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- Valuation procedures for Establishing fair market rents

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CHAPTER 8. VALUATION INSTRUCTION PROCEDURES FOR ESTABLISHING FAIR MARKET RENTS

SECTION 8-1. DEFINITIONS.

- a. Fair Market Rents, established pursuant to this Chapter are the principal basis for determining the maximum gross rents which can be paid to a property owner under the Section 8 program for newly constructed or substantially rehabilitated units of specific sizes; i.e., zero bedroom, 1 bedroom, 2 bedroom, 3 bedroom, 4 bedroom, etc. These Fair Market Rents are further classified by structure type.
 - (1) The Fair Market Rents will be established and published in the Federal Register by HUD on an annual basis or more frequently when warranted.
 - (2) The Fair Market Rents (FMR) for family dwelling units are the rents which are published in the Federal Register. The Fair Market Rents for 0, 1, and 2 bedroom dwelling units designed for occupancy by the elderly or handicapped are the products of the rents published in the Federal Register for 0, 1, and 2 bedroom dwelling units and 1.05 rounded to the nearest whole dollar amount (round upward for fractional amounts of 50¢ or more).
- b. "Gross Rents" means rents which include all utilities (except telephone), whether paid to the utility company by the owner or the occupant, and ranges and refrigerators, parking, and all maintenance and management services. (The term Gross Rents as used in this Chapter is not the same as the definition in Section 881.102 of the Regulations.)
- c. The Fair Market Rent Limits (Maximum Gross Rents) are the products of the published Fair Market Rents and a given multiplier or multipliers.
 - (1) The multiplier for non-elderly dwelling units is 1.00 (or 100 percent).
 - (2) The multiplier for 0, 1, and 2 bedroom units designed for occupancy by the elderly or handicapped, is 1.05 (or 105 percent).
 - (3) Gross Rents may in some circumstances be permitted to exceed the Fair Market Rents by up to 10% (prerogative of the Field Office Director), or by up to 20% (prerogative of the Assistant Secretary-Commissioner).

- (8-1)
- (a) If neither of these prerogatives is exercised the Fair Market Rents (FMR) and the Fair Market Rent Limits (FMRL) are the same.
 - (b) When the Field Office Director's prerogative is exercised, the multipliers for determining the FMRL become 1.10 for family dwelling units and 1.05 x 1.10 or 1.155 for 0, 1, and 2 bedroom dwelling units designed for occupancy by the elderly or handicapped.
 - (c) When the Assistant Secretary-Commissioner's prerogative is exercised, the multipliers for determining the FMRL become 1.20 for family dwelling units and 1.05 x 1.20 or 1.26 for 0, 1, and 2 bedroom dwelling units designed for occupancy by the elderly or handicapped.
- (4) When calculating a Fair Market Rent Limit, round the product to the nearest whole dollar amount (round upward for fractional amounts of 50¢ or more).
- (5) Both of the aforementioned prerogatives are exercisable only on a proposal by proposal basis. Once the decision has been finally made to use a given multiplier for a project, the resulting Fair Market Rent Limits become the maximum gross rents permitted to be paid for initial occupancy of dwelling units which are assisted under Section 8. Subsequent to initial occupancy the rents are limited solely by the provisions of the Housing Assistance Payments Contract (HAPC). Once the HAPC is executed the FMR or FMRL are no longer relevant to those dwelling units.
- d. The Fair Market Rents for Congregate Housing dwelling units are the same as for non-congregate units of the same structure type.
 - e. The Fair Market Rents for Single-room Occupancy dwelling units are those for 0-bedroom units of the same structure type.
 - f. If Fair Market Rents for Mobile Homes are required, schedules for the affected market areas will have to be initiated by the Field Office. It is expected that in addition to market rental data, if available, Fair Market Rents for mobile homes will be based on data relating to space rental charges, utility expenses, and the carrying and financing charges required to be paid to amortize the cost of moderately

priced new mobile homes. Such Fair Market Rents will not be effective until they have been reviewed and approved at the Regional and Central Office levels, published for comment in the Federal Register, and then published in final form after expiration of the comment period.

- g. The Market Areas for the Fair Market Rents shall be the same as the areas for which public housing prototype costs are established.
- h. Structure Types. The applicable definitions of structure types are those contained in the HUD Minimum Property Standards (MPS).

8-2. RECOMMENDATIONS, APPROVALS AND PUBLICATION.

- a. Area/Insuring Offices. Schedules of Fair Market Rents (Form HUD-52507B) for newly constructed and substantially rehabilitated units (see Exhibit B) for those individual market areas which are within the jurisdiction of an Area Office for both public housing and mortgage insurance programs will be based upon the recommendations of the Area Office Director.
 - (1) The Fair Market Rent schedules for those market areas which are within the jurisdiction of an Area Office for public housing programs but are within the jurisdiction of an Insuring Office for mortgage insurance programs will be based on the recommendations of the Insuring Office Director.
 - (2) When the schedules are based on the recommendations of the Insuring Office Director, references herein to Area Office personnel and units are to be interpreted to mean the most nearly equivalent personnel and units of an Insuring Office.
- b. Regional Offices. The Regional Administrator and/or the Assistant Regional Administrator for Housing Production and Mortgage Credit will either concur or recommend modification of the Schedules of Fair Market Rents submitted by Field Office Directors.
- c. Central Office. The Assistant Secretary-Commissioner will approve the Fair Market Rent schedules either as recommended by the Field Office Director and approved by the Regional Administrator and/or ARA for HPMC or as modified after

revision by Central Office; the rents so approved will be published in the Federal Register for comment and then for effect after expiration of the comment period.

8-3. VALUATION BRANCH/SECTION ESTIMATES OF FAIR MARKET RENTS. Estimates of Fair Market Rents by unit size (by bedroom count), structure type and market area shall be made by the Valuation Branch/Section. Estimates for each unit size, by bedroom count, of a particular structure type in a particular market area shall be based on a sampling of the rents paid for comparable newly constructed dwelling units of modest design in that market area.

a. Hypothetical Units of Modest Design. The Fair Market Rents, which are to be published for general applicability, must be distinguished from the market comparison determination on the rents of a specific proposal where the references used in the adjustment of the rental comparables are the dwelling units as described in the proposal. In estimating Fair Market Rents for general applicability, there is no subject proposal. Consequently, it is necessary for the appraiser to hypothesize dwelling units to be used in lieu of specific subject units, as common reference points or standards in the comparison process, in accordance with the following criteria:

(1) Prescribed unit sizes in square feet and number of baths by unit type shall be as listed below:

0	1	2	3	4	(Bedrooms)
415	540	800	1050	1150	(Square feet)
1	1	1	1-1/2	2	(Baths)

(2) The following are the combinations of structure types and unit sizes by bedroom count for which estimates are required (except as noted below);

- (a) Detached, 2 through 4 bedrooms.
- (b) Semi-detached/row, 1 through 4 bedrooms.
- (c) Walk-up, 0 through 4 bedrooms.
- (d) Elevator, 0 through 2 bedrooms.

(8-3)

- 1 There may be structure types or combinations of unit size and structure type within certain market areas for which Fair Market Rents are not needed because of the unlikelihood of receiving proposals to which they would apply. Fair Market Rents for such units may be omitted. Any such deviations shall be accompanied by justification.
- 2 On the other hand, if there will be a need for Fair Market Rents for combinations of structure types and unit sizes other than those listed above, they should be added. Any such deviations shall be accompanied by justification.
- 3 The Fair Market Rents established for 4 bedroom dwelling units shall serve as the Fair Market Rents for units of 4 or more bedrooms.

(3) Assume dwelling units of modest design, suitable for the market and climate of the market area. Modest in this context means non-luxury: If in a particular market area a facility or service is typically included in new projects whose rentals are moderate (not in the luxury range), that facility or service may be considered to be within the bounds of modest design. (Too restrictive an interpretation of modest design will lead to the production of units that are only marketable to subsidized or assisted tenants. On the other hand, too liberal an interpretation will result in the imprudent expenditure of Federal funds.)

b. Market Rent Comparison. The samples of market rent comparables drawn for each unit size by bedroom count and structure type should be representative of newly constructed units of modest design throughout the major submarket area (or areas) within the Section 8 delineated market area. Each sample should consist of 12 or more market rent comparables from different projects or developments. If information in the data bank is found to be insufficient to provide the desired quantitative and qualitative sample for a particular combination of unit size and structure type, every feasible effort must be made to collect the desired data.

- (1) Rent comparables may be obtained from recently constructed rental projects, either conventionally financed or insured by HUD under Sections 207, 220, 221(d)(3), 221(d)(4), and 231.

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- (8-3)
- (a) Caution should be exercised in using HUD insured units as comparables since, due to rent formula restrictions, they may not accurately reflect the level of market rents.
 - (b) Subsidized or assisted rental units are not to be used as rent comparables.
 - (c) Since rent comparables for detached units are not generally found in project aggregations, they must be obtained individually, unit by unit.
 - (d) The rent comparables comprising each sample pertaining to a particular combination of unit size and structure type shall be entered on Form HUD 52507A, Determination of Fair Market Rent (see Exhibit A).
- (2) Adjustments shall be made to each comparable for differences between the hypothetical standard unit and each comparable in (a) number of baths, (b) utilities and services furnished, (c) unit size, and (d) time and trend.
- (a) Time and trend is a combined adjustment for the lapse in time from the effective date of the comparable rent (i.e., the dates those rents were found to be in effect) to the current date and a trend projected from the current date to a date two years past the date the Schedule of Fair Market Rents is expected to be published for effect in final form in the Federal Register. Generally, you should expect it to take 4 months beyond the month in which you begin work on the Fair Market Rents to their publication in final form. This allows time for the preparation of the schedules, review at the Regional and Central Office levels, publication for comment in the Federal Register, and evaluation of comments received. Two years of the trend adjustment allows time for processing and construction. Therefore, the trend period is 2 years and 4 months or 2-1/3 years.
 - (b) The Fair Market Rent Limits derived from the published Fair Market Rents will apply without further adjustment regardless of the anticipated length of the processing and construction periods for a particular proposal.

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- (8-3) (c) The anticipated length of the processing and construction periods for a particular proposal will be taken into account by the appraiser when he estimates the market rental values of the dwelling units.
- (d) (See paragraph 8-5 for a detailed discussion of trend factors.)

(3) It is important to carefully consider the utilities and services included in the comparable rents. This applies to all structure types. However, it is especially important for detached units, since they are customarily rented on the basis of the tenant paying all utilities. They are also frequently rented with the expectation that the tenant will supply some of the maintenance. Adequate adjustments must be made for all such exclusions since the Fair Market Rents must include all essential utilities and services.

(4) Generally, other adjustments will not be required. However, when in the opinion of the appraiser other adjustments are necessary, he should enter all such adjustments in aggregate under "other" and explain the entry in a footnote. If, for example, a comparable is used that is more than 1 or 2 years old, an adjustment for age should be included under "other." Note that the description of the comparable includes year built.

c. Initial Estimates of Fair Market Rents.

(1) Adjusted Rentals. The adjusted rentals rounded to the nearest whole dollar will have a range from the lowest to the highest which could, for example, be \$168 to \$193 for a 1-bedroom walkup unit. The desired rental limit within this range is one that would allow the rental of a substantial portion, but not all, of the units represented by the sample. The desired initial estimate is the adjusted comparable rent which is closest to the 75th percentile of the sample with the adjusted rentals arrayed in ascending order.

(2) Preparation.

(a) List the adjusted comparable rents within each sample by their magnitude, beginning with the lowest at the top of the list and ending with the highest at the bottom (see Item E. of Exhibit A, Form HUD-52507A).

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- (8-3)
- (b) Multiply the number of comparables comprising the sample (12 or more) by .75.
 - (c) Round the result to the nearest whole number (round upward for a fraction of .5 or more).
 - (d) Select the comparable which is in the position (counting from the top of the list) which corresponds to the number just obtained.
 - (e) Assume a sample composed of 14 comparables:
 $14 \times .75 = 10.5$; 10.5 rounded yields 11.
 - (f) Assume further that the adjusted rent for the eleventh comparable from the top of the list of adjusted rents for 1 bedroom walk-up units is \$186.
 - (g) This amount shall be selected as the initial estimate of the Fair Market Rent for 1 bedroom walk-up units in the subject market area.

d. Preparing Schedules of Fair Market Rents.

- (1) Enter the initial estimates of Fair Market Rents for each market area on a Schedule of Fair Market Rents (see Exhibit B, Form HUD-52507B) in rows corresponding to the structure types and in columns corresponding to the sizes by bedroom count.
 - (a) The estimated effective date designated should be 4 months after the month in which the Valuation Branch begins to collect and analyze data for the purpose of preparing new or revised Schedules of Fair Market Rents.
 - (b) This is to allow time for the preparation of new or revised schedules, review at the Regional and Central Office levels, publication for comment in the Federal Register, and evaluation of the comments received.

- (8-3) (2) Examine the schedules for each market area.
- (a) Check whether the progressions of rentals from bedroom size to bedroom size and from structure type to structure type are logical and reasonably consistent.
 - (b) The rent schedules should exhibit within columns a logical progression commensurate with the relative differences in the costs of producing units in the four structure classifications.
 - (c) The detached rents should be higher than the semi-detached rents and the semi-detached/row rents should be higher than the walk-up rents.
 - (d) The rents for elevator units should be higher than those for walk-up units, but they should not extend into the luxury range.
- (3) Carefully identify those rentals in the schedule that appear reasonable and are well supported by relevant market data. Then adjust all other rentals in the schedule as may be necessary by interpolation. The Appraiser may project rents for those combinations of unit size and structure type for which revisions are needed based on the relative differences in the costs of producing units in the four structure classifications or on some other logical and defensible basis. The Appraiser shall indicate methodology used and submit supporting documentation with the recommended schedules of Fair Market Rents as required by Paragraph 8-4 of this Handbook.

For example: A 2BR unit in structure type A has a substantiated Fair Market Rent based on market comparables of \$200 per month; a 2BR unit in structure type B has a maintenance and utilities expense which is \$10 per month higher than for the 2BR unit in structure type A, and a total estimated production cost which is \$3,000 higher than for the 2BR unit of structure type A. The Fair Market Rent for the 2BR unit of structure type B could be projected as follows:

2BR (Type A) Fair Market Rent	\$200
Difference in maintenance and utilities	10
Debt service on \$3,000 (@8.5% + .5% MIP 30 year term) $\$3,000 \times 9.73\% + 12 =$	<u>24</u>

2BR (Type B) Fair Market Rent	\$234
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- (8-3) (4) A straight rent formula or cost type approach should be avoided except in those rare instances where market data are lacking even for walk-up units and a straight rent formula or cost type approach is the only practical method available.
- (5) The estimation of Fair Market Rents for detached and semi-detached/row units is frequently more difficult than for other structure classifications. In assessing the acceptability of Fair Market Rents applicable to detached or semi-detached/row units, the total housing expense reported in Item 14 of Form FHA-2900-2 for modestly priced, proposed and recently constructed sales housing may be a useful reference, since the Fair Market Rents could not reasonably be expected to be lower than the total housing expense of an owner occupant.
- (6) Acceptable schedules of Fair Market Rents are expected to be sufficient to induce private entrepreneurs to produce units for lease under Section 8, but not high enough to support the production cost of inefficient developers or to encourage the production of units that are not modest in design.
- (7) It should be noted that the Conference Report on the HCD Act of 1974 contains the following statement with regard to the establishment of Fair Market Rents: "The conferees believe that the establishment of realistic fair market rentals will be a prime factor in the success or failure of the new housing assistance program. In establishing such rentals, the HUD Secretary is expected to take into account factual data, analyses, and recommendations from community sources familiar with prevailing rents and costs in various market areas; and he should take into account the need to provide housing with suitable amenities and sound architectural design."
- (8) The appraiser should carefully consider all comments and data received from community sources; however, the Fair Market Rents should not be altered or revised unless his analysis of these and other data sources clearly indicates that alterations or revisions are warranted.

- 8-4. SUBMISSION OF FIELD OFFICE RECOMMENDED SCHEDULES OF FAIR MARKET RENTS. The schedules of Fair Market Rents recommended by the Field Office Director must be mailed to the Director, Office of Underwriting Standards, through the ARA for HPMC. The submission shall include copies of all relevant forms (HUD-52507A and HUD-52507B) and supporting data.
- 8-5. TREND FACTORS.
- a. New or revised estimates of Fair Market Rents shall be made at least annually following the above instructions; except that no more often than every other year, a revision may be made by application of trend factors to the Fair Market Rents to reflect the expected changes in the rentals of newly constructed dwelling units of modest design from the "Trended To" date of the Fair Market Rents to the "Trended To" date of the revised Fair Market Rents.
 - b. Generally the best data for estimating rental trend factors are the observed changes in the rents of newly constructed rental units over the past 1 to 2 or more years.
 - c. However, when judging the adequacy of the data relating to past performance as a forecast of future performance, the appraiser should also consider the rates of change in construction costs, utility expenses, financing charges, etc., and the effect they are likely to have on the rates of change of market rents.
 - d. Percentage changes in construction costs and utility expenses cannot be translated directly into percentage changes in rent. They must be adjusted by multiplying them by the percentage that that component is of the total rent. They should also be adjusted to reflect the portion of the increased cost that you would expect unsubsidized tenants to be willing and able to absorb in that market area.
- 8-6. ANNUAL REVISION. An annual reanalysis and updating of the schedules shall be initiated by the Valuation Branch/Section on September 1 of each year. Updated and/or revised schedules shall be submitted to the Director, Office of Underwriting Standards, on or before November 15 of each year. New, revised, or updated schedules shall not be effective until both Regional and Central Office approvals have been obtained and the new, revised, or updated schedules have been published in the Federal Register for comment and then for effect after expiration of the comment period.

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- 8-7. SPECIAL REVISION. A special revision of one or more of the schedules may be initiated by a Field Office at any time. Revisions may involve only some or all of the entries comprising a schedule for a particular market area. Revised schedules must be supported by current market rent comparables. A revised schedule shall not be effective until both Regional and Central Office approvals have been obtained and the revised schedules have been published in the Federal Register for comment and then for effect after expiration of the comment period.