Property Valuation, Appraisals, and Racial Wealth Disparities

Gregory D. Squires and Ira Goldstein

Racial disparities in property valuation, assessments, and appraisals have been longstanding contributors to racial wealth disparities in American cities (Flippen 2004, Howell and Korver-Glenn 2020, Perry et. al. 2018, Zonta 2019, Barry 2021). In recent years, substantial new evidence of racial disparities in home appraisals has garnered widespread headlines and interest among advocates, policymakers, and the industry itself (Mock 2021, Pittinger 2013, Roha 2020, Parker, et al. 2021). A variety of factors have contributed to these disparities and subsequent inequities. Ironically, many of those institutional actors who have perpetrated housing inequalities are also paying a price for inequitable and inaccurate appraisals.

President Biden's recently released "Memorandum on Redressing Our Nation's and the Federal Government's History of Discriminatory Housing Practices and Policies" captured these historical and ongoing realities stating:

"During the 20th century, Federal, State, and local governments systematically implemented racially discriminatory housing policies that contributed to segregated neighborhoods and inhibited equal opportunity and the chance to build wealth for Black, Latino, Asian American and Pacific Islander, and Native American families, and other underserved communities. Ongoing legacies of residential segregation and discrimination remain ever-present in our society. These include a racial gap in homeownership; a persistent undervaluation of properties owned by families of color…" (Biden 2021)

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To begin, an accurate appraisal is important to all parties in a real estate transaction: buyers, sellers, refinancers, and lenders – as well as the Government-Sponsored Enterprises, other mortgage securitizers, and investors who purchase mortgage-backed securities. For example, to the buyer the appraisal represents what is presumed to be the fair and objective value of the purchase they are making. To the seller it enables them to get a fair price for their property. For homeowners seeking to refinance, it unlocks an ability to capture equity in their homes. For lenders they can be assured the home is ample collateral for the loan.

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Undervaluing homes in non-White neighborhoods is a longstanding feature of the US housing market. Several factors have contributed. The federal government played a key role in the initial underwriting rules of the Federal Housing Administration and other agencies that excluded non-White communities from participation, declaring in part: "If a neighborhood is to retain stability, it is necessary that properties shall continue to be occupied by the same social and racial classes. A change in social or racial occupancy generally contributes to instability and a decline in values" (U.S. Federal Housing Administration 1938, par. 937). Real estate agents followed with the code of ethics of the National Association of Realtors including the following guideline until 1950, "A realtor should never be instrumental in introducing into a neighborhood a character of property or occupancy members of any race or nationality, or any individual whose presence will be detrimental to property values in the neighborhood." (Judd 1984, 284). Some cities enacted zoning laws that prohibited non-Whites from living in White communities. Redlining by banks and insurance companies contributed to the segregated patterns of many cities. Until the 1948 Supreme Court decision in *Shelly v. Kraemer*, covenants in property deeds legally blocked Black people (and persons of other races, religions, and nationalities) from purchasing homes with such covenants. The Supreme Court held these covenants to be legally unenforceable with that 1948 decision. Urban renewal resulted in the destruction of many stable Black communities and concentrated many families of color in segregated public housing projects. Highways facilitating the commute of White suburbanites to downtown offices destroyed more non-White neighborhoods. Exclusionary zoning to this day continues to keep many non-White families out of many communities (Massey and Denton 1993, Hirsch 1998, Trounstine 2019)

Today, notwithstanding the passage of the federal Fair Housing Act in 1968 and its significant amendments in 1988, there are still discriminatory practices in the real estate industry, writ large, that impact the racial gap in home values. Moreover, conscious and unconscious bias of homeowners and renters have played and still play a role (Massey and Denton 1993, Rothstein 2017, Squires 2018, Trounstine 2019).

One consequence of discrimination in the real estate industry – and other aspects of social and economic life – is the wide disparity in homeownership rates. Today, 72 percent of White (not-Hispanic) families own their homes compared to 42 percent of Black families and 48 percent of Latino families. Not only are the rates of homeownership disparate, but non-White families who own their homes do not accumulate the same equity as White homeowners. Non-White families generally purchase homes later in life, their homes have lower property values and those values appreciate more slowly, and those families have fewer years of ownership from which they accumulate equity and subsequent wealth (Flippen 204. Perry, et al. 2018). A Brookings Institution report found that a home in a Black neighborhood is valued 23 percent less than a similar home in a White neighborhood effectively costing Black homeowners $165 billion in cumulative losses. Recently, Redfin released a study of more than 7.3 million home sales between 2013 and February 2021 showing that comparable homes in Black and White areas are valued at $46,000 less in the Black areas (Redfin 2021). Philadelphia's undervaluation was estimated to be $25,623 equating to a 27 percent undervaluation. Today, the typical White family has approximately ten times the wealth of the typical non-White family with much of this gap attributable to homeownership disparities (Dubb 2021, Asset Building Policy Network 2019).

Among the discriminatory practices cited by President Biden was the role of the appraisal industry in undervaluing homes owned by non-White families. It is important to distinguish appraisals from other forms of property valuation. Census surveys based on owner self-evaluation constitute one form of property valuation. Tax assessments are another. Real estate agents often rely on their experience and recent home sales to estimate value. And of course, there are the Automated Valuation Models (or AVMs) that apply a black-box algorithm to estimate a home's value.

Appraisals are one of many approaches for determining property values, though an important one. And the appraisal industry has its own problematic history. Up until the 1970s, training materials used by the American Institute of Appraisers included the following example to illustrate neighborhood analysis, "The neighborhood is entirely Caucasian. It appears that there is no adverse effect by minority groups" (Greene 1980). Racial bias has long crept into the appraisal process (Pittinger 2013, Louis 1997).

While there is substantial evidence of systematic racial and ethnic bias in the evaluation of property, including a HUD settlement of a case under the Fair Housing Act alleging appraisal bias between a Black homeowner and JP Morgan Chase in March of 2021, much of the recent evidence on problematic appraisals is anecdotal. One Florida family, Abena and Alex Horton, recently had their home appraised at $330,000. Mrs. Abena, who is Black, suspected discrimination so she removed all the family photos along with books and other artifacts that reflected her race and requested a second appraisal. Mr. Horton, who is White, met the second appraiser who estimated the home value at $465,000. They shared their story on Facebook and received 2,000 comments with many saying the same story happened to them. It is, in fact, a common practice for real estate agents to advise their non-White clients to "Whiten" their homes as well (Kamin 2020). And while White clients are also advised to take down family photos primarily to declutter their homes, non-White families are given this same advice but for very different reasons (White 2021).

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Several explanations have been offered for appraisal bias. In establishing a property's value, an appraiser typically selects three "comps." Comps are recent sales of similar properties within a given distance of the property being valued. There are often multiple usable comps and the appraiser could select the lower valued sales, yielding a lower appraised value. Then there are "adjustments" for differences between the comp and the property being valued (e.g., differences between the property being valued and the comps' size, amenities, or condition). While there are guidelines for adjustments, these adjustments can make a difference in the value. Accordingly, there are subjective elements of this objective process – consciously or unconsciously – that can introduce bias into an appraisal. Even where "appropriate" comps are selected, the impact of historical discriminatory practices is baked into current property values, thus perpetuating the impact of previous discrimination to current times.

Another possible source of bias is that an appraiser may be from a different neighborhood and of a different race or ethnicity than the person whose home is being appraised and, therefore, may be unfamiliar with homes in that neighborhood (Louis 1997). This can lead to wide variations and, ultimately inaccurate estimates of a property's true value. This was demonstrated by the Appraisal Process Task Group, created by the Cleveland Federal Reserve Bank in 1994, when it asked four different appraisers to appraise the same property in the predominantly Black Hough neighborhood of that city. The appraisals varied from $36,000 to $83,500 (Federal Reserve Bank of Cleveland 1996). Regardless of whatever the property was worth, this experiment suggested that the appraisal industry was challenged to develop valuations fairly and objectively for properties in this community. A subject matter expert that we interviewed on this topic, who is a Black real estate broker in Philadelphia, shared her experience of a homeowner in Yorktown who received a very low appraisal, which was ultimately successfully appealed because the comps were not derived from that very unique area within North Philadelphia.

The racial and ethnic composition of the appraisal industry is one factor that has received little attention. But this is an industry in which the overwhelming proportion of the professionals are White. The Appraisal Institute reports that in 2018, 85.4 percent of appraisers were White. Across the country, Census occupation data show that 86 percent of real estate appraisers are non-Hispanic White, 14 percent are Black or Brown. This compares to 32 percent in banking and 32 percent of real estate brokers and agents who are Black or Brown. The workforce in other occupations is 37 percent Black or Brown. The Philadelphia region is even more unbalanced. Here, 95 percent of appraisers/assessors are White, not-Hispanic and 5 percent are Black or Brown — that compares to 22 percent Black or Brown in real estate and 32 percent in banking (Parker, et al. 2021).

In recent years the real estate and lending industries have recognized the importance of a diverse workforce. Last year, the US House Committee on Financial Services (2020) concluded, based on testimony and studies from researchers at McKinsey and Co. as well as the Harvard Business Review, that a diverse workforce increases profitability, enhances employee engagement and innovation, and is associated with firm growth in market share. Diversity is a win-win for consumers and industry alike.

Ironically, there have been periods in recent history during which appraisals of homes in non-White areas were sometimes problematic because of systematic over-evaluation. When subprime lending leading to the foreclosure crisis was peaking, over-valuation (some of which rose to the level of appraisal fraud) was widespread. Real estate agents, mortgage originators, and others in the home sales pipeline pressured appraisers to come in with numbers to meet the inflated price buyers and sellers agreed to even when objective analysis indicated the homes were not worth the agreed-upon price. Appraisers who did not meet the price often lost business with those lenders who simply wanted an appraisal that would permit the deal to go through even at the artificially high price. Just before the housing bubble burst, 90 percent of appraisers in a national survey reported they were pressured by real estate agents, lenders, and consumers to increase their valuations (Harney 2007). In many cases, appraisers did meet the number so the deals could go through only to result in foreclosure a few years later. At that time, the acronym MAI (Member of the Appraisal Institute) was said to stand for "Made As Instructed." A common element in both the under- and over-appraisal phenomena though is that these practices were concentrated in minority neighborhoods.

Another irony is that faulty appraisals can hurt industries that have contributed to the undervaluation of properties in non-White neighborhoods. If the appraisal is far below the agreed-upon asking price, a deal can fall through costing the real estate agent a fee and costing the lender a profitable origination. If the appraisal is too high, foreclosure could be a costly outcome for the buyer and lender alike.

The appraisal industry has started to take notice. The Appraisal Institute, American Society of Appraisers, American Society of Farm Managers and Rural appraisers, and the Massachusetts Board of Real Estate Appraisers announced an initiative last Fall to address unconscious bias and discrimination. They will develop training programs, review their code of ethics statements, and take steps to bring more people of color into the field (Roha 2020, Mock 2021). And the Appraisal Institute, together with the National Urban League and Fannie Mae, created the Appraisal Diversity Initiative designed to attract more minority appraisers into the field and increase diversity. (Appraisal Institute 2021).

All parties engaged in real estate transactions benefit from accurate appraisals. This is one policy arena where interests that often are at odds with each other can come together for their mutual benefit and the benefit of communities throughout the nation.

More can be done. HUD and other fair housing authorities should conduct systematic testing audits (similar to the four nationwide housing discrimination studies conducted by the Urban Institute) to determine just how frequently the story of Abena and Alex Horton plays out. It is also time to replicate the Cleveland Federal Reserve Bank study. Lenders could seek out local appraisers who are more familiar with traditionally underserved communities.

Cities, faith-based organizations, and other nonprofit groups could lead the way by identifying, working with, and publicizing their partnerships with more progressive appraisers. When these entities buy or sell properties, offer economic development subsidies or purchase goods or services, and when an appraisal is involved, these organizations can retain appraisers who have developed a solid reputation for serving diverse segments of their communities. Aggressive efforts should be undertaken to substantially increase the employment of racial and ethnic minorities in the industry. In those cases where appraisal firms consistently engage in such practices and refuse to take corrective action, sanctions could include fines and, in particularly egregious cases, terminating their license or prohibiting them from engaging in this business.

More attention should be given to the qualifications and experience necessary to become an appraiser. For example, appraisal licensing in Pennsylvania is a function of the State Board of Certified Real Estate Appraisers, and its standards are based on federal standards. In recent years, some changes have been made in Pennsylvania, but more may be necessary. Professional requirements (e.g., 1,250 hours of training doing actual residential appraisals, training with supervisory appraisers with qualifications exceeding the federal standard) that may make it difficult for people of color to become appraisers, for which there is no demonstration of professional import, should be considered for amendment or elimination.

Many cities, including the City of Philadelphia, require the use of appraisers. For example, every one of the more than 2,700 homebuyers under the City's extremely successful Philly First Home program required a property appraisal. The City could, as it does in its other contracting activity, incent the use of appraisers who are people of color. It could similarly incent appraisers who are White to provide the training opportunities to appraisers of color who need those opportunities to gain certification; the field training obligation is mentioned by real estate professionals as an impediment to appraisers who are people of color. The City is a big purchaser of services, and it would not be unprecedented to exercise that economic power to address inequality.

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