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Written Testimony of Craig Steinley, MAI, SRA, AI-GRS, AI-RRS

2023 President of the Appraisal Institute

Before the Appraisal Subcommittee Public Hearing on Appraisal Bias

January 24, 2023

Chair Martinez and Members of the Board of the Appraisal Subcommittee (ASC), thank you for the opportunity to testify at today's public hearing on appraisal bias. On behalf of the largest professional association of real estate appraisers, the Appraisal Institute (AI) welcomes the opportunity to discuss this important issue and share the impactful actions already taken by the profession, as well as offer suggestions for the agencies and the broader ecosystem including the regulatory and enforcement communities and the real estate and mortgage finance sectors.

The appraisal profession is moving to enhance education requirements on valuation bias and fair housing. The Appraisal Institute has been quick to issue guidance to the public on this topic, adopt enhancements to our Code of Professional Ethics and Standards of Valuation Practice, and advance and encourage similar action and alignment through the Appraiser Qualifications Board (AQB) and Appraisal Standards Board (ASB) of the Appraisal Foundation. An exposure draft is currently out for comment relating to proposed new Ethics Rule changes to the Uniform Standards of Professional Appraisal Practice (USPAP), and we are anticipating an additional exposure draft relating to national education requirements on valuation bias and fair housing that we hope will position appraisers with the most rigorous bias and fair housing training requirements of any profession subject to fair housing requirements.

Bias in real estate appraisal can be unintentional. To mitigate bias, appraisers should be aware of the potential for bias and base opinions on rigorous analysis and research. Best practice relies on multiple data sources and techniques to enhance credibility of the opinion of value.

As we look for solutions, education and awareness on valuation bias and fair housing by appraisers, appraisal reviewers and those interacting with appraisals is universally accepted as the most direct way to confront and address the challenges of valuation bias.

We have a range of additional suggestions for the member agencies of the ASC and the ASC itself, as outlined below.

Suggestions for ASC Member Agencies

Reconsideration of Value/Reconsideration of Appraisal Results

The member agencies of the ASC have key roles to play in addressing valuation bias and fair housing in managing loan guarantee programs and providing supervision and enforcement. The agencies, as identified by the Property Appraisal and Valuation Equity (PAVE) Task Force, have appropriately identified the Reconsideration of Value (ROV) or Reconsideration of Appraisal Results (ROAR) as one requiring additional guidance and coordination. Unfortunately, the agencies have, thus far, missed an opportunity to incorporate a pro-consumer protocol that is used effectively in supporting veterans under the Department of Veterans Affairs (VA) "Tidewater Initiative." Prior to completing a VA appraisal, VA Fee Appraisers follow a structured protocol that allows stakeholders to provide relevant information to the appraiser when the appraisal is below the contract price. This protocol helps alleviate consumer concerns prior to the completion of the appraisal. This type of interaction was once a common best practice in the appraisal profession but has since waned as a result of more formalized or structured policies established through the lens of appraisal independence. We have an opportunity now to establish a pro-consumer benefit that virtually all stakeholder support. We urge the agencies to consider the Tidewater protocol as a template for ROV/ROAR and appraisal appeals guidelines and regulations.

Another concern about the current approach taken by the agencies on the ROV or ROAR process is the apparent lack of interagency coordination. If the ASC is contemplating additional hearings, the issues relating to ROV or ROAR are ripe for further investigation and discussion. This would help align the agencies as closely as possible and result in generally consistent protocols and procedures used by participating mortgage lenders. Instead, the agencies seem to be moving separately in developing policies, which may inhibit acceptance and stifle improved consumer awareness and appeal processes.

For instance, the Federal Housing Administration (FHA) has released an open comment request on revised ROV and second appraisal requirements for FHA loans. Relative to second appraisal order protocols, the draft states "material deficiencies" in appraisals may include "indications of unlawful bias in the Appraisal or other violations of applicable local, state, or federal fair housing and nondiscrimination laws." No definition for "indications of unlawful bias" is included in the proposal, raising questions about how to reach and judge compliance. Coinciding with this draft policy, the VA released a new Circular last week to inform the lending industry of enhanced oversight procedures that will enable VA to identify discriminatory bias in home loan appraisals. The VA has moved to review randomly selected reports submitted to the home loan guaranty program using an enhanced technology scanning software. If the initial review indicates a potential discriminatory bias, VA flags the data for an escalated review.

We are aware that the agencies, government sponsored enterprises, lenders, AMCs and others have been developing lists of "do not use" words and phrases for flagging in appraisal reports. While we support efforts to identify unacceptable terms, the real estate, housing, and finance industries are nowhere near consensus on the appropriateness or acceptability of these terms. While some terms may be clearly out of bounds, others may present questions or require alternatives that may not be generally understood or accepted. For the entire industry to align in this endeavor, the agencies must work together and in lockstep to coordinate stakeholder outreach and enhance consensus building.

Our vision for the agencies is for them to undertake a process similar to that used to develop the Interagency Appraisal and Evaluation Guidelines, but specific to the ROV or ROAR process. The guidance should be written across agencies and should be consistent to help institutions establish policies and procedures where they may not currently exist. The guidance should respect appraiser independence but provide a clear way to communicate relevant information that may have been missed by the appraiser. The guidance should establish a process to follow before a second appraisal is considered.

Automated Valuation Models

We understand the agencies have been developing a proposed quality control standard for automated valuation models (AVMs). We commented separately to the CFPB in its framing exercise on common concerns associated with AVMs during the agencies comment request.[1] The general idea of using technology and AVMs to resolve valuation bias concerns has been offered by many. The PAVE 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 – is potentially short-sighted and dangerous.

One thing to be noted is that a good portion of the research that has been conducted on valuation bias 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.

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[1] https://www.appraisalinstitute.org/file.aspx?DocumentId=2974

Focus on Competency

Competency and experience with appraisal standards and methodology will be critical to enforcement efforts on bias and fair housing topics. The agencies have historically not had deep knowledge of appraisal issues in policy or oversight capacities. For example, we believe there are only two credentialed appraisers involved in appraisal policy in all the federal financial institution and consumer regulatory agencies. To improve oversight and enforcement in this area, we believe fair housing and appraisal regulatory officials will need to cross-pollinate their disciplines to bring important competencies to bear.

Looking ahead, as the agencies also develop guidance for regulated financial institutions, we cannot emphasize enough the importance of strong appraisal review functions. Strong appraisal review – by credentialed appraisal reviewers – can mitigate many appraisal quality concerns for the betterment of all parties.

<u>Suggestions for the ASC</u>

We offer several targeted suggestions to the ASC, as it plays a key role in the appraisal regulatory structure and maintaining public trust. Specifically, we believe the ASC should:

1. Work with The Appraisal Foundation (TAF) and state appraiser regulatory agencies to engage in grant activity in support of appraiser diversity efforts, aligning with industry efforts such as the Appraiser Diversity Initiative and the Practical Applications of Real Estate Appraisal (PAREA). We continue to support discussion between the ASC and TAF to establish mutually acceptable terms and conditions in support of appraiser diversity grants.

   While those discussions continue, the ASC's Notice of Funding Availability for State Appraiser Regulatory Agencies Support Grants states that grants can be made for the "Expansion of appraiser credentialing opportunities in under-served markets". We are aware of states that are considering making requests for grant funds to establish scholarship programs for aspiring appraisers to participate in AQB-approved PAREA programs. We strongly encourage the ASC to approve grant funds for PAREA scholarships. To strengthen the effort, we request that the ASC direct states to give priority for the scholarships, grants, etc., to aspiring appraisers who are part of communities that have historically been underrepresented in the appraisal profession, are in underserved and rural markets, and to veterans.

   Consistent with this request, we further encourage the ASC to continue to work with Congress to enact changes to the Financial Institutions Reform, Recovery and Enforcement Act of 1989 that would allow the ASC to expand its existing grant program to include grant making to industry associations. These grants would be used to facilitate activities and practices that ensure diversity in the appraisal profession. Activities funded by the ASC via industry associations could include grants and scholarships for training and education, such as funding for the development and delivery of implicit bias training for appraisers.

2. Provide clear guidance to state appraiser regulatory agencies as to how they are expected to intake, process, investigate and adjudicate appraisal bias complaints. Many states have little to no experience investigating and adjudicating complaints related to appraisal or valuation bias. In most instances, these cases should be investigated by the federal and state agencies with responsibility for enforcing state fair housing and civil rights laws. These agencies have the staff and the expertise to be able to fairly and equitably investigate and to prosecute as necessary.

   The role of state appraiser regulatory agencies as it relates to fair housing, appraisal bias, and discrimination complaints should be limited only to ensuring that the appraisal in question complies with USPAP. At least one state – Texas – has established a partnership with the Texas Workforce Commission (TWC), Civil Rights Division (the state agency tasked with enforcing the Texas Fair Housing Act) whereby both agencies will investigate complaints alleging appraisal bias. TWC will investigate complaints for violations of the Texas Fair Housing Act, while the Texas Appraiser

Licensing and Certification Board will investigate and prosecute violations of the Appraiser Licensing and Certification Act.

3. Legislative changes may be necessary to strengthen the appraiser regulatory structure. However, any changes should not supplant or replace the critical role of the private sector and independent standards setting bodies, but position appraiser regulators, users of appraisal services, appraisers and appraisal firms to share enforcement, background check, and education information through a cloud-based "portal" for appraiser licensing. In this vein, we strongly support the role of the ASC proposed by the bipartisan Portal for Appraiser Licensing Act of 2021 (HR 5756 – 117th Congress).

   We continue to see reference to proposed legislation that seeks to supplant the roles of the Appraisal Foundation in appraisal standards and appraiser qualifications with a new "Federal Valuation Agency." Without seeing the latest iteration of this idea, it is safe to say the appraisal profession will likely view it with skepticism and concern and an unnecessary distraction from more meaningful and beneficial efforts like HR 5756.

We highlight two additional issues that are worthy of the ASC's attention.

- We understand the ASC has recently begun to audit states for licensing and certification requirements that exceed the minimum qualification criteria established in the AQB's Real Property Appraiser Qualification Criteria (RPAQC). We question the ASC's authority to call out states that have established requirements that are greater than those established in the RPAQC as both FIRREA and the RPAQC clearly establish the right of states to establish requirements that exceed the minimums. However, the AI agrees that qualification criteria beyond the minimum required serves as a barrier to entry that disproportionately impacts underserved and rural communities. At least 6 states (GA, IN, NV, NY, OR and WA) have not fully adopted the reduced number of experience hours established in the 2018 edition of the RPAQC. One state – New York – requires Appraiser Assistants to complete the required experience hours for the Licensed Residential and Certified Residential Real Estate Appraiser credential over a period of 24 months rather than the 6 months (Licensed Residential) or 12 months (Certified Residential) required by the AQB. Lastly, there are 8 states that do not have the Licensed Residential appraiser classification. Trainees in those states must complete more education and more experience hours than they would if they were seeking the entry-level Licensed Residential appraiser credential in another state. Astonishingly, the Commonwealth of Puerto Rico requires aspiring appraisers to complete all the courses required for general certification (310 hours) before applying for residential licensure or certification.

- The RPAQC establishes practicum courses as an alternative to the traditional means by which appraisal experience is gained. Recently, the AQB increased the allowance for completion of practicum courses from 50% to 100% of the required experience hours for all three appraiser credentials. However, the RPAQC states that practicum courses "approved by the AQB Course Approval Program or state appraiser regulatory agencies can satisfy the non-client experience requirement." Recently, one state requested and received grant funding from the ASC for the creation of a state-sponsored practicum program. The same state agency that received the funding was then called upon to review, approve, and fund a privately developed program.

  Further, when participants have completed the state-sponsored, but privately run practicum program, they will be required to submit their work product developed as part of the practicum program to the same agency that funded and approved the program. The same agency that funded and approved the curriculum for the program will then be charged with reviewing the work product of program participants. Little information was made available publicly prior to its approval and funding by the state appraiser regulatory agency. Substantive information regarding the curriculum of the program is still not publicly available. Importantly, the state "self-approval" concept is much different than the process that will be in place for the review and approval of PAREA programs. Providers will be required to submit their final PAREA programs *only* to the Appraiser Qualifications Board for rigorous review. The AI believes that the ability for states to engage in self-dealing by both funding and approving practicum programs, and then issuing licenses based upon work product produced within the program, without any outside review and approval significantly diminishes the credibility of these programs and could produce less competent appraisers.

State appraiser regulatory agencies will have a strong disincentive to reject applicant's deficient work product completed as part of a practicum program as doing so would impugn the integrity of the very programs that they funded and approved. Further, we understand that the program was promoted extensively to communities that have historically been under-represented in the appraisal profession, as well as to aspiring appraisers in underserved and rural communities. It would be devastating and unfortunate if these aspiring appraisers were to receive training that was less rigorous and of lower quality than programs that are vetted and reviewed by multiple agencies.

The ASC should utilize its oversight authority of The Appraisal Foundation to strongly encourage the AQB to require that practicum courses undergo the same review and approval process as will be required for PAREA programs. Doing so will help to ensure that the individuals completing these types of alternative training programs are equally as qualified as appraisers who receive their training through the traditional supervisor/trainee path.

Appraisal Institute's Actions

We acknowledge the need for leadership and collective action to address stakeholder concerns about valuation bias and fair housing. Our work has centered around three primary areas of activity – development of education, enhancements to ethics and guidance, and improving appraiser diversity.

Valuation Bias/Fair Housing Education

The AI supports adopting additional laws and/or regulations requiring appraisers to take qualifying and continuing education (QE and CE) specific to valuation bias and discrimination. AI also supports the adoption of reasonable measures that clarify that an appraiser found, via a fully adjudicated administrative or judicial proceeding, to have engaged in valuation bias or discrimination must be appropriately disciplined by state appraiser regulatory agencies, up to and including permanent revocation of his or her license.

To date, AI has supported legislative and regulatory proposals in six states (CA, MN, NY, OH, OR and VA) that put in place requirements for licensees and applicants to complete appraiser-specific QE and CE in the areas of fair housing, valuation bias, and cultural competencies. We are aware of several other states that are in varying stages of discussing the imposition of similar QE and CE requirements and will support fair and reasonable proposals.

The AI has also strongly supported proposed bills and regulations in other states (CA, IN, NJ) that reinforce that appraisers are prohibited from considering any protected characteristics during the valuation process. Two states (IL and MD) have established Task Forces like the PAVE Task Force to investigate appraisal bias related concerns. When formed, the AI will actively participate as part of these groups.

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. We believe it is crucial for all appraisers to understand not only federal and state fair housing laws, explicit bias and discrimination, and systemic bias, but also the concept of implicit bias. Appraisers must be trained to recognize and interrupt biases that may unconsciously and unknowingly become part of their work.

Further, the PAVE 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.

Ethics and Guidance

Over the past three 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 applicable laws that may provide further protection for personal characteristics. Further, we approved a new ethics 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[2]. 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, AI has approved enhancements to our ethics rules pertaining to when an appraiser engages in discriminatory conduct and makes derogatory statements based on actual or perceived personal characteristics. This new rule 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, the Appraisal Institute released a *Guide Note on Personal Characteristics and Valuation Practice* in 2020[3]. 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 people who occupy a subject property, live in the area, or are associated with a transaction – are, with limited exceptions, not relevant to the development of any value opinion. Relevant characteristics in valuing a property include its physical and economic characteristics, not the personal characteristics of those connected to the property. Value is an economic concept which is created because there is effective demand, not because of the characteristics of people.

Appraiser Diversity Initiative and Diversity Efforts

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 (PAVE) Task Force Action Plan for its early progress in addressing diversity issues within the profession. As of today, the program has awarded more than 400 scholarships with nearly 60 individuals who have completed the education requirements. 48 of these individuals are working in the profession, while nearly 300 are currently in the ADI program.

ADI operates through hosted workshop events that introduce appraisal careers to diverse audiences. These workshops share information on the appraiser licensing process and involve panels of diverse appraiser practitioners who share advice and answer questions from the audience. Interest in the ADI workshops have increased since the inception of the initiative and aided by sponsor promotion and outreach. At the end of the workshops, a scholarship competition is opened to participants interested in pursuing an appraisal career. A selection committee reviews all applications and awards scholarships based around a

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[2] One example might involve analysis of age-restricted housing.
[3] https://www.appraisalinstitute.org/assets/1/7/guide-note-18.pdf

standard of work. These scholarships currently cover the qualifying education requirements for the trainee classification and immersive industry support. As ADI evolves, we expect the scholarship to include additional enhancements that bolster scholarship winner's ability to reach licensure and certification as appraisers.

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, which has helped to bolster the ADI scholarship program and provide career and immersive assistance to ADI scholarship winners. We continue to receive strong sponsorship interest from the appraisal and mortgage finance communities, as evidenced by an announcement this week from Flagstar Bank of a $1 million contribution to the ADI program.

Other Diversity Activities

Beyond the ADI, decreasing barriers to entry into the profession is something the AI is focused on through the development of 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 AI 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 experience in flight simulators or surgeons that expand their skills virtually. This application is rapidly under development, with release expected in months. Participant priority will be given to veterans, minorities, and women, and those in underserved and 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 function. This Directory helps clients identify diverse appraisal service providers throughout the country, where service and practice areas can be cross-referenced by property type, business service, and other factors. This program also allows members to report and identify 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 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 have conducted or helped develop surveys in recent years, and we are supportive of the ASC's Census/Survey project announced last year and assisted their researchers in the initial scoping, although we understand this project is currently being rescoped.

Bias Research and Solutions

We acknowledge and appreciate the vast amount of research and evaluation on the matters of valuation bias and fair housing. This research has shed light on the importance of greater awareness and understanding of bias related topics, which has been laudably illustrated through sociological research. We believe the issues of valuation and bias must be discussed more within the appraisal profession and those stakeholders who interact with the appraisal process. This should also include a conversation and better understanding of the appraisal profession and the appraisal process itself. As the holder of the Body of Knowledge in appraisal and one of the largest appraisal education providers in the world, AI takes seriously the need to better educate the public and all stakeholders about the role of appraisers, appraisal standards, and appraisal methods and techniques.

Primarily, appraisals are a critical cog in mortgage finance to help understand collateral risks, which contribute to bank failures, foreclosures, and property market meltdowns. Market value is a foundational piece of information used in local market and secondary market investment decisions. We note that appraisals have an ancillary consumer benefit, as credible appraisals support sustainable, safe and sound financing. We are only a few years removed from the Great Financial Crisis that was fueled by aggressive lending and the relaxation of fundamental risk management strategies and a rash of foreclosures.

To help our organization understand the primary research conducted on bias and fair housing, we established a Bias Research Solutions Project Team (BRSPT) last year to review bias related research and to make recommendations to the AI. The BRSPT was populated with a diverse group of AI Designated members. That report is provided as an appendix to this testimony.

In conducting this work, the BRSPT met with the primary researchers to understand the research approaches, findings, and conclusions and identified strengths and weaknesses of each from an appraiser perspective. The macro suggestions of the BRSPT to the Appraisal Institute include:

1. Evaluation and development of guidance and education that would enable valuation professionals to analyze bias risk within appraisals and valuations. This would add special processes for risk profiling in appraisal reports. This coincides with an additional recommendation to expand and enhance the AI's Body of Knowledge relative to bias identification.

2. Update appraisal review courses relating to identified bias issues. Pre-existing appraisal review courses and textbooks will likely require additional components relating to bias topics.

3. Continue to discuss bias mitigation and with end-users and those downstream from the appraisal process to understand issues, trends, and developments and to strengthen confidence in the appraisal and valuation "process."
4. To mitigate real or perceived concerns about bias, speak out and educate the public about the importance of market and geographic competency within the appraisal procurement and fulfillment processes.

The BRSPT additionally suggested the AI lead a transition away from the term "neighborhood" to utilize "market area" within the body of knowledge. Additionally, the BRSPT recommends development of guidance and education relating to the concepts of market area description, selection of comparable sales, and relevance of comparable sales. The BRSPT suggests that the AI advocate for incorporation of these recommendations in lender collateral underwriting guidelines.

<u>Sales Comparison Approach</u>

We have seen some of the research in this space take issue with or call for the outright elimination of the sales comparison approach in appraisal. The BRSPT suggests those recommendations be ignored, and we will go on record as being outright opposed to such efforts. The sales comparison approach is grounded in economic theory, and it is universally accepted throughout the world. Real estate appraisal is a global profession – appraisal concepts are taught and used every day in real estate transactions and even in command economies where property rights differ from those found in the United States. Buyers and sellers make up a market, and their behavior is illustrated by sales and lease transactions analyzed by appraisal professionals.

Further, the sales comparison approach is universally accepted and relied heavily upon in understanding collateral risks for the member agencies of the ASC. Agency collateral valuation guidelines and handbooks establish common expectations for lenders to review appraisals, including the sales comparison approach. Elimination of the most widely used and accepted approach would create upheaval in the mortgage market and put consumers at risk.

The reason why the sales comparison approach is so widely accepted is because it best reflects the actions of buyers and sellers in the marketplace in owner-occupied housing. Here, the question being asked is - what will this house sell for tomorrow if there is no duress of willing buyers and sellers? You may hear appraisers say, "we do not make the market; we only reflect the market." This is true of the sales comparison approach. Those recent sales are analyzed and confirmed by trained appraisers who then can determine appropriate adjustments which are supported by more detailed verification of the market information.

Those advancing the cost approach as the alternative to the sales comparison approach do not fully understand how the cost approach works. Development of the cost approach requires sales comparison information because a cost approach integrates the sales comparison approach to estimate the depreciation from all causes. This concept of market extracted depreciation is the difference between cost new and what the market is willing to pay and is the basis for concluding depreciation. In estimating adjustments for feature differences in the sales comparison approach, cost new is sometimes used, but typically with another method. The cost approach is extremely important in some situations – like with new construction or in considering improvements such as energy efficient or "green" features. However, strict or sole reliance on the cost approach would create asset bubbles and put taxpayers and consumers at great risk.

OCC Project REACH and Appraisal Gaps

While we oppose efforts to depart from the sales comparison approach, we do support testing and experimentation of additional value constructs that could be used in creative financing and housing policy that seeks to promote economic and community development. The OCC Project REACH has been investigating some of these concepts, including efforts to resolve "appraisal gaps" where the appraisal may fall below a contract price. This is a common issue in some markets where there is an absence of comparable sales information or in new construction markets. Appraisal gaps are also common where the cost to purchase and renovate a property – often in the inner city – is significantly below the appraised value. The property owner / borrower can only obtain financing based upon the "as-is" appraised (or market) value. At least one state (Maryland) has passed a law authorizing the creation of a fund to make grants to real estate developers to offset the difference between the cost to purchase and redevelop a property and the amount that the developer is able to obtain via financing. One such value proposition that won an award from the Brookings Institute and ASHOKA Institute is the concept of "Competitive Restorative Value," which at a basic level involves completion of a market value appraisal with a value absent location. The location factors are evaluated by appraisers using whole market analysis or "big data" approaches, but potentially used by lenders (typically, those holding loans in portfolio) to evaluate loan risks and to quantify Community Reinvestment Act investments. We strongly support this kind of experimentation of creative financing and collateral valuation, which necessitates cross industry and cross sector collaboration and conversation.

Closing Remarks

The AI stands ready to assist the ASC and its member agencies in addressing concerns about valuation bias and fair housing. As the agencies continue development of guidelines and regulations that touch on appraisal topics, we offer the resources of the AI, including our Designated members, to assist with understanding of appraisal standards, appraisal methodology, and appraisal practice.

Bias Research Solutions Project Team Report to the Appraisal Institute

For Educational Purposes Only

The materials presented in this report represent the opinions and views of the project team. Although these materials may have been reviewed by the Appraisal Institute, the views and opinions expressed herein are not endorsed or approved by the Appraisal Institute as policy unless adopted by the Appraisal Institute pursuant to the Bylaws of the Appraisal Institute. While substantial care has been taken to provide accurate and current data and information, the Appraisal Institute does not warrant the accuracy or timeliness of the data and information contained herein. This material is presented for educational and informational purposes only with the understanding that the Appraisal Institute is not engaged in rendering legal, accounting or other professional advice or services. Nothing in these materials is to be construed as the offering of such advice or services. If expert advice or services are required, readers are responsible for obtaining such advice or services from appropriate professionals.

Charge

The charge of the Bias Research Solutions Project Team (BRSPT Project Team) was to review available research and recommend appropriate next steps for the Appraisal Institute. Consideration was given to any proposed solutions in the research, and the anticipated impact the proposed solutions would have on the profession, the real estate industry, and consumers.

Research Papers Reviewed

Research Article 1: *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", Edward Pinto and Tobias Peter. American Enterprise Institute's Housing Center (AEI). (2021, August 5). Available at https://www.aei.org/wp-content/uploads/2021/08/Impact-of-Race-and-Socio-Economic-Status-on-the-Value-of-Homes-by-Neighborhood-Presentation-8.5.21-FINAL-v4.pdf?x91208.

Research Article 2: *How Automated Valuation Models Can Disproportionately Affect Majority Black Neighborhoods,* Michael Neil, Sarah Strochak, Linna Zhu, and Caitlin Young. Urban Institute (UI). (2020, December 29). Available at https://www.urban.org/research/publication/how-automated-valuation-models-can-disproportionately-affect-majority-black-neighborhoods.

Research Article 3: *Racial and Ethnic Valuation Gaps in Home Purchase Appraisals,* Melissa Narragon, Danny Wiley, Doug McManus, Vivian Li, Kangli Li, Xue Wu, and Kadiri Karamon. Freddie Mac Economic and Housing Research Note (2021, September 20). Available at https://www.freddiemac.com/research/insight/20210920-home-appraisals.

Research Article 4: *Neighborhoods, Race, and the Twenty-first-century Housing Appraisal Industry,* Junia Howell and Elizabeth Korver-Glenn. (2018, February 28). Available at https://journals.sagepub.com/doi/10.1177/2332649218755178; and *The Increasing Effect of Neighborhood Racial Composition on Housing Values, 1980-2015, Social Problems*, Volume 68, Issue 4, November 2021, Pages 1051–1071. Available at https://academic.oup.com/socpro/article/68/4/1051/5900507.

Research Article 5: *The Devaluation of Assets in Black Neighborhoods, The case of residential property,* Andre Perry, Jonathan Rothwell, and David Harshbarger. (2018, November 27). The Brookings Institution. Available at https://www.brookings.edu/research/devaluation-of-assets-in-black-neighborhoods/.

Research Article 6: A*ppraising the Appraisal: A closer look at divergent appraisal values for Black and white borrowers refinancing their home,* Jake Williamson and Mark Palim. (2022, February 16). Fannie Mae. Available at https://www.fanniemae.com/media/42541/display

Research Article 7: *How Common is Appraiser Racial Bias – An Update,* Ed Pinto and Tobias Peter. (2022, May). American Enterprise Institute Housing Center. Available at https://www.aei.org/wp-content/uploads/2022/06/How-Common-is-Appraiser-Racial-Bias-An-Update-May-2022-FINAL-corrected-1.pdf?x91208

Project Approach

The Project Team held bi-weekly meetings over the course of five months. As part of its consideration of each research article, the Project Team met with at least one of the author(s) of each article. At these meetings the author(s) had an opportunity to summarize their research and discuss their findings and recommendations with the Project Team.

Project Team Members

Jillian White, SRA, Chair

Akia Smith, MAI

Ayako Marsh, SRA

Barry Diskin, MAI, AI-GRS, P.h.D

Jacinto Munoz, MAI, SRA, AI-GRS, AI-RRS

Marlon Day, MAI, SRA

Matthew George, SRA

Robinson Wilson, SRA, RA

Sharon Harbin, MAI, SRA, AI-GRS

Smedmore Bernard, MAI, SR/WA

Staff Liaisons: Bill Garber, Director of Government and External Relations

Jonathan Thatcher, Senior Research Manager

Organizer: Aaliyah Sheperd, Senior Collateral Associate, Better

Project Team's Macro Recommendations to the Appraisal Institute

1. Evaluation and development of guidance and education that would enable valuation professionals to analyze bias risk within appraisals and valuations. This would add special processes for risk profiling in appraisal reports. This coincides with an additional recommendation to expand and enhance the Appraisal Institute's Body of Knowledge relative to bias identification.

2. Update appraisal review courses relating to identified bias issues. Pre-existing appraisal review courses and textbooks will likely require additional components relating to bias topics.

3. Continue to discuss bias mitigation and with end-users and those downstream from the appraisal process to understand issues, trends, and developments and to strengthen confidence in the appraisal and valuation "process."

4. To mitigate real or perceived concerns about bias, speak out and educate the public about the importance of market and geographic competency within the appraisal procurement and fulfillment processes.

<u>Project Team's recommendations to the Appraisal Institute Related to Research Articles</u>

Research Article 1: *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",* Pinto and Peter

Authors' recommendations	**Project Team's Recommendations to AI**
1. Build generational wealth through sustainable homeownership for low socioeconomic status households by reducing leverage for low income buyers. Reduce leverage by buying down the interest rate on a 20-year mortgage. This would in part subsidize wealth building rather than debt, lower default risk, and help address credit score issues. 2. Increase housing supply and reduce income stratification by making 2–4-unit housing in 1-unit housing areas and allow extra rooms to be rented out. 3. Promote walkable oriented development in mixed use neighborhoods to promote job and education opportunities.	The Project Team found that the recommendations in Research Article 1 do not address the issue of appraisal bias. The Project Team recommends that the Appraisal Institute take no action as to those recommendations.

Research Article 2: *How Automated Valuation Models Can Disproportionately Affect Majority Black Neighborhoods,* Neil, Strochak, Zhu, and Young

Authors' recommendations	**Project Team's recommendations to AI**
1. Encourage direct investment flowing to majority-Black communities, particularly through Black Banks and CDFIs. 2. Support households' seeking to purchase distressed sales for use as a primary residence. 3. Encourage modelers to continue identifying variables in their AVMs to potentially help reduce magnitude of error in majority-Black neighborhoods.	The Project Team found that the recommendations in Research Article 2 do not address the issue of appraisal bias. The Project Team recommends that the Appraisal Institute acknowledge but take no action as to those recommendations.

Research Article 3: *Racial and Ethnic Valuation Gaps in Home Purchase Appraisals,* Narragon, Wiley, McManus, Li, Li, Wu, and Karamon

Authors' recommendations	**Project Team's recommendations to AI**
1. Review of appraisal best practices. 2. Defining uniform standards for AVMs 3. Addressing consumer disclosure and reconsideration of value processes. 4. Revising fair lending exam procedures and risk assessments.	The Project Team provided Freddie Mac with suggestions for further research. The Project Team found that recommendations 1, 3 and 4 in Research Article 3 identify issues that are directly relevant to the appraiser community. The Project Team recommends that the Appraisal Institute explore opportunities to work on these issues.

Research Article 4: *Neighborhoods, Race, and the Twenty-first-century Housing Appraisal Industry,* and *The Increasing Effect of Neighborhood Racial Composition on Housing Values, 1980-2015,* Howell and Korver-Glenn.

Authors' recommendations	**Project Team's recommendations to AI**
1. Standardize measurements a. Automate Floor Plan Technology b. Automate Neighborhood Evaluations c. Automate the Sales Comparison Approach 2. De-racializing property evaluations a. Institutionalize a New Appraisal Method (Redefining market value to consider the amount of natural materials, human labor, and public resources required to construct and build a home b. Create regulatory processes that track equity. 3. Financially incentivizing racial equity a. Housing Policy Reparations: federal policies to provide housing reparations for historical and ongoing unjust policies b. Lower interest rates for federally insured mortgages **c.** Rethink the secondary mortgage market.	The Project Team found that: - Recommendations 1(a) and 1(b) could benefit the appraisal process. The Project Team recommends that the Appraisal Institute lead a transition away from the term "neighborhood" to utilize "market area" within The Body of Knowledge. Develop guidance and education relating to the concepts of market area description, selection of comparable sales, and relevance of comparable sales and advocate for its application in lender collateral underwriting guidelines. - Recommendation 1(c) should be disregarded. - Recommendation 2(a) should be disregarded. Recommendation 2(b) should be recognized. - Recommendations 3(a), 3(b), and 3(c) are policy-related recommendations rather than appraisal-related recommendations.

Research Article 5: *The Devaluation of Assets in Black Neighborhoods, The case of residential property,* Perry, Rothwell, and Harshbarger.

Authors' recommendations (from speaking engagements)	**Project Team's recommendations to AI**
1. "Lenders, real estate agent behavior, elected officials and public policies, biased labor markets as well other predatory housing practices also contribute to the problem of devaluation. Consequently, we need a suite of innovations based on people who are intimate with the issue". 2. "We believe that devaluation reflects discrimination throughout housing markets. Therefore, we are interested in innovations that address low appraisals, mortgage rates and insurance costs." 3. "We will call for the hybrid approach. If a property falls below market rate (contract price) it should trigger another appraisal, an AVM. We must hold appraisers accountable. Appraisers must explain the lower rate. Appeals are hard to come by. Ninety percent of appeals are denied. We need a backup when something goes wrong. If someone feels low-balled, get a White person to stand in for them. Is it individual bias or just a bad appraiser? Is it individual bias or a structural problem? It is a structural problem if you use the price comparison approach. It can be mitigated by using data."	The Project Team found that, for the most part, the recommendations related to Research Article 5 involve policy issues rather than appraisal issues. The Project Team recommends that the Appraisal Institute continue to explore opportunities to work with other entities and groups that are working to address issues of appraisal bias.

Research Article 6: A*ppraising the Appraisal: A closer look at divergent appraisal values for Black and white borrowers refinancing their home,* Williamson and Palim.

Authors' recommendations	**Project Team's recommendations to AI**
1. Increase the use of alternative-scope property valuation approaches such as desktop appraisals and hybrid appraisals. These alternative approaches reduce contact between borrowers and appraisers. 2. Build on existing safeguards to detect valuation errors. For instance, Fannie Mae's Collateral Underwriter provides lenders tools that promote greater appraisal quality and help detect valuation problems in real time. 3. Continue to modernize the appraisal process for home loans - improvement through better use of data, technology, and process design can drive more factual, objective, accurate, and reproducible appraisals. 4. Foster diversity in the appraiser workforce. 5. Enhance the tools appraisers use to validate their opinions. Many valuation problems are related to items like comparable selection, comparable location, and adjustments. It's important that individual appraisers have the same tools necessary to validate these measures as institutions such as Fannie Mae.	The Project Team found that recommendation 1 may create unintended consequences, although the Project Team recognized that if more data is utilized it could reduce subjectivity and bias depending on how the data is collected. The Project Team found that recommendations 2 and 5 relied on data held by the GSEs and that any action related to these recommendations would depend on the GSE's allowing access to their data. The Project Team found that recommendations 3 and 4 addressed ways the housing industry can help minimize the chance of racial bias in home valuation and that the Appraisal Institute should continue to explore opportunities to get involved in these areas.

Research Article 7: *How Common is Appraiser Racial Bias – An Update,* Pinto and Peter

Authors' recommendations	**Project Team's recommendations to AI**
More research is needed to identify the extent of bad apples, implicit bias, and incompetence. An independent regulator should evaluate the work of individual appraisers for both bias and incompetence without delay using readily accessible data.	The Project Team found some analysis of individual appraisers has already been deployed through the Appraiser Quality Monitoring initiative. Much of the data necessary to conduct such an evaluation at the individual level already exists today. Such a study should follow the methodology recently outlined in a Fannie Mae study, for which researchers have already assembled a substantial database.