
 CHAPTER 3. VALUATION INSTRUCTIONS

3-1. GENERAL. Title XI is different from other HUD-FHA multifamily programs in several major respects. It insures mortgages on properties which are entirely non-residential. It insures mortgages on properties which may include items as a part of the security that are not attached to or part of the real estate, namely, movable equipment, furniture and furnishings. There is no division of space to be leased, as the group will commit for the entire insured property in advance of occupancy. Generally, all sections are to follow basic multifamily processing instruction; (see Reference (3) of the Foreword) modifications are clearly defined.

3-2. DATA PROCESSING. The accumulation of adequate reliable data to assist in underwriting decisions is extremely important in all HUD-FHA processing, including Title XI. Data must be gathered, analyzed and classified for each processing phase.

a. Income Data.

(1) Rental income data adjusted to gross floor area are to be accumulated for each major kind of use, including:

* (a) General or specialized medical or osteopathic practice.

(b) General or specialized dental practice.

(c) Optometric practice.

(d) Podiatric practice. *

(2) Other special use space, such as a pharmacy or a laboratory which is connected with the above major uses is to be considered as part of such use.

(3) In areas where there are insufficient group practices from which to obtain needed information, it is acceptable to use data based on group practices conducted in comparable communities or areas where land costs, construction costs, and the general economy of the areas are somewhat comparable. There may be areas where the only data available will be based upon medical arts office buildings, or office buildings which lease a considerable percentage of their space for medical, dental, optometric, osteopathic, or podiatric offices. *

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- (3-2) (a) Inasmuch as group practices generally:
- 1 occupy the entire building in which they are located;
 - 2 have no common use corridors; and
 - 3 have only one waiting room or one waiting room per floor or section, they are to be measured on a gross area basis as a standard, including storage and utility spaces.
- (b) Consequently, adjustment must be made in other types of space to convert to gross floor area rental rate. Gross floor area for these purposes is measured from outside wall to outside wall of each floor.
- (4) Also, due to the above characteristics, group practice facilities will have a greater intensity per square foot of plumbing, electrical outlets, special controls, etc., with a generally higher square foot cost of construction, than professional office buildings leasing for private practice. Consequently, these additional costs must be considered in making adjustments when using such other space for market data purposes. In many instances this higher cost per square foot will yield an economic benefit by enabling the group practice to function more efficiently.
- b. Expense Data. Complete expense data must be accumulated from all types of medical facilities operating in each locality. These data are to be classified by type of building and type of operation.
- (1) Items of expense to be included are:
- (a) Administrative, including office salaries and expense, legal and audit, licenses, permits, payroll taxes, etc., related to the property.
 - (b) Buildings and grounds, including salaries, decorating, utilities, maintenance and repair, and property insurance.

- (3-2) (c) Taxes including realty and non-realty. Tax rates and methods of assessment for both the realty and professional and technical equipment must be included.
- (d) Rental costs for professional and technical equipment for use in those cases where such equipment will be leased.
- (2) The expense data will be grouped on spread sheets by class of operation i.e., group practice facility, medical arts building, professional office building, etc. These data should be converted to expense per square foot of gross floor area for all types of property. In addition, for prepaid group facilities the expense data are to be converted to a per doctor basis.
- c. Market Demand Data. The Department of Health, Education and Welfare will certify as to the suitability of a professional group practice for a particular community. HUD-FHA will determine that market demand exists for a property to be mortgaged at a specific location as distinguished from need for the professional practice which is determined by HEW. Market data must be accumulated, analyzed, and classified so that proposals may be properly evaluated. The necessary market data will include:
- (1) The current supply of all medical practice facilities, classified by type of building, type of use and number of practitioners in each Standard Metropolitan Statistical Area (SMSA) or geographically homogeneous area. The classifications will be in three broad categories:
- (a) Group practice facility
- (b) Medical arts building
- (c) Professional office building
- (2) Construction of additional facilities already being built or firmly proposed.

3-3. PRELIMINARY ANALYSIS. FHA Form 2438(a) GP (See Appendix 16) is to be used to process information contained in FHA Form 2013 GP-1 and subsequent information developed by the appraiser in relation to FHA Form 2013 GP-1. FHA Form 2438(a) GP requires data in three areas: market, site, and feasibility. This form is to be completed by the appraiser and architect, in some instances with special assistance by the land planner.

a. Market Need. Market data discussed in Paragraph 3-2 are to be utilized.

(1) The presence of facilities which are vacant, suitable for the use proposed, and available at rents at or below those which will have to be charged for the proposed facility indicates a weak market demand for group practice medical care.

(2) Vacancy, however, is not a certain indication of weak demand. Rather, because of poor design or other reasons, the vacant facility may not have met the needs of the group for which it was built. Also, the group may have outgrown the building and the property did not lend itself to expansion at such time, or the group may have disbanded due to incomparability even though the building was satisfactory. A new facility in the same area properly designed for the group which is to use it may be successful.

b. Site. Site inspection is to be made by the appraiser. Executive Order 11296 is to be implemented to minimize exposure of the project to potential flood damage. In all cases where any unusual site conditions may exist, such as poor soil, questionable topography, flood plains, etc., the processing should not be completed until the architect, engineer, or land planner has inspected the property and submitted his report to the ADTSB/CU.

c. Feasibility Check. If the annual income requirement per square foot to support the project is at or reasonably below market rental rates for a facility offering the same amenities and facilities, the project is to be considered feasible. If the income requirement is higher than rental

(3-3) rates in the market, compute the amount of the excess construction cost by using the formula shown in (2) below.

(1) The feasibility check being performed here (lower

one-half of FHA Form 2438(a) GP) is on the realty alone. It is therefore necessary to estimate and eliminate that portion of the expenses attributable to equipment in Item 1 under Feasibility Check; K4b is not considered in Item 2, and Item 4 is the Total Annual Obligation on realty alone.

(2) Formula for Excess Construction Cost.

(a) Deduct economic square foot rate from rate in Item 5; e.g., economic rent is at \$3.75 p.s.f. and Item 5 is at \$4.00, 6(a) is therefore 25 cents p.s.f. multiplied by the gross floor area. This is the total amount of the excess of Item 4 over the total economic rent of the realty.

(b) and (c) - Self-explanatory.

(d) This computation takes into account the fact that Items 1 and 2 are somewhat greater than they would have been without the excess construction. This factor of 1.08 is based upon several case examples and is the approximate average of the narrow range of these case examples. The amount of the increase of (d) over (c) will vary directly with the amounts in (a) and (c).

(e) This is the formula for converting the excess amount of the annual obligation into the amount of the excess realty cost.

(3) If a reverse situation appears to exist and economic rent is greatly in excess of total annual obligation, the project should be investigated carefully as the sponsors may be underestimating costs or may have made vital errors and may be requesting an insufficient mortgage while not having sufficient equity capital available to complete the proposal.

d. Unacceptable Project. If, after a thorough check of market need, site and economic feasibility, the project appears to be unacceptable, advise the sponsor of the unacceptability of the proposal by format letter A and indicate willingness to discuss the matter at his convenience. Include a reference to the refund of the \$400 fee, being returned at a later date. If a meeting is scheduled, arrangements should be made in advance for architects and engineers to

assist the sponsor and his architect in investigating areas in which the necessary reductions in cost may be accomplished in order to make the project feasible.

- e. Feasible Proposal. Where the proposal, as analyzed on FHA Form 2438(a) GP, appears to be feasible as to site, market, and economics, the Field Office Director is to forward the application to the Director, Office of Underwriting Standards, Washington, D.C. for forwarding to HEW for their review. *

- (1) Once the application has been forwarded to HEW the \$400 preliminary analysis fee has been committed and is non-refundable.
- (2) If the HEW findings are unfavorable, the application will be returned to the Director, who will issue Format Letter GP-A (See Figure 1) to the sponsor without any reference to the \$400 fee.
- (3) If the HEW findings are favorable, the application will be returned to the Field Office Director, who will issue Format Letter GP-B (See Figure 2 For a Sample Guide) to the sponsor.

- 3-4. PRE-COMMITMENT PROCESSING (FHA FORM 2013 GP-2). FHA Form 2264 GP is to be used to process FHA Form 2013 GP-2. If feasibility is determined after processing FHA Form 2264 GP the Field Office Director is to issue Format Letter GP-C (See Figure 3 For a Sample Guide) to the sponsor. Specific instructions for the FHA Form 2264 GP follow (For FHA Form 2264 GP also See Appendix 15):

- a. Carrying Charges and Financing. Complete this part in accordance with basic instructions. In addition to the normal examination fee add the lump sum \$400 fee.

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- (3-4) b. Legal and Organization. These costs are to be computed in accordance with outstanding instructions. In addition, allow for cost of creating the mortgagor entity, creating a new group practice entity, and of making a prudent analysis of market need. There is no marketing expense involved and these costs should therefore not exceed 2% of the amount of mortgage. Anything greater will be required to be submitted for clearance to Central Office. Most of these allowances will not be permitted to established group practices seeking enlargement or remodeling of existing facilities. Expenses of creating a new prepaid plan, except as to the mortgagor

entity, are not allowable.

c. Reserve for Replacement.

- (1) New Construction, Part III - Line A for the FHA Form 2264 GP, strike out the words "Less Air Cond" and change the factor, .0063 to read .004.
- (2) Rehabilitation, Part III Line A. Amend to show the maximum available mortgage amount. Change the factor .0063 to read .004.
- (3) Item B of Part III will not be completed.
- (4) Total for Non-Realty Equipment. This is the sum of Part III, C. 1 and 2. Multiply this sum by 0.10 to arrive at the annual reserve for replacement of the equipment and furnishings.

d. Land Appraisal. Complete this part in accordance with basic instructions.

- (1) Part B is for entering market data on comparable property in its present condition, either unimproved land or existing property before rehabilitation. If "terms" are a factor in any sale, a column should be so labelled and the terms of sale which are unusual should be recorded and explained.
- (2) "Remarks": Use this to elaborate on unusual factors not covered in the columns. Use the usual correlation in columns. Use the usual correlation and bracketing processes to arrive at an estimate of the market price

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(3-4) of the property, before rehabilitation, by the comparison method.

e. Estimated Annual Operating Expense, Reserves and Taxes.

- (1) Expense Data. If there is no information on a particular item of expense from other projects, make computation based directly on known rates or charges by suppliers or other sources.
- (2) Taxes. Self-explanatory. It is advisable to discuss the probable tax for group practice facilities with the

local assessor. The non-profit aspects of such projects may have a material affect on the taxes to be levied. Short term tax abatement will not be recognized in the tax estimate.

f. Estimate of Value.

- (1) Part VI - A will not be completed.
- (2) Part VI - B will not be completed; however, those entries 1 through 4, which develop the net income and economic life estimates, must be completed so that this information will be made readily available to the mortgage credit processor.
- (3) Part VI - C of the 2264 GP, Estimate of Value by Comparison will not be completed.
- (4) Part VI - E, Estimate of Value of the Project, omit except for line 5 which must be completed when a ground lease is contemplated.

g. Value of Non-Realty Equipment. The appropriateness of the services will have been reviewed by HEW. It is the responsibility of the Field Office to determine if the total cost of equipment proposed to perform those services is acceptable.

- (1) Costs for equipment may be separated into the following major categories:
 - (a) Cost (new) for equipment placed inside the doctor's office. Inquiries recently made showed a range from \$3,500 to \$5,000 per doctor. For certain

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- (3-4) major specialties the investment may be greater and should be appropriate to services to be provided.
 - (b) Cost of major items for general use. Inquiries recently made showed that X-ray equipment alone, including spot developer, may run from \$20,000 to \$25,000.
 - (c) Laboratory Equipment. For a group of under ten physicians, a grand total may be as high as \$15,000. For a group of ten or more, the cost may be higher per physician, even as high as \$2500 per physician

in very large groups whose volume justifies purchase of more costly sophisticated equipment.

- (d) Business equipment. For a group of under ten physicians, a total may be as high as \$12,000 to \$15,000. For a group of ten or more, the cost may run as high as \$2,000 per physician in very large groups.
 - (e) Furniture and furnishings. All furniture and furnishings, including carpeting and draperies, may be included in the mortgage. The total expenditure for this category of cost will vary so greatly that no rule of thumb is suggested. Very small groups may have only one waiting room for pediatrics and for obstetrics. Large facilities may have separate waiting rooms on each floor. These large facilities may also have doctor's lounges, conference rooms, libraries, etc. Each case should be examined on its own merits.
 - (f) Maintenance equipment. Not to be included in mortgage.
- (2) Also eligible for inclusion in the value of non-realty equipment is the "as is" value of used professional and technical equipment acquired by the mortgagor, either by purchase or by contribution by members of the group. The depreciated "as is" value of such used professional and technical equipment will be determined by obtaining price from dealers of used equipment. Equipment items with a durable life of five years or less are not to be included.

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- (3-4) (3) To complete Section D.
- (a) Enter the sponsor's stated costs here.
 - (b) On line 2 enter the prices asked and obtained in the market for the same or similar equipment (after extraction of any financing charges, discounts, or other concessions), developed by the cost analyst.
 - (c) This establishes the worth of the non-realty equipment for HUD purposes.

(d) Enter on line 4 taxes, if any, on the equipment, the estimate of maintenance and repair, insurance and reserves for replacement as previously determined. If non-realty equipment items are leased rather than purchased make no entry. (The leased items are not to be included in the estimate of replacement costs.) Maintenance and repair may be by contract for certain major items of equipment. Include the sum of these annual contract charges in the total cost of equipment maintenance and repairs.

(4) To complete Section F.

The information to be entered in Section F is required by the mortgage credit section in its computation of the debt service criteria. Since the worth of the non-realty equipment is established as described in (3), above it can be properly assumed that a net rental as determined on the FHA Form 2264 GP (section VI. F) can be obtained from the group practice tenancy.

- h. Formula Control of Income. Computation of rent formula (control of return) is not required.
- i. Part VII, delete "The fair market value of the property" in the first certification and substitute the following: "The replacement cost of the property, including non-realty items." Enter the total cost from Part II - G.

Outstanding instructions for the completion of those entries designated "For use in cost certification" are unchanged.

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- j. Group Practice Facilities in Older Declining Urban Areas which meet the criteria of Section 223(e) may now be insured pursuant to Section 223(e) thus making the mortgage insurance an obligation to the Special Risk Insurance Fund.
- 3-5. COMMITMENT PROCESSING. When the sponsor submits the final exhibits, including final working drawings and specifications, they are to be reviewed for completeness and then placed in processing. Plans, specifications and cost estimate are to be examined by appropriate underwriting sections. Plans and Specifications are also to be examined by land planning personnel. The rule of reasonableness is to be applied in requiring changes in the plans and specifications, especially if a delay in processing or increase in cost will result. Any changes which affect the

processing done in pre-commitment are to be made on the FHA Form 2264 GP in red ink, or revised pages are to be substituted as required. Superseded pages are to be so marked, dated, and signed in red ink.

- 3-6. REHABILITATION. Where rehabilitation of an existing building is planned, the following special instructions will apply. (Use FHA Forms 2264 and 2264 GP as appropriate.) The mortgage amount will be based upon the value of the property after rehabilitation including the value of the eligible professional and technical equipment to be used in the group practice.
- a. Required Estimates. The following estimates are required in the determination of value:
- (1) "As is" value of the real property plus cost to rehabilitate.
 - (2) Estimated value of the real property after rehabilitation.
 - (3) Replacement cost of an equivalent new property.
- b. "As Is" Value plus Cost to Rehabilitate.
- (1) Determine "as is" value in accordance with outstanding basic instructions.
 - (2) Use the proposed acquisition cost disclosed by the sponsor as additional data in determining "as is" value.

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- (3-6) (3) The "as is" value found will be used in cost certification and requires the following certification. "Fair market" value of land and improvements before repair or rehabilitation is \$ _____ under remarks.
- (4) To the "as is" value is added the cost of the proposed rehabilitation program estimated by the cost analyst, and completed as in proposed construction in the Valuation Section.
- c. Replacement Cost of an Equivalent New Property. When relevant and as determined by the ADTSB/CU.
- (1) This estimate is to be based upon typical square foot costs of constructing similar new facilities. Such costs are to be furnished by the Cost Analyst. This estimate is to take into consideration the gross

useable area of the building to be rehabilitated but is to exclude waste space which would not be a part of a new building providing similar facilities for the same number of practitioners in a group practice. To this amount is to be added the value of the land, to arrive at the replacement cost of a new property.

(2) In accordance with the principal of substitution, the value of the property for mortgage loan purposes will be the lesser of the three estimates listed in paragraph 3-6a together with the value of the eligible professional and technical equipment; the value of this equipment is to be determined as in proposed cases.

d. Used Equipment: Used professional and technical equipment, if any, owned or to be acquired by the mortgagor in connection with a property to be rehabilitated is to be included in the "as is" value of the property before rehabilitation. The depreciated "as is" value of the used professional and technical equipment is to be determined by obtaining price information from dealers of used equipment. The cost of repairing such equipment may be included in the rehabilitation costs of the project, and the value after rehabilitation will include the used equipment.

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CHAPTER 3, FIGURE 1

FORMAT LETTER GP - A

Re:

Dear

We have completed pre-application analysis of the captioned proposal and, in our opinion, submission of a formal application is not warranted.

Our analysis reveals it would be inadvisable for your to pursue this project for the following reason(s):

We appreciate your interest in the HUD-FHA mortgage insurance programs and regret that we are unable to give you a favorable report with respect to this proposal. If you wish to pursue this proposal we will be pleased to discuss it at your convenience...TX:

Very truly yours,

Director

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CHAPTER 3, FIGURE 2

FORMAT LETTER GP - B

Re:

Dear

We have completed preliminary analysis of the captioned proposal and we believe you are justified in submitting a formal application covering a project consistent with that described in your request for preliminary analysis (or) (modified as follows):

Your application, with fee, will be accepted if submitted within four (4) months from the date of this letter. If your submission is complete, conforms essentially with you preliminary proposal, and is otherwise acceptable, it will be assigned for processing, at which time the fee accompanying the formal application will be considered earned. However, our acceptance of an application, with fee, is no assurance that a commitment will be issued, or, if one is issued that it will provide an insured loan in an amount requested.

Your application must be submitted on the prescribed form, copies of which are attached. The submission should be in accordance with the attached instructions or those contained on the application form. Preliminary Working Drawings and Specifications must accompany the application. Mechanical, plumbing and electrical phases of the plans must be developed in sufficient detail at this stage of permit the preparation of a preliminary cost estimate.

After review of your application and exhibits this office will issue a letter setting forth the tentative estimates. If, at such time, you wish to proceed on the basis of the tentative determinations, the required final drawings and specifications must be submitted. Failure to do so within three months from the date of the feasibility letter will result in cancellation of the application. Any subsequent submission would be considered a new proposal requiring the filing of a request for preliminary analysis on FHA Form No. 2013 GP-1.

Very truly yours,

Director

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4630.1CHAPTER 3, FIGURE 3

FORMAT LETTER GP - C

Dear

The first stage of processing has been completed on your application and the tentative estimates set forth below have been developed:

Estimated market price of site after completion of off-site improvements (this estimate is not to be confused with the value that may be attributed to land for cost certification, and is also subject to reduction to reflect any unusual costs of foundations or site development not known at this time): \$

Tentative Estimate of Replacement Cost: \$

Tentative Estimate of Equipment Cost: \$

Tentative Maximum Mortgage Amount: \$

From the information now available, it is expected that these estimates will closely approximate those that will be established on the basis of detailed commitment processing. However, the estimates are tentative only and this letter is in no way to be considered as a commitment to insure. The exact amount of any commitment must be established on the basis of detailed commitment processing and the issuance of any commitment is subject to the proposal meeting applicable requirements.

If you wish to proceed on the basis of these tentative estimates Final working drawings and specifications should be submitted as promptly as possible, and in no case later than three months following the date of this letter. If they are not received within this time, the pending application will be cancelled and any subsequent submission would be considered a new proposal requiring the filing of a request for preliminary analysis on FHA Form No. 2013 GP-1. If the new Form 2013 GP-1 is received within 90 days of the initial cancellation and an application is invited, the fee previously paid will be applied to the new application.

After the final working drawings and specifications have been submitted and reviewed by HUD-FHA, the required cost estimates should be submitted as soon as possible after request by HUD-FHA

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CHAPTER 3, FIGURE 3

to avoid any unnecessary delay in commitment processing.

Please let us know at your earliest convenience whether you intend to proceed under the present application.

Very truly yours,

Director

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