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RE: Quality Control Standards for Automated Valuation Models, Docket ID OCC–2023–0002, Docket No. R–1807/RIN No. 7100 AG60, RIN 3133–AE23, NCUA–2023–0019, CFPB–2023–0025, RIN 2590–AA62

To Whom It May Concern,

On behalf of the NAACP Legal Defense and Educational Fund, Inc. (LDF) and the Center for Responsible Lending (CRL), we submit the following comments in response to the federal financial regulators' proposed rulemaking on Quality Control Standards for Automated Valuation

Models.[1] Study after study has found ongoing, significant undervaluation of homes in communities of color[2] and owned by people of color.[3] This persistent appraisal bias has contributed to the racial wealth gap[4] and leads to inaccurate valuations that can implicate the safety and soundness of the financial institutions that make loans based on those valuations or hold those mortgages. While some have argued that automated valuation models (AVMs) can reduce or eliminate appraisal bias,[5] because they are developed using data and models that reflect past and ongoing discrimination, these systems risk creating the illusion of objectivity while reproducing systemic inequities. We applaud President Biden's creation of an Interagency Task Force on Property Appraisal and Valuation Equity (PAVE) to remove racial and ethnic bias in home valuations.[6] The proposed quality control rule takes necessary steps to ensure that lenders evaluate AVMs to ensure that they do not perpetuate appraisal bias. We recommend, however, that regulators strengthen the final rule by broadly requiring that all AVMs follow its quality control standards, consistent with the statute, and by specifying that compliance with the "nondiscrimination" standard requires compliance with existing civil rights laws. The federal financial regulators should also provide additional guidance to covered entities on the steps they must take to meet their nondiscrimination obligations.

Founded in 1940 by Thurgood Marshall, LDF is the nation's oldest civil rights law organization.[7] LDF was launched at a time when America's aspirations for equality and due process of law were stifled by widespread state-sponsored racial inequality. For more than 80 years, LDF has relied on the Constitution and federal and state civil rights laws to pursue equality and justice for Black Americans and other people of color. LDF's mission has always been transformative: to achieve racial justice, equality, and an inclusive society.

Since its inception, LDF has worked to increase fair housing opportunities for Black Americans. Some of LDF's early victories in the Supreme Court came in *Shelley v. Kramer*, 334

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[1] Office of the Comptroller of the Currency, et al., Quality Control Standards for Automated Valuation Models, 88 Fed. Reg. 40638 (Jun. 21, 2023), https://www.govinfo.gov/content/pkg/FR-2023-06-21/pdf/2023-12187.pdf (hereinafter "Proposed Rule").

[2] JUNIA HOWELL & ELIZABETH KORVER-GLENN, APPRAISED: THE PERSISTENT EVALUATION OF WHITE NEIGHBORHOODS AS MORE VALUABLE THAN COMMUNITIES OF COLOR (2022), https://static1.squarespace.com/static/62e84d924d2d8e5dff96ae2f/t/6364707034ee737d19dc76da/1667526772835/Howell+and+Korver-Glenn+Appraised_11_03_22.pdf.

[3] Deborah Kamin, *Home Appraised With a Black Owner: $472,000. With a White Owner: $750,000*, N.Y. TIMES (Aug. 18, 2022), https://www.nytimes.com/2022/08/18/realestate/housing-discrimination-maryland.html

[4] *See* TOM SHAPIRO ET AL., LDF THURGOOD MARSHALL INST. & INST. ON ASSETS AND SOC. POL'Y AT BRANDEIS UNIV. THE BLACK-WHITE RACIAL WEALTH GAP (2019), https://tminstituteldf.org/wp-content/uploads/2019/11/FINAL-RWG-Brief-v1.pdf.

[5] *Automated Valuation Models Can Help Identify Home Appraisal Bias in Minority Communities*, BUSINESS WIRE (Jun. 21, 2022), https://www.businesswire.com/news/home/20220621005350/en/Automated-Valuation-Models-Can-Help-Identify-Home-Appraisal-Bias-in-Minority-Communities; *Appraisal Subcommittee Meets to Address Valuation Bias*, DS NEWS (Jan. 27, 2023). https://dsnews.com/news/01-27-2023/asc-address-valuation-bias.

[6] INTERAGENCY TASKFORCE ON PROPERTY APPRAISAL AND VALUATION EQUITY, ACTION PLAN TO ADVANCE PROPERTY APPRAISAL AND VALUATION EQUITY (2022), https://pave.hud.gov/sites/pave.hud.gov/files/documents/PAVEActionPlan.pdf.

[7] LDF has been fully separate from the National Association for the Advancement of Colored People (NAACP) since 1957.

U.S. 1 (1948), and *McGhee v. Sipes*, 334 U.S. 1 (1948), which held that the state enforcement of racially restrictive covenants violated the Equal Protection Clause. In the decades since those victories, LDF has continued to challenge public and private policies and practices that deny Black people housing opportunities.

CRL is a non-profit, non-partisan research and policy organization that works to ensure a fair, inclusive financial marketplace. CRL's work focuses on those who may be marginalized or underserved by the existing financial marketplace -- people who often are targeted for unfair and abusive financial products that leave them worse off. Our affiliate, Self-Help Federal Credit Union ("Self-Help"), a Community Development Financial Institution and SBA lender, was an active Paycheck Protection Program ("PPP") lender throughout the entire program, with 65 percent of its PPP loans going to small businesses or nonprofits led by people of color. Through its Small Business Administration (SBA) lending programs and PPP advocacy, both Self-Help and CRL have had firsthand experience witnessing the barriers to entrepreneurship faced by people of color.

I. As a Result of Past Discrimination and Ongoing Flaws in the Appraisal Process, Appraisal Bias is Widespread.

Government policies entrenched the inaccurate and discriminatory view that homes in Black communities are less desirable, and that the presence of Black homeowners causes real estate values to decline. These biases were explicitly incorporated into appraisal practices into the late 20th Century. While most appraisers may no longer be formally trained to consider race when making a determination of value, appraisal bias remains a persistent problem today, depriving Black homeowners of the full benefits of their investments.

For decades, the federal government encouraged housing discrimination against communities of color through its policies and practices. In the 1930s, the Federal Home Owners Loan Corporation created maps to assess the desirability of particular neighborhoods and set new standards for federal underwriting.[8] To do so, the government relied on the opinions of the leading real estate professionals at the time, including appraisers.[9] These maps assessed value and risk in part based on a neighborhood's racial composition, designating predominantly Black neighborhoods and other neighborhoods of color as hazardous.[10] The Federal Housing Administration, which covered the insurance of over one-third of the U.S. mortgage market by the

[8] Danyelle Solomon, et al., *Systematic Inequality: Displacement, Exclusion, and Segregation How America's Housing System Undermines Wealth Building in Communities of Color*, CTR. FOR AM. PROGRESS (Aug. 2019), https://www.americanprogress.org/wp-content/uploads/sites/2/2019/08/StructuralRacismHousing.pdf; Testimony of Richard Rothstein, Distinguished Fellow of the Economic Policy Institute and Senior Fellow, Emeritus, NAACP Legal Defense and Educational Fund, Inc. on behalf of himself and Sherrilyn Ifill President and Director-Counsel NAACP Legal Defense and Educational Fund, Inc. Before the U.S. Senate Committee on Banking, Housing & Urb. Affairs, *Separate and Unequal: The Legacy of Racial Discrimination in Housing* 6 (Apr. 13, 2021), https://www.naacpldf.org/wp-content/uploads/LDF-Testimony-Senate-Banking-Racial-Discrimination-in-Housing_FINAL.pdf.

[9] BRUCE MITCHELL & JUAN FRANCO, NAT'L CMTY. REINVESTMENT COAL., HOLC "REDLINING" MAPS: THE PERSISTENT STRUCTURE OF SEGREGATION AND ECONOMIC INEQUALITY (Mar. 20, 2018), https://ncrc.org/holc/.

[10] *Id.*

middle of the century,[11] later developed similar maps.[12] This process, known as redlining, denied people of color—especially Black people—access to mortgage refinancing and federal underwriting opportunities while perpetuating the notion that residents of color were financially risky and a threat to local property values.[13]

The federal government then used these maps and other policies to amplify and codify the view that Black communities were less desirable and valuable, and that the presence of Black homeowners caused declining real estate values.[14] For example, the Federal Housing Administration's 1939 Underwriting Manual explicitly prohibited lending in neighborhoods that were changing in racial composition.[15] The Federal Housing Administration also instructed appraisers to focus on the uniformity of neighborhoods, with the presumption that the highest value would be assigned to all-white neighborhoods,[16] and to investigate "areas surrounding a location . . . to determine whether incompatible racial and social groups are present, for the purpose of making a prediction regarding the probability of the locations being invaded by such groups."[17] In a 1941 memorandum concerning St. Louis, the Federal Housing Administration similarly warned that "the rapidly rising Negro population ha[d] produced a problem in the maintenance of real estate values."[18]

These views were explicitly incorporated by the appraisal industry. A 1946 appraisal manual ranked which "nationalities and races having the most favorable influence" in Chicago and stated that "Negroes" and "Mexicans" exerted "detrimental effects" on real estate values.[19] Even after the Fair Housing Act (FHA) was passed in 1968, appraisers continued a race-based approach to valuation. A 1973 appraisal manual still advised, "As a general rule, homogeneity of the population contributes to stability of real estate values. . . . [M]inority groups are found at the

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[11] KRISTEN BROADY, ET AL., BROOKING INST., AN ANALYSIS OF FINANCIAL INSTITUTIONS IN BLACK-MAJORITY COMMUNITIES: BLACK BORROWERS AND DEPOSITORS FACE CONSIDERABLE CHALLENGES IN ACCESSING BANK SERVICES (2021), https://www.brookings.edu/research/an-analysis-of-financial-institutions-in-black-majority-communities-black-borrowers-and-depositors-face-considerable-challenges-in-accessing-banking-services/.

[12] RICHARD ROTHSTEIN, THE COLOR OF LAW: A FORGOTTEN HISTORY OF HOW OUR GOVERNMENT SEGREGATED AMERICA (2017).

[13] *Id.*

[14] *See id.* at 8-10.

[15] *See* DALTON CONLEY, BEING BLACK, LIVING IN THE RED: RACE, WEALTH, AND SOCIAL POLICY IN AMERICA 37 (2010); *see also* DOUGLAS MASSEY & NANCY DENTON, AMERICAN APARTHEID: SEGREGATION AND THE MAKING OF THE UNDERCLASS 54 (1993).

[16] Scott N. Markey, Planning Spatial Obsolescence: Racial Capitalism, the Home Owner Loan Corporation, and the Production of Racialized Devaluation (University of Georgia, May 2023) https://s3.amazonaws.com/na-st01.ext.exlibrisgroup.com/01GALI_UGA/storage/alma/7F/B2/E8/80/6D/F3/3C/2B/80/CD/5C/69/02/22/E4/F5/MarkleyScottPHD.pdf?response-content-type=application%2Fpdf&X-Amz-Algorithm=AWS4-HMAC-SHA256&X-Amz-Date=20230814T171800Z&X-Amz-SignedHeaders=host&X-Amz-Expires=119&X-Amz-Credential=AKIAJN6NPMNGJALPPWAQ%2F20230814%2Fus-east-1%2Fs3%2Faws4_request&X-Amz-Signature=10a706d255334ae3127bf1c0574e5a2e38d93bceb3820af15e4140bcf0c34031.

[17] NAT'L FAIR HOUS. ALLIANCE, ET AL., IDENTIFY BIAS AND BARRIERS, PROMOTING EQUITY: AN ANALYSIS OF THE USPAP STANDARDS AND APPRAISER QUALIFICATIONS CRITERIA (2022), https://nationalfairhousing.org/wp-content/uploads/2022/02/2022-01-28-NFHA-et-al_Analysis-of-Appraisal-Standards-and-Appraiser-Criteria_FINAL.pdf.

[18] Conley, *supra* note 15, at 37.

[19] NAT'L FAIR HOUS. ALLIANCE, ET AL., *supra* note 17, at 15.

bottom of the socio-economic ladder, and problems associated with minority group segments of the population can hinder community growth."[20] Explicitly race-based language was only removed from the American Institute of Real Estate Appraisers' manuals in 1977, when the Department of Justice was able to secure a settlement requiring the American Institute of Real Estate Appraisers to adopt policy statements that forbade appraisers from considering the race of a community or of the owners or buyers of the property when developing an opinion of value.[21] Some appraisers who were trained on that original, discriminatory approach may still be working today.

While appraisal manuals may no longer contain explicit race-based language, discriminatory appraisals remain pervasive. An analysis of appraisal reports by the Federal Housing Finance Agency found that thousands of the reports contained potential race-related language in the "Neighborhood Description" and other free form text fields, indicating that race continues to influence appraisals.[22] Moreover, the sales comparison approach that most appraisers use gives appraisers significant discretion and leaves open the opportunity for bias.[23] Under the sales comparison approach, appraisers identify three to five comparable properties ("comps") which were recently sold in order to develop an estimate of value.[24] Appraisers are trained to limit the comps to homes within the same neighborhoods, yet they frequently select comps in order to confirm their subjective view of the value of the home. For example, purchase mortgage appraisals often exhibit anchoring bias, where appraisers set the value at or above the contract price, choosing comparable properties that confirm their assumption that the contract price is correct.[25] However, the contract price can be affected by temporary market forces and may not reflect the underlying value of the house or the risk of a mortgage based on the price.[26] Appraisers similarly choose comps to reflect their biased views of the value of homes based on the race of the neighborhood or the buyer or seller. According to a 2021 study by Freddie Mac, the average distance between a home and its comps is substantially smaller for Black and Latino neighborhoods than it is for white neighborhoods.[27] As a result, appraisers are more likely to select comps that may by undervalued due to redlining and other historic practices, even if there are similar homes with higher values in

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[20] *Id.* at 16.

[21] *United States v. Am. Inst. of Real Estate Appraisers, Etc*., 442 F. Supp. 1072 (N.D. Ill. 1977)

[22] Fair Hous. Finance Agency, *Reducing Valuation Bias by Addressing Appraiser and Property Valuation Commentary*, FHFA Insights Blog (Dec. 14, 2021), https://www.fhfa.gov/Media/Blog/Pages/Reducing-Valuation-Bias-byAddressing-Appraiser-and-Property-Valuation-Commentary.aspx.

[23] Johnathan Rothwell & Andre M. Perry, *How racial bias in Appraisals Affects the Devaluation of Homes in Majority-Black Neighborhoods,* BROOKINGS INST. (Dec. 5, 2022), https://www.brookings.edu/articles/how-racial-bias-in-appraisals-affects-the-devaluation-of-homes-in-majority-black-neighborhoods/.

[24] Alexander N. Bogin & Jessica Shui, *Appraisal Accuracy, Automated Valuation Models, And Credit Modeling in Rural Areas,* Fed. Hous. Finance Agency, Div. of Hous. Mission & Goals, Office of Pol'y Analysis & Res. (Apr. 2018), https://www.fhfa.gov/PolicyProgramsResearch/Research/PaperDocuments/AVMs-versus-Appraisals-in-Rural-Areas_20180419.pdf.

[25] *Id.*

[26] Yanling G. Mayer & Frank Nothaft, *Appraisal overvaluation: Evidence of price adjustment bias in sales comparisons*, 50 REAL ESTATE ECON. 862 (2022), https://www.maxwell.syr.edu/docs/default-source/research/cpr/property-tax-webinar-series/2022-2023/appraisal-overvaluation-price-adjustment-bias-original-accessible.pdf?sfvrsn=aa390f47_3#page=12.

[27] Freddie Mac, Racial and Ethnic Valuation Gaps In Home Purchase Appraisals (Sept. 20, 2021), https://www.freddiemac.com/research/insight/20210920-home-appraisals.

comparable white neighborhoods nearby. A 2022 Fannie Mae study similarly identified the leading cause of overvaluation of white-owned homes in majority Black neighborhoods as appraisers looking outside the neighborhood to identify comps.[28]

Numerous studies have found that Black neighborhoods and homes owned by Black people continue to be systemically undervalued due to appraisal bias.[29]

- The 2021 Freddie Mac study mentioned above found that a majority of appraisers were more likely to determine that the appraisal value was lower than the contract price in majority Black neighborhoods than in majority white neighborhoods.[30]

- A 2022 study by Brookings Institution found that housing in Black neighborhoods were valued roughly 21-23 percent below what the same homes would be worth in non-Black neighborhoods.[31] Neighborhoods with a majority of Latino or Hispanic, Asian American, or white residents did not experience home price devaluation, using the same model.[32] The study concluded that at least 10 percent of homes are at risk of undervaluation in majority-Black neighborhoods, limiting wealth accumulation for homeowners in majority-Black neighborhoods.[33]

- Researchers looking at the Houston, Texas housing market found that the sales comparison approach produced racially unequal evaluations, assessing homes in white neighborhoods as $170,000 (or 2.5 times) more valuable than comparable homes in comparable neighborhoods of color.[34]

- Researchers Dr. Junia Howell and Dr. Elizabeth Korver-Glenn found that homes in white neighborhoods are appraised at double the value of comparable homes in communities of color.[35]

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[28] JAKE WILLIAMSON & MARK PALIM, FANNIE MAE, APPRAISING THE APPRAISAL: A CLOSER LOOK AT DIVERGENT APPRAISAL VALUES FOR BLACK AND WHITE BORROWERS REFINANCING THEIR HOME (2022), https://www.fanniemae.com/media/42541/display.

[29] NAT'L FAIR HOUS. ALLIANCE, ET AL., *supra* note 17.

[30] Melissa Narragon, et al., *Racial and Ethnic Valuation Gaps in Home Purchase Appraisals, Freddie Mac Economic and Housing Research Note,* FREDDIE MAC RES. NOTE (Sept. 2021), http://www.freddiemac.com/fmac-resources/research/pdf/202109-Note-Appraisal-Gap.pdf.

[31] Rothwell & Perry, *supra* note 23.

[32] *Id.*

[33] *Id.*

[34] Junia Howell, *Color Coded: The Growing Racial Inequality in Home Appraisals, Written Testimony Submitted to the Appraisal Subcommittee (ASC) Public Hearing on Appraisal Bias* (Jan. 24, 2023), https://files.consumerfinance.gov/f/documents/cfpb_appraisal-hearing_junia-howell-testimony_2023-01-24.pdf.

[35] JUNIA HOWELL & ELIZABETH KORVER-GLENN, WEIDENBAUM CENTER FOR THE ECONOMY, GOVERNMENT, AND PUBLIC POLICY AT WASHINGTON UNIVERSITY, APPRAISED: THE PERSISTENT EVALUATION OF WHITE NEIGHBORHOODS AS MORE VALUABLE THAN COMMUNITIES OF COLOR (2022), https://nationalfairhousing.org/wp-content/uploads/2022/11/2022-11-2_Howell-and-Korver-Glenn-Appraised.pdf.

The Brookings Institution estimates that the cost of the undervaluation across the 113 metro areas in the U.S. with at least one majority-Black neighborhood is approximately $162 billion.[36]

Inaccurate appraisals can exacerbate the racial wealth gap. Black households currently have about seven cents on the dollar in net worth relative to white households.[37] Undervaluations due to appraisal bias contributes to this gap: because homes in Black communities are valued less than comparable homes in white communities, Black homeowners cannot build the same amount of wealth through homeownership.

Inaccurate appraisals also create safety and soundness risk. As the federal financial regulators have acknowledged that, "Valuations that are not credible may pose risks to the financial condition and operations of a financial institution."[38] The Consumer Financial Protection Bureau (CFPB) has similarly reiterated that accurate appraisals are essential to the fairness of mortgage lending.[39] Inaccurate appraisals, particularly overvaluations, can lead lenders to underestimate credit risk,[40] increase the risk of foreclosure,[41] and decrease loan quality and profitability for lenders.[42] Overvaluations may also be associated with mortgage fraud.[43] Inaccurate appraisals pose the same risks to the integrity of the residential real estate lending process regardless of whether they result from discrimination or other flaws.

II. Federal Civil Rights Laws Prohibit Appraisal Bias, Including Biased Appraisals by AVMs, by Appraisers, Mortgage Lenders, and Others.

Federal civil rights laws prohibit appraisal bias by individual appraisers, mortgage lenders, and other actors. These laws apply to discrimination in appraisals by both humans and AVMs. The Dodd-Frank Act also grants federal financial regulators with broad authority to impose quality control standards on all AVMs.

Federal financial regulators have existing authority to address discriminatory appraisals made or relied upon by a wide range of actors. The Equal Credit Opportunity Act (ECOA), for example, makes it unlawful for any creditor to discriminate against any applicant, on the basis of

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36 Rothwell & Perry, *supra* note 23.
37 SHAPIRO ET AL., *supra* note 4, at 5.
38 Office of the Comptroller of the Currency, et al., Interagency Guidance on Reconsiderations of Value of Residential Real Estate Valuations, 88 Fed. Red. 47071, 47075 (2022), https://www.govinfo.gov/content/pkg/FR-2023-07-21/pdf/2023-12609.pdf.
39 Patrice Alexander Ficklin, et al., Consumer Financial Protection Bureau, Mortgage Borrowers Can Challenge Inaccurate Appraisals Through the Reconsideration of Value Process (Oct. 6, 2022), https://www.consumerfinance.gov/about-us/blog/mortgage-borrowers-can-challenge-inaccurate-appraisals-through-the-reconsideration-of-value-process.
40 Yangling G. Mayer & Frank E. Nothaft, *Appraisal overvaluation: Evidence of price adjustment bias in sales Comparisons*, 50 REAL ESTATE ECON. 862 (2022), https://www.maxwell.syr.edu/docs/default-source/research/cpr/property-tax-webinar-series/2022-2023/appraisal-overvaluation-price-adjustment-bias-original-accessible.pdf?sfvrsn=aa390f47_3.
41 Patrice Alexander Ficklin, et al., *supra* note 39.
42 Yangling G. Mayer & Frank E. Nothaft, *supra* note 40.
43 *Id.*

race or other protected characteristics, including through appraisals.[44] The FHA similarly prohibits housing discrimination, including discrimination in mortgage lending and appraisals.[45] Federal agencies charged with enforcing the nondiscrimination standards under the FHA and ECOA have made clear that an appraiser's use of or reliance on conclusions based on protected characteristics constitute illegal discrimination.[46] Federal law also prohibits appraisal bias by mortgage lenders. In March 2023, the Department of Justice (DOJ) and the CFPB filed a Statement of Interest asserting that mortgage lenders can be liable under the FHA and ECOA for relying on discriminatory appraisals.[47]

These existing antidiscrimination protections apply when AVMs determine value. Several federal agencies have stated that existing legal authorities including civil rights, non-discrimination, fair competition, consumer protection, and other legal authorities apply to the use of automated systems like AVMs.[48] For example, the CFPB has made clear that creditors who use algorithmic tools in any aspect of their credit decisions must still abide by ECOA;[49] as such, when creditors make credit decisions based on algorithmic tools, creditors need to still comply with ECOA's requirement to provide a statement of specific reasons to applicants against whom adverse action is taken.[50] Similarly, DOJ and the Department of Housing and Urban Development (HUD) have explained in a Statement of Interest that companies who develop algorithmic technologies that result in the denial of housing or different terms and conditions of housing could be liable under the FHA.[51] While that case concerned tenant screening software, similar reasoning would apply to AVMs.

The Dodd-Frank Act is similarly clear that all AVMs must comply with the quality control standards issued under the Act. In the Dodd-Frank Act, Congress required all AVMs to meet certain quality control standards[52] and directed the federal financial regulators develop regulations

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[44] *Id.*
[45] Fair Housing Act, Pub. L. No. 90-285, 82 Stat. 81 (1968) (codified at 42 U.S.C. 3601 *et seq.*).
[46] Consumer Fin. Protection Bureau, CFPB Comments Related to the Appraisal Standards Board Ethics Rule (Ethics Rule) and Advisory Opinion 16 (Feb. 4, 2022), https://files.consumerfinance.gov/f/documents/cfpb_appraisal-discrimination_federal-interagency_comment_letter_2022-02.pdf.
[47] Press Release, U.S. Department of Justice, Justice Department and Consumer Financial Protection Bureau File Statement of Interest in Appraisal Discrimination Case (Mar. 13, 2023), https://www.justice.gov/opa/pr/justice-department-and-consumer-financial-protection-bureau-file-statement-interest-appraisal.
[48] Consumer Financial Protection Bureau, et al., Joint Statement on Enforcement Efforts Against Discrimination and Bias in Automated Systems (Apr. 25, 2023), https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/cfpb_joint-statement-enforcement-against-discrimination-bias-automated-systems_2023-04.pdf;
[49] *Id.*
[50] Consumer Financial Protection Bureau, Adverse Action Notification Requirements In Connection with Credit Decisions Based on Complex Algorithms (May 26, 2022), https://www.consumerfinance.gov/compliance/circulars/circular-2022-03-adverse-action-notification-requirements-in-connection-with-credit-decisions-based-on-complex-algorithms/.
[51] Press Release, U.S. Department of Justice, Justice Department Files Statement of Interest in Fair Housing Act Case Alleging Unlawful Algorithm-Based Tenant Screening Practices (Jan. 9, 2023), https://www.justice.gov/opa/pr/justice-department-files-statement-interest-fair-housing-act-case-alleging-unlawful-algorithm.
[52] 12 U.S.C. § 3354(a).

for AVMs, which Congress defined as "any computerized model used by mortgage originators and secondary market issuers to determine the collateral worth of a mortgage secured by a consumer's principal dwelling."[53] The statute directs that quality control standards must be designed to "(1) ensure a high level of confidence in the estimates produced by automated valuation models; (2) protect against the manipulation of data; (3) seek to avoid conflicts of interest; (4) require random sample testing and reviews; and (5) account for any other such factor that . . . [is] appropriate."[54] Importantly, the Dodd-Frank Act is focused on regulating the technology rather than particular users of the technology, stating that all "[a]utomated valuation models shall adhere to quality control standards"[55]

III. Automated Valuation Models Risk Reproducing Appraisal Bias.

AVMs seek to supplement or replace human appraisals by using algorithms that rely on data regarding prior home sales and other information to arrive at an estimate of value.[56] While advocates for AVMs have argued that that they can reduce human bias in appraisals, these tools can also lead to discrimination. As CFPB Director Chopra has acknowledged, "It is tempting to think that machines crunching numbers can take bias out of the equation, but they can't."[57] The data used to develop and train AVMs, and the models that they use, may incorporate past discrimination, causing the AVM to reproduce similarly biased results.

AVMs use a variety of data and techniques to arrive at valuations, such as comparative assessments of recent sales of other properties; index models that predict the current sales prices of a home based on the prior sales price and market trends; and hedonic models based physical attributes (such as square footage, number of bedrooms, number of bathrooms, year built, lot size, and other features).[58] AVMs may also use a combination of these techniques.[59] Some AVMs also provide "confidence scores" that claim to reflect the relative accuracy of the estimate of value.[60]

Most AVMs are regarded as proprietary. As a result, AVM developers often do not disclose what data sets they used to develop the model or arrive at valuations, how the model was trained, or how it arrives at a valuation, and some AVMs have not been subjected to independent evaluation or testing. Moreover, because AVMs may be developed by entities that are not a mortgage

[53] *Id.* at § 3354(d).
[54] *Id.*
[55] *Id.*
[56] REENA AGARWAL & ERIC FOX, VEROS, IS THERE EVIDENCE OF RACIAL BIAS (2022), https://go.veros.com/hubfs/Veros_White_Papers/AVM%20Performance_Is%20there%20Evidence%20of%20Racial%20Bias_by_VEROS_2022.pdf.
[57] Press Release, Consumer Financial Protection Bureau, Consumer Financial Protection Bureau Outlines Options to Prevent Algorithmic Bias in Home Valuations (Feb. 23, 2022), https://www.consumerfinance. gov/about-us/newsroom/cfpb-outlines-options-to-prevent-algorithmic-bias-in-home-valuations/.
[58] Agarwal & Fox, *supra* note 56.
[59] *Id.*
[60] *Id.*

originator, secondary mortgage issuer, or appraiser, AVM users may not have a full understanding of possible sources of bias embedded in the tool they are using.

In response to the growing body of research demonstrating the persistence of appraisal bias, some have argued that AVMs offer a less-biased alternative.[61] Proponents claim that these models are not biased because they do not include racial or other demographic data about the participants in the transaction or the neighborhood. The AVM company Veros claims, for example, claims that AVMs are "blind to any borrower and neighborhood demographics and therefore offers an objective value determination."[62] In theory, AVMs could also standardize values and processes where appraisers currently have significant discretion, such as controlling the distance for comps, standardizing adjustments, or using pricing models less subject to manipulation.[63]

Unfortunately, regardless of whether they were developed using demographic data and rely on such data to arrive at a valuation, AVMs can still have a disparate impact on people of color. Like other algorithmic systems, the information used to develop and train AVMs is often drawn from existing data sets.[64] As such, according to FTC Commissioner Rebecca Slaughter, these systems may reflect "problematic human biases" and "historical and enduring patterns of prejudice or inequality" that exist in that data.[65] AVMs in particular rely on data on a large number of comparable sales to develop their valuations and can thus reinforce any racial bias present in those that data, such as the undervaluation of homes in formerly redlined areas[66] and ongoing appraisal bias.[67] Even if an AVM does not include race or other protected characteristics, it may include another variable or variables that are correlated with those characteristics, such as zip code.[68] Algorithmic bias can also result from the interaction of several variables that operate together to create a disparate impact.[69] Finally, algorithmic bias can result when the data sets used are not

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[61] *See, e.g.,* Business Wire, *supra* note 5.
[62] Agarwal & Fox, *supra* note 56.
[63] Hannah Gable & David Garcia, UC Berkeley Terner Ctr. for Hous. Innovation, Reducing Bias in Home Appraisals: The Roles for Policy and Technology (Mar. 3, 2022), https://ternercenter.berkeley.edu/research-and-policy/reducing-bias-in-home-appraisals-the-roles-for-policy-and-technology/.
[64] MICHAEL NEAL, ET AL., URBAN INST., HOW AUTOMATED VALUATION MODELS CAN DISPROPORTIONATELY AFFECT MAJORITY BLACK NEIGHBORHOODS (2020), https://www.urban.org/sites/default/files/publication/103429/how-automated-valuation-models-can-disproportionately-affect-majority-black-neighborhoods_1.pdf.
[65] FTC Commissioner Rebecca Kelly Slaughter, Remarks at UCLA School of Law: Algorithms and Economic Justice (Jan. 24, 2020), https://www.ftc.gov/system/files/documents/public_statements/1564883/remarks_of_commissioner_rebecca_kelly_slaughter_on_algorithmic_and_economic_justice_01-24-2020.pdf
[66] Letter from the Nat'l Fair Hous. Alliance to Consumer Fin, Protection Bureau Director Rohit Chopra, CFPB Outline for the Small Business Advisory Review Panel for the Automated Valuation Model Rulemaking, at 5 (May 13, 2022), https://nationalfairhousing.org/wp-content/uploads/2022/05/NFHA-et-al-Comment-Letter_CFPB-re-AVMs_05-13-2022_FINAL.pdf.
[67] *Id.*; *see also, e.g.,* Kamin, *supra* note 3.
[68] *See* Letter from LDF & Student Borrower Protection Center to Dave Girouard, CEO of Upstart Network, Inc. (Jul. 30, 2020), https://www.naacpldf.org/wp-content/uploads/2020-07-30-FINAL-Demand-Letter.pdf; Mikella Hurley & Julius Adebayo, *Credit Scoring in the Era of Big Data,* 8 YALE J.L. & TECH. 148, 182 (2016), hurley_18yjolt136_jz_proofedits_final_7aug16_clean_0.pdf.
[69] Hurley & Adebayo, *supra* note 68, at 202.

representative of the populations that the model will assess. A model that is trained on a data set that does not include fair representation of communities of color, for example, may not accurately assess home values in those communities.

Model developers can assess AVMs' accuracy using a wide variety of metrics,[70] some of which can also replicate human biases. For example, HouseCanary measures its "error rate" by comparing the valuations its model provides with "arm's-length sale prices on closed transactions."[71] However, as noted above, the sales price may not accurately reflect the property's value and instead be impacted by racial bias.

While there is some research suggesting that AVMs exhibit less appraisal bias than human appraisals,[72] other research shows that AVMs are less accurate at predicting the value of homes in Black neighborhoods and can produce discriminatory results. A 2020 study by researchers at the Urban Institute found that the degree of AVM error as a percentage of the property's sale price was higher in majority-Black neighborhoods compared to majority-white neighborhoods, even after controlling for factors like lower home values and worse property conditions."[73] The researchers concluded that "even though an AVM algorithm does not explicitly factor in a neighborhood's majority race, it still can produce racial disparities."[74] In 2022, the same research team confirmed that these disparities persisted even after using a more sophisticated model that accounted for key variables like home value and applying more accurate modeling.[75] They found that if all properties currently in majority-Black neighborhoods "moved" to majority-white neighborhoods, the predicted AVM error could decline by 5.0 percentage points.[76] Ultimately, they concluded, "Racially inequitable inputs, partially rooted in historical racism, can produce racially disparate AVM error."[77]

IV. The Federal Financial Regulators Should Strengthen the Final Rule and Provide Additional Guidance on How to Prevent Appraisal Bias.

We thank the federal financial regulators for initiating this important rulemaking. Eliminating discrimination is essential to achieving an equitable society and ensuring safety and soundness. Any model that undervalues homes owned by people of color is both discriminatory

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[70] Miriam Steurer, et al., *Metrics for evaluating the performance of machine learning based automated valuation models*, J. OF PROPERTY RESEARCH, vol. 38, no. 2 (2021), https://www.tandfonline.com/doi/pdf/10.1080/09599916.2020.1858937.

[71] HouseCanary, Re: Quality Control Standards for Automated Valuation Models (Jul. 23, 2023), https://www.regulations.gov/comment/OCC-2023-0002-0004.

[72] Kadiri Karamon & Douglas A. McManus, *Does Automated Collateral Evaluation Lower Mortgage Credit Risk Relative to Home Appraisal Valuations?,* J. of Structured Finance, vol. 28, no. 2 (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4057658.

[73] NEAL, ET AL., *supra* note 64.

[74] *Id.*

[75] Michael Neal, et al., *What Role Can Property Condition Data and Artificial Intelligence Modeling Play in Understanding AVM Error?*, URBAN INST. (Jun. 15, 2022), https://www.urban.org/urban-wire/what-role-can-property-condition-data-and-artificial-intelligence-modeling-play.

[76] *Id.*

[77] *Id.*

and inaccurate. As AVMs become increasingly common, it is essential that federal financial regulators ensure compliance with existing civil rights laws by setting clear and robust regulatory expectations. We urge the federal financial regulators to broaden the scope of the final rule, including by eliminating the proposed exceptions to which AVMs it covers, clarifying that the "nondiscrimination" quality control standard requires compliance with existing civil rights laws, and providing additional guidance to regulated entities on how to comply with their nondiscrimination obligations.

The proposed rule would require mortgage originators and secondary market issuers to adopt and maintain policies, practices, procedures, and control systems to ensure that automated valuation models used in these transactions adhere to quality control standards.[78] In addition to the four standards outlined in the statute (ensure a high level of confidence in the estimates produced; protect against the manipulation of data; avoid conflicts of interest; and require random sample testing and reviews), the proposed rule would add "nondiscrimination" as a fifth quality control standard.[79] However, the proposed rule would exclude AVMs used for particular purposes from these quality control standards, including AVMs used for monitoring the quality or performance of mortgages or mortgage-backed securities; reviews of the quality of already completed determinations of the value of collateral; or develop an appraisal by a certified or licensed appraiser. Moreover, the proposed rule narrowly defines key terms in ways that unnecessarily limit the application of the rule.

We agree with the National Fair Housing Alliance and other commenters that, in order to address the risk of appraisal bias, the final rule should eliminate the proposed exceptions and broadly define key terms, such as "dwelling," consistent with their uses in the Fair Housing Act and other relevant statutes. Rather than focus on particular users of AVMs, the final rule should follow the language of the statute and cover all AVMs. For example, there is little merit in excluding AVMs used to develop appraisals for these quality control standards. An appraiser who relies on the biased valuation of a discriminatory AVM causes the same harm as an appraiser who comes to a similar determination of value because of personal prejudice. Similarly, the final rule should include AVMs used to review completed determinations, as a discriminatory AVM may not identify discriminatory appraisals. The final rule should also specifically cover Fannie Mae and Freddie Mac, which use AVMs to confirm the accuracy of in-person appraisals and, during the COVID-19 pandemic, used AVMs to reduce the number of in-person appraisals to limit human exposure during the pandemic.[80] These changes to the final rule would provide greater consistency and clarity regarding the standards AVMs must follow and ensure that people of color enjoy equal protection from all automated bias.

Federal financial regulators should also make clear in the final rule that ensuring "nondiscrimination" in compliance with the quality control standards means compliance with ECOA and the FHA, including both disparate treatment and disparate impact.

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[78] Proposed Rule at 40674.
[79] *Id.*
[80] NEAL, ET AL., *supra* note 73.

In addition, federal financial regulators should require a proactive assessment of AVMs to identify and address appraisal bias. As currently drafted, the proposed rule would permit regulated institutions to adopt their own AVM policies and control systems to satisfy the statutory factors, rather than prescribing those policies and systems. More specific guidance is needed to protect consumers from fair lending, fair housing, and safety and soundness risks. This guidance should further specify the steps that AVM developers and users should each take to conduct quality control testing directly and/or engage in appropriate due diligence.

Federal financial regulators should draw from the White House's Blueprint for the AI Bill of Rights[81] and the numerous frameworks by civil rights, consumer, and technology advocates regarding model risk management[82] to provide regulated entities with concrete guidance on how to identify and address appraisal bias by AVMs. The guidance should cover:

- *Model Design:* As discussed above, due to historic and ongoing discrimination, AVMs' reliance on some data sources could create potential disparate impacts on people of color. AVMs should not rely on any data about the buyer or seller, including but not limited to demographic data, to determine value.[83] However, while demographic data should not be used for valuations, it should be available so that developers can assess whether AVMs have a disparate impact on people of color or other protected classes. AVMs should also not use data that can act as a proxy for race to determine value.[84] Developers of AVMs should carefully evaluate whether particular data is actually relevant to the value of the property before including it in the model. For example, introducing alternative data sources that are less directly related to individual consumers' finances, such as social media data,

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[81] WHITE HOUSE OFFICE OF SCIENCE & TECHNOLOGY POLICY, BLUEPRINT FOR AN AI BILL OF RIGHTS (2022), https://www.whitehouse.gov/wp-content/uploads/2022/10/Blueprint-for-an-AI-Bill-of-Rights.pdf (AI BILL OF RIGHTS).

[82] *E.g.* MICHAEL AKINWUMI, ET AL., PURPOSE, PROCESS, AND MONITORING A NEW FRAMEWORK FOR AUDITING ALGORITHMIC BIAS IN HOUSING & LENDING (2022), https://nationalfairhousing.org/wp-content/uploads/2022/02/PPM_Framework_02_17_2022.pdf; Letter from Nat'l Fair Hous. Alliance, LDF, et al., to Board of Governors of the Fed. Reserve Syst., et al., Re: Request for Information and Comment on Financial Institutions' Use of Artificial Intelligence, including Machine Learning (Jul. 1, 2021), https://nationalfairhousing.org/wp-content/uploads/2021/07/Federal-Banking-Regulator-RFI-re-AI_Advocate-Letter_FINAL_2021-07-01.pdf.

[83] See Regulation B, 12 C.F.R. Part 1002, Supp. I, ¶ 2(p)–4 ("Besides age, no other prohibited basis may be used as a variable."); Fed. Fin. Institutions Examination Council, Interagency Fair Lending Examination Procedures at 8 (Aug. 2009) (explaining that overt discrimination includes using "variables in a credit scoring system that constitute a basis or factor prohibited by Regulation B or, for residential loan scoring systems, the FHAct"); Office of the Comptroller of the Currency, Bulletin 97-24, Appendix, "Safety and Soundness and Compliance Issues on Credit Scoring Models" (1997) (noting that "a creditor cannot use a credit scoring system that assigns various points based on the applicant's race, national origin, or any other prohibited basis," with an exception for age).

[84] *See* Office of the Comptroller of the Currency, Bulletin 97-24 at 10 ("Moreover, factors linked so closely to a prohibited basis that they may actually serve as proxies for that basis cannot be used to segment the population.").

can create the risk of bias.[85] Finally, developers should ensure that people of color and communities of color are not underrepresented in model development data.

Model design should also account for existing bias in the residential real estate market. As noted above, comparable homes are appraised for and may sell for different prices based on whether they are located in Black communities or white communities. AVMs that "accurately" reflect this bias are still discriminatory. AVM developers and users should ensure that they do not assess the accuracy of the model based on how well they reflect these biased assessments.

- *Independent Audits*: Federal financial regulators should require independent audits that assess whether an AVM disparately harms or disadvantages individuals on the basis of race or other protected characteristics, and federal financial regulators should outline what standards institutions should use to assess whether their AVM violates the FHA, ECOA, and other civil rights laws.[86] These audits should assess the ways in which biased data, flaws in the AVM, and the surrounding circumstances can affect companies' evaluation of whether an AVM arrives at an accurate valuation. The audits should assess models for differential validity—i.e., whether a model's valuation is less accurate for some groups—as well as accuracy overall. These assessments should occur during the pre-design phase, design and development phase, and on an ongoing basis after deployment.[87]

  Regulated entities should publicly report the findings of these audits, as well as any changes they made to their AVMs in response to the findings from these audits. These reports should be in plain language and easily accessible to the public.[88] Auditors should be truly independent; third-party testing agencies that also provide their own AVM services should not be considered independent, as they may have a conflict of interest when evaluating a competitor or a model that relies on similar data and analysis to their own.

- *Proactively Search for Less Discriminatory Alternatives:* As part of the audits described above, the federal financial regulators should require regulated entities to identify and adopt less discriminatory alternatives.

- *Transparency:* Regulated entities should be required to disclose, in plain language, how their AVMs determine value, what variables they are using to make that assessment, where their data is from, and how the model is trained. In particular, they should be required to disclose how comps are selected and how adjustments are made to the sales price, if the

[85] *See* Testimony of Aaron Reike, Managing Director, Upturn, Examining the Use of Alternative Data in Underwriting and Credit Scoring to Expand Access to Credit, Task Force on Financial Technology, Hr'g before the U.S. House Comm. on Financial Svcs. (July 25, 2019).
[86] *See* Sasha Constanza-Chock, et al., *Who Audits the Auditors? Recommendations from a field scan of the algorithmic auditing ecosystem,* ACM CONFERENCE ON FAIRNESS, ACCOUNTABILITY, & TRANSPARENCY (Jun. 2022), https://facctconference.org/static/pdfs_2022/facct22-126.pdf.
[87] MICHAEL AKINWUMI, ET AL., *supra* note 82.
[88] *See* AI BILL OF RIGHTS at 5, 23; Sasha Constanza-Chock, et al., *supra* note 86.

model uses a sales comparison approach to determine value; and how different aspects of a property are valued in hedonic models. AVM developers should document how they validated their AVM and how reliable it is at assessing value. AVM developers should also preserve copies of all iterations of their AVM, as well as their audits and adverse action notices, to facilitate subsequent regulatory action or litigation. This transparency is essential to understand the fair housing, fair lending, and safety and soundness risks posed by that AVM. However, transparency alone is insufficient to satisfy fair housing and fair lending obligations, absent actions to identify disparate impacts and less discriminatory alternatives.

Federal financial regulators should also release loan-level data from the Uniform Appraisal Dataset to provide a robust dataset which can be used to evaluate AVMs and identify less discriminatory alternatives.

Finally, federal, state, and local governments must develop additional solutions that address other sources of disparities in the value of homes in under-resourced Black communities, such as lack of access to public transportation, high-quality schools, and other critical resources. These disparities are the result of decades of underinvestment in communities of color and will require significant investment to redress.

V. **Conclusion**

Due to decades of past and ongoing discrimination, homes in Black communities and homes owned by Black people are consistently undervalued, contributing to the racial wealth gap. Although some have argued that AVMs can eliminate human bias, these systems can pose the same fair housing, fair lending, and safety and soundness risks.[89] Without stringent quality controls, AVMs risk replicating appraisal bias on a mass scale. While we applaud the federal financial regulators for acknowledging the risk of algorithmic bias in AVMs, they must expand the final rule and issue additional guidance in order to ensure that these tools do not replicate past and present discrimination.

Thank you for the opportunity to comment. If you have any questions, please contact Amalea Smirniotopoulos, Senior Policy Counsel (asmirniotopoulos@naacpldf.org) and David Wheaton, Economic Justice Policy Fellow (dwheaton@naacpldf.org).

Sincerely,

NAACP Legal Defense and Educational Fund, Inc.
Center for Responsible Lending

[89] Fed. Hous. Finance Agency, Reducing Valuation Bias by Addressing Appraiser and Property Valuation Commentary (Dec. 14, 2021), https://www.fhfa.gov/Media/Blog/Pages/Reducing-Valuation-Bias-by-Addressing-Appraiser-and-Property-Valuation-Commentary.aspx.