



**U.S. Department of Housing and Urban Development
Office of Public and Indian Housing**

Special Attention:	NOTICE	PIH 2008-35 (HA)
Public Housing Agencies	Issued:	August 20, 2008
Public Housing Directors	Expires:	August 31, 2009

Subject: Cost-Test and Market Analyses Guidelines for the Voluntary Conversion of Public Housing Units Pursuant to 24 CFR Part 972

I. Applicability: This Notice applies to public housing agencies (PHAs) who are applying to HUD under the voluntary conversion program of Section 22 of the 1937 Housing Act and 24 CFR 972.

II. Background: This Notice provides guidance to PHAs in implementing elements of Section 533 of Quality Housing Work Responsibility Act of 1998 (Title V of P.L. 105-276) (QHWRA), which amended Section 22 of the United States Housing Act of 1937 (the Act), and 24 CFR 972, published in the Federal Register on September 17, 2003 (FR-4476-F-04) (conversion rule). The cost methodology of the conversion rule was published as an appendix to the rule on March 21, 2006 (FR-4475-F-02), with an effective date of April 20, 2006 (cost-test).

Section 22 of the Act and 24 CFR 972 Subpart B authorize a PHA to request approval from HUD to voluntarily convert a public housing property, or portion thereof, to tenant-based assistance, subject to several conditions.

An application for voluntary conversion must incorporate a “conversion assessment” that includes the elements described in 24 CFR 972.218 Conversion Assessment Components. One required component of the conversion assessment is the cost analysis described in 972.218(a), comparing the cost of public housing with the cost of tenant-based assistance. HUD will approve the proposed voluntary conversion of a property (including removal of a property, or portion thereof, from a PHA’s inventory only when the cost analysis component of the conversion assessment demonstrates the total costs of ongoing maintenance and operations for a property exceed the total costs of providing tenant-based assistance.

The HUD Special Applications Center (SAC) approves conversion assessments using an Excel-based cost analysis calculator for use by PHAs. The Excel-based cost analysis calculator is available on the SAC web site at the following link:

<http://www.hud.gov/offices/pih/centers/sac/docs/costcomparison.xls>

In addition to this cost analysis component, the conversion assessment must also include an analysis of the market value of the property as described in 972.218(b) (the “market-value analysis”). This market-value analysis will evaluate various proposed development scenarios and sets of assumptions including use of the property as public, assisted, or market-rate housing based on the as-is and post rehab condition as required as part of the conversion assessment set forth in the voluntary conversion rule (24 CFR Part 972.218).

III. Purpose: This Notice provides “how to” guidance to PHAs regarding the procurement and use of appraisal services to complete the required components of the conversion assessment for properties proposed for voluntary conversion, in particular the cost analysis and market analysis. It instructs PHAs on how they can determine the market value or “highest and best use value” that must be inserted into Section 5(c) of the (excel-based spreadsheet) cost-analysis calculator, a required element of 24 CFR 972.218. This calculator is available on HUD’s Special Application Center (SAC) website at: <http://www.hud.gov/offices/pih/centers/sac/docs/costcomparison.xls>.

This Notice provides guidance to PHAs on preparing the market analyses for the public housing property required as part of the voluntary conversion assessment under 24 972.218(b) of the voluntary conversion rule. These market analyses will assist PHAs in evaluating their recapitalization options, including how rehabilitation and the proposed use of the property (as public, assisted, or market-rate housing) that may affect a property’s value. Several options are available to PHAs involving whether to undertake a voluntary conversion. These include modernization and reuse of the existing building as public, assisted, market-rate, mixed-income or some other form of affordable housing for the low-income.

IV. Appraisal Procurement Instructions

Procurement of appraisal services must be conducted by a PHA in accordance with its procurement policy and with the Procurement Handbook for Public Housing Agencies, HUD Handbook 7460.8 REV 2, dated March 2, 2007, or any subsequent version of the Handbook in effect at the time of the procurement action.

The generally accepted and recognized standards of appraisal practice in the United States are found in the Uniform Standards of Professional Appraisal Practice (USPAP). These Standards are published and updated periodically by the Appraisal Standards Board (ASB) of the Appraisal Foundation, a non-profit organization authorized by Congress as the source of appraisal standards and appraiser qualifications. Their most recent publication is the 2008-2009 USPAP + Guidance, effective January 1, 2008.

A PHA must procure appraisal services from a provider that is qualified and competent to perform an appraisal that addresses the requirements of the conversion assessment. The market-value analysis component of the conversion assessment will require appraisal of the property as subsidized housing and, depending on the nature of the proposed conversion, may require appraisal of the property with proposed improvements, or in the context of altered use-restrictions. These are relatively complex appraisal tasks.

Therefore, when procuring appraisal services, a PHA must obtain the services of a provider that is qualified and competent generally, but that also is competent in the relevant specialized areas, as described in the USPAP.

After a PHA procures an appraiser, the appraiser is expected to exercise professional judgment in accordance with the USPAP, the conversion assessment requirements of 24 CFR 972 and common industry practices regarding market valuations of real estate.

V. Guidance on Conducting Market Analyses of Public Housing Property:

To conduct the cost-test and conversion assessment required by the conversion rule, PHAs must determine the highest and best use market value and estimates of market value based on the five distinct market valuations listed below. The valuation listed in box #5 of this matrix is the value a PHA must insert into the Excel-based conversion cost calculator spreadsheet.

Market Analyses	Approach Used (check one)	Market Value (insert estimate)
1. Current Value “As Is” Public Housing	<input type="checkbox"/> Income <input type="checkbox"/> Comparable Sale <input type="checkbox"/> Tax-Assessment <input type="checkbox"/> Cost Approach	
2. Future Value “Post-Rehab” Public Housing	<input type="checkbox"/> Income <input type="checkbox"/> Comparable Sale <input type="checkbox"/> Tax-Assessment <input type="checkbox"/> Cost Approach	
3. Current Value “As Is” (depends on proposed use) Select One: <input type="checkbox"/> Assisted Housing <input type="checkbox"/> Unassisted Housing <input type="checkbox"/> Market-Rate Housing <input type="checkbox"/> Other	<input type="checkbox"/> Income <input type="checkbox"/> Comparable Sale <input type="checkbox"/> Tax-Assessment <input type="checkbox"/> Cost Approach	
4. Future Value “Post-Rehab and Conversion” (depends on zoning and proposed use) Select One: <input type="checkbox"/> Assisted Housing <input type="checkbox"/> Unassisted Housing <input type="checkbox"/> Market-Rate Housing <input type="checkbox"/> Other	<input type="checkbox"/> Income <input type="checkbox"/> Comparable Sale <input type="checkbox"/> Tax-Assessment <input type="checkbox"/> Cost Approach	
5. “Highest and Best Use Market Value” (Insert this value at Section 5(c) of the Cost Analysis Excel Spreadsheet as the “market value of property”).	<input type="checkbox"/> Income <input type="checkbox"/> Comparable Sale <input type="checkbox"/> Tax-Assessment <input type="checkbox"/> Land Value	

Specific instructions for completing this market analysis and highest and best use valuation are as follows:

Current Market Value as Public Housing (Box #1): This current value as public housing based on the “as is” condition of the property is self-explanatory.

Market Value as Public Housing “Post-Rehab” (Box #2): This value should be based on the costs for any rehabilitation or repairs necessary to keep the development viable for an evaluation period of 20, 30 or 40 years as selected by the PHA (depending on the degree of modernization necessary to keep the property viable). The level of rehabilitation is the primary factor for the remaining useful life evaluation period a PHA will select. A 20-year remaining useful life assumes the repairs necessary to eliminate any deferred maintenance items and other repairs necessary for a property to comply with the International Existing Building Codes (ICC) or Public Housing Modernization Standards in the absence of a local rehabilitation code. A 30-year remaining useful life assumes a level of modernization that addresses all accumulated maintenance backlog and any redesign or reconstruction necessary to ensure compliance with current local codes to ensure long-term viability. A 40-year remaining useful life assumes repairs at a level equivalent to new construction that will create like new conditions within a property. The PHA must provide the appraiser with a capital needs assessment prepared based on the degree of modernization necessary to keep a property viable in accordance with the remaining useful life evaluation period selected by a PHA.

Useful Life	Level of Rehabilitation	Market Value
20 Years	Compliance with existing local or International Building Codes (ICC) or Public Housing Modernization Standards.	Based on operation as public, assisted, unassisted, or market-rate housing and a sale based on the remaining value in the property at the end of the specified term assuming no further use restrictions. This value should be stated as a Net Present Value.
30 Years	Eliminates all accumulated maintenance and backlog of repairs and includes redesign necessary to ensure long-term viability.	
40 Years	Equivalent to “Like New” standards.	

Current Value in “As Is Condition” (as Assisted, Unassisted or Market Rate Housing (Boxes #3): 24 CFR 972.218 requires PHAs to describe the proposed use for a public housing property proposed for conversion and to describe the means and timetable to complete the conversion and relocation of impacted households. The PHA must inform its appraiser how the property will likely be used after conversion. This value should be based on the proposed use and either the comparable sale, income, or most feasible appraisal method to determine an accurate estimate of market value. If a developer/partner or contractor has already been properly procured conditioned upon the approval of this conversion application, then that future use should be provided to the appraiser. The proposed future use of the development will largely depend on site location and physical condition, land use regulations, property tax considerations, local market

conditions, financing options and the zoning limitations or restrictions placed on the property.

Future Value “Post-Rehab” (Assisted Housing, Unassisted or Market Rate Housing (Boxes #4): 24 CFR 972.218 requires PHAs to describe the proposed use for a public housing property proposed for conversion and to describe the means and timetable to complete these redevelopment activities. The instructions for conducting this market analysis are the same as for (Box # 3), except when considering rehabilitation needs, at a minimum a PHA must consider the repair needs identified under the conversion cost-test that are necessary to keep a property viable for the remainder of its useful life during the evaluation period of 20, 30 or 40 years as selected by the PHA under the conversion cost-test. See information and chart above at Box #2 for more explanation on useful life.

The “Highest and Best Use Market Value” (Box #5): HUD requires PHAs to enter the appraised market value of a property into the cost-test in Years 1 through 5 when a PHA anticipates selling a property or receiving income generated from the sale of a property. Under the conversion cost-test after the “highest and best use market value” is determined, a PHA will determine the net residual value of the property. The net residual value is determined by calculating the estimated market value for the property based on the appraisal, minus any costs required for demolition and remediation paid by the PHA. (See Federal Register pp. 14337 and 14338 for the final rule for the Conversion Cost Methodology).

This valuation should be based on the use that provides the greatest potential return to the PHA from the sale of the property in accordance with local zoning requirements and market conditions. The “Market Value” or “Highest and Best Use Value” always assumes a use of the property that will generate the highest economic return associated with a sale of the subject property (as residential or commercial property taking into consideration applicable zoning requirements). This value may be determined with or without regard to the plans of the PHA or a developer procured by a PHA. An appraiser may evaluate existing or proposed uses in the area as well as recent changes in the marketplace which may not yet be reflected in comparable sales. If a new highway interchange has just been announced or a large corporation has just proposed construction of its world headquarters across the street, the impact of those announcements on the value and future use of the subject property may be considered.

VI. Definitions of Housing: The following definitions should be used for purposes of this Notice.

A. Public Housing is property built and operated under an Annual Contributions Contract (ACC) and the Act.

B. Assisted Housing is housing with some form of subsidy provided by private, state or local agencies, the Rural Development Agency, Tenant-based Housing Choice Voucher assistance, or other non-public housing funding. The income levels of tenants in such properties may be regulated or limited by state or local regulations.

C. Unassisted Housing has no subsidy, but provides for a rental cap such as property rent controls consistent with state regulated Low Income Housing Tax Credits or other statutory or regulatory caps or rent controls. The income levels of tenants in such properties may be regulated or limited by state or local regulations.

D. Market Rate Housing has no restrictions on rental rates, operating costs, profits, rental rate increases, or improvements that can be made to the property.

VII. Appraisal Methods

To determine the market-value that must be inserted into the cost-test calculator, the PHA must procure an appraiser 24 CFR 972. While PHAs are urged to use an appraiser to assist with preparing a market analyses, this is left to the discretion of a PHA. In light of the low-income purpose of the public housing program, HUD recognizes appraisers may need to make special adjustments in valuing properties. HUD expects appraisers will select the most feasible appraisal methods. In the section below basic appraisal methods are described for the (Market Comparison Approach, the Cost Approach, the Income Approach, or the Tax-Assessment Approach). PHAs and (procured appraisers) may exercise their professional judgment in deciding on the most feasible valuation method(s) that will be used to conduct the market analyses and appraisals required for the conversion assessment based on market conditions and common industry practices.

In general, public housing developments rarely generate net income, profit, or market value since its tenants pay rents that are equal to or less than the actual operating expenses. Operating expenses for a property may frequently be greater than an authority's income and the federal subsidy it receives never exceeds its operating deficit. With no cash flow above expenses the housing units would have no value in a conventional appraisal. Only when an appraisal considers the potential income of public or assisted housing under the conditions established below using a flat rent, a Housing Choice Voucher assistance rent, or rent from a comparable property in a market in the vicinity of the proposed building, may the relative value of a property potentially be established and evaluated. These special considerations present significant challenges to an appraiser in establishing rental income levels and selecting a vacancy rate or allowance. However, the following appraisal methodologies are outlined with guidance for appraisers and PHAs to consider to derive a reasonable and good-faith estimates of market value for properties proposed for voluntary conversion.

A. Income Capitalization Appraisal Approach: The income capitalization appraisal approach (Income Approach) is used to prepare an estimate of the current value of a property by projecting a property's potential net income in the future and the expected rate of return on investment a reasonable investor would expect to earn in the future. Appraisers will project the future income a property will generate in addition to the estimated expenses. In general, these cost estimates are based on the recent income and expense history for a property. After subtracting expenses from income, the net income for a property is calculated and converted to its present value by dividing it by a

capitalization rate or the rate of return investors would expect to earn on their investment. Although there is a degree of speculation associated with this methodology, this method can be used as an indicator of market value, or to project the estimated value of a property for a potential investor.

There are ten key elements that need to be considered in determining the appraised value of affordable housing units using the Income Approach. These elements are:

- Rental Income
- Vacancy Rate or Allowance
- Operating expenses
- Capital Reserves
- Property Taxes
- Net Operating Income
- Debt Service
- Net Income
- Capitalization Rate
- Market Value

A review of the elements used in the Income Approach covers every aspect of a property's operation. Some of the individual elements considered will have an impact on limited aspects of each of the other appraisal approaches. For instance when using the Market Comparison Approach it will be essential to compare the rents established in the Income Approach with the actual rents of the comparable property used in the Market Comparison Approach. Using the Income Approach requires that an accurate long-term economic projection called a pro-forma be created for the subject property. This pro-forma contains estimates of all ongoing income and expenses related to the property on an annualized basis. The pro-forma projects the amount of cash flow or profit that will remain at the end of the year for a specific development scenario. Based on the rate of return an investor would want to invest in a property of this type, the projected annual income is capitalized based on that desired return to determine the current value of the investment (see example below.) This value may be further increased by the presence of any Low Income Housing Tax Credits (LIHTC) associated with the property. The annualized value of any tax credits are added to the actual cash flow from the property to establish an Internal Rate of Return (IRR) over a projected period of time that may further increase the value of the property to the initial investor.

(1) Rental Income - Public housing rents are generally established as a function of a household's income instead of based on market forces. Although many households within a public housing complex may pay an income-based rent, PHAs are required to establish flat rents for all buildings within a PHA's inventory that are reflective of the local rental market and in accordance with the bedroom size and amenities associated with the applicable property. These flat rents must be market-based and fully cover a property's operating costs.

As an alternative, to estimate rental income for a public housing property, PHAs are permitted to use Housing Choice Voucher assistance rents or rents for comparable properties within the local rental market to estimate the value for a property using the Income Approach. HUD has established income limits for its Housing Choice Voucher (HCV) assistance program based in part on the Area Median Income (AMI) adjusted for family size and set Fair Market Rents (FMR) for local markets. In order to create a uniform basis for establishing project income in the Market Value appraisals for public or assisted housing appraisals when using HCV-based rents, the appraiser for the subject property shall use rents based on the percentages of AMI set forth in the table below for each bedroom size. If, these rents differ significantly from existing Tenant-based Housing Choice Voucher assistance FMRs, a housing authority's flat rents, or a broad and clearly established local market rent for assisted housing, an appraiser may use the local standard when an adequate justification is provided as part of the appraisal. In no event, however, shall the rents used in any appraisal exceed the Tenant-based HCV assistance rents for the area in which the subject property is located. In addition, PHAs may conduct a Rent Comparability Study (RCS) to assist them in determining the rental income of a property.

See Chapter 9 of the Section 8 Renewal Policy Guidebook, available on HUDclips.org and at <http://www.hud.gov/offices/hsg/mfh/exp/guide/s8renew.pdf>. See also HUD-92273 and HUD-92273-S8.

Rental Rates							
Number of Bedrooms	0	1	2	3	4	5	6
Rent as Percent of AMI	11%	12%	16%	18.5%	19.5%	20.5%	21.5%

(2) Vacancy Rate or Allowance: High vacancy rates in public housing properties are generally the result of deferred maintenance or other market factors, which represent the actual capital repairs a voluntary conversion and recapitalization effort are intended to address. Despite this planned effort, the actual condition of a property should be reflected in the “as-is” Market Value appraisal. The “post-rehab” appraisal should carry a vacancy allowance appropriate for the local market and the unit type. Senior units in a strong market might have a low vacancy rate due to low turnover while family units might carry a higher vacancy rate due to higher turnover rates and longer turn-around times for the units. The appraisal should simply reflect the actual conditions in the marketplace, whatever they are.

(3) Operating Expenses - The most accurate indicator of future operating expenses for a property are those currently being incurred, so long as there is not a pattern of deferred maintenance which can be common for some public housing properties. An “as-is” appraisal should use the pro-rated historical operating expenses for the property or the expenses recorded in a site-based management program approved by HUD that includes at least one full year’s operating expenses. For a housing authority these operating expenses are the sum total of all costs associated with the operation and maintenance of its public housing units exclusive of monies from capital grants. In no case should the appraisal use an operating expense less than the current per unit operating cost of the

authority. Appraisals reflecting the operating expenses “post-rehab” should utilize those expenses common to similar affordable housing units in the local market

(4) Capital Reserves – When preparing an “as-is” Market Value appraisal for a property the most recent Physical Needs Assessment (PNA) prepared for the property should be used as a guide to establish capital reserves for the purposes of an appraisal. In instances where Low Income Housing Tax Credits will be utilized as part of the project financing, the standard capital reserves established by the state’s housing finance authority may be used in the “post-rehab” appraisals. In all cases the capital reserves contained in any appraisal, to the extent they exist, should reflect the actual needs of the property and ensure the ability of management to meet and maintain Uniform Physical Condition Standards (UPCS) standards as well as any requirements set forth in the PNA for the site.

(5) Property Taxes - While public housing authorities do not pay real estate taxes, many of the revitalization or development scenarios proposed for a voluntary conversion could expose a property to real estate taxation. The real estate taxes paid by properties designated as affordable housing are usually reduced by local governments using a Payment In Lieu of Taxes (PILOT) agreement between the owner of the property and the taxing authority. The “as-is” appraisal should use whatever property taxes are currently being paid by the housing authority, if any. If title to the property subject to the voluntary conversion is to remain in the name of the authority then the appraisal should include any taxes to be paid pursuant to a PILOT, if any. When the proposed development plan for the subject property creates a potential real estate tax liability, then any appraisal of that property should include, as an expense, the full real estate taxes if no PILOT agreement is contemplated. If the appraisal assumes that any real estate taxes will be subject to a PILOT, then evidence of such an agreement must be provided as part of the appraisal.

(6) Net Operating Income - The Net Operating Income (NOI) of a property, sometimes known as the Net Before Debt Service is the annual income from operating the property that remains after all operating costs have been paid and the necessary deposits from operating income to capital reserves have been made. Within the pro-forma, NOI is the most key determinate of property value when the Income Approach is the appraisal method used. For a housing authority public housing property, the NOI is generally a negative number. It is the subsidy provided by the ACC executed between HUD and every PHA insures that the authority will not operate at a loss. However, once a voluntary conversion has been completed a PHA can redevelop the subject property in ways that create a positive NOI without the benefit of any direct subsidy. This positive cash flow creates value where there was none before and provides the justification necessary for the conversion.

(7) Debt Service - When the post-conversion plan for a public housing property will utilize debt of any kind then the Future Market Value appraisal shall reflect the revenue generated to produce net operating income and cover debt service associated with borrowed financing. The underlying debt may be from a bank loan, a bond issue, a loan from the PHA or other institutional debt. If the property has tax credit investors who are entitled to a guaranteed return, then that return shall be considered debt service in the

appraisal. The voluntary conversion process permits the consideration of different outcomes for the rehabilitation, sale or other use of a property. Whenever one of those scenarios includes debt, the debt service calculation must become part of the appraisal for the evaluation of that option. Since debt is a key element in determining the actual amount of the required investment in a property, it can affect value. The example below provides some guidance on the leverage that debt can bring to an investment.

Value in a real estate investment is created by Net Income within a property (see below) after the payment of all expenses including debt service, the presence of debt and the corresponding debt service has a direct impact on the appraised value of the subject property.

(8) Net Income - If the proposed re-use scenario for the property includes debt service then the Net Income is the NOI less the debt service. If there is no debt service and no LIHTC impact to be considered, then the net income is equal to the NOI. Generally, the presence of LIHTCs adds to the value of a property. This potential result would occur after the conversion of a property if tax credits are secured. Any tax savings associated with LIHTCs represents a source of income to the tax credit investor that is not wholly dependant upon the subject property and is therefore not part of the Net Income.

(9) Capitalization Rate - The capitalization rate reflects several factors including market conditions, perceived risk and expectations of an investor regarding the rate of return desired by an investor for capital invested in a venture. In general, the greater the risk, the higher the return expected up to the point an investor determines the risk associated with a project is not advisable. Public housing represents a greater risk than conventional assisted housing and as indicated in the example below requires a higher return for the investor. The capitalization rate may also be dependant upon the use of debt and the risk introduced by the borrowing associated with any rehabilitation or reconstruction of the site. An investor's Capitalization Rate may also change due to a desire to reinvest in the community.

(10) Value – In this example the value is determined by dividing the net income by the capitalization rate. This calculation creates a simple statement of value. In the real world, however, the determination of value is dependant upon many factors which will be subjectively evaluated by the appraiser. Location, neighborhood conditions, market demand and many other factors can impact the appraised value of a property.

Special Considerations: Following is a list of special issues relevant to operating public and assisted housing properties that impact the operating income generated from properties, how they are financed and recapitalized, and their potential market value. These particular issues are identified for PHAs and appraisers to consider because of their impact on the estimated market value for properties appraised using an Income Approach.

Utilities – To encourage efficient tenant consumption, it is HUD's objective for housing authorities to utilize individually metered, tenant-paid utilities whenever it is feasible.

In accordance with 24 CFR 965.401, all utility service provided to residents must be individually-metered through check meters or retail service, unless individual meters are not practicable or permissible. Since the “post-rehab” units will generally have individually metered utilities, all “as-is” appraisals should be adjusted to that standard to avoid skewing any comparison of the two appraisal results.

Vacancy – The establishment of a vacancy rate factor that accounts for lost income for appraisal purposes can be a highly subjective decision. If the rehabilitation of a property has been anticipated for a long period of time the vacancy rate may have been allowed to rise to reduce relocation costs. Appraisers may exercise their professional judgment when considering management trends and historical patterns regarding vacancies and lost rental income and how these trends may be altered in the future under new management practices.

PNA - Maintenance funding may have been diverted to other properties in anticipation of a voluntary conversion plan resulting in a Physical Needs Assessment that is skewed towards high rehabilitation costs.

Low Income Housing Tax Credits (LIHTC) – LIHTCs offer an investor a fixed return over ten years that is based upon the cost of the improvements to the subject property and the taxable income the investor has to use stemming from the tax credits. This return is only available to the original investor and requires that the property be owned continuously by that investor for a period of ten years. While LIHTCs increase the value of a property, they lessen the capital investment required, may increase a property’s Internal Rate of Return (IRR) and provide more capital for redevelopment. If a property proposed for conversion is eligible for, and has received a commitment of, LIHTCs, the PHA shall provide this information to an appraiser for use in a valuation analysis as is appropriate in accordance with their professional judgment.

Sample Valuation – Income Approach

Project – 100 units of public housing - 50 one bedroom units and 50 two bedroom units.
 AMI - \$50,000
 Current Vacancy – 20% Future Vacancy

	Operated as:	Public Housing	Assisted
Rental Income			
50 one bdr@\$500 per month (12% of AMI)		\$300,000	\$300,000
50 two bdr@\$666 per month (16% of AMI)		<u>\$400,000</u>	<u>\$400,000</u>
	Gross Income	\$700,000	\$700,000
Vacancy Rate or Allowance	20% PH	<u>\$140,000</u>	5% AH <u>\$ 35,000</u>
Effective Income		\$560,000	\$665,000

EXPENSES		
Operating expenses	\$210,000	\$210,000
Capital Reserves	\$ 50,000	\$ 50,000
Property Taxes	<u>\$ 0</u>	<u>\$ 35,000</u>
Net Operating Income	\$300,000	\$370,000
Debt Service	\$ 0	\$210,000
(mortgage \$3,000,000 w/.7000 debt service constant)		
Net Income	\$300,000	\$160,000
Capitalization Rate	10%	10%
Value	\$3,000,000	\$3,700,000
Investment Required	\$3,300,000	\$750,000

In this example, an investor has increased its risk by using debt to leverage its investment while increasing its actual return on invested capital to 22%.

B. Market Comparison Approach: When the Market Comparison Approach (Comparable Sale) is used to perform an appraisal, the appraiser will look at all of the sales of similar properties within a defined geographic area. An appraiser will identify whether there are an adequate number of sales of similar properties within or near the community in which the subject property is located. Generally, these sales should have occurred within a year or two of the appraisal. These properties must then be evaluated according to their similarity to the subject property so that their sales price can be adjusted to reflect any similarities or differences that might impact value. The actual condition of the comparable property at the time of sale should be determined and adjustments must be made in the value to reflect the passage of time and differences in the two properties. The appraiser may adjust for various factors including unit size, amenities, tax credits, rental subsidies, changes in interest rates, and location. In large metropolitan areas where there are frequent sales of assisted housing, this can be an extremely accurate appraisal method. This is especially true if the ultimate disposition of the subject property will include mixed-income units or a mixed-use development for which there would be fewer comparables in a rural community.

C. Tax-Assessment Approach: There are rare instances where this approach may have merit. *However, HUD, in its sole discretion, will determine whether to accept a market analysis conducted pursuant to this approach.* In some jurisdictions local assessors are required to perform a fair market assessment of public housing and other non-profit owned housing even though they do not pay real estate taxes. In other instances, another affordable housing property may have been the subject of litigation between the owner and the taxing authority which established a definitive market value for the property within the local market. Lastly, any existing PILOT agreement obtained by local non-profit providers of affordable housing should be reviewed to establish any long-term trends in taxation that might exist within the subject community. If the subject property

will benefit from a PILOT it is reasonable that the agreement will expire before the evaluation or test period used to determine project viability ends. A review of established trends in existing and recently expired PILOT agreements might offer some insight into whether these payments will escalate dramatically at the end of the initial contract period.

These values, like all others, are subject to adjustment depending on the differences and similarities between the subject property and the comparable property. While the Tax-Assessment Approach is generally not a precise estimate of market value there are instances when it can clearly define the value of the subject property and therefore it should not be overlooked. The negative aspect of the Tax-Assessment Approach is that for political purposes some taxing authorities use highly stylized valuation approaches when establishing the value of affordable housing. Often these values bear no resemblance to reality, so special care must be taken when considering this approach.

D. Cost Approach: While the Cost approach would be of little use in the initial Market Value Public Housing “as-is” appraisal it will generally be at least an element of the Market Value for a property planned for redevelopment or the “post-rehab” appraisal for a property. The cost approach must take into account the value of the land, which may or may not include the value of any remaining structures if the original public housing was not demolished. Any additional costs associated with environmental remediation would also become part of the land cost. Added to this would be the cost of the physical improvements to be made to the property. The sum of the land and improvement cost would be referred to as the Hard Cost of the project.

Any costs associated with design, appraisals, bond financing, tax credits, mortgages, real estate taxes during the construction period, construction loan interest, relocation, advertising, and lease up costs and any other expenses not related to the actual physical improvements would be referred to as Soft Costs.

The total of Hard and Soft Costs becomes the Total Development Cost (TDC) of the development. Depending on the extent of the improvements being made to the subject property and the financing methods being used, the TDC may differ significantly from the valuations arrived at within the standard PNA prepared for or by the PHA. Determining this TDC value, or cost, may become part of an appraisal using the income approach in order to determine the amount of financing needed to support the TDC improvements in addition to any investor capital that may be supported by Low Income Housing Tax Credits (LIHTC.) As a general rule soft costs can be expected to be at least as much as 20-30% of the total project cost.

Total Development Cost (TDC)
Rehabilitation of 100 units of 2 bedroom units

Hard Costs	
Land (incl. buildings)	3,000,000
Demolition	400,000
Remediation	200,000

Construction	<u>6,000,000</u>
Sub Total Hard Costs	9,600,000

Soft Costs	
Construction period interest	400,000
Real estate taxes	20,000
Contingency	460,000
Design	420,000
Legal	250,000
Overhead	600,000
Appraisals	20,000
Mortgage fees	120,000
Marketing	40,000
Miscellaneous	<u>70,000</u>
Sub Total Soft Costs	\$2,500.000

TOTAL DEVELOPMENT COST (TDC) \$12,100,000
TDC per Unit \$121,000

VIII. Paperwork Reduction Act: The information collection requirements contained in this document are approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 2501-3520). The OMB control number is 2577-0075. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB number.

IX. Technical Assistance

Technical assistance is available for PHAs from the SAC.

U.S. Department of HUD
Special Application Center
77 West Jackson Blvd.
Chicago, IL 60604
(312) 886-9754
<http://www.hud.gov/offices/pih/centers/sac>

/s/
Paula O. Blunt, General Deputy Assistant Secretary
for Public and Indian Housing