

## CHAPTER 2. VALUATION PROCESSING

- 2-1. PURPOSE - This chapter describes the valuation processing required to underwrite a Section 203(n) loan for a Corporate Certificate involving a single living unit in a cooperative multifamily project covered by a project mortgage insured under Section 213, 221(d)(3) or any other nonsubsidized section of the National Housing Act.
- 2-2. INTRODUCTION - Section 203(n) of the National Housing Act authorizes HUD to insure a loan secured by the cooperative membership certificate and by the occupancy agreement when the loan is made to assist in the purchase of a membership in order to occupy one dwelling unit in a cooperative project. The Section 203(n) loan is in addition to the portion of the project mortgage which must be attributed to the unit being appraised. The sum of these two debts upon the subject unit may not exceed the amount permitted by the value of the unit at loan ratios (and other rules) applicable to Section 203(b) home mortgages. In practice, the market value of the living unit is estimated; Section 203(n) closing costs are estimated, the maximum debt is computed upon the total of the two as if this were a Section 203(b) home mortgage; the portion of the project mortgage attributed to the subject unit is subtracted; and the remainder is the maximum Section 203(n) loan for conditional commitment.
- 2-3. APPLICATION - The mortgagee applies for a conditional commitment on a single unit by submitting Form FHA 2800 Application for Mortgage Insurance, Section 203(n) Loan for Living Unit in a Cooperative. It is the responsibility of the lender to develop and include in the application information which locates and describes the cooperative project including the subject living unit, giving information about the structure, mortgage or loan balances, area and

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composition of unit types, charges for residential units, parking, and commercial areas as well as equipment furnished and replaced and services paid for by the monthly charges. This information must be shown on the available space on the 2800-1. The appraiser, reviewers and Director, Housing Development utilize the information from the 2800-1 for the development of background information

necessary to complete the appraisal. In the event the appraiser discovers an error in the information on the application, the error will be corrected in colored pen or pencil and initialed and dated. Living area is defined as the area of a dwelling unit measured from the inside surfaces of corridor and exterior walls, and from the inside of walls separating subject living area from adjoining living or commercial areas.

- 2-4. ROUTING - The Director, Housing Division must determine that the documents of the cooperative have been amended as required by Sections 203.43c(c) and (d) of Part 203 of the Regulations using the Area Counsel (see paragraph 1-13, Chapter I). Processing will continue while this determination is being made. The Director of Housing also obtains the insured project files from the Deputy Director for Housing Management/Housing Management Officer which contain the total estimated replacement cost of project for subject project at the time of last firm commitment processing, as well as the files which contain the last three annual inspection reports if available for subject project and also financial statements and operating budgets for the current year and attaches these files to the subject Section 203(n) processing file.
- a. The application is then routed to the Valuation staff and assigned to the processing appraiser. The appraiser reviews all documents and forwards the financial statements to the Mortgage Credit staff for review and comment.
  - b. The appraiser will review the annual inspection reports and determine whether it is necessary to have an immediate architectural review of

the project, or to wait until the appraiser visits the project and unit to determine whether an architectural inspection is necessary. A joint Valuation and Architectural review can be made when necessary.

- c. The appraiser will notify the cost analyst of the application and request that the analyst provide a cost adjustment factor which will be used to update the total estimated cost of the subject project from the date of the last firm commitment to date of the application for the Section 203(n) mortgage insurance.

- 2-5. REPLACEMENT COST ESTIMATE - The Appraiser multiplies the original total estimated replacement cost of project by the cost adjustment factor to get the current total estimated replacement cost of project. He/she then multiplies the current total estimated replacement cost of project by the unit ratio shown in the application. The ratio represents the monthly charges for the subject unit divided by the sum of monthly charges for all units. It is usually shown as a decimal fraction and also indicates what proportion of the whole project is represented by that member's interest. (Once fixed, in the information bulletin when the cooperative is formed, the unit ratio does not change.) The product of the current total estimated replacement cost of project multiplied by the unit ratio is the current estimated replacement cost of the living unit.
- 2-6. ESTIMATED MARKET PRICE OF UNIT - Using Form FHA-2019, Estimates of Market Price by Comparison, record in the Subject Property column as many facts about the subject property as may be capable of influencing changes in the market price of subject property in comparison with competing properties recently sold in the market.

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- (2-6) a. Comparison. Features which may be compared will include square feet of living area, number of baths, balconies, terraces or patios, parking or garage, heating and cooling equipment, kitchen and laundry equipment, livability of design, age of building, floor on which unit is located, other locational advantage or disadvantage within the building, neighborhood desirability (locational factors exterior to the cooperative), street improvements, utilities, or any other features which would affect market price. The ownership of a unit in a cooperative may include ownership of a proportionate share of recreational facilities, or of rental parking, or of income producing commercial space which exceeds the facilities usually available for, and included in, the value of single family dwellings.
- (1) Comparison with sales of competing cooperative living units must give careful consideration to differences in all such variables.
  - (2) Adjustment for differences in such special

facilities consists of estimating the unit market value of the facilities in the subject unit and in the comparable unit and then subtracting the unit value of the comparable unit facilities from the value of those in the subject unit.

(3) The result is the plus or minus adjustment for the special facilities.

- b. Adjustment for Non-cooperative Sales. Competing unit sales will be selected from those which offer advantages and disadvantages generally similar to those of the subject, and from those which compete generally for the same market as does the subject. The competing unit sales should be other cooperative units sales, if these are available. If these are not available, similar condominium, planned unit development (PUD) sales or other single family comparable sales may be used, with appropriate adjustment where the market indicates an adjustment is warranted.

(1) The adjustment is indicated by the relationship between sales prices of cooperative and similar condominium units. The appraiser must gather data on this relationship from the closest area where both types of sales exist. By comparing sales prices of similar units in both types of projects, an adjustment factor from condominiums to cooperatives or from PUD's to cooperatives, can be estimated.

(2) All condominium or PUD comparables must be so identified on Form FHA 2019, and appropriate adjustments made.

- c. Adjustments. Data items concerning each competing property are noted, in turn, and plus and minus dollar adjustments are entered for each significant difference between the subject property and the competing property. The sales price of the competing property is then modified by adding or subtracting the net plus or minus adjustment to provide an indicated market price for the subject living unit.

- d. Correlation. The indicated market prices from several comparables, which include at

least one conventional sale, are correlated to one estimated market price of unit.

- 2-7. CAPITALIZED INCOME OF UNIT - The monthly rental value of the unit multiplied by the monthly rent multiplier equals the capitalized income of the unit.
- a. Monthly Rental Value of Unit. For the subject unit, estimate the market rent a cooperative unit owner could expect to receive from a tenant on the basis that the rent would include the owner furnishing to the tenant those services (including utilities) which are furnished to individual owners by the cooperative corporation at common expense and also furnishing to the tenant those items

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of personal benefit expense which represent maintenance and repair but not those which represent the cost of utilities separately metered to the individual living unit.

- (1) While a 203(n) loan can only be obtained by an owner-occupant, for the purposes of this approach to value, it is to be assumed that the property is rented and the tenant would pay the rent; and, to the utility company, the cost of separately metered utilities. The owner would pay the cooperative charges, the Section 203(n) loan payments, any individual insurance required in addition to that maintained at common expense, and any items of personal benefit expense which represent maintenance and repair. (Note: Rent will never be estimated on the basis that the tenant will directly pay the cooperative charges, and/or the Section 203(n) loan payments, since this would be a risky arrangement in which non-payment by the tenant might cause an owner to lose his/her living unit.)
- (2) Rental values from similar units on different floors from the lowest to the top should reflect the relationship of rents paid in the market for similar units similarly located from bottom to top; this relationship should be used to adjust indicated rents for differences in floor between comparables and subject.

- b. Monthly Rent Multiplier. Any recently rented property which is sold supplies information concerning its own rent multiplier: sales price/monthly rent = monthly rent multiplier. Data from cooperative units where both sales and rentals are known are analyzed to obtain rent multipliers for comparison, but rented condominium apartment sales or rented PUD or other single family comparable sales may also be used with appropriate adjustment, in estimating the typical relationship between rents and sales prices for subject units.

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- 2-8. CORRELATION OF THREE APPROACHES TO VALUE - The appraiser considers the three previously found estimates: current estimated replacement cost of unit, estimated market price of unit, and capitalized income of unit, in estimating the value of unit. The estimate of capitalized income may be used as a guide by the appraiser, but is not required to be a limit to the estimate of value. However, the value of unit may never exceed the lesser of estimated market price of unit or estimated replacement cost of unit.
- 2-9. VALUE OF OCCUPANCY CERTIFICATE - The project mortgage balance is multiplied by the unit value ratio; the product is the project mortgage attributable to the unit. This unit mortgage balance is subtracted from the estimated value of the unit. (The unit value of the leased fee (if any) is also subtracted from the estimated value of the unit.) The remainder is the estimated value of subject membership certificate and occupancy certificate.
- 2-10. CONDITIONAL COMMITMENT MORTGAGE AMOUNT - From the estimated value of the unit, subtract the unit value of the leased fee (if any), and add the Section 203(n) closing costs. On the resulting amount, compute the maximum mortgage that could be committed if this were a 203(b) home mortgage commitment. From this maximum 203(b) mortgage amount, subtract the unit portion of the project mortgage balance. The result is the maximum amount of Section 203(n) loan for an owner-occupant purchaser. The loan amount shall be rounded down to a \$50 multiple. (Section 203(n) loans may not be insured for refinancing for the same owner when a sale or resale of the membership is not involved, nor may they be used to purchase a unit for investment when occupancy is not planned.)

- 2-11. TERM OF SECTION 203(n) LOAN - The loan shall be amortized monthly, and Regulations require that the term shall be 5, 10, 15, 20, 25 or 30 years, and that the term shall not exceed the least of (1) 30 years; (2) the remaining term of the blanket mortgage covering the cooperative development; or, (3) three-quarters of the remaining economic life of the building improvements.

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- 2-12. MONTHLY EXPENSE ESTIMATE - The expenses to be estimated by the appraiser fall into three categories:
- a. Individual Insurance Expense Per Month (If Any). If cooperative charges include adequate insurance coverage, there may be no additional individual insurance expense. On the other hand, the 203(n) mortgagee may require an additional insurance policy to meet its requirements. Check with the mortgagee and enter the monthly amount of any additional insurance which is to be required.
  - b. Cooperative Charges Per Month. The charges made by the cooperative corporation comprise all expenses of operation and maintenance paid by the corporation, including taxes and insurance, and reserves, plus debt service on the project mortgage. Estimates should be verified with the cooperative.
  - c. Personal Benefit Expenses. These are other expenses, such as utility bills, which are paid directly by an owner, rather than being included in the charges made by the cooperative corporation. If the corporation does not provide interior painting within the living unit, this would become an item of personal benefit expense. If gas or electric bills are paid by the member directly to the utility company, these bills become part of the personal benefit expense estimate. In many instances the results are monthly averages of annual estimates.
- 2-13. UNIT VALUE OF LEASED FEE. The leasehold will be that of the project site, if a ground lease exists. The current value of the leased fee shall be estimated by multiplying the updated market price of the site by the unit ratio to arrive at the

unit value of the leased fee. Thus, the value of the leased fee of the project site shall be valued in accordance with instructions in reference (4) of the Foreword.

- 2-14. CONDITIONAL COMMITMENT - Repairs, alterations or additions to the dwelling unit are required to be listed as specific conditions for correction if the conditions work against the continued soundness of the mortgage transaction. This should be accomplished based on the same criteria as is applied under the 203(b) program. In addition, if major repairs to the project are necessary before the dwelling unit would be eligible, such repairs should be listed as having to be corrected before the cooperative project can have insured mortgage financing under Section 203(n) made available.