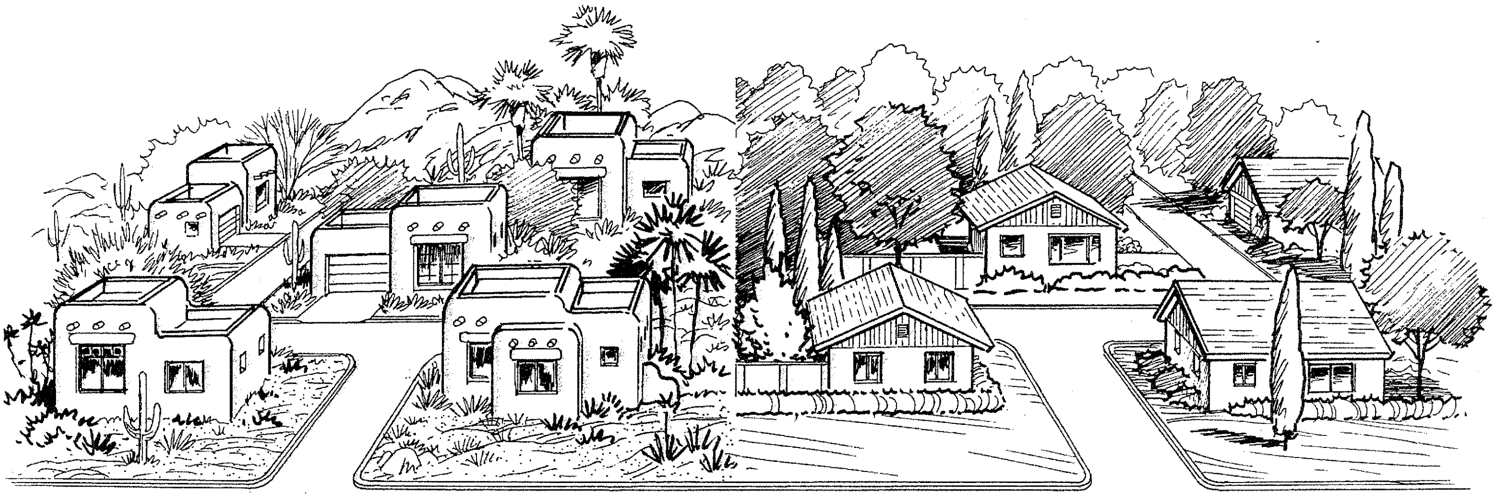

REVIEWING RESIDENTIAL SUBDIVISION APPRAISALS

by
John A. Simpson, MAI

Residential subdivisions are rarely standardized, unlike other property types like industrial buildings or shopping centers. Many issues must be faced by the appraiser. A residential subdivision can be comprised of single family units, townhouses or condominiums. The property can be a planned unit development consisting of any or all of these three and include retail or office components. The subdivision can have a mix of low and moderate income housing or housing reserved for senior citizens. The land can be in an unapproved state, preliminary approved, final approved, final approved and subdivided, subdivided with site improvements, have partially completed units, units unsold in inventory, model units, and other situations. Even if the subdivision is comprised of only one property type, such as single family, the project can be part of one or more market tiers, such as entry-level, mid-level, semi-custom and custom. As you can see, the combinations are almost endless. Although it is the field appraiser's job to run the maze of these situations, the review appraiser must be aware of the intricacies involved with each situation and review accordingly.

REVIEWING UNSUBDIVIDED LAND APPRAISALS

The largest potential pitfall for a reviewer is found in the appraisal of vacant land with no approvals for development. For these conceptual projects, a site map may not have even been prepared. At this point, any value conclusion will be prospective due to the time it takes to

For planned unit developments, the contribution of the commercial component should also be detailed. For instance, defining the trade radius of the retail section, likely mix of tenants to support the development, and projected demand for office space should be presented. The appraiser should also clearly state to what degree the commercial component is dependent upon the residential unit mix of a planned unit development.

Another type of market analysis which is rarely seen but is very insightful is a discussion of the market within the Sales Comparison Approach. The appraiser can mention various market transactions which aren't arm's-length, such as subdivision sales from banks to developers, and clearly display his/her level of knowledge and competence. Doing this effectively paints a picture for the Sales Comparison analysis which follows and provides support for some of the adjustments.

Did the appraiser discuss whether busing is available to the site? Is the project near local schools? Is shopping available, especially food stores, community shopping centers and regional malls? Is it near any railroads which can provide easy access to major cities and other job centers? These items should be discussed in either the Area Analysis or Market Analysis sections.

SITE DESCRIPTION REVIEW

What is the Flood Zone? Are there any streams running through the property and do their locations impact upon the development potential of the property? Are there wetlands? In densely developed areas, such as off major state highways in New Jersey, does the property have roadway access?

Does the topography require extra site improvement costs not considered in the report? Does the report address whether an environmental audit is necessary for the site? Are utilities available? This is extremely important because many appraisers fail to investigate if a sewer or water moratorium is in place, and this can significantly impact on the date the project can be started, the absorption projections, and the resulting value.

DESCRIPTION OF THE PROPOSED IMPROVEMENTS

A great many subdivision appraisals never discuss *the proposed improvements. What is the market niche of* the units and the development? Do the units take full advantage of their market niche by offering all the necessary features? Often conversations with the marketing rep get all the necessary studies and paperwork for the final approvals. It is not uncommon for a project to take two or more years to get approved.

If the property has no approvals, how long will it take to get preliminary and final approvals? This is critical since the absorption schedule and probable market conditions depend upon when the project gets a final approval. How much will it cost? If the property has preliminary approvals, again how long will it take to get final and the cost? What is the probability of obtaining approvals in the first place? What are the costs involved with roll-back taxes if approved for development? If the property is unapproved for development, has the appraiser included an unapproved Sales Comparison Approach? Too often, an appraiser will present the value based on a discounted cash flow analysis which considers a developer's approach scenario and fail to present a Sales Comparison Approach for the property as unapproved for development. Has the appraiser presented a gross sellout figure? Including this within the appraisal can be potentially misleading to a client or a third party since it is not reflective of current market value and does not consider the costs involved with the project or the time it takes to sell it out.

MARKET ANALYSIS

Has the appraiser performed a market analysis? Effective demand analysis can provide helpful insights into the ability of the project to capture a share of its market. Effective demand is "the desire to buy coupled with the ability to pay." An effective demand analysis determines the number of units which will be demanded each year for a particular property type for an area, such as single family, multiply that by the percentage of the market which can afford to buy a home in the subject's price range, and then estimate what percentage of the effective demand will purchase at the subject, also known as a capture rate. The result is the number of lots which can be absorbed at the project over a particular period. Although an effective demand analysis is desirable, it is rarely performed since it takes a significant amount of time and research on the part of the appraiser. Some appraisers feel that the fee they quote doesn't warrant this type of advanced analysis.

At the very least, a competitive survey featuring a discussion of competitive facilities and a conclusion about the marketability of the subject units should be presented. An overview of general macro trends for the county and the township can also be presented, such as trends in population, income levels, labor force trends and residential building permit trends.

developers must still pay for the affordable housing component to buy into the project and they must take the risk of developing them below cost, losing money.

INCOME CAPITALIZATION APPROACH REVIEW

Are the projections for absorption properly documented with comparable projects? Are those absorption comparables in the same market niche as the subject (i.e. entry-level, mid-level, etc.)? Will the reputation of the developer afford the project a higher- than-market absorption rate, such as is found with Toll Brothers custom homes on the East Coast or the Hovnanian Corporations with entry-level townhomes in the Northeast?

Are the locations of the absorption comparables superior and will that warrant a lower absorption estimate for the subject? For instance, if an elementary school system is within walking distance for a project used as an absorption comparable, this location influence should be discussed and appropriately considered when comparing this project's absorption rate to the subject. Are the subject's unit sale prices competitive with other developments or are the subject units at a price disadvantage? This can often be seen between larger entry-level builders and smaller developers with less favorable cost structures.

Are the estimates for site improvements, hard costs and entrepreneurial profit factually based? At the bare minimum, the input of the developer on these issues should be reported. Has the price of options been built into the unit sale prices? Many appraisers use only the base unit sale prices when in reality only a small minority of homes sell without options. The appraiser should determine from the developer or sales representative how much the typical buyer spends above the base cost and include this in the gross unit sale price estimate. Has the appraiser properly considered the cost of developing any project amenities, such as a club house, swimming pool or tennis courts? Does the estimate for closing costs consider the cost of a home owners warranty usually paid by the builder? Has the appraiser given proper consideration to the contributory value of any partial improvements at the project? Has the appraiser considered the cost to construct and hold model units?

Is the discount rate appropriate? Subdivisions should almost always command a higher discount rate than the investment grade real estate reported by various investor surveys. The discount rate premium above pure investment grade real estate should reflect the added risk of resentatives of other competitive projects will highlight how well the subject competes in its market and if their models have the proper unit features to be fully competitive. How much customization is available at the development? Often entry-level developers won't install skylights or other important features, causing buyers to go elsewhere. Lastly, how price competitive are the units compared to other projects? All of these factors will directly affect absorption projections within the report.

ZONING REVIEW

Does the proposed site plan fit into the zoning? Is the proposed density within the zoning limits? If not, the only way to get a higher yield is to get a yield bonus from the township, and the appraiser should discuss the probability of this occurring.

HIGHEST AND BEST USE REVIEW

Should the development be built now or wait for better market conditions? Current absorption levels usually dictate whether it should be developed. It is also possible that the proposed site plan has to be revised to take better advantage of a more profitable market niche. For projects which have been subdivided, the highest and best use conclusion will almost always be to improve the lots according to the individual unit buyer's desires (i.e. his/her model selection).

SALES COMPARISON APPROACH REVIEW

Has the appraiser used comparable sales which are in the same market niche as the subject? Comparing entry-level lots to semi- custom or custom lots is inappropriate since a typical buyer would consider them in different markets.

Has the appraiser used a "sale price to gross sellout ratio" within the Sales Comparison Approach? This is computed by dividing the sale price paid for a comparable land sale by the gross sellout of the project (the number of units times their estimated sale price). This ratio can provide insight into how much developers are paying for land given the market niche of the development. Often, it can point out comparable sales where the developer has paid too much for a property.

Has the appraiser properly adjusted for affordable housing units in the comparables or the housing mix within the comparable? Sometimes the Sales Comparison analysis will use a unit sale price which excludes the affordable housing from the calculation. This is incorrect because

CONCLUSIONS

Reviewing a subdivision appraisal requires a careful check of the many facets of the project. Since subdivisions are more varied than other property types, they do not lend themselves to a boilerplate document and require more unique input from the appraiser. To properly perform subdivision analysis requires an appraiser with excellent research capabilities and better than average writing ability. The reviewer should be aware of this and conduct his/her review according to the many concepts discussed here. Only then can the reviewer achieve a level of comfort with the appraised value and the ability of the appraiser he reviewed.

SYNOPSIS OF SIGNIFICANT POINTS

1. Residential subdivisions are highly varied and don't lend themselves to simple boilerplate types of reports, if done properly.

2. Reviewing a subdivision requires an in-depth probing of the many areas of an appraisal report.

3. The degree of value exposure is higher in a subdivision than other property types and the reviewer is also more exposed (implied within the report, not specifically stated).
4. The article breaks down the different elements of an appraisal report, discusses the key areas which must be reviewed to develop confidence in the value conclusion and offers insights into the many situations which can be encountered in subdivision analysis.

the project in it's marketplace based upon the competitive factors which the appraiser has hopefully detailed within the report.

Have the projected revenues and costs of low and moderate income housing been included? It is rare for a developer to make money on affordable housing. Usually, the best they can hope to do is break even. However, many suffer financial losses for each unit built and this should be factored into the analysis. The appraiser could also determine from the township or state how much the developer can charge for low and moderate income units, apply the cost to construct those units, and isolate whether the developer will break even or lose money on the affordable housing units.

Has the appraiser included construction loan interest within the discounted cash flow? If he/she has, it is usually best to remove it because the amount of the loan drawn down and paid back at any point in time is very difficult to determine. For the reviewer, it is extremely difficult, if not impossible, to determine if this periodic figure is correct.

RECONCILIATION REVIEW

Has the appraiser selected the proper approach for final weight within the reconciliation?

> "Appropriateness, accuracy and quantity of evidence are the criteria with which an appraiser forms a meaningful, defensible final value estimate [within the reconciliation]"

The purpose of a reconciliation section is not to summarize what the appraiser has already done but to choose the most appropriate approach(es) to value based upon the above criteria.

ASSUMPTIONS AND LIMITING CONDITIONS REVIEW

Has the appraiser put in sufficient assumptions and limiting conditions? Usually, this is not the case, especially on unapproved properties when a prospective value with approvals is derived. Any time an appraiser bases a significant conclusion which materially impacts his/her value, a special assumption and limiting condition should be prepared; it should also be clearly stated where appropriate in the body of the report, the assumptions and limiting conditions section and the summary of salient facts. A reference to these special assumptions and limiting conditions directing the reader to another section of the report can also be made on the letter of transmittal.