INSTRUCTIONS FOR PREPARING FORM 1050A, APPRAISAL REPORT

The guidance provided for preparing Form 1050A, Appraisal Report, is general and may not address certain unusual circumstances that 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 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.

Property Identification

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.

Purpose of the Appraisal - Determination of Market Value

The appraiser must strike the current definition of market value on page one of the Form 1050A and replace it in its entirety with the definition as set forth on the Addendum to Form 1050A (Form 1050A-Addendum).

Fannie Mae recognizes that certain 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 $200 per unit for Replacement Reserves, etc.) may deviate from standard appraisal practices in determining market value. The Addendum to Appraisal Report (Form 1050A-Addendum) includes the recognition that the Appraisal was completed in accordance with Fannie Mae's appraisal requirements.

Attachments

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 707 of Part Three of the 5-50 Manual).

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 4325) and an attachment which discusses and sets forth any calculations used in arriving at the value estimate of the leasehold estate.

5. A summary of any applicable rent control laws or regulations.

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.

Summary of Neighborhood and Property

The Summary of Neighborhood and property required by Form 1050A must be based on the appraiser's careful analysis of the neighborhood and property and should agree with the information on the Form 1050A. 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, on-going market for the property.

Area Data

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.

Neighborhood and Marketing Area

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 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 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.

Site

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 multi-phase 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 non-conforming 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 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 the Form 1050A 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.

Description of Improvements

The appraiser must provide a complete and detailed description of existing or planned improvements to the property in the applicable spaces on Form 1050A 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.

2. Any functional obsolescence of the unit mix, size, and layout of the property. Consideration also must be given to 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.

Cost Approach to Valuation

The Cost Approach is required only in the case of a Recently Completed Property. 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.

Comparable Rental Data

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 1050A) 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., recreation facilities, security garages, and storage areas); and

5. Unit types, sizes, and mix.

Monthly Rent Schedule

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.

1. Premium income earned as a result of initial lease terms that are shorter than the market norm, or as a result of leasing units to entities (e.g., corporations, trusts, or several units leased to a single individual), or as a result of leases for furnished units that include additional fees above and beyond the rent for an unfurnished unit may not be included. Premium income is the portion of the rent that exceeds the rent earned on comparable units leased to individual tenants for terms which are common in the market.

2. 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 non-monetary 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 this practice is limited to the property or widespread in the market. If concessions are prevalent in the market area, the appraiser must carefully consider this circumstance in analyzing the rental comparables and developing the vacancy factor for the property.

For the Scheduled Rent section, the appraiser must calculate the property's rental income (appropriately reduced by the amount of any premium income or concessions) based on the current certified rent roll supplied by the Lender. 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 that 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), 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. Effective gross commercial income used in this calculation may not exceed 20 percent of total Effective Gross Income. Thus, the total Effective Gross Income (total commercial plus total residential and other income) may not exceed 125 percent of effective gross residential income plus other income. An economic vacancy factor of not less than 10 percent must be applied to gross commercial income to determine effective gross commercial income.

The following are Fannie Mae's requirements for the appraiser's analysis of commercial lease(s):

1. All leases must have an original term of three years or more. Any leases with remaining terms of less than one year must show proof of lease renewal or the affected space must be included in the vacancy calculation. If, however, a tenant is an established ongoing business in an option period, the appraiser may determine, based on the appraiser's professional judgment, the likelihood of continued lease income from that space.

2. All lease payments must be supported by market comparables. However, if the payment is at a contract rent that is less than market, then the contract rent must be used. No consideration will be given to income that is based upon a percentage of gross sales or any type of participation clause in the lease; only base rent may be considered.

3. The quality of the tenant and the duration of the income stream must be carefully analyzed and 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. In no case may the economic vacancy factor used in the analysis be less than 10 percent.

Market Approach to Value

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 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 timeframe 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 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.

Expenses

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.

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, 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. **Non-Resident 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. A minimum of $200 per unit is required.

Vacancy and Collection Loss (Economic Vacancy)

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 for the property is 5 percent or less, a minimum allowance of 5 percent must be used, and a higher rate must be used if market evidence or property history so indicate. 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 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.

Income Approach to Value

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 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.

Conclusions

In the space on the Form 1050A for "Reconciliation and Value Conclusion," the appraiser must enter the dollar amount estimated using the income and the market approaches (and the Cost Approach in the case of a Recently Completed Property) to value. In the space titled "Final

Reconciliation," 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 in the space for "Conditions & Requirements of Appraisal," the "as-is" market value of the property. The appraiser should also consider the ***PCS***, if appropriate, when developing the final conclusion on value. 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 that 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.