



Firm Application - Appraisal Methodology & Format, Commercial Space, IOD

April 18, 2017



METHODOLOGY & FORMAT

FIRM COMMITMENT STAGE

- **Additional Items Not in Pre-Application Appraisal**
 - Replacement Cost Analysis
 - Marshall Valuation Service
 - Cost Comps – other developments
 - HUD-92328
 - Include Section G from A/E Cost Reviewer
 - Initial Operating Deficit (IOD)
- **New Look at the Market**
 - Rents (HUD-92273)
 - Expenses (HUD-92274)
 - Final HUD-92264
 - Document significant variances



METHODOLOGY & FORMAT

FIRM COMMITMENT STAGE

■ Invitation Letter

- Need to Review
- Address items of concern from HUD
- Any additional support requested?

■ Appraisal Review Checklist

- Content
- Reference where to find
- <https://portal.hud.gov/hudportal/documents/huddoc?id=4430GHS GG.pdf>



COMMERCIAL SPACE SEE SECTION 7.7L THROUGH N

- **Rent Comparable Analysis**
 - **Typical Elements of Comparison:**
 - **Physical Conditions**
 - Size
 - Interior Finish
 - Amenities
 - Functionality
 - **Location**
 - Time-distance
 - Complimentary uses
 - **Visibility**
 - **Walkability / Parking**



COMMERCIAL SPACE

- Unit of Comparison:
 - Typically Price Per SF
 - Separate analysis for each type of space
 - Retail vs. Office
- **Minimum of 3 Comps**
 - Important to discuss active listings
- Impact of residential units on feeding demand for specific retail use types.

- Commercial Elements Comparison:
 - Commencement of lease
 - Term of lease
 - Expense responsibility (CAM, Reserves, taxes, utilities)
 - Triple Net (NNN)
 - Modified Gross
 - Full Service (Gross)
 - Tenant improvement (TI) allowance

- Field Work-Sourcing Comparable Rents:
 - Developer or management company portfolio
 - Contact local brokers / appraisers
 - Database of previous projects
 - Call from signs / listings
 - National sites for smaller towns:
<http://www.loopnet.com/>,
www.remaxcommercial.com/,
<http://commercial.century21.com>

- **Rental revenue from commercial units is often required to be:**
 - tightly tied to actual contractual monthly rental rate from the borrower's certified rent roll,
 - with rent step-ups and escalations only included if documented in the contract,
 - and considered normal in the market.
- **Commercial Vacancy**
 - Minimum 20%
 - Local resources or inventory market



COMMERCIAL SPACE & INCOME LIMITATIONS

- 221(d)(4)
 - 25% of the Net Rentable Area
 - 15% of the Effective Gross Income

Commercial Space and Income Limitations			
SOA	Maximum Percentage of Rentable Area	Allowable Total Net	Maximum Percentage of Effective Gross Income
221(d)(4) and 231	25%		15%
220	25%		30%
223(f)	25%		20%



INITIAL OPERATING DEFICIT (IOD) SECTION 7.14

- Items Needed to Calculate IOD:
 - Gross Revenue
 - Operating Expenses
 - Fixed
 - Variable
 - Debt Service
 - Loan Amount, Interest Rate Breakdown
 - Absorption Projection
 - Supported by comps
 - Consider pending supply
 - 18 Month Max



INITIAL OPERATING DEFICIT (IOD) SECTION 7.14

■ Three Intervals:

■ Interval 1

- CO – Cost Certification
- Applicable expenses during lease-up

■ Interval 2

- Construction time + 2 months
- No more than 2 months, include Interest w/MIP for period

■ Interval 3

- Beginning of Amortization
- Include all Expenses; Fixed & Variable
- Include Reserves



INITIAL OPERATING DEFICIT (IOD)

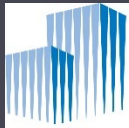
SECTION 7.14

Calculation of Initial Operating Deficit (IOD)													
Sample Apartments													
City, State													
262 units \$85.55 Var OE/mo													
Month	Units Rented	Cumultv Units Rented	Gross Income	Vacancy	EGI	Operating Expenses		NOI	Interest and MIP	Debt Service	Reserve for Replacement	Deficit	Interval
						Fixed	Variable (1)						
1	0	0	\$343,473	100%	\$0	\$0	\$0	\$0				\$0	One
2	0	0	\$343,473	100%	\$0	\$0	\$0	\$0				\$0	One
3	0	0	\$343,473	100%	\$0	\$0	\$0	\$0				\$0	One
4	0	0	\$343,473	100%	\$0	\$0	\$0	\$0				\$0	One
5	0	0	\$343,473	100%	\$0	\$0	\$0	\$0				\$0	One
6	0	0	\$343,473	100%	\$0	\$0	\$0	\$0				\$0	One
7	0	0	\$343,473	100%	\$0	\$0	\$0	\$0				\$0	One
8	0	0	\$343,473	100%	\$0	\$0	\$0	\$0				\$0	One
9	0	0	\$343,473	100%	\$0	\$0	\$0	\$0				\$0	One
10	0	0	\$343,473	100%	\$0	\$48,308	\$0	(\$48,308)				(\$48,308)	One
11	0	0	\$343,473	100%	\$0	\$48,308	\$0	(\$48,308)				(\$48,308)	One
12	0	0	\$343,473	100%	\$0	\$48,308	\$0	(\$48,308)				(\$48,308)	One
13	0	0	\$343,473	100%	\$0	\$48,308	\$0	(\$48,308)				(\$48,308)	One
14	28	28	\$343,473	89%	\$36,707	\$48,308	\$2,395	(\$13,996)				(\$13,996)	One
15	15	43	\$343,473	84%	\$56,372	\$48,308	\$3,679	\$4,385				\$4,385	One
16	15	58	\$343,473	78%	\$76,036	\$48,308	\$4,962	\$22,766				\$22,766	One
17	15	73	\$343,473	72%	\$95,700	\$48,308	\$6,245	\$41,147				\$41,147	One
18	15	88	\$343,473	66%	\$115,365	\$48,308	\$7,528	\$59,529				\$59,529	One
19	15	103	\$343,473	61%	\$135,029	\$48,308	\$8,812	\$77,910				\$77,910	One
20	15	118	\$343,473	55%	\$154,694	\$48,308	\$10,095	\$96,291				\$96,291	One
21	15	133	\$343,473	49%	\$174,358	\$48,308	\$11,378	\$114,672				\$114,672	One
22	15	148	\$343,473	44%	\$194,023	\$48,308	\$12,661	\$133,054				\$133,054	One
23	15	163	\$343,473	38%	\$213,687	\$48,308	\$13,945	\$151,435				\$151,435	One
24	15	178	\$343,473	32%	\$233,352	\$48,308	\$15,228	\$169,816				\$169,816	One
25	15	193	\$343,473	26%	\$253,016	\$48,308	\$16,511	\$188,197	\$266,531			(\$78,334)	Two
26	15	208	\$343,473	21%	\$272,681	\$85,765	\$17,794	\$169,121		\$158,369	\$5,458	\$5,294	Three
27	15	223	\$343,473	15%	\$292,345	\$85,765	\$19,078	\$187,503		\$158,369	\$5,458	\$23,676	Three
28	15	238	\$343,473	9%	\$312,010	\$85,765	\$20,361	\$205,884		\$158,369	\$5,458	\$42,057	Three
29	6	244	\$343,473	7%	\$319,876	\$85,765	\$20,874	\$213,236		\$158,369	\$5,458	\$49,409	Stabilized

Initial Operating Deficit: (\$285,562)

NOTES:

- 1.) Variable Expenses include management, electricity, water, and trash.
- 2.) Insurance begins in Month 26 - after construction is completed and amortization begins.
- 3.) Real Estate Taxes begin in Month 26 - at the beginning of amortization.
- 4.) No operating expenses are included for the first 9 months. It is assumed that taxes/other expenses are included in the escrow account.
- 5.) Leasing costs are projected to begin in Month 11 with the income from the first units leased received in Month 14.
- 6.) Reserves are based upon an annual amount of \$65,500 or \$5,458 per month.
- 7.) The annual debt service is based upon an amount of \$33,667,100 with a 40-year amortization and 4.50% interest rate, 0.25% MIP, and 0.89475% curtail rate for a total rate of 5.644754% yielding a debt service of \$158,369 per month.



Hodges & Pratt Co.
Real Estate Appraisers & Consultants

CONTACT INFORMATION

Nelson C. Pratt, MAI
Hodges & Pratt Co., PC
1528 Coleman Road
Knoxville, TN 37909
P: 865.673.4840 x. 1
C: 865.850.0550
nelson@hodgesandpratt.com
www.hodgesandpratt.com