tech, bias, and housing initiative

The Promise and Perils of Residential Proptech

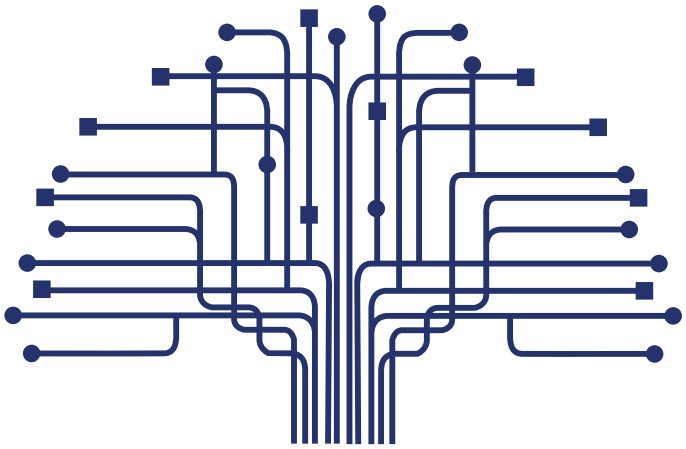
Executive Summary

April 2023



TECHEQUITY COLLABORATIVE

To learn more about the Tech, Bias, and Housing Initiative go to housing.techbias.org



TECHEQUITY COLLABORATIVE

At TechEquity Collaborative, our mission is to mobilize tech workers and companies to advance structural change that addresses economic inequity at its roots.

We do this in three ways:

Education

We create educational spaces in which the tech community can deepen their understanding of structural inequities, the history behind them, and the solutions we can enact together.

Public Policy

We advocate for public policy that addresses structural inequity in our economy. We work on issues that have a nexus with tech and the economy, with a focus on housing and workforce & labor.

Corporate Practice

We research, develop, and promote equitable corporate practices that build equity and opportunity in the broader economy.

Executive Summary

Whether you're trying to find an affordable apartment or buy or sell a home, technology is behind an increasing number of today's housing decisions.[1] [2] As the "Residential Proptech" sector, as it is known, grows, it has promised to dramatically decrease the cost of producing new housing, expand ownership opportunities to marginalized communities, and streamline the tenant/landlord relationship. According to its proponents, Residential Proptech will make housing more accessible and affordable, and eliminate much of the discrimination embedded in America's housing system.

But Residential Proptech also has the potential to exacerbate the bias inherent in our housing system. To understand the risks, as well as the potential benefits, it helps to revisit how we got here.

1. Landlord Tech Enables the Financialization of the Housing Market

In the wake of the Great Recession, Wall Street saw an opportunity in the single-family housing market. The U.S. averaged 10,000 home foreclosures a day in 2008.[3] With so many homes newly unoccupied and too few people with homebuying resources, the Federal Housing Finance Agency (FHFA) created the REO (Real Estate Owned)-to-Rental program in 2012—a pilot program that paved the way for large investors to purchase foreclosed homes in bulk and turn them into rental properties.[4] The program's intent was to prevent vacant homes and communities; it did so by bringing the profit motives of private equity firms to America's doorstep.

With new digital tools and thousands of data points, investor owners came to use algorithms to optimize for profit—at the tenants' expense.

As this landlord tech, as it would become known, took hold, more property managers of all sizes came to rely on it to interface with tenants. One key feature of landlord tech is the use of algorithms to screen rental applicants and assess their suitability as tenants.

Before the advent of algorithmic tenant screening, landlords vetted tenants by having them submit their own records and references from previous landlords or others who could vouch for their trustworthiness. Algorithm-backed screening services, on the other hand, are bundling all the traditional information (whether accurate or not) alongside predictive models. These predictive models make guesses about whether an applicant will be a responsible tenant based not on the history of that specific applicant, but on (as far as we can tell) behavior trends of applicants who have similar characteristics. The data behind these models is rarely made available to either the tenant or the landlord.

From information on company websites, it is not clear what analysis or data is behind subjective determinations of tenant suitability. Based on sample reports, even landlords are not privy to how the determinations are made. Instead, they receive a risk score out of 100 reduced to green, yellow, and red color-coded recommendations.

The emergence of synthesized risk scores using predictive models raises questions: do existing consumer protections such as the Fair Credit Reporting Act apply? Are the landlords that use these services receiving the information they need to fulfill their obligations under the Fair Housing Act?

2. Emerging Alternative Financing Options Reflect Some Predatory Characteristics of Past Models

The expansion of the pool of people left out of the traditional mortgage market, along with a constriction of housing supply and increased competition from investor buyers, created a market for startups offering alternative pathways into homeownership. Of the many models that purport to make homeownership accessible through something other than a traditional mortgage, Rent-to-Own (RTO) has so far gained the most traction.

RTO companies purchase homes on behalf of buyers and retain that ownership until the buyers have made consistent payments over a period of years. These companies can play an important role in easing the path to homeownership for families that do not yet qualify for a traditional mortgage. However, RTO bears some similarities to a Jim Crow housing practice known as Contract-for-Deed (CFD).

TechEquity's comparison of modern RTO models found that many do improve on traditional CFDs with clear terms, future option prices (the pre-agreed price that a buyer will pay for the home), and connection to homeownership counseling. However, some important elements of the arrangements, such as how maintenance is handled and how an option price may change in a shifting market, leave room for buyers to be exploited.

3. Venture Capital Fuels Rapid Expansion with Unclear Housing Outcomes

The rise of Proptech is due, in part, to the desperation felt by average home seekers. As unprecedented capital investment flows into this space, venture-backed companies' winner-take-all approach to growth has the potential to exacerbate inequality rather than combat it.

Because of a lack of transparency in the market, we don't have a clear understanding of the demographics of the companies' target markets. We do know that they heavily concentrate in lower-middle-class neighborhoods and communities of color.[5] Many Proptech companies advertise to people who want to purchase a home but whose credit scores suggest they have "hit a few bumps in the road," or to tenants that might not have enough cash on hand to pay a security deposit in full.[6] [7] This marketing is powerful, bringing in customers who are hoping to find stable housing despite their income restraints, but who end up paying more for it in the long run.[8]

4. Expanded Rights, Protections, and Transparency Offer a Way Forward

As we enter this new era of America's housing history, we must ensure that practices of the past are not transmuted into new tools and business models that have the power to amplify the exclusion that persists in our housing system.

To get us on the right path, we need to both double down on the policies we know work, like building new housing and strengthening tenant protections. We also need to adopt new policies that target the role of technology and new venture-backed business models directly. We encourage Proptech companies to adopt industry standards that prevent harm and invest in the ways that technology can help make housing's future more equitable than its past.

Endnotes

1 Little, H. V., Haru Coryne, Ryan. (2022, October 15). Rent going up? One company's algorithm could be why. ProPublica. https://www.propublica.org/article/yieldstar-rent-increase-realpage-rent

2 "Consumer Financial Protection Bureau Outlines Options to Prevent Algorithmic Bias in Home Valuations." Consumer Financial Protection Bureau, 23 Feb. 2022. https://www.consumerfinance.gov/about-us/newsroom/cfpb-outlines-options-to-prevent-algorithmic-bias-in-home-valuations/

3 OHCHR | Financialization of housing. (n.d.). OHCHR. Retrieved June 29, 2022, from https://www.ohchr.org/en/special-procedures/sr-housing/financialization-housing

4 FHFA Announces Interested Investors May Pre-qualify for REO Initiative. (n.d.). Retrieved February 21, 2023, from https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Interested-Investors-May-PreQualify-for-REO-Initiative.aspx

5 Committee on Financial Services. (2022). Memorandum from Subcommittee on Oversight & Investigations: "Where Have All the Houses Gone? Private Equity, Single Family Rentals, and America's Neighborhoods." United States House of Representatives. https://financialservices.house.gov/uploadedfiles/ hhrg-117-ba09-20220628-sd002.pdf

6 Learn how Divvy's program & pricing work | Divvy. (n.d.). Retrieved February 21, 2023, from https://www.divvyhomes.com/how-it-works

7 LeaseLock Financial Technology for Real Estate. (n.d.). LeaseLock. Retrieved February 21, 2023, from https://leaselock.com/

8 Williamson, A. (2020, December 10). Security deposit alternatives: The misleading marketing of 'renter's choice.' Shelterforce. https://shelterforce.org/2020/12/10/security-deposit-alternatives-the-misleading-marketing-of-renters-choice/