Mortgage Regulation Developments: COVID-19 Assistance and Appraisal Bias

*By Sasha Leonhardt and Christine M. Acree**

Introduction[1]

Mortgage regulation developments continue apace with significant changes related to COVID-19 reverberations in parallel with a strong focus on appraisals, particularly regarding discrimination and biases, as well as standards for automated models.

Although the country is emerging from the COVID-19 crisis, in several instances, federal regulators have extended the pandemic relief programs that were originally implemented to protect mortgagees. A significant number of borrowers will be covered by these programs for the foreseeable future, and notwithstanding the possibility of receding COVID-19 case counts, this number may actually grow as a potential recession and inflation—and the related uptick in interest rates for preexisting variable-rate and new fixed-rate mortgages—may drive up delinquency rates.

During the past year, researchers and interest groups have raised concerns regarding discrimination in real estate appraisals, and the White House assembled an interagency task force to propose recommendations on appraisal bias. A group of regulators began the process of exercising dormant rulewriting authority to promulgate quality control standards for automated valuation models ("AVM"), and preliminary rulemaking documents related to that effort suggest what a proposed AVM rule may contain.

Federal COVID-19 Relief Programs Extended

The Consumer Financial Protection Bureau ("CFPB") issued, under the Real Estate Settlement Procedures Act, a final rule on June 30, 2021, to assist mortgagors affected by the COVID-19 pandemic.[2] The rule became effective on August 31,

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* Sasha Leonhardt is a partner with Buckley LLP in Washington, D.C. Christine M. Acree is senior counsel, product compliance, with ICE Mortgage Technology in Irvine, California. The views expressed in this survey are those of the authors alone.

1. This survey is one in a series of works covering recent updates in various areas of consumer financial services law. For an overview of the other articles in this issue of *The Business Lawyer*, see John L. Ropiequet, Eric J. Mogilnicki & Christopher K. Odinet, *Introduction to the 2023 Annual Survey of Consumer Financial Services Law*, 78 Bus. Law. 497 (2023).

2. Protections for Borrowers Affected by the COVID-19 Emergency Under the Real Estate Settlement Procedures Act (RESPA), Regulation X, 86 Fed. Reg. 34848 (June 30, 2021) (to be codified at

2021, and provides safeguards to help ensure that borrowers have an opportunity to be reviewed for loss mitigation before the servicer begins foreclosure on certain mortgages.[3] The rule allows servicers to offer certain loan modifications even after receiving an incomplete application.[4] It also finalizes temporary changes to early intervention and reasonable diligence obligations on servicers.[5]

After the issuance of that rule, federal agencies continued COVID-19 relief programs. In September 2021, the Federal Housing Finance Agency ("FHFA") announced that the government-sponsored entities ("GSE"), Fannie Mae and Freddie Mac, would continue to offer forbearance to multifamily property owners as needed, following the continued tenant protections it imposed previously during the COVID-19 pandemic.[6] This was the fourth time that the program was extended, and FHFA stated that it would continue to allow forbearance by the GSEs unless it instructed them otherwise.[7] Mortgagors with GSE-backed multifamily mortgages may receive a new or modified forbearance if they have a financial hardship due to the pandemic.[8] These property owners must inform tenants about protections available during the owner's forbearance and repayment, and they may not evict tenants solely for non-payment of rent during forbearance.[9] Tenants are protected during the repayment periods in several ways, including a requirement that property owners provide at least a thirty-day notice to vacate, a prohibition on property owners imposing late fees or penalties for nonpayment of rent, and the requirement that property owners offer tenants flexibility in paying back rent.[10]

In June 2022, the Federal Housing Administration issued temporary partial waivers to its Home Equity Conversion Mortgage Policy, giving mortgagees flexibility to help senior homeowners "who continue to experience significant financial difficulties due to the COVID-19 pandemic."[11] These waivers, effective through December 31, 2022, allow for "repayment plans . . . with unpaid property charges regardless of their total outstanding arrearage," and eliminate the normal three-year waiting period for certain assignments.[12]

Regulations promulgated by the U.S. Department of Veterans Affairs ("VA") provide a hierarchy of preferred options for servicers to follow when evaluating

12 C.F.R. pt. 1024); *see* Sasha Leonhardt & Christine M. Acree, *Mortgage Regulation Developments: Qualified Mortgage Updates and COVID-19 Assistance*, 77 Bus. Law. 507, 512–14 (2022) (in the 2022 *Annual Survey*).

3. *See* Leonhardt & Acree, *supra* note 2, at 514 (detailing requirements).

4. *Id.* at 513.

5. *Id.* at 513–14.

6. Press Release, Fed. Hous. Fin. Agency, FHFA Extends Availability of COVID-19 Multifamily Forbearance (Sept. 24, 2021) [hereinafter FHFA Release], https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Extends-Availability-of-COVID-19-Multifamily-Forbearance.aspx; *see* Leonhardt & Acree, *supra* note 2, at 511–12 (detailing the previous deferral program).

7. FHFA Release, *supra* note 6.

8. *Id.*

9. *Id.*

10. *Id.*

11. Fed. Hous. Admin., FHA Info 2022-64: FHA Extends Temporary Partial Waivers to Its Home Equity Conversion Mortgage Policy for Senior Borrowers Impacted by COVID-19 (June 23, 2022), https://www.hud.gov/sites/dfiles/SFH/documents/SFH_FHA_INFO_2022-64.pdf.

12. *Id.* (referencing temporary partial waivers of Mortgagee Letters 2015-11 and 2016-07).

borrowers for loss mitigation relief.[13] In September 2021, the VA issued a circular[14] informing servicers that, through July 1, 2023, they may continue offering loan deferment to borrowers as a home retention option in accord with the VA's Home Retention Waterfall,[15] which generally "would not be permissible."[16] Fannie Mae continues adding to and updating its payment deferral and flex modification for borrowers impacted by COVID-19, most recently updating the escrow analysis to clarify how escrow shortages should be addressed for single-family mortgages.[17]

Servicing Flexibility Ended

Although the "pandemic continues to affect consumers and mortgage servicers"[18] and various COVID-19 relief programs have been extended, on November 10, 2021, the Board of Governors of the Federal Reserve ("FRB"), the CFPB, the Federal Deposit Insurance Corporation ("FDIC"), the National Credit Union Administration ("NCUA"), the Office of the Comptroller of the Currency ("OCC"), and state financial regulators released a Joint Statement to "communicate to mortgage servicers the agencies' supervisory and enforcement approach as risks . . . continue to change."[19] The agencies believe "servicers have had sufficient time to adjust their operations by . . . taking steps to work with consumers . . . and developing more robust business continuity and remote work capabilities,"[20] rendering inapplicable the "temporary supervisory and enforcement flexibility"[21] announced eighteen months earlier.[22] Therefore, the agencies will "apply their respective supervisory and enforcement authorities, where appropriate, to address any noncompliance or violations of the Regulation X mortgage servicing rules that occur after the date

13. *See* 38 C.F.R. § 36.4319 (2022) ("Servicer loss-mitigation options and incentives").

14. Veterans Benefits Admin., U.S. Dep't of Veterans Aff., Circular 26-21-19; Loan Deferment as a COVID-19 Home Retention Option (Sept. 29, 2021) [hereinafter Circular 26-21-19], https://www.benefits.va.gov/HOMELOANS/documents/circulars/26_21_19.pdf.

15. *See* Veterans Benefits Admin., U.S. Dep't of Veterans Aff., Circular 26-21-13 : COVID-19 Home Retention Waterfall and COVID-19 Refund Modification at para. 3.b. (July 23, 2021), https://www.benefits.va.gov/HOMELOANS/documents/circulars/26_21_13.pdf (providing waterfall format of information flows to help "servicers apply VA's preferred order of home retention options" when assisting borrowers affected by COVID-19).

16. *See* Circular 26-21-19, *supra* note 14, at para. (2)(a) (citing 38 C.F.R. §§ 36.4310(a), 36.4338(a)).

17. Fannie Mae, Lender Letter (LL-2021–07) (May 4, 2022), https://singlefamily.fanniemae.com/media/25121/display.

18. Bd. of Governors of the Fed. Reserve Bd. et al., Joint Statement on Supervisory and Enforcement Practices Regarding the Mortgage Servicing Rules in Response to the Continuing COVID-19 Pandemic and CARES Act 1 (Nov. 10, 2021) [hereinafter Joint Statement], https://www.occ.gov/news-issuances/bulletins/2021/bulletin-2021-53a.pdf.

19. *Id.*

20. *Id.*

21. *Id.*

22. CFPB et al., Joint Statement on Supervisory and Enforcement Practices Regarding the Mortgage Servicing Rules in Response to the COVID-19 Emergency and the CARES Act 6 (Apr. 3, 2020), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200403a1.pdf (announcing, among other forbearances, that "the agencies do not intend to take supervisory or enforcement action against servicers for delays in sending [timely] notices . . . provided that servicers are making good faith efforts to provide these notices and take the related actions within a reasonable time").

of [the Joint Statement]."[23] Pursuant to the Joint Statement, the agencies will "factor in the time it takes to make operational adjustments" and "consider, when appropriate, the specific impact of servicers' challenges that arise" and take those issues "in account when considering any supervisory and enforcement actions."[24]

In December 2021, the U.S. Department of Housing and Urban Development ("HUD") received a letter[25] from the attorneys general of twenty states and the District of Columbia stating that a "number of mortgage loan servicers employed by [Federal Housing Administration]–approved lenders are failing to adequately implement [relief programs]" and are "routinely sending borrowers letters that fail to include . . . recovery modification as an available option, are requiring paperwork and imposing qualifications that are not necessary . . . , and are instructing borrowers . . . that this option does not exist," even though this program was required to be implemented no later than October 21, 2021.[26] The letter requested that "[the agency] take immediate action to ensure that all [agency]-approved lenders and mortgage servicers servicing [agency]-backed loans are fully implementing . . . loss mitigation options . . . and providing accurate and up-to-date information for borrowers attempting to access relief programs."[27]

In April 2022—several months after receiving that letter—HUD updated its policies to add a forty-year loan modification to its available relief options for struggling mortgagors and provided an exemption for mortgages backed by mortgage revenue bonds, primarily affecting state housing finance agencies, to ensure compliance with bond agreement terms and the Internal Revenue Code.[28]

Fair Lending and Appraisal Bias

During the past year, appraisal bias—the artificial inflation or deflation of a home's appraised value based upon a prohibited characteristic, such as race—became a pressing topic in the housing market. Regulators, researchers, and even the White House identified appraisal bias as a priority, making both significant policy statements and beginning a long-delayed rulewriting process on automated real estate valuations. The degree to which appraisal bias affects property values has been the subject of significant empirical and anecdotal research and debate, with studies from Fannie Mae and Freddie Mac identifying significant

23. Joint Statement, *supra* note 18, at 1.
24. *Id.* at 2.
25. Letter from Karl A. Racine, D.C. Att'y Gen., to Lopa P. Kolluri, Principal Deputy Assistant Sec'y, U.S. Dep't of Hous. & Urb. Dev., COVID-19 Recovery Loss Mitigation Program Implementation Failures (Dec. 21, 2021), https://oag.ca.gov/system/files/attachments/press-docs/2021-12-21-Ltr-to-FHA-from-21-Attorneys-General-.pdf.
26. *Id.* at 1–2 (detailing deficiencies).
27. *Id.* at 2.
28. Fed. Hous. Admin., U.S. Dep't of Hous. & Urb. Dev., Mortgagee Letter 2022-07: Update to the COVID-19 Recovery Loss Mitigation Options (Apr. 18, 2022), https://www.hud.gov/sites/dfiles/OCHCO/documents/2022-07hsgml.pdf.

appraisal bias in the market,[29] while other studies have argued that appraisal bias is "uncommon and not systemic."[30]

Appraisal bias is not a novel concern, and, for decades, various federal laws have addressed appraisal bias. The Fair Housing Act ("FHA") prohibits discrimination on the basis of "race, color, religion, sex, handicap, familial status, or national origin"[31] in a residential real estate transaction, which includes "the selling, brokering, or appraising of residential real property."[32] The Equal Credit Opportunity Act ("ECOA") similarly makes it unlawful for a "creditor" to discriminate on the basis of protected classes in "any aspect of a credit transaction."[33] The Truth in Lending Act prohibits appraisers from considering "any factor other than the independent judgment of the appraiser."[34] And, Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act requires federal agencies to issue rules establishing minimum appraisal standards.[35]

Property Appraisal and Valuation Equity Task Force

On June 1, 2021, President Biden announced the creation of a "first-of-its-kind interagency effort to address inequity in home appraisals, and [to] conduct[] rulemaking to aggressively combat housing discrimination."[36] The resulting Task Force on Property Appraisal and Valuation Equity ("PAVE Task Force"), led by HUD Secretary Marcia Fudge and White House Domestic Policy Advisor Susan Rice, was tasked with evaluating the "causes, extent, and consequences of appraisal bias" and providing recommendations "to root out racial and ethnic bias in home valuations."[37] With thirteen members, including HUD, the U.S. Department of Justice, and all of the major federal financial regulatory agencies, the PAVE Task Force brought together departments with varied areas of policy

29. *See* Jake Williamson & Mark Palim, Appraising the Appraisal (Feb. 2022), https://www.fanniemae.com/media/42541/display; Freddie Mac, Racial and Ethnic Valuation Gaps in Home Purchase Appraisals (Sept. 2021), https://www.freddiemac.com/fmac-resources/research/pdf/202109-Note-Appraisal-Gap.pdf; *see also* Nat'l Fair Hous. Alliance, Identifying Bias and Barriers, Promoting Equity: An Analysis of the USPAP Standards and Appraiser Qualifications Criteria (Jan. 2022), https://nationalfairhousing.org/wp-content/uploads/2022/01/2022-01-18-NFHA-et-al_Analysis-of-Appraisal-Standards-and-Appraiser-Criteria_FINAL.pdf.

30. Edward Pinto & Tobias Peter, How Common Is Appraiser Racial Bias—An Update 1 (May 2022), https://www.aei.org/wp-content/uploads/2022/06/How-Common-is-Appraiser-Racial-Bias-An-Update-May-2022-FINAL-corrected-1.pdf?x91208.

31. 42 U.S.C. § 3605(a) (2018).

32. *Id.* § 3605(b)(2).

33. 15 U.S.C. § 1691(a) (2018).

34. *Id.* § 1639e(b)(1).

35. 12 U.S.C. § 3339 (2018).

36. Press Release, The White House, FACT SHEET: Biden-Harris Administration Announces New Actions to Build Black Wealth and Narrow the Racial Wealth Gap (June 1, 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/01/fact-sheet-biden-harris-administration-announces-new-actions-to-build-black-wealth-and-narrow-the-racial-wealth-gap/.

37. Interagency Task Force on Prop. Appraisal & Valuation Equity, Action Plan to Advance Property Appraisal and Valuation Equity 1 (Mar. 2022) [hereinafter PAVE Action Plan], https://pave.hud.gov/sites/pave.hud.gov/files/documents/PAVEActionPlan.pdf.

expertise, delegated rulewriting authority under the FHA and the ECOA, and distinct litigation and enforcement priorities.[38]

The PAVE Task Force issued a report summarizing its findings in March 2022.[39] The report contains twenty-one commitments for its member agencies divided among five categories: strengthening guardrails against unlawful discrimination in all stages of residential valuation; enhancing fair housing/fair lending enforcement and driving accountability; building a well-trained, accessible, and diverse appraiser workforce; empowering consumers to take action; and obtaining better data to study and monitor valuation bias.[40] Of note, PAVE Task Force members pledged to issue guidance on how the FHA and the ECOA apply to the appraisal industry, to include appraisal oversight in supervisory compliance and examination requirements, to coordinate appraisal bias actions, and to revisit memoranda of understanding for information sharing across supervisory and enforcement agencies.[41] In addition to carrying out the twenty-one commitments contained in the report as well as monitoring and measuring their own progress toward addressing appraisal bias, the PAVE Task Force's members committed to formalizing "a long-term research and policy agenda . . . with the goal of embedding equity and fairness in the policy-making process"[42]

Artificial Intelligence and Appraisal Bias: Automated Valuation Models

In recent years, AVMs have gained popularity because of their lower cost, their ability to mitigate COVID-19 logistical and safety challenges, and their perceived potential to reduce human appraisal bias.[43] However, some have argued that even AVMs that have no human involvement can disproportionately affect home values on a prohibited basis.[44] For example, CFPB Director Chopra expressed concern that AVMs could produce biased outcomes: "It is tempting to think that machines crunching numbers can take bias out of the equation, but they can't."[45]

38. *Id.* at 46 app. I.

39. *Id. passim*; *see* Press Release, The White House, Fact Sheet: Biden-Harris Administration Releases Action Plan to Address Racial and Ethnic Bias in Home Valuations (Mar. 23, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/03/23/fact-sheet-biden-harris-administration-releases-action-plan-to-address-racial-and-ethnic-bias-in-home-valuations/.

40. PAVE Action Plan, *supra* note 37, at 22 (identifying five categories); *id.* at 22–42 (identifying twenty-one commitments).

41. *Id.* at 23, 28, 29.

42. *Id.* at 45.

43. *See* Michael Neal, Sarah Strochak, Linna Zhu & Caitlin Young, How Automated Valuation Models Can Disproportionately Affect Majority-Black Neighborhoods 1–2 (Dec. 2020), https://www.urban.org/sites/default/files/publication/103429/how-automated-valuation-models-can-disproportionately-affect-majority-black-neighborhoods_1.pdf.

44. *Id.* at 1 ("But AVMs in majority-Black neighborhoods produce larger errors, relative to the underlying sales price, than AVMs in majority-white neighborhoods, potentially contributing to the wide housing wealth gap between Black and white homeowners.").

45. Press Release, Consumer Fin. Prot. 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/.

When Congress passed the Dodd-Frank Act in 2010, it required the FRB, OCC, the FDIC, the NCUA, the FHFA, and the CFPB (collectively "AVM Regulators") to promulgate regulations to implement quality control standards for AVMs.[46] AVMs must ensure a high level of confidence, protect against the manipulation of data, avoid conflicts of interest, and require random sampling and reviews.[47] In addition, Congress delegated to the AVM Regulators the ability to designate, via rulemaking, "any other such factor" that should be added to these four standards for an AVM.[48]

Prior to beginning the rulemaking process, the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA")[49] required the CFPB to convene a panel to evaluate the effect of a future AVM rule upon small businesses.[50] The CFPB began this process in February 2022 when it issued an initial outline of proposals for the SBREFA panel's review,[51] and the SBREFA panel produced its final report in May 2022.[52] Accordingly, while the AVM Regulators had not published a Notice of Proposed Rulemaking as of this writing,[53] the SBREFA process nevertheless provides some insight into the elements the AVM Regulators may include in their eventual rulemaking.

Among the forty-five questions raised by the CFPB, it asked the SBREFA panel members whether an eventual AVM rule should include within its scope: the use of AVMs to monitor the quality or performance of mortgage loans;[54] AVMs used after origination, such as for loan modifications, HELOC reductions or suspensions, or securitizations;[55] and the use of AVMs for transactions "where the secondary market issuer's use of an AVM is covered instead,"[56] such as loans issued under Fannie Mae or Freddie Mac's AVM models.[57] The SBREFA panel members generally preferred to exclude these transactions from the AVM rule, although

46. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1473(q), 124 Stat. 1376, 2198 (2010) (codified as amended at 12 U.S.C. § 3354 (2018)). The AVM Regulators are also required to consult with the Appraisal Foundation, a non-profit corporation that sets standards and qualifications for appraisers and provides guidance on valuation methods and techniques. *Id.*; *see* 12 U.S.C. § 3350(9) (2018) (defining "Appraisal Foundation"); *About Us*, Appraisal Found., https://www.appraisalfoundation.org/imis/TAF/About_Us/TAF (last visited Dec. 9, 2022).

47. 12 U.S.C. § 3354(a)(1)–(4) (2018).

48. *Id.* §§ 3354(a)(5), 3354(b).

49. 5 U.S.C. §§ 601–612 (2018).

50. Consumer Fin. Prot. Bureau, Small Business Advisory Review Panel for Automated Valuation Model (AVM) Rulemaking 3 (Feb. 23, 2022) [hereinafter AVM Rulemaking], https://files.consumerfinance.gov/f/documents/cfpb_avm_outline-of-proposals_2022-02.pdf.

51. *Id.* at 3–4.

52. Consumer Fin. Prot. Bureau, Final Report of the Small Business Review Panel on the CFPB's Proposal and Alternatives Under Consideration for the Automated Valuation Model (AVM) Rulemaking (May 13, 2022) [hereinafter AVM Final Report], https://files.consumerfinance.gov/f/documents/cfpb_avm_final-report_2022-05.pdf.

53. *See Amendments to FIRREA Concerning Automated Valuation Models*, Off. of Info. & Regul. Affs., https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202204&RIN=3170-AA57 (last visited Dec. 9, 2022).

54. AVM Rulemaking, *supra* note 50, at 7.

55. *Id.* at 9–12.

56. *Id.* at 13.

57. *Id.* at 13–14.

some panel members raised concerns about balancing consumer protections against institutional burdens when using AVMs in credit line reductions or suspensions.[58]

The CFPB indicated that the AVM Regulators are considering requiring regulated institutions to adopt "policies, practices, procedures, and control systems" for AVM-related quality control standards.[59] The CFPB asked the SBREFA panel members whether the AVM rule should follow a "flexible and principles-based" approach or a "prescriptive rule with more detailed and specific requirements."[60] In response, the SBREFA panel members generally supported a principles-based approach to developing and implementing quality control standards, but expressed concern about future "regulation by enforcement."[61]

Finally, while there are already four statutory quality control standards,[62] the AVM Regulators are considering exercising their discretion to promulgate a fifth quality control factor specifically focused on nondiscrimination—but the CFPB did not indicate what this factor would be.[63] In response, the SBREFA panel members "uniformly voiced concern"[64] with an additional nondiscrimination factor, citing the inability of small institutions to validate and test AVMs provided by third parties and noting that fair lending laws already address appraisal bias.[65] If the AVM Regulators were to promulgate an additional nondiscrimination factor, the SBREFA panel members suggested a safe harbor, a small entity exemption, or a model policy or procedure to facilitate compliance.[66]

58. AVM Final Report, *supra* note 52, at 18–21.
59. AVM Rulemaking, *supra* note 50, at 20–21.
60. *Id.*
61. AVM Final Report, *supra* note 52, at 24.
62. 12 U.S.C. § 3354(a)(1)–(4) (2018).
63. AVM Rulemaking, *supra* note 50, at 23–26.
64. AVM Final Report, *supra* note 52, at 30.
65. *Id.* at 30–31.
66. *Id.* at 31–32.