AEI Housing Center

A Response to the Recommendations of the PAVE Working Group

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On June 1, the Interagency Task Force on Property Appraisal and Valuation Equity (PAVE) released its recommendations on how to address racial bias in home valuations.

While, we agree that the appraisal industry needs to change, PAVE's recommendations came up short because they do not 1) identify and address the root causes of the industry's problems, 2) identify and address in a timely and comprehensive manner appraiser racial and ethnic bias and inaccuracies, and 3) avoid overreach and damaging unintended consequences.

The following summarizes PAVE's main recommendations and our responses to them:

PAVE recommendation #1: "Preventing algorithmic bias in home valuation."

PAVE specifics:

- "The proposed rule, subject to a 60-day public comment period, would establish quality control standards to help ensure AVMs are accurately and fairly assessing home values."
- "The proposed rule expressly includes a nondiscrimination quality control standard."

Our response:

This recommendation probably largely stems from an Urban Institute paper that found that properties with the same characteristics had a 3.5 ppts. greater Automated Valuation Model (AVM) error in majority Black neighborhoods than those in majority White neighborhoods.[2] Yet it is plausible that other factors that went uncontrolled for in the study could potentially account for some, if not all, of this difference. Two shortcomings merit further exploration:

1. Home condition:

   Even though the paper controls for home quality as measured by an exterior condition rating, we found in other work that exterior condition ratings can be quite different from interior condition ones.[3] We also found that home interior quality can be a significant factor in the difference between

[1] The views expressed are those of the authors alone and do not necessarily represent those of the American Enterprise Institute or of any individual who provided comments.
[2] Zhu, Linna, Michael Neal, and Caitlin Young. "Revisiting Automated Valuation Model Disparities in Majority-Black Neighborhoods." (2022). The AVM tested was not specified in the report.
[3] Our work also found that listing, deed, and tax assessment data provided useful additional information on quality. We concluded that terms such as "fixer upper", "motivated seller", "as-is", "investment property" were

an AVM and a home's sale price and that for a small number of properties with extreme conditions that difference was significant.[4]

2. Buyer characteristics:

The presence of first-time homebuyers (FTBs) or the use of seller concessions could affect the sale price relative to the AVM. Our analysis in "Exploring Alternative Explanations for Appraisal Under-Valuation" shows a significantly higher share of FTBs in tracts with lower levels of non-Hispanic White residents. This is significant because the literature shows that FTBs tend to overbid for a home by approximately $3,000, or about 1% of the contract price for the average home compared to repeat buyers and that they use a higher share of seller concessions, which can amount to 2.01-3% of the property price.

While it is true that AVMs are black boxes and that quality varies widely among providers (for example some AVMs snap to a list price or incorporate refi and appraisal data), this PAVE recommendation is premature.

FHFA should first direct Fannie and Freddie, who have access to vast amounts of data (homebuyer characteristics and home quality from appraisals, which by the way includes non-GSEs properties that flow through their systems), to test some of these hypothesis outlined above. Only once this is known, should we think about overall and nondiscrimination quality control standards.

Further, FHFA should direct Fannie and Freddie to publicly release much more of the underlying data. Steps FHFA has taken to date to release appraisal data have been woefully inadequate (for more on this, see point 3 below).

PAVE recommendation #2: "Empowering consumers to take action against appraisal bias"

PAVE specifics:

- "When consumers encounter potentially inaccurate or biased appraisals, reconsiderations of value (ROV) provide an opportunity to challenge potentially inaccurate appraisal valuations when obtaining or refinancing a mortgage."
- "Agencies are taking actions to promote industry-wide consistency for ROV processes and increase consumers' knowledge about the option to pursue an ROV"

Our response:

If the impetus for this policy is appraiser bias, this recommendation is premature.

Over time, the debate around appraiser bias has shifted significantly. In the 2000s, the focus was on presumed appraiser overvaluations that enabled borrowers to take out large amounts of equity

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indicators of decay as was a vacant property flag in the tax assessor data, pictures from the listings, or a re-sale within a year.)

[4] When we investigated a small sample of properties (N-count of 20) with an assessment to sales ratio of over 10% in Chicago, our virtual review found that 80% of all 1 unit detached properties with such a ratio had detectable (from public records data) and undetectable abnormalities (only apparent from a review of online pictures and listings data).

exposing them to greater risk of default when the market was primed for home price declines. Today, the focus is on claims of systemic appraiser under-valuations primarily on refinances that have resulted in individual Black borrowers receiving low-ball appraisals or claims that entire Black neighborhoods have been systemically undervalued leaving its homeowners at a significant wealth disadvantage.

We have pointed out serious flaws in numerous studies that purport to show widespread appraiser bias or systemic devaluations of neighborhoods.[5] Therefore, granting borrower initiated ROVs (rather than servicer-initiated ones) –even if they are for alleged racial bias of the appraiser- is premature and may also lead to unintended consequences. First, appraisers may decide to organize their practice to avoid assignments with high propensities for ROVs. Second, increasing the ease and prevalence of ROVs may well lead to inflated valuations. And third, it may impose an additional cost on consumers, since the widespread no-questions-asked adoption of ROVs, which are costly to lenders and appraisers, would, by necessity need to be priced into the cost of the application process and ultimately be passed on to all applicants.

To better measure and document appraiser racial bias, we once again propose reviewing every appraiser for racial bias and deliberate inaccuracies based on a comprehensive review of their past refinance appraisals. To that end, we have demonstrated a working methodology in "A Blueprint for Mass Screening Appraisers for Racial Bias and Inaccuracy Based on an Atlanta, GA Study" that could be implemented today by either FHFA, Fannie Mae, or Freddie Mac.

Ultimately, the goal of public policy should be to identify biased and inaccurate appraisers and to prosecute the former and to educate and retrain the latter. This would then increase confidence in the remaining appraisers while avoiding the unintended consequence of allowing some borrowers a second bite at the apple if that borrower dislikes the initial appraisal.

PAVE recommendation #3: "Increasing transparency and leveraging federal data to inform policy and improve enforcement against appraisal bias."

PAVE specifics:

- "The Federal Housing Finance Agency (FHFA) is announcing that it will update the Uniform Appraisal Dataset (UAD) Aggregate Statistics with new appraisal data to further its commitment to making appraisals available to the public."
- "These statistics are based on more than 48 million appraisal records, and FHFA's quarterly update will add approximately 600,000 new records. Using these data, academic researchers have already published new analyses illustrating stark differences in home valuations across racial and ethnic groups."

Our response:

We need to hold appraisers individually, not collectively, responsible for biased or inaccurate appraisals. FHFA's Aggregate Statistics Data File and Dashboards do not have the anonymized individual appraiser

[5] See for example our reports on "Exploring alternative explanations for appraisal under-valuations: A critique of FHFA, Brookings, and Freddie Mac reports on racial bias", "How Common Is Appraiser Racial Bias—an Update" or "AEI Housing Center Response to Perry and Rothwell (2021)."

data that would allow for a rigorous individual statistical analysis of appraisers. The data are aggregated to various levels of geography with census tract being the lowest level.

In the media stories that drove awareness around the issue of appraiser racial bias, the under-valuation was (to our knowledge) always on a refinance appraisal (or in one instance a home equity loan). FHFA's Aggregate Statistics Data only allows for a comparison between appraisal amount and agreed upon sale price, which only applies to purchase loans, which as we pointed out before is fraught with issues. To measure the extent of bias on refinances, these data are useless.

Similarly, the studies allegedly showing stark differences in home valuations across racial and ethnic groups referenced by PAVE fall woefully short as we have documented in our report "Exploring Alternative Explanations for Appraisal Under-Valuation: A critique of FHFA, Brookings, and Freddie Mac reports on Racial Bias."

We recommend that the FHFA, Fannie Mae, or Freddie Mac immediately screen each appraiser for bias and inaccuracy along the lines of our blueprint.

PAVE recommendation #4: "Breaking down barriers to entry into the appraisal profession."

PAVE specifics:

- "The Appraisal Subcommittee (ASC) will continue to provide ongoing assistance to states interested in reducing barriers to entry. Today's announcement builds on ongoing efforts by the PAVE Task Force to create a more representative and well-trained appraiser workforce"

Our response:

We applaud efforts to lower barriers and recruit a more diverse workforce, while maintaining industry standards. However, much of the blame for the appraisal industry's lack of diversity and high barriers to entry rests with the Appraisal Foundation (AF) and the regulatory dysfunction created under the 1989 Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA). FIRREA established the AF, a private foundation, and the Appraisal Subcommittee (ASC), a federal regulatory agency. The AF has operated under the cloak of congressional authority, but outside the supervisory purview of the ASC. The AF has implemented barriers to entry that have artificially limited the number of appraisers and impeded greater diversity in the industry. Given its structure and entrenched interests, the AF on its own is unlikely to materially undertake needed reforms.

One reform model would implement procedural changes that would bring the AF within the regulatory and supervisory purview of the ASC. This includes the ASC having final approval authority for the establishment of appraisal standards and appraiser qualification criteria by the AF and the authority to review current standards and qualifications criteria.

- The ASC should be mandated to examine the barriers to entry for the profession.
- The ASC should develop educational resources and undertake outreach efforts with the AF to broaden diversity in the appraisal industry.