



Rural Development

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TO: State Directors
Rural Development

ATTN: Community Programs Directors

FROM: Joel C. Baxley /s/ *Joel C. Baxley*
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SUBJECT: Requirements of Appraisals for Community Facility Applications

INTRODUCTION

The purpose of this Unnumbered Letter (UL) is to clarify the requirements for appraisals under the Community Facilities (CF) Guaranteed and Direct Loan Programs. This UL replaces all previous guidance issued on this subject.

7 CFR 1942, Subpart A, section 1942.3, and 7 CFR 3575, Subpart A, section 3575.47 establish the requirements for preparation of appraisal reports.

BACKGROUND

Community Facility Direct and Guaranteed loans are required to be fully secured under 7 CFR 1942.17(g) and 7 CFR 3575.48 respectively. While CF prefers the security obtained through general obligation bonds, assessments, and bonds which pledge taxes or revenues, we can also accept real estate as security. Where real estate is taken as security, in order to determine whether the project meets the requirements of 7 CFR 1942.17(g) or 7 CFR 3575.48, CF requires an appraisal of the proposed real estate which demonstrates the value of the security is equal to or exceeds the loan amount.

This UL provides the minimum requirements for the content of the appraisal report, the type of appraisal, and the timing based on the loan purpose.

EXPIRATION DATE:
October 31, 2019

FILING INSTRUCTIONS:
Community Programs

APPRAISAL REPORTS

The Agency must receive a real estate appraisal report of the secured property as described below. The property's prospective (post rehab/post construction) market value must be reported pursuant to Uniform Standards of Professional Appraisal Practice (USPAP) and Agency appraisal requirements. The loan amount may not be greater than the appraised value of the property, which must demonstrate there is adequate security in the event of default.

Appraisal reports must be performed by a certified general real estate appraiser licensed in the state where the property is located. The appraiser must have the specific qualification, experience and competency to appraise the type of facility being financed.

For purposes of this UL, the definition of Market Value is found at 12 CFR, Chapter 1, Subpart C, Part 34.42(h). As of the date of this UL, Market Value is defined as follows:

Market value means 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:

- (1) Buyer and seller are typically motivated;
- (2) Both parties are well informed or well advised, and acting in what they consider their own best interests;
- (3) A reasonable time is allowed for exposure in the open market;
- (4) Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
- (5) 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.

Types of appraisals

For loans which include the purchase of an existing facility, the appraisal should report the "As Is" Market Value of the property.

For loans which contain a construction component (new construction or rehabilitation), the initial appraisal should estimate the "As Is" Market Value and the "Prospective Market Value" as of the date of completion of construction. If the date of the appraisal is more than one year from the estimated date of closing, an updated appraisal will be required prior to closing the loan.

In order to estimate the market value of the subject facilities as defined above (i.e. existing, new construction, or rehabilitation), other methods of valuation may be necessary, including valuation of the property as a going concern. Analysis of historical incomes, expenses, operating uses, recognition of personal property (including fixtures, trade equipment, and other tangible and

intangible assets of the business), may be required as part of the appraisal assignment. If market value of the going concern is estimated by the appraiser, values of both tangible and intangible assets, including real property, personal property, and intangible assets, must be reported individually and separately within the appraisal.

Valuation of chattel (FF&E) property, exclusive of inventory, must be developed and reported separately from the market value of the real estate. Chattels must be evaluated in accordance with generally accepted methods of determining value. Appraisals of chattel must reflect and report the age, condition, and remaining useful life of the equipment or fixture.

For these assignments the value reported should be the “Market Value of the Going Concern” as defined within the *Dictionary of Real Estate Appraisal, Sixth Edition*, Appraisal Institute.

Appraisals completed for servicing actions (i.e. acceleration and/or foreclosure), should report the “As Is” Market Value of the property (as discussed above) as well as an estimate of “Liquidation Value” as defined within the *Dictionary of Real Estate Appraisal, Sixth Edition*, Appraisal Institute.

The appraisal report must contain the specific contents outlined in Attachment A.

Timing of Appraisals

As outlined in AN 4859, Eligible Loan Purposes under the Community Facility Programs, when the loan purpose includes the purchase of an existing facility, an appraisal must be submitted with the application.

For direct loans that have a construction component, the appraisal must be submitted prior to issuing RD Instruction 1942-A Guide 1 or 1a to the interim construction lender. For guaranteed loans that have a construction component, the appraisal must be submitted with the application. Construction cannot begin until the appraisal is complete and reflects a value equal to or exceeding the loan amount. Once construction is complete and prior to closing the Agency direct loan, any appraisal more than one year old must be updated and the value must demonstrate the Agency is fully secured. All appraisals must be reviewed and accepted by the Agency appraiser prior to issuing Guide 1 or 1a for a direct loan and prior to obligation for a guaranteed loan.

All appraisal requirements will be outlined in the Letter of Conditions or Conditional Commitment for Guarantee.

IMPLEMENTATION

To insure applicants are aware of the requirement for an appraisal early in the application stage, State Directors will require staff administering the CF program to discuss these requirements with potential applicants, lenders and financial or project consultants. The date and results of the discussion will be documented and included in the applicant’s project file.

SUMMARY

If you have any questions about the type of appraisals that should be required, please contact the National Office for assistance. Determining appraisal requirements early in the application process is essential to a successful underwriting and approval process.

If you have any other questions regarding the information in this unnumbered letter, please contact your CF Regional Coordinator.

Attachment A – Appraisal Report Format

APPRAISAL REPORT FORMAT

Reports shall be in compliance with the reporting requirements of *USPAP* Standard Rule 2-2 for an Appraisal Report and with USDA-RD requirements.

Reports must, at a minimum, contain the following items:

1. Transmittal letter;
2. Factual information about the property;
3. Regional and neighborhood data, including presentation and analysis of competitive market area;
4. Description of the subject property;
5. Description of existing and planned (if applicable) improvements;
6. Highest and best use analysis;
7. A statement regarding any environmental issues, such as potential contamination of the property from hazardous substances, hazardous wastes, or petroleum products;
8. A cost approach analysis;
9. A sales comparison approach analysis;
10. An income approach analysis;
11. If one of these standard approaches is not used, the reconciliation narrative shall provide a full and complete explanation of the reasons for exclusion of the approach;
12. A reconciliation of the value indications derived from the included approaches to value consistent with SR 1-6;
13. A signed certification in accordance with SR 2-3.

In addition, the following general information is to be included in the report:

- The appraisal report must comply with the current edition of *USPAP* as of the date of the report.
- The appraisal report must include a legal description of the subject property.
- The appraisal report must include photographs of the interior and exterior of the subject property and of the exterior of all comparable properties including any comparable rentals and comparable sales included within the report.
- The appraisal report must include the following maps, showing the location of the subject property:
 - Regional map
 - City map
 - Neighborhood map
 - Flood plain map
 - Land Sales map
 - Sales Comparable Map
 - Rent Comparable Map

Attachment A

- The appraisal report must include the following exhibits of the subject property:
 - Survey (if available)
 - Site plan (if available)
 - Floor plans of the existing improvements, with exterior dimensions, together with any proposed new construction separately identified.
- Copies of the existing lease, historical occupancy levels, incomes, expenses, and a list of all existing furniture, fixtures and equipment should be requested from the client and included within the appraisal report.
- All analyses within the income approach should be well supported with narrative discussion. Appraisers must provide good support for the income, occupancy, expense, and capitalization rate analyses within the approach. The expense analysis should be supported by the 3-year operating history of the applicant and by comparable market analysis. Analysis and discussion must include presentation of comparable data utilized to estimate income, expenses and the overall rate conclusions of the income approach.
- The capitalization rate selected to provide a market value indication for the subject property must be derived from the most recent sales of similar use properties in the local (or nearest similar) competitive market. Support for the overall rate may be provided using other accepted methods such as the band-of-investment technique, the debt coverage ratio formula, and regional investment criteria surveys.
- If the 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.
- The appraisal report must include an estimate of the remaining economic life of the property in its presently developed condition.
- The appraisal report must include a discussion of any deferred maintenance present as of the effective date of valuation. Items of deferred maintenance must be listed, and the effect on market value of the property should be estimated, with support provided.
- The final opinion of value presented in the appraisal report must have considered a cost approach, sales comparison approach, and an income approach. If one of these standard approaches is not used, the reconciliation narrative will provide a full and complete explanation of the reasons for exclusion of the approach.
- The reconciliation will also fully discuss and reconcile variances in the value indications concluded by each approach, and set forth value indications of each intangible component contributing to the concluded value as required by SR 2-2(a)(viii).
- The appraisal report must contain a 5-year ownership and sales history for the property being appraised.

Attachment A

- If the appraiser observes potential contamination from hazardous substances, hazardous wastes, or petroleum products on the property, or obtains other information about such contamination, that information should be provided to the Agency together with an indication of its potential impact on the value of the property.
- The appraisal report is subject to review by Rural Development. Appraisers must be prepared to discuss their analyses, opinions, and conclusions and provide additional written support, clarification, and a corrected electronic appraisal report, at no additional cost, if requested by a USDA Regional Appraisal Reviewer.