WHAT DOES LAND VALUE MEAN TO YOU?

Why language matters in real estate

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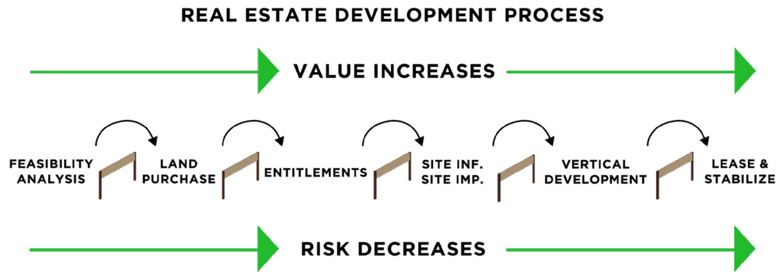
> In discussions with colleagues, industry professionals and developers, I'm continuously reminded that "land value" can represent different things to different parties. When tasked with determining land value, we must recognize that land has phases of entitlement and improvement which influence value.

It is important to identify which condition of land you are appraising for your assignment: raw land, approved land or approved and improved land. In many cases, there are multiple physically possible and legally permissible development options for a given parcel of land. Are the approvals and site improvements for your subject property, if any, consistent with your highest and best use conclusion? Although difficult to uncover in many circumstances, we must be especially diligent to consider the physical and non-physical contributors (or detractors) of value when appraising this incredibly complex property type — a property type valued in every right of way appraisal.

It should be noted that land is just one component of the overall development flowchart. Although there are many subphases within each broader phase, the general real estate development flowchart is as follows:



It should be understood that there are varying levels of "land value" depending on entitlements [1], site improvements, and site infrastructure. Land entitlement, site infrastructure, and site improvements are development "hurdles" of their own; it is important to recognize that risk decreases as each phase of development is cleared. As risk decreases, value typically increases.

Many real estate professionals generically and incorrectly utilize the phrase "vacant land" to describe land in any of its three differing conditions:

1. **Raw Land —** not approved for development or improved with utilities or other infrastructure necessary for vertical development. This is the least valuable condition of land in the development process.

   a. The value of raw land varies widely from developer to developer based on experience and risk tolerance.

   b. Likelihood of rezoning or increasing development density is factored into a developer's preferred acquisition price of raw land — each of which can be difficult to credibly support.

2. **Approved (Entitled) Land —** approved land is otherwise known as entitled land. Approvals are for a specific use. "Approvals" refer to the governing municipality's interpretation of compliance for proposed development's use, density, conformance and safety and access from public roadways, among other considerations. If a project meets the standards of the zoning code, it is often approved. This condition of land is approved for development but not improved with site infrastructure/site improvements necessary for vertical development.

   a. Municipalities (zoning hearing board, planning commission, board of supervisors) determine whether to approve a given project based on the prospective development's conformance to the zoning code and potential benefit to the community.

   b. Soft costs to entitle include: township zoning approval fees, legal fees, engineering fees (site plans), architect fees (building plans) and interim real estate taxes and insurance.

   c. Approvals/entitlements are often granted for a specific use which is not always consistent with the highest and best use. For example, if a piece of land is entitled for a single-family home, but the highest and best use is for development of a retail building, the entitlements for single-family residence may not actually enhance the site value whatsoever. In other words, an entitlement not consistent with highest and best use may not be desirable (valuable) to the market.

   d. For raw land to become approved land, a property owner must undertake risk and incur soft costs during the entitlement process. For example, there is risk that a large residentially zoned piece of raw land with a concept plan will have significantly less lot yield [2] than what will ultimately be approved by the municipality. Therefore, all else being equal, the value of a parcel that is approved for a subdivision (with known lot yield) is often times significantly more valuable than the same parcel that is not yet approved. Theoretically, the difference in value between raw and entitled land is comprised of some combination of entrepreneurial incentive and the anticipated soft costs incurred for entitlement, which can vary based on the proposed development and developer.

3. **Approved and Improved Land —** otherwise known as pad ready in commercial real estate. This condition is approved for development and improved with all necessary site improvements to break ground on vertical development.

   For entitled land to become "pad ready," a property owner must undertake risk and incur site infrastructure and site improvement costs to prepare the site for vertical development.

   "Pad ready" may mean different things to different people; however, the components listed below are typically the physical characteristics of interest for an entitled and improved site.

   a. Site Infrastructure typically comes first. Hard costs include site grading, retaining walls, extending utility lines, stormwater management

   b. Site Improvements typically comes next. Costs include entry/access roads, landscaping, sidewalks, curbing, parking lot, lighting, fencing

   c. Given the number of line-item costs in this phase of development, it is important to know what site infrastructure and site improvements were in place at the time of sale, if utilizing the site as a comparable sale.

   d. Probably the most important reason as to why entitled and improved land is the most valuable of the three conditions is that timing is a more predictable variable. A developer or future owner occupant knows that they can break ground immediately, and they can make alternative investment decisions accordingly. Most investment decisions and associated risk are determined based on opportunity cost which is much more of a known variable when land is entitled and improved for vertical construction.

In conclusion, it is my opinion that we as real estate professionals need to change the way we discuss "land value":

- As appraisers, we need to get more specific when asking brokers or buyers questions about a land transfer to utilize as a comparable sale. Almost no land comparable sale will be in the same phase of development as the subject property — related to required site infrastructure, required site improvements or entitlement risk. This must be quantified or qualified to produce a reliable comparison to any given subject property.

- As brokers, we need to get more specific when asking buyers, sellers and municipalities what their criteria are for development. This will better inform how to quantify projected risk and cost prior to acquisition or breaking ground.

- As owners, we need to get more specific when comparing our sites to "comparable" sites that sold. As the article relays, there are seemingly infinite steps in land development and no two sites are ever identical with regard to stage of entitlement or necessary site work (on- or off-site). Ultimately, it is difficult to utilize comparable sales when underwriting land value due to elements specific to any given subject site. ✪

[1] Entitlements are legal rights conveyed by approvals from government entities to develop a property for a certain use, intensity, building type, and orientation on a site. Entitlements can be a major factor in the ultimate use, viability, and value of land.

[2] "Yield" in this context refers to the number of lots that the development will be approved for. Although some developers are extremely accurate with their predictions of what a raw piece of land can yield, it's impossible to know the lot yield until final land development plans are approved and recorded. Among many other examples of development density, yield can also refer to the amount of square feet that is able to be developed on a proposed commercial or industrial site as well.

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