Chapter 7

Valuation Analysis

7.1 Purpose of the Valuation Analysis

A. The Valuation Analysis is made for the purpose of evaluating the existing or proposed property as security for a long-term HUD-insured mortgage. Included in the evaluation is an estimation of the market value of the property and an analysis of the market need, location, earning capacity, operating expenses, and warranted cost of the property.

B. Valuation Analysis develops conclusions with respect to feasibility, suitability of improvements, extent, quality, and duration of earning capacity and other factors that have a bearing on the economic soundness of the property. The objective is to have a properly designed project in the right location, capable of supporting the loan. Such a project meets the demands of the rental market at rents which will pay all expenses of operation, debt service, and return to equity where such return is permitted.

7.2 Selection of Appraisers and Market Analysts

The MAP Lender is responsible for the selection, approval, and training (if needed) of appraisers and market analysts who are familiar with HUD reviews and guidelines. Lenders must ensure that each appraiser and market analyst selected is qualified to appraise or perform market analyses for multifamily properties by reviewing their education, quality, and frequency of multifamily experience, sample appraisals and market studies, professional affiliations, and state licenses or certifications.

A. Should the MAP Lender have difficulty finding a Certified General Appraiser, the Appraisal Subcommittee of the Federal Financial Institutions Examination Council maintains a national registry of Certified General Appraisers who are authorized, under Federal law, to perform Appraisals in connection with federally-related transactions. The MAP Lender would be able to review this list on the Internet at http://www.asc.gov.

B. The appraiser or the market analyst may not be affiliated with any individual or institution involved in the application other than the MAP Lender. Appraisers or market analysts who are on the Lender’s staff must be independent of the lending, investment, and collection functions of the Lender.
C. The Department reserves the right to examine the credentials of all appraisers and market analysts hired by the Lender, and to reject any and all individuals that it considers unqualified

### 7.3 Appraiser and Market Analyst Qualifications

#### A. Each appraiser must meet the following minimum qualification requirements:

1. Be a Certified General Appraiser under the appraiser certification requirements of the State in which the subject property is located,
2. Be currently active and regularly engaged in the appraisal of multifamily properties,
3. Meet all requirements of the Competency Rule described in Uniform Standards of Professional Appraisal Practice (USPAP), this applies to each certified appraiser who signs the report. If any of the persons involved in preparing the report is a trainee acting as an assistant only, this should be disclosed to the processing center.
4. Have at least three years of income property appraisal experience,
5. Be knowledgeable concerning current real estate market conditions and financing trends in the geographic market area where the subject property is located, and
6. Be experienced in appraising multifamily properties with the complexity and characteristics similar to those of the subject property.

These requirements apply to EACH certified general appraiser signing the report. It is not permissible for an appraiser who is not certified in the appropriate jurisdiction to circumvent certification requirements by having a locally certified appraiser co-sign the report. Appraisers or appraisal assistants not certified in the appropriate jurisdiction may not perform the MAP required property inspections of the subject or comparable properties. If any of the persons involved in preparing the report are not certified general appraisers and are acting as an analyst, assistant or trainee, this must be disclosed to the processing center. Temporary certifications are permissible, however, competency requirements as defined above still apply.

#### B. Each Market Analyst must meet the following minimum qualification requirements:

1. Have at least three years of experience in performing market analysis for income producing property,
2. Be currently active and regularly engaged in performing market studies for multifamily properties,
3. Be knowledgeable concerning real estate market conditions and financing trends in the geographic market area where the property is located, and
4. Be experienced in performing market studies for multifamily properties with the complexity and characteristics similar to those of the subject property.

C. The appraisal and the market analysis may be performed by the same person or entity.

D. The Appraisal and market study must be complete and independent reports, even if prepared by the same person.

E. If the processing center believes that a lender is contracting unqualified or unlicensed professionals, they should refer the specifics of the case to the Lender Qualifications and Monitoring Division in Headquarters.

7.4 Appraisal Requirements

A. Each appraisal must meet the following requirements:

1. Be prepared for the Lender and paid for and initiated by the Lender.

2. For value-based programs, Section 223(f), Section 232 and Section 232/223(f), each appraisal shall be a complete appraisal in accordance with all applicable requirements contained in USPAP Standards Rule 1 and in compliance with this guidebook. For Sections 220 and 221, the appraiser may prepare a limited appraisal as outlined in paragraph 7.4 A 4 below. The appraiser should reference the Jurisdictional Exception Rule where appropriate. The Departure Rule is not authorized. The appraisal report format must meet the specifications of Standards Rule 2-2a and be a Self-Contained Report. Form HUD-92264 (92264-HCF for Section 232 projects) and supporting forms, i.e., HUD-92264-A, HUD-92273 and HUD-92274 must be completed by the appraiser. The self contained report will be supportive of and consistent with the conclusions made on the forms.

3. Adequately describe the geographic area, neighborhood, rental competition, sales comparables, site, and improvements.

4. Produce a fair market value supported by the reconciliation of the cost, income, and direct sales comparison approaches to value for Section 207/223(f), 232, and 232/223(f). The cost or summation approach must consider all applicable forms of depreciation for 223(f) and 232/223(f) cases. For this reason, the replacement cost approach shall not automatically set the upper limit of value for these programs. For New Construction and Substantial Rehabilitation pursuant to Section 232, the replacement cost or summation approach shall in all cases set the upper limit of value in the reconciliation process. This policy is not intended to negate the necessity of the final reconciliation of the three approaches. Section 232 remains a value-based program. It is rather an acknowledgment of the basic principle of substitution in that no prudent purchaser would pay more for a property than the cost to acquire a similar site.
and construct improvements of equal desirability and utility. A Limited appraisal using the Replacement Cost for projects insured through Sections 221(d) and 220 should be supported by the cost approach to value. Support “As Is” value in Substantial Rehabilitation by use of the income and direct sales comparison approaches to value.

5. Have an effective date within 120 days before the date the Firm Commitment application or pre-application package is delivered by the Lender to HUD. Updated appraisals can be submitted with the appraiser re-inspecting the subject property, re-surveying the rental comparables, and reviewing the market for any additional sales comparables.

6. Be prepared with the list of information supplied by the MAP Lender contained in Appendix 4.

7. Include appraiser’s certification. See certification format in Chapter 11 of MAP Guide.

8. Under MAP the USPAP Departure Rule is not authorized. Instead, the appraiser shall invoke the USPAP Jurisdictional Exception Rule to fulfill MAP underwriting requirements. By definition, the Jurisdictional Exception Rule renders a specific portion of USPAP void and of no force or effect; therefore, for the purposes of that assignment, the excepted portion of USPAP does not exist and so cannot be subject to the Departure Rule. Pre-application valuation exhibits should be viewed as an Appraisal Consulting Assignment as defined in USPAP Standard 4, and are prepared as a precursor to the final report submitted at the firm commitment phase. For Section 223(f), Section 232 and Section 232/223(f), the appraisals should be a Complete Appraisal in accordance with all applicable requirements contained in USPAP Standards Rule 1, and in compliance with this guidebook. For Sections 220 and 221, the appraiser may prepare a Limited Appraisal as outlined in paragraph 7.4 A 4.

9. The primary appraiser designated by the Lender and approved by HUD must perform the property inspection AND sign the appraisal report and the supporting HUD forms.

10. Photos of the subject, comparable sales and comparable rentals are required with all submissions.

B. Discrimination in appraising. As the basis of determining value, the appraiser may not consider, analyze, or report any information that makes reference to race, color, sex, handicap, familial status, religion, or national origin of the geographic area, neighborhood, occupants, owners or prospective owners. HUD will reject any Firm Commitment application for mortgage insurance that considers any of these issues in the preparation of an appraisal.

C. The Discounted Cash Flow (DCF) is not a permissible analysis technique under MAP or TAP for any HUD programs.

### 7.5 Market Study Requirements

Each market study must meet the following requirements:
A. Be prepared for the Lender and paid for and initiated by the Lender. A market study that has already been prepared for the borrower by a third party market analyst and meets all other market study elements as stated in the MAP Guide is acceptable.

B. Adequately describe the geographic boundaries and general characteristics of the market area, specific housing market conditions, characteristics of projects under construction and in the planning stages, and contain a demand estimate and analysis and estimated absorption time (absorption time is normally not applicable to refinance and purchase cases pursuant to Section 223(f)).

C. Have an effective date within 120 days before the date the pre-application is delivered by the Lender to HUD or within 120 days before the Firm Commitment application is delivered for a 232/223(f).

D. Be prepared with the list of information supplied by the MAP Lender described in Appendix 4.

E. Be prepared in conformance to the market study format found in Appendix 7A.

F. Both the appraiser and market analyst may be the same person or entity. If the same person does prepare the market study, it must be submitted as an independent exhibit.

G. Include market analyst’s certification. See certification format in Chapter 11 of MAP Guide.

7.6 Estimated Rental Income

A. Rental estimates. First the annual gross income of the subject project is estimated. The processing will include estimates of income from market comparables, rental concessions, and an assessment of the general health of the rental market. The gross income estimate assumes a 100 percent occupancy level and reflects rent levels current as of the appraisal date or date of the market study. Also, the effect that any proposed repairs to the project will have on rents, expenses, and net income must be considered. (Not all repairs increase rents, occupancy, net income, and/or decrease expenses.)

B. Rent comparables. Market Rent by Comparison shall be estimated by the Lender’s appraiser by completing HUD-92273. Note that use of HUD Form 97723-S8 is not authorized for FHA mortgage application processing. One HUD-9273 form is to be prepared for each type and size (if significantly different) of rental unit in the subject property. The rent comparables and units selected for comparison shall be as similar as possible to the subject property and units as they relate to location, structural type, number of bedrooms, and average unit size. Market rate units
from partially assisted projects can be used as rental comparables in the absence of better rental data. Consistent adjustments for significant differences between the comparables and the subject units shall be derived from the market and applied to the subject rent estimate. Rental adjustments are always made to the comparables for differences from the subject project. The Lender’s appraiser should select the final rent estimate based on accepted correlation procedures. Generally, the indicated rent estimate will be from the central 60 percent of the rental range of the indicated rents. Just as the most appropriate rent comparable must receive more weight, the general health of the rental market must be recognized before relying upon one or two optimistic indicators. On tax credit and/or bond financed applications the appraiser should also complete the HUD-92264T in determining the appropriate processing rents.

C. Rents as of the appraisal date or market study date. Rather than being trended to some future date, rental estimates shall be made as of the appraisal or market study date. Since rent estimates are made based upon street rents currently being obtained by the comparables, no time adjustment is needed for an estimate as of the appraisal or market study date. Medicaid reimbursement rates may be trended for proposed nursing homes and intermediate care facilities.

D. Equipment and services. Equipment and services included in the subject rent must be identified—such as ranges, refrigerators, microwave ovens, air conditioning equipment and laundry facilities. Services frequently included are heat, air conditioning, water, trash removal services, etc. Comparable project equipment and services must correspond to the same items of equipment and services provided by the owner for the subject proposal. Differences between comparable equipment and services and those of the subject proposal must be reconciled by the adjustment process. Note: The above also applies to the expense analysis.

E. Vacancy and collection losses.

1. The Lender’s appraiser must establish a factor for vacancy and collection loss when determining the effective gross annual income for the residential units. The factor must consider both historical and current data (applicable for existing properties) of the subject property, the rental comparables, and any anticipated changes in the market. The factor selected must reflect long-term occupancy rates that are expected to continue.

2. The vacancy and collection loss rate used by the Lender’s appraiser may not be less than 5 percent and must be adjusted upward if property and/or market conditions require. This requirement applies to all programs, 221(d), 223(f), and 232 under MAP.

F. Commercial income. Where commercial facilities are included in a project, a separate analysis must be made of the effect that the commercial operation will have on the project. The Lender must calculate income, vacancy and collection loss, operating expenses, and replacement reserves attributable to commercial space separately from the residential. An individual analysis should be performed for each type space using the HUD Form 92273 or a similar format to summarize appropriate adjustments to comparable data. These studies can be incorporated in the overall
residential market study submitted at the pre-application or firm stages, depending on the program requirements. In addition to the following requirements, the study should also comply with Appendix 7A. Care should be taken in reviewing the allowable square footage and income percentage attributable to the commercial/office space. These requirements vary by program. See Chapter 3, Sections 3.4 I, 3.8 N, and 3.9 F for a more complete synopsis of space and income limitations.

1. The Lender’s appraiser must: Conduct a complete analysis of at least three commercial income and expense comparables. Provide for each comparable the name of the tenant, the type and address of business, square feet, rent, vacancy, any concessions and major lease terms. Provide data to support the subject’s commercial vacancy rate in relation to the overall market commercial vacancy rate and review the rollover risk and cost of tenant improvements to re-lease space. Use a vacancy factor of not less than 10 percent for Section 223(f) and 232/223(f); 20 percent for Section 221, 220 and 232 new construction/substantial rehabilitation to obtain effective gross commercial income for underwriting purposes. Provide for each lease, the term, commencement date, expiration date, name of the tenant, square footage, calculation of gross rents, expenses, reimbursement of expenses, cancellation clauses, and renewal clauses.

2. Limitations on the amount of commercial space and income vary by program. (See Chapter 3.)

3. The project expense estimate must include all commercial expenses payable by the project owner. The analysis of all commercial income and expenses must be reflected on Form HUD-92264 with all the supporting data attached to the form.

G. Project rent concessions. Rent concessions in a comparable must be included in the data and an appropriate adjustment made to the rent from that comparable unit. In all cases, adjustment should reflect the actual impact on gross annual income resulting from the comparable rental concession.

H. Occupancy. When the occupancy rate in a comparable project is less than the long-term occupancy rate estimated for the subject, a downward adjustment shall be made to the comparable’s rent

I. Utilities/Services. All of the items for consideration under this heading refer to the cost of the services of water, sewer, gas and electricity included in the rent. In some cases, even though both the subject and the comparable units have the same service included in the rent, an adjustment may still be warranted to bring the comparable in line with the subject, due to size, equipment, utility rate, type of utility, etc. If included in the comparable rent, but not in the subject, enter a minus adjustment reflecting the portion of the comparable’s rent attributable to the inclusion of the service. If excluded from the comparable rent, but included in the subject rent, enter a plus adjustment reflecting the estimated increase in rental value attributable to including the service in the subject’s rent.
J. Project location. Consider the subject location relative to distance from shopping, recreational, social, medical and employment centers, neighborhood desirability, transportation, special hazards and nuisances.

K. Project amenities.

1. Among those “other” items that may be considered herein, are the following:
   a. Livability—reflect good or poor room sizes, layout adequacy of closets, lighting, elevators and laundry facilities, etc.
   b. Condition of improvements—reflect lack of maintenance, soundproofing, etc.
   c. Parking—reflect parking rates, adequacy of parking for visitors, proximity of parking to the units, inclusion/exclusion of parking space with unit rental, etc.
   d. Project density—consider open space or crowding of units, if the degree of either is such that it would affect the level of attainable rental.
   e. Unit location—reflect here features of location of unit within the project, such as view, proximity to swimming pool, tennis or other recreational facility, and/or other factors of this nature.

2. Elevator rents. Only high-rise elevator comparables are to be compared with the subject elevator high-rise proposal. Mid-floor level rents of the comparables are compared with the mid-floor level of the subject project. Adjustments for heights of the comparables above and below the mid-floor level of the subject also must be made, as indicated by the market.

L. Other income.

1. The Lender may consider income from laundry facilities, parking, and other sources such as equipment rental, vending machines, pet fees, pool fees, cable fees, and forfeited security deposits in the calculation of income based on the operating history of the project, if applicable, and whether income from these sources are common in the market. The Lender can consider the net amount of this income based on the actual or projected (as appropriate) amount received, adjusted for vacancy and income loss. The analysis must be discussed in the Remarks Section of Form HUD-92264.

2. The Lender should not include in the calculation of income any interest income or premiums for certain types of leases.

7.7 Operating Expense Estimates

A. Purpose. A determination is made of the portion of gross income, which must be used to maintain, operate, and repair the property and to defray the costs of ownership arising from it. An accurate
analysis of operating expenses is essential in determining a realistic net income estimate for the project.

Form HUD-92274, Operating Expense Analysis Worksheet, is used for the development of project expense estimates for Section E of Form HUD-92264, Project Income Analysis and Appraisal. Form HUD-92274 will be prepared for all cases processed. It is included in the processing file as supporting documentation for Form HUD-92264. For Section 232 and board and care facilities, an equivalent expense analysis must be provided based on line items found in Form HUD-92264-HCF.

B. Sources of expense data.

1. For new construction projects, operating expenses must be estimated on the basis of comparable projects.

2. For existing projects, operating expenses must be estimated on the basis of comparable projects, as well as tested against the past 3 years of operating experience for the subject project.

3. For refinance transactions where the project may not have been of under the current ownership for the 3-year period financial statements for the entire 3 years may not be available. This is particularly true for bankruptcies or the acquisition of defaulted properties.

4. Financial statements for the last 3 years are not required if there is satisfactory evidence that they are not obtainable because of circumstances beyond the mortgagor’s control. However, the mortgagor must submit the project financial statements that are available including an owner-certified year-to-date balance sheet and operating statement. Furthermore, the mortgagor must submit a statement that explains why all the required records are not obtainable and a memorandum from the Lender stating that he has evaluated the mortgagor’s statement and agrees that the information is not available.

5. For special cases in purchase transactions, such as acquisition through adversarial action, not all the required information may be available for reasons beyond the purchaser’s control. Consequently, in such unusual circumstances, the requirement will not apply, provided the mortgagor provides a statement that explains why the required records are not obtainable and the Lender provides a memorandum stating that he has evaluated the mortgagor’s statement and agrees that the information is not available.

6. Where the current owner has owned the project for 1 year or longer, an owner-certified year-to-date balance sheet and operating statement for the period since acquisition must be submitted.

7. The current owner also must submit financial statements beyond the period covered by the owner’s certified financial statements (up to 3 years), if available.

8. Any owner-certified financial statement or owner-certified balance sheet and operating statement must include the following acknowledgment:
WARNING: 18 U.S.C. 1001 provides, among other things, that whoever knowingly and willingly makes or uses a document or writing containing any false, fictitious, or fraudulent statement or entry, in any matter within jurisdiction of any department or agency of the United States, shall be fined not more than $10,000 or imprisoned for not more than five years, or both.

9. It must be remembered that all projects must stand on their own and must not reflect shared expenses from nearby projects under the same management. If the nearby project should be subjected to foreclosure, the subject project would be adversely affected, thereby constituting an unacceptable underwriting risk. Furthermore, for the same reason, estimated expenses must reflect typical long-term operation and must not reflect a specific sponsor or management entity whose operation would not be typical.

C. General: operating expense. Operating expenses are periodic expenses needed to maintain real property and to continue the production of its effective gross income. For appraisal purposes, an operating statement that conforms to the above definition of operating expenses may differ from statements prepared for accounting purposes. Current or historic statements prepared for a property being appraised are either on a cash or accrual basis. It is important to know the accounting basis for the operating statement, since project operating expenses for appraisal purposes must be reported on a cash basis. Typical categories of expenses are as follows:

1. Fixed expenses. Fixed expenses are those that generally do not vary with occupancy and that has to be paid regardless of whether the property is occupied or vacant. Real estate taxes and insurance costs are typically included as fixed expenses. These expenses generally do not fluctuate greatly from year to year.

2. Variable expenses. Variable expenses comprise operating expenses that generally vary with the level or occupancy or the intensity of property operation. Operating expenses for large properties frequently list many types of expense variables, but typical broad categories include the following:
   a. Management charges.
   b. Utilities – electricity, gas, water, sewer charges.
   c. Heating and air conditioning expenses.
   d. General payroll and security expenses.
   e. Cleaning expenses.
   f. Maintenance and repairs.
   g. Decorating expenses.
   h. Grounds maintenance expenses.
   i. Exterminating expense.
j. Trash removal expense.

k. Miscellaneous expenses (supplies, etc.).

3. Reserve for replacements. This reserve category provides for the periodic replacement of the building components that wear out more rapidly than the building shell itself and must be replaced periodically during the building’s economic life. These components may include among other things:

   a. Roof covering.
   b. Carpeting.
   c. Kitchen, bath, and laundry equipment.
   d. Compressors, furnaces and boilers.

4. Total operating expenses. Total operating expenses for residential properties are the sum of the fixed expenses and variable expenses updated to the appraisal date, plus the reserve for replacements.

5. Commercial facilities. Where commercial facilities are included in the subject project, a separate analysis must be made of the effect that the commercial operation will have on the project expense estimate.

D. Estimate of operating expenses by units of comparison. Items of expense shown under each comparable and the expense items applicable to the subject proposal reflected in a suitable unit of comparison—such as expense per unit per annum (PUPA), expense per room per annum (PRPA), and expense per square foot of net rentable area per annum (PSFPA), or percent of effective gross income. The expense comparables and units selected must be as similar as possible to the subject project and units as they relate to the subject location, structural type, number of bedrooms, and average unit size.

For consistency purposes, expense components should be expressed in the same units of comparison so that the expenses for the subject proposal can be totaled. However, if the unit of comparison for a specific component is different from the basic unit of comparison for the other expense items, this different unit of comparison must be explained in the expense narrative. The dollar amount of the expense item can afterwards be converted to the same unit of comparison selected for the other expense components. Additional documentation should be submitted, as needed, for all component estimates that are not self-explanatory.

E. Expense adjustments. Project expenses must be expressed in the same units of comparison in order to ensure accurate adjustments and correct reporting of expense estimates. Consistent adjustments for significant differences between the comparables and the subject units shall be derived from the market and applied to the indicated subject expense estimate. The appraiser should enter the dollar amounts attributable to significant differences between the subject proposal and each of the expense comparables—such as for physical characteristics, equipment, services
provided, the level of management furnished to tenants and any differences in rates between tax and utility jurisdictions. Next, the process of correlation must be used to correlate the comparable expense for each component which is applicable to the subject project.

F. Updating procedures. It should be stressed that HUD no longer uses a “trended to” procedure to reflect a time adjustment from the effective date of the most recent expense comparable to the anticipated date of project occupancy following construction and initial endorsement. Expenses estimates should be effective as of the date of the appraisal. Income and expense estimates must reflect the same year of operation.

HUD does allow the appraiser to use an updating percentage to bring expense comparables up to the same date as the most current expense comparable in order to make a more creditable comparison. However, if all of the expense comparables have data from the same operating year, no updating percentage is necessary.

G. HUD has the right to request from the Lender’s appraiser the names and addresses of any confidential expense comparables used in the expense analysis. The Confidentiality sub-section of the Ethics Rule, along with Standards 3.1.e and 3.2.f of the Uniform Standards of Professional Practice (USPAP) support this position. If the appraiser still refuses to provide this information, the HUD appraiser has the right to request from the contract appraiser additional non-confidential comparables.

### 7.8 Site Analysis

Key analyses for consideration of site acceptability for a proposed project are as follows:

A. Analysis of location. The analysis of location involves a determination of the desirability and utility of the site by reason of its location. The analysis of location requires a forecast of the changes likely to be experienced at the site due to probable future neighborhood trends in addition to an appraisal of the present situation. The pattern of appropriate improvements, the level of available rents, the level of warranted costs of construction, and the probable economic life of the structures are to a high degree determined by location factors.

B. Specific location. The specific site is considered in relation to neighborhood and city-wide physical, social, and economic influences. Limitation of use imposed by zoning or deed restrictions are discovered. Trends of development, stability, decay, and rehabilitation are discovered. Availability of utilities, services, and centers appropriate for the intended use are identified. The many and varied influences operating on the site which affecting its market and income potential, when improved, are analyzed. This includes a review of the crime rate in the area, its impact on the proposal and how the impact, if any, can be addressed through design or staffing.

C. Civic, social and commercial centers. When judging the desirability of a location, full consideration must be given to the sufficiency of community facilities as they relate to the needs of tenants of the
proposed project. A location for a multifamily project must be adequately served by grade and high schools, neighborhood shopping centers, churches, playgrounds, parks, libraries, hospitals, and theaters.

1. Schools. Accessibility to schools will be judged by the time involved, utilizing the means provided, or available, rather than walking distance alone. Thus, if school bus service will be provided and the time involved is reasonable, the location is acceptable. Overcrowded schools are the responsibility of the community in the granting of permitting zoning and the issuance of building permits. A project which is otherwise feasible will not be rejected because the local schools are considered overcrowded. School accessibility will not be a factor in projects designed for the elderly.

2. Neighborhood shopping centers. The convenience of a shopping facility should be judged on the basis of time rather than distance. The importance of grocery, drug, and other neighborhood shopping facilities within a reasonable walking distance will generally increase with the number of tenants who do not have private transportation.

3. Religious and recreation centers. Ready access to religious and recreation centers is desirable. Projects designed for large families (predominantly three- and four-bedroom units) have a greater need for playgrounds and active recreation areas. Adequate on-site provisions for playgrounds and other recreation areas should be incorporated into the proposal where adequate facilities are not in close proximity to the project site and available to the occupants.

D. Transportation. Convenient transportation to places of employment, major shopping districts and civic and social centers is a prerequisite to project location acceptability. In those communities where local public transportation is the principal means of commuting by the prospective tenants, the location of a project designed for such occupancy shall be within a reasonable walking distance to public transportation.

E. Special hazards and nuisances. Such conditions include unusual topography, subsidence, flooding, unstable soils, unusual traffic hazards and noise, danger from fire and explosion, exposure to airport noise and low-flying airplanes, smoke, chemical fumes, noxious odors, stagnant ponds or marshes, and sewage disposal failure. Any of these, or similar conditions, if serious and infeasible to overcome, will render a specific location ineligible for mortgage insurance.

F. Parking facilities. Consideration must be given to the effect on parking facilities in the neighborhood and on all-night parking, in particular, which would be caused by the additional number of cars of the tenants who would live in the proposed project. If the project site lacks adequate space for parking tenants’ cars, the availability of other off-street parking space may be considered. An estimate shall be made of the number of parking spaces which would be required by the tenants of the proposed project and their guests and a recommendation shall be given as to the adequacy of the parking facilities to meet the estimated need.
G. Site suitability. The site must be adequate in size, shape, exposure, and contour for the proposed project. Building height limitation, project unit size and numbers, necessary on-site parking and play areas must be considered.

H. Sites Sold by a Public Body.

1. Fair Market Value of Land Fully Improved. Where sites are sold by a public body to the developer for a specific re-use purpose, the Fair Market Value of Land Fully Improved is the lesser of:

   a. The amount found by comparison with other sites having the improvements and amenities that the subject site will have upon completion.

   b. The dollar amount paid by the purchaser as set forth under terms of the purchase contract with the public body, plus an estimate of those costs, if any, additionally imposed under its terms or by HUD-FHA. Costs referenced above are those to be borne by the purchaser because of terms of the purchase contract, e.g., real estate taxes and special assessments accruing from date of purchase to date of commitment, legal fees incident to the land purchase, re-zoning costs, installation of certain designated off-site improvements, interest on investment in site from date of purchase to date of appraisal, razing structures and clearance of the site (after allowance for any income to the purchaser). This is not a complete list of items covered but these will serve as a guide to such costs required by the purchase contract.

2. “As-Is” Value of Land. The Assistant Secretary-FHA Commissioner’s Estimated Value of Land “As is” for Cost Certification may include all of the items in paragraph 1.b above with the following exceptions: Installation of off-site improvements and cost of razing structures and clearing the site (less income received). This is intended to avoid duplication of costs that might be reflected in the Estimated Value of Land “As Is” and also allows for the sponsor to include them as separate items in Cost Certification which includes both off-site costs and demolition. The dollar amount of the land purchase contract plus a breakdown of the estimate of additional costs, must be fully itemized and documented.

7.9 Pre-Application Stage for Sections 221(d) and 220

A. Exhibits

   1. Application for Multifamily Housing Project, Form HUD-92013

   2. Location map
3. Phase I Environmental Site Assessment (ESA) with a narrative environmental report. If the Phase I Assessment indicates a need for further study, a Phase II Assessment should also be submitted at this time.

4. Evidence of site control (deed, purchase agreement, or option)

5. Market study with comparables

6. Estimate of Market Rent by Comparison, HUD-92273

7. Photographs and location map of rental comparables used in the HUD-92273 analysis.

8. Operating Expense Analysis Worksheet, HUD-92274

B. Lender’s responsibilities

1. Based upon the market study prepared by the Lender’s market analyst Lender’s appraiser and the rental income and expense estimates prepared by the Lender’s appraiser, the Lender is responsible for making the following determinations before recommending the proposed project to HUD:
   a. Determine the current occupancy levels, market absorption rates, and market demand for the number and type of units proposed.
   b. Analyze site for acceptability in accordance with Section 7.8 of this chapter.
   c. Determine market rents reflecting amenities, services, and equipment offered in accordance with Section 7.6 of this chapter.
   d. Estimate project income utilizing the methodology in Section 7.6 of this chapter.
   e. Estimate total operating expenses in accordance with Section 7.7 of this chapter.
   f. Estimate mortgage amount based on HUD 92264-A, Criteria 5, Debt Service Ratio.
   g. Make a determination of feasibility or non-feasibility of the sponsor’s proposal.

2. The MAP Lender will have the Phase I ESA and narrative report prepared in accordance with Chapter 9.

3. The Lender’s appraiser or market analyst will prepare the market study and project comparables in accordance with the requirements of Sections 7.5, 7.6, and 7.7 of this chapter.

4. The Lender’s appraiser will determine project rents, estimated rental income, and operating expenses by completing forms HUD-92273, Estimate of Market Rent by Comparison, and HUD-92274, Operating Expense Analysis Worksheet, in accordance with Section 7.6 and 7.7 of this chapter. The forms and specific instructions to complete the forms can be found in the Appendix. For projects receiving Substantial Rehabilitation the Lender’s appraiser will complete the HUD-92273 and HUD-92274 forms based on the assumption that all proposed substantial rehabilitation to the project has been completed.
5. The MAP Lender will utilize information and soft-cost and land cost information provided by the sponsor to calculate the total replacement cost. The Lender will compare its estimate of the total replacement cost with the mortgagor’s amount.

6. The MAP Lender will also complete income, expenses, and total settlement portions of the HUD-92013 utilizing information from the comparables.

7. The Lender will compare the calculations on the HUD-92013 with those proposed by the mortgagor and either accept the mortgagor’s proposal, recommend its modification, or reject it and advise the mortgagor that the project is infeasible.

C. HUD Review

1. The Lender will submit the exhibits listed in Section 7.9.A of this chapter to HUD.

2. The HUD appraiser and the EMAS economist will each provide a desk review of the market study submitted by the Lender. EMAS will not perform its own market analysis of a particular project. The EMAS advisor review would be provided to the team leader who would in turn provide it to the HUD appraiser. The HUD appraiser makes final recommendations to the team leader regarding market demand for the project.

3. The HUD appraiser will inspect the subject site and a reasonable number of the comparables used in the Lender’s appraiser’s HUD-92273 and HUD-92274 analyses.

4. In accordance with Chapter 9, the HUD appraiser will review the Lender-submitted Phase I ESA, prepare as much as possible HUD-4128, “Environmental Assessment and Compliance Findings for Related Laws” and the sample field notes checklist found in the MAP Form Book. The HUD appraiser will utilize procedures found in Chapter 9.

5. The HUD appraiser will review site characteristics for compliance to requirements found in Section 7.8 of this chapter. Based on the environmental analyses, and the site visits, the HUD appraiser will make a recommendation regarding site acceptability to the Team Leader.

6. The HUD appraiser will determine that the projects submitted as comparables to the subject property are acceptable comparables.

7. From a review of Forms HUD-92013, HUD-92273 and HUD-92274, and supporting information, the HUD appraiser will make a recommendation (Format in Appendix 7C ) to the Team Leader regarding:
   a. The acceptability of proposed rents and estimated rental income and their compliance to requirements found in Section 7.6 of this chapter.
   b. The acceptability of total operating expenses and compliance to requirements found in Section 7.7 of this chapter.

7.10 Firm Commitment Processing for Sections 221(d) and 220
A. Exhibits

1. Application for Multifamily Housing Project, Form HUD-92013
2. Evidence of permissive zoning
3. Evidence of last arms-length transaction and price
4. Appraisal as described in Section 7.4 of this chapter
5. Rental Housing Project Income Analysis and Appraisal Form, HUD-92264
6. Appraiser’s trial, Supplement to Project Analysis, HUD-92264-A
7. Updated estimates of Market Rent by Comparison, HUD-92273
8. Updated operating Expense Analysis Worksheet, HUD-92274
9. All exhibits for HUD to complete the Environmental Assessment and Complete Findings for the Related Laws (HUD-4128)

B. Lender’s Responsibilities

1. The MAP Lender’s appraiser will complete an appraisal establishing the Replacement Cost for the project utilizing the cost approaches in accordance with requirements found in Section 7.4 of this chapter. Furthermore, the appraisal will update the HUD-92273 and 92274 analyses provided in the Pre-Application.
2. The Lender’s appraiser is also required to determine the “warranted price of the land” for new construction projects and the "As Is" value of the property for substantial rehabilitation projects in accordance with instructions in Section 7.13 of this chapter. In addition, for substantial rehabilitation projects, the Lender’s appraiser must also determine the “value fully improved” of the project site.
3. The MAP Lender will forward information prepared by its cost analyst and any soft-cost and land cost information provided by the sponsor to the Lender’s appraiser to assistance in the calculation of the total replacement cost. The Lender will compare his estimate of the total replacement cost with the mortgagor’s amount.
4. The Lender’s appraiser is to prepare certain sections of the Rental Housing Project Income Analysis and Appraisal, Form HUD-92264, found in the MAP Forms Book, in accordance with specific instructions found in MAP Forms Book, for the type of project proposed. Certain sections are solely the responsibility of the appraiser and others are done in cooperation with the lender’s architect, cost analyst, and mortgage credit analyst.
5. Principal HUD-92664 items to be calculated by the Lender’s appraiser include:
   a. Market rents and estimated income
   b. Estimated total operating expenses
c. Total estimated replacement cost of the project

d. “Warranted Price of the Land” for new construction projects and the "As Is" value for substantial rehabilitation projects

e. Estimate of operating deficit and replacement reserve

6. The Lender must provide written explanations in the underwriter’s narrative of any major changes to key project elements from those set at the pre-application stage.

7. The data provided in the Lender’s HUD-92013 and HUD-92264 should be consistent. Moreover, any inconsistency between the data reported on the HUD-92264 prepared by the Lender’s appraiser and the Lender’s HUD-92264 must be explained in the Lender’s Underwriting Summary.

C. HUD Review

1. The Lender will submit the Exhibits listed in Section 7.10.A of this chapter to HUD.

2. The HUD appraiser will perform a thorough technical review of the appraisal submitted for the project, making sure that it meets the requirements of Section 7.4 of this chapter including all USPAP requirements.

3. In accordance with Chapter 9, the HUD appraiser will complete Form HUD-4128 and the Sample Field Notes Checklist.

4. The HUD appraiser must review and approve each of the following exhibits:
   a. Rental Housing Project Income Analysis and Appraisal, HUD-92264
   b. Estimates of Market Rent by Comparison, HUD-92273 (updated)
   c. Operating Expenses Worksheet, HUD-92274 (updated)
   d. Appraiser’s trial, Supplemental to Project Analysis, HUD-92264-A

Within these forms, the HUD appraiser must focus on and approve major items including the estimated income, the total operating expenses, the total estimated replacement cost, the “Warranted Price of the Land” or the "As Is" value as appropriate, and the maximum insurable mortgage.

5. The HUD appraiser will issue a written report (Format in Appendix 7C) containing recommendations and forward a copy to the HUD Team Leader.

6. The HUD appraiser will review the Lender’s Underwriting Summary, including justifications of discrepancies between Lender’s and Lender’s appraiser’s conclusions.

7.11 Firm Commitment Processing for Section 223(f)
A. Exhibits

1. Application for Multifamily Housing Project, Form HUD-92013
2. Location map
3. Evidence of permissive zoning
4. Evidence of site control (deed, purchase agreement, option)
5. Evidence of last arms-length transaction and price
6. Phase I Environmental Site Assessment (ESA) with a narrative environment report. A Phase II Environmental Site Assessment must also be submitted, should the Phase I Assessment disclose a need for further study.
7. Complete Self Contained Appraisal
8. Rental Housing Project Income Analysis and Appraisal, HUD-92264
9. Appraiser’s trial, Supplement to Project Analysis, HUD-92264-A
10. Estimates of Market Rent by Comparison, HUD-92273
11. Operating Expenses Analysis Worksheet, HUD-92274
12. Balance sheets and operating statements in accordance with Section 7.7.B of this chapter.
13. Rent roll of the subject property
14. Project Capital Needs Assessment (See Appendix 5S)

B. Lender’s responsibilities

1. The MAP Lender’s appraiser will complete an appraisal of the property establishing market value utilizing the cost, income, and market approaches in accordance with requirements found in Section 7.4 of this chapter. Market studies for Section 223(f) apartment projects would only be required in special circumstances, such as proposed changes in the type of occupancy or high project vacancy rates.

2. The Lender’s appraiser participates in the inspection of the property with the Lender’s Needs Assessor as described in Appendix 5M. The appraiser considers the eligibility of the project, checks the project occupancy level, and verifies the owner’s rent roll during the inspection process. When the appraiser established that the owner’s rent roll is correct, the actual occupancy, based on the owner’s rent roll, is entered in the Remarks Section of form HUD-92264. The appraiser must also determine whether the apartments are furnished or unfurnished.

3. The Lender’s appraiser will analyze the property for acceptability in accordance with Section 7.8 of this chapter utilizing the prepared appraisal.
4. The MAP Lender will have the Phase I ESA and narrative report prepared in accordance with Chapter 9.

5. The Lender’s appraiser will complete HUD-92273, Estimate of Market Rents, utilizing the instruction found in the MAP Forms Book. The Lender’s appraiser will determine project rents and estimated rental income in accordance with Section 7.6 of this chapter, utilizing HUD-92273, the appraisal and the operating history of the property (rent roll and financial statements).

6. The Lender’s appraiser will complete HUD-92274, Operating Expense Analysis Worksheet, utilizing the instruction found in the MAP Forms Book. The appraiser will determine operating expenses for the property in accordance with Section 7.7 of this chapter, utilizing HUD-92274 and the operating history of the property (financial statements).

7. The Lender’s appraiser is to prepare certain sections of the Rental Housing Project Income Analysis and Appraisal, HUD-92264), in accordance with instruction found in the MAP Forms Book for the type of project proposed. Certain sections are solely the responsibility of the appraiser, and others are done in coordination with the Lender’s architect, and cost analyst.

8. Principal HUD-92264 items to be calculated by the Lender’s appraiser include:
   a. Market rents and estimated income
   b. Estimated total operating expenses
   c. Total estimated replacement cost
   d. “Warranted Price of the Land”
   e. Fair market value of the project
   f. Estimate of operating deficit and replacement reserve
   g. Estimated occupancy rate

9. The data provided in the Lender’s HUD-92013 and HUD-92264 should be consistent. Moreover, any inconsistency between the data reported on the HUD-92264 prepared by the Lender’s appraiser and the Lender’s HUD-92264 must be explained in the Lender’s Underwriting Summary.

10. The Lender’s appraiser will provide in the Remarks Section of HUD-92264 the following:
    a. The appraiser’s statement of actual occupancy, based on the owner’s rent roll.
    b. The required amount of initial deposit into the Replacement Reserve Fund as estimated in accordance with Section 15.B of this chapter.
    c. The estimated cost of required repairs as provided in the inspection report.
    d. The estimated amounts for legal, organizational (if applicable) and title and recording expenses based on the maximum insurable 223(f) loan.
C. HUD review

1. The Lender will submit the Exhibits listed in Section 7.11.A of this chapter to HUD.

2. The HUD appraiser will perform a thorough technical review of the appraisal submitted for the project, making sure that it meets the requirements of Section 7.4 of this chapter including all USPAP requirements.

3. The HUD appraiser will inspect the subject site and a reasonable number of the comparables supplied by the Lender’s appraiser. At this visit, the HUD appraiser will also review the Mortgagor’s proposed list of critical and non-critical repairs and provide an opinion of the acceptability of the list based upon the HUD appraiser’s potentially limited knowledge of construction. The HUD appraiser may consult with a HUD construction analyst when formulating the opinion.

4. In accordance with Chapter 9, the HUD appraiser will complete Part A of HUD-4128.

5. The HUD appraiser will review the recommendations of the HUD architectural analyst and the HUD-92264. The appraiser will review property characteristics for compliance to requirements found in Section 7.8 of this chapter. Based on these reviews and the environmental analysis, the HUD appraiser will make a recommendation of site acceptability.

6. The HUD appraiser must review and approve each of the following Exhibits:
   a. Rental Housing Project Income Analysis and Appraisal, HUD-92264
   b. Estimate of Market Rent by Comparison, HUD-92273
   c. Operating Expenses Worksheet, HUD-92274

   Within these forms the HUD appraiser must focus on and approve major items including the estimated income, the total operating expenses, the total estimated replacement cost, the maximum insurable mortgage, and the fair market value of the project.

7. The HUD appraiser will review the Lender’s Underwriting Summary for justifications of discrepancies between Lender’s and Lender’s appraiser’s conclusions.

8. The HUD appraiser will review the Lender’s Underwriting Summary to determine if the Lender’s underwriter carried out a “due diligence” review of the Lender’s appraisal.

9. The HUD appraiser will issue a written report containing recommendations and forward a copy to the HUD Team Leader, Appendix 7C.

7.12 Processing for Section 232

A. In general. Processing is to provide a valuation of a Skilled Nursing Facility (SNF), Intermediate Care Facility (ICF), Board and Care facility (BC), or Assisted Living Facility (ALF). These facilities will serve as the security for the Section 232 insured loan.
1. For new construction and substantial rehabilitation follow instruction for Section 221(d) with additions and modifications as indicated below. Section 232 does not include BSPRA.

2. For Section 232 projects pursuant to Section 223(f) follow instruction for existing projects pursuant to Section 223(f) with additions and modifications as indicated below.

3. The primary difference in determining market value for a healthcare facility as compared to an apartment complex is the net income of a Section 232 proposal includes a return to the realty, non-realty and to the business operation of the proposal. This return to the business operation (proprietary earnings) must be deducted from the net income, since only net income from the realty and major movable equipment may be used to support a Section 232 mortgage.

   a. The appraiser must first identify the overall “Business Value” a.k.a. “Going Concern Value” prior to establishing a proprietary income adjustment and “Real Estate Only” value. The review appraiser should insure that there is a reasonable relationship between “Business” or “Going Concern” value verses “Real Estate Only” value and the proprietary income adjustment. Note that because of the variances in return expectations for a “Business Value” analysis verses “Real Estate Only” value, there may not necessarily be a one-to-one relationship between the two values and the proprietary adjustment, however, if there is a significant difference, the methodology used by the appraiser must be questioned. It shall be the lender’s appraiser’s responsibility to make the determination as to how to best perform this analysis. That determination should be based upon the quantity and quality of information that is available. Several suggested methods of applying this analysis follow:

   b. One method of applying this analysis would be to compare the cost to build a new facility to that same property’s sale price after reaching stabilized operation. In this case, the cost to construct the improvements and major movables would measure the value attributable to the real estate, whereas, the sale of the operating facility would reflect the purchaser’s opinion of value of the total Going Concern or business value. Another method would be to perform an analysis where the appraiser derives capitalization rates from sales of leased facilities to compare to capitalization rates from sales of going concern properties. In this case, analysis of the sales of leased facilities will reflect the landlord’s real estate only interest whereas sales of operating facilities will reflect the value of the total business or the going concern.

   c. When this concept is applied to the analysis of comparable sales in an attempt to derive market extracted capitalization rates, the analysis should generally follow the following guidelines.

<table>
<thead>
<tr>
<th>Capitalization Rate Extraction and Analysis Technique (sales of stabilized &amp; operating facilities)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale 1</td>
</tr>
<tr>
<td>Number Beds/Units</td>
</tr>
<tr>
<td>Sale Price</td>
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<tr>
<td>NOI</td>
</tr>
<tr>
<td>Overall Cap Rate</td>
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<tr>
<td>Proprietary Earnings</td>
</tr>
<tr>
<td>Proprietary Cap Rate</td>
</tr>
<tr>
<td>Capitalized Proprietary Earnings</td>
</tr>
<tr>
<td>Adjusted Real Estate Only Value</td>
</tr>
<tr>
<td>NOI Real Estate Only</td>
</tr>
<tr>
<td>(85% of total NOI)</td>
</tr>
<tr>
<td>Real Estate Only Cap Rate</td>
</tr>
<tr>
<td>Ratio of Real Estate to Business Value</td>
</tr>
</tbody>
</table>

d. Note that the preceding examples are provided as guidance only and are not represented to be the only proper methods of performing the required “Business Value” versus “Real Estate Only Value” analysis. It is the appraiser’s responsibility to make the determination as to how this analysis should be accomplished based upon the quantity and quality of data available, which will be specific to each report.

4. If the chosen method of deriving a capitalization rate is the cash dividend to equity method, the appraiser must use the prevailing market rates of return to both equity and the mortgage, without regard to any discounted or special financing specific to the subject property.

5. As detailed example 3c above, if the comparable sale property was the transfer of real property along with the business component, the appraiser must adjust the comparable accordingly when deriving the Real Estate Only rate of capitalization, or Gross Income Multiplier. This is also true when applying the sales comparison approach.

6. When deriving the final “Real Estate Only” value (HUD’s insurable value determination), and when preparing the HUD 92264 and HUD 92264a, a management fee should not be included as an operating expense under Section 232. Management fees are viewed as a portion of the proprietary income deduction, so that applying a management fee in the Real Estate Only analysis and in preparation of the HUD 92264 and HUD 92264a would be a duplication of expenses thus unfairly penalizing the property.
7. The appraiser may NOT use apartment sales in lieu of health care facilities to derive capitalization rates as comparables in the sales comparison approach.

8. The cost or summation approach must consider all applicable forms of depreciation for 232/223(f) cases. Due to this requirement, the replacement cost approach does not automatically set the upper limit of value for 232/223(f) projects. For New Construction and Substantial Rehabilitation pursuant to Section 232, the replacement cost or summation approach shall in all cases set the upper limit of value. This does not negate the necessity of the reconciliation process for the three approaches to value. Section 232 remains a value based program and all three approaches to value must be considered. It is rather an acknowledgment that no prudent purchaser would pay more for a property than the cost to acquire a similar site and construct improvements of equal desirability and utility.

9. Appraisers are permitted to use a modified version of HUD Forms 92273 and 92274 to estimate the per bed/or unit charges and expenses for skilled nursing (NH) and intermediate care facility (ICF) proposals under Section 232. It is imperative that the forms and materials submitted in lieu of the 2273 and 2274 achieve the intent of these forms by providing the data that is needed to perform a thorough underwriting analysis and review.

B. Exhibits for New Construction and Substantial Rehabilitation

1. Pre-Application.
   a. Application–Project Mortgage Insurance, HUD-92013-NHICF.
   b. Certificate of Need for Health Care Facility and Assurance of Enforcement of State Standards, HUD-2576-HF, for SNF and ICF facilities. For state without certificate of needs procedures, an alternative study of market needs and feasibility with the state standards and enforcement of certification may be substituted.
   c. Section 1616(e) Certification (Keys Amendment) of the Social Security Act is required for Board and Care facilities.
   d. Market study with comparables. (See Appendix 7B)
   e. Location map.
   f. Phase I Environmental Site Assessment (ESA) with a narrative environmental report. A Phase II Environmental Site Assessment must also be submitted, should the Phase I Assessment disclose a need for further study.
   g. Evidence of site control.
   h. Prospective reimbursement rate and percentage of population for each patient type.
   i. Description of services included in base rate and any additional personal care fees above the base rate for Assisted Living and Board and Care facilities.
Chapter 7

Valuation Analysis

j. HUD 92273 and HUD-92264T analysis, if appropriate, and operating expense analysis completed by the Lender’s appraiser according Section 7.6, 7.7 and 7.12 of this chapter.

k. Lender’s appraiser’s estimate of occupancy rate for the project.

l. Lender’s appraiser’s estimate of proprietary income and Net Operating Income.

m. Estimate of mortgage amount based on HUD 92264-A, Criterion 5, Debt Service Ratio.

2. Firm Commitment

a. Application – Project Mortgage Insurance, HUD-92013-NHICF.

b. Evidence of permissive zoning.

c. Evidence of last arms-length sale and price.

d. Current provider agreement for Medicare/Medicaid, if any.

e. Current licenses as required by state and local jurisdiction.

f. Appraisal as described in Section 7.4 of this chapter.

g. Health Care Facility Summary Appraisal Report, HUD-92264-HCF and all supporting HUD forms, i.e., HUD-92264-A, HUD-92273 (with appropriate modifications of adjustment characteristics) and expense analysis.

h. All Exhibits needed for HUD to complete the Environmental Assessment.

i. Documentation from the appropriate state regulatory agency of approval or conditional approval of the assisted living facility’s plans and specifications.

j. Operating deficit proforma

k. Business Plan

l. For new construction, a list of major moveable equipment and cost schedule.

m. For substantial rehabilitation, a list of major moveable equipment not being replaced by new equipment during the rehabilitation with a cost new, age and remaining useful life schedule for each piece of equipment. In addition, a list of major moveable equipment to be purchased new with corresponding costs.

C. Exhibits for Existing Projects–Firm Commitment

1. Application – Project Mortgage Insurance, HUD-92013-NHICF.

2. Certificate of Need for Health Care Facility and Assurance of Enforcement of State Standards, HUD-2576-HF for SNF and ICF facilities. For states without certificate of needs procedures, an alternative study of market needs and feasibility with a state standards and enforcement certification may be substituted.
3. Section 1616e Certification (Keys Amendment) of the Social Security Act is required for Board and Care facilities.

4. Assisted Living Facilities must meet state and local licensing requirements.

5. Market study with comparables.

6. Location map.

7. Phase I Environmental Site Assessment (ESA) with a narrative environmental report. A Phase II Environmental Site Assessment must also be submitted, should the Phase I Assessment disclose a need for further study.

8. Evidence of site control.


10. Evidence of last arms-length transaction and price.

11. Current provider agreement for Medicare/Medicaid, if any.

12. Current licenses as required by the state and local jurisdiction and latest state residential care facility agency’s report of operations.

13. Appraisal as described in Section 7.4 of this chapter.


15. Board and Care facilities that have contracts with local and state agencies must submit letters of understanding regarding the subsidized amount.

16. Project Capital Needs Assessment (See Appendix 5M).

17. Three years of balance sheets and operating statements. The most recent year’s financial statement certified by an independent public accountant or certified public accountant.

18. Monthly resident roster/accommodation charges.

19. Unit Vacancy and Resident Turnover Report, HUD-9447.

20. Description of services included in base unit rate and any additional personal care fees above the base rate for Assisted Living and Board and Care facilities.


D. Market analysis

The Certificate of Need (CoN) or alternative market needs study does not relieve the appraiser or market analyst from making an independent determination of current market conditions and demand for the type of facility proposed. The CoN reflects bed-need on a population and use basis without regard to total monthly charges or needs in a specific market or sub-market. The MAP market analysis is mandatory in all cases for Section 232 projects.
E. Equipment

1. Realty (fixed) equipment is included in the construction contract.

2. Major movable equipment may not be included in the construction contract but should be included in Line H-36 of HUD-92264-HCF.

3. Minor movable equipment is considered in the project’s operating expenses and is not included in the estimated replacement cost.

F. Total earnings will include earnings for realty and major movable equipment, and also proprietary earnings. Proprietary earnings provide a return to the business of running a skilled nursing facility, an intermediate care facility, a board and care facility, or an assisted living facility or any combination of the above.

1. Proprietary earnings are not capitalized into the value for realty and major movable equipment.

2. The percentage of total net income before debt service attributable to proprietary earnings found typical is:
   a. Skilled nursing beds—15 to 25 percent.
   b. Intermediate care beds—10 to 20 percent.
   c. Board and care beds—5 to 10 percent.
   d. Living units in an assisted living facility—10 to 15 percent.

The above percentages are only general guidelines. The key should be the intensity of the services provided by the proprietary operation. Accordingly, a board and care facility that will be providing intensive services such as those that might be associated with a drug or alcohol rehabilitation center could, in fact, have a percentage of income attributable to the proprietary operation that might be equal to, or even greater than, a skilled care facility. Net operating income (before debt service) of the realty and major movable equipment is a residual after subtracting proprietary earnings from total earnings.

3. For proposed construction and substantial rehabilitation, charges for no less than 67 percent of SNF beds and ICF beds shall be estimated at Medicaid rates. No more than 3 percent of beds shall be estimated at Medicare rates. Private Pay beds cannot exceed 30 percent. The remainder of SNF and ICF beds shall be estimated at market rates for such facilities. The following exceptions are permitted:
   a. With 223f refinance when the project has demonstrated it has been operating at a different bed unit mix for at least three years.
   b. With substantial rehabilitation when there is no change in the intended use and associated income of the project after completion of substantial rehabilitation. The same three years of bed mix operating history applies.
4. Board and Care beds and Assisted Living Facility units shall be estimated at market rates for similar facilities.

G. Economic life. The appraiser will enter his/her estimate of remaining economic life. The mortgage term may not exceed 75 percent of the remaining economic life.

H. Budget review

1. For proposed construction, the sponsor must submit a budget approved by its Board of Directors or owners showing projected income and expenses for the operation of the facility.

2. For substantial rehabilitation and Section 223(f) proposals, the sponsor must submit for review:
   a. Balance sheet, statements of income and expense and statement of changes in financial position for the last 3 years.
   b. A bed and residential accommodation charge roll listing: each bed; name of each occupant, if any, or vacant if none; source of payment (Medicare, Medicaid or private pay); monthly charge; and amount in arrears, if any.
   c. Copies of all Medicare and Medicaid audits with
      (1) Outstanding findings and/or
      (2) Repayment schedule for over-reimbursement in prior years.

3. The appraiser analyzes the financial information and compares proposed occupancy and room charges from the budget(s) with data from a facility of similar size and providing similar services.

I. Principal elements of the Lender’s appraiser’s duties

1. Land appraisal. Estimate the value of the site fully improved.

2. Site and market acceptability. Decide whether the site is acceptable for the project and whether a market exists for the units or beds at the estimated charges.

3. Bed and residential accommodation charges by comparison. Prepare estimates based on comparison for private pay and the reimbursement formula for Medicaid and Medicare units. Show formula and calculations. Board and Care beds and Assisted Living Facility units shall be estimated at market rates for similar facilities.

A. Because by definition, market value assumes a value in exchange, many appraisers make the assumption that there will be an automatic increase in the property’s reimbursement rate when appraising in states that permit such a step increase with a change in ownership. HUD has determined that Medicaid and Medicare reimbursement rates used in the value (Criteria 3) and debt service analysis (Criteria 5) may NOT assume an automatic increase based upon this “Value in Exchange” concept.
for refinance transactions where there is no true change in ownership. The net income estimates used for calculation of both Criteria 3 and Criteria 5 should be based upon the actual expected reimbursement rate for the up-coming year of operation for the applying ownership. Note that this does not preclude the appraiser from re-basing the rates and operating expenses based on current and expected conditions. It should be stressed that the NOI proforma presented for processing should reflect the true rate of reimbursement that the applying ownership can expect to receive. The appraiser is directed to invoke a Jurisdictional Exception, and amend his/her definition of market value used in the report as directed herein.

B. For 223(f) acquisitions, the appraiser must make an analysis and determination of the new ownership’s likely rate of reimbursement. Note that there are cases where new ownership of an existing facility may actually experience a decrease in their reimbursement due to depreciation laws specific to certain states and associated re-basing of the property. In true 223(f) acquisitions, if there will be an increase in the reimbursement rate for the new ownership, the appraiser must document, analyze and provide supporting documentation from the appropriate authorities in that jurisdiction.

4. Annual expense. Estimate project expenses based on comparison with actual operating expense data from SNF, ICF, BC facilities, or ALF separate living units depending on type of occupancy. The expense estimates must reflect typical long-term operations.

5. Net income computations. After the gross income has been developed, then estimate occupancy and effective gross income; then subtract annual expense to arrive at net income before debt service and before subtraction of the return on proprietary earnings.

6. Determination of project value. Estimate the value of the project utilizing the income, cost, and market approaches. In order to prevent manipulation of data to circumvent the purpose of the proprietary income adjustment, an administrative decision has been made that each appraisal of properties submitted under MAP and TAP, Section 232 must first identify the overall “Business” or “Going Concern” value of the property prior to establishing a proprietary income adjustment and the “Real Estate Only” value. The review appraiser should insure that there is a reasonable relationship between “Business Value” versus “Real Estate Only” value and the selected proprietary income adjustment. Note that because of variances in return expectations for a “Business Value” analysis versus “Real Estate Value” there may not necessarily be a one-to-one relationship between the values and the proprietary adjustment, however, if there is a significant difference the methodology used by the appraiser must be questioned.

A. The cost or summation approach must consider all applicable forms of depreciation for 232/223(f) cases. Due to this requirement, the replacement cost approach does not automatically set the upper limit of value for 232/223(f) projects.

B. For New Construction and Substantial Rehabilitation pursuant to Section 232, the replacement cost or summation approach shall in all cases set the upper limit of value. This does not negate the necessity of the reconciliation process for the three approaches to
value. Section 232 remains a value based program and all three approaches to value must be considered. It is rather an acknowledgment that no prudent purchaser would pay more for a property than the cost to acquire a similar site and construct improvements of equal desirability and utility.

7. Operating deficit. Estimate the operating deficit expected during the initial absorption period. See MAP Guide Section 7.14 for the procedures for calculating the operating deficit.

J. Substantial rehabilitation processing under Section 232

1. In general. The "As Is" value of the existing land and structures is used in the replacement cost in place of land, in substantial rehabilitation cases. Only the cost of the repairs is used in the cost estimate, rather than the cost of constructing the structures and other improvements. This definition of replacement cost in substantial rehabilitation provides for depreciation by using the "As Is" value of the existing realty, rather than including the construction cost new.

2. General processing consideration. As is value of the property (realty/major movable equipment) before rehabilitation is based on:
   a. The property’s intended use, not the current or highest and best use,
   b. Its condition at the time of appraisal, and
   c. If the property is an operating health care facility, the "As Is" value must not include proprietary income.

3. The appraiser will complete the "As Is" appraisal using a supplemental HUD-92264-HCF as well as a narrative containing all pertinent conclusions and documentation.

4. Once the "As Is" value is determined, complete Form HUD-92264-HCF for value after rehabilitation for new construction, with the following exceptions and amplifications:
   a. Section C. Estimate of income. Estimate bed/unit charges to be obtained after rehabilitation.
   b. Section H. Replacement Cost. Comparable sales of an operating health care facility normally include the CON. Accordingly, the organization line item should not include any cost relating to the CON except for cases where costs are incurred in obtaining a CON for ALF units.
   c. Section L. Remarks. A deposit to reserve for major movable equipment must be calculated for those existing items of equipment which are not going to be replaced by the rehabilitation. The amount of this required initial deposit may be computed by the appraiser taking into account the cost and useful life information on these items from the accepted mortgagor’s schedule.
   d. Section H. Estimated replacement cost. Complete the appropriate replacement cost format to show mortgage replacement cost were the only limiting criterion.
e. HUD-92264A. Complete the trial HUD-92264A to show the mortgage to be used in completing Section H.

K. Assisted living facility/board and care processing. The Lender's appraiser will process ALF or BC proposals following the instructions as outlined for SNF and ICF proposals for the completion of HUD-92264-HCF with the exception of the following:

1. Section C. Estimate of income. The type of room or unit should be analyzed carefully as to market:
   a. Particularly whether 3- and 4-person occupancy rooms or units will be marketable at the rate used in processing.
   b. BC and ALF charges are predicted on current market rates. Accordingly, income for a “stand-alone” ALF or BC proposal will not be trended to date of the initial project occupancy. However, charges for ALF units or BC beds which are part of a SNF or IDF proposal will be trended to the beginning of operations if Medicaid rates are established and projected into the future by the state reimbursement administrator. The state agency on aging may be able to provide a listing of ALF and BC projects for data purposes.

2. Sections D and F. Payroll salaries and estimate of annual operating expenses. Make an analysis of the expense component relating to the particular ALF and BC facilities. If data on BC and ALF expenses is lacking, SNF comparables may be used and adjusted on the basis of the intensity of the services being contemplated. However, this should be done only as a last resort.

3. Section K. Estimate of value of capitalization. Line 5—“Net Return to Realty and Major Movable Equipment Based on Leased Nursing Homes.” If the project is to be entirely a BC facility or an ALF, and data on leased BC facilities or ALFs is lacking, adjustments to the best available data will have to be used.
   a. As a guideline, the amount of income attributable to proprietary earnings should fall in a range of 5 to 10 percent for BC facilities and 10 to 15 percent for ALFs.
   b. Generally, the greater the services provided, the greater the percentage attributable to proprietary income.

4. Section L. Comparison approach to value. If the project is entirely BC or ALF, data from sales of such leased facilities should be obtained if at all possible. If the project is primarily a SNF or ICF, sales data from that type use will be used with appropriate adjustments for any differences. Comparables that include proprietary value in their sales must be adjusted to exclude such value from the sales. The documentation supporting the estimates must be reasonable and convincing.

L. Processing projects under the Section 232 program pursuant to 223(f). The valuation and processing of a SNF, ICF, BC facility and ALF units under Section 223(f) program is basically the same as processing under the 232 program, new construction. Listed below are the differences:
1. Bed and AFL unit charge list. An inspection of a sufficient number of residents’ accommodations will be required.

2. Financial statements (audited or owner-certified) for a 3-year period.

3. In a value program, such as an existing Section 223(f) project, the replacement cost must reflect the accrued depreciation that results from physical deterioration, functional obsolescence, or external obsolescence, or any combination of these sources. The replacement cost estimate must include the following under Section 223(f):
   a. Total cost of structures and equipment included in the construction contract,
   b. Soft costs during construction,
   c. Major movable equipment,
   d. Warranted price of land.

   Items a, b, and c are depreciable items. Land value for the site is determined as if vacant, but for its intended use, not its highest and best use.

4. A blended Loan-to-Value ratio must be calculated when the mortgage includes both the purchase or refinance of an existing health care facility (HCF) and new construction of any type of additional health care facility:
   a. The estimated monthly income from the SNF, ICF, B & C beds or ALF units in the proposed addition are added to the estimated total monthly income of the existing facility.

      For example, assume that the addition will include 40 ALF units with a total monthly income estimated to be $112,541. This amount is divided by the total income for the property (both existing and new addition) in the amount of $312,700. The result indicates that 35.99 percent of the income will come from the proposed addition; while 64.01 percent of the income will come from the existing property.

   b. The 35.99 percent of income from the proposed addition is multiplied by 90 percent authorized for profit-motivated owners loan ratio for proposed construction under Section 232 to equal a blended portion of 32.39 percent.

   c. The 64.01 percent of income from the existing property is multiplied by 85 percent authorized for profit-motivated owners of existing property to equal a blended portion of 54.41 percent.

   d. The blended ratio of loan to value of both the existing and the proposed addition to the subject is the sum of the blended portions under calculated above, or 86.80 percent.

   e. If the sponsorship of the HCF is a nonprofit, the percentage of income from the proposed addition would be multiplied by 95 percent and the income from the existing property would be multiplied by 90 percent.
5. The Lender's appraiser will provide in the Remarks Section of HUD-92264-HCF for the following.
   a. Occupancy of the subject as of the date of inspection plus an estimate of time required, if any, to reach sustaining occupancy.
   b. Loss of income due to incomplete repairs at endorsement.
   c. Estimated cost of required repairs including additional repairs and improvements proposed by sponsor reflecting what the appraiser considered in his/her value.
   d. Estimated amounts for legal, organization (if applicable) and title and recording based on the maximum insurable loan.
   e. Lender's appraiser’s should determine a tentative maximum insurable mortgage. Attach HUD-92264a with Criteria1, 3, and 5 completed.

M. HUD review

1. The Lender will submit the Exhibits listed in Section 7.12.B for New Construction and Substantial Rehabilitation or Section 7.12.C for Existing Projects.

2. The HUD appraiser and the EMAS economist will each provide a desk review of the market study submitted by the Lender. EMAS will not perform its own market analysis of a particular project. The EMAS advisor review would be provided to the team leader who would in turn provide it to the HUD appraiser. The HUD appraiser makes final recommendations to the team leader regarding market demand for the project.

3. For projects at the Pre-Application stage, the HUD appraiser will inspect the subject site and a reasonable number of the comparables used in the Lender’s appraiser’s HUD 92273, income estimation, and the expense analysis.

4. The HUD appraiser will prepare the HUD-4128 in accordance with Chapter 9 from the Phase I ESA and supporting narrative submitted by the Lender and complete the Sample Field Notes Checklist.

5. Based on his site visit and environmental analysis, the HUD appraiser will make a recommendation to the Team Leader regarding the acceptability of the site.

6. The HUD appraiser will determine that the projects submitted as comparables to the subject are acceptable comparables.

7. At the Pre-Application stage, from his review of the Lender’s appraiser’s HUD-92273 and HUD92264T if appropriate, and expense analysis and all supporting information including the Lender’s HUD-92013, the HUD appraiser will make a recommendation regarding:
   a. The acceptability of the proposed rents and estimated rental income and their compliance to requirements to requirements to Section 7.6 and 7.12 of this chapter.
b. The acceptability of operating expenses and compliance to Section 7.7 and 7.12 of this chapter.

c. The acceptability of the proprietary earnings estimate used in the Net Operating Income calculation and its compliance to Section 7.12 of this chapter.

d. The acceptability of the vacancy factor used in the Net Operating Income calculation.

e. The acceptability of the estimated mortgage amount based on HUD 92264-A, Criteria 5, Debt Service Ratio.

8. At the pre-application stage the HUD appraiser will issue a written report (format in Appendix 7C) containing recommendations and forward a copy to the HUD Team Leader.

9. At Firm Commitment, the HUD appraiser will perform a thorough technical review of the appraisal submitted for the project, making sure that it meets the requirements of Section 7.4 of this chapter including all USPAP requirements.

10. At Firm Commitment, the HUD appraiser must review and approve each of the following exhibits completed by the Lender’s appraiser:

   a. Health Care Facility Summary Appraisal Report, HUD-92264HCF

   b. Estimates of Market Rent by Comparison, HUD-92273

   c. Expense estimate analysis

   d. Operating Deficit Proforma

   Within these forms, the HUD appraiser must focus on and approve major items including the estimated income, the total operating expenses, the proprietary earnings estimate, the total estimated replacement cost, the “Warranted Price of the Land” or the “As Is” value as appropriate, and the maximum insurable mortgage.

11. The HUD appraiser will review the Lender’s Underwriting Summary, including any justifications of discrepancies between Lender’s and Lender’s appraiser’s conclusions.

12. The HUD appraiser will issue a written report (Checklist in Appendix 7C) containing recommendations and forward a copy to the HUD Team Leader.

### 7.13 Substantial Rehabilitation Processing for Sections 220 and 221(d)(3) and 221(d)(4)

A. In general. A substantial rehabilitation project is processed in accordance with the instructions found in Sections 7.9 and 7.10 of this chapter, except as noted below.
B. Processing of HUD-92264: Form HUD-92264 is completed in accordance with basic valuation instructions for Sections 221(d) and 220 processing in Section 7.10 of this chapter, with the following modifications:

1. Supplemental HUD-92264. A supplemental HUD-92264 will need to be completed to estimate the “As Is” Value. The form should be titled Supplemental 92264 “As Is” Value. Both the Direct Sales Comparison and Income approaches to value are used in the value estimation.

2. The HUD-92273 and HUD-92274 analysis used to support the income and expenses on the primary HUD-92264 will reflect the conditions that exist after substantial rehabilitation has taken place. An estimate of replacement cost new is made on a worksheet (a supplementary form, HUD-92264, Section G) and the result is reported in Part O, Remarks Section of the primary HUD-92264.

3. A value for the land without improvements will need to be estimated and entered on the primary HUD-92264 in Section H.

C. "As Is" value in multifamily rehabilitation. The estimate of “As Is” value of the property before rehabilitation will be estimated by the direct market comparison approach and the income approach to value. The “As Is” value by the residual approach can be used in circumstances where there is a lack of market sales. The Fair Market Value (FMV) by the market comparison approach will be based upon market prices for comparable properties in similar condition to the project being appraised. For example, if comparable sale properties in similar condition are available at $4,000 per unit, there is no justification for finding a value “As Is” in an amount substantially in excess of $4,000 per unit.

D. Valuation Processing

1. Find the market value of the property "As Is". Complete the Location and Description of the Property, Information concerning Land or Property, Estimate of Income, Equipment and Services Provided in Rent, Estimate of Annual Expenses, Income Computations, Income Approach to Value, and Comparison Approach to Value on a supplemental HUD-92264. Do not complete the Summation estimate in Section M. This is the "As Is" value before rehabilitation. If the project involved rehabilitation and new construction with additional land to be added, also complete a land appraisal on the supplemental form for that portion of the land to be added for new construction.

   The market value of the project is the sum of the land appraisal for the vacant portion of the subject site and the value of the existing property (land and improvements) based upon the lesser of the "As Is" value by market comparison and the "As Is" value by a residual approach.

2. Use the Replacement Cost by Formula, Rehab Projects, with or without BSPRA, found in the MAP Forms Book to find the total project cost (summation estimate) using the market value
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"As Is" of the property, and the rehabilitation cost estimate furnished by the cost analyst, plus carrying charges and financing.

3. Complete HUD-92264, headed “Value of the Project after Rehabilitation.” In Section G of that form, the market "As Is" value of the property before rehabilitation will be shown on the line titled "As Is" value of property.”

4. "As Is" value of property acquired as a leasehold estate. Instruction for limiting the "As Is" value of property before rehabilitation—when that property is acquired as a leasehold estate—are to be found in Ground Leases, Section 7.16 of this chapter.

5. To find the project mortgage amount for Section 220 and Section 221, use the lower of Criteria 1, 3, 4, or 5 on HUD-92264A. Estimate the "As Is" value of the property before rehabilitation. Then, add the total for all improvements, plus soft costs to the AS-IS Value to obtain the sum of the above costs. Afterwards, multiply the sum of the project costs listed above by 90 percent based upon Criterion 3 to obtain the maximum project mortgage amount. Under the Section 221(d)(3) program for nonprofit mortgagors, multiply 100 percent against the sum of the project’s cost.

E. Contingency reserves. For the purpose of provision for unanticipated costs inherent in the rehabilitation of older structures, there will normally be included in the mortgage amount a reserve for contingencies. This reserve is based on the percentage of estimated rehabilitation cost without fees (the sum of the total land improvements, total structures and general requirements). This percent may range between 0 percent and 10 percent, depending upon the job conditions, the experience and financial ability of the sponsor, the mortgagor and contractor. In determining the amount of the contingency reserve, judgment should be made on whether the contractor’s bid already contains a reserve for contingencies. This percentage, determined by the cost analyst, is included as a separate line item in the estimate of replacement cost on HUD-92264.

F. Interest during construction. For Section 220/221 projects, interest during construction will be calculated based on the sum of one-half the mortgage amount plus one-half of the "As Is" value of the property, plus demolition, plus off-site costs.

G. Inspection fee. The inspection fee is calculated at .5 percent of the loan amount when the project involves new construction. For substantial rehabilitation projects, the inspection fee is calculated as the sum of Total for All Improvements (plus BSPRA, if applicable), rounded to the next higher $100, times .5 percent.

H. Offsite costs. If there are any offsite costs associated with the rehabilitation, enter them as a line item in the Estimated Replacement Cost. This separate entry is necessary in rehabilitation processing, since the "As Is" value does not include offsite cost requirements.

I Rehabilitation cost not attributable to residential use. This entry must be completed for all rehabilitation projects. This cost is prepared on Rehabilitation Cost Not Attributable to Residential
Use, found in The MAP Book. This cost (line 8) is transferred to line 4b under Criterion 4, Amount Based on Limitations per Family Unit, HUD-92264A.

J. Developer’s Fee. HUD Notice H 96-63 shall apply for MAP Projects.

### 7.14 Calculating Operating Deficits

A. In general. Estimate the operating deficit, if any, in the early years. A project which cannot rent-up in the first years should be carefully examined from a feasibility standpoint. On the other hand, it takes time to move tenants into a large project, and it is almost inevitable that the average overall occupancy percentage for the first year will be something less than the break-even percentage. When it is anticipated that the entire project net income will not be available during the initial rent-up period, the Lender’s appraiser must estimate the anticipated project operating deficit, utilizing the following steps:

1. Estimate the total project expenses and add the debt service requirement (including principal, interest and M.I.P.). This total is divided by the potential gross income for the project. The resultant ratio is the break-even occupancy level. Multiply that percentage times the total project units to obtain the number of units required for break-even occupancy. (A fraction of a unit is rounded up.)

2. Afterwards, estimate the total number of units expected to be occupied at the time of project endorsement. The difference between the total units required for break-even occupancy and those occupied units at the time of project endorsement represent the total number of units that must be rented in order to reach a break-even occupancy level.

3. The appraiser must then make an estimate of the likely rate of absorption of the available units. The selected rate must take into account the current and proposed supply of housing units in the subject’s market and must be balanced against demographic demand considerations. The absorption or lease-up rate should be supported by comparison with similar project’s historic rates of absorption during their lease-up period whenever this comparison can be made. The number of units to be absorbed, divided by the monthly absorption rate, will yield the total number of months of the entire operating deficit period.

4. Because the deficit period can begin at certificate of occupancy, continue through the cost certification phase, and run into the amortization phase, there are three distinct expense Intervals to consider during the total deficit period. Note that not every project will require using all three intervals. Interval 1 spans the period of time between certificate of occupancy and the end of the construction period/cost certification period. (Note that the construction period is defined as construction time plus two months for cost certification purposes). This will be an optional interval, because some projects may have the same certificate of occupancy date and construction completion date and thus would not need an Interval 1. When calculating expenses for this Interval, there should be no debt service included as an expense.
The mortgage interest for this interval is included in the mortgage in Section G Line 53 "Construction Interest". Ground rent is also not to be included in Interval 1. The MAP Guide, at 7.16G, requires ground rent during the construction period to be included in the mortgage. Replacement reserves are also not included in Interval 1 (the MAP Guide at 7.146 directs that reserves are not included until amortization begins). This interval should only include the appraiser's estimate of all of the applicable operating and leasing expenses for each month (period) in this interval.

Interval 2 begins at the end of the construction period/cost certification process (construction time plus two months) and ends at the beginning of amortization. This period can be no greater than 2 months and is also an optional interval. (Map Guide at 8.5A says amortization must begin "no later than 4 months after construction completion for insurance of advances and first day of second month after final endorsement for insurance of completion cases"). If amortization begins at the end of the construction period, this interval will not be necessary. Debt service should include payment for interest and MIP, but not amortization, as the beginning of amortization signals the beginning of Interval 3. (Section G Line 53 of the 92264 includes mortgage interest for the construction period plus two months. If amortization is deferred until 4 months after construction completion, there will be two months of unaccounted-for interest and MIP that must be included in the IOD). Ground rent must be included if the property is a leasehold. (only ground rent during construction can be included in the mortgage, this Interval begins after construction completion so ground rent must be included if there is a ground lease). Replacement reserves are not included in Interval 2. This interval should include the appraiser's estimate of applicable operating expenses for each month (period).

Interval 3 begins at the beginning of amortization. Amortized debt service is mandatory in this Interval, and should include payment to principle and interest and MIP. Ground rent, if applicable, is also mandatory in interval 3. Replacement reserves also are mandatory in Interval 3. This interval should include the appraiser's estimate of applicable operating expenses for each month (period). Interval 3 should end when NOI become positive.

Note that operating deficits can occur before and after the start of amortization. The operating deficit calculation for the first interval should begin at the point the Certificate of Occupancy is secured.

5. If the dollar debt service for a period is greater than the net income for that period, the difference represents the estimate of the operating deficit. One period of positive income does not cancel a prior period of income deficiency.

6. The operating deficit represents the total of all cumulative losses projected to occur before the project “breaks even” and produces a positive cash flow to the equity position.
B. Where commercial facilities are included in the project, a separate analysis will be made of the effect that the commercial operation will have on the project expense estimate. A separate operating deficit estimate of income loss for commercial rent-up will then be made. The appraiser should insure that expenses included in the residential deficit estimate are not duplicated in the commercial space deficit estimate so as to unfairly penalize the property. The commercial space deficit is then added to the residential operating income deficit to determine the total deficit escrow that will be necessary. It should be noted that positive income attributable to the commercial space during the deficit period does not offset the residential operating deficit requirements.

7.15 Reserve for Replacement Escrow

A. Sections 221, 220 and 232 annual deposits to the Replacement Reserve shall be calculated by the following formulas:

1. Section 221 and 220
   a. New construction: 0.006 X Total Structure Cost
   b. Substantial rehabilitation: 0.004 X Mortgage Amount

2. Section 232
   a. New construction:
      (1) Realty: 0.006 X Total Structure Cost
      (2) Major Movable Equipment: 0.10 X Major Movable Equipment Cost
   b. Substantial Rehabilitation:
      (1) Realty: 0.004 X Mortgage Amount
      (2) Major Moveable Equipment: 0.10 X (Major Movable Equipment Cost + Replacement Cost new of existing equipment not being replaced by the rehabilitation)

Note: An Initial Deposit to Reserve for Major Movable Equipment must be calculated for those existing items of equipment which are not going to be replaced by the rehabilitation:

\[ \sum (\text{Cost new of each of the non-replaced major movable equipment} \times \text{percentage of useful life used up for the piece of equipment}) \]

B. Section 223(f) Initial and Annual Deposits to the Replacement Reserve: In general, the Lender’s Needs Assessor will conduct a Project Capital Needs Assessment (PCNA) for long-term capital needs. The Lender’s appraiser will provide a plan for financing the capital needs. See Appendix 5M for full details.
A. DEFINITIONS. When used in this section, the words and phrases below are defined as follows:

1. Fee Simple Estate. This represents the entire ownership, from beneath the soil to the air above, enduring by inheritance and, indefinitely into the future. However, governmental limitations to the fee simple estate include taxation, condemnation, and police power (the power to regulate for the general good). Subject to these limitations, the owner of a fee simple estate may use the property and may exclude others from its use; he may dispose of the property by sale or by deeding it to another as a gift, or by allowing it to pass to an heir at his death including its bequest in the owner’s will. The owner may also retain his ownership while allowing another person (a tenant) to use the property for a certain number of months or years in return for the payment of money (rent).

2. Lease. A lease is a contract between an owner (the lessor) and a tenant (the lessee) which contains a written agreement of the conditions under which the lessor transfers the use of real property to the lessee in return for lease payments (or rent).

3. Ground Lease. The term ground lease is frequently used when a lessor leases an unimproved site to a lessee long enough (in years) to enable the lessee to construct a building on the leased site.

4. Ground Rent. The payments on a ground lease are frequently called ground rent, and must bear a reasonable relationship to the value of the site "As Is" (before construction of on-site or off-site improvements).

5. Leasehold Estate. The interest of the lessee (user or tenant) under a ground lease for a term of years is called a leasehold estate. When the term of the lease expires, all rights to possession and use revert back to the lessor/fee simple owner and the leasehold estate terminates.

6. The Leased Fee. The interest of the lessor/fee simple owner during the period when the property is under lease.

7. In computing payments due under the lease, the terms “gross collections,” “operating expenses and taxes,” “net income before debt service payments,” and “net cash flow” shall be defined as follows:
   a. Gross collections (or effective gross income) shall mean the annual amount collected from all sources, less refunds.
   b. Operating expenses and taxes shall be composed of items of operating expense and taxes in accord with generally accepted accounting principles. However, for lease payment computations, taxes shall not include income taxes, and operating expenses shall not include interest charges, or charges or allowances for depreciation of real or personal property, or amortization of financing expense, or payments to any officer or director of the corporation, unless such payments are for services at the project which are necessary to
the operation of the project. Conversely, operating expenses shall include the annual
amounts deposited to replacement reserve funds.

c. Net income before debt service payments shall mean the annual amount which remains
after operating expenses and taxes are subtracted from effective gross income.

d. Debt service payments shall be the annual amounts paid to mortgage principal, interest, and
mortgage insurance premium.

e. Net cash flow shall be the annual amount remaining after debt service payments are
subtracted from net income.

B. Term of Lease. Leaseholds must conform to the FHA Lease Addendum Form FHA-2070. The
term of the Lease Addendum may be varied to conform with applicable State and local law,
except that the HUD closing attorney must approve:

1. The legal need for any proposed lease term changes, and

2. That any term changes are consistent with the following requirements of the Section of the
Act under which the project is underwritten:

a. Section 207/223(f). The lease term must satisfy one of the following requirements):

   (1) Term is 99 years and is renewable, or

   (2) Term is at least 50 years from the date the mortgage is executed (where a lease is
   on trust/other land on a reservation the HUD closing attorney must ensure that the
   lease provisions are coordinated with Bureau of Indian Affairs requirements).

b. Section 220, 221(d) and 232. The lease term must satisfy one of the following
requirements:

   (1) Term is 99 years and is renewable, or

   (2) Term has at least 10 years to run after maturity date of the mortgage.

C. Marketability. The purchaser of a multifamily housing project is typically an investor in a national or
regional market of competing investments. The marketability of a rental project is based primarily
on an investor’s estimate of the present worth of future cashflows. If the ground lease increases the
cash flow to equity, most investors will consider marketability enhanced. However, the leasehold
estate cannot be considered marketable unless the lease meets the underwriting review
requirements described in this section.

D. Regulation for Leaseholds. HUD regulations state “Reduced mortgage amount - leaseholds. In the
event the mortgage is secured by a leasehold estate rather than a fee simple estate, the value or
replacement cost of the property described in the mortgage shall be the value or replacement cost
of the leasehold estate (as determined by HUD) which shall in all cases be less than the value or
replacement cost of the property in fee simple.”
E. Legal Review. The lease must receive both a legal review and MAP Lender underwriting review. Neither of these reviews may be substituted for the other. Legal review, performed by the HUD legal counsel, shall establish that the proposed lease is in conformity with the applicable statute, HUD regulations, Form No. 2070 (the Lease Addendum model form), and applicable provisions of local law. Any substantive deviations from Form 2070 must be to the Assistant General Counsel for Multifamily Mortgage Insurance.

F. Underwriting Review of Lease at Firm Commitment. In testing the lease payments for acceptability, the appraiser takes the following actions:

1. The appraiser performs a Firm Commitment review to develop the following estimates:
   a. Fair market value of land fully improved (in fee simple)
   b. Warranted price of site fully improved (in fee simple)
   c. Value of site "As Is" (in fee simple)
   d. Gross income
   e. Effective gross income
   f. Total operating expenses and taxes
   g. Net income
   h. Replacement cost by formula
      (NOTE: The replacement cost formula to be used with leasehold estates will be found in the MAP Form Book.)
   i. Value of project (in fee simple) if applicable
   j. Mortgage amount, by completing a valuation trial copy of Form HUD-92264A. (NOTE: The value of the leased fee equals the value of site "As Is" in fee simple, before construction of on-site or off-site improvements.)
   k. Annual debt service payments to principal, interest, and MIP.
   l. Annual cash flow to equity (after debt service payments but before ground lease payments.)

2. The appraiser analyzes lease provisions which determine the amount of annual lease rental payments (or ground rents). Although it has been administratively determined that certain kinds of ground rents will be permitted that vary with the passage of time, this must be accomplished without weakening the tests which are designed to assure that the position of the mortgagor and of HUD in an insured mortgage secured by a leasehold estate would be no worse than if the property were held in fee.

   a. Some methods of determining variable lease payments are not acceptable as these methods contain the danger of future payments being too burdensome to be made without default in
mortgage payments. Examples of unacceptable methods of determining variable ground rents are:

1. A graduated schedule of future increases on a lump sum year-by-year basis.
2. COLA increases.
3. Increases based on the results of future appraisals.

b. To determine if the initial amounts are within underwriting limitations, ground rents may be computed using any of the following three methods:

1. A fixed percentage of gross collections (or effective gross income). The percentage must remain the same throughout the term of the lease.
2. A fixed percentage of net cash flow to equity (after debt service payments but before lease payments). The percentage must remain the same throughout the term of the lease.
3. A stated dollar amount per year, which must remain fixed for at least ten years more than the term of the insured mortgage. (If monthly or quarterly payments are required, these will be converted to annual amounts by the appraiser). When the lease contains more than one method of computing lease payments, it will also indicate whether the amount to be paid shall be the greatest or the least, or the sum of these amounts. The stated annual dollar amount may be described as a minimum payment.

3. The appraiser estimates the lease payments, using the lump sum annual amounts and percentages contained in the lease provisions, as applied to the estimated annual effective gross income or annual cash flow to equity indicated by the appraisal and on Form HUD-92264. (The estimates are not based on the income which would be available during any period of deficit operation, but should reflect the effective gross income shown on Form HUD-92264 and the corresponding cash flow to equity which result when sustaining occupancy has been reached.)

4. Example: Assume the facts are as shown in the following example:

**LAND VALUE**

Warranted Price of Land Fully Improved (In Fee Simple)..........................$ 125,000
"As Is" Value of Land (In Fee Simple).. 115,000
Value of Leased Fee........................ .................................................................115,000

**Income and Cash Flow**

Estimated Effective Annual Gross Income, All Sources.............................$ 242,455
Estimated Total Annual Expense (incl. Replace. Res.).................................120,500
Estimated Net Income (before mortgage payments)........................................121,955
Annual Mortgage Payments (principal, interest, MIP) ......................................................... 99,661
Estimated Annual Cash Flow to Equity (before ground rent) ............................................. 22,294

**Estimated Replacement Cost and Mortgage Amount**

Estimated Replacement Cost (or Value) of Project
(In Fee Simple) $1,250,000

Estimated Value of the Leased Fee ................................................................. 115,000

Estimated Replacement Cost (or Value)
Of Project (leasehold Estate) ................................................................. 1,135,000

Maximum Mortgage Amount From Form 92264A
(Leasehold Estate) $1,021,500

Annual Ground Rent Required

Assume that provisions of the lease require annual lease payments to equal the greatest of the three following calculations:

a. Three percent (3%) of annual gross collections;

b. Twenty percent (20%) of annual net cash flow to equity (after debt service payments but before lease payments); and

c. Seven Thousand Dollars ($7,000.00) per year minimum.

The appraiser will use estimates he/she previously made in the appraisal for annual gross collections (effective gross income), and for the annual net cash flow to equity (after debt service payments but before lease payments.) The appraiser estimates the three amounts as follows:

a. 3% of annual gross collections ($242,455) = $7,274

b. 20% of annual net cash flow ($22,294) = $4,459

c. $7,000 per year, minimum = $7,000

The appraiser notes that the amount of initial ground rent required by the lease is the greatest of these three amounts: 3% of annual gross collections, or $7,274. This amount is next tested to determine whether it is within permissible limits.

5. Test for Acceptability of Variable Lease Payments. In the above example (Paragraph 4, above), the appraiser has determined the amount of the initial annual ground rent required by the lease; to be acceptable.
Except for level lease payments described in sub-paragraph g, the annual ground rents must not exceed the value of the site "As Is" in fee simple ($115,000) multiplied by 90% of the interest rate of the insured mortgage (.90 x .09 = .081).

The following is an example of Test for Acceptability of Variable Lease Payments:

$7,274, based on the estimate of annual gross collections (effective gross income) used in the appraisal. Thus $115,000 x .081 = $9,315. The ground rent ($7,274) is less than ($9,315) the value of the site "As Is" multiplied by 90% of the interest rate of the insured mortgage; therefore, the annual rent is acceptable.

6. Form No. 2070, 207 Lease Addendum. The appraiser also reviews provisions of the lease (other than those concerned with annual lease payments) to determine that they will not restrict the successful operation of the project. In analyzing the lease the appraiser must keep in mind that the provisions of Form 2070, the 207 Lease Addendum, must be included in, or legally appended to, the lease. The proposed lease must not contain any provisions in conflict with the lease addendum. If the above conditions are met and the annual lease payments required under the lease meet the test for acceptability described above, the appraiser recommends that the lease be accepted.

7. Test for Acceptability of Level Lease Payments. The provisions of the lease may require only payments that are a stated dollar amount per year, and these stated annual ground rent payments must remain fixed for at least 10 years more than the term of the insured mortgage.

A lease may require payments that are in accord with the stated dollar amount, but may not require payments of a fixed percentage of gross collections, or a fixed percentage of net cash flow to equity (after mortgage payments but before ground lease payments). In such case, the amount of stated annual ground rent will be acceptable if it does not exceed the value of the site "As Is" multiplied by 100% of the interest rate of the insured mortgage.

8. Single, up-front payment Leases are not acceptable. HUD has a longstanding policy of only insuring mortgage proceeds for land that is owned in fee simple. Up-front, single payment ground rents are to be subtracted from property value in Criterion 3 (Line B-1 identified as “value of the leased fee”) and are not to be included in the mortgage. They are treated as any other leased fee in this regard because they do not include the total bundle of rights that are included in a fee simple case.

G. Ground Rent during Construction. For proposed construction under all sections of the Act, lease payments during construction MUST be included in the estimated replacement cost of the project (and also in the certified cost), subject to the following conditions:

1. The period for which ground rent is estimated is the same as that for which interest and other related charges are calculated, namely, the estimated construction time plus two months.

2. Ground rent during construction is entered in Line G 69 of Form HUD-92264 (currently labeled “Construction Fee.”) A remark should be entered in Section H, indicating that the amount in Line G 69 represents Ground Rent During Construction.
3. Ground rent is not to be included in the base on which Section 220, 221(d) Builder and Sponsor Profit and Risk Allowance (BSPRA) is calculated.

4. The annual amount of ground rent during construction may not exceed the test for acceptability of lease payments.

H. Replacement Cost by Formula

A formula that will provide the total project replacement cost and mortgage amount, based on cost for proposed construction where a leasehold estate is involved. This formula provides for Sections of the Act, which use BSPRA and also those without BSPRA. A separate formula is necessary for leasehold properties because the mortgage amount is less than it would be if no ground lease were involved.

H. Value of the Leased Fee

1. The procedures for estimating the value of the leased fee are composed of a general rule and two exceptions.

   a. General Rule. Except as provided in subparagraph b below, the value of the leased fee must be estimated to equal the market value of the site "As Is" in fee simple. The value of the leased fee must equal the value of the site "As Is" regardless of whether the ground rent is an escalating amount based on a percentage of gross collections, or cash flow, or whether it is a level stated dollar amount each year.

      (1) The value of the leased fee, so estimated, is entered in the appropriate space in line K-6, Form HUD-92264.

      (2) Next, the annual ground rent, based on the lease provisions and estimates of income and expense used in the appraisal is entered in the appropriate space in line K-6, Form HUD-92264.

      (3) Dividing the ground rent by the value of the leased fee will result in the earning rate indicated by this ground rent. This rate is also entered in line K-6.

   b. Exception for Leases Containing an Option to Buy. In cases which meet the following conditions, the value of the leased fee may be estimated by capitalizing the ground rent.

      (1) The lease must give the lessee an option to buy the site in fee simple for a stated purchase price at some time during the term of the lease. This stated purchase price must not exceed the value of the leased fee estimated by capitalization at the time of project review.

      (2) The annual ground rent required by the lease must be level payments of a stated dollar amount. The amount of these payments must remain unchanged from the date of mortgage endorsement to at least ten years after the mortgage term.
(3) The capitalization rate used must be the market capitalization rate for similar investments except that it may never exceed the interest rate of the insured mortgage. The ground rent divided by the capitalization rate results in the estimated value of the leased fee to be entered in line K-6, Form 92264.

J. Option Price for Assistant Secretary for Housing–Federal Housing Commissioner. The Assistant Secretary - Federal Housing Commissioner’s option price in the lease addendum must reflect the value of the leased fee in Form HUD-92264.

K. Ground Leased from Public Bodies. Where sites are leased by a public body to a developer for a specific purpose, the procedures outlined in this chapter remain unchanged, except that the "As Is" market value of the site in fee simple (before construction of on-site and off-site improvements) may not exceed the value of the leased fee.

L. Rehabilitation of an Existing Leasehold Project. When a leasehold estate with existing buildings thereon is to receive an insured mortgage for substantial rehabilitation, Valuation processing will vary from fee simple rehabilitation processing as follows:

1. "As Is" Value of Entire Property, Land, and Buildings
   a. Tentative "As Is" value of both land and building(s) is made in the usual way by capitalization and by comparison.
   b. Value of land without building improvements is made by market comparison based on sales of similar sites.
   c. Acquisition Cost of Buildings. The maximum ground rent is limited by the value of the land without buildings multiplied by 100 percent of the market mortgage interest for level ground rent payments, or multiplied by 90 percent of the market mortgage interest rate for acceptable escalating payments. Since the value of the land without improvements does not include buildings, the cost of the acquisition of the buildings will be whatever added cash amount the buyer pays the seller of the subject property for the buildings, at or before initial closing. A certificate of the separately agreed amount for purchase of the buildings shall be submitted with the application exhibits. In a refinancing rehabilitation loan, which does not involve a buyer and seller, the acquisition cost of the buildings may not exceed the remaining mortgage balance.
   d. Final "As Is" value of entire property is the lesser of Paragraph 7.16.L.1.a or the sum of Paragraphs 7.16.L.1.b and 7.16.L.1.c.

2. Value of the Leased Fee. This value will be the amount shown in Paragraph 7.16.L.1.b, Value of Land without Building Improvements.

3. Term of Ground Lease. The term of the leasehold must comply with Paragraph 8 above.
4. Value of the Leased Fee. The value of the leased fee is estimated to equal the value of the site in fee without the on-site improvements and is entered on Line K-6 of Form HUD-92264.

5. Underwriting Review of Lease. The appraiser follows procedures in Paragraph F in this section of the Chapter to determine whether the annual ground rental is acceptable.

6. Lease Addendum. Form 2070 must be included in, or legally appended to, the lease. The appraiser also reviews provisions of the lease (other than those concerned with annual lease payments) to determine that they will not restrict the successful operation of the project. If the above conditions are met and the annual lease payments meet the test for acceptability, the appraiser recommends that the lease be accepted.

7. Ground Rent during Construction. For rehabilitation under all Sections of the Act, ground rent during rehabilitation MUST be included in the replacement cost in a manner which meets the requirements of Paragraph G above.

8. Replacement Cost by Formula. A formula which will provide the total project replacement cost and mortgage amount, based on cost for substantial rehabilitation wherein a leasehold estate is involved, is shown in the MAP Forms Book. This formula provides both for sections of the act which use BSPRA and those without BSPRA.

### 7.17 Site Not Attributable to Dwelling Use

For each project where the trial HUD-92264-A indicates the mortgage will be limited by Criterion #4, Amount Based on Limitation per Family Unit, the portion of the site value allocated to facilities not attributable to dwelling use will be calculated by the Lender’s appraiser and entered in the Remarks portion of HUD-92264 or HUD-92264HCF.

**A.** The Lender’s appraiser will calculate the site not attributable based on the square footage estimate of the Cost not attributable to Land developed by the Lender’s Cost Analyst. For simplification designate this amount as \(A\).

**B.** The Lender’s appraiser next takes the total site square footage from his estimate on the front of the HUD-92264 or HUD-92264HCF. For simplification designate this amount as \(B\).

**C.** The Lender’s appraiser next takes the value estimate for the total site from the front of the HUD-92264 or HUD-92264HCF. For simplification purposes designate this amount as \(C\).

**D.** To calculate the Site Not Attributable (S.N.A.) the Lender’s appraiser uses the following formula:

\[ S.N.A. = \left(\frac{A}{B}\right) \times C \]

**E.** The Lender’s appraiser will then enter the S.N.A. cost on line 4.c of the trial HUD-92264-A.

### 7.18 Tax Abatement Procedures
Tax Abatement is a reduction of property taxes for a specified term by the appropriate taxing body. Properties with a tax abatement agreement may be eligible for an increased mortgage amount, when the Debt Service Mortgage Criteria 5 controls the calculation of the FHA Maximum Insurable Mortgage. Additionally, the tax abatement must run with the real estate and not with the type of sponsorship if it is to secure additional mortgage proceeds. These tax abatement procedures are applicable to Sections 220, 221(d)(3), 221(d)(4), 223(f) and Section 232 processing.

A. **Fixed Long Term Tax Abatement**

If the amount of the tax abatement is fixed and runs the entire term of the mortgage, the real estate tax expense reported on the HUD-92264 should be the actual amount of taxes to be paid after the abatement is applied. The full amount of the real estate taxes without the abatement should be noted in the remarks section of the HUD-92264. This allows the property to benefit from an increased mortgage amount due to the lower proforma operating expenses and thus an increased NOI estimate. **Note, where the abatement is fixed for the full term of the mortgage no adjustment is made to Form HUD 92264A Criteria 5.**

B. **Short Term or Variable Tax Abatement**

If the abatement is short term or varied, it may be used to secure additional mortgage proceeds. The amount of the additional mortgage is the amount that the abated taxes will amortize over the term of the abatement. A special amortization plan must be requested which has debt service payments that are increased by the amount of additional net income generated from the abatement, over the agreed term of the abatement.

When processing a short term or varied abatement, the full amount of the property taxes will be estimated and included in the total project expenses on Form HUD-92264 as if there were no tax abatement. The additional debt service ability resulting from the abatement should be calculated on line I, criteria 5 of HUD 92264A.

**If Criteria 5, “Amount Based on Debt Service Ratio”, does not control the mortgage, then the short term or variable abatement cannot be used to secure additional mortgage proceeds due to statutorily controlled loan to value limitations.**

1. **Short Term Abatements:** Assume that Property A has been awarded a 5 year tax abatement of $5,000 per year. The interest rate on the loan is quoted at 7.5%. The FHA Mortgage Insurance Premium (MIP) is .5%. The amount of additional mortgage is calculated by dividing the annual abatement, $5,000 by the applicable debt service rate (P, I, and MIP). In this example the debt service rate is .245455383.

\[
\frac{\$5,000}{.245455383} = \$20,370 \text{ Additional Mortgage Amount.}
\]

The mortgage amount based upon debt service, Criteria 5 of HUD 92264A would be increased by $20,370 and a special amortization schedule would be requested with a debt service payment that is $5,000 per year greater in years 1 through 5.
2. Variable Abatements: Varied tax abatements are a little more complex to quantify, but are essentially calculated in the same manner. Assume that Property B has been awarded a 15 year tax abatement. In years 1 through 5, the abatement is $25,000; in years 6 through 10 the abatement is $10,000; and in years 11 through 15 the abated amount is $5,000. The interest rate on the loan is quoted at 7.5%; MIP is .5%. The amount of additional mortgage is again calculated as the amount that could be fully amortized by the varied payments over the fifteen-year period based on the financing terms as stated. The graph below illustrates the calculation.

When there is more than one abatement amount and period, and the amounts decline, the abatement amount for each period may be found by subtracting the abatement amount of the next period. Period 1 will run 5 years, Period 2 will run 10 years, and Period 3 will run 15 years. Because all three periods begin amortization at the same point, or year 0, you must subtract the amount of the abatement for the next period to avoid double counting.

(1) Abatement Period 1 = $25,000 minus $10,000 (the amount of abatement in period 2) = $15,000 for 5 years. The debt service rate for a 5 year term at 7.5% interest with 5% MIP is .245455383. Dividing $15,000 by .245455383 indicates additional mortgage proceeds of $61,111 attributable to period 1.

(2) Abatement Period 2 = $10,000 minus $5,000 (the amount of abatement in period 3) = $5,000 for 10 years. The debt service rate for a 10 year term at 7.5% interest with
.5% MIP is 0.147442123. Dividing $5,000 by 0.147442123 indicates additional mortgage proceeds of $33,912 attributable to period 2.

(3) Abatement Period 3 = $5,000 minus $0 (since there are no periods remaining) = $5,000 for 15 years. The debt service rate for a 15 year term at 7.5% interest with .5% MIP is 0.116241483. Dividing $5,000 by 0.116241483 indicates additional mortgage proceeds of $43,014 attributable to period 3.

(4) Adding the supportable mortgages from each of the abatement periods results in a total additional supportable mortgage of:

<table>
<thead>
<tr>
<th>Period</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Period 1</td>
<td>$61,111</td>
</tr>
<tr>
<td>Period 2</td>
<td>$33,912</td>
</tr>
<tr>
<td>Period 3</td>
<td>$43,014</td>
</tr>
<tr>
<td>Total</td>
<td>$138,037</td>
</tr>
</tbody>
</table>

The mortgage amount based upon debt service, or Criteria 5 of HUD 92264A would be increased by $138,037 and a special amortization schedule would be requested with a debt service payment that reflects $25,000 per year in years 1 through 5; $10,000 in years 6 through 10; and $5,000 in years 11 through 15.