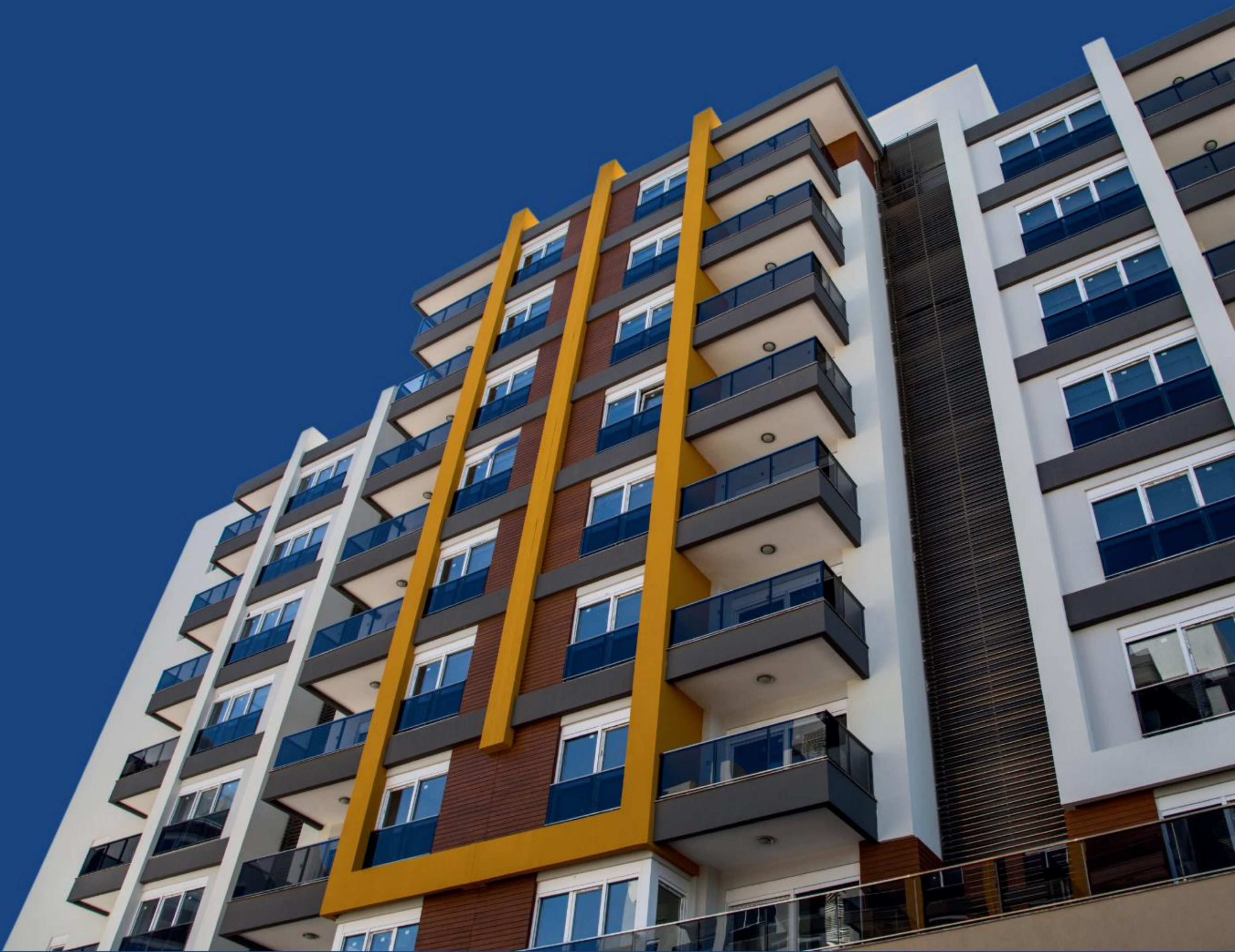
Freddie Mac
MULTIFAMILY

Appraisal Forum 2023

November 16, 2023

PARTICIPANT
WORKBOOK



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Content contained in this workbook is current as of 11/16/2023 and may be updated or revised from time to time.

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Freddie Mac Multifamily Appraisals Website: https://mf.freddiemac.com/lenders/uw/appraisals

Freddie Mac Seller/Servicer Guide Chapter 60 https://mf.freddiemac.com/docs/chapters/mf_guide_ch_60.pdf

PRESENTATION

TAX GUIDANCE

Freddie Mac Underwriting Assumptions

- Freddie Mac underwriters conclude to their own tax expense at underwriting. Underwriting assumptions are not solely dependent on the expense projections in the appraisal

Multifamily Seller/Servicer Guide, Chapter 60.12(c) Tax Information

Link to The Guide: https://mf.freddiemac.com/docs/chapters/mf_guide_ch_60.pdf

The appraiser must consider, analyze and report property tax and assessment requirements of the jurisdiction where the Property is located. The appraiser must verify that the Property has been fully or partially assessed and provide the most recent assessment date and the next scheduled assessment date of the Property. The appraiser must consider, analyze, adequately support and report any effect on value due to future scheduled assessments, property tax abatements or other property tax benefits.

Property tax comparables must be part of the discussion of the Property's appropriate level of tax liability. The appraiser should identify the taxing jurisdiction of each of the property tax comparables and include in the discussion any differences in valuation methodology, tax rates and/or reassessment schedules between these and the Property's taxing jurisdiction.

The risk of the Property's reassessment must be considered and appropriately analyzed and reported. Any adjustment to the capitalization rate must have adequate support and discussion.

Property Taxes in an Appraisal

Common Issues We See

- Risk of a tax reassessment is not adequately discussed.
- Date or scope of the next reassessment is not discussed.
- Property tax estimate was outside the range of the observed comparables and is not discussed.
- Adjustment to the capitalization rate is not adequately supported or discussed.
- Tax liability projection does not assume a sale.
- Future successful tax appeal assumed without written confirmation.
- Allocation of tangible and intangible value not adequately discussed.

What We Want to Know Regarding Property Taxes

1. 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
   - Adequately address and analyze the subject's base tax rate, any special or direct assessments, any special fees, Mello-Roos (CA only) and supplemental taxes
   - Even with static assessment values, property taxes might be materially variable from year-to-year
2. Are the tax comparables appropriate?
   - Why not use the rental comparables as tax comparables, too?
   - If a tax comparable reflects a successful tax appeal following a sale, it must be noted and the appraiser must discuss why it is appropriate to consider
3. Is the tax assessment value similar to the appraiser's value?
   - If not, why not?
4. Risk of reassessment at the appraiser's value:
   - Given the definition of Market Value, the tax liability projection utilized in the valuation of the Property must assume a sale and may not consider the loan purpose in any way
   - The valuation may not assume a future successful tax appeal without written confirmation from the taxing authority that the appeal has been or will be granted within the next 12 months
   - Utilize a non-loaded capitalization rate if reassessment will occur in Year 1. If reassessment will occur after Year 1, it may be appropriate to load the capitalization rate to account for future reassessment risk. It is not appropriate to estimate the risk of reassessment by merely applying an unsupported bump to the capitalization rate. Any adjustment to the capitalization rate must have adequate support and discussion.

Suggestions for Incorporating Risk of Reassessment

Select several multifamily sales within the same or similar taxing jurisdiction that have been reassessed after the sale.

- A comparability chart can be constructed to compare each sales price with the new tax assessment
- So, if other comparable/similar properties were reassessed at an average of, say, 75% of the sales price, then it would be reasonable to assume that the subject would be also be reassessed at that amount

Sale Date	Property Name	Property Type	Recorded Sale Price	Assessment at Sale	Next Year Assessment	Percentage Increase	Percentage of Sale Price
Date	Sale 1	LIHTC	$31,000,000	$17,491,090	$19,503,300	11.5%	62.9%
Date	Sale 2	Conventional	$21,600,000	$19,784,990	$19,784,370	0.0%	91.6%
Date	Sale 3	Conventional	$89,500,000	$56,459,960	$56,841,190	0.7%	63.5%
Date	Sale 4	Conventional	$86,100,000	$56,019,680	$63,419,190	13.2%	73.7%
Date	Sale 5	LIHTC	$18,100,000	$14,622,200	$17,221,080	17.8%	95.1%
Date	Sale 6	Conventional	$42,400,000	$30,120,500	$32,965,520	9.4%	77.7%
Date	Sale 7	Conventional	$16,200,000	$12,900,100	$14,402,460	11.6%	88.9%
Date	Sale 8	Conventional	$19,350,000	$11,839,100	$19,149,340	61.7%	99.0%
Date	Sale 9	Conventional	$120,791,000	$79,386,200	$111,680,700	40.7%	92.5%
						Min % of Sale Price	62.9%
						Max % of Sale Price	99.0%
						Average	82.8%
						Median	88.9%

The above table indicates the assessments following the sales ranged from 62.9% to 99.0% of the sale price with an average of 82.8% and a median of 88.9%. The subject's current assessment is approximately 80% of the value derived late in this report, which is below the range. In the analysis, we have estimated a pro-forma tax assessment of $50,000,000, which is 88% of the contract price.

This type of information helps us answer the questions:

- "What is the re-assessment methodology of the local assessor?"
- "If the property is due for re-assessment in the near future, what is the risk that the assessor will be similar to the property's market value or recent sales price?"

If the appraiser's comparables were mostly chosen from the same or a similar taxing jurisdiction, then the market's measurement of the uncertainty of reassessment could already be built into the capitalization rate.

- There would be no need for an adjustment to the appraiser's capitalization rate

Multifamily Seller/Servicer Guide, Chapter 60.3 Market Value Definition

Appraisers must use the definition of market value set forth below, which conforms to the definition of market value adopted in the Uniform Standards of Professional Appraisal Practice (USPAP). The Appraisal must be completed in accordance with the definition below, as defined within the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA") of 1989:

"The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition are the consummation of a sale as of a specified date and the passing of the title from seller to buyer under conditions whereby:

1. Buyer and seller are typically motivated.
2. Both parties are well informed or well advised, and acting in what they consider their best interests.
3. A reasonable time is allowed for exposure in the open market.
4. Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto.
5. The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

Market Value Definition

- Market value definition assumes a sale and therefore the tax liability projection must do the same. The appraiser may not consider the loan purpose in their analysis (i.e., a refinance).

Reasonable Assumptions

- Any assumption regarding near term (i.e., within twelve months) successful tax appeal, abatement or allocation must have a reasonable basis (i.e., documentation from the tax jurisdiction).

Tax Comparables

- The tax comparables are from the current year, are of similar vintage and within the same tax jurisdiction
- The tax comparables may not include properties that have assessments that are allocated between real property and personal property

Reassessment Risk

- The report should adequately discuss and analyze the reassessment risk in the near term
- Recently sold and reassessed comparables in the same tax jurisdiction are recommended to support the projected reassessment

NOTES

PRESENTATION

INSPECTION REQUIREMENTS

Multifamily Seller/Servicer Guide, Chapter 60.12(b) Inspection

At least one appraiser signing the report must have made both an interior and exterior inspection of the Property. The interior inspection must include interior common areas, community amenities, a sample of unit interiors and commercial suites. In addition to exterior inspections of residential units, the exterior inspection must also include any accessible areas that are subject to nonresidential leases as defined in Section 8.11(a) and Section 8SBL.11(a).

Since the seller/servicer's delivery of the property condition report and environmental report to the appraiser is optional under certain circumstances (see Sections 60.12(e) and 60.13 for a description of these circumstances), it is important that the appraiser's inspection of the Property be sufficiently detailed to adequately incorporate property-specific physical and economic characteristics into the Appraisal's discussion, analyses and valuation conclusion.

1. For Properties with fewer than 25 units, the appraiser must inspect:
    - A minimum of two units
    - All vacant units to determine their state of readiness for occupancy
    - All Down Units to determine and comment on the amount of repairs/renovations necessary to make them ready for occupancy
    - A representative sample of the commercial units, chosen by the appraiser. The appraiser must include in the report which units were inspected and a description of the level of finish.

If this requirement results in more than five residential units to be inspected, the appraiser may sample the vacant units, but all Down Units must still be inspected regardless of the number of Down Units. The appraiser must clearly state in the Appraisal how this sample was selected.

2. For Properties with 25 to 50 units, the appraiser must inspect:
    - A minimum of three units
    - All vacant units to determine their state of readiness for occupancy
    - All Down Units to determine and comment on the amount of repairs/renovations necessary to make them ready for occupancy
    - A representative sample of the commercial units, chosen by the appraiser. The appraiser must include in the report which units were inspected and a description of the level of finish

If this requirement results in more than five residential units to be inspected, the appraiser may sample the vacant units, but all Down Units must still be inspected regardless of the number of Down Units. The appraiser must clearly state in the Appraisal how this sample was selected.

3. For Properties with 25 to 50 units, the appraiser must inspection:

   - A minimum of five units
   - All vacant units to determine their state of readiness for occupancy
   - All Down Units to determine and comment on the amount of repairs/renovations necessary to make them ready for occupancy
   - At least one unit of each unit type and comment on the marketability of each unit type's floor plan, design, layout, amenities and level of finish
   - A representative sample of the commercial units, chosen by the appraiser. The appraiser must include in the report which units were inspected and a description of the level of finish

   If this requirement results in more than 15 residential units to be inspected, the appraiser may sample the vacant units, but all Down Units must still be inspected regardless of the number of Down Units. The appraiser must clearly state in the Appraisal how this sample was selected.

4. The Appraisal must identify the specific units inspected and into which category each unit falls.
5. For Small Balance Loan (SBL) properties, the appraiser must inspect the improvements (if able to be visually inspected) and report if they are generally aligned with evidence of capital expenditures or construction provided by the seller.
6. The appraiser must report any physical condition concerns with the Property's land or improvements observed during the appraiser's inspection of the Property or known to the appraiser.
7. The appraiser must report any environmental concerns commonly known in the geographic area where the Property is located and any environmental concerns with the Property's land or improvements observed during the appraiser's site inspection or known to the appraiser.
8. It is not acceptable for the appraiser to merely state that the appraiser did not notice any physical and/or environmental issues during their inspection; the appraiser must discuss the extent of the appraiser's inspection for these issues.
9. Appraisers must report the extent of their due diligence and describe their environmental observations, analysis and conclusions in the Appraisal. It is not acceptable for the appraiser to only state that the appraiser is not qualified to detect environmental issues and thus has made no observations during their physical inspection of the Property.

Property Condition

Look out for and document any erosion, cracking around the foundation (sealed or not), patching on roofs, water stains, mold, visible rotting, trip hazards, textured ceilings, aluminum wiring and storage tanks.

Additional Appraisal Requirements Memoradum

- An external email notification sent on January 30, 2023 stated:

  The property inspection requirements set forth in Chapter 60.12(b) of the Guide have been fully reinstated.

  Please coordinate with the property contact ahead of time to ensure that more than the required number of units are notified of the inspection. This should guarantee that the required number of units can be inspected if the appraiser is unable to enter one or more of the units. As a reminder, all vacant units should be physically inspected by the appraiser until the required number of units outlined in the Guide is reached (i.e., for properties with more than 50 units, a sample of vacant units is permitted if the total number of units inspected would exceed 15).

- The appraiser selects the units to inspect
- Select a representative sample of units from different buildings (if applicable), on different floors and different floor plans
- Select more than the required number of units for property management to notify to ensure that enough occupied units can be inspected to adequately meet the Freddie Mac inspection requirements

Number of Units

Residential	Residential Unit Inspection			Commercial Inspection
Total Units	Min.	Down	Vacant	Units
< 25	2	ALL	ALL, unless total residential units inspected exceeds 5	Representative sample
25 to 50	3	ALL	ALL, unless total residential units inspected exceeds 5	Representative sample
> 50	5	ALL	ALL, unless total residential units inspected exceeds 15	Representative sample

Qualifications of Inspecting Appraiser

At least one of the individuals signing the appraisal must be a licensed appraiser in the state that the property is located and must complete an in-person interior and exterior inspection of the property. An appraiser trainee co-signing the report, or an unlicensed individual, may not be the sole inspector of the property.

Extraordinary Assumptions

Assumptions about the condition of uninspected units must have a reasonable basis. Reliance upon third-party reports or communications from property management should be disclosed as the basis for the assumption. It is not appropriate to utilize an assumption without asking about the condition of uninspected units.

NOTES

PRESENTATION

FAIR LENDING

FHFA Advisory Bulletin on Fair Lending Compliance/Risk Mitigation (AB 2021-04)

- Provide expectations and guidance to GSEs on compliance with fair lending laws (Fair Housing Act, Equal Credit Opportunity Act, and Safety and Soundness Act)
- GSEs play a unique and important role in the mortgage market, and their operations and policies can promote fair lending compliance and the public interest
- Maintain a program that identifies, assesses, monitors and mitigates fair lending risk and prevents violations internally and externally with business partners

Multifamily Seller/Servicer Guide, Chapter 60.8

- Appraisal requirements to promote fair lending compliance since 2004
- Updated in June 2022 to expand Prohibited Factors (7 to 11) and require factual, unbiased and specific descriptions of the Property and neighborhood
- Cautions use of subjective terminology or veiled language that could indicate underlying bias
- Chapter 60.8 Discrimination in appraising

The appraiser must describe the Property and the neighborhood in factual, unbiased and specific terms. The appraiser may not consider any information about the geographic area, neighborhood, occupants, owners or prospective owners of the Property that involves the following prohibited factors ("Prohibited Factors").

- Race
- Color
- Religion
- National origin
- Age
- Disability
- Sex, sexual orientation and gender identity
- Marital status
- Receipt of income of tenants derived from any public assistance program
- The retaliation for exercise of any federally protected civil right
- Familial status

As a matter of corporate policy, **Freddie Mac will reject any Mortgage supported by an Appraisal that refers to Prohibited Factors or incorporates subjective terminology or veiled language** that may be code words that could indicate underlying bias that are or may be a substitute for one or more of the Prohibited Factors.

Contextual Text Mining Procedure for Appraisals

- Randomly select appraisals ordered by each Optigo Lender
- Search for Words of Concern and perform a risk-based contextual review
- Appraisers and Optigo Lenders notified of potential issues or violations
- New and evolving challenge for everyone to screen 100- to 200-page narrative appraisals

Examples of References to Prohibited Factors or Subjective Terminology

- Hub of Irish activity
- Spanish-speaking tenants
- Increased ethnic diversity of the county
- Festival Latino is celebrated throughout the park
- 27.6% of students are Hispanic and 14.4% are Black
- Predominant Latino population or Latino flavor of the area
- Population data by gender/sex, race/ethnicity, household/familial status, or marital status
- Multi-racial community; majority Latino and Asian; growing white and African American population
- Best neighborhood for young adults
- Lower rental rates may be a result of crime issues
- Suffers from some level of blight and higher crime levels

NOTES

PRESENTATION

UPCOMING INITIATIVES

2024-25 USPAP

- Updates to the Ethics Rule and new Advisory Opinions relating to nondiscrimination and Fair Housing
- Revising definition of Personal Inspection to be an in-person observation completed by an appraiser
- Standards Rule 1-5(b) and Advisory Opinion 1 updated to "analyze all sales and other transfers of the subject property that occurred within the three (3) years prior…"

Appraiser Independence

Appraisals should be prepared independently, objectively and without bias.

New Freddie Mac Appraisal Compliance Process

- Risk-based
- More timely feedback
- Focused on current market conditions and emerging risks

NOTES

PANEL

EMERGING RISKS PANEL DISCUSSION

In this panel, you will hear from Freddie Mac experts in several business areas including, Physical Risk, Insurance, Risk Distribution & Credit, Small Balance Loans, Seniors Housing and Targeted Affordable Housing.

The following are notes and key takeaways from this discussion held November 16, 2023.

Risk Distribution & Credit

Panelists Karen Clark, Manager, Risk Distribution & Credit

- Market Condition Concerns
  - Recurring investor concerns include: lack of sales comparables, negative leverage, overvalued cash-out refinances, properties located in tertiary markets, capitalization rates below 5%, markets with new supply pipelines, and unsupported value growth.
  - Appraisals are dated by the time investors review them and the capitalization rate may no longer be valid. This is why it is crucial to include recent sales or a pending transaction in the Sales Comparison Approach.
  - There is no consensus of when interest rates will start trending downward, however, some industry experts are projecting the second half of 2024.
- Property Condition Concerns
  - Investors conduct their own inspections during the due diligence period to make sure that the borrower is maintaining the property and making capital investments to investor standards.
  - Loans are removed from a pool when an investor believes the borrower cannot properly maintain the property.
  - Investor sentiment is that replacement reserves are often too low and should be closer to $500 or $600 per unit.

Insurance

Panelist: Nash Hensley, Manager, Insurance

- Rising Insurance Premiums
  - Insurance costs have increased significantly ,and often times, for less coverage. This trend is expected to continue into 2024.
  - Rising insurance costs is a result of numerous factors including: increase in frequency and severity of catastrophic weather events, under-reported property values to insurers, and inflationary pressures on materials and labor costs.

- Reinsurers signaled rate increases and increased focus on valuations in 2022. This has resulted in insurers limiting capacity and charging more for what is offered.

- Freddie Mac Insurance relies on the insurable value provided in the appraisal and these values should be based on current market costs and multipliers to accurately reflect the buildings at the property.

- Insurance in Underwriting

  - Insurance has been increasing for various reasons and has a material impact on underwriting. Insurance should be based on market figures rather than historicals, due to rapidly changing attitudes toward risk by insurers.

  - Appraisers' initial insurance projection is typically much lower than the final insurance premiums. Once the final quotes are received by Freddie Mac, a revision to the appraisal may be requested.

Physical Risk

Panelist: Justin Thomson, Director, Physical Risk

- Deferred Maintenance Issues

  - There is a heightened focus on accurately understanding and reflecting the current condition of a property.

  - Appraisers should look out for deferred maintenance including: moisture intrusion, non-functioning components or systems (down elevators, HVAC systems not operating), and other issues that should be handled through property maintenance (overgrown trees or landscaping, general property upkeep, peeling pain, damaged siding).

  - Appraisers should also look out for problematic materials including: aluminum wiring, galvanized pipes, or problematic siding, such as T1-11.

  - Appraisers should be on the lookout for life safety issues (unsafe railings or balconies, leaning retaining walls, trip hazards, broken windows, etc.), illegal units or bedrooms, locked rooms in basements, staged units, short-term rentals or Airbnb's, etc.

- Physical Risk in Underwriting

  - Deferred maintenance or any other significant repair or environmental concerns should be noted in the appraisal and the other third-party reports.

  - The Property Condition Report should be the starting point for the appraiser's replacement reserve estimate. These figures are derived by the engineer by considering the Remaining Useful Life of the building components and systems.

Small Balance Loans

Panelist: Risk Farmer, Director, Small Balance Loans Underwriting

- Market Adjustments, Expenses and Rents
  - Market adjustments of 3% may not be sufficient in the current market. Potential value stressors include: interest rate increases, rent decline or increased vacancy in certain markets, and potential correction from prices paid during the pandemic.
  - Expense comparables over one year old may be dated, given the recent increase in inflation. Most expense line items have likely been impacted by inflationary pressures.
  - An average of in-place rents does not necessarily equate to market rent and simply bracketing market rent with rent comparables is not enough to ensure that the market rents are supported.
  - Although SBL reports have a 50-page limit, that should not limit the appraiser's analysis. The page limit may be exceeded if it is necessary for the appraiser to provide credible assignment results (ie; adequate analysis).
- Unique Property Types
  - Accessory Dwelling Units (ADU's) are becoming more prevalent on the west coast and in other markets, such as Chicago. ADU's add more apartment supply to markets that have high demand and limited supply. These types of units may also have an affordability component.
  - Freddie Mac Underwriting has not yet seen appraisals take into consideration the potential to add ADU's to a property as part of the upside analysis.
  - Many sellers are not aware of the upside potential and there are some SBL investors who target these types of properties.
  - Motel conversions have raised concerns with investors, as it can be difficult to find both sales and rent comparables due to the uniqueness of these assets.
  - The appraisal should take into consideration that motel conversions typically have smaller unit sizes and fewer amenities than other multifamily properties in the market.
  - Appraisers may need to expand their search parameters for motel conversions and the appraisals should provide additional narrative to describe the search parameters and why the comparables were selected.

Seniors Housing

Panelist: Ben Barash, Manager, Seniors Housing Underwriting

- Areas of Renewed Focus
  - Freddie Mac is relying more than ever on market participant/investor and current listings.
  - Freddie Mac Underwriting is kicking back a disproportionate amount of appraisals due to unsupported assumptions including: occupancy well above market, unsupported capitalization rate conclusion, and exclusion of agency care expense from the proforma.
- Active Adult Communities
  - Active Adult communities are underwritten by conventional underwriting with conventional loan parameters.
  - Appraisals for Active Adult communities should consider both multifamily and independent living comparables and reconcile to a capitalization rate.
  - Appraisers should look out for commercial kitchens, dining rooms, home health/physical therapy, or other observations that might indicate that the property is offering services beyond the scope of an Active Adult community during their inspections.
- Seniors Housing Trends
  - There will be an influx of individuals entering the 80+ age cohort within the next 3 to 5 years.
  - The US elderly population is expected to increase to 40% of the total population by 2050.
  - There has been minimal new supply of seniors housing since the COVID-19 pandemic.
  - There is over $10 billion in seniors housing debt maturing over the next 24 months.
  - Occupancy and margins are expected to continue to improve.

Targeted Affordable Housing

Panelist: Deona Epps, Manager, Targeted Affordable Housing Underwriting

- Capitalization Rate Analysis
  - Freddie Mac internal data and market assessments suggest higher capitalization rates than what is provided in appraisals in most markets.
  - Additional analysis for capitalization rate conclusions outside of sales comparable range is critical.

- » Freddie Mac scrutinizes capitalization rates for supplemental loans.
- » Additional analysis is needed when no affordable sales comparables are used in the capitalization rate analysis.

- Focus on Affordable Sales Comparables
  - » Freddie Mac preference is to search for local then regional affordable sales comparables before opening search parameters to include market-rate sales comparables.
  - » Adequate explanation for sales comparable adjustments must be provided including: location, condition, physical attributes, etc.
  - » Using blanket statements such as: "buyers and sellers have different motives for affordable properties" is not acceptable.
  - » Freddie Mac is seeing acquisitions of affordable housing in many markets.
  - » The use of supplemental affordable comparables used in the capitalization rate analysis, but not the sales comparison approach raises questions.