Indianapolis Neighborhood Housing Partnership

RESEARCH BRIEF

Appraisal Bias

SEPTEMBER 2021

STATE OF THE RESEARCH

Appraisers—like all actors within the real estate sector—are bound by law not to discriminate based on race, ethnicity, or other distinguishing characteristics; however, recent research from the Brookings Institute—as well as stories within the popular press—suggests homeowners of colors often confront racial bias in the valuation of their homes. When houses owned by households of color are valued less than those of similarly situated white owners, the reduced valuation erodes the net worth of the homeowner and reduces opportunities to refinance and/or sell homes; writ large, reduced valuations of neighborhoods with higher concentrations of minority residents reduces these same opportunities for the community as a whole.

BACKGROUND

For most homeowners, the largest component of their wealth/net worth is the value of their home; therefore, it naturally follows that the value of one's home has a significant influence on one's net worth. Where a higher net worth can open opportunities—such as refinancing to lower interest rates and otherwise borrowing against one's assets; lower net worth can similarly limit one's options in refinancing a current mortgage or realizing a fair price when selling a property.

Estimating the value of real estate mixes quantitative analysis of a home and neighborhoods features and attributes with comparable properties as well as some more subjective determinations around condition and quality. The subjectivity involved can lead to substantial differences in results of appraisals. There are numerous reports, in the press and elsewhere, of homeowners of color receiving less than favorable appraisals only to subsequently receive much higher appraisals once they removed material from their home that eliminated the ability of the appraiser to know the race of the homeowner.

In May, the *Indianapolis Star* featured the story of a Black homeowner with a house in the Flanner House Homes neighborhood who sought to refinance her mortgage, only to have two appraisals come in low relative to expectations—$125,000 and $110,000 respectively—while a market analysis for her home showed a possible list price of $187,000. After removing material from her home that might identify her race, communicating with a third appraiser only via email, and having a white friend stand in for her to meet the appraiser, her appraisal came back at $259,000.

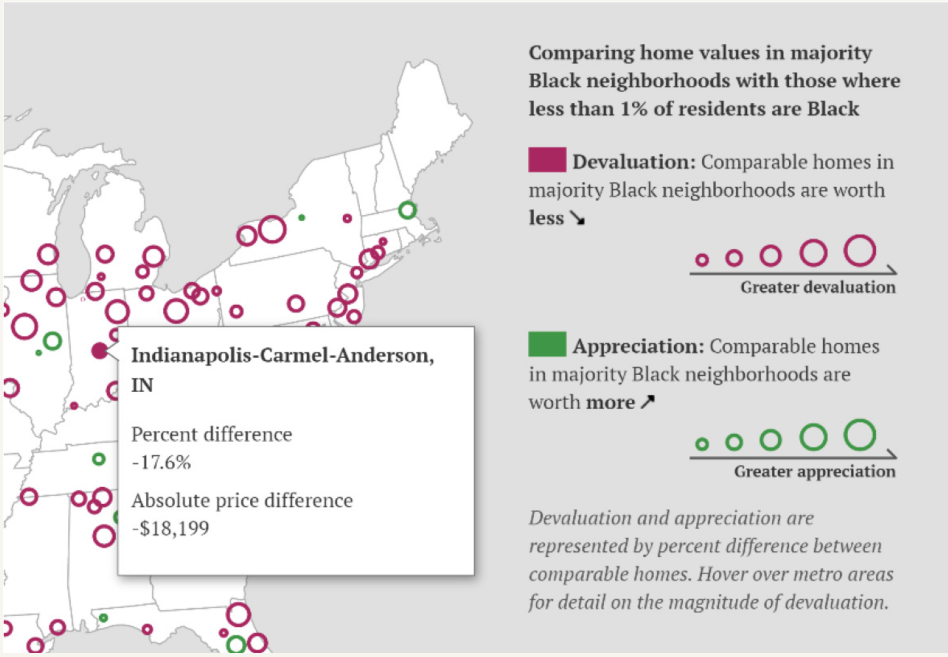
While any individual instance of appraisal bias harms the individual that owns the asset being appraised, in the aggregate, appraisal bias erodes the value of and wealth in communities of color. Further, the bias can become systematized where properties in communities of color are appraised in comparison to other communities of color, which results in a reduced appraisal and may establish a diminished value for future comparisons. The research distinguishes these types of bias as "individual bias" and "neighborhood bias"; both have a pernicious effect on eroding the wealth of homeowners and communities of color.

SUMMARY OF RESEARCH FINDINGS

Beyond the several anecdotes provided across press outlets, researchers are becoming increasingly interested in quantifying the impact of racial bias in valuing housing in communities of color. A recent study published in the academic journal *Social Problems* found that homes in white neighborhoods appreciated $200,000 more than comparable homes in communities of color since 1980. The divergent experiences of communities of color relative to similar white communities contributes to the racial wealth gap—as the assets held by homeowners of color are devalued—and limits the ability of homeowners of color to fund their retirements, invest in college education, access credit, or weather unexpected expenses.

Andre Perry of Brookings sought to estimate the cost of racial bias by identifying the value lost through the valuation assigned to homes in majority-Black communities relative to other communities with very few or no Black residents. The research found on average, across the nation, Black neighborhoods are undervalued by $48,000 on average (23 percent less), amounting to $156 billion in cumulative undervaluation.

The same research effort sought to assess these differences across metropolitan areas. Within the Indianapolis-Carmel-Anderson metropolitan statistical area, it found comparable homes in majority-Black neighborhoods were 17.6 percent below (or $18,199 below) comparable homes in neighborhoods with few Black residents (see image below).



Source: Brookings

The Appraisal Institute—a trade association for the appraisal industry—has recently acknowledged that there are issues that need to be addressed in addressing unconscious bias. It is not yet clear what may come of such an examination. Some have pointed to alternate methods of conducting appraisals—for example, examining the income a property generates or examining what it would cost to build a similar house to the same scale. Others are examining the potential for artificial intelligence to evaluate properties in a racially-neutral way; this technology began to be seen as more acceptable during the pandemic, when in-person valuations were limited.

RELATED RESEARCH & COMMENTARY

The Devaluation of Assets in Black Neighborhoods (Brookings): Available at https://www.brookings.edu/research/devaluation-of-assets-in-black-neighborhoods/

Black homeowner had a white friend stand in for third appraisal. Her home value doubled (Indianapolis Star): Available at https://www.indystar.com/story/money/2021/05/13/indianapolis-black-homeowner-home-appraisal-discrimination-fair-housing-center-central-indiana/4936571001/

Race determines home values more today than it did in 1980 (Rice University's Urban Edge) Available at https://kinder.rice.edu/urbanedge/2020/09/24/housing-racial-disparities-race-still-determines-home-values-America

The Increasing Effect of Neighborhood Racial Composition on Housing Values, 1980–2015 (Social Problems): Available at https://academic.oup.com/socpro/advance-article/doi/10.1093/socpro/ spaa033/5900507

What It Will Take to Close the Race Gap in Home Appraisals (Bloomberg City Lab): Available at https://www.bloomberg.com/news/articles/2021-03-03/appraisers-acknowledge-bias-in-home-valuations

Black Homeowners Face Discrimination in Appraisals (New York Times): Available at https://www.nytimes.com/2020/08/25/realestate/blacks-minorities-appraisals-discrimination.html

Will AI solve the problem of appraisal bias? (HousingWire) Available at https://www.housingwire.com/articles/appraisal-bias-ai-solution/