

# Large Increase in Value in a Short Time

## Valuation Issue

Since late 2020, we have seen many appraisals that indicate remarkable value growth in a short period of time, such as 50% over two years or 75% over three years, without adequate support. A real-life example of the minimal support we see from appraisers is:

“Since the prior sale, rents have increased, and capitalization rates have compressed. In addition, the owner has continued to renovate the property. Since the 2019 sale, the owner has spent \$3,556,000 or \$7,408 per unit on renovations. The renovations include updates and upgrades to the common areas and unit interiors. These factors have resulted in the subject increasing in value since the most recent sale (i.e., an increase in value from \$62,400,000 to \$95,900,000 in 24 months).”

It is not credible to equate \$3.6 million in renovations with a two-year \$33,000,000 increase in value, almost 900%.

Sometimes we see that the explanation for a large differential in value over a short time might include a statement implying that the buyer or the seller were remarkably good negotiators or that the property was “off market”. An “off-market” sale does not necessarily mean that the buyer got a “good deal” and/or that the price is abnormally low. Remember the definition of market value is based on a “willing buyer/willing seller, each acting in its own best interest ...”, so why would a seller or buyer purposely leave \$XXX,XXX at the closing table just because someone came to them directly with an offer to purchase?

And, for clarity, Freddie Mac is not suggesting that the multifamily sales market has not experienced rapid pricing and value increases in the past couple/several years. However, we are saying that the appraisals we have been receiving typically do not support or provide a basis for understanding why the values and pricing are increasing.

This material increase in short-term value is an indicator of elevated valuation risk. Knowing why there is elevated valuation risk can be helpful to our underwriting teams.

## Guidance

The Uniform Standards of Professional Appraisal Practice (USPAP) requires the appraiser to analyze and summarize all agreements of sale, options and listings of the subject, both current and within the three years prior to the date of value (Standards Rules 1-5 and 2-2x).

However, Freddie Mac requires a more detailed analysis than USPAP, and these requirements can be found in Section 60.12d of the *Freddie Mac Multifamily Seller/Service Guide* (Guide), and shown below:

**d. Sales and other concessions (09/28/18)**

- 1) The Seller/Service 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, and the contract or listing price.
  - 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.

- 2) The appraiser must identify the current owner of the Property as described in the local land records
- 3) If the Property is subject to a current sales contract, the appraiser must identify the potential purchaser
- 4) If available to the appraiser, the appraiser must report:
  - a. How long the Property was on the market
  - b. Number of offers
  - c. The owner rationale for selecting the buyer's offer

The appraiser *must* support any material value growth and it is their responsibility to explain and support that growth in terms of:

- Rent growth, and/or
- NOI growth, and/or
- Capitalization rate changes, and/or
- Capital improvements and renovation, and/or
- Examples of value growth with period-over-period re-sales in the subject's market

And, as mentioned, an adequate analysis of a material increase in value is both a USPAP and a Freddie Mac requirement.

## Appraiser's Validation of a Material Value Increase

It is important for the appraiser to adequately discuss any material increases in value over a short period of time (typically two to three years) since this might be an indicator of elevated valuation risk.

The chart below is a suggested format for the appraiser to visually and narratively provide support for their observed rapid pricing or value increases. Note: This chart is only a suggestion, not a requirement, and we are flexible for how appraisers lay out their discussion, data and support in the report.

<b>Property name</b>			
<b>Property location (City, St Zip)</b>			
<b>Freddie Mac Loan #</b>			
<b>Appraisal date of value</b>			
<b>Value Contributory Item</b>	<b>Previous (as of: X date)</b>	<b>Current (as of: X date)</b>	<b>% or \$ Change</b>
Value and/or Sales Price	\$	\$	
Date of previous value or price			
Subject's recent renovation costs	\$	\$	
Subject's actual rents	\$	\$	
Appraiser's market rents	\$	\$	
Subject's occupancy	%	%	
Subject's property taxes	\$	\$	
Subject's operating expenses	\$	\$	
Market capitalization rate	%	%	
Subject's capitalization rate	%	%	
Area unemployment			
Other indicator / metrics (specify):			
Appraiser's commentary and support for the above market observations: <ul style="list-style-type: none"> <li>•</li> <li>•</li> <li>•</li> <li>•</li> </ul>			

Again, this format is only a suggestion to help the appraiser comply with the requirements of the Guide.