CHAPTER 10. VALUATION INSTRUCTIONS

10-1. BASIC CONSIDERATIONS. The following characteristics should be taken into consideration:

a. The Absence from the monthly housing cost of the owner's profit inherent in most rental projects.

b. Taxes. In common with other home owners, the cooperative member may deduct from his gross income for federal income tax purposes his proportionate share of the mortgage interest and real estate taxes paid on the property. Under appropriate circumstances, if an individual sells a home and there is a capital gain, and in turn, acquires a cooperative unit, he is accorded basically the same tax treatment as though individual homes were involved.

c. Income Losses. Rental schedules usually include an allocation for vacancy loss. In a cooperative, the monthly charges include only such income losses, if any as have actually been incurred.

d. Maintenance Costs in a well-operated cooperative are minimized since experience has shown that owners take better care of their property. Cooperative members frequently handle the redecoration of their units on a "do-it-yourself" basis, thus, eliminating this as a project expense.

e. Accrual. If a cooperative is successfully operated, equity accrual upon resale normally results. (There are, however, limitations on equity accrual, particularly in Section 221 (d)(3) BMIR cases and rent supplement.)

f. Operating Costs. A cooperative is operated on a non-profit basis. Thus, increases in the monthly housing cost are limited to actual increases in operating costs.

g. The Cooperative Living Units are not Individually Owned by the occupant and cannot ordinarily be separately sold or financed, but an individual member, as in the case of an owner of an individual dwelling property, may wish or find it necessary to sell his holdings which are, in cooperatives, evidenced by his stock in the non-profit corporation. The corporation has the first right of purchase under terms of the by-laws. When offered for sale to a new member, the quality of the project location, housing accommodation and amenities and the cost of occupancy and participation in the corporation will be compared by the prospective purchaser with competitive housing accommodations available to him in the market.

h. The Cost of Operating and Maintaining the Project as a whole must be met by the cooperative members and, in the estimating of these costs, the project should be considered in its entirety. These costs are, however, of two classes. The first are those attributable to the individual living units occupied by members of the corporation and which are considered as, and capable of being the occupants' individual responsibility. Such costs can be, for example, interior decorating or replacement of a stove or refrigerator. Such costs are considered, and shown, as personal benefit expense. The second class of costs are those which by their nature, or cooperative agreement, are the responsibility of the cooperative group as a whole and whose cost is shared proportionately. These costs are, for example, the care, decorating and maintenance of common hallways, lobbies and other space, roof and exterior maintenance, grounds, central heating, etc., and, of course, fire insurance, taxes and other operating costs of the project as an entirety. These costs are shown as common expenses. The two classes of costs are not arbitrarily made but are determined by cooperative agreement and will be indicated in application FHA Form 3201.

i. Reserve for Replacement. In low-cost management-type projects where downpayments are typically less than $500, the mortgagor corporation must assume responsibility for the reserve for replacement account. The corporate replacement reserve computation must include all items that are normally included in rental housing projects.

j. Presale Requirement. Under the management type program, HUD-FHA does not commit to endorse the mortgage unless and until 90% of the total membership is procured and approved by HUD-FHA prior to initial endorsement. (See Chapter 1 of this Handbook.)

10-2. FEASIBILITY STAGE PROCESSING, PROPOSED CONSTRUCTION. Sponsor's request will be submitted on FHA Form 3201, under Section 213 management-type with required exhibits. Plans are not required at the feasibility stage but the application gives a physical description of the project including number, size and composition

of living units, parking space and commercial spaces and contains sponsor's estimates of replacement cost, common expense, personal benefit expenses, commercial income and the annual operating budget for the cooperative. The application also shows what equipment and Services will be furnished the members as common expense.

10-3. SITE ACCEPTABILITY AND LAND APPRAISAL.

a. The first step in valuation processing, using FHA Form 2264-B, is analysis of site acceptability involving the following determinations:

(1) That the location is acceptable for the type of project proposed and the market to be served.

(2) That there is a market need for the project as evidenced by a reasonably rapid absorption of cooperative units offered to the market. In the absence of market data, the presale requirement is deemed sufficient evidence of market.

(3) That the site is adequate in size, shape, exposure and contour for the proposed project.

(4) That zoning is permissible for the project proposed.

(5) That utilities and streets are adequate or can be made available for the proposal.

(6) That, if information in data files or on-site suggests subsoil problems, the ADTS/CU has been advised.

(7) That, the land value of the site is acceptable. (See Reference (18) of the Foreword).

b. The site is appraised and Page 4 of FHA Form 2264-B completed to the extent possible. Information developed, verified by interview of persons having accurate knowledge of the acquisition cost of the site, and recorded in Items 12 and 13 of Page 4, must concern the last arms-length transaction of the subject site, wherein it first came under direct or indirect control of the sponsor. This will not necessarily correspond with the first page entry in Section B which is simply a copy of the sponsor's statement of a transaction of the subject site, and which frequently concerns a resale of subject site occuring after the last arms-length transaction.

10-4. PHYSICAL DESCRIPTION OF PROPERTY AND ESTIMATED ACCESSORY INCOME.

Copy from the application information concerning the location and physical description of the project, including the type, number, size and composition of the living units, number of parking spaces and size of commercial spaces (if any). Downpayments and monthly charges for the living units are not entered at this time. The total number of open parking spaces in the project will be shown followed (in parentheses) by the number which will be separately rented rather than supplied to the occupants of each living unit and included in monthly living unit charge. The accessory income from separately rented parking spaces will be shown at market rates for subject location. Accessory income will be shown for commercial space rental at market rates for subject location. Net rentable commercial space may not exceed 10% of the sum of the net rentable residential areas and net rentable commercial area. Income anticipated from submetering of utilities, maid or valet service, pay telephones, vending machines, etc., must not be included in project income estimates. Income from the rental of commercial space may be included and recorded in dollars per square foot.

10-5. EQUIPMENT AND SERVICES INCLUDED IN CHARGES. The sponsor's application will indicate the equipment and services to be furnished by the cooperative corporation at common expense. In the case of ranges and, refrigerators, this includes provision of the original equipment and provision of replacement equipment as separate items. (A smaller allowance will be made later for Replacement Reserve, if replacement of ranges and refrigerators is an individual expense rather than a common expense.) However, if the sponsor's application (or HUD-FHA processing) should indicate a low cost project, with the downpayment of a substantial proportion of the units being less than $500 a unit, it is administratively required that the corporate replacement reserve include all items normally included in rental housing projects. This requirement recognizes that residents of such projects often lack the ready cash to replace items of this nature, and that it will be in their interest to have the kitchen equipment included in the replacement reserve. In such projects, also, all utilities should be in the common expense and utility meters so arranged that utility payments will be a common expense rather than a personal benefit expense.

10-6. ESTIMATE OF ANNUAL COMMON EXPENSE. If the data bank includes information on similar competing cooperative projects supplying the same services and equipment as the subject, direct comparison with adjustment for variations between subject and comparables will be the best source. If comparable cooperative project data is lacking and the project most nearly resembles a multifamily rental project, estimate common expenses by appropriate adjustments to multifamily rental project data. If the project most nearly resembles townhouse or single-family properties, the expense data would be drawn from the most comparable source, and appropriately adjusted to represent the subject property and the equipment and services to be supplied at common expense.

10-7. REPLACEMENT RESERVE. Where replacement of ranges and refrigerators at common expense is included, replacement reserve equals Line 50, "Total Structures" multiplied by .006. Where range and refrigerator replacement is not included, replacement reserve equals Line 50 multiplied by .004.

10-8. ESTIMATE OF TAXES. The estimate of real estate taxes is made based upon taxes charged to comparable projects and upon knowledge of the tax assessor's methods and tax rates. The estimate of Total Common Expense may be made on an overall basis without entering details of the component expense items, but the real estate tax estimate is required.

10-9. REPLACEMENT COST ESTIMATE. The Cost Analyst uses the square foot method of cost estimation from data most nearly comparable to subject property, with appropriate adjustments, supplying estimates for land improvements, structures, fees, and estimated construction time. BSPRA is not authorized for cooperatives. The Cost Analyst will estimate the builder's overhead and builder's profit allowances (for projects in Urban Renewal areas) in consideration of data showing levels of profit typically attained in that area. The appraiser enters the items of carrying charges and financing (assuming a mortgage amount based on replacement cost). Legal, organization, development service and marketing expense is estimated in accordance with Reference (19) of the Foreword. Consultant Fee is not applicable. Estimated Market price of site is entered from Item 14(3) of Page 4, Warranted Price of Land Fully Improved (Replacement Cost Items excluded). The sum of the above items is the Total Estimated Replacement Cost of Project.

10-10. TOTAL ANNUAL EXPENSE AND FIXED CHARGES. In Section E using the maximum mortgage amount from a worksheet copy of FHA Form 2264-C, the appraiser computes the annual amounts needed to pay principal and interest on a level annuity mortgage and to pay the MIP. On separate worksheet the sum of principal and interest payments, MIP and total common expense is multiplied by 3% to compute the operating reserve. In low cost projects with downpayments below $500, an additional 2% reserve for vacancy and collection loss is computed as above. This operating reserve is added to debt service and the sum is entered as total annual fixed charges. When total common expense is added to the above, the result is entered as total annual expense and fixed charges.

10-11. TOTAL NET COMMON EXPENSE AND FIXED CHARGES. The total annual expense and fixed charges above is before consideration of any common income. Therefore, we will call this, in Section G, the total gross annual expense and fixed charges. Next, enter estimate of accessory rental income and subtract allowance for vacancy. From the gross annual common expense and fixed charges, subtract the effective accessory rental income; the difference is entered as the total annual net common expense and fixed charges. This is followed by the total monthly net common expense and fixed charges. This last amount is divided by the the number of rooms in the living units; the result is the total monthly net common expense and fixed charges per room.

10-12. UNIT CHARGES PER MONTH. Carrying charges for individual units are developed by the Sponsorship and not by HUD. The total is, however, subject to HUD approval.

10-13. ESTIMATED PERSONAL BENEFIT EXPENSES. In Section I, those costs which must be paid individually because they represent utilities, decorating, or maintenance which is not furnished at common expense, are estimated and entered as personal benefit expenses by type of unit.

10-14. TOTAL REQUIREMENTS FOR SETTLEMENT (SECTION J). This Section is completed by the mortgage credit processor. It indicates the total estimated future cash requirement. If the appraiser increases it by the amount of any difference between the indebtedness on the land and the total acquisition cost of the land, it will indicate the total cash downpayment that must be charged if the contractor-sponsor is to receive the profit used in the replacement cost estimate. This total cash downpayment is divided by the total number of rooms in family units to give the

average cash downpayment per room. When this amount is multiplied by the number of rooms in a unit and the result rounded upward to the next multiple of fifty dollars, the amount may be entered as downpayment for that unit type in Section C. This amount may be greater than the required downpayment, but is shown as useful information if the cooperative corporation is to develop the cash to pay the items shown in Section J.

10-15. ESTIMATED ANNUAL OPERATING STATEMENT (SECTION K). The appraiser now has sufficient information in Sections C, E, F, and G to prepare the annual operating budget in Section K.

10-16. COST NOT ATTRIBUTABLE TO DWELLING USE - COST OF OFF-SITE REQUIREMENTS. Section L is completed by the Cost Analyst.

10-17. CALCULATION OF BUDGETED CONSTRUCTION COST (SECTION M). In management type cooperatives, the construction budget is taken entirely from various items in Section H, Estimated Replacement Cost, beginning with Item 80, Total Estimated Replacement Cost of Project. The sum of land value, carrying charges and financing, legal organization and marketing, design architect fee, supervisory architect fee, bond premium, and other fees is subtracted from the budgeted total estimated replacement cost to result in the balance available for construction including builder's fee.

10-18. MORTGAGE AMOUNT. Mortgage amount will be determined by the mortgage credit processor on FHA Form 2264-C in accordance with outstanding instructions for Criteria 1, 2, 3, (Replacement Cost) and 4.

10-19. FEASIBILITY DETERMINATION. A finding of feasibility is justified:

a. When data indicate and sponsor agrees, that he can plan and build the project for the amounts within the construction budget.

b. When sponsor agrees that he can successfully market the cooperative units, and meet the presale requirement, using the project mortgage amount stated in the feasibility letter.

10-20. CONDITIONAL AND FIRM COMMITMENT STAGES. These stages are primarily for development of plans and specifications. Re-analysis is limited to changes necessitated by sponsor actions.

10-21. EXISTING CONSTRUCTION. Existing multifamily rental projects which have been previously insured by HUD-FHA (or which otherwise meet administrative requirements) may be converted to cooperative ownership under Section 213 Management Type. Rehabilitation is not required if the structures are in good condition.

10-22. FINDING OF VALUE. The mortgage is limited to 97% of appraised value, rather than 97% of replacement cost.

10-23. VALUE FOR CONTINUED USE AS A COOPERATIVE. "Appraised value for continued use as a cooperative" refers to a price which a cooperative group is warranted in paying for a property, rather than a price for which a property may be sold. Under the principle of substitution, it must be recognized that a cooperative group is not warranted in paying more than an equivalent property would currently cost to acquire in the rental investment market.

10-24. VALUATION AS A RENTAL PROJECT. A supplementary FHA Form 2264 is completed as in Section 207, including capitalization and comparison approaches to value, except that the rent formula is not required. In Section O, Remarks, the value will be shown with the following typed line:

"Estimated Market Price of Property by
Capitalization Comparison $ _______________."

10-25. PROCESSING AS A COOPERATIVE. FHA Form 2264-B will be completed as in proposed construction, with the following exceptions:

a. Section H, Estimated Replacement cost, will not be completed. Instead the following will be typed in the blank space below Item 80:

Estimated Market Price of Property By Capitalization or Comparison	$ ____________
Estimated Closing Costs (above)	$ ____________
Estimated Legal, Organization & Marketing	$ ____________
Value for Continued Use as a Cooperative	$ ____________

(10-25) b. The first line is brought over from FHA Form 2264. Estimates of closing costs are Items 66, 68 and 71. Mortgage discounts may not be included.

c. Items of legal, organization and marketing will be computed in accordance with Reference (19) of the Foreword, and shown in 73, 74 and 75.

d. Sections A, B, C, D, E, F, G, I and K will be completed as in proposed construction. Section J will be completed by the mortgage credit processor. Section I will be completed by the Cost Analyst.

e. Sections M and O may be omitted.