

PART 1922 - APPRAISAL

Subpart B - Appraisal of Real Estate Security for Rental, Cooperative, and Labor Housing Loans and Grants.

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PART 1922 - APPRAISAL

Subpart B - Appraisal of Real Estate Security for Rental,
Cooperative, and Labor Housing Loans and Grants

§1922.51 General.

This subpart prescribes the policies and procedures for appraising Rural Development financed housing consisting of four or more living units and related facilities. The Multi-Family Housing (MFH) programs involved are Rural Rental Housing (RRH), Rural Cooperative Housing (RCH), Farm Labor Housing (LH), along with prepayment requests. Appraisals of real estate security with fewer than four housing units or domestic farm LH are to be appraised in accordance with RD Instructions 1922-C and 1922-1, respectively, when arriving at the final estimate of value. With a few exceptions outlined at §1922.52 (b)(2) of this subpart, private appraisers contracted by Rural Development will perform appraisals for MFH real estate security. Rural Development personnel must assure that the justification and reconciliation of the indicated values for each approach used to determine appraised values are clearly and completely documented. (Revised 08-25-93, PN 211.)

§1922.52 Administrative issues.

(a) State MFH Appraisal System Manager. The State MFH Appraisal System Manager (ASM) and an Assistant are to be appointed, in writing, by the State Director. Duties of these positions are to maintain the MFH appraisal system within the State, by:

(1) Maintaining acceptable appraisal quality within the State. The ASM is to conduct a review of every MFH appraisal. Reviews are to include an examination of all exhibits, formulas, calculations, and other data and exhibits the appraiser used in the appraisal. All explanations are to be logical and justify the final value conclusion.

(2) Monitoring MFH appraisals for compliance with the statement of work prior to payment; see §1922.53 (a) of this subpart. (Revised 08-25-93, PN 211.)

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Real Property
Appraisal

(b) Contract Appraisals.

(1) Instructions for contracting with, and monitoring the work of, appraisers is provided at Exhibit C of this subpart.

(2) Exceptions to the use of contract appraisal services: With proper documentation the loan approval official may authorize the ASM to conduct an appraisal under the following situations:

(i) If the cost of the contract appraisal exceeds what is typical for the size and type of project for a similar market.

(ii) When a contractor cannot complete the appraisal within a maximum time frame of 45 days.

(c) Appraisal form. Form RD 1922-7, "Appraisal Report for Multi-Unit Housing," is to be used for all MFH appraisals.

(d) Proposed operation. The principle of highest and best use, the probable use that will support the highest value as of the appraisal date, is to be addressed for each project appraised and for all methods of appraisal utilized. The appraiser should give a value for the property for rental housing purposes.

(e) Nondiscrimination appraisal criteria. It is unlawful, under the Fair Housing Amendments Act of 1988, for a Rural Development employee or contract appraisal service to do the following in connection with doing appraisals for 515 rural rental housing or 514 and 516 farm labor housing:

(1) To use factors that are discriminatory on the basis of race, color, religion, sex, handicap, familial status or national origin in the sale, rental, leasing or financing of housing.

(2) To use an appraisal in connection with the sale, rental or financing of a dwelling, that the appraiser knows, or reasonably should know, improperly takes into consideration race, color, religion, sex, handicap, familial status or national origin. All appraisals completed under the loan programs noted in §1922.52 (e) must comply with this statute.

§1922.52 (e) (Con.)

(3) As more fully described at RD Instruction 2024-A, the announcement process seeking bids for contracted appraisal services will be publicized to the fullest extent possible and include publications serving minorities and minority appraisers.

(f) Unacceptable appraisals. When the ASM finds the appraisal unacceptable, the appraisal report and a copy of review comments will be returned to the appraiser. A meeting will be scheduled with the contractor, the ASM, and the Contracting Officer to discuss the appraisal and contract terms. All contractual actions taken by the Agency must be through the Contracting Officer and comply with the Federal Acquisition Regulations (FAR). Continuation of the contract(s) will be based upon the contractor's ability to meet or exceed the conditions of the contract statement of work.

(g) ASM appraisal duties. The ASM is to perform appraisals on an as-needed basis according to the circumstances of Section 1922.52(b)(2). Other duties are to monitor contract appraisals for compliance with Subpart D of Part 1944 and §1944.222(a) of Subpart E of Part 1944 and provide program orientation to the Rural Development contract appraisers.

(h) Income's effect on value. In all cases, income producing property's value is derived from its ability to produce a monetary net return sufficient to justify the improvements. Put another way, value comes from the value of the site as improved, the building value with its improvements, and the income stream produced.

(i) Prepayment requests. For prepayment requests, appraiser may place more emphasis on the principle of highest and best use.

§1922.53 Appraisal System Components.

(a) Components for contract appraising. When using contract appraisers the State Director will establish a contract appraisal system, which includes:

(1) Appointing a State MFH ASM and assistant ASM to be responsible for the contract appraisal system maintenance and the review of all MFH appraisals. These individuals are to have professional training and be knowledgeable of industry standards and meet the requirements of §1944.222 of Subpart E of Part 1944.

(2) Establishing a priority system for timely completion of appraisals and appraisal reviews. Time-frames are not to exceed 45 days from the date the assignment is accepted by the contractor.

(3) Establishing a method for monitoring the appraisals utilizing the appraisal review Form RD 1922-13, "Reviewer's Appraisal Analysis."

(4) Maintaining a data base that will establish "benchmarks" for typical project construction costs and typical project expenses and incomes for use in appraisal reviews.

(5) Maintaining a list of qualified appraisers interested in receiving solicitations. Names of interested appraisers or appraisal firms who are professionally trained and have experience in appraising multi-family income producing property will be collected from applicable sources. Examples of sources are appraisal industry papers, newsletters, local appraisal chapter newspapers, direct contact, etc.

(6) Developing an orientation plan to provide contractors with an overview of MFH programs. The ASM is to instruct contractors on the completion of the appraisal report form and contract payment conditions. Materials to be furnished by Rural Development include sample Operating and Management (O&M) budgets from which a realistic net operating income (NOI) can be calculated, copies of the subject market study, the environmental impact assessment, and other relevant information that can be released under the Freedom of Information Act.

(7) Establishing a policy for appraisal completion and submission similar to those of other appraisals completed in the area. An extension, not to exceed 30 days, may be granted when it can be documented that the delay is beyond the appraiser's control. Any extension must be clearly documented by the loan approval official.

(8) The practice of contractors using automated cost estimator services for calculating construction cost should be encouraged. Review appraisers are to use the automated Marshall & Swift (RE2 or SEG) cost estimating service as a cost monitoring tool in all appraisal reviews.

(b) Management of appraisal system.

(1) Prior to executing a contract, the State Director will assure that proposed appraisal fees are typical for the area. Prior to payment, the State Director will review the appraisal for compliance with the conditions of the contract statement of work. Payments for contracts are to be charged to the revolving fund using Form RD 838-B, "Invoice Receipt Certification." Contract appraisers are expected to provide the appraisal report with attachments and expert witness services (when applicable) for fees that are typical for work of similar complexity in the subject market area.

(2) The State Director will establish a system for appraisal monitoring that will return unacceptable appraisals for correction or additional documentation prior to Rural Development acceptance and contract payment.

RD Instruction 1922-B
§1922.53 (b) (Con.)

(3) The appraisal monitoring system data should be used by the ASM when determining typical cap rates, O&M expenses and incomes, rents and construction costs.

(i) Establish a data base which can be used for value estimate purposes. Data is to be developed from the sale/transfer of ownership of subsidized housing. Sources of this data are State housing agencies, Rural Development, other governmental housing agencies, and applicable conventional sales data.

(ii) Typical construction costs are to be obtained from a wide variety of sources as mentioned above. Construction costs can be used from throughout a particular State or adjoining State when the data is from a similar market.

(iii) O&M expense and income data can be obtained from conventional rental housing markets. Although conventional data must be adjusted to account for additional expenses unique to subsidized housing (e.g., reporting and recordkeeping of tenant information, on site manager, etc.), expenses and income obtained from State housing authorities, government housing agencies, and Rural Development year-end audits should closely represent the typical costs for subsidized housing. Appraisers should refer to Exhibit B of this subpart, "Guide for Determining Subsidy Value Within the Income Approach," for guidance in this area. When determining typical project expenses, it is recommended that a grid containing data from a minimum of 5 comparable projects be developed.

(4) A method for prompt payment of contracts will be established:

Instructions for payment of contracts are found in subpart A of Part 2024 and Exhibit D, "Acquisition, Sales, and Leasing Authority." The request for payment is to be submitted on Form RD 838-B, "Invoice Receipt Certification." Rural Development is to aid contractors, as needed, with the proper completion of payment forms.

§1922.53 (b) (Con.)

(5) All MFH appraisals are to contain the three approaches to value: Cost, Comparable Sales, and Income. In all Rural Development appraisals these valuation approaches must support each other. Industry convention is that they should not vary much over ten percent (10%). For Rural Development MFH appraisal purposes, any variance above industry convention is to have all supporting justification documented. Appraisals should comply with the guidance provided in Exhibit A of this subpart, "Appraiser's Guide to Rural Rental Housing."

§1922.54 Steps preliminary to making the appraisal.

The appraisal will be made when the applicant has been found to be eligible and sufficient information has been developed to enable the appraiser to evaluate the property. Plans and specifications for the building, site improvements, environmental assessment, and other relevant material is to be furnished to the appraiser. Plans are to be in sufficient detail for the appraiser to determine the size and type of structures to be built or improved, the materials to be used, and the site improvements. As a general rule, an appraisal and review will be completed prior to the obligation of funds.

§1922.55 Appraisal Review Form.

Form RD 1922-13 will be used to review all MFH appraisals involving four or more units. The ASM will assure that an appraisal review is conducted on all appraisals.

§1922.56 Appraisal orientation and reviewer training.

Appraisal orientation will be provided by the State ASM upon request. Annual meetings with contractors is considered essential for the successful implementation and maintenance of contracts.

Additional appraisal organization training courses for appraising and appraisal reviews are to be provided on an annual schedule for each employee designated as ASM and Assistant ASM. It is imperative that these individuals be knowledgeable and keep current of the appraisal industry.

§§1922.57 - 1922.100 [Reserved]

Attachments: Exhibits A, B, C, and D

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APPRAISER'S GUIDE TO RURAL RENTAL HOUSING

Part I. General.

This guide gives rural rental housing (RRH) appraisers technical guidance which must be used in completing an appraisal for Farmers Home Administration. Topics included in this Guide are:

I. Definitions.

(a) Capitalization value. This is the value that is based on enabling the income stream to support the annual debt service, operating and maintenance (O&M) expenses, funding the reserve and giving a return to the owner in a specified time-frame. Capitalization value is a direct ratio between annual net operating income (NOI) and value/sales price. Typically, this ratio is expressed in terms of money or its equivalent.

(b) Replacement value. This is the summation of the costs of the property. Replacement cost includes land, fees, Davis Bacon wage rates (when required), and services that would be required to replace or duplicate the property as improved.

(c) Comparable sales value. That value determined from the analysis of sold units which are from the subject market area. Sales data could be from a similar area (demographically and economically) and are similar to the subject in size, function, type of construction, construction material used, location, financing, etc.

(d) Loan value. For RRH proposals, the loan approval official will determine this value not to exceed the loan amounts established in Rural Development instructions. For Labor Housing proposals, the loan approval official will consider this value to be the combination of loan and grant funds.

(e) Market value. For the purposes of Rural Development subsidized housing, market value is the reconciliation of the three valuation approaches, Cost, Income and Comparable Sales, where the following relationships exist:

- (1) The buyer and seller are typically motivated; both parties are well informed or well advised.
- (2) Each is acting in what they consider to be their own best interest.
- (3) A reasonable time is allowed for exposure in the open market.
- (4) Payment is made in cash or its equivalent.
- (5) Typical financing in the community, as provided by Government subsidized loan/grant rates and terms or conventional lending rates and terms.
- (6) The price represents a normal consideration for the property sold, utilizing conventional or Government financing, unaffected by any other special financing amounts and/or terms, services, fees, costs, or credits incurred in the transaction.

(f) Depreciation. Depreciation is a loss of utility from physical deterioration and/or obsolescence.

(g) Obsolescence. Obsolescence is the impairment of desirability and usefulness brought about by new inventions, recent changes in design, and improved processes for production or from external influencing factors which make a property less desirable for continued use. Obsolescence may be either functional or economic.

- (1) Functional obsolescence is shown by conditions within the property. Some of these conditions could be poor design, functional inadequacy, overadequacy due to size, etc.
- (2) Economic/locational obsolescence is diminished useful life arising from factors external to the property. Causes of this could be environmental changes, legislation, deteriorating neighborhood, economic conditions, etc.

(h) Economic life of housing. The economic life of a structure is the period of time over which enough income is produced to cover the cost of operation and maintenance, plus an adequate return for the use of the site. The economic life of a building can never be greater than its physical life. For example, a structure can have many years of physical life remaining and yet have reached the end of its economic life.

(i) Site. A site is land that is ready and suitable for development.

(j) Sure rate. A capitalization rate selected from a investment that has virtually no risk.

(k) Current appraisal. "Current appraisal" is an appraisal for a new loan request or the revision of an existing appraisal. Revising an existing appraisal is acceptable when the following conditions exist:

(i) The appraisal being revised is not more than one (1) year old;

(ii) Adequate supporting documentation is attached to the revised estimate of value;

(iii) Substantial changes have not been made to the property;
and

(iv) The property has been inspected by the appraiser.

Part II. Administrative considerations for the appraiser.

The appraiser will be required to furnish photographs of the front, rear, and side exposures, current tax and plot plan, along with the proposed operating plan and budget. If the appraiser determines that it is not appropriate to complete the appraisal, he/she should list the reason(s) and request further instructions from the Contract Officer or Contract Officer's Representative.

(a) Administrative considerations for Contract Appraisers.

(1) Before the appraiser inspects the property, the loan approval official will review the market data to verify that a need exists for the type of proposal requested, i.e., family, elderly, etc.

(2) The Agency should provide the appraiser with a copy of the market study to use in analysis of the subject market area. It should be documented whether the subject community is progressing or declining, the market area's economic stability, and the age and income levels of the population. Other documents that should be furnished for the valuation process are the environmental assessment and operating budgets from similar Rural Development projects.

(3) The appraiser should document if the Rural Development basic rents are less than, equal to or greater than the market area's conventional rental rates. When the basic rents are equal to or greater than the conventional markets rents, it is a sign of an extremely soft market. When this situation occurs, the appraiser should make a special notation in the appraisal for the Appraisal Systems Manager (ASM) to review. It is the responsibility of the ASM to inform the loan approval official of any limiting conditions in the appraisal.

(b) Inspection of property.

(1) The appraiser is to identify the property. Boundary lines are to be checked for accuracy against the plot plan and legal description. The appraiser's knowledge of the proposed housing should be based on a careful inspection of the site, factual information previously gathered in the community and general observations. For rehabilitation of structures, the appraiser will examine the property to be sure that plans and descriptions furnished are adequate to carry out the proposal. Appraisers should check to see that plans comply with local ordinances.

(2) The appraiser should see development in the area surrounding the proposal and note in the appraisal desirable and undesirable elements of the market area. Zoning and land use plans for the area should be reviewed. Variations to zoning or land use plans and future development surrounding the subject property should be reflected in the appraisal. Data should be reviewed that will determine if any health and safety risks are present. Natural barriers against blight or undesirable use of neighbor properties should be recorded in the appraisal. Observations that affect the property's marketability and recommended market value are to be documented by the appraiser.

Part III. Considerations that influence value.

(a) General.

(1) The location of the housing development with respect to availability of essential goods and services, employment, transportation, shopping and potential alternative uses are important considerations in appraising multi-unit housing. Housing is to be on a public road. All housing complexes must have adequate and unrestricted access to a public street.

(i) The appraiser should be aware of any unfavorable factors that will impact the recommended market value. This is one of the most important variables in determining the value for the property. Objectivity is essential in identifying and discussing unfavorable location factors; such as potential risks to human health and safety caused by the presence of floodplains, mudslide areas, steep slopes, hazardous waste materials, high shrinkswell soils, seismic conditions, drainage problems, high noise levels, traffic conditions, etc.

(ii) Housing located so that the occupants will have ready access to their daily needs and be close to medical and hospital facilities generally will have a higher market value than similar property located where essential services are not as readily available.

(iii) Consideration should be given to the population trends of the local community to determine demand/need for housing. The appraiser should avoid generalizations about population trends of neighborhoods. In developing areas, population changes can often be determined by the on-going visible changes in land use. In undeveloped or sparsely developed areas, local zoning and comprehensive plans may serve as the best available information for projecting future population trends.

(2) Alternative uses: The appraisal purpose is to determine the estimated market value of the rental housing project (site) building improvements and income stream) that will be used by Rural Development for determining loan amount.

(3) Financing: Amortization periods for rental housing is over a long period of time. Appraisers should be aware of and thoroughly document the environmental conditions that are likely to affect marketability. Examples of property factors that affect recommended market value are industrial development, highway construction proposals, future community development plans, etc.

(4) Design: Specialty designed housing intended for only one type of use generally has an adverse effect on value. Such properties ordinarily carry a higher risk factor requiring net earnings to be capitalized at a higher rate to attract investors. There may be some design features which are necessary for special purpose housing that have little or no application for other uses. Added value consideration should be given only to design features that are customary for the market in which they are to serve.

(5) Non-contiguous sites: When housing projects utilize noncontiguous sites, a separate appraisal must be developed for each site. A narrative exhibit will be attached to the appraisal report (Form RD 1922-7, "Appraisal Report for Multi-Unit Housing,") which discusses the value each site contributes to the overall appraisal. The narrative must provide "how and why" the final estimated market value of the non-contiguous sites was determined.

The final estimate of value is to be derived from the reconciliation of the property values being appraised. The appraiser will not assume that the indicated value for each property can be summed to provide the final estimated market value. The Reconciliation and Value Conclusion, (Part 0 of Form RD 1922-7, "Appraisal Report for Multi-Unit Housing,") will be completed as an attached narrative using the format in the appraisal form.

(6) Capitalization Rate Components:

NOI is calculated as follows:

Potential Gross Income (project income from rents) (-) vacancy rate (+) any other project income (=) Estimated Gross Income

Estimated Gross Income (-) Operating and Maintenance Expenses (=) Net Operating Income

When computing this approach, the first year contract rents (Rural Development market rents), as mandated in the promissory note, are to be used to determine NOI. To determine what realistic operating expenses should be, data from successful complexes should be made available to the appraiser.

Cap rate terminology:

Market rate: Capitalization rate extracted from market data. Market data must be from the subject market.

Sure rate: A cap rate known to be obtainable from an investment with similar risk. Typically, this method is used when the subject market data is considered unreliable for a specific market area mentioned.

Built-up cap rate: Building an appropriate cap rate from the subject's mortgage data and cap rate data from the market area.

The capitalization rate used should be derived from the market in which the subject is to operate. If the appraiser determines that market data is of insufficient quality or quantity, then the appraiser is to use the build-up method for a cap rate. The use of a sure rate or the construction of a cap rate from investments with similar risk are other acceptable methods to obtain cap rates. The appraiser must keep in mind that although the risk associated with subsidized housing is less than other investments, it is not a risk free investment. Therefore, when a sure rate, built-up method of substitution of similar risk investments cap rate is used, the appraiser will document the method used and why. It is recommended that each appraisal have an exhibit which documents four methods of obtaining a cap rate. These are, band of investment (built-up method), market rate, sure rate and substitution of similar risk investment rate.

(b) Evaluating structures.

(1) New structures that are well located and have good design, typically, will have a market value approximating the cost of building, the site and the value of the income stream. Thorough documentation of all adjustments must be made for any obsolescence caused by improper design, poor location, atypical construction, etc.

(2) Older structures being rehabilitated present complex appraisal problems. Adjustments must be made for depreciation and obsolescence. Depreciation should be handled in one of two ways:

(i) Depreciation/obsolescence adjustments should be calculated using data from the subject or similar market. Adjustments are to be from similar type housing and must be thoroughly documented.

(ii) When the appraiser determines it appropriate, a component depreciation method can be used. This calculation produces the item's time-in-use versus life expectancy ratio. The time-in-use adjustment is subtracted from the installed new cost to determine the as-is value. The as-is value subtracted from the installed new cost nets the amount of each line item's physical depreciation. Typically, depreciation and obsolescence prevent older properties from exceeding the replacement cost approach value.

(iii) In many instances the use of depreciation schedules may be applicable for this calculation. When this method is used, the appraiser is to document the reason for selecting this technique.

(3) Value-in-use. Exhibit D of this subpart may be used in all cases involving supplemental energy saving devices. The device must show a potential cost savings. Exhibit D emphasizes that a supplemental device must show a cost savings in order to be cost effective within its realistic economic life. If the calculations in the instruction reflect a substantial negative savings, deductions in cost/value of the device are justified.

(4) Special consideration for all housing projects designed for elderly or handicapped persons. The following are some of the special factors to be considered by the appraiser which affect value of rental housing.

(i) The provisions of the Fair Housing Amendments Act of 1988, which mandates provisions for handicapped persons and convertibility of existing units.

(ii) The distance to shopping centers, places of worship, neighborhood stores, medical and recreational facilities are to be considered. The availability of transportation is a significant factor in evaluating the location of rental housing units.

(iii) Adequacy of police, fire, municipal services, and hospital facilities are important considerations.

(iv) The site should physically lend itself to a good site plan. This is a site plan which permits economical and convenient installation of housing improvements and related facilities for use by the tenants.

(c) Considerations for LH projects.

(1) Financing.

The appraiser will assume that the economic life of the development will equal or exceed the amortization period of the loan. LH grants are a subsidy to the project. Therefore, grant valuation is to be determined using the subsidy valuation method, Exhibit B to this subpart. No such loan or loan/grant combination shall exceed the development cost or the value of the security, whichever is less.

(2) Construction.

Typically, LH is to be designed and constructed similar to RRH housing or typical to similar structures in the subject community. Different types of LH will require the appraiser to consider the design and materials used in the proposed facility, such as year-round occupancy versus seasonal occupancy.

(3) Other factors the appraiser will need to consider in determining the recommended market value of the property.

It is to be assumed that the future use of this property will likely be for housing domestic farm laborers. Location of the facility to employment and community services such as schools and transportation, are important considerations. LH units are to provide privacy, be home-like and comfortable. Housing should be suited to the type of laborers being employed; i.e., single men, families, mixed singles, etc. Generally, the housing should be for family units or be readily convertible to accommodate families.

GUIDE FOR DETERMINING SUBSIDY VALUE
WITHIN THE INCOME APPROACH

Rural rental housing (RRH) loan eligibility criteria locates housing in rural areas and is intended to serve low and very low income households. Achievement of these goals dictates that subsidies be applied to RRH loans. Subsidies may provide additional value for the project when commercial rents are lower than the note rate rents proposed for the project.

To have an accurate appraisal, the value of subsidy must be measured and reflected in the appraisal. The income stream received from subsidy is a positive value when determining the value of subsidized housing. Although, when a subsidized market exists, where subsidized comparable sales, rents and cap rates are available for use in the appraisal, the subsidy calculation is a mute point because the subsidized housing market will reflect the value of subsidies. When this method is used, the value of the subsidy is used as an adjustment factor. Also, when using this method, the principles of cash flow discounting should be thoroughly understood. This methodology is not recommended when commercial rents are equal to or more than Farmers Home Administration note rate rents.

Application of this technique to LH grants is explained in #6 of this exhibit.

1. The method shown below should be viewed as the state of the art for valuation of rental project subsidies.

EXAMPLE:

NOTE RATE (9%)

15 1BR UNITS (X)	\$350/mo (X)	12mo =	\$63,000
15 2BR UNITS (X)	\$454/mo (X)	12mo =	<u>81,020</u>
TOTAL GROSS ANNUAL NOTE RATE INCOME			\$144,720

BASE RATE (1%)

15 1BR UNITS (X)	\$242/mo (X)	12/mo =	\$43,560
15 2BR UNITS (X)	\$282/mo (X)	12/mo =	<u>50,760</u>
TOTAL GROSS ANNUAL BASE RATE INCOME			\$ <u>94,320</u>

ANNUAL INCOME STREAM FROM SUBSIDY	\$ 50,400
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(Note rate income less base rate income = value of subsidy.)

2. Adjustments to the Subsidy Income Stream, When Comparing Subsidized to Conventional Income Streams.

The management requirements on Rural Development projects differ from commercial projects due to regulatory restrictions, reporting requirements of the Agency, Certified Public Accountant (CPA) audits and other requirements for Rural Development that are not observed by the commercial owners. The appraiser will need to acquire and determine the typical management expense differences that should be used for each market area. These costs differences on a national basis are:

	Annual Expense:
Rural Development requires an annual audit by a CPA	\$1,500
Rural Development on-site manager costs differing from commercial projects	2,000
Rural Development requires bookkeeping and reports that differ from commercial projects	2,000
Vacancy % collection loss (give__% of inc.)	<u>3,000</u>
 TOTAL COST ADJUSTMENT ATTRIBUTED TO Rural Development	 \$8,500
 Annual income stream	 \$ 50,400
Less total cost attributed to Rural Development	<u>(8,500)</u>
ANNUAL ADJUSTED SUBSIDY INCOME STREAM	\$ 41,900

\$41,900 div. by 12 = \$3,492 monthly subsidy income stream from total project.

3. Calculate the total value of the monthly subsidy income stream, based on the "Present Worth of a Dollar Per Period (annuity factor)".

EXAMPLE:

- a. A holding period of 20 years (restrictive use clause in the deed).
- b. A capitalization rate of 9 percent (as extracted from the market, adjusted build-up method or cap rate from a similar risk investment).
- c. And finally a monthly payment of $(\$41,900/12) = \$3,492$

n = 20 year holding period (X) 12 = 240
i = 9% cap rate (X) 12 = .75*
pmt= monthly subsidized income stream = \$3,492

Key strokes for the Hewett-Packard HP12C calculator:
20 [g][n], 9 [g][i], 3,492 [CHS][PMT], [PV] = \$388,081

TOTAL VALUE OF SUBSIDY ROUNDED \$388,000

*The discount rate will vary from one market area to another. It is crucial that the methodology for determining the discount rate be clearly documented and justified. Methods to obtain discount rates are: market extraction, band of investment, risk adjusted built-up rate, etc. It is recommended that all of these methods be documented to support the selected cap rate.

4. The value of the Rural Development interest credit subsidy is worth approximately \$388,000. This amount can then be used as the subsidy adjustment value to the three approaches to value.

5. When the valuation for subsidy method is used the following conditions must be met:

- a. Part A of Form RD 1922-7, "Appraisal Report for Multi-Unit Housing," under instructions to appraiser, items (5) and (6) In the definition of Market Value are to be modified as follows:

Substitute Item (5) with: "Typical financing in the community is provided by subsidized rates and terms granted by government or private lenders."

Substitute Item (6) with: "The price represents a normal consideration for the property sold that will be affected by special financing amounts and/or terms, services, fees, costs or credits incurred in the transaction."

- b. Discount rate and holding period must be justified in the comments of the appraisal.
 - c. The method for evaluating the subsidy must be explained in PART N of Form RD 1922-7 or on a continuation sheet.
 - d. The adjustment for financing now becomes the calculated value of subsidy and is used as an adjustment factor for the approaches to value, assuming the appraiser is using conventional market data.
 - e. Part 0 on page 10 of 10, Form RD 1922-7, must clearly state that the calculation for the "Estimated Market Value" has taken into consideration the value of the subsidized rates and terms that are typical in the community for the type of property being appraised. This should be discussed, clearly explained and included in the "Contingent and Limiting Conditions" box or attached as a continuation for PART 0.
6. For valuation of LH loans and grants the following factors will be used:
- a. The loan and grant portion is to be amortized using the current 515 market interest rate.
 - b. The holding period is to be for 33 years.
 - c. This type of facility is considered to be risk free; therefore, capitalization rates of similar risk investments can be used with appropriate documentation.

With the above factors, the steps in item 1 through 5 are to be followed.

EXHIBIT C

GUIDE FOR MULTI-FAMILY HOUSING CONTRACT APPRAISAL SERVICES AND
SAMPLE STATEMENT OF WORK

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GUIDE FOR MULTI-FAMILY HOUSING CONTRACT APPRAISAL SERVICES

Part I. General.

This Guide provides guidance for the procurement of contract appraisal services for multi-family housing (MFH) properties. Contract appraisal authorities are in RD Instruction 2024-A. (Revised 07-21-93, PN 209.)

Part II. Program Responsibilities.

A. Government Inspection of Property. In accordance RD Instruction 2024-A, contract services shall not involve decision-making or other inherently Governmental functions. Accordingly, prior to initiating procurement action for appraisal or MFH property, program personnel will conduct an on-site inspection of the dwelling and/or building site. The purpose of the inspection is to determine the following:

1. Eligibility of the dwelling and/or site in accordance with Subpart E of Part 1944 of this chapter.
2. Thermal performance of the dwelling in accordance with Subpart A of Part 1924 of this chapter.
3. Rural area determinations in accordance with 7 CFR part 3550. (Revised 01-23-03, SPECIAL PN.)
4. Environmental program compliance in accordance with Subpart G of Part 1940 of this chapter.
5. Repairs necessary to insure the property meets Rural Development program property requirements. (This list of repairs will be provided to the contractor on Form RD 1924-13, "Estimate and Certificate of Actual Cost.") This form is to be made a part of the appraisal document.

B. Preparation of Procurement Request. Program personnel will prepare and submit Form RD 1955-62, "Request for Contract Services for Custodial/Inventory Property or Program Services," to the Contracting Officer (CO) to initiate procurement for contract appraisal services. The following provides guidance, in addition to the Forms Manual Insert for Form RD 1955-62, for the preparation of the procurement request:

1. Statement of Work. An integral part of the procurement request is the description of work requested or the Statement of Work (SOW). A sample SOW for contract appraisal services is provided in Attachment 1 to this exhibit. Program personnel should review the requirements in the sample to ensure that the work requirements are expressed in concise, accurate and comprehensible terms. It may be necessary to modify the sample SOW to ensure the final SOW addresses particular requirements and circumstances. The objective is to develop a SOW that sets forth minimum standards which will provide Rural Development with a method of determining if the contractor will meet the contractual requirements.

2. Other considerations. The following provides other requirements which should be taken into consideration in the development of the procurement request. Program personnel should discuss these considerations with the CO.

a. Government furnished material. The Government shall provide the following for use in the performance of the requirements in the SOW:

(i) Legal description and/or address of the property to be appraised; list of property repairs, if appropriate; plan and specification for new construction; environmental assessment; approved budget of operating and maintenance expenses, if applicable; copies of floor plans and elevation views; tenant waiting lists, if appropriate; and any other information necessary for the contractor to complete the appraisal.

(ii) Forms RD 1922-7, "Appraisal Report for Multi-Unit Housing," and RD 1924-13 are to be used for the preparation of the appraisal.

(iii) Appropriate Rural Development Instructions and Regulations will be available for review at _____ during working hours.

A copy of RD Instructions 1922-B (with Exhibits A, B, C, and D), 1922-E, and 1944-E along with appropriate application documents that can be released under the Freedom of Information Act, will be furnished to potential offerors. (Revised 08-25-93, PN 211.)

b. Preparation of proposals. To be considered for award, offerors shall submit a proposal which clearly documents the offeror's ability to accomplish the requirements in the SOW. As a minimum, offerors should furnish the following with their proposals:

(i) A brief written summary of experience and qualifications of key person(s) or firms expected to perform the requirements specified in the SOW.

(ii) Provide all necessary documentation and certifications that substantiate that the offeror is certified, licensed and/or authorized to perform MFH appraisals within the area specified in the SOW.

(iii) At a minimum two (2) written statements of performance from individuals or firms (including Rural Development if possible) for whom the offeror has performed similar professional services. These statements shall include the name, address, and telephone number of the reference.

c. Professional insurance coverage. The contractor shall maintain professional insurance coverage in accordance with local and State government statutes.

d. Technical considerations. Personnel proposed for work on the contract must demonstrate knowledge, skill, and experience in appraising income producing MFH property.

e. Orientation meeting. After contract award, the contractor shall attend an orientation meeting with the Contracting Officer Representative (COR) for the purpose of acquainting the contractor with Rural Development. The COR shall respond to questions, further amplify and clarify the appraisal process, and provide copies of appropriate Rural Development regulations and procedures. It is the contractor's responsibility to be knowledgeable of Rural Development procedures any policy and to ensure that his/her employees are prepared and trained to perform the requirements specified in the contract on contract effective date.

f. Progress reports. The Contractor shall provide a written report of the status of assigned tasks to the COR (insert report interval, i.e., weekly, bi-weekly).

g. Inspection and acceptance. The CO or the COR shall inspect and accept the supplies and/or services to be provided under this contract. No payment shall be made until the work is accepted. If deficiencies are noted in the inspection, the appraisal shall be returned to the contractor for correction within (specify time period for correction, i.e., hours, days) at no additional cost to the Government.

The COR shall serve as the duly authorized representative of the CO.

Part III. Evaluation of offers.

There are two methods of evaluating offers: (1) Negotiated Procurement, and (2) Basis for Contract Award. The CO will consult with program personnel to: (1) Develop evaluation criteria, (2) determine the method of evaluating offers; and (3) conduct a technical review of proposals. While cost is an important criteria in determining the best offer received, due consideration should also be given to the qualifications and experience of the offerors as it relates to the requirements specified in the SOW. The following provides additional information to be considered during this process:

A. Negotiated procurement. Negotiated procurement is a formal evaluation process which must be used for all contracts \$25,000 and over. This process involves:

(1) Develop evaluation criteria and assigning weight factors. The following is provided for consideration when developing evaluation criteria:

- a. Experience and knowledge of the person(s) proposed to perform the requirements in the SOW.
- b. Commitment of the offeror to perform the requirements specified in the SOW.
- c. Technical approach of the offeror to perform the requirements specified in the SOW.

(How does the offeror plan to accomplish the requirements prescribed in the SOW? Is the offeror experienced in conducting MFH appraisals?)

- (2) Convene the technical evaluation committee to evaluate all technical proposals received;
- (3) Establish the competitive range;
- (4) Negotiate with offerors in the competitive range;
- (5) Receive best and final offers from offerors;
- (6) Evaluate best and final offers;
- (7) Source selection; and
- (8) Debrief unsuccessful offerors.

B. Basis for Contract Award. This method will be used in evaluating proposals for small purchases under \$25,000. This process accomplishes the same results as the negotiated procurement process, but does not require the formal technical evaluation committee or negotiations with the offerors. The evaluation of each proposal will be based on how well it demonstrates the offeror's ability to perform the SOW. The following is provided for consideration when developing the solicitation for contractors:

The Government intends to award a contract resulting from this solicitation on the basis of price and other factors. The other factors are documented evidence of professional training, experience, a proposal which demonstrates how the offeror will perform the requirements specified in the SOW. The Government may reject any or all offers, or award a contract on the basis of initial offers received without discussions. The Government can accept and award a contract for other than the lowest price offered. Therefore, each initial offer should provide the offeror's best price and a written proposal as outlined above.

SAMPLE
STATEMENT OF WORK FOR MULTI-FAMILY HOUSING
CONTRACT APPRAISAL SERVICES

Background. Rural Development provides loans to eligible applicants for multiple family income producing housing property.

Objective. Rural Development requires the services of qualified persons or firms to provide appraisal services for the purpose of determining the market value of multiple family income producing housing property. If required, the Contractor shall defend the appraisal in court or in the Rural Development appeals process. Except where noted herein, the Contractor shall provide all facilities, materials, supplies, tools, equipment, personnel, and travel to accomplish the performance of the requirements of this contract.

Scope. The Contractor shall provide appraisals for _____ MFH properties in _____ county(s) for a period of twelve months from the date of award. The contract appraisals will be used to determine the market value of MFH property for loan making, servicing, acquisition, and sale. The contractor shall be notified of required work through the issuance of a Task Order. (NOTE: THE SOLICITATION SHOULD PROVIDE SPECIFIC DETAILS REGARDING THE INFORMATION WHICH WILL BE PROVIDED IN THE TASK ORDER. FOR EXAMPLE, THE TASK ORDER SHOULD SPECIFY THE PROPERTY SUITABILITY, NEW CONSTRUCTION OR EXISTING STRUCTURE, REPAIR REQUIREMENTS (ATTACH REPAIR REQUIREMENTS DEVELOPED DURING THE GOVERNMENT INSPECTION), ETC.) The required work as defined herein shall be submitted to the Contracting Officer Representative (COR) within _____ calendar days of issuance of the Task Order. (NOTE: Completion time will not exceed 45 days unless authorized by the State Director.) In emergency cases, a shorter time period may be required for submission of the appraisal.

Detailed Work Requirements. The Contractor shall provide appraisal services for Rural Development as follows:

1. Appraisals shall be completed in accordance with Exhibit A and Exhibit B on Forms RD 1922-7, "Appraisal Report for Multi-Unit Housing," and RD 1924-13, "Estimate and Certificate of Actual Cost." The appraisal shall be in typewritten or legible ink print form. (NOTE: AUTOMATION VERSIONS of Form RD 1922-7 and the Marshall & Swift On-Line Computerized Cost Data System - RE2 or SEG program (report), may be permitted with the prior approval/acceptance of the Rural Development State Director.) The appraisals shall be completed giving due consideration for the following:

A. Location of property: Adhere to legal descriptions and surveys for proper location of site to avoid errors such as infringement, encroachment, etc., when appraising a property.

B. Use of comparables: Use comparable sales of multiple family residential properties. The use of bonafide arms length Rural Development comparable sales is an acceptable practice.

C. Property improvements: In the event Rural Development provides to the contractor a list of repairs required to improve the property, these repairs shall be reflected in the appraisal process and must be listed on Form RD 1924-13.

D. Depreciation: A property with an effective age of five years or more shall have documentation for short-lived and long-lived physical depreciation calculations.

E. Approaches to property value: The market data approach (comparable sales), cost approach, and the income approach shall be used by the contractor in reconciling the final estimate of market value of the property.

F. Budget of operating and maintenance expenses: If required, complete Form RD 1930-7, "Statement of Budget and Cash Flow," in accordance with applicable Forms Manual Insert instructions.

2. Supporting documentation: Documentation supporting the development of the appraisal shall be submitted to the COR with the completed appraisal. As a minimum, the supporting documentation shall include the following:

A. Clear and concise explanations for all calculations utilized to develop the appraisal. As a minimum, the documentation shall include all mathematical calculations of adjustments, justification for adjustment, and a narrative explanation supporting any other basis utilized in the decision process.

B. Provide photographs of the subject property, in accordance with Form RD 1922-7, photographs of the comparable sales, and comparable sales data used in the appraisal.

Guide for Appraisal Energy Saving Measures,
the "Value-in-Use" Approach

Introduction.

This guide may be used for appraisal of energy savings measures or for estimating the impact of energy saving measures on market value.

The described methodology, indicated in this guide, is an adaptation of the procedure for Life Cycle Cost Analysis developed by the Department of Energy and published in 10 CFR Part 436. This methodology is applicable for use on those energy savings measures which have been approved by the State Director and/or are otherwise acceptable in accordance with Rural Development procedures and policy.

Definitions.

Value-in-Use. The value of an economic good to its owner/user/investor based upon its expected productivity or savings.

Energy Saving Measure. Any device, equipment, material, process, construction method, system, structure or combination thereof that will result in a reduction of energy usage when compared to conventional energy related practice in the area of the project.

Conventional Energy Related Practice. Any device, equipment, material, process, construction method, system, structure or combination thereof as they relate to energy usage, that are common to a particular area and/or are required by local, State or federal regulations or standards.

Representative Structure. A building or facility similar in all ways to the proposed or existing building or facility with the exception that conventional energy related practice has been substituted for the proposed energy saving measures.

Economic Life. The period of time over which the energy saving measure may reasonably be expected to perform the function for which it was designed or intended without major renewal or overhaul.

Study Period. The period of time equal to the economic life of the energy saving measure or 25 years, whichever is shorter.

Annual Energy Cost Savings. The difference in the first year cost of energy of the proposed or existing building or facility as compared to the energy cost of its representative structure. For the purpose of this methodology the cost of energy may be based upon the unit fuel cost applicable in the project area at the time of the appraisal.

Annual Operation and Maintenance Cost. The incremental cost to operate and maintain an energy saving measure as compared to the operation and maintenance (O&M) costs of its representative structure.

Methodology.

Worksheet A (attached) may be used to organize the information and calculations of the Value-in-Use appraisal.

Step 1: Identify the energy saving measures.

Step 2: Identify the representative structure upon which energy cost savings, incremental construction cost and incremental O&M costs will be based.

Step 3: Determine the study period of the energy saving measure (item C on worksheet). The study period is equal to the economic life of the energy saving measure or 25 years, whichever is shorter.

In determining the economic life, consideration may be given to obsolescence, age, durability and reliability of components, cost and complexity of O&M procedures and the likelihood that the owner will carry out the necessary O&M or undertake necessary repairs. In this regard, the availability of qualified service personnel, spare parts and the quality of O&M manuals as well as warranties and long term service contracts may be considered.

Ordinary energy saving measures which depend upon the operation of mechanical subsystems are not assigned a useful life greater than 15 years. Furthermore, of these systems, only durable, low maintenance, non-complex systems with well documented O&M procedures, located in areas having ready access to service personnel are assigned a useful life as high as 15 years.

If the study periods of identified energy saving measures differ, the energy saving measures having similar study periods should be grouped together. Each of these groups will form the basis of a separate Value-in-Use computation. The composite Value-in-Use is simply the sum of the Value-in-Use computed for each of these groups.

Step 4: Determine the first year annual energy cost savings (item D on worksheet). This determination may be made from information provided by the proponent of the project, an energy auditor, the manufacturer/supplier of the energy saving measure or as determined by Rural Development analysis of the proposed energy saving measures. If energy cost savings cannot be reasonably determined using accepted calculation procedures, or if the savings are otherwise indeterminable, the Value-in-Use methodology is not applicable. It may be

possible in some of these instances, however, to establish a minimum level for expected energy cost savings. This savings may be used in the Value-in-Use analysis. The annual energy cost savings may be increased by 10 percent for proposed or newly implemented energy saving measures to approximate the value of energy savings that may not be reflected in the current average price of fuel.

Step 5: Determine the annual O&M cost of the energy saving measures as compared to the representative structure (item E on worksheet). These costs include service contracts, energy required to operate the energy saving measure (Pumps, motors, blowers, etc.), insurance, chemicals, minor repairs and/or replacement of components and other costs necessary to operate and maintain the energy saving measures. For the purpose of this method, the total incremental O&M cost may be averaged over its study period without regard to the actual timing of the costs. Unless other information is available, the annual incremental O&M costs may be assumed equal to one (1) percent of the incremental construction cost of the energy saving measure as compared to its representative structure. Energy saving measures which have no mechanical system operations may be assumed to have zero annual O&M cost unless other information indicates that another incremental cost is appropriate. If annual energy cost savings are increased by 10 percent as described in step 4, then applicable energy related O&M costs should be similarly increased by 10 percent.

Step 6: Determine the inflation modified uniform present worth factor as it applies to the energy savings measure, from the applicable Tables (B-1 through B-10) published by the Department of Energy in 10 CFR Part 436. (These tables will be kept current and supplied to the appraisers by the Architect or Engineer in each State.) These modified uniform present worth factors are based on a real rate of return of 7 percent and are adjusted for the relative price inflation of various fuels over a period of 25 years. They are tabulated for each Department of Energy Region and type of facility (Residential, Commercial or Industrial). (See Items D and E on worksheet.)

Step 7: Determine the uniform present worth factor for future annually recurring costs. (See Item E on worksheet.) This factor is given in table LA-2 of 10 CFR Part 436. (These tables will be provided by the State Architect and/or Engineer.) It is used in conjunction with the annual O&M costs determined in Step 5. Note: The O&M costs may contain a fuel use component. For the purpose of this methodology, the simplifying assumption is made that use of the factor given in Table A-2 for non-fuel and for fuel related O&M costs would not significantly reduce the accuracy of the Value-in-Use determination. If fuel usage, however, is a significant portion of the O&M costs as determined by the appraiser, it may be shown separately under a second category of O&M expense. (See item E 2 of worksheet.)

The appropriate discount factor for fuel related O&M costs would then be found in the applicable table of Tables B-1 through B-10 for the type of fuel used in operation and/or maintenance activities.

Step 6: Compute the Value-in-Use following the steps shown in Worksheet A. (See Item F on worksheet.)

Appraisal. (See Item G on worksheet.)

The total estimated property value is determined by adding the computed Value-in-Use or the incremental construction cost of the energy saving measures (whichever is lower) to the estimated value of the representative structure.

Value-in-Use and Cost Effectiveness.

In general, an energy saving measure(s) will be considered cost effective, from the point of view of Federal government investment, when the Value-in-Use is greater than the incremental construction cost of the energy saving measure. If the incremental construction cost exceeds the Value-in-Use the energy saving measure may still be cost effective when:

1. Salvage value of energy saving measures having economic lives greater than 25 years is significant; or
2. The economic life of the energy saving measure is greater than the economic life of the alternative conventional energy related practice.

In these instances further analysis may be necessary to determine cost-effectiveness. In most instances, however, the Value-in-Use will be an acceptable estimate for the cost-effective limit of Rural Development investments in energy saving measures.

WORKSHEET "A"

PROJECT: _____
 ADDRESS: _____

ENERGY SAVING MEASURES:
 (List)

- A. DEPARTMENT OF ENERGY (DOE) REGION _____
 B. TYPE OF FUEL SAVED _____
 C. STUDY PERIOD _____ (YEARS)

CALCULATION OF VALUE-IN-USE

	<u>\$/YEAR</u>		<u>PRESENT WORTH FACTOR (1)</u>	
D. <u>ANNUAL ENERGY COST SAVINGS</u>	_____	X	_____	= _____
			From Table B	"V1"
E. INCREMENTAL ANNUAL O&M COSTS				
E-1 <u>GENERAL O&M</u>	_____	X	_____	= _____
			From Table A-2	"V2"
E-2 <u>FUEL RELATED O&M (optional)</u>	_____	X	_____	= _____
			From Table 5	"V3"
	Fuel Type: _____			
F. <u>VALUE-IN-USE</u>	= "V1" - "V2" - "V3"			= \$ _____
G. INCREMENTAL CONSTRUCTION COST:				\$ _____
APPRAISAL OF ENERGY SAVING MEASURE (2):				\$ _____

NOTES

(1) Present Worth factors are published by the Department of Energy in 10 CFR Part 436, "Methodology and Procedures for Life Cycle Cost Analysis."

(2) Lower of Line F or Line G.