



Real Estate Analysis Division
2007 Real Estate Analysis Rules

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1 **§1.31 General Provisions**

2 (a) **Purpose.** The Rules in this subchapter apply to the underwriting, market analysis, appraisal,
 3 environmental site assessment, property condition assessment, and reserve for replacement standards
 4 employed by the Texas Department of Housing and Community Affairs (the "Department" or "TDHCA").
 5 This chapter provides rules for the underwriting review of an affordable housing development's financial
 6 feasibility and economic viability that ensures the most efficient allocation of resources while promoting
 7 and preserving the public interest in ensuring the long-term health of the Department's portfolio. In
 8 addition, this chapter guides the underwriting staff in making recommendations to the Executive Award
 9 and Review Advisory Committee ("the Committee"), Executive Director, and TDHCA Governing Board
 10 ("the Board") to help ensure procedural consistency in the determination of Development feasibility
 11 (§§2306.0661(f) and 2306.6710(d), Texas Government Code). Due to the unique characteristics of each
 12 development the interpretation of the rules and guidelines described in this subchapter is subject to the
 13 discretion of the Department and final determination by the Board.

14 (b) **Definitions.** Many of the terms used in this subchapter are defined in the Department's Housing
 15 Tax Credit Program Qualified Allocation Plan and Rules, known as the "QAP", as proposed. Those terms
 16 that are not defined in the QAP or which may have another meaning when used in subchapter B of this
 17 title, shall have the meanings set forth in this subsection unless the context clearly indicates otherwise.

18 (1) **Affordable Housing**--Housing that has been funded through one or more of the Department's
 19 programs or other local, state or federal programs or has at least one unit that is restricted in the rent
 20 that can be charged either by a Land Use Restriction Agreement or other form of Deed Restriction.

21 (2) **Bank Trustee**--A bank authorized to do business in this state, with the power to act as
 22 trustee.

23 (3) **Cash Flow**--The funds available from operations after all expenses and debt service required
 24 to be paid has been considered.

25 (4) **Credit Underwriting Analysis Report**--Sometimes referred to as the "Report." A decision
 26 making tool used by the Department and Board containing a synopsis and reconciliation of the
 27 application information submitted by the Applicant.

28 (5) **Comparable Unit**--A Unit, when compared to the subject Unit, similar in overall condition,
 29 unit amenities, utility structure, and common amenities, and

30 (A) for purposes of calculating the inclusive capture rate targets the same population and is
 31 likely to draw from the same demand pool;

32 (B) for purposes of estimating the Restricted Market Rent targets the same population and is
 33 similar in net rentable square footage and number of bedrooms; or

34 (C) for purposes of estimating the subject Unit market rent does not have any income or rent
 35 restrictions and is similar in net rentable square footage and number of bedrooms.

36 (6) **Contract Rent**--Maximum Rent Limits based upon current and executed rental assistance
 37 contract(s), typically with a federal, state or local governmental agency.

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38 (7) **DCR--Debt Coverage Ratio.** Sometimes referred to as the "Debt Coverage" or "Debt Service
39 Coverage." A measure of the number of times loan principal and interest are covered by Net Operating
40 Income.

41 (8) **Development--**Sometimes referred to as the "Subject Development." Multi-unit residential
42 housing that meets the affordability requirements for and requests or has received funds from one or
43 more of the Department's sources of funds.

44 (9) **EGI--Effective Gross Income.** The sum total of all sources of anticipated or actual income for
45 a rental Development less vacancy and collection loss, leasing concessions, and rental income from
46 employee-occupied units that is not anticipated to be charged or collected.

47 (10) **ESA--Environmental Site Assessment.** An environmental report that conforms with the
48 Standard Practice for Environmental Site Assessments: Phase I Assessment Process (ASTM Standard
49 Designation: E 1527) and conducted in accordance with the Department's Environmental Site Assessment
50 Rules and Guidelines in §1.35 of this subchapter as it relates to a specific Development.

51 (11) **First Lien Lender--**A lender whose lien has first priority.

52 (12) **Gross Program Rent--**Sometimes called the "Program Rents." Maximum Rent Limits based
53 upon the tables promulgated by the Department's division responsible for compliance by program and by
54 county or Metropolitan Statistical Area ("MSA") or Primary Metropolitan Statistical Area ("PMSA").

55 (13) **Market Analysis--**Sometimes referred to as "Market Study." An evaluation of the economic
56 conditions of supply, demand and rental rates or pricing conducted in accordance with the Department's
57 Market Analysis Rules and Guidelines in §1.33 of this subchapter as it relates to a specific Development.

58 (14) **Market Rent--**The unrestricted rent concluded by the Market Analyst for a particular unit
59 type and size after adjustments are made to rents charged by owners of Comparable Units.

60 (15) **NOI--Net Operating Income.** The income remaining after all operating expenses, including
61 replacement reserves and taxes have been paid.

62 (16) **Primary Market--**Sometimes referred to as "Primary Market Area" or "Submarket" or "PMA".
63 The area defined by the Qualified Market Analyst as described in §1.33(d)(8) of this title from which a
64 proposed or existing Development is most likely to draw the majority of its prospective tenants or
65 homebuyers.

66 (17) **PCA--Property Condition Assessment.** Sometimes referred to as "Physical Needs Assessment,"
67 "Project Capital Needs Assessments," "Property Condition Report," or "Property Work Write-Up." An
68 evaluation of the physical condition of the existing property and evaluation of the cost of rehabilitation
69 conducted in accordance with the Department's Property Condition Assessment Rules and Guidelines in
70 §1.36 of this title as it relates to a specific Development.

71 (18) **Rent Over-Burdened Households--**Non-elderly households paying more than 35% of gross
72 income towards total housing expenses (unit rent plus utilities) and elderly households paying more than
73 40% of gross income towards total housing expenses.

74 (19) **Reserve Account--**An individual account:

75 (A) Created to fund any necessary repairs for a multifamily rental housing development; and

76 (B) Maintained by a First Lien Lender or Bank Trustee.

77 (20) **Restricted Market Rent--**The restricted rent concluded by the Market Analyst for a
78 particular unit type and size after adjustments are made to rents charged by owners of Comparable
79 Units with the same rent and income restrictions.

80 (21) **Secondary Market--**Sometimes referred to as "Secondary Market Area". The area defined by
81 the Qualified Market Analyst as described in §1.33(d)(7) of this title.

82 (22) **Supportive Housing--**Sometimes referred to as "Transitional Housing." Rental housing
83 intended solely for occupancy by individuals or households transitioning from homelessness or abusive
84 situations to permanent housing and typically consisting primarily of efficiency units.

85 (23) **Sustaining Occupancy--**The occupancy level at which rental income plus secondary income
86 is equal to all operating expenses and mandatory debt service requirements for a Development.

87 (24) **TDHCA Operating Expense Database--**Sometimes referred to as "TDHCA Database." A
88 consolidation of recent actual operating expense information collected through the Department's Annual
89 Owner Financial Certification process and published on the Department's web site.

90 (25) **Underwriter--**The author(s), as evidenced by signature, of the Credit Underwriting Analysis
91 Report.

92 (26) **Unstabilized Development--** A Development with Comparable Units that has been approved
93 for funding by the TDHCA Board or is currently under construction or has not maintained a 90%
94 occupancy level for at least 12 consecutive months following construction completion.

95 (27) **Utility Allowance--**The estimate of tenant-paid utilities, based either on the most current
96 HUD Form 52667, "Section 8, Existing Housing Allowance for Tenant-Furnished Utilities and Other

97 Services," provided by the local entity responsible for administering the HUD Section 8 program with
98 most direct jurisdiction over the majority of the buildings existing or a documented estimate from the
99 utility provider proposed in the Application. Documentation from the local utility provider to support an
100 alternative calculation can be used to justify alternative Utility Allowance conclusions but must be
101 specific to the Subject Development and consistent with the building plans provided.

102 (28) **Work Out Development**--A financially distressed Development seeking a change in the
103 terms of Department funding or program restrictions based upon market changes.

104 (c) **Appeals.** Certain programs contain express appeal options. Where not indicated, 10 Tex. Admin.
105 Code §§1.7 and 1.8 include general appeal procedures. In addition, the Department encourages the use
106 of Alternative Dispute Resolution methods as outlined in 10 TAC §1.17.
107

108 **§1.32 Underwriting Rules and Guidelines**

109 (a) **General Provisions.** The Department Governing Board has authorized the development of these
110 rules under its authority under §2306.148, Texas Government Code. The rules provide a mechanism to
111 produce consistent information in the form of an Underwriting Report to provide interested parties
112 information the Board relies upon in balancing the desire to assist as many Texans as possible by
113 providing no more financing than necessary and have independent verification that Developments are
114 economically feasible. The Report generated in no way guarantees or purports to warrant the actual
115 performance, feasibility, or viability of the Development by the Department.

116 (b) **Report Contents.** The Report provides an organized and consistent synopsis and reconciliation of
117 the application information submitted by the Applicant.

118 (c) **Recommendations in the Report.** The conclusion of the Report includes a recommended award
119 of funds or allocation of Tax Credits based on the lesser amount calculated by the program limit method
120 (if applicable), gap/DCR method, or the amount requested by the Applicant as further described in
121 paragraphs (1) - (3) of this subsection, and states any feasibility conditions to be placed on the award.

122 (1) **Program Limit Method.** For Developments requesting Housing Tax Credits, this method is
123 based upon calculation of Eligible Basis after applying all cost verification measures and program limits
124 as described in this section. The Applicable Percentage used is as defined in the QAP. For Developments
125 requesting funding through a Department program other than Housing Tax Credits, this method is based
126 upon calculation of the funding limit based on current program rules at the time of underwriting.

127 (2) **Gap/DCR Method.** This method evaluates the amount of funds needed to fill the gap created
128 by total development cost less total non-Department-sourced funds or Tax Credits. In making this
129 determination, the Underwriter resizes any anticipated deferred developer fee down to zero before
130 reducing the amount of Department funds or Tax Credits. In the case of Housing Tax Credits, the
131 syndication proceeds needed to fill the gap in permanent funds are divided by the syndication rate to
132 determine the amount of Tax Credits. In making this determination, the Department adjusts the
133 permanent loan amount and/or any Department-sourced loans, as necessary, such that it conforms to
134 the DCR standards described in this section.

135 (3) **The Amount Requested.** The amount of funds that is requested by the Applicant as reflected
136 in the application documentation.

137 (d) **Operating Feasibility.** The operating financial feasibility of Developments funded by the
138 Department is tested by adding total income sources and subtracting vacancy and collection losses and
139 operating expenses to determine Net Operating Income. This Net Operating Income is divided by the
140 annual debt service to determine the Debt Coverage Ratio. The Underwriter characterizes a
141 Development as infeasible from an operational standpoint when the Debt Coverage Ratio does not meet
142 the minimum standard set forth in paragraph (4)(D) of this subsection. The Underwriter may choose to
143 make adjustments to the financing structure, such as lowering the debt and increasing the deferred
144 developer fee that could result in a re-characterization of the Development as feasible based upon
145 specific conditions set forth in the Report.

146 (1) **Income.** In determining the Year 1 proforma, the Underwriter evaluates the
147 reasonableness of the Applicant's income estimate by determining the appropriate rental rate per unit
148 based on contract, program and market factors. Miscellaneous income and vacancy and collection loss
149 limits as set forth in subparagraphs (B) and (C) of this paragraph, respectively, are applied unless well-
150 documented support is provided.

151 (A) **Rental Income.** The Program Rent less Utility Allowances or Market Rent or Restricted
152 Market Rent or Contract Rent is utilized by the Underwriter in calculating the rental income for
153 comparison to the Applicant's estimate in the application. Where multiple programs are funding the
154 same units, Contract Rents are used, if applicable. If Contract Rents do not apply, the lowest Program

155 Rents less Utility Allowance ("net Program Rent") or Market Rents or Restricted Market Rent, as
156 determined by the Market Analysis that are lower than the net Program Rents, are utilized.
157 (i) **Market Rents.** The Underwriter reviews the attribute adjustment matrix of
158 Comparable Units by unit size provided by the Market Analyst and determines if the adjustments and
159 conclusions made are reasoned and well documented. The Underwriter uses the Market Analyst's
160 conclusion of adjusted Market Rent by unit, as long as the proposed Market Rent is reasonably justified
161 and does not exceed the highest existing unadjusted market comparable rent. Random checks of the
162 validity of the Market Rents may include direct contact with the comparable properties. The Market
163 Analyst's attribute adjustment matrix should include, at a minimum, adjustments for location, size,
164 amenities, and concessions as more fully described in §1.33 of this title.
165 (ii) **Restricted Market Rent.** The Underwriter reviews the attribute adjustment matrix of
166 Comparable Units by unit size and income and rent restrictions provided by the Market Analyst and
167 determines if the adjustments and conclusions made are reasoned and well documented. The
168 Underwriter uses the Market Analyst's conclusion of adjusted Restricted Market Rent by unit, as long as
169 the proposed Restricted Market Rent is reasonably justified and does not exceed the highest existing
170 unadjusted market comparable restricted rent. Random checks of the validity of the Restricted Market
171 Rents may include direct contact with the comparable properties. The Market Analyst's Attribute
172 Adjustment Matrix should include, at a minimum, adjustments for location, size, amenities, and
173 concessions as more fully described in §1.33 of this title.
174 (iii) **Program Rents less Utility Allowance.** The Underwriter reviews the Applicant's
175 proposed rent schedule and determines if it is consistent with the representations made in the
176 remainder of the application. The Underwriter uses the Program Rents as promulgated by the
177 Department's division responsible for compliance for the year that is most current at the time the
178 underwriting begins. When underwriting for a simultaneously funded competitive round, all of the
179 applications are underwritten with the rents promulgated for the same year. Program Rents are reduced
180 by the Utility Allowance. The Utility Allowance figures used are determined based upon what is
181 identified in the application by the Applicant as being a utility cost paid by the tenant and upon other
182 consistent documentation provided in the application.
183 (I) Units must be individually metered for all utility costs to be paid by the tenant.
184 (II) Gas utilities are verified on the building plans and elsewhere in the application
185 when applicable.
186 (III) Trash allowances paid by the tenant are rare and only considered when the
187 building plans allow for individual exterior receptacles.
188 (IV) Refrigerator and range allowances are not considered part of the tenant-paid
189 utilities unless the tenant is expected to provide their own appliances, and no eligible appliance costs
190 are included in the development cost breakdown.
191 (iv) **Contract Rents.** The Underwriter reviews submitted rental assistance contracts to
192 determine the Contract Rents currently applicable to the Development. Documentation supporting the
193 likelihood of continued rental assistance is also reviewed. The underwriting analysis will take into
194 consideration the Applicant's intent to request a Contract Rent increase. At the discretion of the
195 Underwriter, the Applicant proposed rents may be used in the underwriting analysis with the
196 recommendations of the Report conditioned upon receipt of final approval of such increase.
197 (B) **Miscellaneous Income.** All ancillary fees and miscellaneous secondary income, including
198 but not limited to late fees, storage fees, laundry income, interest on deposits, carport rent, washer and
199 dryer rent, telecommunications fees, and other miscellaneous income, are anticipated to be included in
200 a \$5 to \$15 per unit per month range. Exceptions may be made at the discretion of the Underwriter for
201 garage income, pass-through utility payments, pass-through water, sewer and trash payments, cable
202 fees, congregate care/assisted living/elderly facilities, and child care facilities.
203 (i) Exceptions must be justified by operating history of existing comparable properties.
204 (ii) The Applicant must show that the tenant will not be required to pay the additional
205 fee or charge as a condition of renting an apartment unit and must show that the tenant has a
206 reasonable alternative.
207 (iii) The Applicant's operating expense schedule should reflect an offsetting cost
208 associated with income derived from pass-through utility payments, pass-through water, sewer and trash
209 payments, and cable fees.
210 (iv) Collection rates of exceptional fee items will generally be heavily discounted.
211 (v) If the total secondary income is over the maximum per unit per month limit, any cost
212 associated with the construction, acquisition, or development of the hard assets needed to produce an
213 additional fee may also need to be reduced from Eligible Basis for Tax Credit Developments as they may,

214 in that case, be considered to be a commercial cost rather than an incidental to the housing cost of the
 215 Development.

216 (C) **Vacancy and Collection Loss.** The Underwriter uses a vacancy rate of 7.5% (5% vacancy
 217 plus 2.5% for collection loss) unless the Market Analysis reflects a higher or lower established vacancy
 218 rate for the area. Elderly and 100% project-based rental subsidy Developments and other well
 219 documented cases may be underwritten at a combined 5% at the discretion of the Underwriter if the
 220 historical performance reflected in the Market Analysis is consistently higher than a 95% occupancy rate.

221 (D) **Effective Gross Income.** The Underwriter independently calculates EGI. If the EGI figure
 222 provided by the Applicant is within 5% of the EGI figure calculated by the Underwriter, the Applicant's
 223 figure is characterized as reasonable in the Report; however, for purposes of calculating DCR the
 224 Underwriter will maintain and use its independent calculation unless the Applicant's proforma meets the
 225 requirements of paragraph (3) of this subsection.

226 (2) **Expenses.** In determining the Year 1 proforma, the Underwriter evaluates the reasonableness
 227 of the Applicant's expense estimate by line item comparisons based upon the specifics of each
 228 transaction, including the type of Development, the size of the units, and the Applicant's expectations as
 229 reflected in their proforma. Historical stabilized certified or audited financial statements of the
 230 Development or Third Party quotes specific to the Development will reflect the strongest data points to
 231 predict future performance. The Department's database of property in the same location or region as the
 232 proposed Development also provides heavily relied upon data points. Data from the Institute of Real
 233 Estate Management's (IREM) most recent Conventional Apartments-Income/Expense Analysis book for the
 234 proposed Development's property type and specific location or region may be referenced. In some cases
 235 local or project-specific data such as Public Housing Authority ("PHA") Utility Allowances and property
 236 tax rates are also given significant weight in determining the appropriate line item expense estimate.
 237 Finally, well documented information provided in the Market Analysis, the application, and other sources
 238 may be considered.

239 (A) **General and Administrative Expense.** General and Administrative Expense includes all
 240 accounting fees, legal fees, advertising and marketing expenses, office operation, supplies, and
 241 equipment expenses. The underwriting tolerance level for this line item is 20%.

242 (B) **Management Fee.** Management Fee is paid to the property management company to
 243 oversee the effective operation of the property and is most often based upon a percentage of Effective
 244 Gross Income as documented in the management agreement contract. Typically, 5% of the Effective
 245 Gross Income is used, though higher percentages for rural transactions that are consistent with the
 246 TDHCA Database can be concluded. Percentages as low as 3% may be utilized if documented by a fully
 247 executed management contract agreement with an acceptable management company. The Underwriter
 248 will require documentation for any percentage difference from the 5% of the Effective Gross Income
 249 standard.

250 (C) **Payroll and Payroll Expense.** Payroll and Payroll Expense includes all direct staff payroll,
 251 insurance benefits, and payroll taxes including payroll expenses for repairs and maintenance typical of a
 252 conventional development. It does not, however, include direct security payroll or additional supportive
 253 services payroll. The underwriting tolerance level for this line item is 10%.

254 (D) **Repairs and Maintenance Expense.** Repairs and Maintenance Expense includes all repairs
 255 and maintenance contracts and supplies. It should not include extraordinary capitalized expenses that
 256 would result from major renovations. Direct payroll for repairs and maintenance activities are included
 257 in payroll expense. The underwriting tolerance level for this line item is 20%.

258 (E) **Utilities Expense (Gas & Electric).** Utilities Expense includes all gas and electric energy
 259 expenses paid by the owner. It includes any pass-through energy expense that is reflected in the EGI.
 260 The underwriting tolerance level for this line item is 30%.

261 (F) **Water, Sewer and Trash Expense.** Water, Sewer and Trash Expense includes all water,
 262 sewer and trash expenses paid by the owner. It would also include any pass-through water, sewer and
 263 trash expense that is reflected in the EGI. The underwriting tolerance level for this line item is 30%.

264 (G) **Insurance Expense.** Insurance Expense includes any insurance for the buildings,
 265 contents, and liability but not health or workman's compensation insurance. The underwriting tolerance
 266 level for this line item is 30%.

267 (H) **Property Tax.** Property Tax includes all real and personal property taxes but not payroll
 268 taxes. The underwriting tolerance level for this line item is 10%.

269 (i) The per unit assessed value will be calculated based on the capitalization rate
 270 published on the county taxing authority's website. If the county taxing authority does not publish a
 271 capitalization rate on the internet, a capitalization rate of 10% will be used or comparable assessed
 272 values may be used in evaluating this line item expense.

273 (ii) Property tax exemptions or proposed payment in lieu of tax agreement (PILOT) must
 274 be documented as being reasonably achievable if they are to be considered by the Underwriter. At the
 275 discretion of the Underwriter, a property tax exemption that meets known federal, state and local laws
 276 may be applied based on the tax-exempt status of the Development Owner and its Affiliates.

277 (I) **Reserves.** Reserves include annual reserve for replacements of future capitalizable
 278 expenses as well as any ongoing additional operating reserve requirements. The Underwriter includes
 279 minimum reserves of \$250 per unit for new construction and \$300 per unit for all other Developments.
 280 The Underwriter may require an amount above \$300 for Developments other than new construction
 281 based on information provided in the PCA. Higher levels of reserves also may be used if they are
 282 documented in the financing commitment letters.

283 (J) **Other Expenses.** The Underwriter will include other reasonable and documented
 284 expenses, not including depreciation, interest expense, lender or syndicator's asset management fees, or
 285 other ongoing partnership fees. Lender or syndicator's asset management fees or other ongoing
 286 partnership fees also are not considered in the Department's calculation of debt coverage. The most
 287 common other expenses are described in more detail in clauses (i) - (iv) of this subparagraph.

288 (i) **Supportive Services Expense.** Supportive Services Expense includes the documented
 289 cost to the owner of any non-traditional tenant benefit such as payroll for instruction or activities
 290 personnel. The Underwriter will not evaluate any selection points for this item. The Underwriter's
 291 verification will be limited to assuring any anticipated costs are included. For all transactions supportive
 292 services expenses are considered in calculating the Debt Coverage Ratio.

293 (ii) **Security Expense.** Security Expense includes contract or direct payroll expense for
 294 policing the premises of the Development. The Applicant's amount is typically accepted as provided. The
 295 Underwriter will require documentation of the need for security expenses that exceed 50% of the
 296 anticipated payroll expense estimate discussed in subparagraph (C) of this paragraph.

297 (iii) **Compliance Fees.** Compliance fees include only compliance fees charged by TDHCA.
 298 The Department's charge for a specific program may vary over time; however, the Underwriter uses the
 299 current charge per unit per year at the time of underwriting. For all transactions compliance fees are
 300 considered in calculating the Debt Coverage Ratio.

301 (iv) **Cable Television Expense.** Cable Television Expense includes fees charged directly
 302 to the owner of the Development to provide cable services to all units. The expense will be considered
 303 only if a contract for such services with terms is provided and income derived from cable television fees
 304 is included in the projected EGI. Cost of providing cable television in only the community building should
 305 be included in General and Administrative Expense as described in subparagraph (A) of this paragraph.

306 (K) The Department will communicate with and allow for clarification by the Applicant when
 307 the overall expense estimate is over 5% greater or less than the Underwriter's estimate. In such a case,
 308 the Underwriter will inform the Applicant of the line items that exceed the tolerance levels indicated in
 309 this paragraph, but may request additional documentation supporting some, none or all expense line
 310 items. If an acceptable rationale for the difference is not provided, the discrepancy is documented in
 311 the Report and the justification provided by the Applicant and the countervailing evidence supporting
 312 the Underwriter's determination is noted. If the Applicant's total expense estimate is within 5% of the
 313 final total expense figure calculated by the Underwriter, the Applicant's figure is characterized as
 314 reasonable in the Report; however, for purposes of calculating DCR the Underwriter will maintain and
 315 use its independent calculation unless the Applicant's Year 1 proforma meets the requirements of
 316 paragraph (3) of this subsection.

317 (3) **Net Operating Income.** NOI is the difference between the EGI and total operating expenses.
 318 If the Year 1 NOI figure provided by the Applicant is within 5% of the Year 1 NOI figure calculated by the
 319 Underwriter, the Applicant's figure is characterized as reasonable in the Report; however, for purposes
 320 of calculating the Year 1 DCR the Underwriter will maintain and use his independent calculation of NOI
 321 unless the Applicant's Year 1 EGI, Year 1 total expenses, and Year 1 NOI are each within 5% of the
 322 Underwriter's estimates.

323 (4) **Debt Coverage Ratio.** Debt Coverage Ratio is calculated by dividing Net Operating Income by
 324 the sum of loan principal and interest for all permanent sources of funds. Loan principal and interest, or
 325 "Debt Service," is calculated based on the terms indicated in the submitted commitments for financing.
 326 Terms generally include the amount of initial principal, the interest rate, amortization period, and
 327 repayment period. Unusual financing structures and their effect on Debt Service will also be taken into
 328 consideration.

329 (A) **Interest Rate.** The interest rate used should be the rate documented in the commitment
 330 letter.

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331 (i) Commitments indicating a variable rate must provide a detailed breakdown of the
332 component rates comprising the all-in rate. The commitment must also state the lender's underwriting
333 interest rate, or the Applicant must submit a separate statement executed by the lender with an
334 estimate of the interest rate as of the date of the statement.

335 (ii) The maximum rate allowed for a competitive application cycle is evaluated by the
336 Director of the Department's division responsible for Credit Underwriting Analysis Reports and posted to
337 the Department's web site prior to the close of the application acceptance period. Historically this
338 maximum acceptable rate has been at or below the average rate for 30-year U.S. Treasury Bonds plus
339 400 basis points.

340 (B) **Amortization Period.** The Department generally requires an amortization of not less than
341 30 years and not more than 50 years or an adjustment to the amortization structure is evaluated and
342 recommended. In non-Tax Credit transactions a lesser amortization period may be used if the
343 Department's funds are fully amortized over the same period.

344 (C) **Repayment Period.** For purposes of projecting the DCR over a 30-year period for
345 Developments with permanent financing structures with balloon payments in less than 30 years, the
346 Underwriter will carry forward Debt Service calculated based on a full amortization and the interest rate
347 stated in the commitment.

348 (D) **Acceptable Debt Coverage Ratio Range.** The acceptable Year 1 DCR range for all priority
349 or foreclosable lien financing plus the Department's proposed financing falls between a minimum of 1.15
350 to a maximum of 1.35. HOPE VI and USDA Rural Development transactions may underwrite to a DCR less
351 than 1.15 based upon documentation of acceptance from the lender.

352 (i) For Developments other than HOPE VI and USDA Rural Development transactions, if
353 the DCR is less than the minimum, the recommendations of the Report are conditioned upon a reduced
354 debt service and the Underwriter will make adjustments to the assumed financing structure in the order
355 presented in subclauses (I) - (III) of this clause.

356 (I) A reduction of the interest rate or an increase in the amortization period for
357 TDHCA funded loans;

358 (II) A reclassification of TDHCA funded loans to reflect grants, if permitted by
359 program rules;

360 (III) A reduction in the permanent loan amount for non-TDHCA funded loans based
361 upon the rates and terms in the permanent loan commitment letter as long as they are within the ranges
362 in subparagraphs (A) and (B) of this paragraph.

363 (ii) If the DCR is greater than the maximum, the recommendations of the Report are
364 conditioned upon an increase in the debt service and the Underwriter will make adjustments to the
365 assumed financing structure in the order presented in subclauses (I) - (III) of this clause.

366 (I) A reclassification of TDHCA funded grants to reflect loans, if permitted by
367 program rules;

368 (II) An increase in the interest rate or a decrease in the amortization period for
369 TDHCA funded loans;

370 (III) An increase in the permanent loan amount for non-TDHCA funded loans based
371 upon the rates and terms in the permanent loan commitment letter as long as they are within the ranges
372 in subparagraphs (A) and (B) of this paragraph.

373 (iii) For Housing Tax Credit Developments, a reduction in the recommended Tax Credit
374 allocation may be made based on the gap/DCR method described in subsection (c)(2) of this section.

375 (iv) Although adjustments in Debt Service may become a condition of the Report, future
376 changes in income, expenses, and financing terms could allow for an acceptable DCR.

377 (5) **Long Term Proforma.** The Underwriter will create a 30-year operating proforma.

378 (A) The base year projection utilized is the Underwriter's Year 1 EGI, Year 1 operating
379 expenses, and Year 1 NOI unless the Applicant's Year 1 EGI, Year 1 total operating expenses, and Year 1
380 NOI are each within 5% of the Underwriter's estimates.

381 (B) A 3% annual growth factor is utilized for income and a 4% annual growth factor is utilized
382 for expenses.

383 (C) Adjustments may be made to the Long Term Proforma if sufficient support
384 documentation is provided by the Applicant. Support may include

385 (i) documentation with terms for Project-based Rental Assistance or Operating Subsidy;

386 (ii) a fully executed management contract with clear terms;

387 (iii) documentation prepared and signed by the Central Appraisal District (CAD) with
388 jurisdiction over the Development indicating the appraisal methodology consistently employed by the

389 CAD and a ten-year history, beginning with the Application year, of tax rates for each taxing district with
390 jurisdiction over the Development; and
391 (iv) required reserve for replacement schedule prepared and signed by the proposed
392 permanent lender or equity provider. In no instance will the reserve for replacement figure included in
393 the Long Term Proforma be less than the minimum requirements as described in §1.37 of this title.
394 (e) **Development Costs.** The Development's need for permanent funds and, when applicable, the
395 Development's Eligible Basis is based upon the projected total development costs. The Department's
396 estimate of the total development cost will be based on the Applicant's project cost schedule to the
397 extent that it can be verified to a reasonable degree of certainty with documentation from the Applicant
398 and tools available to the Underwriter. For new construction Developments, the Underwriter's total cost
399 estimate will be used unless the Applicant's total development cost is within 5% of the Underwriter's
400 estimate. In the case of a rehabilitation Development, the Underwriter may use a lower tolerance level
401 due to the reliance upon the PCA. If the Applicant's total development cost is utilized and the Applicant's
402 line item costs are inconsistent with documentation provided in the Application or program rules, the
403 Underwriter may make adjustments to the Applicant's total cost estimate.
404 (1) **Acquisition Costs.** The proposed acquisition price is verified with the fully executed site
405 control document(s) for the entire proposed site.
406 (A) **Excess Land Acquisition.** Where more land is being acquired than will be utilized for the
407 site and the remaining acreage is not being utilized as permanent green space, the value ascribed to the
408 proposed Development will be prorated from the total cost reflected in the site control document(s). An
409 appraisal or tax assessment value may be tools that are used in making this determination; however, the
410 Underwriter will not utilize a prorated value greater than the total amount in the site control
411 document(s).
412 (B) **Identity of Interest Acquisitions.**
413 (i) The acquisition will be considered an identity of interest transaction when an Affiliate
414 of, a Related Party to, or any owner at any level of the Development Team
415 (I) is the current owner in whole or in part of the proposed property, or
416 (II) was the owner in whole or in part of the proposed property during any period
417 within the 36 months prior to the first day of the Application Acceptance Period.
418 (ii) In all identity of interest transactions the Applicant is required to provide the
419 additional documentation identified in §50.9(h)(7)(A) of this title to support the transfer price to be used
420 in the underwriting analysis.
421 (iii) In no instance will the acquisition cost utilized by the Underwriter exceed
422 (I) the original acquisition cost listed in the submitted settlement statement or, if a
423 settlement statement is not available, the original asset value listed in the most current audited
424 financial statement for the identity of interest owner, or
425 (II) the "as-is" value conclusion in the submitted appraisal.
426 (C) **Acquisition of Buildings for Tax Credit Properties.** In order to make a determination of
427 the appropriate building acquisition value, the Applicant will provide and the Underwriter will utilize an
428 appraisal that meets the Department's Appraisal Rules and Guidelines as described in §1.34 of this title.
429 The value of the improvements are the result of the difference between the as-is appraised value less
430 the land value. The Underwriter may alternatively prorate the actual or identity of interest sales price
431 based upon a lower calculated improvement value over the as-is value provided in the appraisal, so long
432 as the resulting land value utilized by the Underwriter is not less than the land value indicated in the
433 appraisal or tax assessment.
434 (2) **Off-Site Costs.** Off-Site costs are costs of development up to the site itself such as the cost of
435 roads, water, sewer and other utilities to provide the site with access. All off-site costs must be well
436 documented and certified by a Third Party engineer on the required application form.
437 (3) **Site Work Costs.** Project site work costs exceeding \$9,000 per Unit must be well documented
438 and certified by a Third Party engineer on the required application form. In addition, for Applicants
439 seeking Tax Credits, documentation in keeping with §49.9(h)(6)(G) of this title will be utilized in
440 calculating eligible basis.
441 (4) **Direct Construction Costs.** Direct construction costs are the costs of materials and labor
442 required for the building or rehabilitation of a Development.
443 (A) **New Construction.** The Underwriter will use the Marshall and Swift Residential Cost
444 Handbook and historical final cost certifications of all previous housing tax credit allocations to estimate
445 the direct construction cost for a new construction Development. If the Applicant's estimate is more than
446 5% greater or less than the Underwriter's estimate, the Underwriter will attempt to reconcile this
447 concern and ultimately identify this as a cost concern in the Report.

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448 (i) The "Average Quality" multiple, townhouse, or single family costs, as appropriate,
449 from the Marshall and Swift Residential Cost Handbook, based upon the details provided in the
450 application and particularly site and building plans and elevations will be used to estimate direct
451 construction costs. If the Development contains amenities not included in the Average Quality standard,
452 the Department will take into account the costs of the amenities as designed in the Development.

453 (ii) If the difference in the Applicant's direct cost estimate and the direct construction
454 cost estimate detailed in clause (i) of this subparagraph is more than 5%, the Underwriter shall also
455 evaluate the direct construction cost of the Development based on acceptable cost parameters as
456 adjusted for inflation and as established by historical final cost certifications of all previous housing tax
457 credit allocations for:

458 (I) the county in which the Development is to be located, or

459 (II) if cost certifications are unavailable under subclause (I) of this clause, the
460 uniform state service region in which the Development is to be located.

461 (B) **Rehabilitation Costs.** In the case where the Applicant has provided a PCA which is
462 inconsistent with the Applicant's figures as proposed in the development cost schedule, the Underwriter
463 may request a supplement executed by the PCA provider supporting the Applicant's estimate and
464 detailing the difference in costs. If said supplement is not provided or the Underwriter determines that
465 the reasons for the initial difference in costs are not well-documented, the Underwriter utilizes the
466 initial PCA estimations in lieu of the Applicant's estimates.

467 (5) **Contingency.** All contingencies identified in the Applicant project cost schedule will be
468 added to Contingency with the total limited to the guidelines detailed in this paragraph. Contingency is
469 limited to a maximum of 5% of direct costs plus site work for new construction Developments and 10% of
470 direct costs plus site work for rehabilitation Developments. For tax credit Developments, the percentage
471 is applied to the sum of the eligible direct construction costs plus eligible site work costs in calculating
472 the eligible contingency cost. The Applicant's figure is used by the Underwriter if the figure is less than
473 5%.

474 (6) **Contractor Fee.** Contractor fees are limited at a total of 14%. The percentage is applied to
475 the sum of the direct construction costs plus site work costs. For tax credit Developments, the
476 percentages are applied to the sum of the eligible direct construction costs plus eligible site work costs
477 in calculating the eligible contractor fees. For Developments also receiving financing from TX-USDA-RHS,
478 the combination of builder's general requirements, builder's overhead, and builder's profit should not
479 exceed the lower of TDHCA or TX-USDA-RHS requirements.

480 (7) **Developer Fee.** Developer fee claimed must be proportionate to the work for which it is
481 earned and consistent with §49.9(d)(6) of this title.

482 (A) For Tax Credit Developments, the development cost associated with developer fees and
483 Development Consultant (also known as Housing Consultant) fees included in Eligible Basis cannot exceed
484 15% of the project's Total Eligible Basis less developer fees for developments proposing 50 units or more
485 and 20% of the project's Total Eligible Basis less developer fees for developments proposing 49 units or
486 less, as defined in the QAP.

487 (B) In the case of a transaction requesting acquisition Tax Credits

488 (i) the allocation of eligible developer fee in calculating rehabilitation/new construction
489 Tax Credits will not exceed 15% of the rehabilitation/new construction basis less developer fees for
490 developments proposing 50 units or more and 20% of the rehabilitation/new construction basis less
491 developer fees for developments proposing 49 units or less, and

492 (ii) no developer fee attributable to an identity of interest acquisition of the
493 Development will be included in Eligible Basis.

494 (C) For non-Tax Credit Developments, the percentage can be up to 15% but is based upon
495 total development costs less the sum of the fee itself, land costs, the costs of permanent financing,
496 excessive construction period financing described in paragraph (8) of this subsection, reserves, and any
497 other identity of interest acquisition cost.

498 (8) **Financing Costs.** Eligible construction period financing is limited to not more than one year's
499 fully drawn construction loan funds at the construction loan interest rate indicated in the commitment.
500 Any excess over this amount is removed to ineligible cost and will not be considered in the determination
501 of developer fee.

502 (9) **Reserves.** The Department will utilize the terms proposed by the syndicator or lender as
503 described in the commitment letter(s) or the amount described in the Applicant's project cost schedule
504 if it is within the range of two to six months of stabilized operating expenses less management fees plus
505 debt service.

506 (10) **Other Soft Costs.** For Tax Credit Developments all other soft costs are divided into eligible
507 and ineligible costs. Eligible costs are defined by Internal Revenue Code but generally are costs that can
508 be capitalized in the basis of the Development for tax purposes. Ineligible costs are those that tend to
509 fund future operating activities. The Underwriter will evaluate and accept the allocation of these soft
510 costs in accordance with the Department's prevailing interpretation of the Internal Revenue Code. If the
511 Underwriter questions the eligibility of any soft costs, the Applicant is given an opportunity to clarify and
512 address the concern prior to removal from Eligible Basis.

513 (f) **Developer Capacity.** The Underwriter will evaluate the capacity of the Person(s) accountable for
514 the role of the Developer to determine their ability to secure financing and successfully complete the
515 Development. The Department will review financial statements, and personal credit reports for those
516 individuals anticipated to guarantee the completion of the Development.

517 (1) **Credit Reports.** The Underwriter will characterize the Development as "high risk" if the
518 Applicant, General Partner, Developer, anticipated Guarantor or Principals thereof have a credit score
519 which reflects a 40% or higher potential default rate.

520 (2) **Financial Statements of Principals.** The Applicant, Developer, any principals of the
521 Applicant, General Partner, and Developer and any Person who will be required to guarantee the
522 Development will be required to provide a signed and dated financial statement and authorization to
523 release credit information in accordance with the Department's program rules.

524 (A) **Individuals.** The Underwriter will evaluate and discuss financial statements for
525 individuals in a confidential portion of the Report. The Development may be characterized as "high risk"
526 if the Developer, anticipated Guarantor or Principals thereof is determined to have limited net worth or
527 significant lack of liquidity.

528 (B) **Partnerships and Corporations.** The Underwriter will evaluate and discuss financial
529 statements for partnerships and corporations in the Report. The Development may be characterized as
530 "high risk" if the Developer, anticipated Guarantor or Principals thereof is determined to have limited net
531 worth or significant lack of liquidity.

532 (C) If the Development is characterized as a high risk for either lack of previous experience
533 as determined by the TDHCA division responsible for compliance or a higher potential default rate is
534 identified as described in paragraph (1) or (2) of this subsection, the Report must condition any potential
535 award upon the identification and inclusion of additional Development partners who can meet the
536 Department's guidelines.

537 (g) **Other Underwriting Considerations.** The Underwriter will evaluate numerous additional
538 elements as described in subsection (b) of this section and those that require further elaboration are
539 identified in this subsection.

540 (1) **Floodplains.** The Underwriter evaluates the site plan, floodplain map, survey and other
541 information provided to determine if any of the buildings, drives, or parking areas reside within the 100-
542 year floodplain. If such a determination is made by the Underwriter, the Report will include a condition
543 that:

544 (A) The Applicant must pursue and receive a Letter of Map Amendment (LOMA) or Letter of
545 Map Revision (LOMR-F); or

546 (B) The Applicant must identify the cost of flood insurance for the buildings and for the
547 tenant's contents for buildings within the 100-year floodplain; or

548 (C) The Development must be designed to comply with the QAP, as proposed.

549 (2) The Underwriter will identify in the report any Developments funded or known and
550 anticipated to be eligible for funding within one linear mile of the subject.

551 (3) **Supportive Housing.** The unique development and operating characteristics of Supportive
552 Housing Developments may require special consideration in the following areas:

553 (A) **Operating Income.** The extremely-low-income tenant population typically targeted by a
554 Supportive Housing Development may include deep-skewing of rents to well below the 50% AMI level or
555 other maximum rent limits established by the Department. The Underwriter should utilize the Applicant's
556 proposed rents in the Report as long as such rents are at or below the maximum rent limit proposed for
557 the units and equal to any project based rental subsidy rent to be utilized for the Development.

558 (B) **Operating Expenses.** A Supportive Housing Development may have significantly higher
559 expenses for payroll, management fee, security, resident support services, or other items than typical
560 Affordable Housing Developments. The Underwriter will rely heavily upon the historical operating
561 expenses of other Supportive Housing Developments provided by the Applicant or otherwise available to
562 the Underwriter.

563 (C) **DCR and Long Term Feasibility.** Supportive Housing Developments may be exempted
564 from the DCR requirements of subsection (d)(4)(D) of this section if the Development is anticipated to

565 operate without conventional debt. Applicants must provide evidence of sufficient financial resources to
566 offset any projected 15-year cumulative negative cash flows. Such evidence will be evaluated by the
567 Underwriter on a case-by-case basis to satisfy the Department's long term feasibility requirements and
568 may take the form of one or a combination of the following: executed subsidy commitment(s), set-aside
569 of Applicant's financial resources, to be substantiated by an audited financial statement evidencing
570 sufficient resources, and/or proof of annual fundraising success sufficient to fill anticipated operating
571 losses. If either a set aside of financial resources or annual fundraising are used to evidence the long
572 term feasibility of a Supportive Housing Development, a resolution from the Applicant's governing board
573 must be provided confirming their irrevocable commitment to the provision of these funds and activities.

574 (D) **Development Costs.** For Supportive Housing that is styled as efficiencies, the
575 Underwriter may use "Average Quality" dormitory costs from the Marshall & Swift Valuation Service, with
576 adjustments for amenities and/or quality as evidenced in the application, as a base cost in evaluating
577 the reasonableness of the Applicant's direct construction cost estimate for new construction
578 Developments.

579 (h) **Work Out Development.** Developments that are underwritten subsequent to Board approval in
580 order to refinance or gain relief from restrictions may be considered infeasible based on the guidelines in
581 this section, but may be characterized as "the best available option" or "acceptable available option"
582 depending on the circumstances and subject to the discretion of the Underwriter as long as the option
583 analyzed and recommended is more likely to achieve a better financial outcome for the property and the
584 Department than the status quo.

585 (i) **Feasibility Conclusion.** An infeasible Development will not be recommended for funding or
586 allocation unless the Underwriter can determine a plausible alternative feasible financing structure and
587 conditions the recommendations of the report upon receipt of documentation supporting the alternative
588 feasible financing structure. A development will be characterized as infeasible if paragraph (1) or (2) of
589 this subsection applies. The Development will be characterized as infeasible if one or more of
590 paragraphs (3) - (5) of this subsection applies unless paragraph (6) of this subsection also applies.

591 (1) **Inclusive Capture Rate.** Defined in §1.33 of this title. The Underwriter will independently
592 verify the inclusive capture rate. The Development

593 (A) is characterized as Rural, Elderly or Special Needs and the inclusive capture rate is above
594 75% for the total proposed units; or

595 (B) is not characterized as Rural, Elderly or Special Needs and the inclusive capture rate is
596 above 25% for the total proposed units.

597 (C) Developments meeting the requirements of subparagraph (A) or (B) of this paragraph may
598 avoid being characterized as infeasible if clause (i) or (ii) of this paragraph apply.

599 (i) **Replacement Housing.** The Development is comprised of Affordable Housing which
600 replaces previously existing substandard Affordable Housing within the Primary Market Area as defined in
601 §1.33 of this title on a Unit for Unit basis, and gives the displaced tenants of the previously existing
602 substandard Affordable Housing a leasing preference.

603 (ii) **Existing Housing.** The Development is comprised of existing Affordable Housing
604 which is at least 80% occupied and gives displaced existing tenants a leasing preference as stated in the
605 submitted relocation plan.

606 (2) **Deferred Developer Fee.** Development requesting an allocation of tax credits cannot repay
607 the estimated deferred developer fee, based on the Underwriter's recommended financing structure,
608 from cashflow within the first 15 years of the long term proforma as described in subsection (d)(5) of this
609 section.

610 (3) **Restricted Market Rent.** The Restricted Market Rent for units with rents restricted at 60% of
611 AMGI is less than both the net Program Rent and Market Rent for units with rents restricted at or below
612 50% of AMGI unless the development proposes all restricted units with rents restricted at or below the
613 50% of AMGI level. The requirement in this section may be waived by the Executive Director of the
614 Department on appeal if documentation is submitted by the Applicant to support unique circumstances
615 of the market that would provide mitigation.

616 (4) **Initial Feasibility.** The Year 1 annual total operating expense divided by the Year 1 Effective
617 Gross Income is greater than 65%.

618 (5) **Long Term Feasibility.** Any year in the first 15 years of the Long Term Proforma, as defined
619 in subsection (d)(5) of this section, reflects

620 (A) negative Cash Flow; or

621 (B) a Debt Coverage Ratio below 1.15.

622 (6) **Exceptions.** Developments meeting the requirements of one or more of paragraphs (3) - (5)
623 of this subsection may be re-characterized as feasible if one or more of subparagraphs (A) - (C) of this
624 paragraph and subparagraph (D) of this paragraph apply.

625 (A) The Development will receive Project-based Section 8 Rental Assistance and a firm
626 commitment with terms including contract rent and number of units is submitted at application.

627 (B) The Development will receive rental assistance in association with USDA-RD-RHS
628 financing.

629 (C) The Development will be characterized as public housing as defined by HUD.

630 (D) The units not receiving Project-based Section 8 Rental Assistance or rental assistance in
631 association with USDA-RD-RHS financing, or not characterized as public housing do not propose rents that
632 are less than the Project-based Section 8, USDA-RD-RHS financing, or public housing units.
633

634 **§1.33 Market Analysis Rules and Guidelines**

635 (a) **General Provision.** A Market Analysis prepared for the Department must evaluate the need for
636 decent, safe, and sanitary housing at rental rates or sales prices that eligible tenants can afford. The
637 analysis must determine the feasibility of the subject Property rental rates or sales price and state
638 conclusions as to the impact of the Property with respect to the determined housing needs.

639 (b) **Self-Contained.** A Market Analysis prepared for the Department must allow the reader to
640 understand the market data presented, the analysis of the data, and the conclusions derived from such
641 data. All data presented should reflect the most current information available and the report must
642 provide a parenthetical (in-text) citation or footnote describing the data source. The analysis must
643 clearly lead the reader to the same or similar conclusions reached by the Market Analyst. All steps
644 leading to a calculated figure must be presented in the body of the report.

645 (c) **Market Analyst Qualifications.** A Market Analysis submitted to the Department must be prepared
646 and certified by an approved Qualified Market Analyst (§2306.67055). The Department will maintain an
647 approved Market Analyst list based on the guidelines set forth in paragraphs (1) - (3) of this subsection.

648 (1) If not listed as approved by the Department, Market Analysts must submit subparagraphs (A) -
649 (F) of this paragraph at least thirty days prior to the first day of the Application Acceptance Period for
650 which the Market Analyst must be approved. To maintain status as an approved Qualified Market
651 Analyst, updates to the items described in subparagraphs (A) - (C) of this paragraph must be submitted
652 annually on the first Monday in February for review by the Department.

653 (A) Documentation of good standing in the State of Texas.

654 (B) A current organization chart or list reflecting all members of the firm who may author or
655 sign the Market Analysis.

656 (C) Resumes for all members of the firm or subcontractors who may author or sign the
657 Market Analysis.

658 (D) General information regarding the firm's experience including references, the number of
659 previous similar assignments and time frames in which previous assignments were completed.

660 (E) Certification from an authorized representative of the firm that the services to be
661 provided will conform to the Department's Market Analysis Rules and Guidelines, as described in this
662 section, in effect for the application round in which each Market Analysis is submitted.

663 (F) A sample Market Analysis that conforms to the Department's Market Analysis Rules and
664 Guidelines, as described in this section, in effect for the year in which the sample Market Analysis is
665 submitted.

666 (2) During the underwriting process each Market Analysis will be reviewed and any discrepancies
667 with the rules and guidelines set forth in this section may be identified and require timely correction.
668 Subsequent to the completion of the application round and as time permits, staff or a review appraiser
669 will re-review a sample set of submitted market analyses to ensure that the Department's Market
670 Analysis Rules and Guidelines are met. If it is found that a Market Analyst has not conformed to the
671 Department's Market Analysis Rules and Guidelines, as certified to, the Market Analyst will be notified of
672 the discrepancies in the Market Analysis and will be removed from the approved Qualified Market Analyst
673 list.

674 (A) In and of itself, removal from the list of approved Market Analysts will not invalidate a
675 Market Analysis commissioned prior to the removal date and at least 90 days prior to the first day of the
676 applicable Application Acceptance Period.

677 (B) To be reinstated as an approved Qualified Market Analyst, the Market Analyst must
678 amend the previous report to remove all discrepancies or submit a new sample Market Analysis that
679 conforms to the Department's Market Analysis Rules and Guidelines, as described in this section, in
680 effect for the year in which the updated or new sample Market Analysis is submitted.

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- 681 (3) The list of approved Qualified Market Analysts is posted on the Department's web site and
682 updated within 72 hours of a change in the status of a Market Analyst.
- 683 (d) **Market Analysis Contents.** A Market Analysis for a rental Development prepared for the
684 Department must be organized in a format that follows a logical progression and must include, at
685 minimum, items addressed in paragraphs (1) - (12) of this subsection.
- 686 (1) **Title Page.** Include Property address or location, effective date of analysis, date report
687 completed, name and address of person authorizing report, and name and address of Market Analyst.
- 688 (2) **Letter of Transmittal.** The date of the letter must be the date the report was completed.
689 Include Property address or location, description of Property, statement as to purpose and scope of
690 analysis, reference to accompanying Market Analysis report with effective date of analysis and summary
691 of conclusions, date of Property inspection, name of persons inspecting subject Property, and signatures
692 of all Market Analysts authorized to work on the assignment. Include a statement that the report
693 preparer has read and understood the requirements of this section.
- 694 (3) **Table of Contents.** Number the exhibits included with the report for easy reference.
- 695 (4) **Assumptions and Limiting Conditions.** Include a description of all assumptions, both general
696 and specific, made by the Market Analyst concerning the Property.
- 697 (5) **Identification of the Property.** Provide a statement to acquaint the reader with the
698 Development. Such information includes street address, tax assessor's parcel number(s), and
699 Development characteristics.
- 700 (6) **Statement of Ownership.** Disclose the current owners of record and provide a three year
701 history of ownership for the subject Property.
- 702 (7) **Secondary Market Area.** All of the Market Analyst's conclusions specific to the subject
703 Development must be based on only one Secondary Market Area definition. The entire PMA, as described
704 in paragraph (8) of this subsection, must be contained within the Secondary Market boundaries. The
705 Market Analyst must adhere to the methodology described in this paragraph when determining the
706 secondary market area (§2306.67055).
- 707 (A) The Secondary Market Area will be defined by the Market Analyst with
708 (i) size based on a base year population of no more than 250,000 people for
709 Developments targeting families, and
710 (ii) boundaries based on
711 (I) major roads,
712 (II) political boundaries, and
713 (III) natural boundaries.
714 (IV) A radius is prohibited as a boundary definition.
- 715 (B) The Market Analyst's definition of the Secondary Market Area must be supported with a
716 detailed description of the methodology used to determine the boundaries. If applicable, the Market
717 Analyst must place special emphasis on data used to determine an irregular shape for the Secondary
718 Market.
- 719 (C) A scaled distance map indicating the Secondary Market Area boundaries that clearly
720 identifies the location of the subject Property must be included.
- 721 (8) **Primary Market Area.** All of the Market Analyst's conclusions specific to the subject
722 Development must be based on only one Primary Market Area definition. The Market Analyst must
723 adhere to the methodology described in this paragraph when determining the market area
724 (§2306.67055).
- 725 (A) The Primary Market Area will be defined by the Market Analyst with
726 (i) size based on a base year population of no more than
727 (I) 100,000 people for Developments targeting the general population, and
728 (II) 250,000 people for Qualified Elderly Developments or Developments targeting
729 special needs populations,
730 (ii) boundaries based on
731 (I) major roads,
732 (II) political boundaries, and
733 (III) natural boundaries.
734 (IV) A radius is prohibited as a boundary definition.
- 735 (B) The Market Analyst's definition of the Primary Market Area must be supported with a
736 detailed description of the methodology used to determine the boundaries. If applicable, the Market
737 Analyst must place special emphasis on data used to determine an irregular shape for the PMA.
- 738 (C) A scaled distance map indicating the Primary Market Area boundaries that clearly
739 identifies the location of the subject Property and the location of all Local Amenities must be included.

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(9) Market Information.

(A) For each of the defined market areas, identify the number of units for each of the categories in clauses (i) - (vi) of this subparagraph; the data must be clearly labeled as relating to either the PMA or the Secondary Market, if applicable

- (i) total housing,
- (ii) rental developments,
- (iii) Affordable Housing,
- (iv) Comparable Units,
- (v) Unstabilized Comparable Units, and
- (vi) proposed Comparable Units.

(B) **Occupancy.** The occupancy rate indicated in the Market Analysis may be used to support both the overall demand conclusion for the proposed Development and the vacancy rate assumption used in underwriting the Development (§1.32(d)(1)(C)). State the overall physical occupancy rate for the proposed housing tenure (renter or owner) within the defined market areas by

- (i) number of Bedrooms,
- (ii) quality of construction (class),
- (iii) Targeted Population, and
- (iv) Comparable Units.

(C) **Absorption.** State the absorption trends by quality of construction (class) and absorption rates for Comparable Units.

(D) **Turnover.** The turnover rate should be specific to the Targeted Population. The data supporting the turnover rate must originate from documented turnover rates from at least one of the following

- (i) Comparable Units,
- (ii) the defined PMA,
- (iii) the defined Secondary Market, and
- (iv) a Third Party data collection agency or demographer.

(E) **Demand.** Provide a comprehensive evaluation of the need for the proposed housing for each Unit type by number of Bedrooms proposed and rent restriction category within the defined market areas using the most current census and demographic data available.

(i) Demographics.

(I) **Population.** Provide population and household figures, supported by actual demographics, for a five-year period with the year of application as the base year.

(II) **Target.** If applicable, adjust the household projections for the Qualified Elderly or special needs population targeted by the proposed Development. State the target adjustment rate.

(III) **Household Size-Appropriate.** Adjust the household projections or target household projections, as applicable, for the appropriate household size for the proposed Unit type by number of Bedrooms proposed and rent restriction category based on 1.5 persons per Bedroom (round up). State the Household Size-Appropriate adjustment rate.

(IV) **Income Eligible.** Adjust the household size appropriate projections for income eligibility based on the income bands for the proposed Unit type by number of Bedrooms proposed and rent restriction category with

- (-a-) the lower end of each income band calculated based on the lowest gross rent proposed divided by 35% for the general population and 40% for Qualified Elderly households, and
- (-b-) the upper end of each income band equal to the applicable gross median income limit for the largest appropriate household size based on 1.5 persons per Bedroom (round up).
- (-c-) State the Income Eligible adjustment rate.

(V) **Tenure-Appropriate.** Adjust the income-eligible household projections for tenure (renter or owner). State the Tenure-Appropriate adjustment rate.

(ii) **Demand from Turnover.** Apply the turnover rate as described in subparagraph (D) of this paragraph to the target, income-eligible, size-appropriate and tenure-appropriate households in the PMA projected at the proposed placed in service date.

(iii) **Demand from Population Growth.** Calculate the target, income-eligible, size-appropriate and tenure-appropriate household growth in the PMA for the twelve month period following the proposed placed in service date.

(iv) Demand from Secondary Market Area.

(I) Apply the turnover rate as described in subparagraph (D) of this paragraph to the target, income-eligible, size-appropriate and tenure-appropriate households in the Secondary Market Area projected at the proposed placed in service date.

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799 (II) Only 25% of the demand calculated in subclause (I) of this clause may be included
800 in the calculation of demand as described in paragraph(10)(D) of this subsection and for use in
801 calculation of inclusive capture rate as described in paragraph (10)(E) of this subsection. In addition, 25%
802 of the Comparable Units from Unstabilized Developments within the Secondary Market Area must be
803 included in the calculation of inclusive capture rate.

804 (v) **Demand from Other Sources.** The source of additional demand and the methodology
805 used to calculate the additional demand must be clearly stated. Calculation of additional demand must
806 factor in the adjustments described in clause (i) of this subparagraph.

807 (10) **Conclusions.** Include a comprehensive evaluation of the subject Property, separately
808 addressing each housing type and specific population to be served by the Development in terms of items
809 in subparagraphs (A) - (G) of this paragraph. All conclusions must be consistent with the data and
810 analysis presented throughout the Market Analysis.

811 (A) **Unit Mix.** Provide a best possible unit mix conclusion based on the occupancy rates by
812 Bedroom type within the PMA and target, income-eligible, size-appropriate and tenure-appropriate
813 household demand within the PMA.

814 (B) **Rents.** Provide a separate market rent and Restricted Market Rent conclusion for each
815 proposed Unit type by number of Bedrooms and rent restriction category. Conclusions of Market Rent or
816 Restricted Market Rent below the maximum net Program Rent limit must be well documented as the
817 conclusions may impact the feasibility of the Development under §1.32(i) of this title.

818 (i) **Comparable Units.** Identify developments in the PMA with Comparable Units. In
819 Primary Market Areas lacking sufficient rent comparables, it may be necessary for the Market Analyst to
820 collect data from markets with similar characteristics and make quantifiable location adjustments.
821 Provide a data sheet for each development consisting of

822 (I) Development name,
823 (II) address,
824 (III) year of construction and year of rehabilitation, if applicable,
825 (IV) property condition,
826 (V) population target,
827 (VI) unit mix specifying number of Bedrooms, number of baths, net rentable square

828 footage and

829 (-a-) monthly rent, or
830 (-b-) sales price with terms, marketing period and date of sale,

831 (VII) description of concessions,
832 (VIII) list of unit amenities,
833 (IX) utility structure,
834 (X) list of common amenities, and
835 (XI) for rental developments only

836 (-a-) occupancy, and
837 (-b-) turnover.

838 (ii) Provide a scaled distance map indicating the Primary Market Area boundaries that
839 clearly identifies the location of the subject Property and the location of the identified developments
840 with Comparable Units.

841 (iii) **Rent Adjustments.** In support of the Market Rent and Restricted Market Rent
842 conclusions, provide a separate attribute adjustment matrix for each proposed unit type by number of
843 Bedrooms and rental restriction category.

844 (I) The Department recommends use of HUD Form 92273.

845 (II) A minimum of three developments must be represented on each attribute
846 adjustment matrix.

847 (III) Adjustments for concessions must be included, if applicable.

848 (IV) Total adjustments in excess of 15% must be supported with additional narrative.

849 (V) Total adjustments in excess of 25% indicate the Units are not comparable for the
850 purposes of determining Market Rent and Restricted Market Rent conclusions.

851 (C) **Effective Gross Income.** Provide rental income, secondary income, and vacancy and
852 collection loss projections for the subject derived independent of the Applicant's estimates.

853 (D) **Demand.** State the target, income-eligible, size-appropriate and tenure-appropriate
854 household demand by Unit type by number of Bedrooms proposed and rent restriction category (e.g.
855 one-Bedroom units restricted at 50% of AMFI; two-Bedroom units restricted at 60% of AMFI) by summing
856 the demand components applicable to the subject Development discussed in paragraph (9)(E)(ii) - (v) of
857 this subsection. State the total target, income-eligible, size-appropriate and tenure-appropriate

858 household demand by summing the demand components applicable to the subject Development
859 discussed in paragraph (9)(E)(ii) - (v) of this subsection.

860 (E) **Inclusive Capture Rate.** The Market Analyst must calculate inclusive capture rates for
861 the subject Development's proposed Unit types by number of Bedrooms and rent restriction categories,
862 market rate Units, if applicable, and total Units. The Underwriter will adjust the inclusive capture rates
863 to take into account any errors or omissions. To calculate an inclusive capture rate

864 (i) total

865 (I) the proposed subject Units,

866 (II) Comparable Units with priority, as defined in §49.9(d)(2) of this title, over the
867 subject that have made application to TDHCA and have not been presented to the TDHCA Board for
868 decision and

869 (III) Comparable Units in previously approved but Unstabilized Developments, and

870 (ii) divide by the total target, income-eligible, size-appropriate and tenure-appropriate
871 household demand stated in subparagraph (D) of this paragraph.

872 (iii) Refer to §1.32(i) for feasibility criteria.

873 (F) **Absorption.** Project an absorption period for the subject Development to achieve
874 Sustaining Occupancy. State the absorption rate.

875 (G) **Market Impact.** Provide an assessment of the impact the subject Development, as
876 completed, will have on existing program Developments in the Primary Market (§2306.67055).

877 (11) **Photographs.** Provide labeled color photographs of the subject Property, the neighborhood,
878 street scenes, and comparables. An aerial photograph is desirable but not mandatory.

879 (12) **Appendices.** Any Third Party reports including demographics relied upon by the Market
880 Analyst must be provided in appendix form. A list of works cited including personal communications also
881 must be provided, and the Modern Language Association (MLA) format is suggested.

882 (e) The Department reserves the right to require the Market Analyst to address such other issues as
883 may be relevant to the Department's evaluation of the need for the subject Development and the
884 provisions of the particular program guidelines.

885 (f) All Applicants shall acknowledge, by virtue of filing an application, that the Department shall not
886 be bound by any such opinion or Market Analysis, and may substitute its own analysis and underwriting
887 conclusions for those submitted by the Market Analyst.

888

889 §1.34 Appraisal Rules and Guidelines

890 (a) **General Provision.** An appraisal prepared for the Department must conform to the Uniform
891 Standards of Professional Appraisal Practice (USPAP) as adopted by the Appraisal Standards Board of the
892 Appraisal Foundation.

893 (b) **Self-Contained.** An appraisal prepared for the Department must describe sufficient and adequate
894 data and analyses to support the final opinion of value. The final value(s) must be reasonable, based on
895 the information included. Any Third Party reports relied upon by the appraiser must be verified by the
896 appraiser as to the validity of the data and the conclusions.

897 (c) **Appraiser Qualifications.** The qualifications of each appraiser are determined on a case-by-case
898 basis by the Director of Real Estate Analysis or review appraiser, based upon the quality of the report
899 itself and the experience and educational background of the appraiser. At minimum, a qualified
900 appraiser must be appropriately certified or licensed by the Texas Appraiser Licensing and Certification
901 Board.

902 (d) **Appraisal Contents.** An appraisal prepared for the Department must be organized in a format
903 that follows a logical progression. In addition to the contents described in USPAP Standards Rule 2, the
904 appraisal must include items addressed in paragraphs (1) - (12) of this subsection.

905 (1) **Title Page.** Include a statement identifying the Department as the client, acknowledging that
906 the Department is granted full authority to rely on the findings of the report, and name and address of
907 person authorizing report.

908 (2) **Letter of Transmittal.** Include reference to accompanying appraisal report, reference to all
909 person(s) that provided significant assistance in the preparation of the report, date of report, effective
910 date of appraisal, date of property inspection, name of person(s) inspecting the property, tax assessor's
911 parcel number(s) of the site, estimate of marketing period, and signatures of all appraisers authorized to
912 work on the assignment including the appraiser who inspected the property. Include a statement
913 indicating the report preparer has read and understood the requirements of this section.

914 (3) **Table of Contents.** Number the exhibits included with the report for easy reference.

915 (4) **Disclosure of Competency.** Include appraiser's qualifications, detailing education and
916 experience.

917 (5) **Statement of Ownership of the Subject Property.** Discuss all prior sales of the subject
918 property which occurred within the past three years. Any pending agreements of sale, options to buy, or
919 listing of the subject property must be disclosed in the appraisal report.

920 (6) **Property Rights Appraised.** Include a statement as to the property rights (e.g., fee simple
921 interest, leased fee interest, leasehold, etc.) being considered. The appropriate interest must be
922 defined in terms of current appraisal terminology with the source cited.

923 (7) **Site/Improvement Description.** Discuss the site characteristics including subparagraphs (A) -
924 (E) of this paragraph.

925 (A) **Physical Site Characteristics.** Describe dimensions, size (square footage, acreage, etc.),
926 shape, topography, corner influence, frontage, access, ingress-egress, etc. associated with the site.
927 Include a plat map and/or survey.

928 (B) **Floodplain.** Discuss floodplain (including flood map panel number) and include a
929 floodplain map with the subject clearly identified.

930 (C) **Zoning.** Report the current zoning and description of the zoning restrictions and/or deed
931 restrictions, where applicable, and type of Development permitted. Any probability of change in zoning
932 should be discussed. A statement as to whether or not the improvements conform to the current zoning
933 should be included. A statement addressing whether or not the improvements could be rebuilt if
934 damaged or destroyed, should be included. If current zoning is not consistent with the highest and best
935 use, and zoning changes are reasonable to expect, time and expense associated with the proposed
936 zoning change should be considered and documented. A zoning map should be included.

937 (D) **Description of Improvements.** Provide a thorough description and analysis of the
938 improvements including size (net rentable area, gross building area, etc.), number of stories, number of
939 buildings, type/quality of construction, condition, actual age, effective age, exterior and interior
940 amenities, items of deferred maintenance, etc. All applicable forms of depreciation should be addressed
941 along with the remaining economic life.

942 (E) **Environmental Hazards.** It is recognized appraisers are not experts in such matters and
943 the impact of such deficiencies may not be quantified; however; the report should disclose any potential
944 environmental hazards (e.g., discolored vegetation, oil residue, asbestos-containing materials, lead-
945 based paint etc.) noted during the inspection.

946 (8) **Highest and Best Use.** Market Analysis and feasibility study is required as part of the highest
947 and best use. The highest and best use analysis should consider paragraph (7)(A) - (E) of this subsection
948 as well as a supply and demand analysis.

949 (A) The appraisal must inform the reader of any positive or negative market trends which
950 could influence the value of the appraised property. Detailed data must be included to support the
951 appraiser's estimate of stabilized income, absorption, and occupancy.

952 (B) The highest and best use section must contain a separate analysis "as if vacant" and "as
953 improved" (or "as proposed to be improved/renovated"). All four elements (legally permissible, physically
954 possible, feasible, and maximally productive) must be considered.

955 (9) **Appraisal Process.** It is mandatory that all three approaches, Cost Approach, Sales
956 Comparison Approach and Income Approach, are considered in valuing the property. If an approach is not
957 applicable to a particular property an adequate explanation must be provided. A land value estimate
958 must be provided if the cost approach is not applicable.

959 (A) **Cost Approach.** This approach should give a clear and concise estimate of the cost to
960 construct the subject improvements. The source(s) of the cost data should be reported.

961 (i) Cost comparables are desirable; however, alternative cost information may be
962 obtained from Marshall & Swift Valuation Service or similar publications. The section, class, page, etc.
963 should be referenced. All soft costs and entrepreneurial profit must be addressed and documented.

964 (ii) All applicable forms of depreciation must be discussed and analyzed. Such discussion
965 must be consistent with the description of the improvements.

966 (iii) The land value estimate should include a sufficient number of sales which are
967 current, comparable, and similar to the subject in terms of highest and best use. Comparable sales
968 information should include address, legal description, tax assessor's parcel number(s), sales price, date
969 of sale, grantor, grantee, three year sales history, and adequate description of property transferred. The
970 final value estimate should fall within the adjusted and unadjusted value ranges. Consideration and
971 appropriate cash equivalent adjustments to the comparable sales price for subclauses (I) - (VII) of this
972 clause should be made when applicable.

973 (I) Property rights conveyed.

974 (II) Financing terms.

975 (III) Conditions of sale.

- 976 (IV) Location.
- 977 (V) Highest and best use.
- 978 (VI) Physical characteristics (e.g., topography, size, shape, etc.).
- 979 (VII) Other characteristics (e.g., existing/proposed entitlements, special
- 980 assessments, etc.).

981 (B) **Sales Comparison Approach.** This section should contain an adequate number of sales to
982 provide the reader with a description of the current market conditions concerning this property type.
983 Sales data should be recent and specific for the property type being appraised. The sales must be
984 confirmed with buyer, seller, or an individual knowledgeable of the transaction.

985 (i) Sales information should include address, legal description, tax assessor's parcel
986 number(s), sales price, financing considerations and adjustment for cash equivalency, date of sale,
987 recordation of the instrument, parties to the transaction, three year sale history, complete description
988 of the property and property rights conveyed, and discussion of marketing time. A scaled distance map
989 clearly identifying the subject and the comparable sales must be included.

990 (ii) The method(s) used in the Sales Comparison Approach must be reflective of actual
991 market activity and market participants.

992 (I) **Sale Price/Unit of Comparison.** The analysis of the sale comparables must
993 identify, relate, and evaluate the individual adjustments applicable for property rights, terms of sale,
994 conditions of sale, market conditions, and physical features. Sufficient narrative must be included to
995 permit the reader to understand the direction and magnitude of the individual adjustments, as well as a
996 unit of comparison value indicator for each comparable.

997 (II) **Net Operating Income/Unit of Comparison.** The net operating income statistics
998 for the comparables must be calculated in the same manner. It should be disclosed if reserves for
999 replacement have been included in this method of analysis. At least one other method should accompany
1000 this method of analysis.

1001 (C) **Income Approach.** This section must contain an analysis of both the actual historical and
1002 projected income and expense aspects of the subject property.

1003 (i) **Market Rent Estimate/Comparable Rental Analysis.** This section of the report should
1004 include an adequate number of actual market transactions to inform the reader of current market
1005 conditions concerning rental units. The comparables must indicate current research for this specific
1006 property type. The comparables must be confirmed with the landlord, tenant or agent and individual
1007 data sheets must be included. The individual data sheets should include property address, lease terms,
1008 description of the property (e.g., unit type, unit size, unit mix, interior amenities, exterior amenities,
1009 etc.), physical characteristics of the property, and location of the comparables. Analysis of the Market
1010 Rents should be sufficiently detailed to permit the reader to understand the appraiser's logic and
1011 rationale. Adjustment for lease rights, condition of the lease, location, physical characteristics of the
1012 property, etc. must be considered.

1013 (ii) **Comparison of Market Rent to Contract Rent.** Actual income for the subject along
1014 with the owner's current budget projections must be reported, summarized, and analyzed. If such data is
1015 unavailable, a statement to this effect is required and appropriate assumptions and limiting conditions
1016 should be made. The contract rents should be compared to the market-derived rents. A determination
1017 should be made as to whether the contract rents are below, equal to, or in excess of market rates. If
1018 there is a difference, its impact on value must be qualified.

1019 (iii) **Vacancy/Collection Loss.** Historical occupancy data and current occupancy level for
1020 the subject should be reported and compared to occupancy data from the rental comparables and
1021 overall occupancy data for the subject's Primary Market.

1022 (iv) **Expense Analysis.** Actual expenses for the subject, along with the owner's projected
1023 budget, must be reported, summarized, and analyzed. If such data is unavailable, a statement to this
1024 effect is required and appropriate assumptions and limiting conditions should be made. Historical
1025 expenses should be compared to comparables expenses of similar property types or published survey
1026 data (e.g., IREM, BOMA, etc.). Any expense differences should be reconciled. Include historical data
1027 regarding the subject's assessment and tax rates and a statement as to whether or not any delinquent
1028 taxes exist.

1029 (v) **Capitalization.** The appraiser should present the capitalization method(s) reflective
1030 of the subject market and explain the omission of any method not considered in the report.

1031 (I) **Direct Capitalization.** The primary method of deriving an overall rate (OAR) is
1032 through market extraction. If a band of investment or mortgage equity technique is utilized, the
1033 assumptions must be fully disclosed and discussed.

1034 (II) **Yield Capitalization (Discounted Cash Flow Analysis).** This method of analysis
1035 should include a detailed and supportive discussion of the projected holding/investment period, income
1036 and income growth projections, occupancy projections, expense and expense growth projections,
1037 reversionary value and support for the discount rate.

1038 (10) **Value Estimates.** Reconciliation final value estimate is required.

1039 (A) All appraisals shall contain a separate estimate of the "as vacant" market value of the
1040 underlying land, based upon current sales comparables. The appraiser should consider the fee simple or
1041 leased fee interest as appropriate.

1042 (B) Appraisal assignments for new construction are required to provide an "as completed"
1043 value of the proposed structures. These reports shall provide an "as restricted with favorable financing"
1044 value as well as an "unrestricted market" value.

1045 (C) Reports on Properties to be rehabilitated shall address the "as restricted with favorable
1046 financing" value as well as both an "as is" value and an "as completed" value. The appraiser should
1047 consider the fee simple or leased fee interest as appropriate.

1048 (D) If required the appraiser must include a separate assessment of personal property,
1049 furniture, fixtures, and equipment (FF&E) and/or intangible items. If personal property, FF&E, or
1050 intangible items are not part of the transaction or value estimate, a statement to such effect should be
1051 included.

1052 (11) **Marketing Time.** Given property characteristics and current market conditions, the
1053 appraiser(s) should employ a reasonable marketing period. The report should detail existing market
1054 conditions and assumptions considered relevant.

1055 (12) **Photographs.** Provide good quality color photographs of the subject property (front, rear,
1056 and side elevations, on-site amenities, interior of typical units if available). Photographs should be
1057 properly labeled. Photographs of the neighborhood, street scenes, and comparables should be included.
1058 An aerial photograph is desirable but not mandatory.

1059 (e) **Additional Appraisal Concerns.** The appraiser(s) must be aware of Department program rules
1060 and guidelines and the appraisal must include analysis of any impact to the subject's value.
1061

1062 §1.35 Environmental Site Assessment Rules and Guidelines

1063 (a) **General Provisions.** The Environmental Site Assessments (ESA) prepared for the Department
1064 should be conducted and reported in conformity with the standards of the American Society for Testing
1065 and Materials. The initial report should conform with the Standard Practice for Environmental Site
1066 Assessments: Phase I Assessment Process (ASTM Standard Designation: E1527-05). Any subsequent reports
1067 should also conform to ASTM standards and such other recognized industry standards as a reasonable
1068 person would deem relevant in view of the Property's anticipated use for human habitation. The
1069 environmental assessment shall be conducted by a Third Party environmental professional at the expense
1070 of the Applicant, and addressed to TDHCA as a User of the report (as defined by ASTM standards). Copies
1071 of reports provided to TDHCA which were commissioned by other financial institutions should address
1072 TDHCA as a co-recipient of the report, or letters from both the provider and the recipient of the report
1073 should be submitted extending reliance on the report to TDHCA. The ESA report should also include a
1074 statement that the person or company preparing the ESA report will not materially benefit from the
1075 Development in any other way than receiving a fee for performing the Environmental Site Assessment,
1076 and that the fee is in no way contingent upon the outcome of the assessment. The ESA report must
1077 contain a statement indicating the report preparer has read and understood the requirements of this
1078 section.

1079 (b) In addition to ASTM requirements, the report must

1080 (1) State if a **noise study** is recommended for a property in accordance with current HUD
1081 guidelines and identify its proximity to industrial zones, major highways, active rail lines, civil and
1082 military airfields, or other potential sources of excessive noise;

1083 (2) Provide a copy of a **current survey**, if available, or other drawing of the site reflecting the
1084 boundaries and adjacent streets, all improvements on the site, and any items of concern described in
1085 the body of the environmental site assessment or identified during the physical inspection;

1086 (3) Provide a copy of the current **FEMA Flood Insurance Rate Map** showing the panel number
1087 and encompassing the site with the site boundaries precisely identified and superimposed on the map.

1088 (4) If the subject site includes any improvements or debris from pre-existing improvements,
1089 state if testing for **asbestos containing materials (ACMs)** would be required pursuant to local, state, and
1090 federal laws, or recommended due to any other consideration;

1091 (5) If the subject site includes any improvements or debris from pre-existing improvements,
1092 state if testing for **Lead Based Paint** would be required pursuant to local, state, and federal laws, or
1093 recommended due to any other consideration;

1094 (6) State if testing for **lead in the drinking water** would be required pursuant to local, state,
1095 and federal laws, or recommended due to any other consideration such as the age of pipes and solder in
1096 existing improvements; and

1097 (7) Assess the potential for the presence of **Radon** on the property, and recommend specific
1098 testing if necessary.

1099 (c) If the report recommends further studies or establishes that environmental hazards currently
1100 exist on the Property, or are originating off-site but would nonetheless affect the Property, the
1101 Development Owner must act on such a recommendation or provide a plan for either the abatement or
1102 elimination of the hazard. Evidence of action or a plan for the abatement or elimination of the hazard
1103 must be presented upon Application submittal.

1104 (d) For Developments in programs that allow a waiver of the Phase I ESA such as a TX-USDA-RHS
1105 funded Development, the Development Owners are hereby notified that it is their responsibility to
1106 ensure that the Development is maintained in compliance with all state and federal environmental
1107 hazard requirements.

1108 (e) Those Developments which have or are to receive first lien financing from HUD may submit HUD's
1109 environmental assessment report, provided that it conforms to the requirements of this subsection.
1110

1111 **§1.36 Property Condition Assessment Guidelines**

1112 (a) **General Provisions.** The objective of the Property Condition Assessment (the PCA) is to provide
1113 cost estimates for repairs, replacements, or new construction which are: immediately necessary;
1114 proposed by the developer; and expected to be required throughout the term of the regulatory period
1115 and not less than 30 years. The PCA prepared for the Department should be conducted and reported in
1116 conformity with the American Society for Testing and Materials "Standard Guide for Property Condition
1117 Assessments: Baseline Property Condition Assessment Process (ASTM Standard Designation: E 2018)"
1118 except as provided for in subsections (b) and (c) of this section. The PCA must include discussion and
1119 analysis of the following:

1120 (1) **Useful Life Estimates.** For each system and component of the property the PCA should assess
1121 the condition of the system or component, and estimate its remaining useful life, citing the basis or the
1122 source from which such estimate is derived.

1123 (2) **Code Compliance.** The PCA should review and document any known violations of any
1124 applicable federal, state, or local codes. In developing the cost estimates specified herein, it is the
1125 responsibility of the Housing Sponsor or Applicant to ensure that the PCA adequately considers any and
1126 all applicable federal, state, and local laws and regulations which may govern any work performed to the
1127 subject property.

1128 (3) **Program Rules.** The PCA should assess the extent to which any systems or components must
1129 be modified, repaired, or replaced in order to comply with any specific requirements of the housing
1130 program under which the Development is proposed to be financed, particular consideration being given
1131 to accessibility requirements, the Department's Housing Quality Standards, and any scoring criteria for
1132 which the Applicant may claim points.

1133 (4) **Cost Estimates for Repair and Replacement.** It is the responsibility of the Housing Sponsor
1134 or Applicant to ensure that the PCA provider is apprised of all development activities associated with the
1135 proposed transaction and consistency of the total immediately necessary and proposed repair and
1136 replacement cost estimates with the development cost schedule submitted as an exhibit of the
1137 Application.

1138 (A) **Immediately Necessary Repairs and Replacement.** Systems or components which are
1139 expected to have a remaining useful life of less than one year, which are found to be in violation of any
1140 applicable codes, which must be modified, repaired or replaced in order to satisfy program rules, or
1141 which are otherwise in a state of deferred maintenance or pose health and safety hazards should be
1142 considered immediately necessary repair and replacement. The PCA must provide a separate estimate of
1143 the costs associated with the repair, replacement, or maintenance of each system or component which is
1144 identified as being an immediate need, citing the basis or the source from which such cost estimate is
1145 derived.

1146 (B) **Proposed Repair, Replacement, or New Construction.** If the development plan calls for
1147 additional repair, replacement, or new construction above and beyond the immediate repair and
1148 replacement described in subparagraph (A) of this paragraph, such items must be identified and the
1149 nature or source of obsolescence or improvement to the operations of the Property discussed. The PCA

1150 must provide a separate estimate of the costs associated with the repair, replacement, or new
1151 construction which is identified as being above and beyond the immediate need, citing the basis or the
1152 source from which such cost estimate is derived.

1153 (C) **Expected Repair and Replacement Over Time.** The term during which the PCA should
1154 estimate the cost of expected repair and replacement over time must equal the longest term of any land
1155 use or regulatory restrictions which are, or will be, associated with the provision of housing on the
1156 property. The PCA must estimate the periodic costs which are expected to arise for repairing or
1157 replacing each system or component of the property, based on the estimated remaining useful life of
1158 such system or component as described in paragraph (1) of this subsection adjusted for completion of
1159 repair and replacement immediately necessary and proposed as described in subparagraphs (A) and (B)
1160 of this paragraph. The PCA must include a separate table of the estimated long term costs which
1161 identifies in each line the individual component of the property being examined, and in each column the
1162 year during the term in which the costs are estimated to be incurred and no less than 15 years. The
1163 estimated costs for future years should be given in both present dollar values and anticipated future
1164 dollar values assuming a reasonable inflation factor of not less than 2.5% per annum.

1165 (b) If a copy of such standards or a sample report have been provided for the Department's review, if
1166 such standards are widely used, and if all other criteria and requirements described in this section are
1167 satisfied, the Department will also accept copies of reports commissioned or required by the primary
1168 lender for a proposed transaction, which have been prepared in accordance with:

- 1169 (1) Fannie Mae's criteria for Physical Needs Assessments,
1170 (2) Federal Housing Administration's criteria for Project Capital Needs Assessments,
1171 (3) Freddie Mac's guidelines for Engineering and Property Condition Reports,
1172 (4) TX-USDA-RHS guidelines for Capital Needs Assessment, or
1173 (5) Standard and Poor's Property Condition Assessment Criteria: Guidelines for Conducting
1174 Property Condition Assessments, Multifamily Buildings.

1175 (c) The Department may consider for acceptance reports prepared according to other standards
1176 which are not specifically named above in subsection (b) of this section, if a copy of such standards or a
1177 sample report have been provided for the Department's review, if such standards are widely used, and if
1178 all other criteria and requirements described in this section are satisfied.

1179 (d) The PCA shall be conducted by a Third Party at the expense of the Applicant, and addressed to
1180 TDHCA as the client. Copies of reports provided to TDHCA which were commissioned by other financial
1181 institutions should address TDHCA as a co-recipient of the report, or letters from both the provider and
1182 the recipient of the report should be submitted extending reliance on the report to TDHCA. The PCA
1183 report should also include a statement that the person or company preparing the PCA report will not
1184 materially benefit from the Development in any other way than receiving a fee for performing the PCA.
1185 The PCA report must contain a statement indicating the report preparer has read and understood the
1186 requirements of this section. The PCA should be signed and dated by the Third Party report provider not
1187 more than six months prior to the date of the application.
1188

1189 **§1.37 Reserve for Replacement Rules and Guidelines**

1190 (a) **General Provisions.** The Department will require Developments to provide regular maintenance
1191 to keep housing sanitary, safe and decent by maintaining a reserve for replacement in accordance with
1192 §2306.186. The reserve must be established for each unit in a Development of 25 or more rental units,
1193 regardless of the amount of rent charged for the unit. The Department shall, through cooperation of its
1194 divisions responsible for asset management and compliance, ensure compliance with this section.

1195 (b) The First Lien Lender shall maintain the reserve account through an escrow agent acceptable to
1196 the First Lien Lender to hold reserve funds in accordance with an executed escrow agreement and the
1197 rules set forth in this section and §2306.186.

1198 (1) Where there is a First Lien Lender other than the Department or a Bank Trustee as a result of
1199 a bond indenture or tax credit syndication, the Department shall

1200 (A) Be a required signatory party in all escrow agreements for the maintenance of reserve
1201 funds;

1202 (B) Be given notice of any asset management findings or reports, transfer of money in
1203 reserve accounts to fund necessary repairs, and any financial data and other information pursuant to the
1204 oversight of the Reserve Account within 30 days of any receipt or determination thereof;

1205 (C) Subordinate its rights and responsibilities under the escrow agreement, including those
1206 described in this subsection, to the First Lien Lender or Bank Trustee through a subordination agreement
1207 subject to its ability to do so under the law and normal and customary limitations for fraud and other

1208 conditions contained in the Department's standard subordination clause agreements as modified from
1209 time to time, to include subsection (c) of this section.

1210 (2) The escrow agreement and subordination agreement, if applicable, shall further specify the
1211 time and circumstances under which the Department can exercise its rights under the escrow agreement
1212 in order to fulfill its obligations under §2306.186 and as described in this section.

1213 (3) Where the Department is the First Lien Lender and there is no Bank Trustee as a result of a
1214 bond indenture or tax credit syndication or where there is no First Lien Lender but the allocation of
1215 funds by the Department and §2306.186 requires that the Department oversee a Reserve Account, the
1216 Owner shall provide at their sole expense for appointment of an escrow agent acceptable to the
1217 Department to act as Bank Trustee as necessary under this section. The Department shall retain the right
1218 to replace the escrow agent with another Bank Trustee or act as escrow agent at a cost plus fee payable
1219 by the Owner due to breach of the escrow agent's responsibilities or otherwise with 30 days prior notice
1220 of all parties to the escrow agreement.

1221 (c) If the Department is not the First Lien Lender with respect to the Development, each Owner
1222 receiving Department assistance for multifamily rental housing shall submit on an annual basis within the
1223 Department's required Owner's Financial Certification packet a signed certification by the First Lien
1224 Lender including:

1225 (1) Reserve for replacement requirements under the first lien loan agreement;
1226 (2) Monitoring standards established by the First Lien Lender to ensure compliance with the
1227 established reserve for replacement requirements; and
1228 (3) A statement by the First Lien Lender

1229 (A) That the Development has met all established reserve for replacement requirements; or
1230 (B) Of the plan of action to bring the Development in compliance with all established reserve
1231 for replacement requirements, if necessary.

1232 (d) If the Development meets the minimum unit size described in subsection (a) of this section and
1233 the establishment of a Reserve Account for repairs has not been required by the First Lien Lender or
1234 Bank Trustee, each Owner receiving Department assistance for multifamily rental housing shall set aside
1235 the repair reserve amount as described in subsection (e)(1) - (3) of this section through the date
1236 described in subsection (f)(2) of this section through the appointment of an escrow agent as further
1237 described in subsection (b)(3) of this section.

1238 (e) If the Department is the First Lien Lender with respect to the Development, each Owner
1239 receiving Department assistance for multifamily rental housing shall deposit annually into a Reserve
1240 Account through the date described in subsection (f)(2) of this section:

1241 (1) For new construction Developments:
1242 (A) Not less than \$150 per unit per year for units one to five years old; and
1243 (B) Not less than \$200 per unit per year for units six or more years old.

1244 (2) For rehabilitation Developments:
1245 (A) An amount per unit per year established by the Department's division responsible for
1246 credit underwriting based on the information presented in a Property Condition Assessment in
1247 conformance with §1.36 of this title; and
1248 (B) Not less than \$300 per unit per year.

1249 (3) For either new construction or rehabilitation Developments, the Owner of a multifamily
1250 rental housing Development shall contract for a third-party Property Condition Assessment meeting the
1251 requirements of §1.36 of this title and the Department will reanalyze the annual reserve requirement
1252 based on the findings and other support documentation.

1253 (A) A Property Condition Assessment will be conducted:
1254 (i) At appropriate intervals that are consistent with requirements of the First Lien
1255 Lender, other than the Department; or
1256 (ii) At least once during each five-year period beginning with the 11th year after the
1257 awarding of any financial assistance for the Development by the Department, if the Department is the
1258 First Lien Lender or the First Lien Lender does not require a third-party Property Condition Assessment.

1259 (B) Submission by the Owner to the Department will occur within 30 days of completion of
1260 the Property Condition Assessment and must include:
1261 (i) The complete Property Condition Assessment;
1262 (ii) First Lien Lender and/or Owner response to the findings of the Property Condition
1263 Assessment;
1264 (iii) Documentation of repairs made as a result of the Property Condition Assessment;
1265 and

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- 1266 (iv) Documentation of adjustments to the amounts held in the replacement Reserve
1267 Account based upon the Property Condition Assessment.
- 1268 (f) A Land Use Restriction Agreement or restrictive covenant between the Owner and the
1269 Department must require:
- 1270 (1) The Owner to begin making annual deposits to the reserve account on the later of:
- 1271 (A) The date that occupancy of the Development stabilizes as defined by the First Lien
1272 Lender or in the absence of a First Lien Lender other than the Department, the date the property is at
1273 least 90% occupied; or
- 1274 (B) The date that permanent financing for the Development is completely in place as defined
1275 by the First Lien Lender or in the absence of a First Lien Lender other than the Department, the date
1276 when the permanent loan is executed and funded.
- 1277 (2) The Owner to continue making deposits until the earliest of the following dates:
- 1278 (A) The date on which the Owner suffers a total casualty loss with respect to the
1279 Development;
- 1280 (B) The date on which the Development becomes functionally obsolete, if the Development
1281 cannot be or is not restored;
- 1282 (C) The date on which the Development is demolished;
- 1283 (D) The date on which the Development ceases to be used as a multifamily rental property;
- 1284 or
- 1285 (E) The later of
- 1286 (i) The end of the affordability period specified by the Land Use Restriction Agreement
1287 or restrictive covenant; or
- 1288 (ii) The end of the repayment period of the first lien loan.
- 1289 (g) The duties of the Owner of a multifamily rental housing Development under this section cease on
1290 the date of a change in ownership of the Development; however, the subsequent Owner of the
1291 Development is subject to the requirements of this section.
- 1292 (h) If the Department is the First Lien Lender with respect to the Development or the First Lien
1293 Lender does not require establishment of a Reserve Account, the Owner receiving Department assistance
1294 for multifamily rental housing shall submit on an annual basis within the Department's required Owner's
1295 Financial Certification packet:
- 1296 (1) Financial statements, audited if available, with clear identification of the replacement
1297 Reserve Account balance and all capital improvements to the Development within the fiscal year;
- 1298 (2) Identification of costs other than capital improvements funded by the replacement Reserve
1299 Account; and
- 1300 (3) Signed statement of cause for:
- 1301 (A) Use of replacement Reserve Account for expenses other than necessary repairs, including
1302 property taxes or insurance;
- 1303 (B) Deposits to the replacement Reserve Account below the Department's or First Lien
1304 Lender's mandatory levels as defined in subsections (c), (d) and (e) of this section; and
- 1305 (C) Failure to make a required deposit.
- 1306 (i) If a request for extension or waiver is not approved by the Department, Department action,
1307 including a penalty of up to \$200 per dwelling unit in the Development and/or characterization of the
1308 Development as Materially Non-Compliant, as defined in §60.1 of this title, may be taken when:
- 1309 (1) A Reserve Account, as described in this section, has not been established for the
1310 Development;
- 1311 (2) The Department is not a party to the escrow agreement for the Reserve Account;
- 1312 (3) Money in the Reserve Account
- 1313 (A) Is used for expenses other than necessary repairs, including property taxes or insurance;
- 1314 or
- 1315 (B) Falls below mandatory deposit levels;
- 1316 (4) Owner fails to make a required deposit;
- 1317 (5) Owner fails to contract for the third party Property Condition Assessment as required under
1318 subsection (e)(3) of this section; or
- 1319 (6) Owner fails to make necessary repairs, as defined in subsection (k) of this section.
- 1320 (j) On a case by case basis, the Department may determine that the money in the Reserve Account
1321 may:
- 1322 (1) Be used for expenses other than necessary repairs, including property taxes or insurance, if:
- 1323 (A) Development income before payment of return to Owner or deferred developer fee is
1324 insufficient to meet operating expense and debt service requirements; and

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1325 (B) The funds withdrawn from the Reserve Account are replaced as cashflow after payment
1326 of expenses, but before payment of return to Owner or developer fee is available.

1327 (2) Fall below mandatory deposit levels without resulting in Department action, if:

1328 (A) Development income after payment of operating expenses, but before payment of return
1329 to Owner or deferred developer fee is insufficient to fund the mandatory deposit levels; and

1330 (B) Subsequent deposits to the Reserve Account exceed mandatory deposit levels as cashflow
1331 after payment of operating expenses, but before payment of return to Owner or deferred developer fee
1332 is available until the Reserve Account has been replenished to the mandatory deposit level less capital
1333 expenses to date.

1334 (k) The Department or its agent may make repairs to the Development if the Owner fails to complete
1335 necessary repairs indicated in the submitted Property Condition Assessment or identified by physical
1336 inspection. Repairs may be deemed necessary if the Development is notified of the Owner's failure to
1337 comply with federal, state and/or local health, safety, or building code.

1338 (1) Payment for necessary repairs must be made directly by the Owner or through a replacement
1339 Reserve Account established for the Development under this section.

1340 (2) The Department or its agent will produce a Request for Bids to hire a contractor to complete
1341 and oversee necessary repairs.

1342 (l) This section does not apply to a Development for which the Owner is required to maintain a
1343 Reserve Account under any other provision of federal or state law.