Valuation of Multifamily Properties: The Perspective of the End User

Martin A. Skolnik, MAI (Marty)

July 26, 2016
A **Better** Freddie Mac

...and a **better** housing finance system

**For families**
...innovating to improve the liquidity, stability and affordability of mortgage markets

**For customers**
...competing to earn their business

**For taxpayers**
...reducing their exposure to mortgage risks
Martin A. Skolnik, MAI (Marty)
Director, Multifamily Appraisals
Freddie Mac
How many apprentices did they lose before they figured out that the largest two guys should be on the left side of the platform?
Introduction and Market Metrics
Valuation of Multifamily Properties: 
The Perspective from the End-User

Abstract:
Multifamily housing continues to be one of the most successful real estate products since the economic downturn and, since 2008, Freddie Mac and Fannie Mae have been a consistent source of transactional finance even when other lenders have scaled back financing other commercial property types.

The structure of this market has changed considerably since the mid-2000s since now most loans purchased by the GSEs are being securitized. With the increasing level of lending by the GSEs and with the addition scrutiny given to the documentation of each transaction by securitization participants, there is a greater need for real estate appraisers to be competent in the nuances of multifamily valuation.

This panel will focus on those items that are unique to the valuation of multifamily properties including a discussion of common errors in multifamily appraisal reports, and a discussion of the reporting requirements of the GSEs in general and Freddie Mac in particular, not a “how-to” appraise multifamily properties.
The Multifamily Division of Freddie Mac helps to ensure an ample supply of affordable rental housing by purchasing mortgages secured by apartment buildings with **five or more units**.

Freddie Mac buys loans from a network of approved Multifamily Seller/Servicers (lenders); we do not make loans.

We began shifting in 2009 from a “buy and hold” to a “buy and sell” model and are currently securitizing about 95% of the loans we purchase.

Freddie Mac Multifamily follows a “prior-approval” underwriting approach and completes the underwriting and credit reviews of all multifamily mortgages in-house.
The Multifamily Division of Freddie Mac funded $47.3 billion in new business volume in 2015, which provided financing for more than 3,500 multifamily properties representing 650,000± apartment units. This was a 67% increase over 2014 levels.

Funded $17.5 billion in new business volume in 1Q2016 (financing for more than 1,100 multifamily properties, representing 209,000± apartment units.)
Freddie Mac Multifamily Purchase Volume 2005 - 1Q 2016

Financed 209,000 rental units in 1Q 2016

- **2005**: $11.2B
- **2006**: $13.0B
- **2007**: $21.6B
- **2008**: $24.0B
- **2009**: $16.6B
- **2010**: $15.4B
- **2011**: $20.3B
- **2012**: $28.8B
- **2013**: $25.9B*
- **2014**: $28.3B*
- **2015**: $47.3B*
- **1Q 2016**: $18.0B*

* FHFA has set a volume cap annually since 2013. In 2013 and 2014, $25.9 billion; $30 billion in 2015; $35 billion in 2016. However, since 2014, certain purchases that promote affordable housing do not count toward the cap; therefore, total purchase volume may exceed the limit. FHFA expanded the definition of uncapped purchases in May 2015 and raised the cap from $31 billion to $35 billion in May 2016 based on market demand.

Source: Freddie Mac
Freddie Mac Multifamily – Credit Profile Data

- Average origination Loan-to-Value ranges from 61% to 75%

- Average origination Debt Service Coverage ranges from 1.39x to 2.17x
Background Information: Multifamily Real Estate Market

Delinquency Rates

Portfolio Delinquency Rates (GSE)

Source: Freddie Mac, Fannie Mae, TREPP (CMBS multifamily 60+ delinquency rate, excluding REOs), American Council of Life Insurers (ACLI) Quarterly Investment Bulletin, and FDIC Quarterly Banking Profile
Background Information: Multifamily Real Estate Market

Moody’s/RCA CPPI: Apartment and Core Commercial Composite Indices

© 2015 Real Capital Analytics. mrppi=Moodys/RCA CPPI

Apartments
All Property Types
Commercial
Background Information: Multifamily Real Estate Market

Apartment Vacancy Rate and Effective Rent Trends

Source: REIS 1Q16 First Glance
Background Information: Multifamily Real Estate Market

Multifamily (5+ unit) Permits, Starts, and Completions: 1980 - 2016 Q1

Sources: Moody’s Analytics DataBuffet.com, U.S. Census Bureau
Notes: Starts and completions based on all areas of the United States, while permits only for areas that require a building or zoning permit. Moody’s Analytics estimated that, in 2000, 95% of population was living in permit issuing area.
Freddie Mac Multifamily sources its loans from a select group of experienced multifamily lenders.

- The small size of the network promotes quality originations and a high level of service to lenders and borrowers.
- Our Seller/Servicers must comply with our standards for both origination and servicing of multifamily loans, which includes meeting minimum financial requirements and undergoing satisfactory annual audits.

### Seller/Servicers

<table>
<thead>
<tr>
<th>ACRE Capital, LLC</th>
<th>KeyBank NA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arbor Commercial Mortgage, LLC *</td>
<td>M&amp;T Realty Capital Corporation</td>
</tr>
<tr>
<td>Bellwether Enterprise Real Estate Capital, LLC</td>
<td>NorthMarq Capital</td>
</tr>
<tr>
<td>Berkadia Commercial Mortgage, LLC</td>
<td>PennyMac Commercial Real Estate Finance *</td>
</tr>
<tr>
<td>Berkeley Point Capital LLC</td>
<td>Pillar Multifamily, LLC</td>
</tr>
<tr>
<td>Capital One Multifamily Finance, LLC *</td>
<td>Pinnacle Bank *</td>
</tr>
<tr>
<td>CBRE Capital Markets *</td>
<td>PNC Real Estate - Multifamily</td>
</tr>
<tr>
<td>Citibank N.A.</td>
<td>Prudential Affordable Mortgage Company</td>
</tr>
<tr>
<td>Community Preservation Corporation *</td>
<td>Prudential Johnson Apartment Capital Express</td>
</tr>
<tr>
<td>Financial Federal Bank</td>
<td>ReadyCap Commercial, LLC *</td>
</tr>
<tr>
<td>Grandbridge Real Estate Capital LLC</td>
<td>Red Mortgage Capital, LLC *</td>
</tr>
<tr>
<td>Greystone Servicing Corporation *</td>
<td>RICHMAC Funding LLC</td>
</tr>
<tr>
<td>Holliday Fenoglio Fowler, L.P.</td>
<td>Sabal Financial Group, L.P. *</td>
</tr>
<tr>
<td>Hunt Mortgage Group *</td>
<td>Walker &amp; Dunlop, LLC</td>
</tr>
<tr>
<td>Jones Lang LaSalle, LLC</td>
<td>Wells Fargo Multifamily Capital</td>
</tr>
</tbody>
</table>

* Approved Small Balance Loan Lender
Appraisals at Freddie Mac
The underlying exercise of a Freddie Mac review of a third-party real estate appraisal review is to determine if the appraiser has *adequately* supported his/her opinion of market value.
In the appraisal report, we want to know:

- **What** the appraiser knows about the subject property and its market…

- **How** they know it…, and

- **The impact** it has on the subject’s market value.

**Not:** “…based on my years of experience and knowledge of the area…”
Parking -- Real life example:
The appraiser says that parking is “assumed adequate”

- There was no discussion of:
  - the actual number of spaces at the property
  - the ratio of spaces per unit, and/or
  - the local zoning requirement

- Questions that the appraiser should answer in the appraisal:
  - Is the parking ratio compliant with local zoning regulations?
  - Is the parking ratio/number of spaces adequate in this market?

If the answer to either or both questions is “no”, then what is the impact on value?
My favorite answer to most appraisal questions:

*It depends…!*
Quick refreshers and “ground rules”:

» Third-party appraisals come to Freddie Mac through the Seller/Servicer in advance of a loan acquisition.

» According to Section 12.12 of the Seller/Servicer Guide (the “Guide”), the Seller/Servicer:
  – Must review each appraisal in detail “for its completeness, accuracy, appraising logic, and adherence to the requirements” of Chapter 12 of the Guide, and
  – Represents and warrants that the appraisal complies with the Uniform Standards of Professional Appraisal Practice (USPAP).
So, the point of this presentation is to:

a) Talk about the risk factors that would indicate that an appraiser *has* or *has not* adequately supported his/her opinion of market value, and

b) Discuss suggested solutions to the issues we most commonly find in appraisal reports
Appraisers are generally good at extracting data from the market and analyzing that data in each of the three approaches to value.

But, many appraisal reports we see lack a narrative thread that relates how the appraiser’s observations and findings impact the value of the subject property.
A well-written appraisal anticipates and addresses a reviewer’s questions in advance.

We have found that the difference between a reasonably well-written appraisal and a below average appraisal is usually the addition of a short/concise summary at the conclusion of each section.

Typically, the addition of this verbiage can dramatically improve the efficiency of our review process by reducing the need for “go-backs” to clarify the appraiser’s narrative.

*Saves everyone in the process both time and money… and frees up more time for everyone in the lending chain to do additional quality transactions!*
Causes of “Go Backs”

» Data and conclusions without discussion or adequate analysis

» Murky “Scope of Work”
  – Inspection requirements
  – Third-party reports
  – Missing specific intended user/reliance language

» Administrative issues
  – Property name
  – Property address
  – Number of units
Solutions for “Go Backs”

» A quality engagement letter

» *READ* the engagement letter

» Confirm specific issues with the client prior to commencing the engagement

» Confirm specific issues with the client prior to report submission

  – Administrative issues, in particular

» Communication with the client during the engagement
Important point of perspective for much of this discussion:

• Appraisers look at some of these issues differently than underwriters

• Appraisers are trying to mirror actions of buyers and sellers in the market and give their opinion of the *most probably selling price* of the subject property (i.e., market value)

  - vs -

• Underwriters are trying to complete a business transaction, and have more considerations than just market value
Multifamily Appraisal Reviews

• Some areas of differences:
  • Effective Gross Income
  • Real estate taxes
  • Occupancy/vacancy
  • Reserves for replacement
  • Proposed vs. existing restricted rent contracts

*We rely on the appraiser to “call it like they see it”*
Top 5 Observations from Appraisals

If the appraiser gets these right, then the appraisal value should be adequately supported.
1. Appraiser’s market rents are too dissimilar from the subject property’s actual recent leasing activity without adequate explanation

» We look at the three months of recent leasing from the rent roll and compare that to the appraiser’s estimates of market rents

» If the appraiser is not reasonably close to recent actual leasing, we would expect an explanation

<table>
<thead>
<tr>
<th>Unit type</th>
<th>Unit SF</th>
<th>Actual Rent</th>
<th>Appraiser’s Market Rent</th>
<th>Difference</th>
<th># of Units</th>
<th>Deviation from Actual Rent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 bedroom</td>
<td>903</td>
<td>$1,673</td>
<td>$1,761</td>
<td>$88</td>
<td>168</td>
<td>5.2%</td>
</tr>
<tr>
<td>2 bedroom</td>
<td>1,285</td>
<td>$2,410</td>
<td>$2,425</td>
<td>$15</td>
<td>75</td>
<td>0.6%</td>
</tr>
<tr>
<td>3br/2ba</td>
<td>1,733</td>
<td>$3,405</td>
<td>$3,845</td>
<td>$440</td>
<td>35</td>
<td>12.9%</td>
</tr>
<tr>
<td>3br/3ba</td>
<td>2,575</td>
<td>$5,470</td>
<td>$5,245</td>
<td>-$225</td>
<td>2</td>
<td>-4.1%</td>
</tr>
</tbody>
</table>

Rents sampled are from July, August, September and through October 17, 2014

53 recently rented units are in the sample above
18.9% of the property’s total number of units are in the recently rented sample

© Freddie Mac
2. Appraiser’s operating expense conclusions are not supported by the appraiser’s own expense comparables from the subject's market area.

» When our group reviews an appraisal, we pull out property taxes and analyze those separately, then compare the appraiser's expense comparables' core expenses to the appraiser's estimate of the subject's operating expenses.

» This type of analysis eliminates the influence of any jurisdictional differences in property tax assessment variations.
### Comparable Expense Analysis (Per Unit and % of EGI)

<table>
<thead>
<tr>
<th>Expense Comparable #:</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>2012</th>
<th>2013</th>
<th>Subject’s Operating History</th>
<th>Appraiser’s Proforma</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Effective Gross Income</strong></td>
<td>$16,222</td>
<td>$14,004</td>
<td>$12,722</td>
<td>$17,100</td>
<td>$11,380</td>
<td>$13,738</td>
<td>$14,774</td>
<td>$18,027</td>
<td>$20,617</td>
</tr>
<tr>
<td><strong>Real Estate Taxes</strong></td>
<td>$1,567</td>
<td>$1,534</td>
<td>$1,505</td>
<td>$1,856</td>
<td>$1,067</td>
<td>$1,160</td>
<td>$1,480</td>
<td>$1,257</td>
<td>$300</td>
</tr>
<tr>
<td><strong>Reserves for Replacement</strong></td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$300</td>
<td>$0</td>
</tr>
<tr>
<td><strong>Operating Expenses</strong></td>
<td>$6,573</td>
<td>$5,945</td>
<td>$5,081</td>
<td>$6,318</td>
<td>$4,463</td>
<td>$5,217</td>
<td>$5,690</td>
<td>$6,022</td>
<td>$6,022</td>
</tr>
<tr>
<td><strong>Expenses as a Percent of EGI</strong></td>
<td>41%</td>
<td>42%</td>
<td>40%</td>
<td>37%</td>
<td>39%</td>
<td>38%</td>
<td>39%</td>
<td>38%</td>
<td>38%</td>
</tr>
<tr>
<td><strong>Modified Operating Expenses</strong></td>
<td>$5,006</td>
<td>$4,411</td>
<td>$3,576</td>
<td>$4,462</td>
<td>$3,396</td>
<td>$4,057</td>
<td>$4,210</td>
<td>$3,661</td>
<td>$3,661</td>
</tr>
<tr>
<td><strong>As a percent of EGI</strong></td>
<td>31%</td>
<td>31%</td>
<td>28%</td>
<td>26%</td>
<td>30%</td>
<td>30%</td>
<td>28%</td>
<td>23%</td>
<td></td>
</tr>
</tbody>
</table>

**Range of Per Unit Expenses**
- **Low**: $3,396
- **High**: $5,006
- **Appraiser’s Proforma**: $3,661

**Range of Expenses as % of EGI**
- **Low**: 26%
- **High**: 31%
- **Appraiser’s Proforma**: 23%
3. The capitalization rate development and supporting discussion is/are weak

» Five ways to support a capitalization rate
   – Comparable sales
   – Band of Investment model
   – Debt Coverage Ratio model
   – Published surveys
   – Appraiser’s interviews of local market participants
1. Sales

- Financial data of the comparable sales should be verified and the source of the data should be disclosed in the appraisal

- Generally, the preferred type of data should be current to the date of sale or forward looking
  - This is different than how our underwriter looks at this
  - Underwriter’s capitalization rates based on T-12 are typically 50bps to 100bps lower (more aggressive) than the appraiser’s method.

- An “Appraiser’s Estimate” of a sale’s financial terms, conditions, and operating parameters is not appropriate
Top 5 Appraisal Observations

» **Sales (continued)**

– The comparable sales emphasized in the capitalization rate development should be the same ones emphasized in the Sales Comparison Approach

  - *Or* there should be an adequate explanation for the inconsistency

  - **Example**: If sales #1, #3, and #4 are the best sales in the Sales Comparison Approach, why place equal weight on all the sales in the capitalization rate selection?

– Be careful about adding new sales in the capitalization rate discussion without adequate supporting materials and discussion
2. **Band of Investment**

<table>
<thead>
<tr>
<th>Band of Investment model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan % x Mortgage Constant = Loan contribution</td>
</tr>
<tr>
<td>Equity % x Equity Dividend Rate = Equity contribution</td>
</tr>
<tr>
<td>= Capitalization Rate</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>BAND OF INVESTMENT CALCULATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mortgage Component</td>
</tr>
<tr>
<td>Equity Component</td>
</tr>
<tr>
<td>Indicated Capitalization Rate</td>
</tr>
<tr>
<td><strong>INDICATED CAPITALIZATION RATE</strong></td>
</tr>
</tbody>
</table>

**Equity Dividend Rate**
- Sources
- Meaning of the rate relationship
3. **Debt Coverage Ratio (DCR) model:**

\[
\text{Debt Coverage Ratio} \times \text{Loan Percentage} \times \text{Mortgage Constant} = \text{Capitalization Rate}
\]
## Top 5 Appraisal Observations

PwC survey *(free version from the Appraisal Institute website)*

<table>
<thead>
<tr>
<th>Economic Indicators</th>
<th>PwC Real Estate Investor Survey, Q1 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Regional Mall</strong></td>
</tr>
<tr>
<td><strong>Discount Rate (IRR)</strong></td>
<td></td>
</tr>
<tr>
<td>Range (%)</td>
<td>5.00–12.00</td>
</tr>
<tr>
<td>Average (%)</td>
<td>7.63</td>
</tr>
<tr>
<td>Change (bps)</td>
<td>–2</td>
</tr>
<tr>
<td><strong>Overall Cap Rate (OAR)</strong></td>
<td></td>
</tr>
<tr>
<td>Range (%)</td>
<td>4.00–9.00</td>
</tr>
<tr>
<td>Average (%)</td>
<td>6.00</td>
</tr>
<tr>
<td>Change (bps)</td>
<td>–3</td>
</tr>
<tr>
<td><strong>Residual Cap Rate</strong></td>
<td></td>
</tr>
<tr>
<td>Range (%)</td>
<td>4.00–9.00</td>
</tr>
<tr>
<td>Average (%)</td>
<td>6.50</td>
</tr>
<tr>
<td>Change (bps)</td>
<td>–3</td>
</tr>
</tbody>
</table>

Ranges so large you can pick any number you want
## Top 5 Appraisal Observations

- Example: CBRE’s semi-annual survey

### MULTIFAMILY SUBURBAN | UNITED STATES KEY RATES

<table>
<thead>
<tr>
<th>Class A</th>
<th>Class B</th>
<th>Class C</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CAP RATES FOR STABILIZED PROPERTIES (%)</strong></td>
<td><strong>EXPECTED RETURN ON COST FOR VALUE-ADD PROPERTIES (%)</strong></td>
<td><strong>EXPECTED RETURN ON COST FOR VALUE-ADD PROPERTIES (%)</strong></td>
</tr>
<tr>
<td><strong>CHANGE</strong></td>
<td><strong>CHANGE</strong></td>
<td><strong>CHANGE</strong></td>
</tr>
<tr>
<td>ATLANTA</td>
<td>5.00 - 5.50</td>
<td>6.25 - 6.75</td>
</tr>
<tr>
<td>BOSTON</td>
<td>4.50 - 5.00</td>
<td>5.75 - 6.25</td>
</tr>
<tr>
<td>CHICAGO</td>
<td>4.75 - 5.00</td>
<td>5.25 - 5.50</td>
</tr>
<tr>
<td>DALLAS/FORT WORTH</td>
<td>4.75 - 5.75</td>
<td>4.50 - 5.50</td>
</tr>
<tr>
<td>HOUSTON</td>
<td>5.25 - 5.75</td>
<td>5.25 - 5.75</td>
</tr>
<tr>
<td>N. CA: OAKLAND</td>
<td>4.50 - 5.00</td>
<td>4.50 - 5.00</td>
</tr>
<tr>
<td>N. CA: SAN FRANCISCO</td>
<td>3.75 - 4.25</td>
<td>4.00 - 4.50</td>
</tr>
<tr>
<td>N. CA: SAN JOSE</td>
<td>4.00 - 4.50</td>
<td>4.25 - 4.75</td>
</tr>
<tr>
<td>NY: N. NEW JERSEY</td>
<td>4.75 - 5.25</td>
<td>5.75 - 6.25</td>
</tr>
<tr>
<td>NY: STAMFORD</td>
<td>5.50 - 6.00</td>
<td>6.25 - 6.75</td>
</tr>
<tr>
<td>S. CA: INLAND EMPIRE</td>
<td>4.75 - 5.25</td>
<td>5.00 - 5.50</td>
</tr>
<tr>
<td>S. CA: LOS ANGELES</td>
<td>3.75 - 4.25</td>
<td>4.25 - 4.75</td>
</tr>
<tr>
<td>S. CA: ORANGE COUNTY</td>
<td>4.00 - 4.50</td>
<td>4.75 - 5.25</td>
</tr>
<tr>
<td>S. FL: FORT LAUDERDALE</td>
<td>4.25 - 5.00</td>
<td>5.00 - 5.50</td>
</tr>
<tr>
<td>S. FL: MIAMI</td>
<td>4.25 - 4.75</td>
<td>5.00 - 5.50</td>
</tr>
<tr>
<td>S. FL: WEST PALM BEACH</td>
<td>4.25 - 4.75</td>
<td>5.00 - 5.50</td>
</tr>
<tr>
<td>SEATTLE</td>
<td>4.50 - 5.00</td>
<td>4.75 - 5.00</td>
</tr>
<tr>
<td>WASHINGTON, D.C.</td>
<td>4.50 - 5.25</td>
<td>4.75 - 5.50</td>
</tr>
</tbody>
</table>
5. Interviews with local market participants

» The date of the interviews and the names of the interviewees would be helpful

<table>
<thead>
<tr>
<th>NAME</th>
<th>TITLE</th>
<th>COMPANY</th>
<th>DATE</th>
<th>RANGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shane Shafer</td>
<td>Apartment Broker</td>
<td>Berkadia</td>
<td>1Q 15</td>
<td>5.00%  to 5.25%</td>
</tr>
<tr>
<td>Stewart Watson</td>
<td>Apartment Broker</td>
<td>Marcus &amp; Millichap</td>
<td>1Q 15</td>
<td>5.00%  to 5.25%</td>
</tr>
</tbody>
</table>
Appraisers tend to use “capitalization rate compression” as the reason for choosing an aggressive rate, without providing support...
4. Adjustments for the comparable sales are not adequately explained

- Large individual adjustments
  - Anything over 20%, there should be better supporting discussion or data

- Unusually precise adjustments
  - 1%, 2%, 3%, etc., etc.
  - The market tends to think in terms of multiples of 5%, not 3% or 7%
4. Adjustments for the comparable (continued)

» We aren’t looking for a paired sales analysis

- But, what about paired rentals?

Example:

- The subject property (A) has washer/dryers but Comparable Sale #2 does not
  - During the market rent research, the appraiser found that the average charge for washer/dryers in this market is $25 per month and average rents are $1,000 per month
    - $25 / $1,000 = 2.5% adjustment
4. Adjustments for the comparable (continued)

– What about relative differences in:
  • Household income
  • Average rents
  • Average single-family sales prices
  • Employment differentials
  • Walking scores

Something more than:
“Based on my years of experience and knowledge of the area”
5. The results of third-party reports (environmental, property condition, zoning, etc.) are not typically incorporated in the appraisal report.

Without a third-party consulting report, the appraisers are not providing their observations from their physical inspection of the subject property. Instead, we see this type of language:

“We did not receive an environmental report or property condition report and we are not experts in this field, so we have no knowledge about the subject’s environmental or property condition issues.”

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

“Even though we did not receive a draft environmental or property condition report, 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>.”
Environmental and Property Condition Issues

– The property condition report and environmental assessment report are not typically incorporated into the appraisal as required.

– The appraiser needs to reference any material issues raised by the third-party consultant and state their impact on value.

– The appraiser should analyze and discuss the **contributory value** of the repairs on the subject property’s value?

  • Is it really a dollar-for-dollar subtraction of repairs?
Top 5 Appraisal Observations

- If there are issues on the property that *might* impact value but for which the appraiser says that there is no value impact, *the appraiser should discuss the reasoning for its non-impact and provide market support for his/her rationale*
  - Flood
  - Zoning (density, parking, rebuildability)
  - Property condition
Common Appraisal Issues
The appraiser should call-out/note/discuss the report’s deficiencies

- Sales: Older or a wide geographic area
- Sales: Poor or missing financial data
- Sales: Poor comparability or quantity
- Income: Bad rent roll from the property manager
- Income: Not a substantial operating history
- Income: Capitalization rate is dependent on the quality of the sales information
- Market: In flux or other issues
- General: Lack of cooperation by the property management
A SWOT analysis/discussion would be helpful

- Strengths
- Weaknesses
- Opportunities
- Threats

**STRENGTHS, WEAKNESSES, OPPORTUNITIES AND THREATS (SWOT)**

**Strengths/Opportunities**
- The subject property offers market rate and rent-restricted units;
- Affordable projects typically have steady cash flows;
- Unit turnover is low at the subject according to the on-site representative;
- The subject’s occupancy is typically high relative to similar market rate projects due to the amount of affordable units;
- Low income housing units are in high demand in Orange County. There is strong demand for low-income apartment units within the area. It is typical to have waiting lists ranging up to 5 years in length.
- The subject has good freeway access and is in close proximity to schools, parks, shopping centers and employment.
- There is a limited amount of new apartment construction planned for the immediate area.
- The owner could potentially apply for a tax abatement

**Weaknesses/Threats**
- Affordable projects lack significant rent increases.
- The subject does not currently benefit from a tax abatement.
Common Issues – Sales Comparison Approach:

– No support for the “Changing Market Conditions” adjustment

– Adjustments for “unit size” were abnormally large
NOI Adjustments

A comparative adjustment for NOI differential in the Sales Comparison Approach should not be part of an appraisal for Freddie Mac.

Adjustments to the sales should reflect specific characteristics that affect a property’s income such as level of operating expenses, quality of management, tenant mix, rent concessions, lease terms, location, physical condition, amenities, and the like, *not just that the resulting NOI is greater or lesser than the subject.*

- Besides being double accounting for these items, an appraiser should discuss the *causes* of the differences in NOI, *not just that a difference exists.*
Economies of Scale adjustments in the Sales Adjustment Grids that don’t make sense

- 10%, 20%, etc.

- Economies of scale is typically a by-product of normal price negotiation and is a relatively minor feature contributing to the value of a property. It is not necessarily a conscious item of price negotiation or evaluation by a purchaser.

- By applying a XX% adjustment, the appraiser is essentially saying that economies of scale affected the sale prices of the comparable similarly as location, condition, or amenity package.

- Example: A 10% adjustment on a $50,000,000 property implies that the buyer paid a $5,000,000 differential just for economies of scale!
**Question:** “Can appraisers use listings or sales in escrow in the Sales Comparison Approach?”

**Answer:** *Of course!* (with an explanation …)

- The Freddie Mac Seller/Servicer Guide states (Section 12.14(b) that the appraiser must use at least three recently sold comparable properties. It also says:

- “*If there is an absence of recent comparable improved sales, the appraiser must consider that absence in estimating the market value. 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*” should be in the back of the appraiser's mind as he/she analyzes the local market.
Income Approach:

- Discounted Cash Flow Analyses (DCF)
  - **Problem**: A DCF on a stabilized property
  - **Problem**: A 10-year DCF when the property will be stabilized in 6, 12, 18, 24, 36, 48, etc., months
  - **Problem**: Annual discounting on short-term DCFs
    - Maybe short-term (less than a few years) should be in quarters, not years
  - **Problem**: Unsupported assumptions
Common Issues – Property Tax:

- The appraisers did not adequately discuss/analyze the risk of a tax reassessment at the appraiser’s estimate of market value
- The appraiser did not discuss the date or scope of the next reassessment
- The appraiser did not discuss why his/her property tax estimate was outside the range of the observed comparables
Property taxes (continued)

- Is the tax assessment value similar to the appraiser’s value estimate?
  - If not, why not?
  - California issues

- Are the tax comparables appropriate?
  - Why not use the rental comparables as tax comparable, too?

- 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*
Suggested methodologies for incorporating risk of reassessment:

1. 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
2. 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.
Common Issues – Other:

- Multiple appraisers signed the appraisal but only one appraiser inspected the subject property.
  - Freddie Mac requires that everyone signing the report must have inspected the property.

- Everyone who signs the appraisal must be licensed/certified in the state in which the property is located!
Common Issues – Other, continued:

- It is not clear if the Freddie Mac appraisal requirements (Chapter 12 of the Seller/Servicer Guide) are being conveyed to the appraiser
Property Inspections:

» Which units did the appraiser inspect?
» What was their condition, configuration, and utility?

Focus of the inspection on particular issues:

- Down units
- Vacant units
- A sample of each unit type
- Top floors and bottom floors
What’s wrong with this statement?

**IMPROVEMENTS DESCRIPTION**
We have not been provided with a detailed description of the proposed improvements. The following is a description of the improvements based on our assumptions and familiarity with other affordable housing developments throughout New York City.

The Comment to USPAP Standards Rule 1-2(e)(v) (which Advisory Opinion 17 expounds upon) states:

“When appraising proposed improvements, an appraiser must examine and have available for future examination plans, specifications or other documents sufficient to identify the character of proposed improvements.”
Speaking of Property Inspections…

This is my favorite description of on-site conditions, taken from the appraisal of a seniors housing property:

“In addition to significant turnover in the senior management team, we observed during our inspection that the Director of Marketing kept confusing assisted living with independent living and was not sure what the asking rates were or how the additional fees for care were assessed or charged. There were no brochures or any kind of promotional materials available for any prospective residents or family members. The Assisted Living Manager was too busy texting to look up or introduce herself while we stood in her office. The Executive Director had been there only a few days and represents at least the third ED in as many years. In fact, the only person who seemed to have a handle on the subject and its operations was the Maintenance Director.”
## Example of construction description error

<table>
<thead>
<tr>
<th>Structural System:</th>
<th>Brick bearing walls and wood joists</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exterior Walls:</td>
<td>Brick façade</td>
</tr>
</tbody>
</table>
Building Description – Real life example:

Roof Type: Flat with parapet walls
Roof Cover: Built-up assemblies with tar and gravel cover
Parking -- Real life example #2:

The appraiser states, “We requested, but were not provided an exact number of parking spaces.”

Solution: *The appraiser should count them…!*

» Walk the site, or
» Plat or survey, or
» Aerial photograph (Google or Bing)
Contract Price vs. Appraised Value:

- The appraiser did not discuss a material difference between the final appraised value and a recent sale or contract.
- Appraiser’s conclusions are at the aggressive end (at either the high or low ends) of the range for rents, expenses, capitalization rate, and Sales Comparison conclusions, yielding an overly aggressive value.

The appraiser's duty is not to hit or meet a contract price or a recent sales price but to offer an opinion of value independent of that price.

If the subject property's value does not support the sales price, the appraiser should make the client aware of this …

That is his/her fiduciary responsibility.
Leased Fee vs. Fee Simple:
A fundamental problem in multifamily appraisals

Many times, an appraiser will state that the appraisal is the valuation is of the “fee simple” interest.

» The Appraisal of Real Estate (13th edition, page 114) states that leased fee ownership is the ownership interest held by the lessor regardless of the duration of the lease or of the specified rent.

» Specifically, “…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.”
Leased Fee vs. Fee Simple (continued)

» 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.

*We have found that if the appraiser gets this wrong, there will be probably material review issues in the rest of the appraisal report.*
Real World Examples
Student Housing Example

The subject is a 27-story former office building located at the southwest corner of Van Buren Street and Wabash Street. The subject was originally developed in 1927/1929 and has been vacant the last few years.

The property operated from inception until 2002 as a commercial office building, housing such tenants as Mobil Oil.

In 1999 The Buckingham was listed on the National Register of Historic Places, and in 2002, the city of Chicago designated the building as part of the Historic Michigan Boulevard District, a Chicago Landmark District.

The building was vacant for the three years preceding 2007.
Multifamily Appraisal Reviews
Examples

Subject Property

Sale #1 (The best sale?)
The project amenities include a 1,500 square foot fitness, rooftop club room, internet café, study rooms, practice rooms 9 (musicians), meeting rooms, bicycle storage, residency life center with advisors and a state-of-the-art security card reader system. The entire building contains high speed telecommunications including WIFI “ready” in all units and common meeting rooms.

The interior of the units contain 9.5 foot ceilings, washer/hook-ups, walk-in closets and track lighting. All units with the exception of the studios are corner units featuring views of the Lake Michigan, Grant Park and Millennium Park.

This property, one-block from USC, has resort-style amenities, such as a swimming pool and two spas, a large indoor/outdoor fitness center (including treadmills and ellipticals with individual plasma TVs), a health spa that includes 2 steam rooms, 2 saunas, several showers, a massage therapy room and a rooftop sundeck with views from the Coliseum to the downtown skyline. All residential floors include group study rooms, study lounges with individual work spaces, and laundry facilities with smart card technology. Each apartment has high speed internet, Dish Network TV service (HDTV-ready), and one gated, reserved subterranean parking space per bedroom, with additional parking available at $150 per space.
Cost Approach Example

- If the appraiser did not develop the Cost Approach, there must be a reasonable rationale for its exclusion.

- Throw-away statements are not acceptable or appropriate:
  - “The Cost Approach has not been developed due to difficulty estimating depreciation due to current market conditions”
  - “Buyers do not use the Cost Approach in their analysis of properties”
  - “I did not feel like it”
Is the subject property’s construction recent enough that the Cost Approach could tell the reader something about external obsolescence or current market conditions?

- **External obsolescence:**
  - Correlation of actual construction costs with value
  - Correlation of replacement costs with feasible rents

- **Functional obsolescence:**
  - Comparison of actual construction costs with replacement cost (i.e., *Marshall Valuation* estimates) could indicate over improvement
Real life appraisal report example for a property built between 2002 and 2006 in a major metropolitan area:

- "In deriving a cost figure for the subject, Marshall Valuation Service (MVS) was used. Data pertaining to the subject’s original construction costs were not made available to the appraiser. The Insurable Value Base Building Cost figure derived from MVS of $182,700,000 (rounded) is above the market value derived by the Income and Sales Comparison Approaches. As this figure does not include indirect costs or land value, there is obviously some form of obsolescence occurring, most likely external obsolescence as there is no evidence that the property suffers from functional obsolescence. There are already new projects under construction in the immediate area, and it is the appraiser’s belief that the inclusion of the Cost Approach would not help to define any significant market occurrence or trend at this point in time. As a result, the addition of the Cost Approach is not seen as a reliable valuation method for the subject property and has not been included."
Appraisal Example:

“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 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 I would expect the appraiser to mirror the local practice.

Note #1: I would also expect the appraiser to discuss this in the appraisal

Note #2: Value is value, regardless of how it is measured. If the value per foot is materially different than the value per unit, it is appropriate to ask the appraiser to reconcile/address the issue

SubNote: I would be concerned if it appears that the appraiser used “price per square foot” to manipulate the value conclusion
Appraisal Example:

Sales Comparable issue: “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.”

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

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

However, if not, then this is a violation of Section 12.14(b) of the Freddie Mac Seller/Servicer Guide:

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.
Appraisal Example (continued):

Sales Comparable issue: “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.”

The $1,730,000 renovation costs can be used as an indicator for a “Condition Adjustment” in the sales comparison grid.

*Just a thought:* What would the appraiser do to this comparable if the buyer did not complete the planned capital improvements?

Would he/she still have adjusted this comparable $1,730,000 upfront?
Appraisal Example:

“We asked the lender to question the appraiser on the local market and the ability of the subject to maintain 100% occupancy with the highest rents in town. What we got in response was a revision of the appraisal showing the Concluded Value as $4,210,000 compared to the original Concluded Value of $4,480,000, with no explanation as to why they choose to do that. They also never responded to our question regarding the subject being able to maintain 100% occupancy while having the highest rents in town.”

This is an example of poor customer service; partly the appraiser’s fault and partly the fault of the lender

- Freddie Mac should not be in the “appraisal review business”
  - We should be appraisal users, not reviewers
- The appraiser is not our vendor so communication is an issue
Appraisal Example:

“The sale comp #1 is actually the subject property. I do not understand how an appraiser can use the property being appraised as a comparable for itself?”

This is ok, with some caveats:

» From Section 12.14(b) of the S/S Guide:

“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.”
Appraisal Example:

- “We could not get comfortable with the price per unit valuation approach completed given the lack of comparables in the same area or even with the same market vicinity. These are Chicago price per unit prices, not Battle Creek, Michigan.”
Appraiser’s explanation:

Analysis of Comparable Sales

The state of Michigan market was researched for recent sales involving rental communities similar to the subject, but, due to the lack of data, our search was expanded to include recent sales of communities throughout the region including Ohio, Indiana and Wisconsin. The sales used in this analysis are mapped and summarized below, while detailed descriptions are included in the Exhibits section of this report for your review.

Is this plausible?
To answer the underwriter’s question, we did a little more research from our internal database:

Ok, so what about Ann Arbor sales?

<table>
<thead>
<tr>
<th>Freddie Mac Loan Number</th>
<th>Property Name</th>
<th>Property Type</th>
<th>Sale Price</th>
<th>Square Feet</th>
<th>Units</th>
<th>Sales Price/Sq. Ft.</th>
</tr>
</thead>
<tbody>
<tr>
<td>708114652</td>
<td>Sharrock Homes</td>
<td>Conventional Apartments Garden</td>
<td>$1,950,000</td>
<td>38,200</td>
<td>60</td>
<td>$51</td>
</tr>
<tr>
<td>10/01/2014</td>
<td>723-801 Campbell Ave</td>
<td></td>
<td>03/01/2014</td>
<td></td>
<td></td>
<td>$32,500</td>
</tr>
<tr>
<td></td>
<td>Ypsilanti</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>708245579</td>
<td>Covington Apartments</td>
<td>Conventional Apartments Garden</td>
<td>$1,800,000</td>
<td>71,891</td>
<td>86</td>
<td>$25</td>
</tr>
<tr>
<td>08/18/2015</td>
<td>1926 Washtenaw Avenue</td>
<td></td>
<td>01/15/2014</td>
<td></td>
<td></td>
<td>$20,930</td>
</tr>
<tr>
<td></td>
<td>Ypsilanti</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Multifamily Appraisal Reviews
Examples

…and perhaps Grand Rapids’ sales?

<table>
<thead>
<tr>
<th>Freddie Mac Loan Number</th>
<th>Property Name</th>
<th>Property Address</th>
<th>Property Type</th>
<th>Sale Price</th>
<th>Sale Date</th>
<th>Square Feet</th>
<th>Units</th>
<th>Sales Price/Sq. Ft</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>708258854 11/11/2015</td>
<td>Meadow Ridge Apartments 1605 Meijer Dr. Greenville</td>
<td>Conventional Apartments Garden</td>
<td>$3,398,000</td>
<td>07/31/2015</td>
<td>53,840</td>
<td>52</td>
<td>$63</td>
<td>$85,346</td>
<td>![ ]</td>
</tr>
<tr>
<td>708259854 11/11/2015</td>
<td>Edgewater Apartments 625 S. Greenville Rd. Greenville</td>
<td>Conventional Apartments Garden</td>
<td>$3,950,000</td>
<td>07/13/2015</td>
<td>41,400</td>
<td>40</td>
<td>$96</td>
<td>$99,000</td>
<td>![ ]</td>
</tr>
<tr>
<td>708258854 11/11/2015</td>
<td>Rockford Ridge Apartments 148 W. Division St. NE. Rockford</td>
<td>Conventional Apartments Garden</td>
<td>$1,632,000</td>
<td>05/15/2015</td>
<td>34,048</td>
<td>28</td>
<td>$48</td>
<td>$56,206</td>
<td>![ ]</td>
</tr>
<tr>
<td>708254403 12/01/2015</td>
<td>Danbury Place Apartments 2600 SE. Marshall Ave. Grand Rapids</td>
<td>Conventional Apartments Garden</td>
<td>$2,523,000</td>
<td>04/10/2015</td>
<td>75,600</td>
<td>66</td>
<td>$33</td>
<td>$38,227</td>
<td>![ ]</td>
</tr>
<tr>
<td>708250882 09/01/2015</td>
<td>Danbury Place Apartments 2600 SE. Marshall Ave. Grand Rapids</td>
<td>Conventional Apartments Garden</td>
<td>$2,523,000</td>
<td>04/10/2015</td>
<td>75,600</td>
<td>66</td>
<td>$33</td>
<td>$38,227</td>
<td>![ ]</td>
</tr>
<tr>
<td>708250882 09/01/2015</td>
<td>Oak Park Apartments 4130 Oak Park Dr. SE. Grand Rapids</td>
<td>Conventional Apartments Garden</td>
<td>$1,277,000</td>
<td>04/10/2015</td>
<td>29,244</td>
<td>42</td>
<td>$44</td>
<td>$30,405</td>
<td>![ ]</td>
</tr>
<tr>
<td>708250837 09/09/2015</td>
<td>Danbury Place Apartments 2600 SE. Marshall Ave. Grand Rapids</td>
<td>Conventional Apartments Garden</td>
<td>$2,523,000</td>
<td>04/10/2015</td>
<td>75,600</td>
<td>66</td>
<td>$33</td>
<td>$38,227</td>
<td>![ ]</td>
</tr>
<tr>
<td>708250707 01/14/2016</td>
<td>Danbury Place Apartments 2370 Marshall Avenue Southeast Grand Rapids</td>
<td>Conventional Apartments Garden</td>
<td>$2,523,000</td>
<td>04/04/2016</td>
<td>62,698</td>
<td>66</td>
<td>$40</td>
<td>$38,227</td>
<td>![ ]</td>
</tr>
<tr>
<td>932393098 12/17/2016</td>
<td>Hopson Flats 212-216 Grandville Ave SW Grand Rapids</td>
<td>Conventional Apartments Garden</td>
<td>$9,394,840</td>
<td>03/16/2015</td>
<td>42,600</td>
<td>42</td>
<td>$221</td>
<td>$223,887</td>
<td>![ ]</td>
</tr>
<tr>
<td>708250082 09/01/2015</td>
<td>Royal Oak Apartments 4738 Eastern Ave. SE. Kentwood</td>
<td>Conventional Apartments Garden</td>
<td>$1,439,500</td>
<td>09/17/2014</td>
<td>29,100</td>
<td>36</td>
<td>$49</td>
<td>$38,986</td>
<td>![ ]</td>
</tr>
</tbody>
</table>
Oh, wait…wait…. Battle Creek is near Kalamazoo…

| Current Search Criteria: Region: North America; Country: USA; MSA: Kalamazoo; State: Michigan; Property Type: Conventional Apartments; Sale Between: 01/01/2014 and 9/01/2015; Units: Between: 20 and 100 |
|---------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
| Freddie Mac Loan Number   | Property Name                   | Property Type                   | Sale Price                      | Sales Price/Sq. Ft.             |
| Date of Appraisal Report  | Property Address City           | Property Sub Type               | Sale Date                       | Sales Price/Unit                |
| 708235417                 | Woodstone Apartments 3707 Greenleaf Blvd, Kalamazoo | Conventional Apartments Garden | $ 4,400,000 01/14/2015          | $ 39 $ 44,444                   |
| 05/04/2015                |                                 |                                 | 112,500 99                      |                                 |
| 708646719                 | Woodstone Apartments 3707 Greenleaf Boulevard Kalamazoo | Conventional Apartments Midrise | $ 4,400,000 01/14/2015          | $ 43 $ 44,444                   |
| 11/19/2015                |                                 |                                 | 102,839 99                      |                                 |
| 708256481                 | Austin View Apartments 1525 Bacon Ave, Portage | Conventional Apartments Midrise | $ 1,210,000 02/25/2014          | $ 26 $ 25,208                   |
| 01/04/2016                |                                 |                                 | 46,992 48                       |                                 |
| 708647707                 | Woodstone Apartments 3707 Greenleaf Boulevard Kalamazoo | Conventional Apartments Midrise | $ 4,400,000 01/14/2015          | $ 43 $ 44,444                   |
| 01/14/2016                |                                 |                                 | 102,839 99                      |                                 |

So, in less than 10 minutes (which included having to change my password), I found 15 +/- sales closer to the subject than the appraiser.
Multifamily Appraisal Reviews
Examples

Appraisal Example:

VIEW OF THE SUBJECT EXTERIOR
## Dates of Sale:

### Dates of sale

<table>
<thead>
<tr>
<th>Comparable #</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of Sale</td>
<td>Nov 2013</td>
<td>May 2013</td>
<td>Sep 2012</td>
<td>Feb 2012</td>
<td>Feb 2011</td>
</tr>
<tr>
<td>Date of Value</td>
<td>Sep 2, 2015</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2709-2713 12th Street NE
Washington, District of Columbia
### Multifamily Appraisal Reviews

#### Examples

A map of the sales:

<table>
<thead>
<tr>
<th>Sale #</th>
<th>Location</th>
<th>Average Household Income</th>
<th>Median Household Income</th>
<th>Percent Change since 2000</th>
<th>Percent Change since 2010</th>
<th>Median Home Sale Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Columbia Heights</td>
<td>$96,538</td>
<td>$67,226</td>
<td>79%</td>
<td>0%</td>
<td>$442,875</td>
</tr>
<tr>
<td>2</td>
<td>Adams Morgan</td>
<td>$116,529</td>
<td>$81,916</td>
<td>54%</td>
<td>-1%</td>
<td>$567,375</td>
</tr>
<tr>
<td>3</td>
<td>Dupont Circle</td>
<td>$100,841</td>
<td>$77,837</td>
<td>65%</td>
<td>0%</td>
<td>$377,875</td>
</tr>
<tr>
<td>4</td>
<td>Cleveland Park</td>
<td>$149,194</td>
<td>$104,013</td>
<td>39%</td>
<td>1%</td>
<td>$740,000</td>
</tr>
<tr>
<td>5</td>
<td>Georgetown</td>
<td>$149,339</td>
<td>$100,479</td>
<td>40%</td>
<td>1%</td>
<td>$799,500</td>
</tr>
<tr>
<td>Subject</td>
<td>Brookland</td>
<td>$66,069</td>
<td>$54,124</td>
<td>34%</td>
<td>-2%</td>
<td>$357,625</td>
</tr>
</tbody>
</table>

Issue (continued): Sale #1

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Site Development Status</td>
<td>N/A</td>
</tr>
<tr>
<td>Shape</td>
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<tr>
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**Improvements**

<p>| | |</p>
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<td>National</td>
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This represents the transaction of a three story commercial building in the Columbia Heights neighborhood of Washington, D.C. At the time of sale, the building had a first floor tenant (Lourdes Bakery) and apartment tenants on the second and third floors. According to the buyer, he plans on renovating the second floor into additional commercial space for office use.
Issue: Appraiser’s Comments for Sales #2 through #5

Sale #2:
This represents the transaction of a three story commercial building in Adams Morgan. The top three stories are rented for office use while the lower level is used as retail. The building was purchased by an end-user.

Sale #3:
This represents the transaction of a three story commercial building in the Adams Morgan submarket of Washington, D.C. The building was improved as an art gallery at the time of sale and the buyer was an end user.

Sale #4:
This represents the transaction of a three story commercial building in the Cleveland Park neighborhood of Washington, D.C. The first floor contains two retail tenants while the second and third floors contain apartment units.

Sale #5:
This represents the transaction of a two story commercial building in the Georgetown neighborhood of Washington, D.C. The building contains a first floor retail tenant with second floor multi-family.
Issue (continued):

Reconciliation:

“The Sale Comparables selected represent the best data available for comparison with the subject. The Comparables represent older transactions and have been adjusted for market conditions (time). The adjusted sale price PSF range from $170 to $306 with an average of $238 PSF.

Given the lack of available information, it is difficult to determine the quality/condition of the comparables.

Given the subject’s age/quality/condition, however, we estimate that the subject would be above average relative to the comparables, in the range of $250 to $260 PSF (NRA).

The Sale Comparables indicate a capitalization rate of 6.25% to 6.35%.”
Last Issue:

“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 OAR 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.

1. We do not appear to have a valid appraisal
   - (Disclaimer – I did not have the loan number or property name, so I did not specifically review this entire appraisal to confirm these issues for this presentation)

2. The “comparable 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!>

3. How does the appraiser make the leap of faith from $69,804 per unit to $113,889 per unit?
Problems with Exhibits
My issues:

» What is the date of the survey?

» Why is the capitalization rate higher for new properties?
  – That is contrary to the appraiser’s position that capitalization rates increase as the property ages.

» The actual capitalization rate chosen for this property was 6.75%. Where is it on this chart?
What is this chart trying to tell us?

- **Time/Market Conditions:** The time adjustment reflects changes in market conditions (e.g., supply, demand, macroeconomic conditions) between those existing at the time of sale and those as of the effective date of appraisal. Statistical data gathered and contained in our proprietary database has been tracked over the past twelve years is presented below:

- **Trends in Prices (median):**
Some appraisers provide a graph of the relationship between sales price and NOI that implies how strong their analysis is:

- This is just a graph of the calculated capitalization rates.
- A discussion that implies anything else is probably misleading.
### Summary of Improved Sales

| Property Name | Address | Land Area (ac) | Building Area | Property Type | Year Built | Year Revalued | No. of Units | Average Unit Size | Condition | Year of Sale | Sale Price | Bone Price | Gross Rent | Value Assessed | Sales Terms | Comments |
|---------------|---------|----------------|---------------|---------------|------------|--------------|--------------|-----------------|-----------|-------------|-----------|------------|------------|-------------|-------------|-----------|----------|
| 1             | Beachwood Gardens | 1.688           | 83,069        | 16,877        | 1997       | 2008         | 621          | 0.86            | Average     | 2004        | $10,500   | $6,500      | $4,000      | $2,500      | Fee Simple |          |
| 2             | Newport Village | 141,038         | 120,614       | 16,877        | 1985       |              | 182          | 855             | Average     | 2004        | $12,000   | $6,000      | $6,000      | $2,000      | Fee Simple |          |
| 3             | Mainstream Apartments | 111,000       | 120,614       | 16,877        | 1985       |              | 272          | 855             | Average     | 2004        | $12,000   | $6,000      | $6,000      | $2,000      | Fee Simple |          |
| 4             | Waterbrook Apartments | 111,000       | 120,614       | 16,877        | 1985       |              | 272          | 855             | Average     | 2004        | $12,000   | $6,000      | $6,000      | $2,000      | Fee Simple |          |

**Statistics**

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**Problems with Exhibits**

This is an example of a multifamily appraisal review. The exhibit includes detailed information such as property descriptions, unit sizes, condition, and sales terms, which are essential for evaluating the property's value and marketability.
Favorite phrases *<he says sarcastically>*:

- “The sales indicate that, in general, investors are willing to pay more for properties with greater income potential.”

- “Economics are the primary factors driving the sales prices of seniors housing properties, not physical differences.”

- “Based on my years of experience and knowledge of the area, I conclude that…. ”

- “But if I make that change to the rents, I’ll have to report a lower value.”
Wrap-up!
Sometimes appraisals are easy...
Sometimes appraisals are hard...

Plant growth

Mold and water damage

Slobs

Hurricane

Fire Damage
Questions?