An Analysis of Underwriting And Appraisal Practices and Their Impact on Credit Availability

by Calvin Bradford

> "The biggest problem with our generation of bankers is that they don't know how to do risk analysis."
> —Ronald Grzywinski, South Shore National Bank of Chicago.

At the heart of the controversy over redlining, disinvestment, and reinvestment is the question of risk analysis. Viewed from a lender's point of view, the decision not to lend, or to lend on more restrictive terms, in certain areas which he perceives as risky may appear to be a wise business decision dictated by his responsibility to protect his depositors and stockholders. Viewed from the community's point of view, such decisions cut that community off from its access to vitally needed credit.

Disinvestment studies (conducted by public officials and community groups) which document the lack of conventional mortgage money in older, minority, or racially changing neighborhoods across the country have served to dramatize the issue and to force public officials to examine it. These studies, however, do not *necessarily* address the question of whether lenders are making unfortunate, but essential, business decisions in order to avoid taking undue risk and incurring excessive losses on loans in these communities. What separates a wise business decision from one which creates a self-fulfilling prophecy of neighborhood decline is the validity and accuracy of the lenders' claim that community conditions create unacceptable credit risks.

It is essential that lenders base their analysis of the risks involved in a loan on sound, well-informed, and trustworthy methods. Many of the professional loan underwriting standards incorporate models of neighborhood life cycles and assumptions about sound neighborhood conditions which are based on little, contradictory, or fragmented evidence. The application of these models or assumptions to a specific loan, in a specific community, at a specific point in time, therefore, is often highly suspect.

State and federal regulations require institutional lenders to base their real

---

Calvin Bradford is a visiting scholar at the Center for Urban Affairs at Northwestern University in Evanston. Previously, he was associate director of the Center for Urban Studies of the University of Illinois Chicago Circle Campus.

estate loans on the present appraised value of a property being used as collateral. This is designed to insure that lenders protect their investments by loaning less than the full value of a property and generally requiring some equity (down payment) from the purchaser. Typically, a lender requires about a 20% down payment as a cushion against such risks as foreclosure. If the value of the property decreases rapidly, however, this cushion may not be enough to pay all the costs associated with foreclosure or some other losses. Thus, the lender must estimate the trends in the market and decide whether there are clear and present threats to the value of the property which represent an unreasonable risk for a standard loan. This part of property loan underwriting is similar to appraisal, except that value trends are projected from the present into the future.

Lenders have relied on professional appraisers for standards and techniques of long-term property underwriting. Frequently, lenders train their underwriters by enrolling them in the programs of the professional appraisal organizations. The literature, training manuals, and texts of the professional real estate appraising industry define the standards, assumptions, and models used in judging neighborhood factors and loan risks. A review of the development of this literature reveals the sources upon which these standards, assumptions, and models are based.

THE ORIGINS OF NEIGHBORHOOD LIFE CYCLE MODELS

The early works on appraising and real estate principles reflect views of the relationship between ethnic change, age of the community, and the community life cycles which still appear in much of the professional material today. Two theories of urban decay are commonly used to support the contention that neighborhoods pass through natural life cycles and that racial change indicates a cycle of decline. Both of these theories, or models, were developed at the University of Chicago in the 1920s and 1930s. They are the "human ecology" model and the "filtering" model.

The human ecology model, which became the dominant social model of urban development, was formulated principally by the Chicago School of Sociology in the work of Robert Park, Roderick McKenzie, and Ernest Burgess. It stems from a strong social Darwinistic influence, where not only animals, but people are seen to survive and reach positions of power and status because they are innately the strongest species. This school is also heavily influenced by plant biology, particularly studies of how various plants would take over a piece of land previously occupied by a different species. It is believed that the "invading" plant, as it is called, drives out the original inhabitants because the invaders are better suited to the particular environment.[1]

When applied to human society and the neighborhood development patterns of urban areas, in particular, this model holds that different groups of people "infiltrate" and "invade" territory held by others, and that through a process of "competition"—which is a kind of war of survival—the group most suited to that environment wins out and eventually takes over completely. Neighborhoods and communities, therefore, are seen not so much as conscious man-

made environments, but rather as natural phenomena, subject to the laws "of all nature."

As the level of industrial technology in society advances, certain areas are seen as best suited to that level of technology, and thus become the location of the most successful businesses and residents. Areas less suited to advanced technology become inhabited by the businesses and residents least suited for survival at that state in the evolution of society and technology. Thus, areas, neighborhoods, and communities are identified as going through natural life cycles. First they grow to a point of success. But then as the technology of the society develops and favors different locations, the community is invaded and taken over by lower uses and lower class people in continuing waves of invasion, competition, and succession.

There are temporary plateaus of stability when the area is occupied by a homogeneous population or land use, analogous to a single species of plant taking over its most beneficial location. When this homogeneity is interrupted by the "invasion" of a different type of land use, property, or class of persons, this starts the downward cycle. According to the literature based on the human ecology model, the process continues until the area reaches its inevitable place as a slum.

Robert Park's own statement about the Eastern Europeans then occupying Chicago's slums best expresses the Darwinistic and discriminatory biases of this human ecology model of neighborhood dynamics:

> "In the great city of the poor, the vicious and the delinquent, crushed together in an unhealthful and contagious intimacy, breed in and in, soul and body, so that it has often occurred to me that those generations of the Jukes and The Tribes of Ishmael would not show such a persistent and distressing uniformity of vice, crime, and poverty unless they were peculiarly fit for the environment in which they are condemned to exist."[2]

At the same time, a colleague of Park's, Homer Hoyt, was working on real estate models of land values. In an historical analysis of land values in Chicago, Hoyt included a discussion of race and land values. He surveyed some local Realtors® (members of the Chicago Real Estate Board, which prohibited members from selling to a black on a white block). One West Side Realtor gave him a list of ethnic groups ranked in *descending order*, from those which are most desirable to those which have the most adverse effect on property values.

The list was as follows:[3]

1) English, Germans, Scotch, Irish, Scandanavians
2) North Italians
3) Bohemians or Czechs
4) Poles
5) Lithuanians
6) Greeks
7) Russians, Jews (lower class)
8) South Italians
9) Negroes
10) Mexicans

McMichael's Appraising Manual, often called the bible of appraising, is a commonly used appraisal text which was first published in 1931. Appraisers were then advised to determine whether there were "undesirable racial elements" in an area.[4] The 1951 edition responds to a Supreme Court decision striking down racially restrictive covenants by saying it created "further confusion to appraising properties in foreign and negro-occupied districts." The text then praises Hoyt's study of land values in Chicago and reproduces his ranking of ethnic groups and their effect on property values. Following this, there is a discussion of how the "ingress" of certain ethnic groups precedes blight.[5]

This orientation is superimposed on a work which Hoyt did for the FHA in 1939, *The Structure and Growth of Residential Neighborhoods in American Cities.*[6] In this book, Hoyt defines what has come to be known as the "filtering" or "trickle-down" model of neighborhood decline. This model suggests that as properties and neighborhoods get older, they filter down into the hands of poorer and less capable people until they finally become slums. This filtering concept, which transforms the human ecology model into real estate terms, has been the basis for various models of the life cycle of neighborhoods in later real estate and appraisal literature.

Although Hoyt is considered the founder of the filtering model, Frederick Babcock, who gained his real estate experience while working in Chicago during the time the Chicago School of Sociology was developing, implied such a filtering concept in his influential 1932 book, *The Valuation of Real Estate.* After describing six characteristics of neighborhood decline, Babcock states:

> "The process can be described as inevitable in all residential districts. Given time, all such areas become decadent districts or slums occupied by the poorest, the most incompetent, and least desirable groups in the city. Ragged urchins play on marquetry floors."

Two pages later he comments:

> "Most of the variations and differences between people are slight and value declines are, as a result, gradual. But there is one difference in people, namely race, which can result in a very rapid decline. Usually such declines can be partially avoided by segregation and this device has always been in common usage in the South where white and negro populations have been separated."[7]

The first edition of the American Institute of Real Estate Appraisers (AIREA) text, published in 1935, echoes Park, Hoyt, and Babcock by warning of the adverse effects of the "infiltration of inharmonious racial groups."[8] The text suggests that areas can be protected from these adverse effects by deed restrictions "which forbid whites to sell their homes to blacks."[9]

Accompanying his testimony before a HUD meeting on redlining in July of 1976, Walter Winius of the American Institute of Real Estate Appraisers submitted 21 articles which have appeared in the Institute's *Appraisal Journal* since 1938. The Journal does not represent the official position of the Institute, but was described as "a forum for the presentation of new ideas and concepts having to do with the appraisal of real estate, many of which have ultimately appeared in our textbooks." He explained that an

article in 1959 by Charles Abrams "issued a clarion call in respect to the analysis of neighborhoods." That article suggested that there had been a bias against integrated neighborhoods and against blacks, and that this bias was unwarranted. Winius cited several articles published prior to 1967 which demonstrated, using statistical studies, that racial change had no adverse effect on property values.[10] Nevertheless, in the 1967 edition of the Institute's basic text, *"The Appraisal of Real Estate,"* the chapter on Neighborhood Analysis reads:

> The value levels in a residential neighborhood are influenced more by the social characteristics of its present and prospective occupants than by any other factor. Therefore, the appraiser must give major consideration to the importance of social data.
>
> The causes of racial and religious conflicts are not the appraiser's responsibility. However, he must recognize the fact that values change when people who are different from those presently occupying an area advance into and infiltrate a neighborhood.[11]

The *Student Outline* used in a 1973 session of the Institute's basic course reads:

> Ethnological information also is significant to real estate analysis. As a general rule, homogeneity of the population contributes to stability of real estate values. Information on the percentage of native born whites, foreign whites, and non-white population is important, and the changes in this composition have a significance. *As a general rule, minority groups are found at the bottom of the socio-economic ladder, and problems associated with minority group segments of the population can hinder community growth.* Similar comments are appropriate for occupational types in a community.[12] (Emphasis added.)

In a slide show on single-family appraising shown during the course, the scene of a burned out store was accompanied by the words: ". . . One exceptional factor which may affect value is the influx of inharmonious social or racial groups."[13]

DEFINITION OF STABLE NEIGHBORHOODS

Changes over a period of time have deleted direct statements that racial change leads to declining communities. The definition of a neighborhood as relatively homogeneous, however, remains.[14] Both the 1967 and the 1977 editions of the AIREA text define a neighborhood as "a homogeneous grouping of individuals, buildings or business enterprises within, or as part of, a larger community."[15] Both versions go on to say:

> Residential neighborhoods assume many of the characteristics of the individuals who live in them. These neighborhoods express the mutual desires of people with compatible interests, related traditions, and similar social and economic status.[16]

The notion that a neighborhood should be homogeneous in order to remain stable or to increase in value is reinforced by what appraisers and underwriters call the *principle of comformity.* The American Institute of Real Estate Appraisers states that "the principle of conformity holds that maximum value is realized when a degree of sociological and economic homogeneity is present."[17] The manual of the Society of Real Estate Appraisers (SREA)

presents eight aspects of the principle of conformity:

1) Similar types of houses.
2) Houses of similar utility.
3) Similar age and size of houses.
4) Similar quality of houses.
5) Similar price range of houses.
6) Residents' income in the same general bracket.
7) Residents of similar cultural, educational, *ethnic,* and social backgrounds. (Emphasis added.)
8) Similar land uses.[18]

THE CYCLE OF DECLINE MODEL

The belief that neighborhoods inevitably, or at least typically, pass through a life cycle of birth and death has been extracted from the work of Park and Hoyt and placed at the core of the professional appraisal and underwriting wisdom on neighborhood risk analysis. The model has permeated not only real estate literature, but popular beliefs as well. Nonetheless, surprisingly little research has been done on the causes of decline and improvement since Park first introduced the theory in the 1920s based on his analogy to plant behavior.

To test the theory, a study would have to test all the possible causes of decline against each other over a large number of different communities across the country. Such a study would have to be continually repeated to insure that as time passed and the environment changed, the causes of decline didn't also change. All of these studies would have to favor a single model or set of causes in order to justify the acceptance of the model. Among the things which would have to be taken into account as causes of decline or improvement are not only age and racial change (as is the case with the model used in underwriting texts), but also the individual market behavior of the residents, the actions of government bodies, the impacts of lending decisions on the viability of the neighborhood economy, external conditions such as the state of the regional and national economy, the rate and location of new development, and finally the interrelationships among all of these factors.

No such study exists. What exists are some fragmented, often conflicting, studies of these individual factors. Most research is based on one, or a small group, of communities in one location at one point in time.[19]

Most contemporary descriptions of life cycle models were designed to describe how heavily blighted or abandoned areas progressed to this state.[20] Obviously, such areas declined from an earlier, and healthier, condition. These models can, and do, break down this decline into several stages. There is no indication in such studies, however, that *all* communities should be expected to pass through these cycles.[21]

Although there is a lack of evidence in support of such models, they are clearly stated as facts in the appraisal and underwriting professions. For example, the most recent text of the SREA reads:

> All neighborhoods exhibit a life cycle which varies only in the intensity and duration of each phase. The phases are:
>
> 1) *Development and Growth.* This is the period during which prices are increasing

and the neighborhood is built up.

2) *Stability.* This period may last from approximately the 10th to 15th year of the life of the neighborhood, perhaps through its 40th year. This is generally the period of highest value and attractiveness of the neighborhood.
3) *Transition and Decline.* This occurs as the attractions of the neighborhood are offset by those of new, competitive areas. The properties become functionally obsolescent, as does the pattern of the neighborhood. New uses begin to move in, and transition frequently results in lower values.
4) *Renewal and Rehabilitation.* In some instances, it is possible to renew and revive a neighborhood. Examples may be found in nearly every city: e.g., Old Town in Chicago, and Society Hill in Philadelphia.[22]

HOMOGENEITY, CONFORMITY, AND MORTGAGE RISKS

In spite of the emphasis which appraisers and underwriters have placed on the need for homogeneity and conformity of land uses, building types, styles of construction, and social characteristics of the residents, and aside from some studies of race and property values, there are no studies which systematically compare homogeneous and heterogeneous communities to assess the risk posed by lack of conformity and uniformity. These notions were based on the human ecology model derived from analogies to plant behavior.

Though there have been no systematic studies, there is some indication that mixed land uses and building types may actually be *beneficial.* A major study carried out for HUD tried to estimate the optimum land mix best suited for environmental impacts. This study, *Costs of Sprawl,* cited a high degree of mix between commercial, industrial, low-rise, and high-rise development as the most beneficial. Moreover, while underwriters have been looking critically at mixed use patterns in older communities, they have viewed the development of the Planned Unit Development (PUD) concept for new development as a sound, even risk-reducing technique. One of the basic tenets of the PUD is that the developer is allowed to mix land uses and combine single-family, multi-family and commercial or industrial uses within the same development area. By not depending upon one particular style of building or one particular market, the developer is supposed to minimize the risk of failure in the project and maximize the development of socially and economically sound communities.

RISKS POSED BY RACE AND RACIAL CHANGE

Property Values and Racial Change

An analysis of the major studies on property values and race reveals that in all but one of the studies, property value trends *either* increased or remained about the same after racial change.[23] In the one study which documents that prices did not *rise* after racial change—"Racial Succession and Changing Property Values in Residential Chicago"—the author notes that values were declining prior to black entry.[24] Seven of the studies which considered the socio-economic factors of the incoming blacks, indicated that blacks had either a higher class level or a higher income level than the whites who already lived in the area.[25] Finally, there are two studies of racially changing areas in

Chicago which arrive at different conclusions about racial change and property values.[26]

The existing studies of property values and racial change do not take account of the effects of disinvestment. There are some areas where racial change has taken place and where property values have declined or risen at rates lower than in comparable white areas. One would expect that disinvestment, once it takes place, would eventually effect property values. There is one study which examined both disinvestment and property values.

A detailed study of disinvestment in northwest Philadelphia compared similar communities, one which changed racially and one which did not.[27] The area which changed racially actually showed increases in family income, level of education, and employment status compared to the area which did not change. The study traced both the level of conventional mortgages and the property values in the two areas. Generally, property values rose more in the racially changing area *prior* to heavy disinvestment by conventional lenders. *After* several years of disinvestment, property values in the racially changing area slowed and increased at a lower rate than properties in the all white area.

Causes of Mortgage Default and Foreclosure

There are a number of studies of factors which predict default and foreclosure. Most of the studies were carried out in the 1960s, during a period of unusually high foreclosure rates throughout the lending industry. Most focused on FHA and VA loans and paid little attention to the factors associated with conventional loans. Since 1970, several more studies have been done but most of them, like the earlier studies, have serious methodological problems such as poor and biased samples, exclusion of several factors believed to be important in delinquency and foreclosures, lack of data on a neighborhood level, and lack of attention to explaining the causes of the statistical relationships presented.[28]

Most of the studies suggested that delinquencies and foreclosures were related to factors representing the individual characteristics of the borrower, the conditions of the loan, or the condition of the property.[29] Of the three studies which suggest that neighborhood factors do influence delinquency and foreclosure rates, two of these studies were carried out in the Pittsburgh area.[30]

The one study which was not carried out in Pittsburgh was done by FNMA.[31] It covered only two FHA low-income programs, and used zip codes as the basic unit of analysis. It did not consider the individual loan characteristics which previous studies had found to correlate with mortgage risk. While there are some correlations with neighborhood (actually zip code) characteristics, they were not strong and race was not one of these factors. Interestingly, this study showed that the level of indictments for illegal use of federal housing programs was one of the most important predictors of foreclosure in one program.[32]

A Pittsburgh study found that no neighborhood characteristics were associated with both delinquency and foreclosures, and that only high neighborhood unemployment was associated with foreclosure.[33] All the neighborhood factors together could explain only 12% of the delinquency levels and 9% of the levels of foreclosures on the loans studied.

A second Pittsburgh study by George von Furstenberg and Jeffrey Green represents the most detailed study of neighborhood characteristics and delinquency in mortgage payments.[34] The study found no conclusive relationships. It could not identify any clear relationship between racial characteristics of an area and delinquency rates. The study did find a relationship between the age of the mortgaged property and delinquency, but this was not consistent with an earlier, more extensive, study made by von Furstenberg alone.[35] The von Furstenberg and Green study suffers from the fact that all the loans studied came from one lender and do not represent the general market, even for Pittsburgh.

The most recent study of mortgage risks was produced by Andrew Brimmer for the U.S. League of Savings Associations. This report, published in April of 1977,[36] attempts to separate risk from racial discrimination. It concludes that inner-city, minority communities represent higher risks. However, the study was not based on any *new* research. His conclusions were based on an earlier study from the FHLBB, which showed that minority-owned S&L's did not perform as well as white-owned S&L's.[37]

Brimmer had no data on the actual location or conditions of *any* loans made by *any* of the white or minority S&L's, but assumed that the white S&L's loaned in white areas and that the minority institutions loaned in inner-city, minority areas. The study Brimmer relies on was not intended to evaluate the lending risks in any area. Like most other such studies, it draws attention to the lack of management expertise—not lending risks—as the major cause of low performance by minority institutions. Thus, this study must be considered of extremely limited value since its findings are based on illogical and unfounded assumptions.

There are several examples of sound lending opportunities in older, minority, racially changing communities for lenders who ignore the conventional wisdom of decline and risk. At HUD's meeting on discrimination in mortgage lending held in Hartford in 1974, Robert Gnaizda, a public interest lawyer, presented a study which showed how the largest savings and loans in California had redlined the Mission District of San Francisco. Then he indicated that a minority-owned institution, formed in the last two years, had placed 88% of its loans in the Mission District with not one current delinquency, default, or foreclosure.[38] In testimony before HUD's Philadelphia Meeting on Redlining in 1976, James Vitarello of the Washington, D.C. Residential Mortgage Investment Commission, gave an example of another minority-owned institution in Washington (Independent Federal Savings and Loan Association) which has 89% of its loans in the city of Washington. It has no defaults on any of these loans.[39]

In the South Shore community of Chicago, which had been defined as being "clearly declining," a local group of investors bought out the bank which was trying to move out of the area because the racial change and alleged decline had made it impossible for them to survive. The new owners set out to make the bank a vehicle for community development. They have reversed the bank's losses and turned larger profits each year. Last year alone, the bank

made 52 home loans in its community. It has only two defaults and no foreclosures on these loans.[40]

In Philadephia, there is a program by several of the commercial and mutual savings banks to revise their underwriting practices in order to include older neighborhoods. The new underwriting criteria permit conventional lending in any block which does not have more than 10% of the properties abandoned and vacant. Even if the abandonment rate is higher, conventional loans will be made if there is evidence of community activity to put the block back on its feet.[41] In spite of what many lenders consider to be excessively liberal definitions of sound neighborhood, the delinquency rate for the Philadelphia Plan has been as low or lower than for mortgages in the suburban areas around Philadelphia.[42]

RECENT CHANGES IN THE USE OF ETHNICITY IN APPRAISING AND UNDERWRITING

In the past several years, there have been changes made by some appraisal and underwriting organizations as well as by some federal regulatory agencies. Some of these changes have been significant.

The savings and loan industry is the largest originator of home loans, making more than 50% of all such mortgages. The Federal Home Loan Bank Board (FHLBB) directly regulates federally chartered savings and loan associations; and through its Federal Savings and Loan Insurance Corporation (FSLIC) indirectly regulates the practices of most state chartered savings and loans.

In 1974, an opinion from the general counsel for the FHLBB stated that consideration of the ethnic composition of the area where a loan is to be made is a violation of civil rights law.[43] Moreover, later regulations adopted by the FHLBB state:

> The use of lending standards which have no economic basis and which are discriminatory in effect is a violation of law even in the absence of an actual intent to discriminate. However, a standard which has a discriminatory effect is not necessarily improper if its use achieves a sound business purpose which cannot be achieved by means which are not discriminatory in effect or less discriminatory in effect.
>
> Refusal to lend in a particular area solely because of the age of the homes or the income level in a neighborhood may be discriminatory in effect since minority group persons are more likely to purchase used housing and to live in low-income neighborhoods. *The racial composition of the neighborhood where the loan is to be made is always an improper underwriting consideration.*[44] (Emphasis added.)

The U.S. League of Savings Associations is the trade organization of the savings and loan industry. Among its functions is the training of lenders seeking advancement in the industry. For years the organization has trained its members on the use of its own recommended appraisal form, known as the "Green Hornet." One of the items on this form asked for the "ethnic composition" of the area. The appraiser—either a staff member of the S & L, or a contract appraiser—was to check off either "stable" or "unstable" conditions.

In response to the 1974 opinion of FHLBB's general counsel, this form was changed to replace ethnic information with data on "sales velocity." In the League's underwriting text, the wording surrounding the copy of the Green Hornet form was not changed. In addition, the League's 1975 text, *Lending Principles and Practices,* states that racial change, even fear of racial change, is identified with increased volume of sales—*thus linking sales velocity to ethnic change.*[45]

On April 16, 1976, the Justice Department filed a suit against AIREA, SREA, and two professional associations of lenders charging that these groups were teaching their members discriminatory practices.[46] AIREA, which had already been making some progress in revising its materials, provided its course instructors with a set of sample questions and answers to be used in response to student inquiries about race and property valuation. These sample materials, which were distributed on July 9, 1976, detailed a position that racial change did not necessarily affect property values.[47]

On November 23, 1977, the Institute reached a settlement in the case.[48] The Justice Department dropped its charges without requiring any statement of guilt. For its part, AIREA made extensive, point by point revisions of its forthcoming text and added sections and interpretations to its Code of Professional Ethics and Standards of Professional Conduct. In addition, AIREA developed an Affirmative Action Program, which they had been working on prior to the court suit, and issued a three-point policy statement in regard to neighborhood analysis. The first point reads:

> It is improper to base a conclusion or opinion of value upon the premise that the racial, ethnic or religious homogeneity of the inhabitants of an area or of a property is necessary for maximum value.

The third point reads:

> It is improper to base a conclusion or opinion of value, or a conclusion with respect to neighborhood trends, upon stereotyped or biased presumptions relating to race, color, religion, sex or national origin or upon unsupported presumptions relating to the effective age or remaining life of the property being appraised or the life expectancy of the neighborhood in which it is located.[49]

These statements were incorporated into the detailed revisions of the Institute's text which will soon appear in a new revised edition. The new text contains clear statements that previous notions and statements about race and property values are not considered proper any more. The principle of conformity is redefined to omit references to social homogeneity. While the chapter on neighborhood analysis still presents a general model of cycles of growth and decline, they are not stated as inevitable and are specifically not related to race. The views expressed in the policy statement on neighborhood analysis are also incorporated in the new sections interpreting the Code of Professional Ethics. As part of the settlement, AIREA members and candidates for membership were all sent copies of the settlement agreement, including appendices containing the changes in the text book and Code of Ethics.

SREA, on the other hand, actively sought to block the settlement between AIREA and the Justice Department. In an official policy statement at their

national convention, they reasserted their right to teach whatever they thought important as part of their Constitutional right of free speech.[50]

CONCLUSION

The lack of sound evidence for models of racial change and decline, the individual cases of conventional lending successes in some inner-city areas, and the evidence from the literature on mortgage risks and property values all suggest that the existing models are in serious need of revision. Admittedly, the methodological purity of many of the individual studies of foreclosure risks and the relationships between racial change and property values is not impressive. What is striking, however, is the lack of any body of empirical work to *support* the models of race and decline.

In the controversy between the lenders and the community groups and regulators investigating charges of redlining and disinvestment, the burden of proof is shifting to the lenders. In no small measure, this is due to the assumptions and standards expressed in the traditional approaches to racial change and neighborhood decline. When seeking to distinguish between patterns which reflect sound lending and those which indicate discrimination, objective evidence of risk and value trends becomes the determining factor. While it may be clear that traditional assumptions are not appropriate, it is not equally as clear what standards, assumptions, information, or techniques are appropriate. Lenders may have to go through a painful process of learning to do risk analysis under the watchful eyes of both regulators and community groups. Whatever revised underwriting processes are developed, they will have to survive public scrutiny and debate.

REFERENCES

1. The first complete presentation of these concepts appears in Robert E. Park, Ernest W. Burgess and Roderick McKenzie, *The City* (Chicago: University of Chicago Press, 1925).
2. Robert E. Park, *The City*, p. 45.
3. Homer Hoyt, *One Hundred Years of Land Values in Chicago* (Chicago: The University of Chicago Press, 1933), p. 316.
4. Stanley McMichael, *McMichael's Appraising Manual* (Englewood Cliffs: Prentice-Hall, 1931), p. 278.
5. Stanley McMichael, *McMichael's Appraising Manual*, 4th ed. (Englewood Cliffs: Prentice-Hall, 1951), pp. 156 and 161.
6. Homer Hoyt, *The Structure and Growth of Residential Neighborhoods in American Cities* (Washington, D.C.: Federal Housing Administration, 1939).
7. Frederick Babcock, *The Valuation of Real Estate* (New York: McGraw Hill Book Company, 1932), pp. 89 and 91.
8. American Institute of Real Estate Appraisers, *Real Estate Appraisal*, text no. 9 (Chicago: American Institute of Real Estate Appraisers, 1935), p. 10.
9. *Ibid.*
10. Statement of Walter Winius before the Office of Fair Housing and Equal Opportunity, U.S. Department of Housing and Urban Development, *Administrative Meeting on Redlining and Disinvestment as a Discriminatory Practice in Residential Mortgage Loans* (July 14-16, 1976 in Philadelphia), transcript of July 14, pp. 14-15.
11. American Institute of Real Estate Appraisers, *The Appraisal of Real Estate*, 5th ed. (Chicago: American Institute of Real Estate Appraisers, 1967), p. 90.
12. American Institute of Real Estate Appraisers, *Student Outline, Course 1-A—Real Estate Appraisal* (Chicago: American Institute of Real Estate Appraisers, 1973), p. 166.

13. Slide show presented in "Course 1-A—Appraisal of Real Estate" taught by the American Institute of Real Estate Appraisers (Chicago, Illinois, Nov. 6, 1973).
14. See "Plaintiff's Response to the First Set of Interrogatories of the Defendant American Institute of Real Estate Appraisers," filed by the U.S. Department of Justice in the case of *U.S. v. American Institute of Real Estate Appraisers, et al.*, 76 C.1448 (N.D. Ill., 1976) for a detailed history of how direct statements about the adverse effects of racial change on property values were gradually replaced with more subtle references to "homogeneity" and "congeniality" in the professional appraisal literature.
15. American Institute of Real Estate Appraisers, *The Appraisal of Real Estate,* 5th ed. (1967), p. 82 and 6th ed. (1977), p. 88.
16. *Ibid.*
17. *Ibid.*, 6th ed., p. 40.
18. Society of Real Estate Appraisers, *An Introduction to Appraising Real Property* (Chicago: Society of Real Estate Appraisers, 1975), pp. 6-11.
19. For example, William Grisby *(Housing Markets and Public Policy.* Philadelphia: University of Pennsylvania Press, 1963) studied filtering in one Philadelphia neighborhood only, yet his work is widely used as a major restatement of the filtering model applying to all neighborhoods; George Steinlieb and Robert Burchell studied small multi-family properties in Newark and concluded that this decline was largely a result of low demand and that this decline created significant risks to a lender *(Residential Abandonment: The Tenement Landlord Revisited.* New Brunswick: Center for Urban Policy and Research, 1973); while Frederick Case studied inner-city lending in nine cities, and concluded that there are opportunities for sound lending, but that lenders were not taking advantage of them (*Inner City Housing and Private Enterprises.* New York: Praeger, 1972).
20. Most recent models of decline are modifications of: National Urban League and the Center for Community Change, *The National Survey of Housing Abandonment* (New York: April, 1971).
21. The recent and popular report *The Dynamics of Neighborhood Change* (Public Affairs Counseling, Washington, D.C.: U.S. Department of Housing and Urban Development, 1975) is also based on previous research on abandonment. It provides a very readable and graphic synthesis of the existing models, though it does not include any new studies or data of its own.
22. Society of Real Estate Appraisers, *An Introduction to Appraising Real Property,* p. 6-16.
23. See Calvin Bradford and Dennis Marino, *Redlining and Disinvestment as a Discriminatory Practice in Residential Mortgage Loans* (Washington, D.C.: U.S. Department of Housing and Urban Development, Office of Fair Housing and Equal Opportunity, 1977) section entitled "Evidence Relating Racial Factors to Mortgage Risk" and the annotated bibliography for a summary and listing of the major studies on race and property values.
24. Frederick E. Schietinger, "Racial Succession and Changing Property Values in Residential Chicago," *Urban Sociology,* E. Burgess and D. Bogue, eds. (Chicago: University of Chicago Press, 1964), pp. 86-89.
25. Thomas Gilette, "A Study of the Effects of Negro Invasion on Real Estate Value," *The American Journal of Economics and Sociology,* vol. 15 (January, 1957), pp. 151-162; Erdman Palmore, "Integration and Property Values," *Phylon,* vol. 27 (Spring, 1966), pp. 15-19; Erdman Palmore and John Howe, "Residential Integration and Property Values," *Social Problems,* vol. 10 (Summer, 1962); Chester Hunt, "Integrated Housing in Kalamazoo," *Research Report on Integrated Housing in Kalamazoo* (Kalamazoo, Michigan: Upjohn Institute for Community Research, 1959),pp.3-25; Chicago Urban League, *Housing Costs in the Black Submarket of Chicago: A Reassessment of the Filtering Model* (Chicago: Chicago Urban League, 1977); Luigi Laurenti, "Effects of Nonwhite Purchases on Market Prices of Residences," *The Appraisal Journal,* vol. 20 (July, 1952), pp. 314-329; and Luigi Laurenti, *Property Values and Race* (Berkeley: University of California Press, 1960).
26. Brian Berry, "Ghetto Expansion and Single-Family Housing Prices: Chicago 1968-1972," *Journal of Urban Economics,* vol. 3, no. 4 (October, 1976) sees values declining while the Chicago Urban League (*supra,* note 25) sees values increasing with racial change.
27. Northwest Community Housing Association, *Mortgage Disinvestment in Northwest Philadelphia* (Philadelphia, 1973).
28. See Kerry Vandell, Barbara S. Hodas, and Rachel Bratt, *Financial Institutions and Neighborhood Decline: A Review of the Literature* (a report prepared for the Federal Home Loan Bank Board by the Joint Center for Urban Studies at Harvard-MIT, under the direction of Arthur P. Solomon, November 1974) and Calvin Bradford and Dennis Marino (*supra,* note 23) for detailed reviews of the literature on mortgage risks.
29. *Ibid,* Vandell *et al.*, pp. 72-75 and 89-93, and Bradford and Marino, pp. 81-88 and 148-153.
30. George von Furstenberg and Jeffrey Green, "The Effect of Income and Race on the Quality of Home Mortgages: A Case for Pittsburgh," George von Furstenberg, Ann R. Horowitz, and Bennet Harrison, eds. *Patterns of Racial Discrimination, Volume I: Housing* (Lexington: Lexington Books, 1974) and Alex Williams, William Beranek, and James Kenkel, "Factors Affecting Mortgage Credit Risk in Urban Areas—A Pittsburgh Prototype Analysis," presented at the American Real Estate and Urban Economics Association Meeting, Dec. 29, 1973.

31. Federal National Mortgage Association, Office of Economic Analysis, *Estimation of the Socio-Economic Determinants of Foreclosures on 221(d)2 and 235 Mortgages* (Washington, D.C.: 1974).
32. Section 221(d)2.
33. Williams, *et al.* (*supra,* note 30).
34. Von Furstenberg and Green (*supra,* note 30).
35. The complete summary of the four articles which von Furstenberg wrote from this earlier study can be found in: George von Furstenberg, *Technical Studies of Mortgage Default Risk: An Analysis of the Experience with FHA and VA Home Loans During the Decade 1957-1966* (Ithaca, New York: Center for Urban Development Research—Cornell University, 1971).
36. Brimmer and Company, Inc., *Risk v. Discrimination in the Expansion of Urban Mortgage Lending* (Chicago: U.S. League of Savings Associations, April, 1977).
37. William D. Bradford, "The Viability and Performance of Minority Controlled Savings and Loan Associations," Research Working Paper No. 62, prepared for the Office of Economic Research, Federal Home Loan Bank Board (1975).
38. Statement of Robert Gnaizda before: Office of Fair Housing and Equal Opportunity, U.S. Department of Housing and Urban Development, *Administrative Meeting on Discrimination in the Financing of Housing* (May 20-21, 1974 in Hartford, Connecticut), transcript of May 21, pp. 260-261.
39. Statement of James Vitarello before the Office of Fair Housing and Equal Opportunity, *Administrative Meeting on Redlining and Disinvestment (supra,* note 12), July 15, pp. 215-216.
40. Judith Barnard, "Money Matters," *Chicago Magazine* (February, 1977).
41. Dennis Marino, *The Philadelphia Mortgage Plan* (Chicago, Illinois: Woodstock Institute, July, 1977).
42. *Ibid.*
43. Opinion from the FHLBB general counsel to the FHLBB Office of Housing and Urban Affairs (Mar. 21, 1974).
44. 12 C.F.R.531.8(b) and 531.8(c).
45. See U.S. League of Savings Associations, "Residential Appraisal Form (17-PRA)" and *Lending Principles and Practices* (Chicago: U.S. League of Savings Associations, 1975), p. 67.
46. *U.S. vs. American Institute of Real Estate Appraisers, et al. (supra,* note 14).
47. National Education Committee of the American Institute of Real Estate Appraisers memorandum on the valuation of residential property in racially integrated neighborhoods (July 9, 1976).
48. A summary of the agreement and the complete text of all revisions in educational material, changes in the Code of Professional Ethics, and the statement of policy related to neighborhood analysis are contained in a memorandum from the American Institute of Real Estate Appraisers to all "Members and Candidates," titled "Settlement Agreement and Affirmative Action Program" (Dec. 22, 1977).
49. *Ibid.*, "Summary of Settlement Agreement and Settlement Order," pp. 7-8.
50. For the position of the SREA see "Resolution of the Board of Governors of the International Society of Real Estate Appraisers" (unanimously passed Aug. 6, 1977), reprinted in *Appraisal Briefs,* vol. 12, no. 44, (Nov. 2, 1977).

REPLY

by Pierre de Vise

Although Professor Bradford's article is couched in the language and syntax of objective scientific inquiry, it is in fact a highly polemical piece which discounts conventional analysis of community decline and legitimizes populist critiques of conventional analysis and institutional behavior.

At the very outset, Bradford takes for granted that lenders redline minority neighborhoods. He is charitable enough to recognize the possibility that the redlining may be based on a sound determination of risk, yet he presumes that the problem of redlining is one of lenders not lending to creditworthy applicants rather one of an absence of demand on the part of creditworthy applicants. This presumption is akin to asking why a man beats his wife before determining that he has in fact beaten his wife.

Lenders are accused of determining risk on assumptions based on "little, contradictory, or fragmented evidence." This shortcoming is somewhat diminished a dozen pages later when Bradford admits that there is no comprehensive model of neighborhood change: "What exists [sic] are some fragmented, often conflicting, studies of these individual factors."

Bradford next examines two major explanations of neighborhood change which equate racial transition with decline. These are the "human ecology" model and the "filtering" model. These models are deterministic and are derived from allegedly immutable laws of nature in which human behavior is reduced to the competition of vegetable life for scarce land. Communities of superior people are infiltrated and invaded by inferior people much as inferior weeds infiltrate and replace superior flowers. The racial and religious bias implicit in these concepts is made more explicit by colorful quotes from the 40 and 60-year old pioneering studies of Hoyt and Park.

Bradford shows that underwriting manuals gave credence, until very recently, to models identifying racial change, and "inharmonious population and land use" as factors in community instability and decline. Bradford then cites studies that indicate that black inmigration increased the income level and enhances property values in the neighborhood, and that mixed land uses can be beneficial. (Never mind that most of those studies are based on the

---

In this article, Pierre de Vise, author of "The Devil Theory of Redlining" in the Summer 1977 edition (vol. 2 no. 1) of *Real Estate Issues* responds to Mr. Bradford's comments on the subject.

Pierre de Vise is on the faculty of the College of Urban Sciences at the University of Illinois, Chicago Circle Campus. His analysis of the causes of the decline of Chicago and other large cities has been reported in the *New York Times* and *U.S. News and World Report* among others, and his findings were presented to the Senate Banking Committee's oversight hearings of November 23, 1976.

experience of exceptional communities in the tight housing markets of the immediate postwar years).

Bradford accepts uncritically studies that deny the influence of race, poverty, and mixed land uses on neighborhood stability. His critical gaze is focused instead on studies that support the conventional wisdom equating racial change with community decline. These studies are of "extremely limited value" because he believes their findings are based on illogical and unfounded assumptions, have serious methodological problems, biased samples, lack small area data, and ignore relevant factors.

Not so impugned are studies of "sound lending opportunities in older, minority, racially changing communities for lenders who ignore the conventional wisdom of decline and risk." Yet data reported for those studies are too cryptic and unspecified to judge whether these studies are themselves based on unbiased samples and small area data, and take account of all relevant factors. What geographic detail is provided is not reassuring. The city of Washington is larger than a neighborhood, and the elite black communities of the Mission District and South Shore are a biased sample of black communities in San Francisco, Oakland and Chicago. Are 52 home loans given last year in Chicago's South Shore a large number for a community of 4,000 single-family houses? Are these loans mortgage loans or improvement loans? Is a 4% default rate in the first year not much higher than the average default rate? Would foreclosures be expected in the first year when foreclosures legally take two years?

In his conclusion, Bradford says that on the issue of redlining "the burden of proof is shifting to the lenders." Because the lenders cannot be proven guilty ("it is not clear what standards are appropriate"), let us consider them guilty, he seems to urge, until they can prove their innocence. To survive this public inquisition, Bradford says lenders will have to expiate their guilt and undergo the painful redemption of learning correct risk analysis under the watchful eyes of government and community groups.