RD AN No. 3978 (1922-B)
May 3, 2004

TO: State Directors
Rural Development

ATTENTION: Multi-Family Housing Program Directors or Coordinators, State Appraisers, State Contracting Officers, Program Support Staff

FROM: Arthur A. Garcia ***(Signed by Arthur A. Garcia)***
Administrator
Rural Housing Service

SUBJECT: Terminology, Value Types, and Procedures Used in Multi-Family Housing Appraisals

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to provide guidance concerning terminology, value types, and procedures to be used in Rural Housing Service (RHS) multi-family appraisals. Guides for selection of value types based on the intended use of the appraisal, for writing a Statement of Work (SOW) when contracting for an appraisal, for valuation of interest credit subsidy, and for calculation of insurable value are presented to clarify RHS appraisal requirements. The intended outcome of this guidance is to obtain appraisals that include current appraisal terminology and acceptable appraisal procedures so that they are useful to both the Agency and participating lenders.

COMPARISON WITH PREVIOUS AN:

This AN replaces RD AN No. 3652 (1922-B), which expired April 30, 2002. Significant changes from or additions to the previous AN include the following:

Expiration Date:
May 31, 2005

Filing Instructions:
Preceding RD Instruction 1922-B

- Guidance on changes and additions to terminology and value types to be used (Attachment A, Value Types Used in Multi-Family Appraisals);
- Guidance on derivation of a capitalization rate from sales of similar properties in the local conventional apartment market for valuation of restricted real property (Attachment A);
- Guidance on separate valuation of real property and all types of favorable financing (Attachment A);
- Addition of guidance on property rights to be valued, (Attachment B, Property Rights Valued);
- Addition of a guide for identification of value types to be used based on the intended use of the appraisal (Attachment C, Specific Value Types to be Requested and Reported Based on Intended Use of Appraisal);
- Addition of an updated standard Statement of Work (Attachment D, Standard Statement of Work (SOW) for Multi-Family Housing Contract Appraisals);
- Addition of an updated guide for valuation of interest credit subsidy (Attachment E, Guide for Valuation of Interest Credit Subsidy); and
- Addition of a guide for calculation of insurable value (Attachment F, Insurable Value Calculation).

BACKGROUND:

The Office of Management and Budget (OMB) Circular A-129 requires federal agencies administering federal credit programs to ensure that an appraisal is prepared for all credit transactions (real property loans) over $100,000. A multi-family housing appraisal must be prepared by a State Certified General Appraiser and comply with the Uniform Standards of Professional Appraisal Practice (USPAP). The Rural Housing Service (RHS) uses appraisals to determine whether the security offered by an applicant or borrower is adequate to secure a loan or to aid in loan-servicing, preservation, or disposition decisions. Appraisals used for Agency decision-making must be current, unless the Agency and the applicant or borrower mutually agree to the use of an appraisal that is not current. A *current appraisal* is an appraisal with a report date that is not more than one year old. As the subject of an appraisal, subsidized housing can be a complex property type due to the restrictive-use agreements and multi-layered financing involved. Several different value types are typically required in Agency multi-family appraisals depending on the loan-making or loan-servicing decision(s) to be made.

There are many types of value. Sixteen value types are listed and defined in the Appraisal Institute's 4th Edition of The Dictionary of Real Estate Appraisal, and several of these are commonly used in RHS multi-family appraisals. The value types to be requested in the Agency's Statement of Work (SOW) and reported in the appraisal depend on the intended use of the appraisal. RD Instruction 1922-B does not provide specific instructions regarding value types. Furthermore, the multi-family housing regulations, written before the advent of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) and USPAP, include terms that are inconsistent with those currently used in the appraisal industry. These instructions and regulations will be revised or replaced within one year of the expiration date of this AN to incorporate the guidance in this AN. This AN gives detailed directions on current terminology and value types to be used, property rights to be valued, and several appraisal procedures to be followed in RHS multi-family appraisals.

IMPLEMENTATION RESPONSIBILITIES:

Responsibilities for implementing the guidance presented in this AN will be shared by Multi-Family Housing Program Directors or Coordinators, State Contracting Officers, State Appraisers, contract appraisers, and the Multi-Family Housing Processing Division (MFHPD) Review Appraiser in the National Office. These responsibilities are broken down as discussed below.

It is the responsibility of the State Contracting Officer to write a Statement of Work (SOW) and a Request for Quote (RFQ) when contracting for appraisals that are consistent with the guidance in this AN. The State Contracting Officer should consult with the State Appraiser or the Multi-Family Housing Program Director when writing the SOW and the RFQ to ensure that Agency appraisal requirements and information necessary to complete the assignment are accurately conveyed to the appraiser. It is recommended that the State Appraiser act as the Contracting Officer's Representative (COR) in the contracting aspect of the appraisal process. This may involve actually writing the appraisal SOW and RFQ.

Attachment D of this AN, Standard Statement of Work (SOW) for Multi-Family Housing Contract Appraisals, includes a sample Appraisal Information Sheet. The State Contracting Officer or State Appraiser can use the Standard SOW as a template in writing an appraisal SOW. It is intended as a guide that should be modified when contracting for a specific appraisal assignment. This standard SOW lists the Agency's requirements for a typical complete appraisal. A copy of this AN, while current, should be provided to contract appraisers, along with the SOW and data package, at the time an appraisal assignment is made. After expiration of this AN, contract appraisers should be referred to the revised or new multi-family housing appraisal instructions, which will incorporate the information in this AN.

State Appraisers and contract appraisers who write multi-family appraisals for the Agency should incorporate the terminology, value types, and procedures discussed in this AN in their appraisals. State Appraisers and the MFHPD Review Appraiser in the National Office who perform technical reviews of Agency multi-family appraisals should ensure the appraisals are consistent with the guidelines in this AN before they are accepted.

Attachments

VALUE TYPES USED IN RHS MULTI-FAMILY APPRAISALS

A discussion of the various types of value used in RHS appraisals follows. A definition of each value type, with sources referenced, is provided. These value types (expressed in the language used) and definitions are acceptable for use by State Contracting Officers in writing SOWs and RFQs when contracting for appraisals and by appraisers in writing multi-family appraisals for RHS. General procedures for developing and reporting some of these value types are included.

Market Value

The 4th Edition of The Dictionary of Real Estate Appraisal includes several definitions for *market value*. The following definition from the dictionary is used by the federal agencies that regulate insured financial institutions in the United States.

"*Market value: the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:*

- *Buyer and seller are typically motivated;*
- *Both parties are well informed or well advised, and acting in what they consider their best interests;*
- *A reasonable time is allowed for exposure in the open market;*
- *Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and*
- *The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.*"

Most appraisers and users of Agency multi-family appraisals understand the definition of *market value* to mean the value as a conventional or unrestricted or market property. However, to avoid confusion when requesting or reporting this value type, the term "as conventional or unrestricted" should be added to the term *market value* (i.e. "market value, as conventional or unrestricted").

In an appraisal report, a *hypothetical condition* on which the *market value* is based should be prominently stated wherever the *market value* is reported. The *market value* of a Section 514/515 housing project is always based on a *hypothetical condition*, which is defined by the 4th Edition of The Dictionary of Real Estate Appraisal as, "that which is contrary to what exists but is supposed for the purpose of analysis." An existing 514/515 apartment complex that is the subject of an appraisal ordered by the Agency is subsidized (restricted) at the time of the appraisal. A market value concluded for the property would be based on the hypothetical condition that the property is a conventional (market) property, which it is not. USPAP Standards Rules 1-2(h) and 2-2(a)(viii), (b)(viii), and (c)(viii) require the appraiser to identify and state any hypothetical conditions necessary in the assignment.

Market value should be requested by the Contracting Officer and reported by the appraiser when the intended use of the appraisal is to aid in determining:

- the appropriate amount of an equity loan as a prepayment incentive;
- the amount of an equity loan in a preservation transfer;
- a reasonable sale price, or the basis for a liquidation value, for a property in foreclosure; or
- a reasonable sale price for a non-program property.

Market Value, subject to restricted rents

A definition of *market value, subject to restricted rents*, as the term is used by RHS, derived from the definition of *market value* above, is stated as follows. *Market value, subject to restricted rents: the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:*

- *Buyer and seller are typically motivated;*
- *Both parties are well informed or well advised, and acting in what they consider their best interests;*
- *A reasonable time is allowed for exposure in the open market;*
- *Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and*
- *The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.*

It considers any rent limits, rent subsidies, expense abatements, or restrictive-use conditions imposed by any government or non-government financing sources but does not consider any favorable financing involved in the development of the property.

Market value, subject to restricted rents, refers only to the value of the subject real property, as restricted, and excludes the value of any favorable financing. The *market value*, *subject to restricted rents,* is based on a pro forma that projects income, vacancy, operating expenses, and reserves for the property under a restricted (subsidized) scenario. This restricted pro forma includes the scheduled restricted rents, a vacancy and collection loss factor that reflects any rental assistance (RA) or Section 8, and operating expenses and reserves projected for the subject as a subsidized property. Subsidized apartments typically experience higher management, auditing, and bookkeeping expenses, relative to similar conventional apartments, but often have lower real estate tax expenses.

Rural Development will provide a 3-year operating history of the subject property and the most recent operating statements for a set of expense comparables, if available, to the appraiser. Expense comparables data is proprietary information, so the name and location of the expense comparables should not be given to the appraiser. Much of this information is available on the Agency's Multi-Family Information System (MFIS). For the appraisal of a Section 8/515 project, Rural Development should provide the appraiser with a copy of the Housing Assistance Payment (HAP) contract and a contact at the agency that administers the HAP contract for the U.S. Department of Housing and Urban Development (HUD). The appraiser must consider the restrictions imposed on the subject property by both the U.S. Department of Agriculture (USDA) and HUD in concluding the *market value, subject to restricted rents*.

In the appraisal, the Income Approach for the *market value, subject to restricted rents,* is the best indication of value and should be most heavily weighted. Direct capitalization, as opposed to a discounted cash flow, should typically be used. The net operating income (NOI) from the restricted pro forma can be capitalized using a capitalization rate derived from sales of similar properties in the local conventional apartment market. Use of an overall rate from the conventional market, which reflects conventional financing, is appropriate because all favorable financing will be valued separately from the *market value, subject to restricted rents,* of the real property. This procedure, a departure from the method used by the Agency for many years, is standard appraisal practice. National appraisal firms use, and their clients accept, this as a primary method in the valuation of subsidized housing.

A method that includes the use of note rate rent as potential gross income (PGI) in the Income Approach pro forma to derive a value equal to the sum of the *market value, subject to restricted rents,* plus the value of the interest credit subsidy is not acceptable appraisal practice. Appraisers must not use this procedure in Agency multi-family appraisals, and State Appraisers must not accept this procedure when reviewing appraisals.

In an appraisal concluding *market value, subject to restricted rents*, the Income Approach is the most important section of the appraisal and must be complete. Appraisers must provide good support for the income, vacancy, expense, and capitalization rate analyses within the approach. The expense analysis must be well supported by the 3-year operating history of the subject and by expense comparables. A current expense survey from RHS or a State housing authority would provide additional support. The capitalization rate selected for the subject must be derived from the most recent sales of similar properties in the local (or nearest similar) conventional apartment market. Support for this overall rate should be provided using alternate methods such as the band-of- investment technique, the debt coverage formula, and regional investment criteria surveys. Rural Development appraisers performing technical reviews must not accept appraisals unless/until all Income Approach analyses are adequately supported.

The Cost Approach can be used to support the *market value, subject to restricted rents,* indication from the Income Approach, especially for new construction. The usefulness of the *market value, subject to restricted rents*, indication via the Cost Approach for existing properties more than twenty years old (typical of the RHS portfolio) is questionable due to the difficulty in estimating the three types of depreciation. However, when ordering appraisals, the SOW should require the Cost Approach for determination of *market value, subject to restricted rents*. Important information, including site value, construction costs, remaining economic life, and external obsolescence, can be extracted from this approach. Deduction for external obsolescence, which is basically calculated by capitalization of the difference between economic NOI and restricted NOI, results in a *market value, subject to restricted rents*, indication in the Cost Approach.

The Sales Comparison Approach is rarely applicable in concluding a *market value, subject to restricted rents*, due to the lack of sales of subsidized apartments in small rural markets and the difficulty of making meaningful adjustments for financing terms to the sales comparables. When ordering appraisals, the SOW should not require the Sales Comparison Approach for determination of the *market value, subject to restricted rents*.

The *market value, subject to restricted rents,* must include the value of any *rental assistance* (RA) available. When the subject property has rental assistance, the appraisal must include a discussion of the Section 521 Rental Assistance Program, the number of RA units at the subject, and how RA affects the *market value, subject to restricted rents,* of the property. Rental assistance is a rent subsidy provided to owners of 514/515 projects. The renter of an RA unit is required to pay a tenant contribution toward the approved shelter cost (rent plus tenant based utilities) of the unit that is equal to no more than 30% of his/her income. RA is the portion of the approved shelter cost paid by the Agency to compensate a borrower for the difference between the approved shelter cost and the tenant contribution. RA usually adds value to a 514/515 project in three ways. 1) It guarantees that the scheduled base rate rent for all occupied RA units will be attained, 2) it usually increases demand for the subject's units and consequently decreases the vacancy rate, and 3) it reduces the risk of investment in the subject project by improving the durability of the income stream. Rental assistance need not be separately valued; the value of RA can be incorporated within the *market value, subject to restricted rents*. This can be accomplished within the Income Approach by taking into account the three ways that RA increases value, listed above. 1) Base rate rents should be included as Potential Gross Income (PGI) in the restricted pro forma, 2) a vacancy and collection loss factor that reflects the amount of RA at the property should be included, and 3) a capitalization rate may be selected for the subject toward the low end of the indicated range to account for the reduced risk to the investor due to RA.

When determination of *market value, subject to restricted rents,* is part of an appraisal assignment, all favorable financing in place at the time of the appraisal must also be valued, but separately from the real property. Multi-layered financing, involving multiple financing sources, has become the norm in the building and rehabilitation of affordable housing. Favorable financing is offered to developers of subsidized housing to offset external obsolescence that results from a weak apartment market and restrictions placed on the properties by the financing sources. Favorable financing is valuable to the developer/owner, and an appraiser can calculate the value of each type of favorable financing. Several types of favorable financing can be used to develop 514/515/538 projects, including 514/515 direct loans with interest rates as low as 1%, low-interest loans from non-Agency sources, tax credits, tax-exempt bond financing, and grants. When favorable financing is involved, the appraisal report should contain a narrative identifying each source of financing. The amount and terms of each type of favorable financing should be described, and each type of favorable financing should be valued separately from the *market value*, *subject to restricted rents*, of the property. The appraisal SOW should specifically request each value type required, including the value(s) of each type of favorable financing.

Valuation of "interest credit subsidy" from Section 514/515 loans should be consistent with Attachment E, Guide for Valuation of Interest Credit Subsidy. This updated guide should be used instead of RD Instruction 1922-B, Exhibit B, Guide for Determining Subsidy Value Within the Income Approach. It is intended that RD Instruction 1922-B will be revised or replaced before the expiration date of this AN and that the revised or new instructions will incorporate Attachment E of this AN. The methodology presented in Attachment E can also be used to calculate the value of low-interest loans from non-Agency financing sources.

It is emphasized that the *market value, subject to restricted rents*, includes the value of any rental assistance at the subject property but does not include the value of any favorable financing, including Agency financing. The *security value* (see *Security Value* section below) of the property, upon which an Agency loan might be based, is derived from the sum of the *market value, subject to restricted rents,* plus the total value of the favorable loans.

"As-Is" Value

The 4th Edition of the Dictionary of Real Estate Appraisal defines *value as is* as follows. "*Value as is: the value of specific ownership rights to an identified parcel of real estate as of the effective date of the appraisal; relates to what physically exists and is legally permissible and excludes all assumptions concerning hypothetical market conditions or possible rezoning.*"

The term "As-Is" applies not only to the physical condition of the subject property at the time of the appraisal but to the legal status of the property. Therefore, the term "As-Is" should not be used with the term *market value* unless the property is a conventional or market property at the time of the appraisal. The term "As-Is" should precede the term *market value, subject to restricted rents,* when the *market value, subject to restricted rents,* of the project at the time of the appraisal is required.

Prospective Value

The term *prospective value* is defined by the 4th Edition of The Dictionary of Real Estate Appraisal as follows. "*Prospective value: a forecast of the value expected at a specified future date. A prospective value opinion is most frequently sought in connection with real estate projects that are proposed, under construction, or under conversion to a new use, or those that have not achieved sellout or a stabilized level of long-term occupancy at the time the appraisal report is written.*"

As used in Agency regulations and instructions, the term “as-improved value” refers to the value of real property after completion of proposed improvements. The Agency’s intended meaning of “as-improved value” is the same as the definition of *prospective value*. However, use of the term “as-improved value” can cause confusion for two reasons. 1) The term “as-improved”, as used in a Highest and Best Use analysis, refers to the subject real estate as it has already been improved at the time of the appraisal, not as it is proposed to be improved. Therefore, “as-improved value ” could be interpreted to refer to the value of the subject property as it has already been improved at the time of the appraisal. 2) There is a common misconception with the use of the term “as-improved value” that this is a value based on a hypothetical condition; that is, the value of the property as if it were improved, as proposed, as of the date of inspection. Since this scenario is impossible, an “as-improved value”, as of appraisal date (inspection date), is not useful. The term *prospective value* is better understood than the terms “as-improved value” and “as-complete value” by appraisers and users of appraisals and has replaced these terms in appraisal literature and common usage. Therefore, the term *prospective value* should be used when requesting or reporting a forecasted value, and the associated date of value should be the projected date of completion of construction.

Value-in-Use

The 4th Edition of The Dictionary of Real Estate Appraisal defines *use value (value-in-use)* as follows. "*Use value: the value a specific property has for a specific use; may be the highest and best use of the property or some other use specified as a condition of the appraisal.*"

Value-in-use is the type of value that should be requested in the appraisal SOW and reported in the appraisal of an on-farm labor housing project. The Cost Approach is the only applicable approach in an appraisal of on-farm labor housing. This type of property does not produce rental income, and sales of these projects are virtually non-existent. Consequently, the Cost Approach is the only approach to value that should be required in the appraisal SOW and included in the report by the appraiser.

USPAP requires a Highest and Best Use (HBU) analysis in all real property appraisals when the value type to be developed and reported is *market value*. When *value-in-use*, not *market value*, is to be concluded, USPAP does not require a HBU analysis and neither does the Agency. The Agency identifies the use or intended use of the subject property as farm labor housing to the appraiser. Therefore, the appraisal SOW for a *value-in-use* appraisal should instruct the appraiser to value the property as farm labor housing and not require a Highest and Best Use analysis as part of the scope of work. The appraiser should explain in the report why a HBU analysis was omitted and include a *limiting condition* in the report that states the *value-in-use* is based on the specified use of the subject property as farm labor housing.

Liquidation Value

Liquidation value is defined by the 4th Edition of The Dictionary of Real Estate Appraisal as follows. "*Liquidation value: the most probable price that a specified interest in real property is likely to bring under all of the following conditions:*

1. *Consummation of a sale will occur within a severely limited future marketing period specified by the client.*
2. *The actual market conditions currently prevailing are those to which the appraised property interest is subject.*
3. *The buyer is acting prudently and knowledgeably.*
4. *The seller is under extreme compulsion to sell.*
5. *The buyer is typically motivated.*
6. *The buyer is acting in what he or she considers his or her best interest.*
7. *A limited marketing effort and time will be allowed for the completion of a sale.*
8. *Payment will be made in cash in U.S. dollars or in terms of financial arrangements comparable thereto.*
9. *The price represents the normal consideration for the property sold, unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.*"

Liquidation value should be requested in the appraisal SOW and reported in the appraisal when it is in the best interests of the Agency: 1) not to take a non-program property into inventory but to sell it at a foreclosure sale; or 2) to dispose of a non-program inventory property when a very limited marketing period is available. *Liquidation value* should be derived from *market value* by applying a discount extracted from the market, when possible. Therefore, *market value* should always be requested in the appraisal SOW whenever a *liquidation value* is sought.

Security Value

The *security value* of real property used to secure an Agency 514/515/538 loan can be defined as follows. *Security value: the value of a real property asset that is pledged as a guarantee of the payment or fulfillment of an obligation or debt. It is equal to the sum of the* market value, subject to restricted rents, *plus the total value of all favorable financing, excluding the value of any tax credits or grants, minus any prior or parity liens on the housing project.*

Security value comprises the *market value, subject to restricted rents,* of the real property plus the value of *some* types of favorable financing. Not all types of favorable financing are components of security value. Below-market financing instruments (e.g. 514/515 direct loans, low-interest loans from non-Agency sources, and tax-exempt bond financing) that are assumable are typically considered intangible enhancements and add value for collateral purposes. However, the values of grants and tax credits, while reducing the risk of investment in the property, do not represent security value. Grants and tax credits are subsidies that offset the external obsolescence in the property, making it financially feasible. Grants and tax credits are part of the *investment value*, and they should be discussed and separately valued as part of an RHS appraisal assignment, but they do not represent *security value*. As an example, a proposed 514 project is to be financed with a 514 loan, a 516 grant, tax-exempt bond financing, and tax credits. The underwriter should include the *market value, subject to restricted rents*, of the real property, plus the value of the "interest credit subsidy" from the 514 loan, plus the value of the tax-exempt bond financing as *security value*. The values of both the grant and the tax credits should not be included as part of the *security value*.

It should be emphasized that *security value* does *not* comprise the sum of *market value* plus the total value of the favorable loans. This combination does not represent any real scenario. If an apartment is a conventional (market) property, there is no favorable financing, so the value of favorable financing cannot be added to the *market value*. If an apartment is subsidized, the *market value, subject to restricted rents,* should be concluded (based on a pro forma that projects income, vacancy, operating expenses, and reserves at the property as restricted), and the total value of the favorable loans should be added to this value to calculate the *security value*.

Insurable Value

A definition of *insurable value* acceptable for use in Agency multi-family housing appraisals is as follows: *Insurable value: the value of the destructible portions of a property which determines the amount of insurance that may, or should, be carried to indemnify the insured in the event of loss. The estimate is based on replacement cost new of the physical improvements that are subject to loss from hazards, plus allowances for debris removal or demolition. It should reflect only direct (hard) construction costs, such* *as construction labor and materials, repair design, engineering, permit fees, and contractor's profit, contingency, and overhead. It should not include indirect (soft) costs, such as administrative costs, professional fees, and financing costs.*

The term "insurable cost" is sometimes used instead of the term *insurable value* because it is based strictly on a cost estimate, not a value concluded in an appraisal. However, the term *insurable value* is more commonly used. Attachment F, Insurable Value Calculation, is a worksheet that should be used as a guide by State Appraisers and fee appraisers contracted by the Agency in calculating *insurable value*.

Attachment B

PROPERTY RIGHTS VALUED

In identifying the subject property, the appraiser must state and should define the particular rights or interests being valued. A thorough discussion is warranted in appraisals of fee simple estates subject to restrictive-use agreements and short-term leases. USPAP Standards Rule 1-2(e)(ii) requires the appraiser to identify the real property interest to be valued.

The property interest to be valued in the appraisal of a Section 514/515 project, when the value type to be concluded is *market value*, is the *fee simple estate*. This property interest is subject to short-term leases and should therefore be referred to as the *fee simple estate, subject to short-term leases.*

A Section 514/515 affordable housing project is usually subject to a restrictive-use agreement imposed by USDA Rural Development that places restrictions on the property for a specified period of time. These restrictions pertain to use, transfer, and operation of the property. They include rent limits and restrictions on tenant eligibility based on income. Additionally, when tax credit financing is involved, these properties have deed restrictions imposed by the Low-Income Housing Tax Credit (LIHTC) program. These restrictions are a type of *encumbrance*. The 4th Edition of the Dictionary of Real Estate Appraisal defines *encumbrance* as "an interest or right in real property that may decrease or increase the value of the fee estate but does not prevent its conveyance by the owner. An encumbrance effects a permanent reduction in an owner's property rights, while a lien represents a claim against the owner's property rights, which may or may not become permanent. Mortgages, taxes, and judgements are liens; restrictions, easements, and reservations are encumbrances."

The property interest to be valued in the appraisal of a Section 514/515 project, when the value type to be concluded is *market value, subject to restricted rents*, is neither the *fee simple estate*, nor the *leased fee estate*, nor the *leasehold estate*. The 4th Edition of the Dictionary of Real Estate Appraisal defines *fee simple estate* as "absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat." Since Section 514/515 properties are encumbered with restrictive-use agreements, and sometimes LIHTC deed restrictions as well, the property interest to be valued is not the *fee simple estate*. However, the property interest to be valued could reasonably be referred to as the *fee simple estate, as restricted, subject to short-term leases.* To comply with USPAP, the appraiser should identify this as the property interest to be valued and provide a description of these property rights and the restrictions involved.

SPECIFIC VALUE TYPES TO BE REQUESTED AND REPORTED BASED ON INTENDED USE OF APPRAISAL

Value types that should be requested in an appraisal Statement of Work (SOW) and reported in an Agency multi-family appraisal are specific to the loan-making, loan-servicing, preservation, or disposition decision(s) for which the appraisal is ordered. In other words, the intended use of the appraisal determines the value type(s) to be requested and reported. Depending on the decision(s) to be made, several value types may be required in one appraisal, including the separate values of different types of favorable financing. Listed below are several Agency program loan-making/loan-servicing situations. Specific value types that should typically be requested for each situation, as they might be stated in the appraisal, are listed under each category. Some of the listed value types may not be required, depending on the needs of the State Office. The State Contracting Officer and Contracting Officer's Representative (COR) should use this guidance in determining which value types to request in the appraisal SOW and Request for Quote (RFQ). The State Appraiser or contract appraiser should follow this guidance when reporting values in the appraisal. The State Appraiser, when reviewing an Agency appraisal, should require the report to be consistent with this guidance.

The appraisal rules adopted by the Federal Financial Institutions Regulatory Agencies[1] (FFIRA) to comply with Title XI of FIRREA impose a requirement on regulated institutions to obtain appraisals that include the *market value* of the subject property. Even if the subject of an appraisal is a subsidized housing project and the regulated institution does not use *market value* as the basis for the loan amount, the *market value, as conventional or unrestricted*, must be reported in the appraisal. The USDA is not regulated by the FFIRA and is not bound by this requirement. However, when Rural Development is participating with a conventional lender, an appraisal ordered by Rural Development would have to include the *market value, as conventional or unrestricted*, as of appraisal date, in order for the conventional lender to be able to accept the appraisal. For proposed construction or rehabilitation, the *prospective market value, as conventional or unrestricted*, would also have to be included in the report for it to be useful to the conventional lender.

The value types listed under each situation described below are required by Rural Development in appraisals ordered by the Agency. When Rural Development is partnering with a conventional lender, additional value types, as discussed above, and other specific requirements[2] may be necessary. It is important to note that Fannie Mae

[1] Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), Federal Deposit Insurance Corporation (FDIC), Federal Reserve Board (FRB), and National Credit Union Administration (NCUA)

[2] For example, Fannie Mae DUS multifamily appraisal guidelines require inclusion of Fannie Mae Form 1050 as an addenda item, inclusion of the Sales Comparison Approach in concluding *market value, subject to restricted rents,* limitations on Other Income sources, use of a minimum 5% vacancy factor, use of a minimum $150 per unit for Replacement Reserves, and do not allow trending of rents to any future date.

DUS lenders require inclusion of the Sales Comparison Approach in appraisals that conclude *market value, subject to restricted rents*, while the Agency does not. When the Agency has agreed with a lending partner to order an appraisal that meets the appraisal requirements of that lending partner, the COR should contact the lender's appraisal division to determine what those requirements are and ensure that they are included in the appraisal SOW.

Original loan for proposed project (new construction)

- Prospective market value, subject to restricted rents, of the fee simple estate, as restricted, subject to short-term leases, of (*name of property*), as of completion of construction, (*projected date of completion*)
- Value of the interest credit subsidy from 514/515/538 loan
- Value of the low-interest loan from non-Agency source (if applicable)
- Value of the tax-exempt bond financing (if applicable)
- Value of the tax credits (if applicable)
- Value of the grant (if applicable)

Subsequent loan (rehab loan) for existing project, no change in ownership

- Prospective market value, subject to restricted rents, of the fee simple estate, as restricted, subject to short-term leases, of (*name of property*), as of completion of construction, (*projected date of completion*)
- Value of the interest credit subsidy from original 514/515/538 loan
- Value of the interest credit subsidy from subsequent 514/515/538 rehab loan

Transfer of real estate with loan assumption (new rates and terms), no rehab, no equity payment

- “As Is” market value, subject to restricted rents, of the fee simple estate, as restricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*)
- Value of the interest credit subsidy from assumed 514/515/538 loan (with new terms)

NOTE: The same value types should be requested for the situation above with a loan write-down. The value of the interest credit subsidy from the new loan amount should be requested and reported.

Transfer of real estate with loan assumption (new rates and terms), with rehab, no equity payment

- "As Is" market value, subject to restricted rents, of the fee simple estate, as restricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*)
- Prospective market value, subject to restricted rents, of the fee simple estate, as restricted, subject to short-term leases, of (*name of property*), as of completion of construction, (*projected date of completion*)
- Value of the interest credit subsidy from assumed 514/515/538 loan (new terms)
- Value of the interest credit subsidy from subsequent 514/515/538 rehab loan

NOTE: The same value types should be requested for the situation above with a loan write-down. The value of the interest credit subsidy from the assumed loan with the new loan amount should be requested and reported.

Transfer of real estate with rehab loan and/or tax credits, with equity payment

- Market value of the fee simple estate, as conventional or unrestricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*)
- Prospective market value, subject to restricted rents, of the fee simple estate, as restricted, subject to short-term leases, of (*name of property*), as of completion of construction, (*projected date of completion*)
- Value of the interest credit subsidy from assumed 514/515 loan (with new terms)
- Value of the interest credit subsidy from subsequent 514/515 rehab loan (if applicable)
- Value of the low-interest loan from non-Agency source (if applicable)
- Value of the tax credits (if applicable)

Transfer of real estate with rehab loan and/or tax credits, with no equity payment

Note: The same value types requested and reported for the situation above (except *market value*) should be used for this situation. *Market value* is not required since no equity payment is to be made.

Acquisition of a building with proposed rehab into affordable housing

- Market value of the fee simple estate, as conventional or unrestricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*)
- Prospective market value, subject to restricted rents, of the fee simple estate, as restricted, subject to short-term leases, of (*name of property*), as of completion of construction, (*projected date of completion*)
- Value of the interest credit subsidy from 514/515/538 rehab loan

Subordination of Agency loan for authorized prior lien for rehab

- Prospective market value, subject to restricted rents, of the fee simple estate, as restricted, subject to short-term leases, of (*name of property*), as of completion of construction, (*projected date of completion*)
- Value of the interest credit subsidy from original 514/515/538 loan
- Value of the low-interest loan from non-Agency source (if applicable)

Subordination of Agency loan for authorized prior lien for equity loan

- Market value of the fee simple estate, as conventional or unrestricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*)

Prepayment incentive (equity loan)

- Market value of the fee simple estate, as conventional or unrestricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*)

Prepayment by owner through sale of property

- Market value of the fee simple estate, as conventional or unrestricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*)*

Sale of inventory property (program eligible), no rehab

- "As Is" market value, subject to restricted rents, of the fee simple estate, as restricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*)
- Value of the interest credit subsidy from new 514/515/538 loan

Sale of inventory property (program eligible), with rehab

- "As Is" market value, subject to restricted rents, of the fee simple estate, as restricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*)
- Prospective market value, subject to restricted rents, of the fee simple estate, as restricted, subject to short-term leases, of (*name of property*), as of completion of construction, (*projected date of completion*)
- Value of the interest credit subsidy from new 514/515/538 loan
- Value of the interest credit subsidy from subsequent 514/515/538 rehab loan

Sale of inventory property (program ineligible)

- Market value of the fee simple estate, as conventional or unrestricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*)*
- Liquidation value of the fee simple estate, as conventional or unrestricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*), assuming a severely shortened marketing period of (*number of months*) months

Negotiated debt settlement, when owner retains security

- Market value of the fee simple estate, as conventional or unrestricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*)*
- "As Is" market value, subject to restricted rents, of the fee simple estate, as restricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*)
- Value of the interest credit subsidy from original 514/515/538 loan

Foreclosure valuation

- Market value of the fee simple estate, as conventional or unrestricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*)*
- Liquidation value of the fee simple estate, as conventional or unrestricted, subject to short-term leases, of (*name of property*), as of appraisal date, (*inspection date*), assuming a severely shortened marketing period of (*number of months*) months

* NOTE: Restrictions contained in a durable instrument, such as a deed, sometimes transfer with the property. Even when they do not, leases with below-market rents sometimes remain in place after a sale until all of the leases expire. Temporary rent loss due to below-market rents must be considered when concluding market value.

**STANDARD STATEMENT OF WORK (SOW)
FOR MULTI-FAMILY HOUSING CONTRACT APPRAISALS**

Background: USDA Rural Development provides loans to eligible applicants for multi-family housing properties. In support of this program, Rural Development requires the services of qualified persons or firms to provide appraisals of subsidized multi-family properties. All appraisals must be in compliance with the current edition of the Uniform Standards of Professional Appraisal Practice (USPAP) and Rural Housing Service multi-family housing appraisal requirements (supplemental standards), which are set forth in the Statement of Work, RD Instruction 1922-B, and any current pertinent administrative notices. The appraiser should note that there are other agencies within Rural Development with different appraisal needs and requirements.

Professional Qualifications: All Agency multi-family housing appraisals must be written by a State Certified General Appraiser, certified in the State in which the subject property is located. The appraiser must have the specialized knowledge and experience necessary to be competent to appraise subsidized housing. The appraiser must understand the housing programs, value types and definitions, real and intangible property rights, use restrictions, pertinent tax considerations, and methods for valuation of various types of favorable financing involved in the appraisal of subsidized housing.

Request for Quote (RFQ): The Request for Quote (RFQ) will be used to request proposals from appraisers via fax or e-mail and will contain basic property information, services requested, special requirements, and any additional information the appraiser will need to bid appropriately. It is the appraiser's responsibility to understand the scope of the assignment and its requirements. When the appraiser receives the RFQ, he/she is to notify the requesting representative by fax or e-mail within 24 hours 1) that the appraiser is unavailable to bid on the assignment, or 2) with the amount of the fee and the number of calendar days required to complete the assignment.

Contract for Appraisal Services (CAS): Once the appraiser has been selected to complete the assignment, a Rural Development representative will provide a Contract for Appraisal Services (CAS) by fax or e-mail. The CAS form will contain the same information as the RFQ but will also include Rural Development and property contacts as well as the agreed upon fee and due date. Rural Development will also inform the appraiser if he/she has not been awarded the assignment. The required number of copies of the appraisal may vary, and the appraiser must pay attention to the number specified on the CAS, as well as the specific delivery instructions. The CAS will specify to whom the reports are to be addressed and where the reports and invoice should be delivered.

Subcontracting: The appraiser engaged by Rural Development, or a qualified employee or associate of the appraiser, must perform the appraisal and must not subcontract it, or any part of it, to another person without written consent of the Rural Development Contracting Officer.

Post Award Conference: The appraiser must contact the Contracting Officer's Representative (COR), identified in the CAS, to schedule a post-award telephone conference. The COR (usually the State Appraiser) will discuss appraisal requirements with the appraiser and answer questions about the assignment. Furthermore, the COR will be the appraiser's contact with the Agency during the course of the assignment. Again, it is the appraiser's responsibility to understand the scope of the appraisal and its requirements.

Client: The appraiser must understand and agree that USDA Rural Development is the appraiser's client, and all reports must be addressed to USDA Rural Development (and any other intended user specified by the Agency). Any questions related to the form or substance of the assignment will be directed to the COR and will not be directed to the property owner.

Property Contact: The appraiser should call the property contact, identified in the CAS, for gaining access to the property and in most cases for procuring property specific data relevant to the assignment. Appraisal fees or turnaround times should not be discussed with the property contact. The appraiser must notify the COR *immediately* if any of the following occurs: 1) the appraiser cannot gain adequate access to the property, 2) the appraiser does not receive essential property information in a timely manner, 3) the appraiser has previously appraised or is in the process of appraising the property, 4) the appraiser has any other potential conflict of interest with respect to the assignment.

Confidentiality: The appraiser must keep all information and materials furnished by Rural Development, the owner, and/or property contact regarding the subject property confidential, as required by USPAP and the Gramm-Leach-Bliley Act. The appraiser may use such information only in connection with performance of the assignment. The appraiser must agree to prevent the unauthorized disclosure, misuse, or alteration of the confidential information. Any information obtained through public sources is not considered confidential information. Disregard of this privacy requirement will be cause for immediate debarment as a contractor for the federal government.

Nondiscrimination: All appraisals of Section 515 Rural Rental Housing or Section 514/516 Farm Labor Housing properties must comply with the Fair Housing Amendments Act of 1988. According to the Act, it is unlawful for an appraiser 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.

Assumptions, Hypothetical Conditions, and Limiting Conditions: All extraordinary assumptions, hypothetical conditions, and limiting conditions must be clearly described in a single location near the beginning of the report and in appropriate sections of the appraisal. In addition, extraordinary assumptions and hypothetical conditions must be restated wherever the appraiser opines to the final value(s). Extraordinary assumptions and hypothetical conditions also must be discussed with and agreed to by the COR prior to completion of the report. General assumptions and limiting conditions that reduce the normal scope of appraisal due diligence are not allowed.

Potential Environmental Hazards: The appraiser must note any suspected environmental hazards, including issues external to the property that could adversely impact the property's value. Examples of environmental hazards would include damaged asbestos-containing building materials, underground storage tanks, chemical leaks, spills, or staining of ground surfaces, or on-site waste disposal such as sludge, oil, paints, or chemical residues. If the appraiser observes any suspected environmental hazards, he/she must notify the COR immediately and refrain from finalizing aspects of the appraisal that could be impacted until resolution of the issue or until instructed otherwise.

Americans with Disabilities Act (ADA): Appraisers must be familiar with the general provisions of the ADA because subsidized housing is a property type that is likely to be affected. The appraiser must consider what impact (if any) noncompliance with the ADA has on the value of the subject property. Any impact on value must be supported by market evidence.

Appraisal Report Formats: The appraisal type (complete or limited), report type (self-contained, summary, or restricted use), and report format (narrative or form) will be set forth in Rural Development's authorizing CAS. Narrative formats are required for most multi-family appraisals with the level of detail dependent on the scope of work and the requested appraisal type and report type. Form reports completed on Form RD 1922-7, FNMA Form 1050, FHLMC Form 71A, or the Uniform Commercial Industrial Appraisal Report (UCIAR) are generally acceptable, as long as they are modified to meet USPAP and Agency requirements and are agreed upon in advance.

Approaches to Value: The approaches to value (Cost Approach, Sales Comparison Approach, and Income Approach) that are to be included in the appraisal depend on the specific assignment and will be specified in the CAS. When the purpose of the appraisal is to conclude *market value*, all three approaches to value must be included as part of a Complete Appraisal. When the purpose of the appraisal is to conclude *market value, subject to restricted rents*, the Cost Approach and the Income Approach must be included, but the Sales Comparison Approach is typically not applicable and may be excluded. When the purpose of the appraisal is to conclude *value-in-use* of an on-farm labor housing project, only the Cost Approach is applicable, and the other two approaches are excluded. For some assignments, an approach to value that is typically applicable may not be applicable. When this is the case, the appraiser, upon receiving the RFQ, must discuss this issue with the COR so that the CAS will correctly specify the approaches to value that will be included in the report. If, during the course of the assignment, the appraiser determines that an approach is not applicable, he/she must obtain the approval of the COR to exclude the approach from the report, and the CAS must be modified.

Value Types: The types of value (e.g., *market value* or *market value, subject to restricted rents*) to be reported, including values of various types of favorable financing, will be specified in the CAS. All reports must include the *insurable value* of the subject.

Complete Appraisal Requirements: All RHS Complete Appraisals, Self-Contained or Summary Reports, must comply with the following unless the CAS requires otherwise.

1) All appraisal reports must comply with USPAP. Specifically, all reports must include the following items required by Standards 1 and 2 of USPAP:
   - Identification of the appraisal type and report type,
   - Identification of the client and any other intended users of the appraisal,
   - Identification of the intended use of the appraisal,
   - Description of the subject real estate,
   - Identification of the real property interest (property rights) appraised,
   - Identification of the purpose of the appraisal,
   - Identification and definition(s) of the value type(s) reported,
   - Identification of the effective date(s) of the appraisal and the date of the report,
   - Description of the scope of work used to develop the appraisal,
   - Disclosure of all assumptions, hypothetical conditions, and limiting conditions that directly affect the appraisal,
   - Description of the information analyzed, the appraisal procedures followed, and the reasoning that supports the analyses, opinions, and conclusions,
   - Description of the use of the real estate existing as of the date of value and the use of the real estate reflected in the appraisal; and (for market value) an analysis of the highest and best use of the real estate,
   - Disclosure of any permitted departures from specific requirements of Standard 1 of USPAP and the reason for excluding any of the usual valuation approaches,
   - A signed certification in accordance with USPAP Standards Rule 2-3.
2) All reports must include an executive summary.
3) All reports must include a legal description of the subject property.
4) All reports must include photographs of the interior and exterior of the subject property and of the exterior of all rent comparables and sales comparables.

5) All reports must include the following maps, showing the location of the subject:
   - Regional map
   - City map
   - Flood plain map
   - Land Sales map
   - Sales Comparables map
   - Rent Comparables map
6) All reports must include the following exhibits of the subject property:
   - Survey
   - Site plan
   - Floor plans
7) All analyses within the Income Approach must be well supported. When the assignment is to conclude *market value, subject to restricted rents,* the subject's 3-year operating history should typically be used as the primary data source to project the subject's other income, vacancy, and operating expenses. A set of expense comparables can be compiled from recent operating statements for similar restricted properties within the subject's housing program. This data can be obtained from Rural Development and used to support these projections. All expense analyses must include a tabulated set of expense comparables and should also include supporting information from an expense survey done by RHS or a State housing authority, if available. The capitalization rate selected for the subject must be derived from the most recent sales of similar properties in the local (or nearest similar) conventional apartment market. Support for this overall rate must be provided using alternate methods such as the band-of- investment technique, the debt coverage formula, and regional investment criteria surveys. If the pro forma income, vacancy, expenses, or capitalization rate is not adequately supported, the Rural Development Review Appraiser will require the contract appraiser to make revisions that provide the necessary support before the appraisal can be accepted.
8) Any method that includes the use of note rate rent as potential gross income (PGI) in the Income Approach pro forma to derive a value equal to the sum of the *market value, subject to restricted rents*, plus the value of the interest credit subsidy is not acceptable appraisal practice. Appraisers must not use this procedure in Agency multi-family appraisals.
9) All reports must conclude the market rents for the subject's units. A market rent adjustment grid showing quantified adjustments in specific percentages or dollar amounts must be included and be well supported. When the assignment is to conclude *market value, subject to restricted rents*, the market rents of the subject's units must be compared with the restricted rents of the subject's units.
10) All reports must include an estimate of the remaining economic life of the subject.
11) All reports must include an estimate of the *insurable value* of the subject property.
12) All appraisals of existing properties must include a discussion of deferred maintenance at the subject property. Items of deferred maintenance must be listed, and the cost to cure each item must be estimated, with support provided. The final

value must be calculated by subtracting the total cost estimated to cure all deferred maintenance from the value indicated as if no deferred maintenance existed.

13) When favorable financing is involved, the appraisal report must contain a narrative identifying each source of financing. The amount and terms of each type of favorable financing must be described, and each type of favorable financing must be valued separately from the *market value, subject to restricted rents,* of the property. Valuation of "interest credit subsidy" from Section 514/515 loans should be consistent with Attachment E, Guide for Valuation of Interest Credit Subsidy.
14) When the assignment is to conclude *market value, subject to restricted rents*, the subject's operating statements for the preceding three full years and the proposed budget for the current year must be used in the expense analysis and included in the addenda of the report, if available.
15) Appraisals of properties with proposed rehabilitation must include Form RD 1924-13, Estimate and Certification of Actual Cost, in the addenda.
16) A copy of the Contract for Appraisal Services (CAS) must be included in the addenda of the appraisal report.

Review of Appraisal: Appraisal reports are subject to review by Rural Development. Appraisers must be prepared to discuss their analyses, opinions, and conclusions and provide additional written support, clarification, and/or corrected appraisal pages if requested.

Accountability: The engaged appraiser must inspect the subject property and be prepared to discuss the appraisal report. A staff appraiser or associate may participate in the appraisal assignment but must either sign the report or be identified, by name, as having provided significant professional assistance in the appraiser's certification. If a staff appraiser or associate wrote the majority of the report, that staff appraiser or associate may be present during any discussion of the assignment. However, it is the engaged contract appraiser whose work product has been identified as acceptable by Rural Development, and that appraiser must sign the report and be accountable for it.

Defense of Appraisal: The Agency may require the appraiser to defend the appraisal in court or in Rural Development's appeals process. This would constitute a consulting assignment that would be contracted separately from the original appraisal assignment.

Payment of Services: Late delivery of any report may result in liquidated damages. Lacking specific arrangements in writing to the contrary, Rural Development may impose a penalty equal to the lesser of 5% of the appraisal fee per day, or $100 per day, for each calendar day beyond the scheduled due date. The late fee penalty is based on the calendar days between the due date and the date the appraisal report is received by Rural Development. If delivery of the report is 30 days past due, the appraisal engagement is cancelable by Rural Development, and the appraiser's right to all fees associated with the assignment may be forfeited.

APPRAISAL INFORMATION SHEET (EXAMPLE), ATTACHMENT TO SOW

Appraisal Type: (Complete / Limited)
Report Type: (Self-Contained / Summary / Restricted Use)
Appraisal Format: (Narrative / Form)
Client: Ann Smith, Oregon State Appraiser, USDA Rural Development
USDA Rural Development Contact: Ann Smith, Oregon State Appraiser and Contracting Officer's Representative (COR); Phone: 503-414-3300
Property Contact: Sue Jones, on-site manager; Phone: 503-679-3857
Intended Users of Appraisal: Oregon Housing and Community Services (OHCS); Bedford Falls Limited Partnership (owner)
Intended Use of Appraisal: To fulfill loan underwriting requirements for permanent financing of the subject property
Purpose of Appraisal: To submit supported opinions of the required value(s), in conformity with USPAP and the appraisal policy of USDA Rural Housing Service
Property Type: USDA Rural Development Section 514/516 Off-Farm Labor Housing complex
Property Status: (Existing / Proposed)
Property Interest Appraised: fee simple estate, as restricted, subject to short-term leases
Property Owner: Bedford Falls Limited Partnership
Property Name: Bedford Falls Apartments
Property Address: 1945 Maple Avenue, Bedford Falls, OR 97055
Property Description: (number and type of buildings, number of stories, number and type of units, NRA, GBA, year of construction, site size, amenities, parking, etc.) The subject property is a proposed 30-unit USDA Rural Development Section 514/516 Off-Farm Labor Housing complex, situated on a 2.50-acre site. It will have a NRA of 28,602 SF and a GBA of 32,656 SF. There will be five 2- and 3-story buildings with cementicious siding exteriors and pitched asphalt shingle roofs. 1-, 2-, and 3-BR units, ranging from 643 SF to 1,311 SF, will be offered. There will be a 4,054 SF community building containing offices, kitchens, and laundry facilities, as well as paved parking with 64 open spaces (2 handicapped spaces). Completion of construction is scheduled for April 30, 2005.
Project Financing: Financing for the project will come from four sources, as follows:

- USDA Rural Development will make a Section 514 loan for $1,300,000. The loan term is 33 years, and the loan is amortized over that period. The effective rate of interest is 1%. The borrower's monthly payment is $3,855.59.
- USDA Rural Development will make a Section 516 grant for $1,500,000.
- The Clackamas County Community Development Division has awarded a HOME Grant in the amount of $500,000.
- OHCS has awarded tax credits in the amount of $950,000. (See the borrower's Syndication Proposal Agreement for terms.)

Value Types Required: The following values are required:

- Prospective market value, subject to restricted rents, of the fee simple estate, as restricted, subject to short-term leases, of Bedford Falls Apartments, as of completion of construction, April 30, 2004
- Value of interest credit subsidy from the USDA Rural Development Section 514 loan
- Value of the USDA Rural Development Section 516 grant
- Value of the Clackamas County Community Development Division HOME grant
- Value of the OHCS tax credits
- Insurable value

Approaches to Value: The Cost Approach and the Income Approach must be included in the appraisal. The Sales Comparison Approach is not applicable and is not required.
Rental Assistance: (existing number of units/proposed number of units) The subject property will have 30 units of Rental Assistance (RA).
Utilities: Tenants pay for: ___ Electricity ___ Gas ___ Water/Sewer
Assumptions, hypothetical conditions, and limiting conditions: The *prospective market value, subject to restricted rents*, should be based on the *specific assumption* that the subject property retains its 30 units of Rental Assistance (RA).
Number of Copies: 3
Mail Reports to: Ann Smith (2 copies)
State Appraiser
USDA Rural Development
101 SW Main St., Suite 1410
Portland, OR 97204-3222

James Miller (1 copy)
Director
Oregon Housing & Community Services
725 Summer St., NE
Salem, OR 97309

Appraisal Data Package Checklist:

___ sales contract or purchase agreement
___ legal description
___ Rural Development Mortgage or Deed of Trust
___ Housing Assistance Payment (HAP) contract (if applicable)
___ description of restrictive use provisions
___ environmental report
___ lead-based paint inspection report
___ Rural Development unit-by-unit inspection
___ market study
___ prior appraisal
___ survey
___ site plan
___ floor plans
___ unit mix (number of units by type, size, rent)
___ recent rent roll
___ tenants waiting list
___ operating statements for subject property from previous 3 years
___ operating statements for five expense comparables from last full year (names and addresses of properties deleted; number and size of units included)
___ proposed budget for current year
___ plans, specs, and cost estimates (new construction)
___ Form RD 1924-13, Estimate and Certification of Actual Cost (rehabilitation)
___ Sources & Uses Comprehensive Evaluation (SAUCE Report)
___ ownership history for past three years
___ financing information (list of existing and proposed financing sources with detailed descriptions of terms for each; e.g., amount of financing, loan balance, interest rate, loan term, remaining loan term, amortization period, payment)

GUIDE FOR VALUATION OF INTEREST CREDIT SUBSIDY

Interest Credit Subsidy

Interest credit is a form of federal assistance available to eligible borrowers that reduces the effective interest rate of a loan. The USDA Rural Housing Service (RHS) offers direct loans with very favorable terms for affordable housing in the Rural Rental Housing Program (Section 515) and the Farm Labor Housing Program (Section 514). The Guaranteed Rural Rental Housing Program (Section 538) offers guaranteed loans that can also include *interest credit*. Section 514 and 515 permanent loans for new construction and subsequent loans for rehabilitation include interest rates as low as 1%. These loans are made at a "note rate" of interest, but the effective rate ("basic rate") of interest to the borrower is typically 1%. A monthly mortgage payment is calculated at the note rate of interest, and the loan is amortized at the note rate of interest, but the borrower's actual mortgage payment is based on the basic rate of 1%. The difference between the note rate payment and the basic rate payment is the *interest credit*. The borrower is effectively subsidized with an income stream represented by the monthly *interest credit* that is available for the term of the loan.

In appraisals of Section 514, 515, and 538 multi-family housing properties, valuation of the *interest credit subsidy* (favorable financing) is part of the assignment when the *market value, subject to restricted rents*, must be concluded. When *interest credit subsidy* is the only favorable financing involved, the security value, on which the loan is based, has two components: 1) the *market value, subject to restricted rents*, of the real property, and 2) the value of the *interest credit subsidy*. The present value (PV) of the *interest credit subsidy* can be calculated with a financial calculator using a simple discounted cash flow if three variables are known: payment (PMT), discount rate (i), and period (n). Determination of each of these three variables is discussed below.

Methodology for Valuation of Interest Credit Subsidy

The first variable to consider, which is input as payment (PMT) in a financial calculator, is the income stream that accrues to the borrower from the savings in mortgage payments resulting from the *interest credit*. With the RHS direct or guaranteed loan, the borrower typically will make 360 monthly mortgage payments based on rates as low as 1%. Without the RHS direct or guaranteed loan, the borrower would have to obtain alternative conventional financing at a significantly higher market interest rate, resulting in higher monthly mortgage payments. Therefore, the borrower's income stream is equal to the difference between the monthly mortgage payment that would have been required at the conventional rate of interest and the actual mortgage payment at the reduced rate. (It should be noted that the USDA note rate of interest cannot be used to calculate the higher conventional payment because this rate does not represent a mortgage interest rate available to the borrower at the time of the appraisal.)

The second variable used in the calculation is the discount rate (i). The discount rate to be applied to the income stream is simply the alternative conventional mortgage interest rate. This is the rate of interest at which the borrower would have had to pay if a conventional loan had been obtained, so this is the rate at which the borrower saves with the favorable financing. The conventional mortgage interest rate is extracted from the subject's lending market.

The third variable to determine is the period (n) over which the income stream is to be discounted. The loan term, or remaining loan term, is known at the time of the appraisal. Although the borrower might hold the property for a holding period less than the loan term, the income stream from the favorable loan is available for the period of the loan. The *interest credit subsidy* should be valued according to the actual terms of the loan, so the appraiser should discount the income stream over the term of the loan. For new construction, the loan term is 30 years for a 515 loan and 33 years for a 514 loan. The appraiser should use these terms for the period of the loan. For an existing property, the remaining loan term, which should not exceed the remaining economic life of the property, should be used for the period of the loan.

The value of the *interest credit subsidy* from RHS direct loans on most existing properties can be calculated by subtracting the monthly debt service at the below-market rate of interest from the monthly payment at the current rate offered for conventional loans and discounting the difference by the current conventional interest rate over the remaining loan term. For RHS direct and guaranteed loans on proposed new construction, an additional step is required if the amortization period is longer than the loan term. With conventional financing, a loan with a term of 30 years is amortized at the end of the 30-year term. However, with a RHS direct loan that has a loan term of 30 years and an amortization period of 50 years, a large balloon payment is due at the end of 30 years. The present value (PV) of the balance of the RHS direct loan at the end of the 30-year loan term (the PV of the balloon payment) must be subtracted from the present value of the 30-year income stream to derive the value of the *interest credit subsidy*.

Example Problem and Solution

The following example problem is used to illustrate the method for valuing the *interest credit subsidy*. This method is based on the solution to a typical cash equivalency problem offered in Appraisal Institute courses. In cash equivalency problems, one solves for the value of below-market financing.

Problem:

A Section 515 direct loan of $1,000,000 is offered by USDA Rural Development with a term of 30 years and an amortization period of 50 years. The loan is to be amortized at the USDA note rate of interest of 6.0%, but the effective rate (base rate) of interest to the *borrower is 1.0% . At the end of the 30-year loan term, a balloon payment is due. The current interest rate for mortgage loans on conventional apartments in the subject's market is 7.0%. What is the value of the "interest credit subsidy" or below-market financing?*

Solution:

The loan amount in the example problem is $1,000,000. With conventional financing, the monthly payment at 7.0% interest, amortized over 30 years, would have been $6,653.02. This payment can be calculated on an HP-12C calculator using the following keystrokes:

1,000,000 PV
7.0 g i
30 g n
Solve for PMT = -6,653.02

With the Section 515 direct loan and *interest credit*, the monthly payment, at 1.0% interest, amortized over 50 years, is $2,118.59 (calculated in the same way), but a balloon payment of $734,760 is due at the end of 30 years. The borrower makes a monthly payment based on a 1.0% interest rate. However, the loan is amortized at the note rate of interest at the time of the loan (6.0% in this example), as if the mortgage payment was the sum of the borrower's payment and the *interest credit* calculated by USDA. The balloon due at the end of 30 years on the RHS loan can be calculated on an HP-12C calculator using the following keystrokes:

1,000,000 PV
6.0 g i
50 g n
Solve for PMT = -5,264.05
30 g n
Solve for FV = -734,760

The difference in the payments at the two different interest rates is $4,534.43 ($6,653.02 - $2,118.59) per month. The borrower saves $4,534.43 per month due to the below-market financing. Without the benefit of the favorable financing (*interest credit subsidy*), the owner would pay an additional $4,534.43 per month, at an interest rate of 7.0%, over the projected holding period. The projected holding period for the subject property is the loan term, 30 years.

With the Section 515 direct loan, a large balloon payment is due at the end of the 30-year loan term, but a conventional loan would be fully amortized at the end of the 30-year loan term, and there would be no balloon. Therefore, to calculate the value of the *interest* *credit subsidy*, the present value (PV) of the balance of the RHS loan at the end of the 30-year loan term (the PV of the balloon payment) must be subtracted from the present value of the income stream resulting from the savings in the mortgage payments. The present value of the balloon payment is calculated by discounting the balloon payment ($734,760) by the current mortgage interest rate (7.0%) over the term of the loan (30 years). In this example, the PV of the balloon payment can be calculated with an HP-12C calculator using the following keystrokes:

734,760 CHS FV
7.0 g i
30 g n
Solve for PV = 90,527

The value of the *interest credit subsidy* is equal to the amount of the monthly debt service saved, discounted by the current conventional mortgage interest rate over the remaining loan term, minus the present value of the RHS direct or guaranteed loan balloon payment. The value of the *interest credit subsidy* for the subject property can be calculated with an HP-12C calculator using the following keystrokes:

4,534.43 CHS PMT
7.0 g i
30 g n
Solve for PV = 681,559
90,527 –
Value of interest credit subsidy = $591,032
The Value of the Interest Credit Subsidy is $591,000 (rounded)

Conclusion

When appraising existing properties, calculation of the value of the *interest credit subsidy* usually does not involve a balloon payment. Only valuation of the income stream is considered. The appraiser should obtain the current balance of the original loan from the Rural Development Office. The remaining loan balance and the remaining term of the loan are used to calculate the monthly mortgage payment at the current conventional interest rate. The appraiser should use the borrower's actual payment based on a below-market rate (usually 1%) that has been calculated by the Rural Development Office in this process. The difference in the payments at the two rates is then discounted at the current conventional mortgage interest rate over the remaining loan term to calculate the value of the *interest credit subsidy*.

The *interest credit subsidy* for a RHS original loan should be valued separately from the *interest credit subsidy* of any subsequent RHS loans. *Interest credit subsidy* should be valued separately from the *market value, subject to restricted rents*, of the real property.

Attachment F

USDA Rural Development				
Insurable Value Calculation				
Property Name:				
Street Address:				
City, County, State, Zip:				
BASE COST			$0.00	PSF
Main Structure			$0.00	
Sprinkler			$0.00	
Other			$0.00	
Adjustments and/or Multipliers			0	
TOTAL BASE COST PER SQ. FT			$0.00	
Building Area Square Footage			0	SF
TOTAL REPLACEMENT COST NEW			$0.00	
EXCLUSIONS	Per SF	Percent		
Excavations	$1.00	0.00%	$0	
Foundations	$1.00	0.00%	$0	
Site Work	$1.00	0.00%	$0	
Site Improvements	$0.00	0.00%	$0	
Architect’s Fees	$0.00	0.00%	$0	
Underground Piping	$0.00	0.00%	$0	
TOTAL EXCLUSIONS			$0	
INCLUSIONS				
Appliance Packages			$0	
Patios / Balconies, etc.			$0	
TOTAL INCLUSIONS			$0	
CONCLUDED INSURABLE VALUE				
Total Replacement Cost New			$0	
Less Total Exclusions			$0	
Plus Total Inclusions			$0	
CONCLUDED INSURABLE VALUE			$0	