CHAPTER 8. THE VALUATION PROCESS

8-1. INTRODUCTION. Valuation Analysis is made for the purpose of evaluating the property as security for a long term coinsured mortgage. Included in the evaluation is the analysis of market need, location, earning capacity, expenses and taxes and warranted costs of property. Valuation Analysis develops conclusions with respect to feasibility, suitability of improvements, quality and duration of earning capacity and other factors that have a bearing on the economic soundness of the property.

8-2. PURPOSE. The principal purpose of the appraisal is to estimate the market value of the project. Market value is defined as the most probable price for which a property could be sold, if offered for sale for a reasonable time on the open market, assuming that both the buyer and the seller were well informed, acted intelligently and without compulsion. To estimate the market value, it is necessary to use value limits indicated by the project replacement cost, by capitalization and by direct sales comparison.

8-3. INSPECTION. The appraiser may participate in the inspection of the property with the architect and possibly a representative of the local building inspector's office to identify any code violations or may arrange a separate inspection, if desired.

If it would be more expeditious for the architect to make the physical inspection separately it may be so scheduled. Upon completion of the work write-up the results are transmitted to the appraiser who may visit the site and begin processing. It is not necessary for the appraiser to inspect all the units. The appraiser observes and may discuss with the architect and/or inspector the eligibility of the property and need for required repairs while at the same time supporting or disproving occupancy and rental data information shown in the owner's rent roll by observations on the spot. When it is established to the satisfaction of the appraiser that the rent roll appears to be correct, an entry will be made in Remarks on Form HUD-92264 to that effect, for example, "Actual occupancy, based on owners rent roll and a physical inspection of a representative number of units as of 4/2/83, is 87%." The appraiser must also determine whether apartments are rented furnished or unfurnished. The appraiser may assist in selecting equipment and short-lived building components to be considered in developing the initial deposit to the reserve fund for replacements.

8-4. APPLICATION STAGES. At the option of the lender, the processing may be divided into two stages, the conditional commitment stage, and the firm commitment stage. When two stages are used, the appraiser's work is completed in the conditional commitment stage, unless a change in the local requirements or in the list of proposed repairs and replacements would require confirmation or reconsideration of conclusions previously reached. These stages are explained in more detail in Chapter 4 of this Handbook.

a. Conditional Commitment Stage. The primary purpose of this processing stage is to determine the appraised value and maximum mortgage amount available to an acceptable purchaser. The actual purchaser may not have been identified at this point in time.

b. Firm Commitment Stage. At firm commitment stage, mortgage credit processing determines the amount of mortgage available to the specific purchaser or refinancing mortgagor in the proposed transaction. Usually, no valuation processing is needed at firm commitment stage.

c. Combined Stages. When a purchasing or a refinancing mortgagor wishes to combine the processing stages, he must supply all the exhibits needed for both processing stages, with the application for Firm Commitment, and the appropriate combined fee. All processing required for both the Conditional and Firm Commitment Stages will be performed for the purpose of issuing a Firm Commitment.

8-5. PROCESSING FOR CONDITIONAL COMMITMENT. In order that a conditional commitment application be processed, the following exhibits shall be reviewed by the appraiser:

a. A copy of the completed application form.

b. Balance Sheets and Operating Statements. The most recent year's statement certified by an Independent Public Accountant or Certified Public Accountant.

c. Rent Roll of Subject Property, in columnar form, as described in Chapter 4 of this Handbook. (See Appendix 4.)

d. Legal Description of the project property.

e. Repair List. A list of repairs (if any) (see paragraph 4-3e) which are proposed to be completed and which are to be included in the value.

(8-5) f. Plans and Specifications. Applications involving projects less than 10 years old shall be accompanied by project plans and specifications (complete to the extent possible). For projects 10 years old or more, plans are not required but should be submitted, if available.

8-6. BASIC FORM. The basic form to be used in the coinsurance appraisal process is Form HUD-92264. These forms may be requisitioned from the local HUD office. This form provides for the development and recording of Capitalized Value, Total Estimated Replacement Cost, Comparison Approach to Value and final opinion of Fair Market Value of a multifamily housing project. These estimates, and others, are necessary in making a determination as to the economic soundness of a project. It is important that all information required on the form be completed. This form will eventually be utilized by HUD for program data purposes.

a. General information. Form HUD-92264 is designed to permit processing in an orderly sequence. Completion of the form requires a study and analysis of information obtained from many sources including the following:

(1) Form HUD-92013, Application for Mortgage Insurance.

(2) Owners and operators of rental income properties, management companies, mortgage lending institutions and real estate appraisers specializing in this field.

(3) Housing Market Analysis Reports/Publications.

b. Required exhibits. Exhibits to be attached to Form HUD-92264 include expense comparable analysis, rent comparable analysis, replacement cost formula, comparable project sales data, rent formula for existing housing (see Appendix 9), market absorption data and land sales data.

8-7. INSTRUCTIONS FOR COMPLETING FORM HUD-92264.

a. Section A. Location and Description of Property.

(1) Project name is as shown on the mortgagor's application.

(2) Items 1-15. The information required for completion of these items will be available from the application and exhibits, confirmed by inspection and modified as needed. Items 4a, Census Tract Number, and 4b, Placement Code, are to be left blank.

(8-7) (3) Item 16. Enter year built.

(4) Item 16a. Indicate type of construction by checking appropriate box.

(5) Item 17. Structural System is described as follows:

Steel frame, wood frame, solid masonry, reinforced concrete, etc.

(6) Item 17a. Floor System (structural) steel frame, reinforced concrete, etc. (This does not refer to finished floors.)

(7) Item 17b. Exterior Finish is described as follows:

Brick, masonry, stucco and siding, prefab panels, etc.

(8) Item 18. Heating/Air Conditioning System will be described by use of appropriate symbols. Those symbols preceding the diagonal mark will describe the type of project heating system, if any, while those after will indicate the type of project air conditioning system, if any. The symbols, to be used as appropriate, apply to both the heating and air conditioning systems and are as follows:

I for Individual; C for Central; N for None;
E for Electric; G for Gas; and O for Oil.

For example, a project with individual gas furnaces and individual electric air conditioners would be entered as follows: IG/IE.

b. Section

(1) Items 19-25. The information required for completion of Section B will be taken from the sponsor's application, Form HUD-92013, verified as necessary.

(2) Item 26 is not applicable since under Section 223(f) coinsurance the site is already fully improved.

c. Section C. Estimate of Income.

(1) Items 27-28. The estimated unit rental rates per month will be based upon and supported by current market rents for similar units in comparable projects

(8-7) furnishing comparable services in competing areas. both trended to the projected endorsement date for the subject. In estimating the rates for a specific property, rental data on subsidized projects must not be used as comparables. Appropriate adjustments will be made on a rent comparable analysis sheet (Form HUD 92273 or equivalent format), to reflect measurable differences between the subject units and the comparable units and any variations in the general level of rents expected to occur by the time the project reaches endorsement. For projects subject to local rent control, the rental estimates cannot exceed that permitted by local rent control.

NOTE: OPERATING ANALYSIS. In making estimates of rental rates, occupancy rates, operating expense, and net income, based on data from comparable projects, the appraiser also analyzes the operating history of the subject project. This very pertinent source of information must not be overlooked in cases of existing construction. Estimates of future performances need not be identical to the history of past performance, but the differences should be reasonable and probable and explained by brief logical comment in remarks. For example, analysis of trend might indicate that rents and/or expenses could be expected to be higher (or lower) in the next year, than was the case in the last operating history year. For another example, the market value sought is the estimated market value of the property after completion of required repairs. If the effect of the repairs would be to increase rents, or to increase occupancy rates, or to decrease (or increase) total operating expense, the estimate of net income and of value by capitalization would reflect conditions after completion of repairs required by the commitment.

(2) Section C27 "Number of Each Family Type Unit," "Rentable Living Area (Sq. Ft.)," "Composition of Units," "Unit Rent Per Month," and "Total Monthly Rent For Unit Type" must be completed as appropriate in order to properly describe the subject project/unit characteristics.

(3) "Living Area" is the area of a living unit measured from the inside faces of corridor and exterior walls and from the inside faces of partitions separating the living unit from other living or commercial areas.

(8-7) (4) "Composition of Units" can be filled in by using abbreviations for the various rooms (e.g., "L" for Living Room, "D" for Dining Room, "K" for Kitchen, "BR" for Bedroom (Precede with 0, 1, 2, etc., as appropriate) and "B" for Bath (Precede with 1, 1-1/2, 2, etc., as appropriate), "BALC" for Balcony.

(5) Elevator units will be compared with elevator unit comparables and non-elevator units will be compared with non-elevator comparables. When both elevator and non-elevator units are included in a project, a separate identification and listing of the elevator and non-elevator units will be made.

(6) Item 29, Parking. Enter the number of parking spaces, whether attended or self-park, and the number of open and covered parking spaces. Enter the monthly charge per space. Where the parking charge is included in the basic rental charge, enter N/A in the space provided. Supporting documentation for the monthly charge for parking must be attached to the appraisal report.

(7) Item 30, Commercial. The rental income from commercial space will be estimated on the basis of existing leases and supported by market data.

(8) Additional income anticipated from submetering utilities, valet service, non-laundry coin-operated equipment, cigar stands, vending machines, pay telephones, apartment furniture, etc., must not be included in project income estimates. Income anticipated from the rental of space for concession facilities or the rental value of such space may be included on the same basis as income from commercial areas.

Documentation supporting commercial income estimates must be attached to the Form HUD-92264.

(9) Items 33, 34 and 35. Enter gross floor and net rentable areas of the sponsor's proposal. These figures will be based upon the sponsor's plans or other appropriate sources. The definitions for the various areas are:

(a) Net Rentable Residential Area is the sum of all rentable Living Areas within the exterior walls.

(8-7) (b) Net Rentable Commercial Area is the sum of all commercial areas within the exterior walls, measured from the interior faces of exterior walls, corridor walls and partitions separating the area from other commercial and/or living areas.

(c) Net Rentable Area is the sum of the Net Rentable Residential Area and the Net Rentable Commercial Area.

(d) Gross Floor Area is the sum of all floor areas of headroom height within the exterior walls, measured to the exterior faces of the walls or to the center line of walls separating attached buildings. Note: Built-in garages, commercial area, basement and all other areas within the exterior walls are to be included. Items excluded from the gross floor area are recessed, extended or continuous balconies, attached or detached carports, accessory buildings, patios, porches or terraces and all other areas outside the exterior walls.

(10) Item 36. If non-revenue producing apartment units are provided to project employees, indicate the classification of employees who will occupy the unit and other information in the space provided. In such instance no income will be attributed to non-revenue producing units in Item 27; however, the unit will be listed separately in the column "No. of each family type unit." The loss of this income will not be considered as an item of expense in Section E. The appraiser will, however, review the entry in Section A, Item 11, for accuracy.

d. Section D. Equipment and Services Included in Rent and Special Assessments.

(1) Items 37-38. Check the appropriate items to indicate the equipment and services included in the rent. The sponsor's application will be compared with data to determine competitive effect on rents and marketability. Any deletion of equipment and services typically expected in the market place may affect the rental rate. Any variations will be reflected in the appraiser's estimate, if appropriate, and brought to the attention of the lender.

(8-7) (2) The services to be reported in Item 38 are checked by type of fuel (gas or electricity) and then by the service included. For example, if gas heat is included in the rent, the item "Heat" is checked under the heading, "Gas."

(3) Item 39. Enter the balance of special assessments, if any, the annual payment amount and the remaining term of the special assessment. Check whether prepayable or non-prepayable.

e. Section E. Estimate of Annual Expense.

(1) Items 1-29. The estimating of project expenses will be based upon actual operating experience of the subject and supported by that of comparable projects. An expense comparable analysis worksheet will be used in the development of individual expense estimates and only the totals estimated for Lines 21, 22, 28 and 29, trended to reflect operation of the project at the time of endorsement, will be entered in Section E of the Form HUD-92264. Actual operating expense data from other projects will be carefully analyzed and compared with the case under appraisal in order to provide a basis for determining the reasonableness of the estimate developed for the subject project. In any case, data should be utilized prudently, keeping in mind the similarities and differences between the comparables and the subject property. Inaccuracies or improperly supported estimates have a leverage effect in the estimate of value many times their own magnitude.

(2) The process that develops the final estimate of operating expense is briefly stated as follows:

(a) All estimates must be based upon adequate data.

(b) Data concerning the comparable projects must be sufficiently complete to factually support any adjustments made to the expenses from a comparable project because of differences in size, facilities or services between the comparable and the subject project.

(c) Adjustments are reflected on an expense comparable analysis worksheet for noted differences between the subject project and the comparables involved.

(8-7) In this way the dollar amount representing actual experience of the comparable property can be increased or decreased to more nearly reflect the anticipated experience of the subject project.

(d) Adequate file documentation must demonstrate the reasonableness of the final total expense estimate.

(e) Before entering the estimate of total expenses in Line E-29, the appraiser should review the analysis for completeness and the conclusion for plausibility. In addition to considerations mentioned above, the final estimate must reflect other considerations, some of which are:

1 An expense comparable analysis worksheet (HUD Form HUD-92274, or equivalent format) will be used in the development of individual expense estimates and only the totals estimated for Lines 21, 22, 23, 28 and 29, will be entered in Section E of Form HUD 92264.

2 The effect of any commercial space upon the total expense estimate must also be considered. Where there are commercial facilities that do not exist in the typical comparable, a separate estimate should be developed for inclusion in the total expense estimate. This should not be the case for such normal operations as laundry space which, because of the residential nature, are reflected in most per unit expense data. Documentation supporting the commercial expense estimates must be attached.

3 The final correlation of the several indicated total expense estimates should give greatest weight to the more reliable comparables while tempering estimates developed from individual projects that have unusual expense components that are difficult to refine.

(3) Item 21. Replacement Reserve. See paragraph 8-7r(5) of this Chapter.

(4) Item 29. Total Expenses. The total dollar expense estimated for the project will be compared with the sponsor's estimate. If it is found that the sponsor's total dollar expense estimate for the project could

be reasonably accepted based upon the appraiser's data analysis, the sponsor's dollar expense may be accepted for processing. If not, the appraiser's estimates should be used. Any subsequent revision of the facilities or services to be provided will require reanalysis.

(5) The only mandatory entries in Section E are lines 21, 22, 23, 28 and 29.

f. Section F. Income Computations.

(1) Item 30. Enter amount from Page 1, Section C, line 32.

(2) Item 31. Occupancy Percentage and Rent Loss. It is generally recognized that long term occupancy and rent collection ratios will seldom exceed 93 percent for rental income properties. However, where a higher ratio can be documented, a ratio of 95 percent may be used. Therefore, the occupancy percentage used should not exceed 93 percent and will not in any event exceed 95 percent in processing. Any lower occupancy percentage anticipated during the rent-up period will be reflected in an Operating Deficit requirement calculated by the mortgage credit examiner based on the appraiser's estimate of when sustaining occupancy will be reached.

g. Section G. Estimated Replacement Cost.

(1) Items 36a through 52. The sole purpose of a replacement cost estimate is to arrive at a summation value.

(a) Considerations. The cost estimate shall reflect the general level of costs necessary to build a similar project in new condition. A copy of the estimate developed by the appraiser, including the source of cost data must accompany this submittal. The appraiser may utilize a cost service index such as Marshall Swift or E. H. Boeck in establishing such costs. Appraisers with MAI or SREA designations who have demonstrated experience in cost analysis may develop their own cost estimates supported by comparable square foot data.

(b) Inclusions. The estimate includes the costs for the dwelling units, garages, stores and other structures which are included as improvements to the property. In addition, it will include the

(8-7) costs for the on-site utilities and landscape work required to construct such a project. The estimate of costs for on-site utilities will include extensions of pavements, walks, curbs and utility lines beyond the project boundaries where necessary to connect with facilities adjacent to the project site. No attempt should be made in processing to adjust for structural or material specifications which are no longer typically used in the current building industry.

1 All elements of cost will include but are not limited to:

   a Material and equipment.

   b Fabrication and installation labor.

   c Subcontracts.

   d Sales tax.

   e Workmens' Compensation, Unemployment and Public Liability Insurance.

   f Social Security Tax.

2 Allowances for General Requirements, General Contractor's Fee (Overhead and Profit), Architect's Design Fee, Architect's Supervision Fee, Other Fees and General Contractor's Bond Premium will represent the current prevailing levels, taking into consideration the project type, size, complexity, structural system improvement cost and any other local condition which may influence these allowances.

(2) Item 36a - Unusual Land Improvements: Not Applicable.

(3) Item 36b - Other Land Improvements:

(a) Earthwork (i.e., excavation, cuts and fills).

(b) Site utilities (i.e., sanitary sewer, water, storm drains, gas lines, electrical requirements, etc.).

(c) Roads and walks (i.e., roads, walks, parking areas, curbs and gutters, etc.).

(8-7) (d) Site improvements (i.e., fences, playground equipment, trash receptacles, lawn sprinklers, swimming pools, wading pools, etc.).

(e) Lawns, planting (i.e., trees, shrubs, seeding, sodding, etc.).

(4) Item 36c - Total Land Improvements: Total cost of all items in 36b, Other Land Improvements.

(5) Item 37 - Main Buildings: Buildings which encompass the actual living units of the project.

(6) Item 38 - Accessory Buildings: Adjoining buildings such as utility buildings, carports, etc.

(7) Item 39 - Garage: Self-explanatory.

(8) Item 40 - All Other Buildings: Commercial buildings such as stores, banks, barber and beauty shops, etc.

(9) Item 41 - Total Structures: Sum of Line Items 37 through 40.

h. Fees. The total dollar amounts for each of the fees listed below (Lines 42 through 48) may be determined by using a percentage developed from field source information, i.e., Local Home Builders Associations, Association of General Contractors, personal contact with various trade sources, recognized valuation service publications, etc. The total dollar amounts for each of the fees may be developed by means other than using percentages if local practices so dictate.

(1) Item 42 - General Requirements: (job overhead) The cost for General Requirements will include the costs for those items normally incurred in the construction of a project of the same type as the subject. It will not include general overhead expense of operating the contractor's home office. Items of cost to be considered in determining General Requirements allowance include, but are not limited to, items such as:

(a) Supervision.

(b) Field engineering to provide grades and lines for locating buildings, streets and walks on the site.

(c) Field office and equipment, phones, clerical help, office supplies.

(8-7) (d) Temporary sheds and toilets.

(e) Temporary heat, water, light and power for construction.

(f) Cleaning and rubbish removal.

(g) Building permits.

(h) Medical and first aid facilities.

(i) Temporary protection and fences.

This is typically expressed as a percentage factor which is applied to the subtotal of Land Improvements, Line 36c, and Structures, Line 41. However, a total dollar amount may be entered if the source guide so dictates.

(2) Item 43 - Builder's General Overhead: The cost for Builder's General Overhead will be expressed as a percentage which is the portion of general overhead expenses necessary to conduct his/her business which would directly concern the specific project under consideration. This percentage is applied to the subtotal of Land Improvements, Line 36c, Structures, Line 41, and General Requirements, Line 42.

(3) Item 44 - Builder's Profit: The cost of Builder's Profit will be expressed as a percentage typically allowed on a comparable structure in that geographical area both in size and cost as adjusted. This percentage is applied to the subtotal of Land Improvements, Line 36c, Structures, Line 41, and General Requirements, Line 42.

(4) Items 45 and 46 - Architect's Fees: Design and Supervision. The allowance shall represent the typical fees paid for projects of similar design and services rendered.

(5) Item 47 - Bond Premium: Appropriate information should be obtained from local bonding and surety companies. The amount of the premium will be computed by applying the rates to the subtotal of Land Improvements, Line 36c, Structures, Line 41, General Requirements, Line 42, Builder's General Overhead, Line 43, and Builder's Profit, Line 44.

(8-7) (6) Item 48 - Other Fees: This is a lump sum allowance which would pertain to the construction of this specific project. Allowances may include but are not limited to site and topographic surveys, test borings, subsurface explorations, soil testings and utility tap fees (other than those included in subcontracts).

(7) Item 49 - Total Fees: Self-explanatory.

(8) Item 50 - Total of All Improvements: Self-explanatory.

(9) Item 51 - Cost Per Gross Sq. Ft.: This is computed by dividing Line 50, Total of All Improvements, by Line 33, Gross Floor Area.

(10) Item 52 - Estimated Construction Time: This estimate should represent the typical length of construction time needed to build a project of the same size and structure type as the subject project.

i. Carrying Charges and Financing.

(1) Item 53. Interest is the amount which would be estimated to accrue during the estimated period of construction at the rate requested in Section G of Form HUD-92013 but not to exceed the maximum interest rate permissible under the HUD regulations. It is computed on one-half of the loan amount for proposed construction. For example, the interest based on a $2,600,000 mortgage, for an 18 month construction period, and an 11.0 percent interest rate would be calculated as follows:

One Half the Mortgage	$1,300,000
Interest Rate	.110
	$ 143,000
18 month construction period	
18 / 12 = 1.5 years	1.5
Interest during construction	$ 214,500

(2) Item 54. Taxes which would accrue during the construction period are shown on a pro rata basis for the estimated period of construction. Special assessments, if any, will be estimated on a similar basis and included in the tax amount.

(8-7) (3) Item 55. Insurance includes fire, windstorm, extended coverage, liability and other risks customarily insured against in the community during construction. It does not include workmen's compensation and public liability insurance which are included in the cost estimate.

(4) Item 56. Mortgage insurance premium is the amount estimated to be earned during the presumed construction period. The amount is 0.5 percent of the permanent loan amount per year. An additional 0.5 percent is charged for any additional fractional period in excess of each whole year.

(5) Item 57. FHA examination fee is 0.3 percent of the presumed loan amount associated with constructing such a project.

(6) Item 58. FHA inspection fee is 0.5 percent of the presumed loan amount.

(7) Item 59. The financing fee is 2 percent of the loan amount. This is an initial service charge and is not to be confused with discounts. The maximum charge for this fee is 2 percent and is limited by HUD regulations.

(8) Item 61. FNMA/GNMA Fee. The FNMA/GNMA Fee for commitment and marketing (or equivalent placement fee) is entered for all mortgagors. This fee is assumed to be 1-1/2 percent of the mortgage amount.

(9) Item 62. Title and Recording. This expense is the cost typically incurred in connection with a mortgage transaction and generally includes such items as recording fees, mortgage and stamp taxes, cost of survey and title insurance including all title work normally involved from initial through final endorsement.

(10) Item 64. Legal Expense. Legal expenses are those expenses typically incurred by a sponsor for legal services necessary in the creation of projects similar to the subject in the competitive locality in which the project is located. Legal expenses are separate from organization expenses and must be estimated and listed separately.

Since different types of proposals and/or sponsorships will require varying legal services, this estimate must be based on market data.

(8-7) Legal expenses include the fees usually required for:

(a) the employment of counsel for legal services in connection with organizing a mortgagor entity;

(b) all legal services normally incurred in connection with initial and final closing; and

(c) legal services for normal interim activities in the creation of a project.

(d) For example, legal services in connection with organizing the mortgagor entity ((a) above) qualify only to the extent that the entity formed is typically needed for the creation of the subject project. The cost to create ornate corporate structures, useful to the sponsor for personal reasons over and above the creation of the project (e.g., personal tax shelters, trusts, etc.), is not allowable. Legal services for initial and final closing ((b) above) include the analysis of the closing requirements and preparation and review of the required documents, supervision of their execution and appropriate distribution.

(e) Filing fees and title expense are not part of these fees since they are allowed in Title and Recording expense. Legal expense may include normal legal services typically required in the acquisition of land, but negotiation for acquisition or zoning, examination of title on purchase or defense of title after purchase, are not recognizable in legal expense on Line 64 since they are attributable to the cost of the land to the owner.

(12) Item 65. Organization Expense. Organization expense must be estimated and listed separately and, as with legal expense, must be based on market data. The estimate must properly reflect the kind and size of project and type of sponsorship involved in the subject project.

(a) Organization Expense is the cost of the services typically required to initiate a project, organize its planning, financing and construction, and control and management of the construction of the project through final endorsement. Services and costs included under Organization Expenses are those customary to the organization and construction of projects of similar size and complexity in the locality of the subject project.

(8-7) (b) More specifically, organization expense will reflect the time and effort expended for the administrative aspects involved in the creation of a project. For example, the following, although not a complete listing of items that qualify for organization expense, will serve as a useful guide to identify the type of actions and efforts that qualify for legitimate consideration under this item:

1 Collecting and assembling data and documentation for requests for FHA mortgage insurance for all stages of processing, including analysis of market need, selection and optioning of site and project design considerations.

2 Assembling of the necessary data and documentation for mortgage closings from various parties involved in a project; arranging for execution of documents; and attending to closings. Particular care must be exercised here by the appraiser to insure that only the administrative aspects are reflected so that there will be no duplication of allowances under Item 64, Legal Expenses.

3 Controlling and accounting for disbursement of mortgage proceeds and working capital.

4 Placing mortgagor's hazard and liability insurance; coordinating building release for occupancy.

5 Paying for and assisting auditor to obtain necessary information for FHA cost certification.

6 Continued contact and dealing with HUD through to final endorsement as normally indicated for typical projects.

(13) Item 66. Cost Certification Audit Fee. This is a cost typically incurred by in hiring a CPA to audit the books of account and issue an opinion for mortgagors involved in the development of multifamily projects.

(14) Items 68 through 71 are inapplicable in computing replacement costs for 223(f) projects.

(8-7) (15) Item 72. Total Estimated Development Cost is the sum of Lines 50, 63, 67, 68, 69, 70 and 71.

(16) Item 73. Land (Warranted Price of Land), enter the amount from Page 3, Section J, Line 9.

(17) Item 74. Total Estimated Replacement Cost of Project is the sum of Lines 72 and 73.

(18) Section G will be completed using the replacement cost formula mortgage assuming a 90 percent mortgage. Completion of this section is facilitated by use of the Replacement Cost Formula Format. (See Appendix 10 for format and instructions for its use.)

j. Section H. Maximum Permissible Rental Analysis

(1) Item 1. Rent Formula Residential Total Per Month. Administratively, HUD imposes a limit upon the return a sponsor can expect from the residential portion of a HUD-insured project. This is accomplished by use of a "Formula" to establish the maximum residential gross income that may be collected to permit this limited return. This calculation is made on every rental case processed and the amount of the indicated monthly maximum gross rent is entered on this line. (See Appendix 9 for format to be used in arriving at this amount).

(2) Items 2 and 7 are not applicable to Section 223(f) processing.

k. Section I. Estimate of Operating Deficit

(1) The appraiser will not fill in this section; however, for the purpose of assisting the Mortgage Credit processor in estimating the amount of the operating deficit escrow, the appraiser will enter in Remarks, Section O, of the Form HUD-92264 an estimate of the time required for the subject project to reach sustaining occupancy based on an analysis of market absorption data.

l. Section J. Project Site Analysis and Appraisal

(1) Item 1. Is Location and Neighborhood Acceptable. Analyze the location of the site relative to the needs of the tenants for transportation, schools, shopping,

(8-7) community centers and churches. Determine if any special hazards or nuisances, such as flooding, exposure to aircraft, railroad or highway noise levels, noxious odors, chemical fumes or other similar conditions, affect the subject site. The existence of any of these conditions and their effect on the site should be carefully considered before determining acceptability. If a separate environmental study has been completed, the appraiser may obtain a copy from the lender to assist in this area. Examine existing and proposed land uses in the neighborhood to determine whether they are compatible with the subject development.

(2) Item 2. Is Site Adequate in Size for Proposed Project. Determine if the site is adequate in size, shape, exposure and contour for the continued marketability of the proposal. Compare the density of the proposed project with that of similar successful projects operating in the same market area. Sites which are too large or too small will tend to cause difficulties for a project over the long run.

(3) Item 3. Is Site Zoning Permissive for Intended Use. Determine if the present structure(s) and the number of units are in compliance with current zoning.

(4) Item 4. Are Utilities Available Now to Service the Site. Determine whether the water, sewer, gas and electrical facilities are adequate to handle the needs of the project.

(5) Item 5. Is there a Market at this location for the Units at the Market Rents by Comparison shown in Section C. Analyze all available data concerning market conditions for the area in which the project is located and determine if demand potential exists for the type and number of units at the rents indicated by the Market Rent Comparison. Examine Economic and Market Analysis reports, data from building departments on new construction absorption and vacancy reports and rental schedules in the subject area when performing this analysis.

NOTE: If a negative answer is indicated for an item from J1 through J5, explain under Remarks.

(6) Item 6. Site Acceptable for Type of Project Proposed Under Section _________. Not applicable.

(8-7) (7) Item 7. Site not Acceptable for Reasons Stated Below. Self-explanatory.

(8) Item 8. "Value Fully Improved." Enter in the top row of Item 8 the location of project. The Land Use Intensity Number ________ is left blank. Use the rest of Item 8 to estimate the market value of the site in a fully improved condition by the market comparison approach. Copies of the land sales data cards/sheets of the comparables used in processing are to be attached to the Form HUD-92264. The Value Fully Improved estimated for the subject site must be the value for the intended use for which the mortgage is to be insured (i.e., its value when used for walkup apartments, if that is the use intended; or for elevator apartment structures, if that is the use intended). In the event that a higher and better use for the land is found in the market, the land value shall not be estimated for such higher and better use, but rather for the same use for which the buildings are being valued. For mortgage insurance purposes, it is clearly not desirable to have the land valued for one use, while the improvements are valued for another use.

(9) In Item 8, under the heading, "Adjustments," are found the more significant forces which influence land value, i.e., time, location, etc. Consider each of them when estimating value, whether sales price per foot or sales price per unit is used as the basis for comparison. Adjustments are made from the comparison property to the subject.

(a) Apply the "Total Adjustment" found for each comparable to the comparable's sale price per square foot or per unit to find the "Adjusted Price" for the comparable.

(b) Multiply the area of the subject site by the comparable's adjusted square foot price or number of subject's units times the comparable's adjusted unit price to find an "Indicated Value by Comparison" for the subject.

(c) Follow this procedure for each comparable to arrive at a range of values from which the value of the site fully improved is estimated by correlation and entered in item 9, Value of Site

(8-7) Fully Improved. This value estimate is based on the assumption that any off-site work has been completed and any unusual site conditions corrected.

(d) Pertinent remarks explaining all adjustments must be made in the remarks section or in an accompanying memorandum.

(10) Item 10. Value "As Is." It is not necessary that this item be used in establishing a land value for a Section 223(f) proposal. Enter N/A for "Not Applicable."

(11) Item 12. Acquisition Cost (Last Arms-Length Transaction). The transaction which first brought the sponsor into effective control of the subject property (whether the control was direct or indirect) is the last arms-length transaction. No matter how many transactions are made subsequently between persons, corporations, or trusts controlled by the sponsor, these subsequent transactions shall not be considered "arms-length." Interview principals, brokers or other persons who have knowledge of the price paid for the property in the last arms-length transaction. Record in Item 12 the names and addresses of the principals, the price paid, date of sale and sources of information.

(12) Item 13. Other Costs. Not applicable for Section 223(f) processing.

(13) Item 14. Value of Land and Cost Certification. Not applicable for Section 223(f) processing.

(14) Remarks. Use this section to make pertinent comments concerning any item in the analysis and appraisal of the site. If necessary, attach a separate memorandum to the Form HUD-92264 with a notation under this heading to see the attached memorandum.

m. Section K. Income Approach to Value

The annual net income remaining after payment of expenses is considered to be the principal source of value of the property. Value arises from the right to receive this income stream, and multifamily housing is simply one of several possible investments which may be made for the purpose of producing income or yield on an investment. The value of real estate then is the present worth of the benefits of ownership as anticipated by those investors,

(8-7) buyers, and sellers who constitute the market. Capitalization is the process of expressing future benefits in dollars and discounting them to present worth at the capitalization rate which is necessary to attract capital to similar investments.

(1) Item 1. Estimated Remaining Economic Life. In using the income approach to value, the appraiser will first estimate the remaining economic life of the subject property and enter the estimate in the space provided. The last years of economic life are more difficult to predict than the first years. For this reason, the appraiser must use caution, and avoid overly long estimates of remaining economic life especially for old buildings in old declining neighborhoods. Also, because of the uncertain nature of the last years of economic life, when the estimated economic life of the buildings is not sufficient to support a mortgage term of 10 years, the property is not eligible for mortgage insurance pursuant to Section 223(f).

(2) Item 2. Capitalization Rate Determined by. The appraiser is to check the appropriate box.

(3) Item 3. Rate Selected. Enter here the rate-selected. Complete documentation supporting rate selected must be submitted as an attachment to the Form HUD-92264. The rate selected by the appraiser should reflect the more liberal 90 percent of acquisition cost mortgage permitted, if the project meets the eligibility requirements for a Target Preservation Area project.

(4) Item 4. Net Income (Line F34). Self-explanatory.

(5) Item 5. Capitalized Value (Line 4 - Line 3). Self-explanatory.

(6) Item 6. Value of Leased Fee (if any). The cap rate selected for capitalization of the leased fee must not exceed the interest rate on the coinsured mortgage. The ground rent must not exceed the "as is" value of the land times the selected cap rate.

n. Section L. Market Comparison Approach to Value

(1) Principle of Substitution. The comparison approach to value is based upon the principle of substitution which states that a prudent person will not pay more to buy or rent a property than it will cost to buy or

(8-7) rent a comparable substitute property. The objective of this approach is to deduce from other sales the amount which the subject property would bring on the market. In theory, the best comparable sale would be an exact duplicate of the subject property and would indicate, by the known selling price of the duplicate, the price for which the subject property could be sold.

(2) Units of Comparison. In comparison, the entire project does not offer a convenient basis for comparison with other entire projects since possible differences in size, composition, areas, units and rooms are almost unlimited. For this reason, it is customary to express the market prices found in market comparables in units of comparison. Some frequently used units of comparison are: sale price per living unit, sale price per room, sale price per square foot, gross income multiplier (GIM) and effective gross income multiplier (EGIM). Market comparison approach to value should have analyses of at least two different units of comparison, one of which should be the gross income multiplier or the effective gross income multiplier. It should be noted that, when using the GIM or EGIM, no adjustment for time need be made, since the GIM or EGIM from the comparable will produce a current indicated value by comparison for the subject when it is multiplied by the current gross income or effective gross income expected for the subject project.

(3) Supporting documentation must be submitted with the completed Form HUD-92264. If the space for remarks is inadequate, an attached sheet, with appropriate notation in Section O that an attachment is involved, is necessary. The indications of value by various units of comparison are correlated into one indication of value by direct sales comparison and it is entered in Item L9 "COMPARISON $______________".

o. Appraisal Summary (Line 9).

(1) Enter here, on the appropriate space, the dollar amount estimated from each of the three approaches to value as applicable to Section 223(f). Since these amounts are estimates they should be rounded down to the nearest hundred.

(2) Capitalization. The estimated annual net income remaining after payment of expenses is transformed into the estimated market value by capitalization, in

(8-7) accord with Chapter 7 of Reference 9 of the Foreword.

Since in 223(f) it is the estimate of market value by capitalization which is desired, it is suggested that the selected rate be extracted from market transactions of comparable properties as a composite overall capitalization rate, as described in paragraph 7-4 of Reference 9 of the Foreword, or extracted from market transactions as a cash flow to equity rate and that cash flow rate be used to construct an overall rate as shown in paragraph 7-5. Each of these rates is readily extracted from sales of comparable properties and will produce values reflecting the comparable sales. The Cash Flow to Equity Rate Method is generally the most responsive to fluctuating mortgage rates and terms.

(3) The appraiser should enter the Total Estimated Replacement Cost of the Project (without depreciation) as Summation; the value indicated by the income approach as Capitalization and the value indicated by direct sales comparison as Comparison. These possible indicators of value must be correlated into the final estimate of value. The Summation estimate will determine the final estimate of value only when it is less than other indicators of value. In most instances, the final estimate of value will be best determined by the indications of value by direct sales comparison or by capitalization. The appraiser should select a final estimate of value between that indicated by comparison and that indicated by capitalization, giving more weight to the approach supported by the best data.

p. Section M. Cost Not Attributable to Dwelling Use. If a mortgage limitation less than the applicable statutory limit has already been established, it may be noted here. In that event, this section of the form need not be completed. Otherwise, the information must be provided as the form requires.

(1) The items to be included are considered without regard to their on-site location or whether the space, facility or improvement is income producing. Included are such items as: special exterior land improvements; commercial spaces and facilities, including prorated amounts for foundations, heating, air conditioning, corridors, halls, lobbys, landscaping; on-site parking, garages and carports including walks and driveways leading to them; swimming pools with related facilities and necessary appurtenances; interior works of art and any other improvements not specifically for dwelling use.

(8-7) NOTE: Items that are not included in the basic estimate, such as: special purpose commercial equipment and finishes, coin operated washers and dryers, will not be considered as cost not attributable. Structures, spaces and mechanical rough-ins for such improvements will be considered as cost not attributable to dwelling use.

(2) Special exterior land improvements. These are defined as on-site features provided to enhance the environment and livability of the project and neighborhood but which are unusual and in excess of those typically encountered in projects of the same rental range.

The percentage factor is computed by dividing the total cost of Cost Not Attributable to Dwelling Use by the total cost of Land Improvements, Line 36c and Structures, Line 41.

(3) Off-site requirements. In the event off-site requirements are necessary, the following items, although outside project boundaries, will be considered to serve the project: utilities, walks, curbs, gutters, streets, drainage structures and landscaping.

q. Section N. Not applicable to Section 223(f).

r. Section O. Remarks. The appraiser enters here any relevant remarks, including, but not limited to:

(1) The appraiser's statement of actual occupancy, and estimate of time required, if any, to reach sustaining occupancy.

(2) The estimated cost of required repairs supplied by the cost analyst. (Additional repairs or improvements proposed by the sponsor are included, since they will be considered in the value, and required by the commitment.)

(3) The estimates amounts for legal, organizational (if applicable) and title and recording expenses based on the maximum insurable 223(f) loan.

(4) The appraiser's determination of the tentative maximum coinsurable mortgage amount. In support of this determination, the appraiser should attach a trial copy of Form HUD-92264A with criteria 3, 4 and 5 completed.

(8-7) (5) The amount of the required initial deposit to the replacement reserve. In addition to the annual deposit which is required throughout the life of the mortgage, an initial deposit may be necessary.

(a) The annual amount which is to be deposited in the Replacement Reserve Fund is .0060 multiplied by Item G-41, Total Structures, on Form HUD-92264. However, since many shortlived items of equipment may have used a good portion of their useful life at the time of appraisal, it is necessary to make an initial deposit into the Replacement Reserve Fund at time of closing. The amount of this required initial deposit is computed by the appraiser taking into account the cost and useful life information regarding replaceable items received from the cost processor, the architect, or the engineer's survey.

(b) If, for example, equipment 10 years old had a normal life of 12 years, 10/12 or 83 percent of its useful life has been used, and an initial deposit of 83 percent of the cost to replace this equipment is needed at closing to prevent the Replacement Reserve Fund from becoming insolvent in two years.

(c) The initial deposit to the Replacement Reserve Fund may be calculated by either a physical takeoff of the items to be considered in the replacement reserve or by multiplying the dollar amount established as Total Structures (Line G-41) by .004 and multiplying the result by the age of the project, not to exceed 15 years, rounded to the nearest full year.

(d) Options. In determining the method to be used in computing the initial deposit to the Replacement Reserve Fund, the appraiser should consider effective age of the items considered in establishing the Reserve Fund. It would be inequitable, for example, to compute the amount of the reserve using the age method described in (c) above for a 15 year old project if most of the Replacement Reserve items had just been replaced. Conversely, the deposit for a 3 year old project with extreme wear or very low quality appliances might be far below the needed reserve amount if the deposit was calculated on the physical age of the project.

(e) Deposit of fund. This fund must be deposited in an account (which may be interest bearing) insured by an agency of the Federal Government, so arranged that it is at all times under the control of the lender.

(f) Attachments. The appraiser must attach the worksheets used in calculating the deposit to the Form HUD-92264.

(6) Where applicable, identification should be provided that the project is located in a Target Preservation Area.

8-8. NARRATIVE SUMMARY. In addition to the preparation of the Form HUD-92264, the appraiser will prepare a brief narrative summary of important conclusions including a correlation and final estimate of value. The narrative should also make reference to the replacement reserve deposit and expand on the computation methods and conclusions as necessary. Both the Form HUD-92264 and this report must be signed by the appraiser.