



Rural Development

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TO: State Directors
Rural Development

ATTN: Community Program Director

FROM: Bruce W. Lammers /s/ *Bruce W. Lammers*
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SUBJECT: COVID-19 Interim Requirements of Appraisals for
Community Facility Applications

INTRODUCTION

The purpose of this Unnumbered Letter (UL) is to issue interim requirements for appraisals under the Community Facilities (CF) Guaranteed and Direct Loan Programs due to the current COVID-19 health emergency. This UL replaces all previous guidance issued on this subject.

7 CFR 1942.3, and 7 CFR 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.

During the COVID-19 health emergency, the Agency's goal is to be as flexible as possible regarding preparation of appraisals for Community Programs and WEP while protecting the health and safety of appraisers, Applicants, stakeholders and our staff. At the same time, we continue to place importance on sound valuation practices and oversight as well as portfolio risk mitigation.

EXPIRATION DATE:
April 30, 2021

FILING INSTRUCTIONS:
Community Programs

Requirements of Appraisals for Community Facility Applications

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.

APPRAISAL REPORTS

The Agency appraisal staff must concur in the appraisal assignment guidance prior to engagement of the appraiser to ensure the correct type of appraisal will be performed.

The Agency must receive a real estate appraisal report of the secured property as described below. The property's "As-is" and/or 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 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.

Property Condition to be Reported within the Appraisal

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 two years from the estimated date of closing, an updated appraisal will be required prior to closing the loan.

Requirements of Appraisals for Community Facility Applications

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. Intangible assets are not permissible security and are not to be considered as collateral for the Agency.

Entrepreneurial Profit represents the anticipated incentive over and above all other measurable costs of a property or project. It is highly important to recognize most projects constructed with financing from the Community Facilities program are special purpose properties which are build-to-suit for owner occupancy. While contractor / builder profit is typical as a hard cost reflected in the construction cost of the project, entrepreneurial profit is typically not a motivating factor in construction of special purpose properties. Given these factors inclusion of entrepreneurial profit may not be appropriate for build-to-suit special purpose properties.

When an appraiser determines entrepreneurial profit is appropriate as an inclusion within the cost approach, the amount of entrepreneurial profit must be determined through analysis of the market, independent of the subject property or analysis of projects in which the parties to the subject project are involved.

When entrepreneurial profit is appropriate, it must be estimated independently through market analysis with support included within the appraisal report.

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. No inflation of the FF&E will be authorized.

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.

Property Inspections for Appraisals

During the COVID-19 health emergency, the Agency will accept real estate appraisals based on the following levels of the subject property’s inspection performed by the Appraiser. It is noted

Requirements of Appraisals for Community Facility Applications

that although the reliability of the appraisal diminishes with the lessening of the level of property inspection by the Appraiser, all three options below can still result in credible appraisal results for use by the Agency:

1. Interior and Exterior Property Inspection

This is the most reliable level of property inspection to support a credible real estate appraisal. In this case, the Appraiser personally inspects both the interior and exterior of the subject property.

2. Exterior Only Property Inspection

If an Appraiser is unable to personally inspect the interior of the property, due to either State or local emergency health orders or due to the Appraiser's personal concerns for health and safety during the COVID-19 health emergency, an exterior only inspection performed by the Appraiser will be acceptable.

If it is necessary for an Appraiser to perform an exterior only level of property inspection, the Appraiser must notify the Agency and receive a concurrence by the Agency for that level of property inspection prior to the Appraiser performing the appraisal assignment.

If an exterior only inspection is the level of inspection for the development of the appraisal report, the Appraiser must request additional and supplemental data from parties to the transaction. This supplemental information would include items such as interior photographs and/or video of the subject property's interior areas, any available third-party inspection reports and any narrative descriptions of the interior from parties familiar with the interior components and condition of the property. Supplemental data could also include sources such as MLS systems and other internet based real estate sites. The Appraiser must report, in the appraisal report, all supplemental data utilized in the development of the appraisal report, including the source(s) of the supplemental data.

3. "Desktop Appraisal" (i.e.-no personal inspection of either interior or exterior, of the subject property by the Appraiser)

If an Appraiser is unable to personally inspect the subject property by either interior or exterior means due to either State or local emergency health orders or due to the Appraiser's personal concerns for health and safety during the COVID-19 health emergency, a "Desktop Appraisal" performed by the Appraiser will be acceptable.

If it is necessary for an Appraiser to perform a "Desktop Appraisal", i.e.- performing the appraisal assignment without any personal onsite inspection, either interior or exterior, the Appraiser must notify the Agency and receive a concurrence by the Agency for the performance of a "Desktop Appraisal" prior to the Appraiser performing the appraisal assignment.

If a "Desktop Appraisal" is performed, the Appraiser must request additional and supplemental data from parties to the transaction. This supplemental information would include items such as interior and exterior photographs and/or video of the subject property, any available third-party

Requirements of Appraisals for Community Facility Applications

inspection reports and any narrative descriptions of both the interior and exterior of the property from parties familiar with the components and condition of the property. Supplemental data may also include sources such as MLS systems and other internet based real estate data sites. The Appraiser must report, in the appraisal report, all supplemental data utilized in the development of the appraisal report, including the source(s) of the supplemental data.

Agency Review Appraiser Written Appraisal Guidance

It is strongly encouraged that prior to an external Appraiser being engaged to perform an appraisal assignment, whether the Borrower/Applicant hires the Appraiser or if the Agency hires the Appraiser for a servicing action, that the RD CF Specialist enter an Appraisal Services Request for a Collaboration and Technical Appraisal Review in the appraisal SharePoint system at https://usdagcc.sharepoint.com/sites/rd_rhub/pss/assign/SitePages/Home.aspx.

An Agency Review Appraiser will prepare written Appraisal Guidance that the Specialist will then provide to the Borrower/Applicant, or to RD procurement if the Agency is engaging the Appraiser for a servicing action, so it can be provided to the external Appraiser before performing the appraisal assignment.

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 refer to RD Instruction 3575-A. 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 two years old must be reappraised and the value must demonstrate the Agency is fully secured. All appraisals must be reviewed and accepted by an Agency review appraiser prior to issuing Guide 1 or 1a for a direct loan and prior to construction for a guaranteed loan.

The requirement of the need for an appraisal will be outlined in the Letter of Conditions or Conditional Commitment for Guarantee.

IMPLEMENTATION

To ensure 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.

Requirements of Appraisals for
Community Facility Applications

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.

Attachments:

Attachment A – Appraisal Report Format

Requirements of Appraisals for
Community Facility Applications

Attachment A
Page 1 of 3

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. The level of property inspection completed by the appraiser;
3. Factual information about the property;
4. Regional and neighborhood data, including presentation and analysis of competitive market area;
5. Description of the subject property;
6. Description of existing and planned (if applicable) improvements;
7. Highest and best use analysis;
8. A statement regarding any environmental issues, such as potential contamination of the property from hazardous substances, hazardous wastes, or petroleum products;
9. A cost approach analysis;
10. A sales comparison approach analysis of truly comparable facilities, preferably within the state or from similar competitive market areas;
11. An income approach analysis;
12. 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;
13. A reconciliation of the value indications derived from the included approaches to value consistent with SR 1-6;
14. 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; OR
- All supplemental data considered in development of the appraisal including any photographs, descriptions, and details provided by or obtained through a third-party.
- 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

Requirements of Appraisals for
Community Facility Applications

Attachment A
Page 2 of 3

- 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. If physical inspection of the property has not been completed by the appraiser, any third-party documentation obtained of floor plans, building layout including 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.

Requirements of Appraisals for
Community Facility Applications

Attachment A
Page 3 of 3

- 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.
- 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.