

# Multifamily Seller/Servicer Guide

## Chapter 66

### Conventional/TAH Physical Risk Report Requirements

#### 66.1 Physical Risk Reports (06/25/20)

Unless otherwise required by Freddie Mac, this Chapter applies to the following:

- A conventional or Targeted Affordable Housing (TAH) Mortgage that has an initial principal balance of \$20 million or less, or a Supplemental Mortgage and the combined initial principal balance of the Supplemental Mortgage and the unpaid principal balances of any senior mortgages encumbering the Property are \$25 million or less in the aggregate
- The Mortgage is not a Moderate Rehabilitation Mortgage, a Lease-up Mortgage, a Value-add Mortgage or a Forward Commitment Mortgage

This Chapter sets forth the requirements, duties and responsibilities of the Seller/Servicer, the Borrower and the physical risk consultant to evaluate the property condition and the environmental hazards associated with the Property and report this information to Freddie Mac. The consultant must provide resolution and costs for any deficiencies and any hazards identified at the Property.

If the Mortgage meets the conditions outlined above, the Seller/Servicer has the option to submit a Form 1108, Physical Risk Report (Physical Risk Report) meeting the requirements of Section 66.3 in lieu of submitting a property condition report and an environmental report. If the Seller/Servicer opts to submit Form 1108, the Seller/Servicer must submit the form before Freddie Mac will issue a Letter of Commitment to purchase a Mortgage.

##### a. Purpose of the Physical Risk Report (12/14/17)

The purpose of the Physical Risk Report is to

- Provide a brief description of all major building components and their condition
- Identify all deferred maintenance that is currently affecting building components or is expected to have a negative impact on building components
- Identify Critical and Priority Repairs (as defined in Guide Section 66.3(b)) needed and provide cost estimates for those items
- Identify Operational Repairs (as defined in Guide Section 66.3(b))
- Identify the capital needs over the term of the Mortgage and establish the appropriate amount of the Replacement Reserve

- Identify any current or past water intrusion, potentially damaging leaks or organic growth issues (Mold) and identify the source(s) of all water and Mold
- Identify problematic materials, equipment or systems as defined in Section 62.5(c)
- Identify all readily observable issues related to non-compliance with applicable codes, including handicapped accessibility requirements, and all issues that could negatively affect the health and safety of the tenants
- For a property in an Elevated Seismic Hazard Region, evaluate the high risk seismic factors identified in Section 64.2(c)
- Identify any recognized environmental conditions at the subject property and on adjacent properties

**b. Information to be provided with the Physical Risk Report (12/14/17)**

The Seller/Serviceicer must submit the completed Physical Risk Report, which conveys information about the property features, conditions, recognized environmental conditions and all recommended remedies, to Freddie Mac along with copies of:

- All information the consultant reviewed, including all data and records provided by the Borrower as well as test results and data reviewed in accordance with Section 66.4 (Key documents, such as test results, environmental databases and renovation scope of work and budgets, should be included in the report appendix.)
- Sufficient standard-size color photographs as are necessary to illustrate the conditions discussed in the report (The consultant must determine the number of photographs that will be necessary and include the photographs, with a description for each photograph.)
- A site plan(s) to adequately locate the Property and provide an indication of the site layout
- The resume of the individual who performed the on-site inspection
- The resume(s) of the individual(s) who reviewed the report, if different from the individual who performed the inspection

**66.2 Specific Seller/Serviceicer duties and responsibilities (12/14/17)**

The Seller/Serviceicer must exercise due diligence when evaluating a Property, and must make appropriate inspections and inquiries to learn its true condition.

The Seller/Servicer's responsibilities are to

- Retain and direct the physical risk consultant

The Seller must review and verify the physical risk consultant's credentials, licensing, certifications, memberships and affiliations. For new consultants, the Seller must check at least three references from lenders who have retained or employed the physical risk consultant to sufficiently evaluate the consultant's capabilities and performance. The Seller must maintain a separate physical risk consultant file for Freddie Mac's use that includes the Seller's ongoing evaluations of each consultant's performance, as well as the consultant's current resume, required references and current certificate(s) of liability insurance in accordance with the requirements of Section 11.5.

The Borrower must not retain or direct the physical risk consultant; however, the Seller may require the Borrower to pay the costs of all physical risk consultant services.

- Disclose if the State where the Property is located has a law that would allow environmental authorities to place a first priority lien on the Property (an "environmental superlien law")

Because an environmental superlien could take precedence over the Mortgage lien, the Seller/Servicer must highlight the existence of the superlien law when the Seller/Servicer brings to Freddie Mac's attention any conditions that could result in such a lien being imposed on the Property.

- Disclose to the Freddie Mac any knowledge of actual or suspected environmental problems, knowledge of Mold problems affecting the Property and knowledge of any physical deficiencies
- Keep abreast of local health, safety accessibility and environmental laws governing the Property
- Provide to the consultant any previously completed Physical Risk Report, property condition report or environmental report and all information pertaining to the maintenance, repair and replacement of major building components or systems before the consultant physically inspects the Property as required in Section 66.4
- Determine if an operations and maintenance (O&M) program is required and obtain an O&M program that is acceptable to Freddie Mac
- Assess the Borrower's ability to successfully execute an O&M program
- Obtain the Physical Risk Report for the Property
  - Review the Physical Risk Report to ensure that it complies with Freddie Mac's requirements and to verify that conclusive recommendations are provided for all identified issues
  - Obtain additional analysis as necessary to resolve any issues with respect to which the consultant was unable to reach a conclusion
- Ensure the appropriate risk management actions have been undertaken for identified environmental hazards

- Provide a copy of the completed Physical Risk Report to the Borrower so that the Borrower can understand their obligations to complete the identified Priority Repairs (including PR-90 Repairs) and Operational Repairs as specified in the Loan Documents
- In accordance with Section 8.17
  - Report Critical Repair findings to Freddie Mac, and follow up to ensure timely completion of Critical Repairs
  - Include funded Reserves in the Loan Documents, if applicable
  - Prepare Loan Documents which include the applicable Rider to the Loan Agreement with funded Reserves for all Priority Repairs
- When problematic materials, equipment and systems are identified, as described in Section 62.5(c)
  - Obtain certification from the appraiser that the problematic materials, equipment and systems were considered in the evaluation of the Property
  - Provide evidence that there is no exclusion in the hazard insurance policy for damage caused by the problematic materials, equipment and systems

### 66.3 Physical Risk Report requirements

#### a. General requirements for Physical Risk Reports (12/14/17)

Each Physical Risk Report must

- Be completed by a consultant who meets the qualifications and requirements stated in Section 66.18
- Document information disclosed by a comprehensive inspection of the Property to analyze all property conditions and environmental hazards
- Meet the inspection requirements of Sections 66.5 through 66.15
- Indicate the appropriate category described below for each repair item except Routine Repairs and Maintenance
- For every Critical Repair, Priority Repair and recognized environmental condition that is identified, provide a suggested remedy and a cost for repair, replacement or remediation
- Include any environmental sampling results

- Reference any environmental O&M programs that are recommended
- If a cost for repair or replacement of any item cannot be identified without further analysis, recommend a scope for the analysis and the estimated cost of such analysis

The physical risk consultant must review pertinent information and records in accordance with Section 66.5.

Sections of Chapter 66 refer to environmental provisions in Chapter 61 to avoid duplication. For the purposes of this Chapter 66, all references to the environmental report in the referenced sections of Chapter 61 are to be understood as referring to the Physical Risk Report, and any references to the environmental consultant are to be understood as referring to the physical risk consultant.

**b. Repair categories (12/14/17)**

See Section 62.3(b) for a description of the repair categories.

**c. Capital needs over the term of the Mortgage (Replacement Reserves) (02/28/18)**

In Section VI, the consultant must

- Identify the items needing repair or replacement that are beyond the scope of regular maintenance but are necessary to maintain the overall condition of the Property
- Provide an assessment of the Property that
  - Projects the need for replacements and repairs for the term of the Mortgage plus two years, to a maximum of 12 years
  - Identifies and quantifies the needs and the annual costs after accounting for the inflation factor as indicated in Section VI of Form 1108, Physical Risk Report

Freddie Mac will review the consultant's assessment and determine the actual Replacement Reserve amount. For a Mortgage with a term of more than 10 years, see Section 39.6(f) for additional Replacement Reserve requirements.

For Seniors Housing Mortgages, see additional requirements for the Replacement Reserve analysis in Section 21.16(e).

For Manufactured Housing Communities Mortgages, see additional requirements for the Replacement Reserve analysis in Section 22.2(i).

**d. Remediation and retesting (12/14/17)**

Refer to Section 61.4(b).

**e. Operations and maintenance (O&M) program (12/14/17)**

Refer to Section 61.4(c).

**f. Specific requirements for the Physical Risk Report (12/14/17)**

The Physical Risk Report must be completed and dated within six months prior to the date on which the full underwriting package is delivered to Freddie Mac.

The site inspection supporting the Physical Risk Report, and the supporting environmental database report, must be dated within 30 days prior to the date of the Physical Risk Report.

The Physical Risk Report must be certified by the physical risk consultant and clearly

- Identify all conditions present during the inspection
- Identify all parties contacted for data or information required for the report
- State any limiting conditions and the intended purpose of the report
- Identify any deviations from the Guide requirements and the most recent version of ASTM standards E2018 and E1527 as well as applicable environmental regulations established by the Environmental Protection Agency (EPA).

**66.4 Data collection and records inquiry for the Physical Risk Report (12/14/17)**

The physical risk consultant must

- Review information pertaining to the maintenance, repair and replacement of major building components or systems
- Review all significant maintenance reports, repair receipts and replacement items completed within the past 12 months, as well as elevator, boiler and safety inspection records and certificates
- Review available information related to planned capital improvements, inclusive of renovation/rehabilitation scope of work, and/or such work in progress
- Determine if any deficiencies identified in the inspection are included in the Borrower's scope of work, and if deficiencies noted are part of planned or ongoing improvements, analyze the Borrower's budget associated with this work to determine the adequacy of the budget



- Note readily observable deficiencies and/or violations of any federal, State or local laws, ordinances or codes that remain open for the Property, including any violations related to zoning, subdivision and use, building and housing accessibility (including the Americans with Disabilities and Fair Housing Acts), health matters, fire safety or energy-related requirements
- Make appropriate inquiry through publicly available sources to determine if any federal, State or local law, ordinance or code violations remain open for the Property, including any violations related to zoning, subdivision and use, building and housing accessibility (including the Americans with Disabilities and Fair Housing Acts), health matters, fire safety or energy-related requirements
- Review all appropriate environmental records, including previous environmental assessment reports, past test results, information on historical use of the subject property and neighboring properties and governmental environmental database records
- Make appropriate inquiry regarding the use and ownership of potentially hazardous equipment at the subject property
- Conduct any required environmental testing in conformance with applicable local, State and federal regulations and licensing requirements.

The Physical Risk Report must identify the information the consultant reviewed and the contacts that the consultant made.

### **66.5 Inspection requirements for the Physical Risk Report (12/14/17)**

The physical risk consultant must perform a complete inspection of the exterior and interior of the Property's components. This inspection must document the types of materials, systems, equipment and recognized hazardous conditions observed. Refer to Sections 62.5(a)-(c) and Section 62.5(e); however, item 62.5(a)(13) does not apply.

Each Physical Risk Report must include an evaluation of the following potential environmental hazards or issues using the methodology described in this Chapter:

1. Asbestos
2. Hazardous materials
3. Storage tanks
4. Lead-based paint (LBP)
5. Drinking water quality

6. Polychlorinated biphenyls (PCBs)
7. Prior use
8. Neighborhood hazardous waste activity
9. Mold
10. Radon
11. Superlien status

#### **66.6 Asbestos-containing materials (ACM) (12/14/17)**

For a physical risk consultant with the requisite asbestos training identified in Section 66.18(b), refer to Sections 61.6(a)-(f). If the physical risk consultant does not have the asbestos training identified in Section 66.18(b), then refer to Sections 62SBL.6(a)-(d).

#### **66.7 Hazardous material (12/14/17)**

Based on a property inspection and input sought from knowledgeable sources, the physical risk consultant must complete a transaction screen questionnaire substantially similar to the current ASTM E1528 standard to initially evaluate this hazardous material risk. If any responses to the questionnaire are “yes” or “unknown”, then further analysis must be completed by a consultant qualified in accordance with the requirements of Section 61.18.

If further analysis is warranted, refer to Sections 61.7(a)-(e).

#### **66.8 Storage tanks (12/14/17)**

Based on a property inspection and input sought from knowledgeable sources, the physical risk consultant must complete a transaction screen questionnaire substantially similar to the current ASTM E1528 standard to initially evaluate this storage tank risk. If any responses to the questionnaire are “yes” or “unknown,” then further analysis must be completed by a consultant qualified in accordance with the requirements of Section 61.18.

If further analysis is warranted, refer to Sections 61.8(a)-(f).

#### **66.9 Lead-based paint (12/14/17)**

Refer to Sections 61.9(a)-(f).



### **66.10 Drinking water quality (12/14/17)**

Based on a property inspection and input sought from knowledgeable sources, the physical risk consultant must complete a transaction screen questionnaire substantially similar to the current ASTM E1528 standard to initially evaluate this drinking water quality risk. If any responses to the questionnaire are “yes” or “unknown”, then further analysis must be completed by a consultant qualified in accordance with the requirements of Section 61.18.

If further analysis is warranted, refer to Sections 61.10(a)-(e).

### **66.11 Polychlorinated biphenyls (PCBs) (12/14/17)**

Based on a property inspection and input sought from knowledgeable sources, the physical risk consultant must complete a transaction screen questionnaire substantially similar to the current ASTM E1528 standard to initially evaluate this PCB risk. If any responses to the questionnaire are “yes” or “unknown”, then further analysis must be completed by a consultant qualified in accordance with the requirements of Section 61.18.

If further analysis is warranted, refer to Sections 61.11(a)-(e).

### **66.12 Prior use/historical sources inquiry (12/14/17)**

The consultant must determine whether any past uses of the Property indicate the potential for contamination to be present due to releases of hazardous materials or petroleum and must analyze at least one of the following three sources of historical information:

- Fire insurance maps
- Aerial photographs
- Local street directories

If a single source does not provide sufficient historical information back to 1940, additional sources must be analyzed.

Based on a property inspection and input sought from knowledgeable sources, the physical risk consultant must complete a transaction screen questionnaire substantially similar to the current ASTM E1528 standard to initially evaluate any risk associated with the prior use of the Property. If any responses to the questionnaire are “yes” or “unknown”, then further analysis must be completed by a consultant qualified in accordance with the requirements of Section 61.18.

If further analysis is warranted, refer to Sections 61.12(a)-(e).

### **66.13 Neighborhood hazardous waste activity (12/14/17)**

Refer to Sections 61.13(a)-(d).

**66.14 Mold (12/14/17)**

Refer to Section s 61.14(a)-(e).

**66.15 Radon (12/14/17)**

Refer to Section s 61.15(a)-(e).

**66.16 Superlien status (12/14/17)**

Refer to Section 61.16.

**66.17 Acceptability of the Physical Risk Report (12/14/17)**

The Physical Risk Report and the condition of the Property must be acceptable to Freddie Mac. The Physical Risk Report must specify an appropriate solution for each deficiency identified. The consultant must identify the scope and estimated cost for all Critical and Priority Repairs and all recognized environmental conditions. Upon Freddie Mac's review of the completed Physical Risk Report, Freddie Mac may impose additional requirements.

**66.18 Physical risk consultant qualifications and requirements (12/14/17)**

Consultants who conduct the on-site inspections and complete the Physical Risk Reports must meet the qualifications and requirements specified in this section.

Because Freddie Mac does not approve physical risk consultants, the Seller/Serviceicer must not consider any representation that a consultant is approved or qualified by Freddie Mac to prepare Physical Risk Reports. The Seller/Serviceicer is responsible for selecting the consultant and is solely accountable for the consultant's performance. The Seller/Serviceicer must ensure that the consultant is qualified to perform the required work.

**a. General requirements (12/14/17)**

Consultants' qualifications may vary with the needs of the specific assignment: general inspection services or specific technical analysis may be required. The consultant must be able to analyze building systems, site conditions, and environmental issues professionally, identify deficiencies and recommend remedial responses with cost estimates.

**b. References and experience (02/28/18)**

A consultant performing inspections and preparing Physical Risk Reports must have all of the following qualifications:

- A bachelor's or graduate degree in architecture or a related engineering field from an accredited institution

- Five or more years of experience in one or more of the following disciplines: architecture, engineering (structural, mechanical or civil) and/or construction/cost estimating
- Three or more years of experience performing multifamily property inspections
- Two or more years of experience conducting similar work for financial institutions

Personnel directly involved with analyzing the environmental information and data for the Physical Risk Report must also have expertise in at least the following relevant areas:

1. Soil and/or ground water contamination
2. Soil and/or ground water sampling
3. Asbestos identification and abatement
4. PCB contamination
5. UST identification, abandonment and removal supervision
6. LBP identification and abatement design and supervision
7. Familiarity with applicable federal, State and local environmental and public health laws and regulations
8. Development of O&M programs

Consultants that are taking samples of suspect asbestos-containing materials must have successfully completed the following courses that, at a minimum, meet the EPA Guidelines for Asbestos Model Accreditation Plan:

- A 24-hour asbestos inspection course
- An annual refresher course

Subsurface soil service providers must also complete the 40-hour Health and Safety Training for Hazardous Waste Operations course, with annual 8-hour refresher courses.

For LBP and asbestos work, some States and municipalities require a license or certificate. The physical risk consulting firm must have a sufficient number of properly licensed or certified employees to complete the project.

The Seller/Serviceicer must check at least three client references from the consultant's previous lenders to determine whether the projects were

- Similar in scope and purpose to the Property
- Completed on time
- Of sufficient quality

The Seller/Serviceicer must review the consultant's licensing and other certifications (in States where they are applicable), as well as listings of affiliations or memberships in professional organizations. The Seller/Serviceicer must also maintain in its file for review by Freddie Mac a current resume for the consultant, a current insurance certificate and the required references.

Freddie Mac will not accept a Physical Risk Report from an individual or firm that has been excluded from EPA-assisted programs. The Seller/Serviceicer must check the Excluded Parties List System (EPLS) at <https://www.epls.gov> for the names of individuals and firms that are excluded by Federal government agencies from receiving

- Federal contracts
- Federally approved subcontracts
- Certain types of financial and non-financial assistance and benefits

**c. Conflicts of interest/provision of related services (12/14/17)**

The consultant may not be affiliated with the Borrower, the Seller/Serviceicer, a buyer or seller of the proposed Property, or engaged in any business that might present a conflict of interest. The consultant may not be engaged to perform any repair or remedial work specified in the Physical Risk Report.

**d. Insurance (12/14/17)**

The consultant must provide the Seller/Serviceicer with an original certificate(s) of liability insurance, at its own expense, which evidences coverage meeting the requirements of Section 11.5. The Seller/Serviceicer must retain the original certificate(s) of insurance in its files.

**e. Unacceptable consultants (12/14/17)**

The Seller/Servicer must send written notification immediately to the Applicable Freddie Mac Multifamily Regional Office if the Seller/Servicer, for cause, discontinues the use of a consultant who has completed Physical Risk Reports within the past 12 months for Mortgages purchased or credit enhanced by Freddie Mac.

In addition, Freddie Mac reserves the right to refuse to accept Physical Risk Reports completed by any specific consultant. Freddie Mac will maintain, on FreddieMac.com, the [Multifamily Restricted Vendor List](#). If a physical risk consultant appears on the Multifamily Restricted Vendor List, the Seller/Servicer may not use that consultant to inspect a Property until notified otherwise by Freddie Mac. The decision to place a third-party vendor on the Multifamily Restricted Vendor List is solely within Freddie Mac's discretion.

The Multifamily Restricted Vendor List is made available to Seller/Servicers for the sole purpose of ensuring that physical risk consultants who are not acceptable to Freddie Mac do not prepare reports for use by Freddie Mac. The Multifamily Restricted Vendor List constitutes "Confidential Information" as defined in Section 2.8.

**66.19 Mortgage Servicing (12/14/17)**

Refer to Section 61.19.

**66.20 Representations and warranties (09/28/18)**

The Seller/Servicer is deemed to make the warranties regarding the Physical Risk Report and the physical risk consultant set forth in Section 5.4.