Fannie Mae Multifamily/Delegated Underwriting and Servicing Guide/Part III: Underwriting (08/23/99)/III, Chapter 5: Appraisal (08/24/99)

III, Chapter 5: Appraisal (08/24/99)

This Chapter describes Fannie Mae's requirements for valuing multifamily Properties under the DUS product line. The appraiser's role in DUS is to provide a complete, accurate description of the Property and market and an estimate of the market value of the Property. All conclusions reached must be based upon and supported by market data, logical analysis, and sound, professional judgment.

Fannie Mae requires the Lender to use only appraisers who adhere to the Uniform Standards of Professional Appraisal Practice of the Appraisal Foundation and which meet the qualification requirements set forth below.

The Lender must ensure that the appraiser complies with Fannie Mae's antiredlining policy as set forth in Section 301.01 and supplemented in Sections 503 and 507.04 of this Part.

Fannie Mae Multifamily/Delegated Underwriting and Servicing Guide/Part III: Underwriting (08/23/99)/III, Chapter 5: Appraisal (08/24/99)/III, 501: Appraiser Qualifications (08/24/99)

III, 501: Appraiser Qualifications (08/24/99)

a. Review of Appraiser's Qualifications

Fannie Mae does not approve specific appraisers for the DUS product line. The Lender is responsible for selecting appraisers and is solely accountable for their performance.

The Lender must ensure that each appraiser selected is qualified to appraise multifamily properties by reviewing the appraiser's education, quality and frequency of multifamily appraisal experience, sample appraisals, professional affiliations, and state licenses or certifications. The appraiser (the individual actually signing the form as "appraiser," not just the review appraiser) must have at least four years of multifamily appraisal experience and currently be active in appraisal work. Fannie Mae requires the Lender to select appraisers who are experienced in the market area in which the Property is located. If the Lender obtains Appraisals from in-house appraisers, they must possess the same professional qualifications, experience, and state licenses and certifications as independent fee appraisers and must comply with the same standards. If any appraiser is used who is not fully familiar with the market area in which the Property is located, the appraiser must take the appropriate steps to ensure compliance with the competency provisions of the Uniform Standards of Professional Appraisal Practice, one of which requires an affiliation with local sources and citing those sources in the Appraisal.

Fannie Mae reserves the right, at any time, to refuse to accept Appraisals prepared by specific appraisers and to notify the Lender that Fannie Mae will no longer accept Appraisals made by a certain appraiser.

b. Licensing and Certification Requirements

Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") requires Fannie Mae and its Lenders to use only state-licensed and certified appraisers. Because

Fannie Mae expects its Lenders to use appraisers that are state-licensed or certified to appraise the Properties that secure Mortgages they intend to deliver to Fannie Mae, all Fannie Mae Lenders (and any third-party originators they use) must be aware of, and in full compliance with, state laws for licensing and certification of real estate appraisers. The Lender must document that the appraisers it uses, including in-house appraisers, are licensed or certified as appropriate under the applicable state law. This can be accomplished by the appearance of the appraiser's license or certification number on individual Appraisal Report Forms.

When the Lender delivers a Mortgage, the Lender warrants that the Property has been appraised by a state-licensed or certified appraiser. Fannie Mae's Appraisal Report Forms define the appraiser as the individual who personally inspected the Property being appraised, inspected the exterior of the comparables, performed the analysis, and prepared and signed the Appraisal Report as the appraiser. This definition does not preclude an appraiser from relying on individuals that are not state-licensed or certified to provide professional assistance (such as an appraiser trainee or an employee of the appraiser doing market data research or data verification) in the development of the Appraisal. The state-licensed or certified appraiser who signs the Appraisal Report must acknowledge in the report the extent of the professional assistance provided by others. Under some state laws, the Lender's use of a review appraiser who is state-licensed or certified will satisfy the state's licensing and certification requirement even if the appraiser who prepares and signs the report is not a state-licensed or certified appraiser. Additionally, Fannie Mae requires that the reviewer, in such a case, personally inspect both the interior and exterior of the subject Property, and the exterior of the rental and sales comparables. Fannie Mae will rely on the Lender's determination that the appraisers it is using are in compliance with individual state licensing and certification requirements.

Fannie Mae Multifamily/Delegated Underwriting and Servicing Guide/Part III: Underwriting (08/23/99)/III, Chapter 5: Appraisal (08/24/99)/III, 502: General Guidelines for the Appraisal Report (08/24/99)

III, 502: General Guidelines for the Appraisal Report (08/24/99)

The Appraisal must be prepared for the Lender and must be paid for and initiated by the Lender. The Appraisal Report must be completed using Fannie Mae Form 1050 (Exhibit III-4) which must be completed in its entirety. A narrative attachment to the report is also required to support the appraiser's conclusions.

With the Lender's permission, the Fannie Mae Form 1050 is not required if the appraisal is performed by an MAI, i.e., only a narrative appraisal report is required in such cases. In all other instances, use of the Fannie Mae Form 1050 with narrative attachment is required unless otherwise stated in this Guide.

Fannie Mae requires the appraiser to meet the requirements described in this Chapter. If the appraiser becomes aware of other items, issues, or facts about the Property and market that are not specifically covered by this Guide, but which, in the appraiser's opinion, would be important to the Lender or Fannie Mae, the appraiser should report such items in the report. The Appraisal Report, including the Form 1050, must be complete and its conclusions fully documented.

The Lender must review each Appraisal for adequacy and compliance with the requirements of this Chapter. The Lender must return any incomplete report or a report lacking credibility to the appraiser with a letter identifying deficiencies and requesting appropriate explanations, documentation, or additional market data support.

If the Appraisal contains some errors or problems, but is otherwise acceptable and the Lender has time constraints which may preclude obtaining a response from the appraiser, the Lender must determine an Underwriting Value (see Section 403.01 of this Part) for use in determining the Mortgage amount. The Lender's review of the Appraisal and the Underwriting Value developed by the Lender must be discussed in the Underwriter's Narrative.

Fannie Mae Multifamily/Delegated Underwriting and Servicing Guide/Part III: Underwriting (08/23/99)/III, Chapter 5: Appraisal (08/24/99)/III, 503: Unacceptable Appraisal Practices (08/24/99)

III, 503: Unacceptable Appraisal Practices (08/24/99)

Certain practices are unacceptable when appraising Properties that will secure Mortgages. The Lender must ensure that the Appraisals do not reflect any of the following unacceptable practices:

1. Use of inaccurate data about the market, the neighborhood, the site, or the improvements to the site.

2. Development of a valuation conclusion that is based — either partially or completely — on the race, color, national origin, or handicapped status of either the Borrower or prospective occupants of the Property or of the present owners or occupants of the properties in the vicinity of the Property.

3. Failure to comment on the Property's proximity to any adverse natural or man-made influences.

4. Selection and use of inappropriate comparables or failure to use comparables that most resemble the Property in terms of market area, location, and physical similarity.

5. Making adjustments to comparables that do not reflect the market reaction to the differences between the Property and the comparables, or failure to make adjustments to comparables when they are indicated.

6. Inconsistent analysis from one indicator of value to another that is not reconciled or explained.

7. Use of a capitalization rate inconsistent with current investor (i.e., the typical purchaser of conventional multifamily properties) requirements.

8. Use of economic rents that are inconsistent with the Property or market area history or the failure to reflect any downward trend in rents in the Property or in comparable properties in the market area.

9. Use of expenses that are inconsistent with current Property expenses, expenses of comparable properties, and current trends in the market area.

10. Failure to report and analyze any sales transactions, option agreements, or contracts of sale involving the Property that are currently being negotiated or that were concluded within the preceding three years. This requirement includes any transactions or agreements of which the appraiser had, or reasonably should have had, knowledge.

11. Use of data, particularly comparable sales data, that was provided by parties who have a financial interest in the sale or financing of the Property without the appraiser's verification of the information from a disinterested source. For example, it would be inappropriate for an appraiser to use comparable sales provided by the real estate broker who is handling the sale of the Property,

unless the appraiser verifies the accuracy of the data provided with another source and makes an independent investigation to determine that the comparables provided were the best ones available.

Fannie Mae Multifamily/Delegated Underwriting and Servicing Guide/Part III: Underwriting (08/23/99)/III, Chapter 5: Appraisal (08/24/99)/III, 504: Date of Valuation (08/24/99)

III, 504: Date of Valuation (08/24/99)

The date of original valuation may not be more than six months prior to the date the Lender requests a Commitment. An update letter (see below) is required for an Appraisal dated more than six months, but less than nine months, prior to the date the Lender requests a Commitment. A complete reappraisal of the Property is required for Appraisals that are dated more than nine months prior to the date the Lender requests a Commitment.

If, at any time, the Lender has reason to believe that the Property's value has declined since the date of the Appraisal, an update letter must be obtained regardless of the date of the original valuation.

Any update letter must:

1. be signed by the original appraiser and provide an updated value and valuation date;

2. state that the appraiser has reinspected the Property, the market rental comparables, and the market area; and

3. if the Property value has changed since the original date of valuation, specifically address and document those factors which contributed to the change in value. Such documentation may include a new estimate of income and expenses as well as discussion of vacancies, concessions, and capitalization rates based upon a revised analysis of market conditions.

Fannie Mae Multifamily/Delegated Underwriting and Servicing Guide/Part III: Underwriting (08/23/99)/III, Chapter 5: Appraisal (08/24/99)/III, 505: Documents Provided by the Lender to the Appraiser (08/24/99)

III, 505: Documents Provided by the Lender to the Appraiser (08/24/99)

The Lender must furnish the following documents and other materials to the appraiser:

1. Appraisal Report Form (Form 1050).

2. Addendum to Appraisal Report Form (Attachment to Exhibit III-4)

3. Part III, Chapter 5 of this Guide, calling particular attention to Sections 507.11 through 507.15.

4. A rent roll dated and certified as true and correct by the Borrower.

   The date on the certified rent roll submitted to the appraiser does not have to be the same as the date on the fully executed Certification to Project Rent Roll (Form 4243, Exhibit III-3) utilized by the Lender in the underwriting (see Section 304 of this Part). However, if the Lender determines during the due diligence process that there are material differences (e.g., concessions, rent premiums, vacancies) between the appraiser's rent roll and the fully executed Certification to Project Rent Roll, the Lender must bring the differences to the appraiser's attention (see Section 403.01 of this Part).

5. Original operating statements, including profit and loss statements for the preceding three full years and year-to-date operating statements. The operating statements must be dated and must be certified as true, correct, and complete by the managing general partner or the chief operating officer of the Borrower, as applicable. All operating statements provided by the Lender (both originals and any restructured statements prepared by the Lender) must be attached to and made a part of the Appraisal. All restructured statements must be dated and must be certified by the individual that restructured the statement. The certification must either indicate that no adjustments were made to the Borrower's income and expense numbers or that all adjustments have been disclosed. Such disclosures must be attached to the restructured statement.

6. For Moderate Rehabilitation Properties, information regarding the scope of and schedule for the rehabilitation, and the request for both an "as-is" and "as-rehabilitated" value.

7. Any existing as-built survey of the Property showing the location and dimensions of all improvements, and of parking areas, driveways, recreational facilities, setback requirements, easements, lot line dimensions, and any special hazard area boundaries.

8. Legal description of the Property.

9. Any current certificates of building code compliance or the results of any recent code compliance inspection.

10. Copies of any leases for commercial rental space in the Property.

11. If the Property is a leasehold, Form 461 completed in its entirety by the Lender with a copy of the Ground Lease and any modifications to the Ground Lease attached, and the request for both the fee simple value and leasehold value estimates.

12. Copies of any reciprocal use agreements relating to recreational facilities, parking areas, private streets, etc.

13. Evidence of any special restrictions or limitations to the Property such as resale restrictions.

14. Any additional instructions needed for Multifamily Affordable Housing Properties. The Lender must provide the appraiser with any documentation pertaining to the nature, term, number of units affected, and amount of any restricted rents (i.e., rents below market). The appraiser must estimate value based on the scheduled (as-restricted) rents.

15. When completed, the Physical Needs Assessment, any other engineering reports, including any soils report, and the Phase I (and, if applicable, Phase II) environmental assessment, if, in the Lender's opinion, the reports disclose any information which could materially impact the appraised value. If the Appraisal has been completed prior to the completion of the engineering and environmental reports, the Lender may request an update letter from the appraiser.

16. If an acquisition, a copy of the Property sales contract, including all addenda.

Fannie Mae Multifamily/Delegated Underwriting and Servicing Guide/Part III: Underwriting (08/23/99)/III, Chapter 5: Appraisal (08/24/99)/III, 506: Special Requirements for Moderate Rehabilitation Properties (08/24/99)

III, 506: Special Requirements for Moderate Rehabilitation Properties (08/24/99)

For all Moderate Rehabilitation Properties, the Appraisal must provide both an "as-is" and an "as-rehabilitated" value. When determining the "as-rehabilitated" value, the appraiser must consider the scope of the rehabilitation, the schedule for completing the rehabilitation, the historic, current, and forecasted absorption and turnover rates for both the Property and the Property's market area, and any other pertinent factors affecting the Property's ability to attain the "as-rehabilitated" rents and value.

When determining the "as-rehabilitated" value, the appraiser must, where warranted by the scope of the rehabilitation, develop economic rents and provide alternate rental and sales comparables (using duplicate pages of the Form 1050) which would reflect the current rental of the Property's units and the sale of the Property if rehabilitation were complete. The appraiser should consider any existing units in the Property which have already been rehabilitated as well as market comparables. If the "as-rehabilitated" rents represent a significant increase, the impact of turnover and releasing must be factored into the economic vacancy rate used in developing the "as-rehabilitated" value. A separate market study is not required; however, the appraiser must carefully address how issues discussed in the Summary of Neighborhood and Property (Section 507.04 of this Part), Area Data (Section 507.05 of this Part), and Neighborhood and Marketing Area (Section 507.06 of this Part) specifically relate to the determination of the "as-rehabilitated" value.

Fannie Mae Multifamily/Delegated Underwriting and Servicing Guide/Part III: Underwriting (08/23/99)/III, Chapter 5: Appraisal (08/24/99)/III, 507: Preparing a Form 1050Appraisal Report (08/24/99)

III, 507: Preparing a Form 1050Appraisal Report (08/24/99)

The Appraisal Report Form 1050 must be fully completed and in accordance with the instructions provided on Form 1050 as modified by the Addendum to Appraisal Report (Exhibit III-4) and the guidelines in this Chapter. The Appraisal Report Form must be supplemented with a narrative report which supports the appraiser's conclusions as to income, expenses, market, and other factors which cannot be adequately explained on the Appraisal Report Form alone.

This Chapter discusses certain major sections of the Appraisal Report in the order that they appear on the form. The guidance provided is general and may not address certain unusual circumstances which may occur and should be considered in the Appraisal process. For example, Properties that are subject to federal, state, or local rent, occupancy, and/or resale restrictions (other than subsidies, which are discussed in Section 507.11 and Chapter 12 of this Part) often involve special Appraisal issues that are not typical of other Properties. The appraiser must examine applicable, existing, or proposed restrictions of this nature, or any other pertinent factors, and carefully evaluate their impact on the value of the Property.

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III, 507.01: Property Identification (08/24/99)

The Lender should complete the entry for "Property Identification," noting the following items:

1. Legal Description. The appraiser must verify the legal description provided. If an attachment is used to furnish the legal description, so indicate on the form.

2. Current Sales Price. If the Property was sold within the preceding three years, state the sales price. (The sales price can be obtained either from a current sales contract or from a recorded deed.)

Indicate the transaction date and any special terms relating to financing, including loan fees, repairs, remodeling, and unusual conditions that should be considered in Market Data Analysis.

3. Property Rights Appraised. If the type of interest in which Property rights are held is a leasehold, the Lender must indicate that the appraiser is to appraise both the fee simple and the leasehold estate (i.e., the Lender must check both the Fee and Leasehold boxes on the Property Rights Appraised line). In addition, in an attachment to the Appraisal, the appraiser must discuss and set forth calculations used in arriving at the value estimate of the leasehold estate.

4. Instructions to Appraiser. The Lender should direct the appraiser to the Property site and indicate how the appraiser can enter the Property for inspection purposes.

Fannie Mae Multifamily/Delegated Underwriting and Servicing Guide/Part III: Underwriting (08/23/99)/III, Chapter 5: Appraisal (08/24/99)/III, 507: Preparing a Form 1050Appraisal Report (08/24/99)/III, 507.02: Purpose of the Appraisal -- Determination of Market Value (08/24/99)

III, 507.02: Purpose of the Appraisal -- Determination of Market Value (08/24/99)

The appraiser must strike the current definition of market value on page one of Form 1050 and replace it in its entirety with the definition as set forth on the Addendum to Form 1050, included in Exhibit III-4.

Fannie Mae recognizes that certain DUS Appraisal requirements (e.g., the minimum 5 percent economic vacancy factor, 10 percent economic vacancy factor for commercial space, limitations on Other Income sources, a minimum $150 per unit for Replacement Reserves, etc.) may deviate from standard appraisal practices in determining market value. The Addendum to Appraisal Report includes the recognition that the Appraisal was completed in accordance with Fannie Mae's appraisal requirements.

Fannie Mae Multifamily/Delegated Underwriting and Servicing Guide/Part III: Underwriting (08/23/99)/III, Chapter 5: Appraisal (08/24/99)/III, 507: Preparing a Form 1050Appraisal Report (08/24/99)/III, 507.03: Attachments (08/24/99)

III, 507.03: Attachments (08/24/99)

In addition to the narrative information necessary to support the conclusions in the Appraisal Report, the appraiser must attach the following to the Appraisal Report:

1. A copy of all of the documents supplied by the Lender (see Section 505 of this Part).

2. Quality color photographs in at least three copies of the Appraisal (or more if required by the Lender). The photographs must be identified with the Property's address and the date the photographs were taken. Photographs are required of the Property (front, side, and rear views and existing improvements), neighborhood and street scenes, rental and sales comparables, and comparable rental properties in the neighborhood (even if not reported as comparables).

3. Map(s) showing the location of the Property and all rental and sales comparables used in the Appraisal Report. The appraiser must indicate the location of the Property and the comparables on the map(s) by means of a key or arrows.

4. Ground Lease Analysis (Form 461, Exhibit III-14) and the additional Ground Lease attachment described in Section 507.01 of this Part, if applicable.

5. A summary of any applicable rent control laws or regulations (see Section 507.11 of this Part).

6. A statement of the appraiser's qualifications, including education (continuing professional and otherwise), employment experience, professional affiliations, principal clients served, and major types of properties appraised.

Fannie Mae Multifamily/Delegated Underwriting and Servicing Guide/Part III: Underwriting (08/23/99)/III, Chapter 5: Appraisal (08/24/99)/III, 507: Preparing a Form 1050Appraisal Report (08/24/99)/III, 507.04: Summary of Neighborhood and Property (08/24/99)

III, 507.04: Summary of Neighborhood and Property (08/24/99)

The Summary of Neighborhood and Property required by Form 1050 must be based on the appraiser's careful analysis of the neighborhood and Property and should agree with the information on pages two and three of Form 1050. For each property or location characteristic the appraiser must make one of the following ratings based on the standards described below:

Good	--	If the characteristic is demonstrably superior to other competing properties.
Average	--	If the characteristic is typical and accords with the norm.
Fair	--	If the characteristic falls below the norm for competing properties of this type.
Poor	--	If the characteristic is demonstrably inferior to, and far below, that of competing properties.

The purpose of a neighborhood analysis is to identify the area — based on common characteristics or trends — that is subject to the same influences as the subject Property. The sales prices of comparable properties in the identified area should reflect the positive and negative influences of the neighborhood. The results of the neighborhood analysis will enable the appraiser to define the area from which to select comparables, to understand market preferences and price patterns, to reach conclusions about the highest and best use of the Property site, to examine the effect of different locations within the neighborhood, to determine the influence of nearby land uses, and to identify any other value influences affecting the neighborhood.

To perform a neighborhood analysis, the appraiser should collect pertinent data, make a visual inspection of the neighborhood to observe its physical characteristics and boundaries, identify land uses, and note any signs that these are changing. Appraisers should extend their search of the subject market area as far as necessary to assure that all significant influences affecting the value of the Property are reflected in the Appraisal Report. Appraisers should use their best judgment in determining and describing neighborhood boundaries. The limits of a neighborhood can be identified by various physical characteristics — including, but not limited to, streets, bodies of water, land uses, types of dwellings, etc. The Lender's underwriter should review carefully the neighborhood description to confirm that the appraiser used comparables from within the subject neighborhood or, if necessary, a comparable neighborhood within reasonable proximity in his or her analysis.

A neighborhood analysis should consider the influence of social, economic, government, and environmental forces on property values in the subject neighborhood. However, neither the racial composition nor the age of a neighborhood is an Appraisal factor. A property located in an older neighborhood can be as sound an investment as a property located in a newer neighborhood, and a property located in a neighborhood inhabited primarily by members of one race can be as sound an investment as one located in a racially mixed neighborhood or in a neighborhood inhabited primarily by a different race. The appraiser must report neighborhood conditions in factual, specific terms; be impartial and specific in describing favorable or unfavorable factors in a neighborhood; and avoid the use of subjective terms or phrases such as "pride of ownership," etc.

Fannie Mae does not designate certain areas as being acceptable or unacceptable — in other words, Fannie Mae does not "redline." Redlining can occur when perceived property risks are based on improper locational factors — such as the arbitrary granting of unfavorable loan terms on the basis of geographic area — or when the perceptions of risk are derived from factors that do not predict risk — either reliably or not at all. An example of a factor that is not predictive of risk is race — and racial redlining is illegal under federal law. Other factors that serve as a proxy for race are equally impermissible. The appraiser, and the Lender's underwriter, must be sensitive to these impermissible factors and apply Fannie Mae's guidelines in a consistent, equitable manner. None of our property guidelines is intended to foster redlining — if any provision is interpreted to do so, it has been misunderstood.

The appraiser should explain any changes that have occurred that might influence the marketability of the properties within the neighborhood. For example, the appraiser must comment if there is market resistance to a neighborhood because of the known presence of an environmental hazard. The Lender must be satisfied that the neighborhood will be acceptable to a sufficient number of buyers or renters to support an active, ongoing market for the Property.

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III, 507.05: Area Data (08/24/99)

The appraiser must consider the following relevant supply and demand factors, among others, in analyzing the market area of the Property:

1. demographic characteristics and trends of typical tenants in the market area, including family size, employment, and level of education;

2. average household income for the market area, if current information is available;

3. information regarding the economic base, including comments on the general health and stability of local industries, new or declining industries in the area, etc.; and

4. stability of the employment base, current unemployment and employment trends, diversity of employment base, etc.

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III, 507.06: Neighborhood and Marketing Area (08/24/99)

In discussing the market area in which the Property is located, the appraiser must explain, in a narrative, the factors that define the market area of the Property. Such factors can include property type, location, income-producing potential, a typical investor profile, a typical tenant profile, or other attributes considered by those participating in the rental or exchange of real property. The appraiser must consider "comparison shopping alternatives" for the typical tenant, including both rental and ownership opportunities. In addition, the appraiser must:

1. Attach a map outlining the market area of the Property and highlighting the Property site, major competing rental developments, the highway network serving the neighborhood, major employment centers, and any other sites of particular relevance to the appraiser's value determination.

2. Describe the major rental competition with the Property within the market area in addition to the three comparables required. In analyzing competition, the appraiser must consider and report on the property name; location; year opened; number of units; bedroom mix; unit size; lease term; rental rate per square foot, per month, and per annum; vacancy; furnished or unfurnished; rental history; density; recreational facilities and other amenities; utilities; type of construction; number of stories; and the condition of improvements.

3. Discuss whether or not the tenant base of the Property and the Property's market area is largely composed of students, seasonal tenants, military personnel, or civilians employed by the military, or if the Property is located in a resort area or an area lacking a diversified economic base.

4. Describe the balance between the existing and anticipated supply and demand for multifamily housing in the market area. The discussion of demand should address the number of market participants and their ages, financial ability, preferences, and behavior patterns. The appraiser should then correlate the factors of demand to the immediate, developing, and potential supply of multifamily units in order to determine the current and projected physical vacancy factor (see Section 507.14 of this Part) for the subject and the market.

   Immediate Inventory — Report on existing rental units in the market area not leased and the prevalence of seasonal or ongoing concessions in the market. The appraiser must indicate how many units are expected to be competing with the Property and the effect of that competition. Where applicable, the appraiser must provide information on differential vacancy rates in various unit sizes, types, or price ranges.

   Developing Inventory — Report on any rental properties in the area already under construction or for which building permits have been issued. The appraiser also must evaluate the competitive impact of such properties.

   Potential Inventory — Where additional vacant land is available or can be assembled, identify and evaluate timing and competitive significance of potential inventory, based on interviews with knowledgeable representatives of the housing industry.

The conclusions should be presented in the form of a summary of the anticipated competitive position and continued market acceptance of the Property.

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III, 507.07: Site (08/24/99)

The appraiser must consider and comment on the following factors relevant to an assessment of the Property site:

1. Whether the size, shape, and topography of the site adequately accommodates existing improvements to the Property, including on-site parking and recreational facilities. Planned or incomplete improvements also must be considered.

2. Whether buildings at the site are located to provide privacy and maximum open area. Density of development should be carefully analyzed; overcrowding could adversely affect the current and future competitive position of the Property.

3. Whether the site has adequate street frontage for ease and safety of ingress and egress, and for visibility and appearance. The appraiser should consider the type of street leading to the Property site, including its width, speed limit, traffic flow during peak periods, service or deceleration lanes, traffic lights, or stop signs.

4. Whether the Property is one phase in a multiphase complex and the impact, if any, on the Property value. The appraiser should consider the specific phase's visibility, accessibility, and ability to operate profitably, independent of the other phases, and the potential impact of any future phases on the Property's market value.

5. Whether the amount and type (e.g., garage, surface, etc.) of on-site parking at the Property is similar to the on-site parking available at comparable properties. If the Property has less on-site parking than comparable properties or if there is less than one parking space per bedroom, the appraiser must specifically address the impact of available parking on the marketability of the Property. The appraiser must discuss any other competitive advantage or disadvantage resulting from the type of parking available at the Property. All parking areas should be paved and should be easily accessible to apartment entrances.

6. Whether the Property is in conformance with all current zoning requirements. If a Property is a legal nonconforming use, the appraiser must discuss any impact on Property value. The appraiser must also address whether the existing improvements may be restored if they are substantially destroyed.

7. Whether the Property site is located in a FEMA (formerly HUD) designated Special Flood Hazard Area. If so, the appraiser should comment on the effect of such location, including the necessity and cost of flood insurance.

8. In connection with the section in Form 1050 for "Site Improvements" (water, sewer, electricity, gas, etc.), "public utility services" means services supplied by a government-owned, supported, or regulated entity. Community or neighborhood systems sponsored, owned, or operated by a developer or a private company and that are not regulated or financed by the government are not included in the term "public utility services."

   If the site is served by a privately owned water or sewer system, the appraiser must clearly indicate this in the Site Improvements section of the Appraisal Report Form. The appraiser also must immediately notify the Lender of this circumstance as public water and sewer systems are required for all Properties.

9. Whether there exist, to the appraiser's knowledge, environmental hazards or any hazardous

conditions on the Property or within the immediate vicinity of the Property that affect the value of the Property. Such hazards include the presence of hazardous wastes, toxic substances, asbestos-containing materials, urea-formaldehyde insulation, radon air pollution, lead painted surfaces, and similar environmental hazards. The appraiser must immediately call any such items found during the appraisal process to the attention of the Lender and discuss in the final Appraisal Report the effect of any hazardous conditions on the Property's value and marketability and make appropriate adjustments in the appraiser's overall valuation of the Property. The Lender must supply the appraiser with the environmental assessment if any of the problems discussed above are identified in the environmental assessment; the appraiser must also consider this information in the valuation of the Property. If the Appraisal has been completed prior to receiving the environmental report (identifying any of the problems discussed above), the appraiser may indicate the effect of any hazardous conditions on the Property's value in an update letter.

III, 507.08: Description of Improvements (08/24/99)

The appraiser must provide a complete and detailed description of existing or planned improvements to the Property in the applicable spaces on Form 1050 and in the narrative attached to that report. The appraiser should note that some reserve items may be items which would be deducted from value by a typical purchaser. The appraiser's analysis must include, and the narrative must comment on:

1. a general evaluation of the quality of construction of the Property. If the appraiser believes that the Property or components are structurally deficient or of questionable quality, the appraiser must address the impact on the marketability of the Property. In addition, the appraiser must list any outstanding violations of building, health, fire, or safety codes which were noted at the Property; and

2. any impairment of desirability and usefulness of the Property (see Section 207 of this Part). Consideration also must be given to the unit mix, size, the adequacy of closets, tenants' storage, laundry facilities, tenants' services, recreational facilities, etc. The appraiser's analysis of the Property's structure and components must be reflected in depreciation, in the calculation of the operating costs, and in the discussion of Property marketability.

III, 507.09: Cost Approach to Valuation (08/24/99)

The Cost Approach is required only in the case of a Recently Completed Property or a Forward Commitment. Under the Cost Approach, the appraiser must prepare both a land value estimate and a replacement cost estimate.

In valuing the land, Fannie Mae requires that the appraiser use the market data approach (the comparison to, and analysis of, sales of similar sites). Justification for the similarity of comparable sites should include the recency, proximity, and quality of the sale. The appraiser must describe all factors affecting the land value estimate. In determining the final value, the appraiser must correlate the sales comparables using both a per square foot and a per unit basis (and other common measures in the market) in order to develop the value conclusion. Comparable land sales must be identified on the market area map.

In determining the replacement cost estimate, the source of replacement cost factors used must be identified (e.g., actual contracts, cost manuals, cost-in-place studies, etc.). Items in the replacement cost estimate must be calculated by square foot and these calculations must be shown. Unenclosed or unroofed areas (e.g., balconies) are to be excluded from the building area calculations, but are to be calculated and reported separately with applicable cost factors. Paved areas for parking, driveways, and walks are also to be calculated and reported separately with their applicable unit measure (e.g., square foot, cubic yard, etc.) cost. The final value estimate is to be based on completion of all needed repairs, which the appraiser must list.

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III, 507.10: Comparable Rental Data (08/24/99)

The appraiser must analyze all competitive market rentals and provide data on no less than three comparables. In those instances where there are numerous comparables that are proximate to and competitive with the Property or if there are extreme variances among the three comparables initially chosen, the appraiser should provide additional comparables (on additional copies of page 5 of Form 1050) in order to develop a final conclusion on value. To judge the comparability of properties, the appraiser must consider the following:

1. locational characteristics (e.g., schools, shopping, transportation, and police and fire services);
2. tenant user categories (e.g., single people, married couples, and elderly);
3. type of building structure (e.g., garden, low-rise, or elevator structures);
4. available amenities (e.g., recreational facilities, security garages, and storage areas); and
5. unit types, sizes, and mix.

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III, 507.11: Monthly Rent Schedule (08/24/99)

In calculating the scheduled or economic rental income of a Property, the appraiser may include the following income:

a. Residential Income

Except as provided below, all income from the rental of residential units may be included.

For the Scheduled Rent section, the appraiser must calculate the Property's rental income based on the current certified rent roll supplied by the Lender. The appraiser must determine whether or not rents charged at the Property are the result of concessions. If concessions are present, the appraiser must reduce the rents for the Property by the amount of any monetary concessions (or the fair market value of any nonmonetary concessions), on an annualized basis, before listing the scheduled rents. For example, if a partial or full month's free rent was given in order to obtain leases which are still in effect, the value of the free rent must be divided by 12 and one-twelfth deducted from the current rent before listing as the scheduled rent. The appraiser must determine the reason for the concessions and whether the practice is limited to the Property or widespread in the market. If concessions are prevalent in the market area, the appraiser must carefully consider the circumstance in analyzing the rental comparables and developing the vacancy factor for the Property. Absent instructions to the contrary, if there are any low- and moderate-income rental restrictions on the Property, the appraiser must list the below-market rents in the Scheduled Rent section.

For the Economic Rent section, the appraiser must:

1. Determine economic rents that would be achievable in the open market at the time of the Appraisal, and may not trend rents to any future date.

2. Deduct premium income and the fair market value of any rental concessions from the comparables.

3. Discuss briefly the adjustments made to the comparable rents for utilities, size, amenities, etc., to arrive at the economic rents.

4. Comment on whether utilities are tenant paid or owner paid. The appraiser must discuss the general industry practice regarding metering in the market area, indicate clearly which comparables include which utilities, and discuss appropriate adjustments where necessary. Where the Property is individually metered, the appraiser must comment on any market impact of the cost of utilities to the tenant, especially where the utility package differs from the comparables.

5. Discuss any applicable or proposed rent control laws or regulations and their impact on the economic rents developed. The appraiser must attach a synopsis of the applicable rent control restrictions and a copy thereof.

6. If the Property is a Multifamily Affordable Housing Property with Low-Income Housing Tax Credits or other rental restrictions associated with the Property, the appraiser must use the restricted rents as the economic rents for the restricted units.

b. Other Income

Income from laundry facilities and parking may be included provided there is adequate history in the Property of consistent revenue from the applicable source. The appraiser must indicate whether laundry equipment is leased or owned. If the equipment is owned, then the appraiser should derive an income figure net of any operating expenses to run the equipment. If parking income is derived from leases which run for a shorter period than the leases on the units, the appraiser must consider this factor, including the potential for cancellation in the warmer months, in calculating income from parking.

Income from any other source such as equipment rental (e.g., air conditioner or washer and dryer), premium income, furnished or corporate units, vending, pool fees, fees for exercise facilities, utility charge-backs, pet fees, and forfeited security deposits, etc., may be included if the Property has consistently earned the income over the previous three years, the income is common for the market, and the future duration of the income is easily predictable.

c. Commercial Income

If a Property contains commercial space, the appraiser must segregate the income attributable to that space from the residential income attributable to the Property.

The following are Fannie Mae's requirements for the appraiser's analysis of commercial space:

1. The appraiser must analyze all current commercial leases. The quality of the tenant and the duration of the income stream must be carefully analyzed. The appraiser must determine, based on the appraiser's professional judgment, the likelihood of continued lease income from the commercial space.

2. Commercial income estimates must be supported by market comparables which have been obtained and analyzed by the appraiser.

3. Consideration must be given to the location of the commercial space as it relates to a commercial user. Among the locational factors to be considered are parking, accessibility, and street exposure. In addition, the appraiser must consider the flexibility and configuration of the space as those factors affect the use of the space by potential future tenants.

4. The economic vacancy factor must consider the typical rate in the market, the existing conditions of the immediate neighborhood, and the condition and history of the Property.

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III, 507.12: Market Approach to Value (08/24/99)

In the market approach to valuation, the appraiser must compare the Property to at least three similar properties. In those instances where there are numerous comparables that are proximate to and competitive with the subject or if there are extreme variances among the three comparables initially chosen, the appraiser should provide additional comparables (on additional copies of page 6 of the Form 1050) in order to develop a final conclusion on value. The appraiser should select as comparable properties those that:

1. are most similar to the Property with regard to age, size, condition, amenities, and tenant user profile;

2. are located in the same neighborhood as the Property or in areas that are physically similar and cater to the same market; and

3. have most recently been sold.

In obtaining data on comparables, the appraiser must be certain that the transactions used were made at arm's-length between buyer and seller. The appraiser also may have to adjust for financing and provide a cash equivalent price. The derivation of the gross rent multiplier or other indicators must reflect any adjustments made to comparable sales prices for cash equivalency.

Where comparables are limited because there have been few transactions in the market area, the appraiser must so state and provide a more thorough discussion of the adjustments made and the resulting value conclusion than might otherwise be necessary.

The trend in market values and capitalization rates must also be carefully considered by the appraiser when selecting the final value indicators. In a declining market, the appraiser must allow for these market conditions and apply a trend reflecting lower values to the sales comparables. When possible, the appraiser must select comparable transactions that have occurred within a reasonable time frame relative to the date of valuation, as dated sales comparisons may result in an inflated valuation based on the past market value. If any comparable property selected by the appraiser has been sold within three years of the date of valuation, the appraiser must specifically comment on any trends in market values in the Property's market area as related to the sales price of the comparable property.

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III, 507.13: Expenses (08/24/99)

The appraiser's expense estimate must:

1. be on a line-by-line basis;

2. cover the 12 months following the date of valuation and include appropriate trending of historical expenses and known or expected increases. If any expense estimate used by the appraiser is lower than the historical expense, the appraiser must be particularly diligent in providing information concerning that expense estimate;

3. include consideration of expenses for comparable properties as well as analyzing the Property's historical operating statements; and

4. include consideration for expenses attributable to any commercial space and must reflect any special conditions indicated in the commercial leases that would reduce the net income of the Property.

The following provides additional guidance on the required treatment of critical expense items:

1. Real Estate Taxes. Except as provided below, the appraiser's tax estimate must reflect current tax rates and assessments as well as historical information, unless the appraiser knows of an imminent change in either the rate or the assessment of taxes.

   For Recently Completed Properties, or in developing the "as-rehabilitated" value for Moderate Rehabilitation Properties, the appraiser's estimate of any increased tax assessment must be based on the value of the improvements as recently completed or as-rehabilitated and must be fully supported by attaching an analysis of comparable properties. If available, a letter from the local tax Assessor's office as to the proposed assessment should be attached.

2. Other Taxes and Assessments. This category would include those taxes and assessments that may become liens against the real estate, excluding assessments for capital improvements. For each item listed, comment by the appraiser is required.

3. Insurance. The appraiser must examine existing coverages and premiums of the Property in conjunction with market comparables. Local requirements in the market may dictate some additional types of insurance coverages and amounts of coverage as appropriate and necessary for the Property.

4. Fuel, Gas, Electricity, and Water and Sewer. The appraiser must itemize and support these items individually. Estimates can be supported by an analysis of historical data, by discussions with appropriate officials of utility companies, and by examination of operating statements of comparable properties. If possible, the portion of gas and electricity that is used for heating and air conditioning should be included under "Fuel," if it is possible.

5. Building Maintenance and Repairs. In developing an estimate for this line item for a Property where deferred maintenance is present, the appraiser should place greater reliance on the expenditures of comparable properties where maintenance has been adequate and less reliance on the historical expenditures at the Property. Also, in examining operating statements, the appraiser should eliminate any known capital expenditures that would normally be included in a Replacement Reserve. However, in all such cases, the items and costs eliminated should be identified and itemized separately.

6. Nonresident Management. Fees paid for off-site management and leasing must be based on the management fee typical in the Property's market area for independent management providing the same services for the same size and type of property. Where the Property's current management fee is greater than the market, the appraiser should not use a lower estimate without assuring that the lower estimate includes any special services, or levels of service, that are currently provided at the Property.

7. Salaries and Payroll Taxes. The function and number of employees at the Property must relate to the needs of prudent management and be supported by analysis of comparable properties. The appraiser must carefully separate expenses related to compensation between salaries and other benefits which should be included in Payroll Taxes or as apartment allowances. If the appraiser cannot readily obtain information on staff, salaries, and benefits at the Property, the information may be requested from the Lender.

8. Apartment Allowances (i.e., overhead units). If the rental value of a resident manager's or other employee's apartment is included in the gross rental projection, the appraiser must deduct such rental value as an expense, at the same rate, and indicate the amount on the appropriate line item for the apartment allowance. The appraiser should also assure that any other units included in the gross rental projections but not available for rental (e.g., models, units converted to storage) are itemized and deducted on a separate line item.

9. Advertising, Telephone, Legal, and Audit. These expenses are often listed as administration expenses on operating statements and the appraiser must differentiate the expense items appropriately to the extent possible. These line items may not include any of the Borrower's as opposed to the Property's expenses (e.g., a partnership audit).

10. Replacement Reserve. The appraiser must include a Replacement Reserve estimate based on the needs of the Property and market practice.

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III, 507.14: Vacancy and Collection Loss (Economic Vacancy) (08/24/99)

Fannie Mae requires that the appraiser consider a physical vacancy and collection loss allowance (combined, the economic vacancy factor) when determining the effective gross annual income for the residential units.

If the economic vacancy in the market exceeds the factor selected for the Property, the appraiser must address both the physical and collection loss components separately as to why the Property's performance is expected to be stronger than the market. Factors to consider include the current and past physical vacancy and collection loss history of the Property, the comparables, and the market. The appraiser must also address the trends that would indicate a change from the current vacancy in the near future. The discussion of trends should include:

1. recent vacancy pattern at the subject and in the market, including any seasonal variations;
2. a change in typical turnover and notices at the Property;
3. an increase or decrease in monthly traffic of potential renters at the subject or in the market; and
4. economic factors (e.g., employment, supply of apartment units) which may have a long term impact.

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III, 507.15: Income Approach to Value (08/24/99)

The income approach to value involves the capitalization of the Property's income stream and often is the predominant indicator of value. The appraiser's determination of the appropriate capitalization rate for the Property must be based on a reconciliation of both the capitalization rate calculated using the direct capitalization method and a capitalization rate developed using the band of investment method.

Under the direct capitalization method, the appraiser extracts the capitalization rate for the Property from the capitalization rates calculated for each of the market sales comparables used in the Appraisal. In calculating the capitalization rate for each of the comparables, the appraiser must divide the comparable's net income at the time of sale, by the cash equivalent sales price. In all cases, the appraiser must use a market cap rate that does not reflect any upward or downward adjustment for special financing, tax credit benefits, any perceived special risks, or reduced up-side potential associated with Multifamily Affordable Housing Properties. The appraiser must comment on the quality of the revenue, expense, and vacancy data used in calculating the overall cap rate, and any impact the variances between the comparables' economic indicators and the subject's economic indicators (e.g., expense ratios) may have in determining the overall rate.

The band of investment method of calculating capitalization rates involves the derivation of a blended rate based on current market rate financing (i.e., not a discount rate, bought down rate, or any below-market rate financing as would be the case in MBS/DUS Participating I or II or tax-exempt bond transactions) and an equity dividend rate supported by market data. The appraiser must make no additional adjustment for either Property appreciation or depreciation.

The appraiser must correlate the two indicators to arrive at the most supportable rate to be used in capitalizing the Property's income stream and provide pertinent discussion as to how the final capitalization rate was determined. The use of a discounted cash flow analysis is not allowed.

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III, 507.16: Conclusions (08/24/99)

At the conclusion of the appraisal, the appraiser must reconcile the income and the market approaches (and the Cost Approach in the case of a Recently Completed Property or a Forward Commitment) to value. The appraiser must state a conclusion as to the final market value of the Property and include a short narrative summary of the rationale for arriving at this final valuation.

The appraiser must indicate the "as-is" market value of the Property, in the case of a Moderate Rehabilitation Property or any required repairs, replacements, etc. The appraiser should also consider the Physical Needs Assessment, if appropriate, when developing the final conclusion on value. In the case of Moderate Rehabilitation Properties, the appraiser must also indicate the value conclusions of the Property "as-rehabilitated." The appraiser may attach information or exhibits to fully explain any conditions or requirements of the Appraisal or any assumptions made regarding Multifamily Affordable Housing Properties with restricted rents.

If the Property has been purchased during the three-year period prior to the date of valuation and there is a substantial difference (i.e., either an increase or a decrease) between the prior purchase price and the appraiser's final value, the appraiser must specifically comment on any trends in values in the Property's market area or other applicable factors which have resulted in the difference.

The Appraisal Report must be dated and signed by the appraiser who inspected the Property. The signature date should be the date the appraiser completed the Appraisal. The date of the valuation must be a current date and may not be as of a projected date.