



Multifamily Real Estate Appraisals

Common Issues and Best Practices

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Topics for Discussion

- Best Practices for Multifamily Properties
 - » The State of the Industry
- Common Issues
- Methodology, Analysis, and Reporting
- Report Format and Documentation

- Originating Lender (also known as Seller/Servicer) engages appraiser, not Freddie Mac
 - » Appraisals must conform to Freddie Mac's Seller/Servicer Guide – Section 12
 - » Lender must convey all necessary information and materials for appraiser to provide a supportable opinion of market value
- Appraisals are to be reviewed by the Lender prior to transmittal to Freddie Mac
- Appraisals are then reviewed by Freddie Mac underwriters or Internal Valuation Unit, depending on loan size
 - » Any questions or comments regarding the appraisal are submitted to the Lender (Seller/Servicer), who then contacts the appraiser

- Relating the facts collected by the appraiser to their impact on value
 - » Well-written appraisals contain detailed descriptive analysis in each section followed by a concise summary

- Helping the client (the Lender and Freddie Mac) understand the methodology and thought process leading to the conclusion

- Anticipating the reviewer's questions and issues

- Zoning and Legal Issues
 - » Does the parking ratio comply with current zoning code?
 - » Does the property's unit density comply with current zoning code?
 - » If the property experiences substantial damage or casualty loss, can it be rebuilt to the same number of units as today?
 - » Does the property have an environmental issue or is located in a flood plain?
 - » If the property has any of these issues, the appraiser needs to address its impact on value. If there is no impact on value, the appraiser should discuss his/her rationale for that conclusion, too!
- Appraiser should cite all sources supporting the discussion of zoning issues
 - » Discussions with authoritative references, links to online zoning codes, etc.

■ Cost Approach

- » Cost Approach should be fully discussed, or the reasons for exclusion should be very clear
 - Specify the source and date of replacement cost data
 - A comparison of actual construction costs to replacement cost data for newly constructed properties should be included
 - Construction cost comparables for newly constructed properties would be helpful
 - Some support/discussion of entrepreneurial profit

■ Sales Comparison Approach

- » Adjustments to comparables must be sufficiently discussed by the appraiser
- » Appraiser should discuss each attribute or component adjustment separately for maximum clarity
- » When applicable, economies of scale should generally require a very small adjustment – large adjustments suggest the property may not be truly comparable to the subject
- » Please – – Do *not* fabricate your own income and expenses for the comparable sales just to generate a capitalization rate and call it “pro forma” data. I/E data should be obtain from a participant in the transaction
- » Appraiser should not use atypical sales transactions
 - i.e., 1031 exchanges or allocated portfolio sales

■ Income Approach

- » Net Income Multiplier = (merely 1 / Capitalization Rate)
 - NIM is not an appropriate tool for the Sales Comparison Approach (see *The Appraisal of Real Estate, 13th Edition*)
- » Appraiser should not ignore contract rents in calculation of Potential Gross Income
 - Vacancy trends are important
 - Concession trends are important
 - “Other Income” is important
 - Multifamily properties should be analyzed as Leased Fee, not Fee Simple

- Income Approach (continued...)
 - » Temporary market conditions should not be capitalized in perpetuity
 - Unusual vacancy and concessions
 - Could be treated as the present value of the rent loss instead of a full Discounted Cash Flow (DCF) analysis
 - » DCF analysis may be required for a property experiencing unstabilized operations
 - Adequate support for assumptions and inputs is required
 - A 10-year analysis of constant increases in rents and expenses is not necessarily appropriate.

■ Capitalization Rates

- » There is a lack of information on capitalization rates in many markets, so a thorough discussion is imperative
- » Discussion must relate selected capitalization rate to subject property's characteristics and market
- » Appraiser *should* develop capitalization rates using each of the following techniques:
 - Data extracted from comparable sales
 - Published sources
 - Personal surveys and interviews with market participants
 - Band of investment method, and
 - Debt coverage ratio model

- Report format and quality are indicative of an appraiser's attention to detail, professionalism, and service value
- Common signs of above average performance
 - » Complete and germane data followed by discussion, analysis, and concluding statements that relate to the subject property
 - » Accurate math calculations
 - » Consistent and easy to follow format
 - » No catchall disclaimers
- Appraiser should document the inspection of units
- Appraiser should document it has reviewed an environmental report as part of the appraisal process

Questions?



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