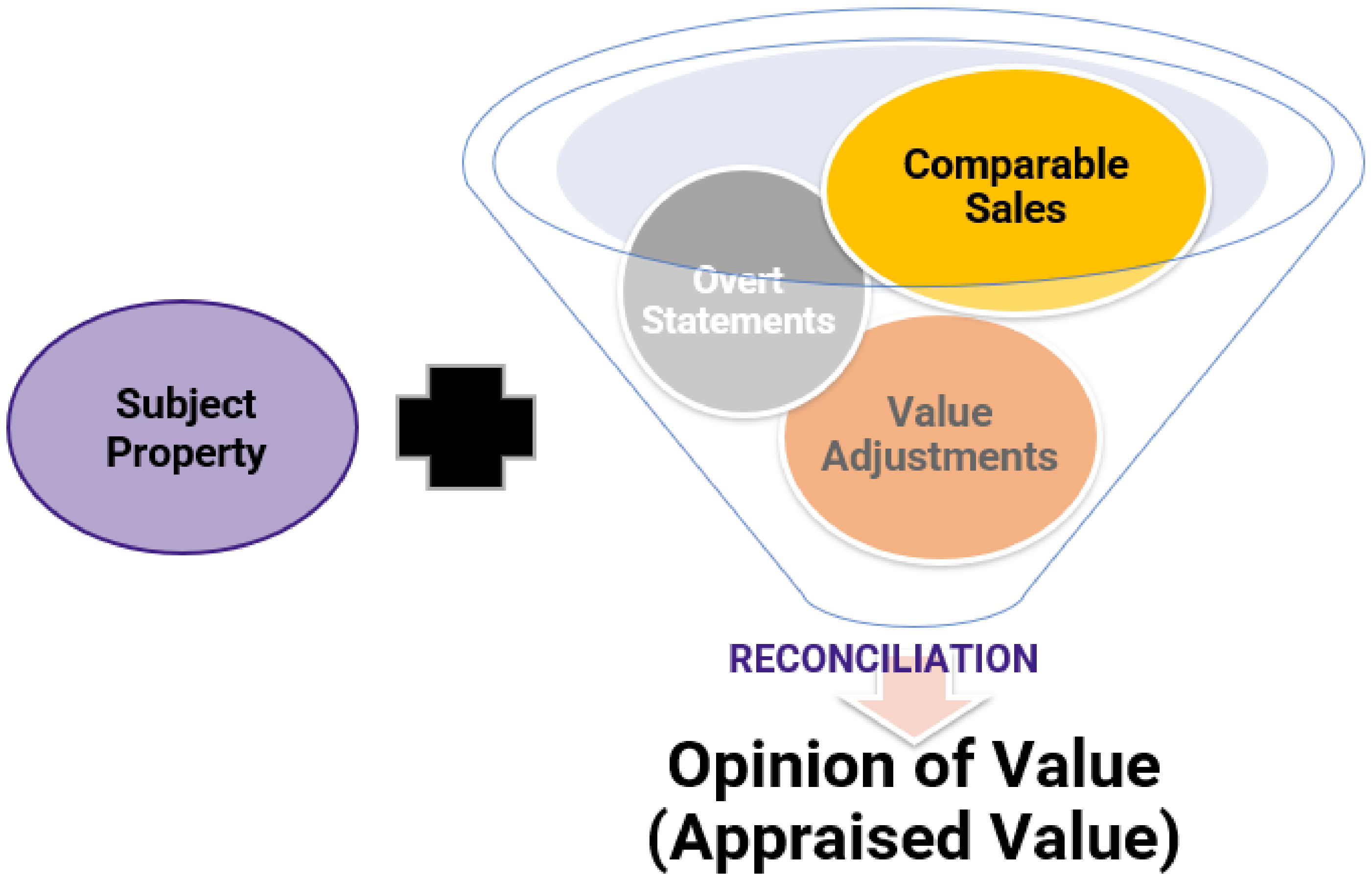
3 | Appraisal Reports

The sales comparison approach & the appraisal report allow for broad discretion, which is a key fair lending risk factor

- **Broad discretion** has long been considered a key fair lending risk factor because it allows for conscious or unconscious **bias** to affect **decisions** and lead to **inconsistent outcomes**

- The **sales comparison approach** provides the appraiser with **broad discretion** to develop the **opinion of value** based on their view of:
  - Relevant **statements** in the free form descriptions,
  - The **subject property,**
  - **Comparable sales,**
  - **Value adjustments,** and
  - **Reconciliation** of the values

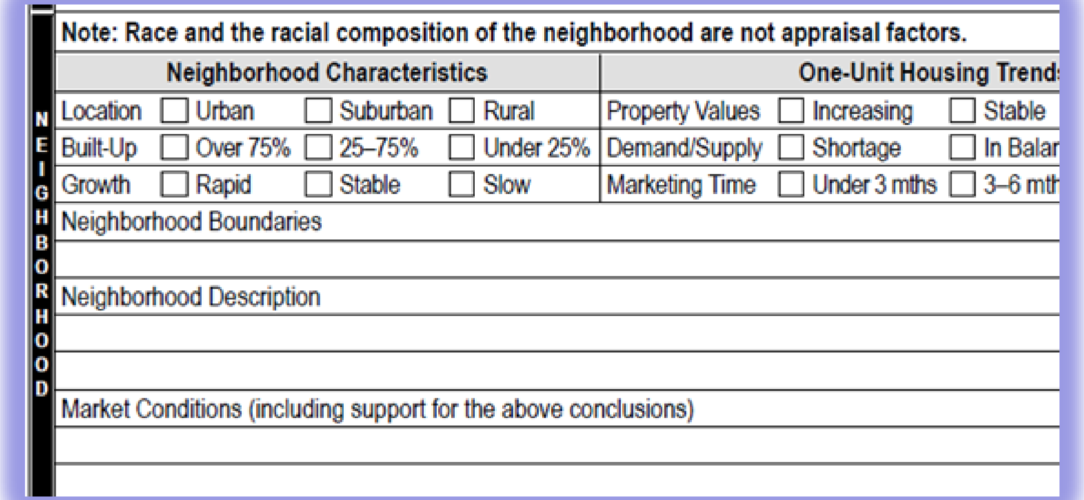
- The **Uniform Residential Appraisal Report** (URAR or appraisal report) captures these fields and enables this broad discretion



Overt statements may indicate the risk of discrimination

- **Overview**: "Overt statements" are statements that expressly reference a protected class and may indicate the risk of discrimination
- For example, the racial composition of the neighborhood is not relevant to the appraised value, so **references to racial demographics** may indicate the risk of discrimination
- Overt statements are more likely to occur in the **free form text** portions of the appraisal report, such as the **Neighborhood Description**

Appraisal Report – example of free form text:


NEIGHBORHOOD

Note: Race and the racial composition of the neighborhood are not appraisal factors.

Neighborhood Characteristics				One-Unit Housing Trends		
Location	☐ Urban	☐ Suburban	☐ Rural	Property Values	☐ Increasing	☐ Stable
Built-Up	☐ Over 75%	☐ 25–75%	☐ Under 25%	Demand/Supply	☐ Shortage	☐ In Balar
Growth	☐ Rapid	☐ Stable	☐ Slow	Marketing Time	☐ Under 3 mths	☐ 3–6 mth

Neighborhood Boundaries

Neighborhood Description

Market Conditions (including support for the above conclusions)

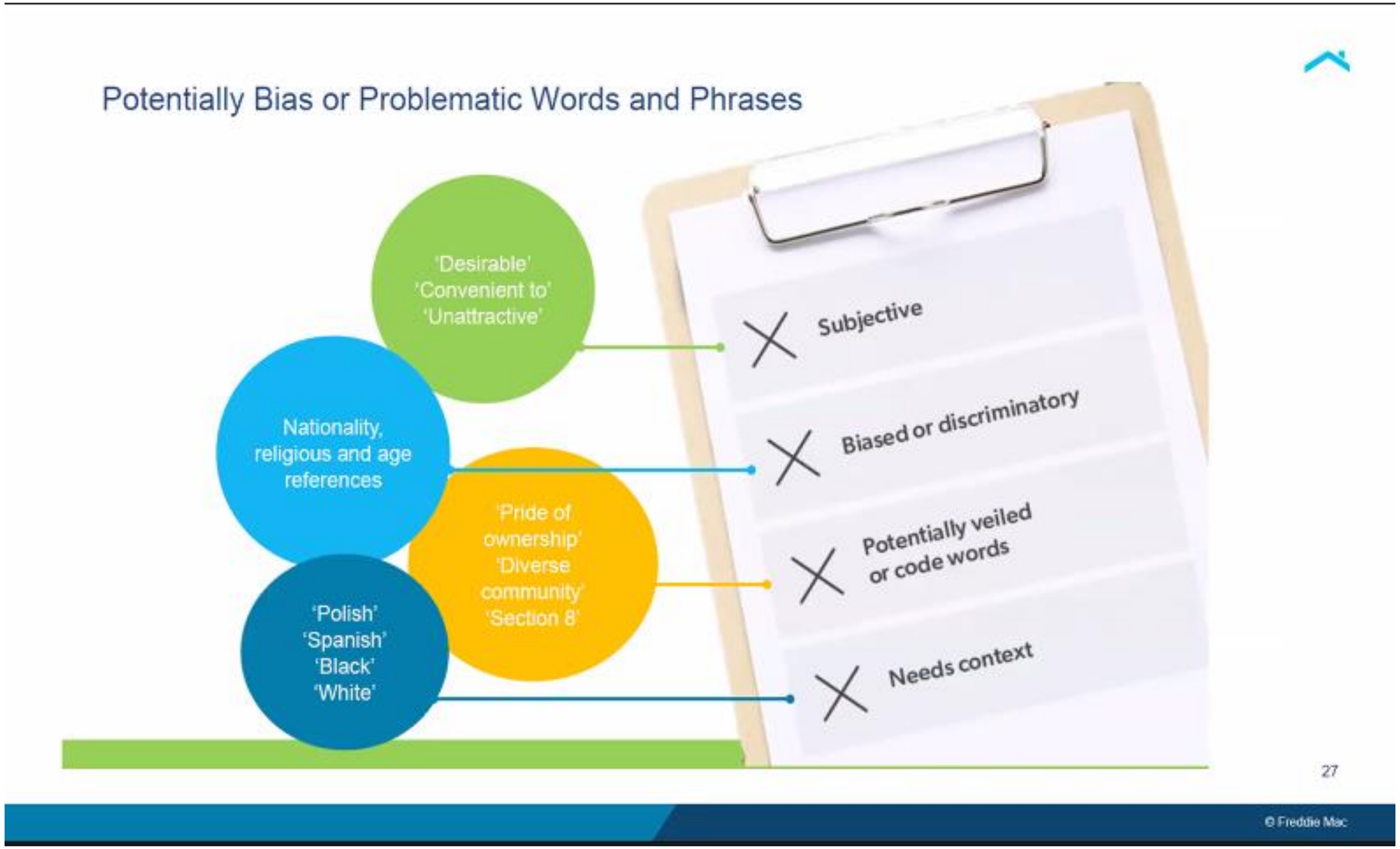
Overt Statements from FHFA Research:

- *"Storefronts supplying Jewish households"*
- *"Working-Class Black" neighborhood*
- *A neighborhood with "more Asian influence of late"*

Source: FHFA Blog, Reducing Valuation Bias by Addressing Appraiser and Property Valuation Commentary (Dec. 14, 2021)

Fannie Mae and Freddie Mac have provided guidance on words or phrases that increase risk

- **Standards**: Fannie Mae and Freddie Mac have provided guidance on **unacceptable appraisal practices**, including **words and phrases** that may signal the risk of discrimination
  - Some lenders or AMCs may have additional **overlays** of problematic words or phrases
- The GSEs and some lenders and AMCs have implemented **text scanning** to detect words or phrases that may indicate the risk of discrimination
  - Appraisals that contain these words or phrases can result in **warnings**, **declined appraisals**, or **referrals to state regulators**



Source: Section B4-1.1-04 of the Fannie Mae Single-Family Selling Guide (Fannie Mae Guide); Section 5603.4 of the Freddie Mac Single-Family Seller Service Guide (Freddie Mac Guide)

Fannie Mae examples show potentially discriminatory words or phrases that can increase risk

- **Examples**: To the right are examples of potentially discriminatory words or phrases that Fannie Mae found in appraisal reports
  - These examples focus on race and sexual orientation, but it would likely be problematic to include any prohibited bases words, phrases, or code words (race, color, national origin, religion, sex, age, familial status, marital status, disability, source of income)

- Vague or subjective words or phrases can also increase the risk that the appraisal is not credible and is infused with bias

Race

- *"While the neighborhood is still predominantly **African-American**, the area is undergoing a demographic shift as new homeowners (mostly **Caucasian**, **Asian** families)…are moving into the neighborhood"*

Sexual Orientation

- *"Many of the businesses in the arts and entertainment district are **LGBT-owned** and/or operated, and 'The Drive' has become a local, regional, and national destination for **LGBT** tourism"*

Source: Fannie Mae (May 2023)

The risk can be managed by…

Eliminating Words That Reference a Protected Class

- The appraiser should be aware of the **protected classes** under applicable federal, state, and local laws, and **eliminate** from the appraisal report any words or phrases that reference those protected classes

Using Objective Data and Analysis

- **Vague and subjective words** or phrases like "good," "desirable," and "pride of ownership" are ultimately not helpful in showing support for the opinion of value

- Instead, the appraiser can use more **precise and objective data and analysis**, such as the distance to amenities and data on mean selling prices and days on market

Subject property descriptions may indicate the risk of discrimination

- **Overview**: Many allegations of discrimination reference **incorrect descriptions** of the subject property
- These descriptions may raise concerns that the appraisal has **unexplained errors** or **departs from industry standards**, which may be evidence of discrimination
- The most important description is found on **page 2 of the appraisal report**, which indicates which features of the home were included as elements of comparison
- Generally, incorrect subject property descriptions fall into two categories:
    - 1) those based on **accuracy** (e.g., actual age, room count, gross living area), and
    - 2) those based on **discretion** (e.g., Quality Rating, Condition Rating, improvements)

Uniform Residential Appraisal Report

There are comparable properties currently offered for sale in the subject neighborhood ranging in price from $

There are comparable sales in the subject neighborhood within the past twelve months ranging in sale price from $

FEATURE	SUBJECT	COMPARABLE SALE # 1		COMPARABLE SALE # 2	
Address					
Proximity to Subject					
Sale Price	$		$		$
Sale Price/Gross Liv. Area	$ sq. ft.	$ sq. ft.		$ sq. ft.	
Data Source(s)					
Verification Source(s)					
VALUE ADJUSTMENTS	DESCRIPTION	DESCRIPTION	+(-) $ Adjustment	DESCRIPTION	+(-) $ Adjustment
Sale or Financing Concessions					
Date of Sale/Time					
Location					
Leasehold/Fee Simple					
Site					
View					
Design (Style)					
Quality of Construction					
Actual Age					
Condition					
Above Grade Room Count	Total Bdrms. Baths	Total Bdrms. Baths		Total Bdrms. Baths	
Gross Living Area	sq. ft.	sq. ft.		sq. ft.	
Basement & Finished Rooms Below Grade					
Functional Utility					
Heating/Cooling					
Energy Efficient Items					
Garage/Carport					
Porch/Patio/Deck					

SALES COMPARI

Fannie Mae and Freddie Mac have provided guidance on the subject property description

Accuracy: elements of the subject property that generally only have one right answer

- **Fannie Mae:** Prohibits misrepresentation of the physical characteristics of the subject property or improvements
- **Freddie Mac**: Prohibits the inclusion of inaccurate or incomplete data about the subject property in the appraisal analysis

Discretion: elements of the subject property that generally are more subjective and rely on judgment

- **Quality and Condition Ratings**: the appraisal report must rate the property on a scale of Q1 (best) to Q6 (not eligible for sale) for quality of construction and C1 (best) to C6 (not eligible for sale) for condition
- **Improvements**: the appraisal report must contain an accurate description of the improvements and describe any factors that may affect the market value

Source: Accuracy - Section B4-1.1-04 of the Fannie Mae Guide; Section 5603.4 of the Freddie Mac Guide; Quality and Condition Ratings - Section B4-1.3-06 of the Fannie Mae Guide and Section 5605.5 of the Freddie Mac Guide; Improvements: Section B4-1.3-06 of the Fannie Mae Guide and Section 5605.5 of the Freddie Mac Guide

Fannie Mae and case examples show how the description of the subject property can increase risk

Accuracy: Gross Living Area

- In a predominately White suburb in Connecticut, a Black doctor and White attorney applied for a refinancing and received an appraisal of **$780,000**
- After whitewashing the home, the second appraisal came in at **$1.2 million**
- Among other things, the first appraisal left out about **900 square feet of living area**
- The homeowners alleged that even if the first appraisal's low price per square foot was accepted, the valuation would have **increased by $130,500** by including the omitted square footage

Discretion: Condition Rating

(this issue is not based on race, but shows the risk of inconsistent outcomes)

Inaccurate Condition Ratings

CU contains MLS photos that can be used to validate quality and condition ratings. The appraiser rated the subject condition as C5, but based on photos (kitchen examples below), a higher rating is warranted. The appraiser made a $37k downward adjustment to the comparable, but side by side comparison of the photos in CU shows that the two are equal condition and no adjustment is warranted. Inaccurate condition ratings resulted in inappropriate condition adjustments for all comparables used in the report.

Subject Property

Appraisal Comparable Sale

An Hour with Fannie Mae | September 2022

Source: [Bailey v Santander](), Case No. 3:2023cv00129 (D. Conn. Complaint filed Feb. 1, 2023)

The risk can be managed by…

Accuracy: Reviewing Public Sources & Conducting Error Reviews

- To minimize the occurrence of incorrect subject property descriptions based on inaccuracies, the appraiser can review public sources, such as tax assessments, MLS listings, and online estimates
- The appraiser can conduct error reviews to look for inconsistencies

Discretion: Developing Checklists and Conducting Audits

- The appraiser can develop checklists of common improvements for that market or common property elements that result in certain Quality or Condition Ratings
- To ensure consistent treatment across all neighborhoods, the appraiser can pull a random sample of appraisal reports to audit them for any unexplained differences
- If there are unexplained differences in treatment, the appraiser can revise the checklists to improve the quality and consistency of the ratings

Appraisal Report – Comparable Sales

The comparable sales may indicate the risk of discrimination

- **Overview**: In the sales comparison approach, the appraised value of the subject property is based on comparing the subject property to other "comparable" properties in the area

- The selection of comparable sales is the **most significant risk factor** because it is the center of the sales comparison approach and provides the appraiser with **broad discretion** to determine which properties are defined as "comparable" to the subject property

- At the right is a graphic of the appraisal report showing the **comparable sales sections** that are commonly subject to errors that may indicate the risk of discrimination:
  - **Neighborhood and proximity to subject**
  - **Time of sale and condition of sale**
  - **Elements of comparison (e.g., room count, improvements, etc.)**

Uniform Residential Appraisal Report File #

There are comparable properties currently offered for sale in the subject neighborhood ranging in price from $ to $.

There are comparable sales in the subject neighborhood within the past twelve months ranging in sale price from $ to $.

FEATURE	SUBJECT	COMPARABLE SALE # 1		COMPARABLE SALE # 2		COMPARABLE SALE # 3	
Address							
Proximity to Subject							
Sale Price	$		$		$		$
Sale Price/Gross Liv. Area	$ sq. ft.	$ sq. ft.		$ sq. ft.		$ sq. ft.	
Data Source(s)							
Verification Source(s)							
VALUE ADJUSTMENTS	DESCRIPTION	DESCRIPTION	+(-) $ Adjustment	DESCRIPTION	+(-) $ Adjustment	DESCRIPTION	+(-) $ Adjustment
Sale or Financing Concessions							
Date of Sale/Time							
Location							
Leasehold/Fee Simple							
Site							
View							
Design (Style)							
Quality of Construction							
Actual Age							
Condition							
Above Grade Room Count	Total Bdrms. Baths	Total Bdrms. Baths		Total Bdrms. Baths		Total Bdrms. Baths	
Gross Living Area	sq. ft.	sq. ft.		sq. ft.		sq. ft.	
Basement & Finished Rooms Below Grade							
Functional Utility							
Heating/Cooling							
Energy Efficient Items							
Garage/Carport							
Porch/Patio/Deck							

Fannie Mae and Freddie Mac have provided guidance related to comparable sales

Fannie Mae prohibits:

- Misrepresentation of the **physical characteristics** of the comparable sales
- Selection and use of **inappropriate** comparable sales
- Failure to use comparable sales that are the most **locationally and physically similar** to the subject property
- Failure to **personally inspect** the exterior of the comparable property when required by the scope of work in the appraisal report

Freddie Mac prohibits:

- Inclusion of **inaccurate or incomplete data** about the neighborhood or any comparable sale used in the appraisal analysis
- Consideration of the **age or location of a dwelling** or the age of the **neighborhood** or census tract where the dwelling is located in a manner that has a discriminatory effect
- Reliance in any appraisal analysis on **inappropriate comparable sales**
- Failure to use comparable sales that are **more similar to or nearer to** the subject property without adequate explanation
- Reliance in the appraisal analysis on comparable sales that were **not personally inspected**, which requires at least a visual inspection by the appraiser of the exterior of the comparable property

Source: Section B4-1.1-04 of the Fannie Mae Guide, Section 5603.4 of the Freddie Mac Guide

Case examples show how discretion in selecting the neighborhood and proximity to the subject can increase risk

- **Cases** often allege that comps were selected based on the race of the homeowner rather than the comps that were the most **locationally and physically similar** to the subject property

- **Case #1**: A Black couple in Maryland received an initial appraisal of **$472,000**, and then received a second appraisal of **$750,000 after whitewashing** the home. The map at right shows that the first appraisal selected two comps (labeled as L2 and L4) that were in **majority-Black census tracts**, one of which was outside the neighborhood. By contrast, the second appraisal used comps (labeled as D1-D5) within the neighborhood and **not directed to majority-Black census tracts**.

- **Case #2**: An appraisal for a Black duplex owner in Oakland, California selected comps that were locationally farther and in a **predominately Black neighborhood**; that appraisal came in at **$800,000**. A second appraisal selected comps from a **radius around the subject property** and came in at **$1,239,000**.

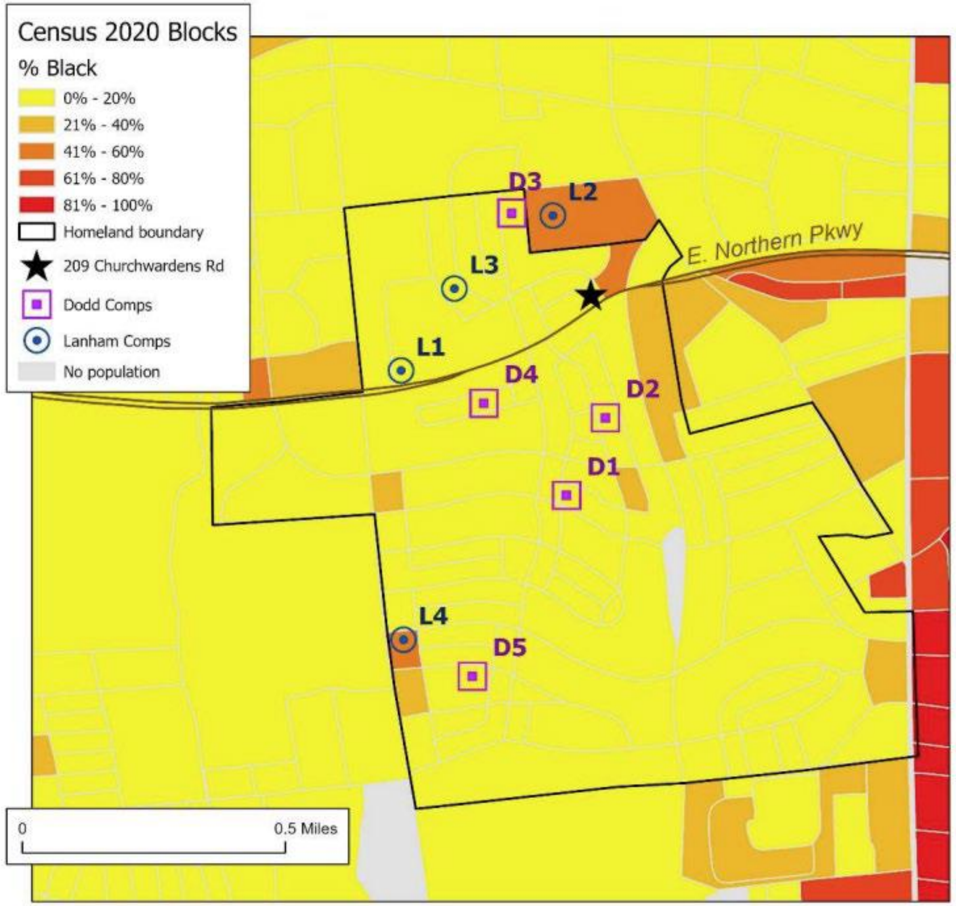


Figure 4: Comparison of Lanham's Comps and Dodd's Comps

Source: Connolly v Lanham, Case No. 1:22-cv-02048-BPG (D.Md. Complaint filed Aug. 15, 2022); Cora Robinson and Fair Housing Advocates of Northern California, HUD Complaint filed July 21, 2021

Discretion in selecting the time and condition of sale can increase risk

Appraisal Report: Time of Sale

VALUE ADJUSTMENTS	DESCRIPTION	DESCRIPTION	+(-) $ Adjustment
Sales or Financing Concessions		ArmLth Conv;8500	
Date of Sale/Time		s07/19;c06/19	

Time of Sale

- The Fannie Mae and Freddie Mac Guides state that the appraisal report generally should use comparable sales that have been closed within the **last 12 months**
- A 2021 appraisal for a mixed-race couple living in a predominately White suburb in Connecticut selected comps that sold **prior to the pandemic housing market boom**, even though other comps closer in time were available

Appraisal Report: Condition of Sale

VALUE ADJUSTMENTS	DESCRIPTION	DESCRIPTION	+(-) $ Adjustment
Sales or Financing Concessions		ArmLth Conv;8500	

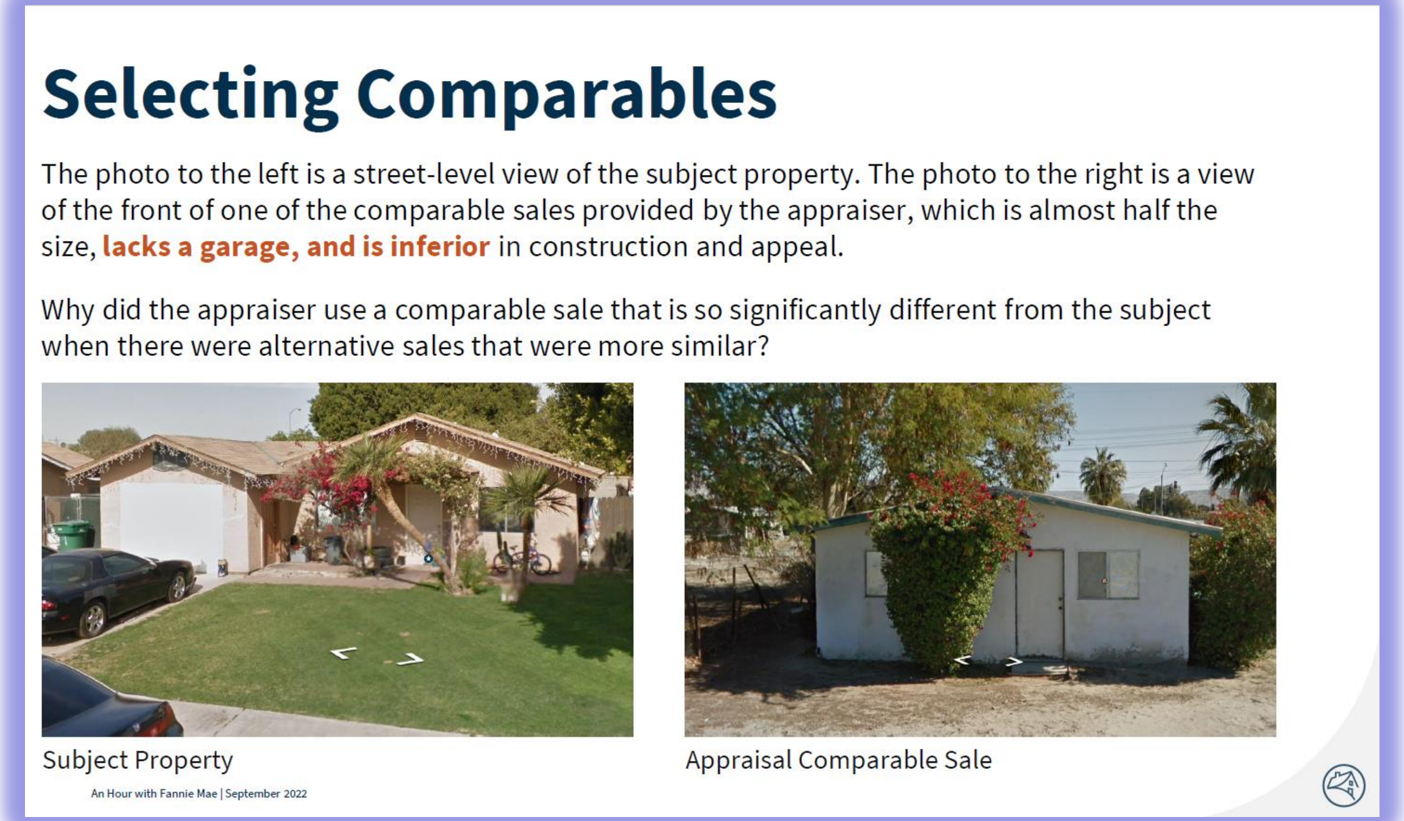
Condition of Sale

- Generally, the appraisal report should use **arms-length transactions**, commonly abbreviated as “ArmLth”
- However, the appraiser has the discretion to use other types of transactions, such as **foreclosure sales or short sales**
- In those cases, there should be an appropriate **value adjustment** to reflect the atypical condition of sale

Source: Section B4-1.3-08 of the Fannie Mae Guide and Section 5605.6 of the Freddie Mac Guide; *Bailey v. Santander*

Fannie Mae and case examples show how discretion in the elements of comparison can increase risk

- **Fannie Mae Guide**: "Comparable sales should have **similar physical and legal characteristics** when compared to the subject property. These characteristics include, but are not limited to, site, room count, gross living area, style, and condition."
- **Fannie Mae Example** (not based on race): In the example at right, one of the comps appeared to be **significantly different and inferior** to the subject property, which increased the risk of **undervaluation**
- **Case Example**: An appraisal for a Black/Latina couple came in at **$1,154,000**. A few months later, a second appraisal came in at only **$900,000** and was based on comps with **boarded-up windows**, a **caved-in garage**, and a roof with **bricks to hold down the shingles**



Source: Section B4-1.3-08 of the Fannie Mae Guide; Julian Glover, [Our America: Lowballed](), ABC (Oct. 2022)

The risk can be managed by…

Developing Checklists

- The appraiser can develop **checklists, policies, and procedures** to provide more **consistency** in the common issue areas, including neighborhood and proximity, condition of sale, time of sale, and elements of comparison

Documenting Decisions

- The appraiser can carefully **document** why certain selections were made, particularly if they relate to the **common issue areas**, including neighborhood and proximity, condition of sale, time of sale, and elements of comparison
- Documentation is especially important when there is a **departure** from standard practice
- In the event of an allegation of discrimination, the appraiser will need to show a **legitimate, non-discriminatory reason** for a decision that otherwise may appear to be different treatment on a prohibited basis

Conducting Audits

- To ensure **consistent treatment** across all consumers and communities, the appraiser can pull a **random sample** of appraisal reports to audit them for any unexplained differences
- Among other things, the appraiser can **plot the comps on maps** that show the race or ethnicity of census tracts to look for any patterns that appear to be based on the race or ethnicity of the borrower or neighborhood

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The value adjustments can indicate the risk of discrimination

- **Overview**: Under the sales comparison approach, the appraisal report should show adjustments for each subject property element that is **different** from the comp AND that the market (or typical buyer) would consider **important** to the value of the home
- The **example** at right shows some typical adjustments in absolute dollars:
  - Addition of $4320 because the subject property's above-grade gross living area is better than the comp;
  - Subtraction of $5,000 because the subject property's kitchen is not as good as the comp's kitchen;
  - A net adjustment of -$680 (-$5000 + $4320); and
  - A final adjusted sale price of $1,003,320 (original sale price of $1,004,000 - $680)
- Generally, errors in the adjustments fall into two categories: **inaccuracies** in the math and **discretion**

SALES COMPARISON APPROACH

VALUE ADJUSTMENTS	DESCRIPTION	DESCRIPTION	+(-) $ Adjustment	DESCRIPTION	+(-) $ Adjustment	
Sales or Financing Concessions		ArmLth Conv;8500		ArmLth Conv;0		Ar Ca
Date of Sale/Time		s07/19;c06/19		s09/19;c08/19		s0
Location	N;Res;	N;Res;		N;Res;		N;
Leasehold/Fee Simple	Fee Simple	Fee Simple		Fee Simple		Fe
Site	1465 sf	1458 sf	0	1020 sf	0	14
View	N;Res;	N;Res;		N;Res;		N;
Design (Style)	AT4;Intr-Town	AT4;Intr-Town		AT4;Intr-Town		AT
Quaity of Construction	Q3	Q3		Q3		Q
Actual Age	21	21		14	0	21
Condition	C3	C3		C3		C
Above Grade Room Count	Total 8, Bdrms. 3, Baths 3.1	Total 8, Bdrms. 3, Baths 3.1		Total 8, Bdrms. 3, Baths 3.1		To
Gross Living Area	2,108 sq.ft.	2,136 sq.ft.	0	2,012 sq.ft.	+4,320	
Basement & Finished Rooms Below Grade	0sf	0sf		0sf		0s
Functional Utility	Adequate	Adequate		Adequate		Ac
Heating/Cooling	FWA/CAC	FWA/CAC		FWA/CAC		FV
Energy Efficient Items	Insulated Wnds	Insulated Wnds		Insulated Wnds		In
Garage/Carport	2gbi2dw	2gbi2dw		2gbi2dw		2g
Porch/Patio/Deck	Deck	Deck		Deck		De
Fireplaces	1 Fireplace	1 Fireplace		1 Fireplace		1
Upgrds/Updts/Rnvts	Average	Supr Kit,Ls Flm	0	Supr Kit Updts	-5,000	Su
Net Adjustment (Total)		☐ + ☐ -	$ 0	☐ + ☒ -	$ -680	
Adjusted Sale Price of Comparables		Net Adj. 0.0 % Gross Adj. 0.0 %	$ 945,000	Net Adj. 0.1 % Gross Adj. 0.9 %	$ 1,003,320	Net Gro

Fannie Mae and Freddie Mac have provided guidance related to adjustments

Fannie Mae prohibits:

- Use of adjustments to comparable sales that do not reflect market reaction to the differences between the subject property and the comparable sales
- Not supporting adjustments in the sales comparison approach
- Failure to make adjustments when they are clearly indicated

Freddie Mac prohibits:

- Use of inordinate adjustments for differences between the subject property and the comparable sales that do not reflect the market's reaction to such differences
- The failure to make proper adjustments when they are clearly necessary

Source: Sections B4-1.1-04 and B4-1.3-09 of the Fannie Mae Guide; Sections 5603.4 and 5605.6 of the Freddie Mac Guide

Case examples show how discretion in the adjustments can increase risk

#1: Elements of Comparison

- An appraisal for a Black couple in a predominately White suburb in Maryland made **downward adjustments** to the sales prices of the comps and failed to make appropriate **upward adjustments** to reflect features that were in the subject property
- A **second appraisal** provided **smaller** downward adjustments and up to **double** the amount of upward adjustments

#2: Quality Ratings

- An appraisal for a mixed-race couple living in a predominately White suburb in Connecticut applied value adjustments **inconsistently**
- For instance, three of the comps were assigned a Q2 rating and had value adjustments of **10%**
- By contrast, another Q2 comp had an adjustment of **20%**

#3: Neighborhoods

- An appraisal for a Black couple living in a majority-Black census tract in a predominately White county in California selected three **comps from outside of the majority-Black census tract**
- When evaluating these comps, the appraisal made **downward adjustments of 25%** less per square foot allegedly based on historical data plus an unexplained additional **28%** reduction

Source: *Connolly v. Lanham; Bailey v. Santander; Austin v. Miller*

The risk can be managed by…

Accuracy: Conducting Error Reviews

- The appraiser can check for **adjustment errors**, such as:
  - **Subtracting** an amount that should instead be added and vice versa
  - Using **different amounts** for the same feature
  - Calculating the **price per square foot**
  - **Totaling** the adjustments
  - **Adding** the total adjustment to the original sale price

Discretion: Developing Checklists, Documenting Decisions, Conducting Audits

- The appraiser can develop **checklists, policies, and procedures** to provide more **consistency**
- The appraiser can carefully **document** why certain selections were made, particularly when there is a **departure** from standard practice
- To ensure **consistent treatment** across all consumers and communities, the appraiser can pull a **random sample** of appraisal reports to audit them for any unexplained differences

The reconciliation can indicate the risk of discrimination

- **Overview**: The appraiser must **reconcile** the adjusted comp values to determine the final opinion of value, which should not be based on an average but rather the relative **relevance** of each comparable
- **Standards**: Fannie Mae and Freddie Mac guidance prohibit reporting an opinion of market value that is **not supportable** by market data or is misleading
- **Example**: While there are no cases directly on point, the guidance suggests the following **risks**:
  - Whether there is a sufficient number of comps to develop an opinion of value
  - Which comps should be given the most weight
  - How to document the reasoning for the final opinion of value
- **Risk mitigation**: The risk can be mitigated by conducting error reviews, developing checklists, documenting decisions, and conducting audits

Effective Date of Data Source(s)

Analysis of prior sale or transfer history of the subject property and comparable sales

Summary of Sales Comparison Approach

Indicated Value by Sales Comparison Approach $

RECONCILIATION

Indicated Value by: Sales Comparison Approach $ Cost Approach (if developed) $ Income Approach (if developed) $

This appraisal is made ☐ "as is", ☐ subject to completion per plans and specifications on the basis of a hypothetical condition that the improvements have been completed, ☐ subject to the following repairs or alterations on the basis of a hypothetical condition that the repairs or alterations have been completed, or ☐ subject to the following required inspection based on the extraordinary assumption that the condition or deficiency does not require alteration or repair:

Based on a complete visual inspection of the interior and exterior areas of the subject property, defined scope of work, statement of assumptions and limiting conditions, and appraiser's certification, my (our) opinion of the market value, as defined, of the real property that is the subject of this report is $, as of , which is the date of inspection and the effective date of this appraisal.

Freddie Mac Form 70 March 2005 Page 2 of 6 Fannie Mae Form 1004 March 2005

Source: Sections B4-1.1-04, B4-1.1-02, B4-1.3-01, B4-1.3-09, B4-1.3-11 of the Fannie Mae Guide; Sections 5603.4, 5605.7 of the Freddie Mac Guide

4 | Business Processes

The consumer interaction can indicate the risk of discrimination

- **Overview**: There are at least two categories of risks in the business process: 1) the consumer interaction and 2) a request for a reconsideration of value
- Differences in **consumer interactions** have long been viewed as evidence of discrimination
- For example, in 2020, Newsday published the results of a three-year fair housing testing investigation showing **widespread evidence of unequal treatment** by New York real estate agents during the initial consumer interaction, including:
  - Making **inappropriate statements** based on race
  - Refusing to provide **services** to testers of color
  - Withholding **information** from testers of color
  - Providing more or better **service** to White testers
  - Imposing **higher requirements** on borrowers of color, such as requiring a prequalification letter or a form of identification
- Some of the real estate agents lost their license as a result of the investigation

Source: Ann Choi et al., *Long Island Divided*, Newsday (Nov. 17, 2019)

Case examples show how the consumer interaction can increase risk

#1: Communication

- A 2022 appraisal discrimination **investigation** by a nonprofit alleged that the biggest differences occurred in customer service
- For example, the nonprofit filed a complaint with HUD alleging that the appraiser **did not return** the Black tester's call and took **75 days** to complete the report
- By contrast the same appraiser **proactively reached out** to the White tester and took **only 17 days** to complete the report

#2: Service Time

- An appraisal discrimination complaint by a mixed-race couple living in a predominately White suburb in Connecticut noted that the appraiser spent **only about 10 minutes** on the property

#3: Consumer Treatment

- An appraisal discrimination complaint by a Black couple living in a predominately White suburb in Maryland noted that the appraiser was **"indifferent and aloof," did not smile**, **did not make eye contact**

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Source: National Community Reinvestment Coalition, Faulty Foundations (Oct. 2022); *Bailey v. Santander; Connolly v. Lanham*

The risk can be managed by…

Following Consistent Processes

- The appraiser can develop and follow consistent processes for consumer interactions, including:
  - Responses to consumer communications and information requests
  - Appraisal report processing times

Avoiding Assumptions

- The appraiser should avoid:
  - Assumptions or differences in treatment based on a consumer's race, ethnicity, religion, or other protected class
  - Perceptions based on the consumer's name, language, or accent
  - Inappropriate comments during the property visit or other interactions

The Reconsideration of Value (ROV) can indicate the risk of discrimination

After the appraisal report is complete, there are several ways in which concerns can be raised about the appraised value

ROV

- The consumer can ask the lender to ask the same appraiser to reconsider the opinion of value
- Typically, the consumer will submit information, such as comparable sales that were available at the time of the appraisal but were not used in the appraisal report

2nd Appraisal

- The consumer can ask the lender to request a second appraisal from a different appraiser
- This is more likely to occur if the consumer believes that the first appraisal was impacted by bias or discrimination

Complaint

- The consumer can submit a complaint to the lender, without a specific request for an ROV or second appraisal
- This is more likely to occur if the consumer does not feel there is time for an ROV or second appraisal

Lender Review

- Most lenders conduct their own collateral risk reviews and will contact the appraiser directly if they are concerned about possible irregularities in the appraisal

The CFPB and DOJ have opined that the Appraiser Independence Rule is not a defense

Source: *Connolly v. Lanham*, DOJ/CFPB Statement of Interest (March 13, 2023)

The federal financial regulators, HUD, and Fannie Mae have provided guidance regarding the Reconsideration of Value

Most guidance is directed to the lender, but the appraiser should be familiar with the guidance to improve their business processes and better serve their lender clients and consumers

Regulators

- Financial institutions may consider developing risk-based ROV-related policies, procedures, control systems, and complaint processes that identify, address, and mitigate the risk of deficient valuations, including valuations that involve prohibited discrimination
- E.g., Establish standardized processes to increase the consistency of consideration of requests for ROVs and 2nd appraisals

HUD-FHA

- If the lender requests an ROV, the appraiser must review all appropriate property and market data that was relevant on the appraisal date and summarize the analysis
- The lender may order a second appraisal by a different appraiser if the lender determines that the first appraisal is materially deficient and the first appraiser is unable or uncooperative in resolving the deficiency

Fannie Mae

- If the lender considers the appraisal deficient, the lender can return the appraisal report to the appraiser
- If the lender is unable to obtain an adequately revised appraisal, a desk or field review may be obtained
- The lender may forego either type of review and obtain a new appraisal

Source: Section B4-1.3-12 of the Fannie Mae Guide; Federal Financial Regulators ROV Proposal (June 8, 2023); HUD-FHA ROV Proposal (Jan. 12, 2023)

Case examples shows how the ROV process can increase risk

#1: ROV Process

- After a complaint from a Black homeowner in Illinois, a bank granted the **request for an ROV,** but found the appraisal credible and therefore denied the request for a **second appraisal**
- Under the HUD Conciliation Agreement (the bank denied official wrongdoing), the bank agreed to:
  - Provide the homeowner with **$50,000** in relief
  - Review the bank's **ROV process** to ensure that customers are **appropriately informed** about their ability to raise concerns
  - Providing additional **training to staff** on appraisal-related fair lending issues and the ROV process
- The bank offers a second appraisal free of charge if there is indicia of discrimination

#2: ROV Process

- A Black couple in Maryland alleged violations of fair lending laws when, among other things, the lender **failed to explain its ROV process** and **imposed an arbitrary and short deadline** for an appeal while the wife was undergoing treatment for cancer

#3: 2nd Appraisal

- A mixed-race couple in Connecticut alleged violations of fair lending laws when, among other things, the lender forwarded their concerns about discrimination in the appraisal to the original appraiser **rather than ordering a second appraisal**

Source: In re JPMorgan Chase, HUD Conciliation Agreement (March 2021); *Connolly v. Lanham; Bailey v. Santander*

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Business Process – Reconsideration of Value

The risk can be managed by…

Carefully Evaluating the ROV Request

- The appraiser can carefully evaluate the request for an ROV, take the time to review the appraisal report for any errors, and thoughtfully consider any new information provided

Documenting the Reasoning

- The appraiser can document the reasoning for revising or maintaining the opinion of value
- The appraiser can use plain language so anyone reviewing the appraisal report can easily understand how the valuation was developed and why certain information was or was not included

5 | Compliance Management Systems

The Compliance Management System (CMS) can indicate the risk of discrimination

- **Overview**: The federal financial regulators and enforcement agencies have long made clear that a weak Compliance Management System (CMS) can be considered an indicator of increased fair lending risk

- **Standards**: The federal financial regulators have defined the key elements of an appropriate CMS as:
  - Board and senior management oversight
  - Policies and procedures
  - Training program
  - Consumer complaints
  - Audits and monitoring

- Third Party Risk Management: The federal financial regulators have made clear that a lender remains responsible for its own CMS as well as the CMS of its third-party vendors, such as the appraiser and AMC

Source: FFIEC, *Uniform Interagency Consumer Compliance Rating System* (2016); FFIEC, *Statement on Examination Principles related to Valuation Discrimination and Bias in Residential Lending* (2024)

Compliance Management System

Best practices: board and senior management oversight

Oversight and Commitment

- Do the board and management (or senior leadership) provide satisfactory oversight of the CMS?
- For example, do the board and management show a commitment to preventing appraisal discrimination?
- Are the compliance resources adequate? Is staff generally able to ensure compliance?
- For example, have the board and management ensured that staff have the resources and ability to identify and prevent appraisal discrimination?

Change Management

- Does management respond in a timely and adequate manner to changes in applicable law and guidance, products, services, and market conditions?
- Does management evaluate products changes before implementation?

Risk Identification and Management

- Does management comprehend and adequately identify compliance risks, including emerging risks in the products and services?
- For example, does management stay informed about appraisal discrimination cases and related lessons learned?
- Does management adequately manage those risks, including through self-assessments?
- Does management adequately respond to and correct deficiencies and/or violations, including adequate remediation, in the normal course of business?

Best practices: policies and procedures

- Are compliance policies and procedures adequate to manage compliance risks?
- For example, does the firm have policies and procedures to ensure that inappropriate words and phrases are not included in the appraisal report?
- For example, does the firm have policies and procedures to ensure consistent treatment and minimize the risk of discretion in developing the opinion of value?

Best practices: fair housing training

- Is compliance training provided in an adequate and timely manner for appropriate staff?
- For example, is comprehensive and accurate fair housing training developed and approved by fair housing experts?
- Is the compliance training updated periodically to address changes in applicable law and guidance, products, services, and market conditions?

Best practices: consumer complaints

- Does the firm have adequate processes and procedures for tracking and addressing consumer complaints?
- For example, has the firm implemented processes and procedures regarding fair and appropriate responses to the Reconsideration of Value?
- Are consumer complaint investigations and responses prompt and thorough?
- Does management adequately monitor consumer complaints and respond to issues identified?
- For example, if an appraisal report includes inappropriate words or phrases, are the policies and procedures updated and staff provided with appropriate training and tiered consequences, such as training, suspension, or termination?

Best practices: audits and monitoring

- Are compliance monitoring practices, management information systems, reporting, compliance audit, statistical analyses, and internal control systems adequate to address compliance risks?
- For example, to minimize the risk of discretion, does the appraisal firm periodically audit samples of appraisal reports to ensure consistency across consumers and communities for the descriptions of the subject property, selection of comparable sales, value adjustments, and reconciliation?
- For example, if monitoring reveals potential bias or discrimination in appraisals, does the CMS provide for:
  - Changes in policies to minimize risk;
  - Tiered consequences for staff including training, suspension, or termination; and
  - Remediation for harmed consumers?

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6 | Statistical Analysis

Statistical Analysis

The statistical analysis can indicate the risk of discrimination

- **Overview**: Unexplained statistical disparities have long been viewed as indicators of the risk of discrimination
- For example, in the 1992 case of *Steptoe v. Savings of America* (excerpt at right), the court found that the plaintiffs had established an initial case of appraisal discrimination in part because the statistical analysis suggested different treatment based on the racial composition of the neighborhood
- There will always be some adverse outcomes in real estate transactions, but there can be a problem when there are unexplained differences in the frequency or amount of the adverse outcomes on a prohibited basis (such as race or national origin)

> and sold for $ 115,000 less than one month after Morgan ordered **[**12]** Clunk to redo his appraisal. [7] William Fall, whom plaintiffs have submitted as an expert appraiser, has sworn that both SOA's and DeCant's appraisals were defective. Plaintiffs' statistical analysis of SOA's lending patterns in the Old West End as compared to Perrysburg, Ohio, a predominantly white suburb of Toledo, supports their position. Taking all of the above into consideration, plaintiffs have certainly made out a *prima facie* case that SOA's conduct had, at the very least, a racially discriminatory effect on the Steptoes and, possibly, all other potential borrowers who wished to purchase homes in the Old West End.

Source: *Steptoe v. Savings of America*, 800 F.Supp. 1542 (N.D. Ohio 1992)

A DOJ case can demonstrate the use of statistical analysis to allege discrimination

United States v. Countrywide

Risk Factors

***Discretion** ***Weak CMS**

Mortgage Loans Originated by Third Party Mortgage Brokers

(non-subprime)

Adverse Outcome: Higher Prices (unrelated to risk)

White Borrowers

Black Borrowers

Latino Borrowers

Statistically Significant Disparities

- Black and Latino borrowers charged higher interest rates and fees than White borrowers (unrelated to risk)
- 59-67 bps more for Black borrowers than White borrowers
- 31-47 bps more for Latino borrowers than White borrowers

Practically Significant Disparities

- Example: average borrower borrowing $200,000 in Chicago
  - $1235 more for Black borrowers than White borrowers
  - $1100 more for Latino borrowers than White borrowers

Source: *United States v. Countrywide Financial Corp. et al.,* Civ. No. CV11-10540-PSG (C.D. Cal. Complaint filed Dec. 21, 2011)

Statistical Analysis

A hypothetical based on Freddie Mac's appraisal research can demonstrate the risk of discrimination

Risk Factors

*Discretion *Weak CMS

Appraisals for Purchase Loans

(GSE/Lender/AMC/Appraisal)

Adverse Outcome: Appraisal Below Contract Price

White Community: 7.4%

Black Community: 12.5%

Latino Community: 15.4%

Statistically Significant Disparities

- Appraisal more likely to come in below contract price in communities of color
- Disparity of 5.2 percentage points between Black and White communities, 8.0 percentage points between Latino and White communities
- Disparity increased and %Black/Latino increased

Practically Significant Disparities

- Possible loss of homeownership opportunity for purchaser and/or loss of equity for seller
- Freddie Mac re community impact: "If houses in minority neighborhoods are more likely to be appraised below the contract price, they are more likely to be transacted at a lower price, thus becoming comps with lower prices in future house sales." [similar to redlining]

Source: Freddie Mac, *Racial and Ethnic Valuation Gaps in Home Purchase Appraisals* (2021)

A hypothetical based on FHFA's appraisal research can demonstrate the risk of discrimination

Risk Factors

*Discretion *Weak CMS

Appraisals for Purchase Loans

(GSE/Lender/AMC/Appraisal)

Adverse Outcome: Use of Time Adjustments

White Community: 67%

Black Community: 45%

Latino Community: 53%

Statistically Significant Disparities

- In communities of color, time adjustments were used less and were less likely to result in appraised value reaching contract price
- Disparity of 22 percentage points less for Black communities v. White communities, 14 percentage points less for Latino communities v. White communities

Practically Significant Disparities

- FHFA: "[T]ime adjustments could make the difference between an appraisal that allows a home purchase to move forward and one that does not." [similar to underwriting disparities]

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Source: FHFA, *Underappraisal Disparities and Time Adjustments* (2024)

A hypothetical based on Fannie Mae's appraisal research can demonstrate the risk of discrimination

Risk Factors

*Discretion *Weak CMS

Appraisals for Refinancings

(GSE/Lender/AMC/Appraisal)

Adverse Outcome:

Variance from AVM in majority-Black communities

Statistically Significant Disparities

- When compared to the AVM value, White-owned homes in majority-Black communities were overvalued in the appraisal by 10 percentage points more frequently than the Black-owned homes
- Some differences between appraisals and AVMs should be expected, but the differences should be similar across demographic groups

Practically Significant Disparities

- For the White-owned homes, the appraiser relied on comparable sales from outside of the subject property's immediate area (in the majority-Black community) even though potentially more appropriate comparable properties were available closer to the subject property

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Source: Fannie Mae, *Appraising the Appraisal* (2022)

The risk can be managed by…

Conducting Error Reviews

Documenting Decisions

Developing Checklists

Auditing and Monitoring

Risk factors

- Higher valuations
- Appraisal report
- Business processes
- Compliance Management System
- Statistical analysis

Risk management

- Leadership oversight
- Policies & procedures
  - Words & phrases
  - Public source review
  - Increase consistency: error reviews, checklists, documentation
- Fair housing training by fair housing experts
- Complaint/ROV process & tracking
- Audit & monitoring

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The National Fair Housing Alliance

The National Fair Housing Alliance® leads the fair housing movement. NFHA™ works to eliminate housing discrimination and ensure equitable housing opportunities for all people and communities.

- Education and outreach
- Member services
- Public policy & advocacy
- Housing and community development
- Tech equity
- Enforcement
- Consulting and compliance programs

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