

Freddie Mac Single-Family Home Starts Here Podcast Episode Transcript:

Appraisal Equity

Announcer [00:00:01] Welcome to the Freddie Mac Single-Family "Home Starts Here Podcast," your connection to all the latest industry trends, insights and points of view on the mortgage market from Freddie Mac leaders and other industry experts.

Liz Mugavero [00:00:17] Welcome to the Freddie Mac Single-Family Home Starts Here Podcast, I'm your host, Liz Mugavero. Those of you who are familiar with Freddie Mac know that our mission is to provide liquidity, stability and affordability to the mortgage market. And as we all watched 2020 unfold and saw not only ongoing societal injustice, but also the impacts of a devastating pandemic where communities of color were hit the hardest, suffering economic losses that ultimately endangered their homes, our leadership called out equity as a fourth key pillar to our mission. We all understand there's so much more as an industry we can do to address barriers to sustainable housing and that's the conversation we're starting here today. Today's episode is the first in a four-part series discussing each of our priorities and identifying and developing solutions to address the array of complex issues, communities of color face in attaining, sustaining and building wealth through homeownership. Freddie Mac is collaborating with stakeholders across the industry to examine appraisal bias, uncover any existing gaps and determine their root causes. By leveraging our portal of appraisal data, we aim to conduct and share research with partners throughout the industry to develop systemic solutions. In order to arrive at those necessary solutions, the industry must first fully understand the nature of the problem, racial and ethnic bias and its impact on the appraisal process. Joining us today is Jillian White, an executive at the growing mortgage lender, Better.com, an appraiser and a former real estate agent, and Pam Perry, vice president of Single-Family Equitable Housing. Jillian will provide her valuable and unique perspective on appraisal equity and discuss with Pam a holistic approach to valuing property. Welcome.

Jillian White [00:02:01] Hi, Liz. Thanks for having me. Very happy to be here.

Pam Perry [00:02:05] Likewise.

Liz Mugavero [00:02:06] It's great to have you both here, ladies. And I think I'm going to start with Jillian. So, Jillian, I'd love to ask you to do a quick overview of the appraisal process and how unconscious bias can be incorporated into it.

Jillian White [00:02:17] I'd be happy to. So, to start, I'd like to define what an appraisal is. An appraisal is an opinion of the value. So, there are no hard and fast specific rules or specific numbers. It's all very much based in opinion. And the way that opinions can reveal biases is that the appraiser has to operate within a certain set of parameters. And those parameters are 'what are the houses in the surrounding area and in that particular neighborhood selling for?' And so, let's say the average range is anywhere from two hundred thousand dollars to three hundred thousand dollars. The appraiser can't appraise a house at four hundred thousand. They can't appraise it at one hundred thousand because a market isn't supporting that. However, where the bias comes in is that it's up to the appraiser's discretion and their really opinion of where within that two hundred to three hundred thousand dollars range the House should appraise for. And so that shows up in a number of different ways. One of those ways is comp selection, is the appraiser selecting comps towards the lower end of the value range or towards a higher into the value range? After they've selected their comps then there are individual adjustments that are being made for each of the features that are a mismatch with the property that's being

appraised. And so, an example of that would be, let's say the house that's being appraised, has three bedrooms and a comparable sale has four bedrooms. The appraiser needs to make an adjustment. The market will dictate how much value that additional bedroom adds. However, that adjustment once again is a range. Depending on the market, an extra bedroom might be worth anywhere from ten thousand dollars to twenty-five thousand dollars. And the appraiser has to determine where within that range to make the adjustment. So, within the parameters of here are the lowest values in the neighborhood, here are the highest values, where that particular house falls within that range that's where all of the discretion comes in and that's where the biases can creep in as well.

Liz Mugavero [00:04:33] That is so interesting because even as a person who works in the industry and someone who has owned homes in the past, I didn't actually realize that it was based so heavily on opinion versus actual data. So, can you talk a little bit about what data and information kind of represent this bias?

Jillian White [00:04:49] So once again, the definition of an appraisal is an opinion. And what we've been seeing as of late over the past year is consistently black homeowners will go to the media and say, "hey, an appraiser came into my home. I felt that the valuation or the opinion that they attached to my home was too low." They go and get a second appraisal. But now, in preparation for the second appraisal, in an attempt to remove anything that might bias the appraiser, they go through the exercise of erasing themselves. Some now are even going as far as inviting their white neighbors to stand in for them and pretend to be them during the appraisal inspection. And then in each of the cases that we've seen in the media, the second appraised value when the homeowner wasn't there and they had erased themselves or somebody else standing in on their behalf, those opinions are coming in higher than the original opinion assigned to the homeowner when they actually occupied the space and made it known that they live there. And I think these anecdotes are pointing to a trend that we need to take a better look at and kind of dig into it, because the anecdotes tell us where to look and where the bias and the discrepancies might be showing up. But we actually need concrete data in scale to know, like, what is the size of this? How often is it happening? And then what is the impact to the communities that are being impacted?

Liz Mugavero [00:06:23] Thanks, Jillian. That's really interesting. So, Pam, what is Freddie Mac seeing in the space?

Pam Perry [00:06:29] Thanks Liz, to follow up on Gillian's comment about the data. Indeed, Freddie Mac has extensive data on appraisals, which consists of a portal of more than 50 million appraisals across a very long-time horizon. As such Freddie Mac is uniquely positioned to investigate potential gaps and bias and add data driven proposals to the public discussion of appraisal bias. So, beginning with the stories in various news outlets, last year, Freddie Mac's researchers conducted an extensive study of appraiser's opinions of value relative to the contract price agreed upon between buyers and sellers. That particular study included a set of over 10 million appraisals for purchase transactions that spanned 2015 to 2021. We evaluated the percentage of time that appraised value was lower than the contract price agreed upon between buyer and seller comparing non minorities, Latinos and Black Americans. The comparisons were done based on the minority composition in the properties' census tract, as well as based on the borrowers' minority status. Our research results show that appraisers opinions of value are more likely to fall below the contract price in census tracts populated by Black and Latino households. And generally, the extent of the gap increases as the percentage of Black and Latino households in the census tract increases. So, I want to pause right there, the more concentrated a census tract is in terms of Black and Latino population, the more likely there are disparities between the appraised value and the contract price. But perhaps even more alarmingly and consistent with some of what we've heard in the news media, the results also show that Latino and Black borrowers receive lower appraised values in the contract price more often than their white counterparts, regardless of where the home is located.

Jillian White [00:08:51] Those numbers are...just the data is incredible and that it moves us away from the anecdotal into specific numbers and therefore specific solutions. But if I may, I'd like to just outline how this would actually play out in a real-world situation. What I'm hearing is that number one, we have the wealth gap. So, working off of the assumption, say a black household has less income and possibly we know less savings than a white household. What that means in terms of the appraisal is that in the event that the appraised value comes in below the contract price for this white family, statistically speaking, there is a greater likelihood that they will have additional cash to bring to the closing in order to still be able to purchase the home. But then if you take a look at Black and minority households, if the appraised value does not come in at the contract price, their likelihood of being able to bring additional cash to the closing and still purchase the

home is reduced. And so, with that, there are families who are right on the edge, the appraised value needs to come in at the contract value, and that's not always the case. Like there are many instances where the house just isn't worth that much. But what you just shared, the likelihood of it appraising at the contract price goes down. So, for these black and brown families, they wouldn't necessarily have to bring more cash to the close and statistically speaking, they'd have fewer funds to do so. And so, it's a way that this cycle just keeps perpetuating itself because then it's harder for Black families to get into the homes in the first place, because this appraisal issue and on top of it, the wealth gap just amplifying everything.

Liz Mugavero [00:10:50] That is really impactful. Jillian, do you think appraisal price differences are geographically related?

Jillian White [00:10:57] So, you know, the first rule of real estate is location, location, location. So, you cannot compare one area to another area in like a different part of the country, you can't even compare differing neighborhoods because the geographic location definitely has a huge influence, the largest influence on the values. But that is not what is being talked about in the media. That's not what I'm referring to when I refer to appraisal bias. I'm specifically talking about when you have two houses in the exact same neighborhood and the only difference between them is the color of the inhabitants. And due to that difference, there is a difference in the appraised value. And so that's what's going on with the anecdotes that we're hearing. Nothing has changed regarding the property. Nothing has changed regarding the geographic location. The only thing that is changing is that with the first appraisal, it looked like there were black inhabitants and the second appraisal, the house was set up to look like there were white inhabitants. And then we see this huge variance with just that one change.

Pam Perry [00:12:03] So, Liz, if I might, I'd like to follow up on that. There are actually two issues going on. So, we're seeing these disparities based on the race and ethnicity of the homeowner, but we're also seeing the disparities based on the race and ethnicity of the borrower and of the neighborhood. And so, for example, when we've tried to evaluate *why* what's contributing to these to these disparities, we really dug into the research and tried to look at a variety of factors that could be contributing. And we looked, for example, at the comp selection. So, one of the things that Jillian explained is that as an appraiser is formulating an opinion of value, the appraiser looks to comps in the surrounding neighborhood and how one defines the surrounding neighborhood often plays a significant role in the ultimate opinion of value. And for example, our research revealed that for Black homeowners, the average distance of comps to the property at issue was much smaller than is true for whites. So, an appraiser may look for comps that are that are that are twice as far in terms of distance from the particular property being appraised when a White borrower is involved. Similarly, the appraiser goes a much shorter distance in defining the neighborhood from which the comps can be selected. This has been particularly enlightening in the research that appraisers are actually doing something different in the actual process of selecting comps. Another interesting thing when you're talking about geographical differences, you know, one of the theories that has been proposed is that the so-called "bad apple theory," this issue is more pervasive in certain communities than it is in other communities and our research revealed just quite the opposite. We often hear the criticism to the stories in the media that this is merely anecdotal and this reflects only a small fraction of appraisers and that if you were to look across multiple geographies or a swath of appraisers the disparities would disappear and the disparities are really related to the actions of very few appraisers. So, we dug into our data set and studied twenty-one thousand appraisers who submitted appraisal reports in both black and white census tracts. And we looked to see how many of these appraisers were contributing to the gaps that we see. And we realized that the statistical power reveals that a large portion of appraisers are generating statistically significant gaps. So that isn't this is not just an issue of a few appraisers are contributing to the stories, the situation that is that is reflected in the anecdotes that have been in the media. In fact, a significant number of appraisers across the country are contributing to these gaps. That's deeply troubling.

Jillian White [00:15:27] Liz, if I may, I'd like to explain to the listeners the implications of what Pam just said. So essentially, the neighborhood and the radius search around the comparables dictates how many comps you have to choose from. So, with black households, if the comp selection is half the radius of that of their white counterparts, that means that four homes owned by white people, the appraiser has more than 2x the selection of comparables as versus black and brown and minority communities. And as an appraiser, I know that when I'm trying to create my narrative and really make my case as to why my opinion of value is valid, the more data I have, the more robust my report. And so now,



based on what you just shared, Pam, we know that appraisers are limiting themselves to a much smaller pool and therefore a much more narrow narrative that they're able to create with the comps available.

Liz Mugavero [00:16:33] Thanks, Jillian, for sharing that. That's fascinating. And I think it's very important to bring all of this information to light so people truly understand how this works. So, what is being done to bring about change? And what is the call to action for the industry to get on board and help drive this change?

Jillian White [00:16:51] The low hanging fruit of being able to tackle this problem and I think the very first step is a diversification of the appraisal industry. The US Bureau of Labor Statistics just came out with a stat that states that the appraisal industry is 96.5% White. And out of all of the industries and all of the United States of America, real estate appraising is the least diverse. And so, when you are dealing with opinions and you have a very homogenous group attaching their opinions to a very heterogeneous group, I think it's a recipe for problems. So, the first step is diversification. However, the way to become an appraiser, you have to already know an appraiser. Appraising is something that is passed down through the generations, through personal networks. And so, when you have a very homogenous group and an industry where you have to know somebody in order to get in, it's no wonder that we're in the situation that we are currently with such a lack of diversity. So, I think the first step is changing the way appraisers are able to enter into the industry and revisiting this whole need for a supervisor appraiser and in appraising there's this very long apprenticeship process and eradicating that because it's making it difficult for anybody to enter into the industry. We are a shrinking pool. And then on top of it, it's having a disparate impact on people of color and their ability to enter into the field. So, at Better, what we are doing in order to address this as we have a very large initiative and push to change the face of appraising and it be representative of the communities that are being served. And so, one of the ways we're going about this is working with the Appraisal Institute on their appraiser diversity initiative. And per my understanding, Freddie Mac is also going to be partnering with them as well.

Pam Perry [00:19:04] That's right Jillian, I'm really excited about Freddie Mac joining the Appraiser Diversity Initiative as a core partner.

Liz Mugavero [00:19:11] So I love this conversation and this is obviously something you both just have so much passion for. Are there any other stories or anecdotes that you would like to share to drive home many of these points?

Jillian White [00:19:24] Liz, I am very passionate about this, mainly because I have experienced bias and appraising firsthand with the appraisal of my parent's home. And I met the appraiser, there was a model match, which means an identical home around the corner, same building, same year, same finishes. I shared that comparable sale with the appraiser and explained what I knew about the neighborhood, which I knew like the back of my hand having lived there and what I knew about my parent's house, which I knew like the back of my hand having lived there, and their appraised value came in low. Now, fortunately, since I was an appraiser, I was able to rebut it, my rebuttal was successful and the appraised value increased by one hundred thousand dollars. But what that really speaks to is that I never address bias or use that word in any sort of way, I just made the argument and in terms of an appraiser would understand and this appraiser changed the estimate of value by one hundred thousand dollars, which essentially means he admitted to making a one hundred thousand dollar mistake the first time around and then kind of saw the light after I highlight these things and revised his opinion. Unfortunately, most Black families do not have an appraiser to go in and advocate for them. So, in a lot of ways, I kind of see myself as an advocate for all those who don't have a daughter or a niece who is so well versed in this topic. And so that's where the passion comes from.

Liz Mugavero [00:20:54] Well, Jillian, that's quite a story. And I think that could be the entire podcast today just to drive home the point that we really need change in this in this industry. And bringing these things to light is going to continue to help us look at ways in which we can make that change. So, thank you both for this compelling conversation. I really look forward to continuing the conversation about equity in the weeks to come and seeing positive, sustainable change in the industry, thanks to women like you. Thank you to our listeners. Don't forget to subscribe wherever you get your podcast so you don't miss our next episode and share with your friends and colleagues. Until next time.



Jillian White [00:21:29] Thanks Liz, this is great. Thank You.

Liz Mugavero [00:21:33] Thank you.

Pam Perry [00:21:34] Thank You.

Liz Mugavero [00:21:35] Thank you, Pam.

Announcer [00:21:36] Thank you for listening to the Freddie Mac Single-Family Home Starts Here Podcast, stay tuned and subscribe to catch additional interviews with key industry leaders and experts. Home Starts Here, is available wherever you listen to your podcasts. We appreciate you rating, reviewing and sharing with your network.

