LEGAL UPDATES

PUBLISHED: APRIL 21, 2023

CFPB and DOJ: Lenders May Be Liable for Third-Party Discriminatory Appraisals

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On March 13, 2023, the Department of Justice (DOJ) and Consumer Financial Protection Bureau (CFPB) filed a statement of interest in a case concerning racial discrimination in the appraisal of a residential home. In that statement, the CFPB and DOJ assert that a lender may be held liable under the Fair Housing Act (FHA) and the Equal Credit Opportunity Act (ECOA) for relying on a discriminatory appraisal of an independent third-party appraiser, if the lender knows or should know that the appraisal is discriminatory.

Facts of the case

A Black family in Baltimore wanted to refinance their home to lower their interest rate. Their lender approved their loan application, subject to an appraisal by an independent third party. When the appraiser visited their home, the couple and their children – all of whom are Black – were present. The independent appraiser valued their home at $472,000, and the lender subsequently denied their application, despite the fact that the family allegedly told the lender that the appraisal was discriminatory.

Months later, the family applied to refinance their home through a different lender. This time, they decided to replace their family photos with those of friends' white families and have a white person pose as the homeowner for the appraisal. The house then appraised for $750,000. The family was then able to refinance their home, but at a higher interest rate than they would have gotten from the first lender.

The family sued the first lender and appraiser for violations of the FHA and ECOA, among other state and federal laws.

CFPB and DOJ Statement of Interest

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In the Statement of Interest, the CFPB and DOJ attack three legal points made by the lender's motion to dismiss, including the lender's contention that it cannot be liable for denying credit based on a third-party appraisal, and that it was prohibited by law from taking any further action to ensure that the appraisal was not discriminatory. The CFPB and DOJ dispute that contention and assert that a lender can be liable for relying on a discriminatory appraisal when determining whether to extend credit, and that federal law authorizes a lender to take certain corrective actions, if the lender knew or should have known the appraisal was discriminatory. Additionally, the Statement of Interest also addresses the appropriate standard for pleading disparate treatment claims under the FHA and ECOA, and the ability to bring a claim under section 3617 of the FHA without an underlying FHA violation.

Lender liability under the FHA and ECOA

Per 42 U.S.C. § 3605(a), it is unlawful for anyone engaging in residential real estate transactions "to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race [or other prohibited basis]." Further, FHA's implementing regulation states that a person is "directly liable" for failing to take "prompt action to correct and end a discriminatory housing practice by a third-party," where the person knew or should have known of the discriminatory conduct and had the power to correct it.

The FHA also prohibits a lender from using an appraisal of residential property in connection with the sale, rental, or financing of any dwelling where the person knows or reasonably should know that the appraisal improperly takes race into consideration. In conclusion, the DOJ asserts that under the FHA, lenders can be liable for a discriminatory appraisal if they knew or should have known that the appraisal was done in a discriminatory way.

The CFPB and DOJ argue that a lender can also be liable for a discriminatory appraisal under ECOA. ECOA makes it unlawful to discriminate "against any applicant, with respect to any aspect of a credit transaction," which would include the creditor's use of an appraisal. Under ECOA's implementing regulation, a creditor may consider any information obtained, so long as the information is not used to discriminate against an applicant on a prohibited basis. The CFPB and DOJ conclude that if a lender relies on a discriminatory appraisal to deny a loan, then the lender has taken a prohibited basis into account in its evaluation of the applicant's creditworthiness.

Steps the lender could have taken

The lender in the case insisted that it could not comply with ECOA and the FHA because it had to comply with the appraisal independence provisions in the Mortgage Reform and Anti-Predatory Lending Act, also known as the Mortgage Reform Act, and that the only course of action for the lender was to request that the appraiser reconsider his valuation and provide an explanation. Specifically, the

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Mortgage Reform Act, which is implemented by the valuation independence provisions in Regulation Z (15 U.S.C. § 1639e(b)(1). See also the implementing regulations at 12 C.F.R. § 1026.42), prohibits a creditor from engaging in an act or practice that "compensates, coerces, extorts, colludes, instructs, induces, bribes, or intimidates" an appraiser for the purpose of causing the appraised value to be based on any factor other than the independent judgement of the appraiser or to seek to influence an appraiser to encourage a targeted value to facilitate the transaction.

The CFPB and DOJ argue that actions that seek to avoid a discriminatory appraisal are not taken for the purpose of causing the appraised value to be based on a factor other than independent appraiser judgment or to encourage a targeted value to facilitate the transaction. Instead, these actions would be undertaken to comply with anti-discrimination laws, including the FHA and ECOA.

Further, the CFPB and DOJ make suggestions on how the lender could have avoided violating the FHA and ECOA. Namely, the lender could have: (1) asked the appraiser to consider additional, appropriate property information or to correct errors in the appraisal report, (2) obtained multiple valuations for the consumer's property and then selected the most reliable valuation, or (3) not relied on an appraisal that is inaccurate or violates the law.

Implications for lenders and appraisers

Although this case is only in the motion-to-dismiss phase, the Statement of Interest is another indication that the CFPB and DOJ are increasing enforcement efforts in the appraisal industry to ensure that consumers are not harmed by discriminatory appraisals when attempting to obtain home financing. The CFPB and DOJ show that they are not afraid to hold lenders liable for the discrimination of independent, third-party appraisers.

This is also one of the latest of many instances demonstrating the Biden administration's increased focus on eliminating bias in the appraisal industry. For example, in June 2021, the administration formed an interagency task force—Property Appraisal and Valuation Equity (PAVE)—to study the issue. One of the commitments by the PAVE task force is to enhance fair housing and fair lending enforcement in the appraisal industry.

Lenders should ensure that their employees re-review and accurately understand the obligations and limitations imposed on lenders by the FHA, ECOA, and the valuation independence provisions of the Mortgage Reform Act (as well as all other applicable legal obligations, prohibitions, and limitations) in connection with the use of independent appraisers and discriminatory appraisals. Otherwise, the lender could be liable for violations of FHA and ECOA for relying on an appraisal done by an independent third party.

What this means to you

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Contact us

If you have questions about appraisal discrimination or other matters related to originating residential mortgage loans, please reach out to Leslie Sowers, Daniel Wilkinson, or your Husch Blackwell attorney.

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