

# Appraisal FAQS

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## Introduction

Although Freddie Mac's Multifamily appraisal requirements can be found in Chapter 60 of the *Multifamily Seller/Service Guide* (Guide), the Appraisal Group frequently receives questions from the appraisal community, from the Optigo® lender network and from Freddie Mac's own underwriters about interpretations of the Guide's finer points as well as questions regarding industry best practices and other appraisal-related issues.

Although these FAQs are not the end-all be-all of answers, we have tried to provide a sample of the more common questions and topics received. And, please remember this caveat: The specifics of your particular issue might not fit into these categories or your fact pattern might be different enough that these answers would not apply to your circumstances, so "it depends" might be an answer, too!

Please feel free to reach out to the Freddie Mac Multifamily Appraisal Group for additional information and guidance using our [contact information](#).

# Table of Contents

Introduction.....	2
Table of Contents .....	3
Sales Comparison Approach .....	4
Income Approach .....	6
Other Appraisal and Reporting Topics.....	8
Property Taxes .....	8
Previous History of Sales .....	8
Extraordinary Assumptions / Hypothetical Conditions .....	9
Definitions: .....	10
Third-Party Reports/Commentary .....	11
Insurable Value.....	11
Miscellaneous Seller/Service Guide Issues .....	11
Contact Information.....	12

## Sales Comparison Approach

### **How do you determine the applicability of comparable sales (i.e., market, property type, date of sale, etc.)?**

It depends on the market, the property size, the property condition, etc. For example, the Washington, D.C., market will have a different depth and breadth of the pool of comparable sales for the appraiser to sample than the Des Moines, Iowa, market. Also, a 120-unit garden apartment in good condition built in 2015 in the D.C. market will have a different depth of sales inventory than a 1960-vintage property located right down the street. A discussion of the quality and strength of the data would be appreciated, where applicable, so the strengths and weakness of the property and its local market can be evaluated.

### **How do we determine if adjustments are supported?**

A unique property in a unique market would probably require more adjustments to the sales due to the disparity from the norm. We do not have a formula or guardrails to indicate when an appraiser might be stretching the adjustments – too high or too low. We have been asking appraisers to provide adequate support for their adjustments, not just “Sale #2’s location is superior”. We would like to know why, either with a discussion (a sentence or two) or with data.

### **How much weight should be given to listings/pending sales?**

Section 60.14b of the Guide (second paragraph) states: “Current contracts and competitive property listings can be helpful to round out the appraiser’s analysis if they are indicative of the state of the current market. The weight given to a contract or listing might be different from the weight given to the actual sales transactions, and the appraiser must discuss these differences in the Appraisal.”

“A listing is just a listing, but a sale isn’t a sale until it sells” is in the back of our minds as we analyze the appraisal.

### **Generally speaking, should the appraiser’s adjustments in the Sales Comparison Approach support the final conclusion for value? As an example, I have a deal where the adjusted price/unit from the sales comparables range from \$79,000/unit to \$89,000/unit, but the final concluded value is actually \$95,000/unit, relying on the Income Approach.**

We are looking for transparency in the appraiser’s analysis and discussion, and we would expect the appraiser to provide an adequate explanation for concluding to a value that is materially outside the conclusion in the Sales Comparison Approach.

If the appraiser chooses a value outside the range of the sales comparables, then we would expect the appraiser to discuss the weaknesses of the sales since typically the sales are a reasonable barometer of value.

Also, if the sales are weak, how does the appraiser explain using those sales as the primary basis for developing the capitalization rate? That is, if the sales are weak in the Sales Comparison Approach, those are the same sales that are used in the Income Approach to develop the capitalization rate. Why, then, suddenly is the value developed in the Income Approach materially stronger than the value developed in the Sales Comparison Approach, especially if both values use the same sales data but apply them differently?

**Generally speaking, should the appraiser’s adjustments in the Sales Comparison Approach support the final conclusion for value?**

We would expect the appraiser to provide an adequate explanation for concluding to a value that is materially outside the conclusion in the Sales Comparison Approach. If the appraiser chooses a value outside the range of the sales comparables, then we would expect the appraiser to discuss the weaknesses of the sales since typically the sales are a reasonable barometer of value. Also, if the sales are weak, how does the appraiser explain using those sales as the primary basis for developing the capitalization rate? That is, if the sales are weak in the Sales Comparison Approach, those same sales are weak in the Income Approach so why, all of a sudden, is the value developed in the Income Approach materially stronger than the value developed in the Sales Comparison Approach, especially if both values use the same sales data but apply them differently?

**The sales price on this property was \$3,955,750 but the appraiser added planned capital improvements that were going to be made post-sale closing in the amount of \$1,730,000 and called the adjusted price \$5,685,750. To me this is completely invalid as a sales comp.**

This is a valid method, but it has limitations that some appraisers forget or gloss over.

This is valid only if (IF!!) the planned improvements affected/influenced the sales price of the comparable sale and/or the amount of proceeds the seller achieved.

The appraiser must provide sufficient discussion and documentation to support the conclusion that the planned improvements affected the proceeds the seller received. Note: This is not the same as a property condition adjustment; this is an adjustment to reflect the difference between the sales price and the influence on the price that the planned improvements had. This is not typically a valid adjustment to a sales price. Again, this is not the same as a property condition adjustment between a sales comparable and the subject property. This is an adjustment to the sales price of the comparable regardless of the condition of the subject property and would be made to this comparable every time it is used in an appraisal report.

Section 60.14(b) of the Guide discusses this phenomenon:

The appraiser must refrain from adjusting the comparable properties’ sale prices for expenses, costs, or renovation that are to be incurred by the buyer after the date of the sale transaction since these costs and expenditures are not typically part of the transaction/consideration price for the property.

**This is a deal in the Bronx, where the value per unit is well above the sales comparables, but the appraiser uses value per square foot (PSF) to conclude their value. How should we view conclusions like these, where they are supported on a PSF basis but not a value per unit?**

In most markets, folks think in terms of price per unit or value per unit. However, if the local market uses “price per square foot”, then we would expect the appraiser to mirror the local practice.

Note #1: We would also expect the appraiser to discuss this phenomenon in the appraisal.

Note #2: Value is value, regardless of how it is measured. If the value per square foot is materially different than the value per apartment unit, it is appropriate to ask the appraiser to reconcile/address the issue. If done correctly, the final value should be the same regardless of the unit of measurement.

Sub-Note: We would be concerned if it appears that the appraiser used “price per square foot” to manipulate the value conclusion.

**This is a nice 18-unit property with attached garages. The appraiser is citing the sale of three Class A single-family townhouse sales to establish a per-unit estimate of value. I looked up all three on Realtor.com and they are all significantly superior to the subject in amenities, size, finish out and appearance. To say nothing of the fact that he is using single-family sales to establish a value for a multifamily property.**

**He then used four apartment sales to establish his capitalization rate, and these comparables averaged \$69,804 per unit sales price on a property he valued at \$113,889/unit.**

**We were able to mitigate this appraisal by reducing the loan-to-value that we would agree to approve. Maybe I am wrong, but I do not see how an appraiser can use single-family townhouse sales to establish the per unit value of an apartment.**

There are so many things wrong with this scenario.

- We do not appear to have a valid appraisal.
- The sales do not appear comparable at all. Sure, they might look like the subject buildings but these are a totally different investment class and potential buyer. Remember the definition of Market Value!
- How does the appraiser make the leap of faith from \$69,804 per unit to \$113,889 per unit?

## Income Approach

### **How to determine whether market rent analysis is supportable, and what if there is a significant variance between rent roll GPR and appraisal GPR?**

When our internal appraisal review unit reviews an appraisal for audit or compliance purposes, we compare the appraiser’s estimate of market rents with the actual recent leasing – three months ±.

- Transform the rent roll PDF in the back of the appraisal to an Excel file.
- Sort the Excel file by date, and choose the last three months.
- Sort that pool by unit type/model type.
- Compare the recent leasing with the appraiser’s estimates: ±5% is “ok”.

### **How do I to evaluate whether the appraiser has completed a thorough/appropriate level of analysis in development of expenses?**

When our internal appraisal review unit reviews an appraisal for audit or compliance purposes, operating expenses should be adequately supported by the expense comparables and by subject’s operating history per unit and as a percentage of Effective Gross Income (EGI). We do this analysis excluding

property tax and reserves to avoid issues surrounding variances in how local taxing jurisdictions develop their property tax assessments.

Typically, we would expect that the appraiser's estimate of total operating expenses (minus real estate taxes and reserves for replacement) would fall within the range of the expense comparables and be supported by the subject property's operating history, both on a per-unit basis and as a percentage of EGI.

### **Does Freddie have any requirements/guidelines with regards to replacement reserves?**

Guide Section 60.12f:

If provided with a third-party property condition report, the appraiser must use the property condition report as the starting point for its estimate of Replacement Reserve deposits unless the appraiser otherwise documents and discusses an alternative reserve figure in the Appraisal.

If not provided with a third-party property condition report, the appraiser must base its estimate of Replacement Reserves on specific market evidence or other substantive basis.

### **Can you discuss credit loss and what is the primary factor you use to help us project that other than the subject's historical operations? In some challenging areas we have seen significant collection loss of 15% to 20%, however, this data from comparable properties is nearly impossible to obtain unless we have appraised them.**

We don't know of any published sources for credit loss data. Developing an internal "Credit Loss Comparables" database from actual appraisals would be cutting edge for any firm.

The data could be displayed much like Expense Comparables. Credit Loss Comparables would probably vary depending on the subject's demographics and experience of similar properties in the subject's market area.

### **If the property is in a very strong market with occupancies well over 95%, does Freddie Mac still underwrite at a 5% vacancy, or will Freddie Mac consider a lower occupancy? Is there a minimum vacancy Freddie Mac prefers to see for vacancy on either commercial or parking income?**

We want the appraiser to "call it like they see it!"

## Other Appraisal and Reporting Topics

### Property Taxes

#### How should the appraiser handle property taxes?

What we want to know regarding property taxes:

- Description of the local assessment process and the next date of revaluation
  - Property tax assessment values may or may not be static – it depends on the laws of the local jurisdiction.
  - Even with static assessment values, property taxes might be materially variable from year to year.
- Are the tax comparables appropriate?
  - Why not use the rental comparables as tax comparables, too?
- Is the tax assessment value similar to the appraiser's value?
  - If not, why not?
- Risk of reassessment at the appraiser's value:
  - It is not appropriate to estimate the risk of reassessment by merely applying an unsupported bump to the capitalization rate.

### Previous History of Sales

**Often a property owner is unwilling to discuss the prior sale of the subject in what we view as enough detail (number of offers, asking price, specific list date, complete list history). We can obviously disclose that we asked for more detail, but what do you recommend us do in this case, and can you please discuss what Freddie requires that may be above and beyond the USPAP requirements?**



## Freddie Mac's Requirements (Section 60.12):

The Seller/Serviceur must provide to the appraiser and the appraiser must consider, analyze and report any

- Current or expired sales contracts, option contracts, contracts for deed, Master Lease and/or listings of the Property known to the appraiser
- Sales of the Property within the past three years

The appraiser must analyze and discuss any material difference between the final appraised value and any recent sale, contract, option and/or Master Lease of the Property.

## USPAP Requirement:

### Standards Rule 1-5

When the value opinion to be developed is market value, an appraiser must, if such information is available to the appraiser in the normal course of business:<sup>14</sup>

- analyze all agreements of sale, options, and listings of the subject property current as of the effective date of the appraisal; and
- analyze all sales of the subject property that occurred within the three (3) years prior to the effective date of the appraisal.<sup>15</sup>

## Extraordinary Assumptions / Hypothetical Conditions

**There is water intrusion in a significant portion of the buildings. The property manager is in the process of correcting the issue and it seems like the remaining work will be completed by July (six months from now). Per the appraiser, the cost is covered by insurance proceeds and they made an extraordinary assumption. However, they are looking for feedback on the approach.**

The appraiser got this wrong. This is not an extraordinary assumption but is a hypothetical condition. [See the definitions below.](#)

**I have an appraisal from the seller and it noted that the appraiser did not deduct for fire-affected units (a total of three out of 394) due to recovered insurance proceeds for the damages. Can you verify if this is the right approach? I typically thought since the units are still down the appraiser normally deducts for the cost to repair, rents loss and time to lease up. Is it safe to say the current appraiser's approach is correct since the number of units are nominal as well as the time down was short, which was approximately about five months?**

The appraiser got this wrong. Even though three units might be a small number relative to the 394 total units, the appraiser's methodology is wrong and it affects the validity of his/her conclusions.

**There was a fire at the property on December 9 (three months ago). The funds to replace the down units are covered by the insurance premium from the first mortgage (they are not being escrowed as a priority repair).**

**The appraiser included the below extraordinary assumptions and hypothetical conditions:  
“Extraordinary Assumption: On December 9, 20XX a fire at the subject property left 12 units damaged and uninhabitable. The value contained herein assumes insurance proceeds repair the damaged units in a workman style manner.”**

The appraiser got this wrong. This is not an extraordinary assumption but is a hypothetical condition. [See the definitions below.](#)

**Statement by an appraiser: “At the clients’ request, we have valued the subject property as if it has no down units as of the date of value. This is contrary to what was observed at our December 22 inspection. A fire on or about November 25 resulted in damage to 12 units in Building 20 and those units are still down as of our valuation date. The use of this Hypothetical Condition does not produce an as-is market value.”**

This is a valid statement and the correct methodology.

#### Definitions:

**Hypothetical Conditions:** A condition, directly related to a specific assignment, which is contrary to what is known by the appraiser to exist on the effective date of the assignment results, but is used for the purpose of analysis.

**Extraordinary Assumptions:** An assignment specific assumption as of the effective date regarding uncertain information used in an analysis, which if found to be false, could alter the appraiser’s opinions or conclusions.

An appraisal with a Hypothetical Condition is not an “as-is” valuation, but an appraisal with an Extraordinary Assumption can be an “as-is” valuation as long as the assumption is credible and is tied to actions, thoughts and/or considerations used by market participants. The appraiser must document the support for these assumptions.

The issue of as-is valuation and insurance proceeds is covered in section 60.12(f) of the Guide. It does not matter if there are insurance funds sitting in a bank or escrowed that are contemplated to be used to fix the property for two reasons:

1. On the date of value, the property actually has the damage and down units, so the reality is that these units are not occupied/usable and are not generating income on that date, and
2. Insurance proceeds (either sitting in a bank or part of a specific escrow fund) are not real estate – it is cash. Freddie Mac buys loans made on real estate, and cash is not real estate.

## Third-Party Reports/Commentary

### **What should the appraiser do if not provided with third-party reports (environmental, property condition, zoning, etc.)?**

Lacking a third-party report, we expect the appraiser to say something like:

“Even though we did not receive an environmental or property condition report, on October 25, we walked around the subject site, including the rear of the buildings, the parking structure, the maintenance shed, the pool area, and down by the stream and over by the storm water management pond (etc., etc.) and did not observe any obvious indicators of environmental contamination or adverse property condition issues...”

or whatever they saw.

## Insurable Value

### **What is the reason that the value using the insurance approach would be the highest as compared with income/cost/sales approaches? An example of this is on the current deal where the as-market value of the property is ~\$14 million, the as-restricted is \$6.2 million, and the insurable value is \$10 million. We were looking for discussion on how the insurable value is calculated and discussion of how the insurable value can be higher than the value we are using.**

Insurable Value (section 60.21 of the Guide):

The Replacement Cost / Insurable Value is the cost to reconstruct a property of an equal number of units with equal quality of building materials with equal utility that would be acceptable to the typical investor and tenant in the market in which the property is located. Replacement Cost is not the cost to construct a replica of the property.

For insurance purposes, the Replacement Cost may not include goodwill or other intangibles such as value/cost of the land, a deduction for depreciation, cost of site improvements, (e.g., driveways, parking lots, sidewalks, or landscaping), cost to reconstruct the foundation(s), entrepreneurial profit, and some indirect costs such as marketing.

## Miscellaneous Seller/Service Guide Issues

### **Should the appraised value represent fee simple vs. leased fee ownership interest?**

Many times, an appraiser will state that the appraisal is the valuation of the “fee simple” interest, and this is not correct.

The *Appraisal of Real Estate* (14th edition, page 72) states that leased fee ownership is the ownership interest held by the lessor (i.e., owner) “regardless of the duration of the lease, the specified rent, the parties to the lease, or any of the terms in the lease contract.”

As such, a leased property, even one with rent that is consistent with market rent, is appraised as a leased fee interest, not as a fee simple interest.

The sales in the Sales Comparison Approach are all leased fee transactions. That is, the sales price is based on the income at each property.

Additionally, the capitalization rates derived from these sales are also leased fee capitalization rates

**Does a MAI-designated appraiser have to sign the appraisal report?**

No, Freddie Mac does not require a MAI sign the appraisal report.

## Contact Information

Below is the contact for the Freddie Mac Multifamily Appraisal Group.

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