

February 9, 2024

Secretary Denis R. McDonough
U.S. Department of Veterans Affairs
810 Vermont Avenue, NW
Washington, DC 20420

Re: Advance Notice of Proposed Rulemaking: Loan Guaranty: Minimum Property Requirements for VA-Guaranteed and Direct Loans

Dear Secretary McDonough,

The National Fair Housing Alliance® (NFHA™)¹ and the undersigned civil rights and consumer advocacy organizations appreciate the opportunity to comment on the Advance Notice of Proposed Rulemaking (ANPR), which, among other things, suggests replacing the Minimum Property Requirements for appraisals for VA-Guaranteed and Direct Loans with the property appraisal Condition Ratings in the Fannie Mae Single-Family Selling Guide (Fannie Mae Guide) and the Freddie Mac Single-Family Seller/Service Guide (Freddie Mac Guide) (collectively, the GSE Guides).² For the reasons described below, we urge the VA to:

- **Recognize that the broad discretion allowed in the Condition Rating increases the risk of appraisal discrimination, and**
- **Conduct the appropriate analysis under fair lending laws and the Fair Housing Act's Affirmatively Furthering Fair Housing (AFFH) provision.**

We commend the VA for seeking input on this important topic and we hope that our comments will help inform the VA's views.

BACKGROUND

A. The VA Needs to Serve the Twin Goals of Equity and Efficiency in the Appraisal Process

An appraisal has the power to determine the value of a consumer's most important financial asset, which can hold the key to determining whether the consumer can purchase a permanent home rather than rent, access credit on reasonable terms, and build wealth for generations to

¹ The National Fair Housing Alliance® (NFHA™) leads the fair housing movement. NFHA works to eliminate housing discrimination and ensure equitable housing opportunities for all people and communities through its education and outreach, member services, public policy, advocacy, housing and community development, tech equity, enforcement, and consulting and compliance programs.

² Department of Veterans Affairs, *Advance Notice of Proposed Rulemaking: Loan Guaranty: Minimum Property Requirements for VA-Guaranteed and Direct Loans*, 88 Fed. Reg. 85863 (Dec. 11, 2023), https://www.govinfo.gov/content/pkg/FR-2023-12-11/pdf/2023-27068.pdf?utm_campaign=subscription+mailing+list&utm_medium=email&utm_source=federalregister.gov.

come. However, federal cases³ and news stories⁴ as well as research by the Federal Housing Finance Agency (FHFA),⁵ Fannie Mae,⁶ Freddie Mac,⁷ Dr. Junia Howell and Dr. Elizabeth Korver-Glenn,⁸ Dr. Andre Perry and the Brookings Institution,⁹ and NFHA¹⁰ have documented the serious and systemic problem of appraisal bias for consumers and communities of color. Appraisal bias can exacerbate the large and growing Black-White and Latino-White homeownership gaps¹¹ and wealth gaps¹² by causing families of color to lose out on homeownership opportunities or get lower valuations. To address this challenge, the Biden-Harris Administration created the Interagency Task Force on Property Appraisal and Valuation

³ *Bailey, et al. v. Santander Bank, N.A., et al.*, Case No. 3:2023-cv-00129 (D.Conn. Complaint Filed Feb. 1, 2023) (plaintiffs settled with bank in December of 2023); *Connolly, et al. v. Lanham, et al.*, Case No. 1:22-cv-02048-BPG (D.Md. Complaint Filed Aug. 15, 2022) (court granted in part and denied in part the motion to dismiss in August of 2023); *Austin, et al. v. Miller, et al.*, Case No. 3:21-cv-09319-JCS (N.D. Cal. Complaint Filed Dec. 2, 2021) (plaintiffs settled with AMC and appraiser in 2022 and 2023).

⁴ See, e.g., Julian Glover and Mark Nichols, ABC, *Our America: Lowballed* (Oct. 2022) <https://abc7.com/feature/our-america-lowball-home-appraisal-racial-bias-discrimination/12325606/>.

⁵ FHFA, *Underappraisal Disparities and Time Adjustments* (Jan. 16, 2024) (finding statistically significant disparities in appraisers making time adjustments to comparable sales for homes in majority-White census tracts than homes in majority-Black or majority-Latino census tracts) <https://www.fhfa.gov/Media/Blog/Pages/Underappraisal-Disparities-and-Time-Adjustments.aspx>; FHFA, *Reducing Valuation Bias by Addressing Appraiser and Property Valuation Commentary* (Dec. 14, 2021) (finding that thousands of appraisal reports still contain references to race, ethnicity, and religion) <https://www.fhfa.gov/Media/Blog/Pages/Reducing-Valuation-Bias-by-Addressing-Appraiser-and-Property-Valuation-Commentary.aspx>.

⁶ Fannie Mae, *Appraising the Appraisal* (Feb. 2022) (finding statistically significant disparities in appraisers using comparable sales outside the neighborhood for refinancings by White homeowners in majority-Black neighborhoods) <https://www.fanniemae.com/media/42541/display>.

⁷ Freddie Mac, *Racial and Ethnic Valuation Gaps in Home Purchase Appraisals* (May 10, 2022) (finding statistically significant disparities in appraisals determining a value below the contract price for homes in majority-Black and majority-Latino census tracts when compared to homes in majority-White census tracts) <https://www.freddie.com/research/insight/20220510-racial-ethnic-valuation-gaps-home-purchase-appraisals-modeling-approach>.

⁸ Dr. Junia Howell and Dr. Elizabeth Korver-Glenn, *Appraised: The Persistent Evaluation of White Neighborhoods as More Valuable Than Communities of Color* (Nov. 2, 2022) (finding that White communities had access to \$15 trillion more in capital than communities of color because of racialized appraisal practices) <https://www.eruka.org/appraised>.

⁹ Dr. Andre Perry, et al., *The Devaluation of Assets in Black Neighborhoods*, Brookings Institution (Nov. 2018) (finding that homes in neighborhoods where the share of the population is 50 percent Black are valued at roughly half the price as homes in neighborhoods with no Black residents) https://www.brookings.edu/wp-content/uploads/2018/11/2018.11_Brookings-Metro_Devaluation-Assets-Black-Neighborhoods_final.pdf.

¹⁰ National Fair Housing Alliance, Dane Law Firm, and Christensen Law Firm, *Identifying Bias and Barriers, Promoting Equity: An Analysis of the USPAP Standards and the Appraiser Qualification Criteria* (Jan. 2022) (describing structural components of the modern-day appraisal industry that restrict meaningful industry oversight and manifest systemic bias in appraisal valuations) <https://nationalfairhousing.org/issue/issue-appraisal-bias/>.

¹¹ In 2021, the homeownership rate was 73% for White households, 51% for Latino households, and 44% for Black households. See National Association of REALTORS® Research Group, *2023 Snapshot of Race and Homebuying in America* (2023) <https://www.nar.realtor/sites/default/files/documents/2023-snapshot-of-race-and-home-buying-in-the-us-03-02-2023.pdf>.

¹² In 2022, the median wealth was \$285,000 for White households, \$61,600 for Latino households (20% of the typical White household), and \$44,900 for Black households (15% of the typical White household). See Aditya Aladangady, Andrew C. Chang, Jacob Krimmel, *Greater Wealth, Greater Uncertainty: Changes in Racial Inequality in the Survey of Consumer Finances*, Federal Reserve Board FEDS Notes (2023), <https://www.federalreserve.gov/econres/notes/feds-notes/greater-wealth-greater-uncertainty-changes-in-racial-inequality-in-the-survey-of-consumer-finances-20231018.html>.

Equity (PAVE Task Force) and the PAVE Task Force's 13 agencies (including the VA) issued a plan pledging to advance equity through concrete actions.¹³

In addition to promoting equity, the Improving Access to the VA Home Loan Benefit Act of 2022 (Act) tasked the VA with improving efficiency and appraisal delivery times.¹⁴ Among other things, the Act required the VA to prescribe updated appraisal regulations, including possible changes to the Minimum Property Requirements.

B. The VA Is Considering Replacing the MPRs with the Fannie Mae/Freddie Mac Condition Ratings

Currently, the VA implements certain statutory requirements regarding the suitability of a dwelling¹⁵ through regulations¹⁶ and the Lenders Handbook, which details the Minimum Property Requirements (MPRs).¹⁷ The MPRs provide a checklist for appraisers regarding 41 topics that indicate the suitability of the dwelling, such as the water supply and sanitary facilities (see Appendix A). Generally, the appraiser must affirm that the property meets these MPRs prior to the VA providing a guaranty for the loan. However, a veteran can request a waiver of the MPR if the property is still habitable from the standpoint of safety, structural soundness, and sanitation.

In this ANPR, the VA has asked whether it should replace the MPRs with the Fannie Mae/Freddie Mac property appraisal Condition Ratings. Generally, Fannie Mae and Freddie Mac require appraisers to provide the Condition Rating (see Appendix B).¹⁸ According to the GSE Guides, the appraisal report must rate the property on a scale C1 to C6 for condition (with C1 being the best).

The Condition Rating can determine whether a mortgage applicant can be approved for a loan that is eligible for sale to the GSEs. A property with a Condition Rating of C6 is not eligible for sale to Fannie Mae, unless repaired to a minimum Condition Rating of C5 prior to delivery of the

¹³ See PAVE Task Force at <https://pave.hud.gov/>.

¹⁴ Improving Access to the VA Home Loan Benefit Act, Pub.L. 117-308 (Dec. 27, 2022), <https://www.congress.gov/bill/117th-congress/house-bill/7735>.

¹⁵ The VA must ensure that any property financed through a VA-guaranteed or direct loan is suitable for dwelling purposes. 38 U.S.C. § 3710(b)(4); see also 38 U.S.C. § 3711. Additionally, any loan for either the purchase or construction of a residential property, in which construction was completed within one year of the loan, must meet or exceed minimum requirements for planning, construction, and general acceptability, as prescribed by VA. 38 U.S.C. § 3704(a). Also, any direct housing loan made by VA under the Native American Direct Loan (NADL) program must meet minimum requirements for planning, construction, improvement, and general acceptability, as prescribed by VA. 38 U.S.C. § 3762(c)(2).

¹⁶ 38 CFR §§ 36.4351, 36.4527(c)(4).

¹⁷ Lenders Handbook, VA Pamphlet 26-7, https://www.benefits.va.gov/warms/pam26_7.asp.

¹⁸ See Section B4-1.3-06 of the Fannie Mae Guide, <https://selling-guide.fanniemae.com/Selling-Guide/Origination-thru-Closing/>; Section 5605.5 of the Freddie Mac Guide, https://guide.freddiemac.com/?gad_source=1&qclid=CjwKCAiA5L2tBhBTEiwAdSxJX95KrG6A7SrwOoS7nV6907MjDXM_z2tW_eevj6-Et65zIaxX-t2yVhoCHf4QAvD_BwE&qclsrc=aw.ds.

loan. Likewise, a property with a Condition Rating of C5 or C6 is not eligible for sale to Freddie Mac, unless the issues are cured prior to delivery.

In the ANPR, the VA stated that it believes that properties rated C1 through C4 would best align with VA's statutory requirement and existing MPRs, but is open to public feedback on the issue. Under this scenario, it seems that a veteran whose home received a C5 or C6 Condition Rating from the appraiser would not be eligible for a loan guaranteed by the VA. The VA did not directly address whether and how the veteran could cure the issues prior to delivery or seek a waiver of the Condition Rating.

COMMENTS

A. The VA Should Recognize that the Broad Discretion Allowed in the Condition Rating Increases the Risk of Discrimination

- 1. The Condition Ratings Allow for Broad Discretion, which Has Long Been Viewed as a Key Discrimination Risk Factor*

Unlike the VA MPRs, the Fannie Mae/Freddie Mac Condition Ratings are written in a way that provides the appraiser with considerable discretion in determining the ratings for a subject property. Broad discretion has long been considered a key fair lending risk factor because it allows conscious or unconscious bias to influence the decision.¹⁹ Even without bias, such broad discretion raises the risk of inconsistent results. In the example below, Fannie Mae's proprietary collateral risk management tool (known as Collateral Underwriter® or CU) detected an incorrect Condition Rating for the subject property, which led to the appraisal report using inappropriate value adjustments for the comparable sales. This incorrect Condition Rating greatly increased the risk of undervaluation for the subject property.

¹⁹ See, e.g., *Interagency Policy Statement on Discrimination in Lending* (April 15, 1994) <https://www.govinfo.gov/content/pkg/FR-1994-04-15/html/94-9214.htm>.

Inaccurate Condition Ratings

CU contains MLS photos that can be used to validate quality and condition ratings. The appraiser rated the subject condition as C5, but based on photos (kitchen examples below), a higher rating is warranted. The appraiser made a \$37k downward adjustment to the comparable, but side by side comparison of the photos in CU shows that the two are equal condition and no adjustment is warranted. **Inaccurate condition ratings resulted in inappropriate condition adjustments for all comparables used in the report.**



Subject Property

An Hour with Fannie Mae | September 2022



Appraisal Comparable Sale



2. *Given the Increased Risk of Discrimination, the VA Must Implement Appropriate Controls before Replacing the MPRs with the Condition Rating*

Given that the broad discretion in the Condition Rating increases the risk of discriminatory outcomes for veterans of color, the VA would need to propose appropriate controls along with this change in policy. To control the risk of discretion, best practices for appropriate Compliance Management Systems (CMS)²⁰ include:

- **Policies and Procedures.** The VA should develop comprehensive and specific policies and procedures to effectively decrease discretion and manage risk.
- **Fair Housing Training.** The VA should require its appraisers to take fair housing training developed by fair housing experts.
- **Audits.** The VA should conduct audits to ensure that appraisers are following the policies.
- **Monitoring.** The VA should track consumer complaints and monitor the data to determine whether there are unexplained, disparate outcomes in the Condition Ratings on the basis of race or other prohibited bases.

²⁰ See, e.g., Federal Financial Institutions Examination Council, *Uniform Interagency Consumer Compliance Rating System* (Nov. 7, 2016) <https://www.ffiec.gov/press/pr110716.htm>.

Moreover, as the VA transitions to a modern appraisal technology platform,²¹ it should ensure that the technology includes appropriate quality control mechanisms to promote consistent, fair, and accurate appraisals.

B. The VA Must Conduct the Appropriate Analysis under Fair Lending Laws and the Fair Housing Act's Affirmatively Furthering Fair Housing (AFFH) Provision

1. The VA Must Conduct the Appropriate Analysis under Fair Lending Laws to Prevent Any Policy Change from Having an Unlawful Disparate Impact on Veterans of Color

Before replacing the MPRs with the Condition Rating, the VA will need to conduct the disparate impact analysis required by the Fair Housing Act.²² The Fair Housing Act applies to the VA and requires a thorough analysis to consider the extent to which this proposed policy change may have a discriminatory effect on veterans of color.²³ Moreover, to the extent that there is a discriminatory effect but legally sufficient justification, the Fair Housing Act requires the VA to consider and implement any less discriminatory alternatives that still achieve the business interest.

2. The VA Must Conduct the Appropriate Analysis under the Fair Housing Act's Affirmatively Furthering Fair Housing Provision to Foster Inclusive Communities

In addition to conducting a disparate impact analysis, the Fair Housing Act requires the VA to affirmatively further fair housing.²⁴ HUD defines "affirmatively furthering fair housing" as follows:

*Affirmatively furthering fair housing means taking meaningful actions, in addition to combating discrimination, that overcome patterns of segregation and foster inclusive communities free from barriers that restrict access to opportunity based on protected characteristics. Specifically, affirmatively furthering fair housing means taking meaningful actions that, taken together, address significant disparities in housing needs and in access to opportunity, and fostering and maintaining compliance with civil rights and fair housing laws. The duty to affirmatively further fair housing extends to all of a program participant's activities and programs relating to housing and urban development.*²⁵

²¹ See VA, Congressionally Mandated Report: Recommendations for Improving Appraisal Delivery Times (April 2023) <https://www.govinfo.gov/content/pkg/CMR-VA1-00183153/pdf/CMR-VA1-00183153.pdf>.

²² Fair Housing Act, 42 U.S.C. § 3601 *et seq.*; HUD Regulation, 24 C.F.R. § 100.135. See also Equal Credit Opportunity Act, 15 U.S.C. § 1619 *et seq.*; Regulation B, 12 C.F.R. Part 1002.

²³ See HUD Discriminatory Effects Rule, 24 C.F.R. § 100.500; see also *Texas Dept. of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, 576 U.S. 519 (2015).

²⁴ The Fair Housing Act states: "All executive departments and agencies shall administer their programs and activities relating to housing and urban development (including any Federal agency having regulatory or supervisory authority over financial institutions) in a manner affirmatively to further the purposes of this subchapter and shall cooperate with the Secretary [of Housing and Urban Development] to further such purposes." 42 U.S.C. § 3608(d).

²⁵ 24 CFR § 5.151.

Thus, prior to replacing the MPRs with the Condition Ratings, the VA will need to conduct the appropriate disparate impact and AFFH analysis, as required by the Fair Housing Act.

Thank you for considering our views.

Sincerely,

National Fair Housing Alliance
Consumer Federation of America
National Coalition for Asian Pacific American Community Development (National CAPACD)
National Community Stabilization Trust
National Consumer Law Center (on behalf of its low-income clients)

APPENDIX

Appendix A: VA Minimum Property Requirements

List of Topics

TABLE 1—VA PAMPHLET 26–7, LENDERS HANDBOOK, CHAPTER 12—MINIMUM PROPERTY REQUIREMENTS

Topic	Topic name	Topic	Topic name
1	Minimum Property Requirement Procedures.	23	Heating.
2	Marketable Real Estate Entity.	24	Leased Mechanical Systems and Equipment.
3	Space Requirements.	25	Alternative Energy Equipment.
4	Access.	26	Roof Covering.
5	Encroachments.	27	Attics.
6	Drainage and Topography.	28	Crawl Spaces.
7	Geological or Soil Instability, Subsidence, and Sinkholes.	29	Basements.
8	Special Flood Hazard Area.	30	Swimming Pools.
9	Coastal Barrier Resources System.	31	Burglar Bars.
10	Lava Flow Hazard Areas.	32	Lead-Based Paint.
11	Non-Residential Use.	33	Wood Destroying Insects/Fungus/Dry Rot.
12	Zoning.	34	Radon Gas.
13	Local Housing/Planning Authority Code Enforcement.	35	Potential Environmental Problem.
14	Utilities.	36	Stationary Storage Tanks.
15	Water Supply and Sanitary Facilities.	37	Mineral, Oil and Gas Reservations or Leases.
16	Individual Water Supply.	38	High Voltage Electric Transmission Lines.
17	Individual Sewage Disposal.	39	High Pressure Gas and Liquid Petroleum Pipelines.
18	Shared Wells.	40	Properties Near Airports.
19	Community Water Supply/Sewage Disposal Requirements.	41	Manufactured Home Classified as Real Estate.
20	Hazards.	42	Modular Homes.
21	Defective Conditions.	43	Energy Conservation and Sustainability.
22	Mechanical Systems.	44	Requests for Waiver of MPR Repairs.

Sources:

- Department of Veterans Affairs, *Advance Notice of Proposed Rulemaking: Loan Guaranty: Minimum Property Requirements for VA-Guaranteed and Direct Loans*, 88 Fed. Reg. 85863, 85863 (Dec. 11, 2023), https://www.govinfo.gov/content/pkg/FR-2023-12-11/pdf/2023-27068.pdf?utm_campaign=subscription+mailing+list&utm_medium=email&utm_source=federalregister.gov
- Lenders Handbook, VA Pamphlet 26–7 (2019) https://www.benefits.va.gov/warms/pam26_7.asp.

Example

15. Water Supply and Sanitary Facilities

Change Date	March 28, 2019 <ul style="list-style-type: none">This chapter has been revised in its entirety.
a. Water and Sewer	The property must have: <ul style="list-style-type: none">a continuous supply of safe and potable water for drinking, bathing, showering and sanitary uses,hot water,sanitary facilities, anda safe method of sewage disposal.
b. Safe Drinking Water	Given the importance of safe drinking water, appraisers must ensure that accurate water supply information is reported in the appraisal and the Staff Appraisal Reviewer (SAR) must condition the NOV appropriately. If the appraiser is aware of any issues regarding the water supply, the appraiser must comment in the appraisal.
c. Market Value Considerations	Appraisers must comment and adjust for any market reaction discovered as a result of water contamination, as well as any environmental stigma.
d. Filtration of Water	Proper mitigation of lead contaminated water must include a central filtering system which filters all water that could serve the property's occupants. When public water must be filtered, the requirements for individual water filtering under Topic 17, Subsection d of this Chapter including a Veteran's acknowledgement, must be applied. Information about water filtration is available at http://www.nsf.org/newsroom/consumer-guide-to-nsf-international-certified-lead-filtration-devices .

Source:

- Lenders Handbook, VA Pamphlet 26-7 (2019) https://www.benefits.va.gov/warms/pam26_7.asp.

Appendix B: Fannie Mae/Freddie Mac Condition Ratings

TABLE 2—UNIFORM APPRAISAL DATASET (UAD) PROPERTY CONDITION RATINGS

Rating	Description in Fannie Mae Selling and Freddie Mac Seller/Service Guides
C1	The improvements have been very recently constructed and have not previously been occupied. The entire structure and all components are new and the dwelling features no physical depreciation.
C2	The improvements feature no deferred maintenance, little or no physical depreciation, and require no repairs. Virtually all building components are new or have been recently repaired, refinished, or rehabilitated. All outdated components and finishes have been updated and/or replaced with components that meet current standards. Dwellings in this category either are almost new or have been recently completely renovated and are similar in condition to new construction.
C3	The improvements are well-maintained and feature limited physical depreciation due to normal wear and tear. Some components, but not every major building component, may be updated or recently rehabilitated. The structure has been well-maintained.
C4	The improvements feature some minor deferred maintenance and physical deterioration due to normal wear and tear. The dwelling has been adequately maintained and requires only minimal repairs to building components/mechanical systems and cosmetic repairs. All major building components have been adequately maintained and are functionally adequate.
C5	The improvements feature obvious deferred maintenance and are in need of some significant repairs. Some building components need repairs, rehabilitation, or updating. The functional utility and overall livability are somewhat diminished due to condition, but the dwelling remains useable and functional as a residence.
C6	The improvements have substantial damage or deferred maintenance with deficiencies or defects that are severe enough to affect the safety, soundness, or structural integrity of the improvements. The improvements are in need of substantial repairs and rehabilitation, including many or most major components.

Sources:

- Department of Veterans Affairs, *Advance Notice of Proposed Rulemaking: Loan Guaranty: Minimum Property Requirements for VA-Guaranteed and Direct Loans*, 88 Fed. Reg. 85863, 85864 (Dec. 11, 2023), https://www.govinfo.gov/content/pkg/FR-2023-12-11/pdf/2023-27068.pdf?utm_campaign=subscription+mailing+list&utm_medium=email&utm_source=federalregister.gov
- Section B4-1.3-06 of the Fannie Mae Guide, <https://selling-guide.fanniemae.com/Selling-Guide/Origination-thru-Closing/>.
- Section 5605.5 of the Freddie Mac Guide, https://guide.freddie.com/?gad_source=1&qclid=CjwKCAiA5L2tBhBTEiwAdSxJX95KrG6A7SrwQoS7nV69Q7MjDXM_z2tW_eevj6-Et65zIaxX-t2yVhoCHf4QAvD_BwE&qclsrc=aw.ds.