

CHAPTER 9. BID FIGURES ON FORECLOSURES, AND DISPOSITION
OF ACQUIRED MULTIFAMILY PROPERTIES

- 9-1. GENERAL. The instructions which follow shall be complied with in all cases. The instructions are so worded that they are applicable both for bid purposes on foreclosure and in making recommendations for the disposition of properties already owned by HUD-FHA. The disposition appraisal will not require as extensive an analysis as the original appraisal for bid purposes if the original appraisal is prepared in a thorough manner in accordance with these instructions and the time interval and economic conditions have not materially changed. The administratively directed special upset value deduction for bidding purposes described below will, of course, not be applicable when the appraisal is for the purpose of disposition of acquired property.
- 9-2. OVERHEAD AND ADMINISTRATIVE COSTS. In all cases, pursuant to an administrative decision to reflect in a special upset value for bidding purposes at foreclosure the approximate cost to the Assistant Secretary-Commissioner of carrying the property during the extra period required for Assistant Secretary-Commissioner handling and resale, the "as is" appraisal will include a further calculation to disclose the special-purpose value of the property to the Assistant Secretary-Commissioner. This will be a deduction from the "as is" value in the dollar amount calculated at 5% of the first \$100,000 of "as is" value, plus 1 1/2% of the "as is" value above \$100,000, but in no event shall such deduction be more than \$25,000. Thus:

Market Value "As Is"		\$1,000,000
Less estimated overhead and administrative costs		18,500
Special Upset Value (for bidding purposes only)		\$ 981,500
5% of \$100,000	=	\$ 5,000
1 1/2% of \$900,000	=	13,500
Total Deduction	=	\$18,500

This calculation shall be made in all cases, and recorded in Section "O," FHA Form 2264 under "Remarks."

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- 9-3. APPRAISER'S RECOMMENDATIONS. The appraiser will assist in recommendations concerning the highest and best use of the property, the proper repair program, the estimate of value and the best method of disposal. There is no limit to the nature and scope of recommendations provided the best interests of the Assistant Secretary-Commissioner are served. These recommendations concerning highest and best use will determine the most logical program to pursue and result in the greatest recovery by the Assistant Secretary-Commissioner in a most reasonable length of time.

- 9-4. SELECTION OF CAPITALIZATION RATES. The freedom of action permitted in these cases precludes the use of any pre-determined capitalization rates, estimates of economic life, occupancy percentages or any other limitations upon the appraisal process. Directives which are issued by any sources which differ from these handbook instructions and are intended to affect underwriting conclusions shall be in writing, signed by the person issuing the instructions and shall be made a part of the file. Under such circumstances, the processing in the Valuation Section shall reflect available data as if no such instructions existed and the appraisal findings will so indicate. Modifications of the original valuation conclusions should be clearly identified and properly documented.
- 9-5. HIGHEST AND BEST USE DETERMINATION. The determination of the highest and best use of the property is the first and critical determination to be made. The detail involved will vary from case to case and will range from the most simple alternative of sale "as is" to that of dividing the project into parts suitable for a variety of uses. Any analysis will be complete, but will stop when the tests applied clearly indicate the proper use of the property, the proper method of disposal, the repair (rehabilitation, etc.) involved, and the resulting indicated values. The appraiser's findings regarding highest and best use is determined as a result of an analysis based on economics, without regard to current use, or limited uses for which mortgage insurance may be written.
- a. Consideration should be given to the following:
- (1) Present use "as is", except for cleaning, etc. (presumably continued as multifamily rental housing project).

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- (9-5) (2) Present use with repair expenditures ("as repaired") repairing deferred maintenance only, or major repairs, alterations, rehabilitation.
- (3) Conversion to other use, such as:
- (a) Furnished apartments;
- (b) Apartment hotel;
- (c) Commercial hotel or motel;
- (d) Office or professional building;
- (e) Cooperative, condominium or subdivision parcel for sale to consumers, or sale to promoter, for subsequent resale to consumers.
- (4) Conversion of Land to other use, such as:

- (a) Separate sale of land, and buildings for removal or re-subdivision of land, as into commercial or industrial parcels.
 - (b) Sale "as is," with or without requirement for removal of buildings by purchaser.
 - (c) Other highest and best uses including any combination of the above.
- b. The decision as to the method used will be the one that obtains the best recovery most expeditiously in light of the Assistant Secretary-Commissioner's best interest.
- c. If an alternate is required in the Valuation study, it may be prepared on the basis of material and labor costs expected to be encountered by the purchaser. An example would be a major conversion, as to an office building or motel, in which case the purchaser might well finance and complete his own plan of conversion or repair, and all work would be done by or at the expense of a cash purchaser of the property.

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- 9-6. APPRAISAL OBJECTIVES. In addition to determining the "highest and best" use, the immediate objective will be to report and substantiate:
- a. Fair Market Value of Property "as is."
 - b. Scope and estimated cost of repairs required and recommended.
 - c. Fair Market Value "as repaired."
 - d. Fair Market Value "as is," for conversion to other use (e.g. commercial).
- 9-7. SUBDIVIDED PARCELS. If sale in subdivided parcels is recommended, the value of each such parcel shall be estimated and recorded in a tabulation attached to the FHA Form 2264. The tabulation will identify each proposed sales parcel, which may be a row house unit, a four family building, or a group of buildings. The value ascribed the project shall be the sum total of all the values of the individual sales parcels.
- 9-8. CONDOMINIUM OR COOPERATIVE CONVERSION. Sale to tenants organized for condominium or cooperative ownership of a project, or sub-divided portions thereof, will be considered as a variation of the original use for multifamily housing. Valuation will be of the entity (or the total of the values of the individual units). The market comparison approach will be used as the principal approach if condominium ownership is

recommended.

- 9-9. UNUSUAL CASES. Unusual cases may include those whose conversion to hotel or transient use may be profitable, but not contemplated in the National Housing Act, especially if a purchase money mortgage is anticipated. Such cases shall be referred to the Office of Technical and Credit Standards. The appraiser shall include a valuation analysis based upon the recommended use.
- 9-10. MARKET CONSIDERATIONS. The appraiser must always consider the market for the property appraised. The project or property will be offered widely, by means of circularizing an extensive list of prospective purchasers, and by use of local advertising media and newspapers in financial centers. Therefore, the valuator should recognize the broad coverage rather than consider only the potential interest in the immediate vicinity.

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- 9-11. AVAILABLE FINANCING. The valuator should consider the financing available to the prospective purchaser. Generally, the project sold "as repaired," or in reasonably good condition, for continued use as a multifamily housing project will be eligible for a liberal HUD-FHA purchase money mortgage, or for a HUD-FHA insured mortgage. This will apply whether the sale is for investment purposes or as a cooperative or condominium. It will also apply if the project is to be subdivided into reasonable, smaller real estate entities, e.g., as single buildings or individual row house dwellings.
- a. Therefore, while appraisals of market value are theoretically made as if for all cash sales, this premise must assume and give effect to the going market mortgage financing. If the property is to be offered for sale on the basis of a high ratio purchase money mortgage or HUD-FHA mortgage insurance, this will be a favorable factor affecting its market value. The availability of conventional financing at reasonable rates will also be favorable.
- b. Note that HUD-FHA may consider taking back a purchase money mortgage or trust note, on the entirety or on separate parcels, and if on the entirety, with release clauses. In the income approach to value, when liberal HUD-FHA mortgage terms will be offered, capitalization by an overall capitalization rate derived by the cash flow method will be used. (See paragraph 7-5.)
- 9-12. USE OF NARRATIVE REPORTS. In reporting his appraisal for other than rental housing use, FHA Form 2264 may not be useable. In such instances, the appraiser will make his report showing the necessary calculations. For example, land, the best use of which is commercial, will be reported at its value per unit of land and total, less cost to clear the land, with the resultant

value opinion supported by a recording of comparisons. Conversion of a high rise apartment to an office building may also be reported by a narrative appraisal, with capitalization and proper comparative support.

- 9-13. USE OF FHA FORM 2264. Appraisal processing will generally follow Section 207 procedure, with exceptions recited herein. The Project Income Analysis and Appraisal, FHA Form 2264, when used in proposed construction, discloses fair market value and

feasibility with respect to production cost. In treating acquired properties, the analysis will develop the most practical method of disposal, bringing the greatest net recovery obtainable within a reasonable time.

- 9-14. INSPECTIONS OF THE PROPERTY. Joint inspection of the property by the Valuation Section with the Architectural Section is a most important phase of examination. The Field Office project Master File may contain FHA Form 2475, Property Report - Rental Project. It may be used for data purposes. However, for the purpose of this analysis, a new form shall be prepared jointly by the Valuator and the Architectural processor. This form will supply most of the information usually available in FHA Form 2013. A FHA Form 2475 will be prepared for the project or for each building as necessary, except that repetitive recording is unnecessary and that Item #10 - Repairs, Replacement and Improvements - need not be completed if it will duplicate data recorded and recommendations made previously.
- 9-15. RECOMMENDED REPAIRS. HUD Form 2060a, Report of Physical Condition and Repair Recommendations, will be used as a worksheet during the inspection of living units and public spaces. Repairs essential to arrest accelerated deterioration will be given first consideration.
- a. Recommended repair beyond those essential will be based on the objective of placing the property in a competitively marketable condition consistent with obtainable rentals and other Valuation assumptions and conclusions. A clear understanding of this objective by both the Architectural and the Valuator processors is essential.
 - b. A list shall be prepared setting forth in specific detail any deficiency and the manner of correction. Each item shall be preceded or followed by the specific locations where such work is to be performed, such as number of building, apartment, room or other identification, which would not permit misunderstanding or oversight. The total estimated cost of each item described shall be stated. When such list is completed and signed by the Architectural processor, it is also signed by the Valuator, indicating his concurrence as to the nature of the work required.

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- c. In the event of a disagreement between the Architectural and Valuation processors as to the repairs to be called for which cannot be resolved, the Architectural processor will affix his signature to his recommendations and the Valuation processor will do the same and submit them to the ADTSB/CU for resolution.
- 9-16. INCOME AND EXPENSE DATA. Accurate projections of income and expense may be made by utilizing data accumulated in the data bank. (See Chapters 5 and 6.) Actual project income and expense data, for the most part, may be unreliable to use.
- a. Causes of failure will very often indicate whether any of the income and expense data can be used.
 - b. Actual income and expense during HUD-FHA ownership is usually untypical since expenses during this period are higher than competitive projects, and income may be less than competing projects.
- 9-17. RESERVE FOR REPLACEMENT. Reserve for Replacements will be computed utilizing the factor shown on the FHA Form 2264. The computation will be based on the cost of "Total Structures" provided by the cost analyst. Major items requiring replacement within two years will be shown separately as an additional cash requirement to the reserve fund.
- 9-18. "AS IS" AND "AS REPAIRED" VALUE. A typical case will require the preparation of two copies of FHA Form 2264; one will be completed on an "as is" basis and clearly labeled "as is"; the other on the assumption that all repairs are completed pursuant to recommendation, and labeled "as repaired." The annual income-expense estimates and remaining economic life will be recorded specifically for each assumption ("as is" and "as repaired") to reflect the differences that will exist. The scope and cost of repairs recommended as necessary to attain the value indicated in the "as repaired" appraisal will be entered under "Remarks," Section "O," FHA Form 2264.
- a. The differences between the "as is" and "as repaired" will normally be at least equal to the cost of repairs or remodeling estimated as required herein, including a reasonable margin for risk and temporary financing charges.

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- b. In some instances this may not be true, inasmuch as the typical potential purchaser may be able to accomplish the work at less cost than would be incurred by the

government. In this event, it may be proper to recommend an "as is" sale and to report an "as is" value that would reflect, to some degree, the more favorable repair position of the purchaser.

- 9-19. CHATTELS. In most instances, items of personal property included in the project being acquired will not be covered in the real estate mortgage. A notation shall be added in the "Remarks" portion of the FHA Form 2264 which will indicate the value of such chattel property. The chattels should be itemized and valued in a separate attachment to the FHA Form 2264.
- 9-20. LEGAL CONSIDERATIONS. When requesting the appraisal, the Office of General Counsel will furnish any necessary special information and instructions with respect to redemption rights and other legal considerations affecting value, including information as to applicable laws and court decisions giving the foreclosed mortgagor the right to collect and retain project income during the redemption period. If an unusually difficult appraisal problem is presented by such redemption rights, special advice or assistance may be sought of the Central Office Appraisal and Mortgage Risk Division.
- 9-21. COMPARISON APPROACH. Estimated Fair Market Value of Property by Comparison, Item L-8, FHA Form 2264, will be completed using the most closely similar investment properties (not necessarily identical) preferably within the housing market area, recently exchanged in the market. If comparisons are made other than on an "as repaired" basis, special comment should be made. Since similar investment property is normally sold for the income it will produce, value estimates by comparison will typically approximate the value by capitalization. However, in the "as is" valuation, it must be recognized that the property, especially if in need of major repairs or rehabilitation, may produce a relatively low net income as compared with potential income and the capitalization rate will usually reflect this fact. In the extreme case, a property may not be rentable in "as is" condition, and yet will have value in consideration of the potential as repaired, or for other use.

- 9-22. APPRAISAL SUMMARY. In the Appraisal Summary, L-9, FHA Form 2264, value by capitalization should represent a reasonable estimate of the price that may be recovered after suitable exposure in the market if the best use is as a rental housing project.

If the project is to be sold "as is," and the income does not reflect the full potential earning capacity of the land, capitalization at investment property income rates will, of course, not be indicative of market value, and the comparative value, or the value as repaired less cost of estimated repairs, or the value for other use of project structures or land may

control.

- 9-23. NARRATIVE SUMMARY AND CONCLUSIONS. A comprehensive statement shall be attached disclosing in narrative form, with recapitulation of repair costs and resultant values, the recommendation of the Valuator as to disposition of the property and the justification therefore. Recapture of repairs, rate of marketability, availability of conventional or HUD-FHA insured financing, the activity and extent (local or otherwise) of the market, and the probable time required for disposal should be discussed.

The summary should also discuss the reasons the project failed. Specific causes of failure should be stated and recommendations, if any, for preventing repetitions.

- 9-24. ROUTING OF COMPLETED APPRAISAL. The Valuation processing of the case having been completed the case is then routed to the Office of the ADTSB/CU.