

Attention: Robert E. Feldman, Executive Secretary  
Comments, Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street NW, Washington, DC 20429

“Proposed Interagency Appraisal and Evaluation Guidelines  
Comments@FDIC.gov.”

#### Page 26. Tract Developments with Unsold Units

Developed Lots. For proposed developments of five or more residential lots, the appraiser must analyze and report appropriate deductions and discounts. Appropriate deductions and discounts should reflect holdings costs, marketing costs, and entrepreneurial profit during the sales absorption period for the sale of developed lots. **The estimated sales absorption period should reflect the expected holding period before development commences as well as the time frame for the actual development and sale of lots.**

The statement, above (in bold), is confusing, because in the present value, or bulk sale/wholesale valuation of finished lots it unconventionally suggests that an analyst should discount for the holding period before development commences (the entitlement process) and for the time during construction. Bulk/wholesale sales of subdivision lots do not transact on the basis outlined, are not usually valued in this manner by analysts employed in the acquisition of finished lots, or by appraisers that are hired to estimate the prospective value.

The methodologies typically employed to estimate the prospective (wholesale) value of subdivision lots are found in the sales approach and the income approach. In some markets, suitably comparable bulk sale transactions are available to directly apply the sales approach and adequately support an estimate of the prospective bulk value, but in other markets there may exist only individual one-lot “retail” transactions or multiple lots sold over a term in a takedown scenario. In these latter two examples a discounted cash flow (DCF) analysis (with an associated forecast of absorption) is employed in order to estimate the present value of finished lots. This model is utilized as an attempt to replicate the scenario of a bulk sale transaction. The development timeline and associated holding costs through construction are not applicable in these valuation scenarios, because, in these circumstances, it is assumed that the lots are finished at some future (prospective) date.

In order to estimate the “As Is” value of a development site, particularly when appropriate “raw land” sale comparables are not available, analysts involved in acquisitions consider the holding costs before development commences as well as the time frame for the actual development, and incorporate these projections into a land residual technique. This development (cost) approach should not be confused with the valuation of finished lots, but more appropriately utilized to estimate the value of the underlying land.

As an example of the estimate of the bulk/wholesale value of finished lots, retail-to-bulk sale discount rates are derived from the subdivision examples on the following page. If these rates are applied (as suggested) to the construction period (6+ months), and the holding period that precedes it (1+ years) to obtain entitlements, a much higher overall discount will result. The developer of the lots in question is expending his own money to develop the lots and accepting the risk of that development. There is no reason for them to accept a lower price for the finished lots for the risk to the end purchaser (lot buyer), as the lot developer is already assuming that risk. It is not the lot buyers risk to assume and hence, the lot buyers risk does not commence until the developer has completed construction of the finished lots. If the lot developer and lot user are the same, there are still two different sets of risk and sets of cost involved in the development, from both a transactional and approval standpoint.

Illustrated below is a summary of retail lot sales, and below that is a table summarizing bulk sale activity in the appraisal of a 22-lot subdivision in Southwest Washington. On the following page is the associated discounted cash flow (DCF) analysis that provides an estimate of the net present value (NPV) of the resulting cash flows.

**Retail Lot Sale Activity – Camas Area**

#	Plat/Location	Lots	Dates	\$/Lot (Avg.)	Sizes ~	Absorption (Mo.)
1	Lookout Ridge	25	6/05-4/06	\$150-\$225K <b>\$180K (Avg.)</b>	10,000	2.5
2	Norta Vista	5	6/05-4/06	\$155K-\$249K <b>\$192K (Avg.)</b>	11,000	0.5
3	Lakeridge Estates	18	7/05-4/06	\$168K-\$285K <b>\$230K (Avg.)</b>	12,000	2.0
4	Dove Hill	22	2/05-4/06	\$160K-\$280K <b>\$232K (Avg.)</b>	12,000	1.6

In the referenced appraisal report, local area subdivisions indicate absorption rates that cluster around two closed sales per month on a retail basis. If the subject's lots were offered for sale sellout would occur in less than a year (10.5 months). Upon analysis, the comparables support retail values that average \$210,000 per lot.

**Single-Purchaser Premise - Bulk Lot Sales – Camas Area**

#	Plat/Location	Lots	Date	\$/Lot	Sizes ~
1	Taverner Ridge	56	1/6	\$150K	8,300
2	Clark Co.	21	Pending	\$180K	7,925
3	Clark Co.	44	Pending	\$195K	11,000
4	Clark Co.	16	Pending	\$200K	10,096
5	Clark Co.	11	Pending	\$204K	10,300
6	Clark Co.	22	Pending	\$210K	7,655
	Subject	22		10,329	

In the referenced appraisal, a sales approach is presented that provides strong direct sale evidence in support of the appraised prospective value at \$190,000 per lot, or \$3,990,000 in bulk. This is \$20,000 per lot less than retail and the overall discount from retail is 9.5

### Subdivision Scenario I - Discounted Cash Flow Analysis (DCF)

1	Average Retail		\$210,000	
2	Absorption			
4	Overhead		2.0%	Per Year
5	RE Taxes & Misc.	\$541	/unit/qtr	0.5% Per Qtr
6	Growth	3.0%	0.75%	/Quarter

  

Period	Qtr 1	Qtr 2	Qtr 3	Qtr 4
Inventory	22	16	10	4
Sales Per Quarter	6	6	6	4
Price Per Unit	\$210,000	\$211,575	\$213,162	\$214,761
<b>Sources</b>				
Sales Revenues	\$1,260,000	\$1,269,450	\$1,278,971	\$859,042
<b>Uses</b>				
Sales & Marketing	5.0%	\$63,000	\$63,473	\$63,949
Closing Costs & taxes	2.0%	\$25,200	\$25,389	\$25,579
Overhead (2%/N)	0.5%	\$6,300	\$6,347	\$6,395
RE Tax & Misc. (\$/unit)	\$541	\$11,897	\$8,652	\$5,408
Total Uses of Cash		\$106,397	\$103,861	\$101,330
Cash Flow		\$1,153,604	\$1,165,589	\$1,177,641
Net Present Value (No DGM)		<b>\$3,994,796</b>		
Developers Gross Margin (DGM)	5.0%	\$63,000	\$63,473	\$63,949
Cash Flow		\$1,090,604	\$1,102,117	\$1,113,692
Net Present Value w/DGM		<b>\$3,870,417</b>		
IRR No DGM	12.3%	3.1%	/Qtr	
IRR w/DGM	8.00%	2.0%	/Qtr	

Internal Rate of Return (IRR) Estimate			
Vm	75%	8.00%	6.0%
Ve	25%	25.0%	6.3%
Vo	100%		12.3%

percent. The DCF on the preceding page (Subdivision Scenario I) attempts to mirror this process and in this regard appropriately deducts for the normal charges for disposal. These expenses include sales & marketing expenditures, closing costs and taxes, overhead, and real estate taxes and other miscellaneous items. The discount rate (12.3%) is derived from a band of investment technique that relies upon developer/builder investment surveys that support an equity yield rate of 25 percent, and conventional construction terms at the 8 percent selected rate. Upon analysis the data provides additional evidence in support the appraised **\$3,990,000** wholesale value conclusion.

If the inappropriate, extended periods of construction and entitlement were added to the time frame of the DCF, the new present value estimate would not mirror a market transaction, but would reflect an artificially low value that does not represent market value (\$3,990,000) as defined by the USPAP. As prescribed this would look something like the DCF on the following page (Subdivision Scenario II) and the result is the **~\$3,600,000** Interagency directed estimate.

Alternatively, if the value sought is "market value" as described by the USPAP, then the discount parameters would have to be revised (see Subdivision Scenario III) to adjust for the extended discount period. This scenario requires a discounted cash flow (DCF) analysis that provides no support for profit, and no return on equity. These are unrealistic expectations. Further, there is no suitable definition for the discounted Interagency estimate requested, and the necessary criteria to equate it to market value results in figures that are not supported by direct sales evidence. Therefore, the request for change in the definition of the appraisal guidelines appears flawed.

Sincerely,

Thomas E. Hollowed, MAI, VP  
Senior Review Appraiser – Banner Bank



### Subdivision Scenario III - Discounted Cash Flow Analysis (DCF)

1 Average Retail		\$210,000				
2 Absorption		2 sales/mo.				
4 Overhead		2.0% Per Year	0.5% Per Qtr			
5 RE Taxes & Misc.	\$541 /unit/qr	Millage	0.0103			
6 Growth	3.0%	0.75% /Quarter				

Period	Year 2			
	Qtr 1	Qtr 2	Qtr 3	Qtr 4
Inventory	22	22	22	22
Sales Per Quarter	0	0	0	0
Price Per Unit	\$210,000	\$211,575	\$213,162	\$214,761
<b>Sources</b>				
Sales Revenues	\$0	\$0	\$0	\$0
<b>Uses</b>				
Sales & Marketing	\$0	\$0	\$0	\$0
Closing Costs & taxes	\$0	\$0	\$0	\$0
Overhead (2%/N)	\$0	\$0	\$0	\$0
RE Tax & Misc. (\$/unit)	\$541	\$11,897	\$11,897	\$11,897
Total Uses of Cash	\$11,897	\$11,897	\$11,897	\$11,897

Cash Flow					
Net Present Value (No DGM)		(\$11,897)	(\$11,897)	(\$11,897)	(\$11,897)
		<b>\$3,974,670</b>			
Developers Gross Margin (DGM)		\$0	\$0	\$0	\$0
Cash Flow		(\$11,897)	(\$11,897)	(\$11,897)	(\$11,897)
Net Present Value w/DGM		<b>\$3,851,606</b>			

IRR No DGM		6.0%	1.5% /Qtr
IRR w/DGM		8.00%	2.0% /Qtr

Internal Rate of Return (IRR) Estimate	
V <sub>m</sub>	75%
V <sub>e</sub>	25%
V <sub>o</sub>	100%

		\$1,298,227	\$1,307,964	\$1,317,774	\$885,105
		\$64,911	\$65,398	\$65,889	\$44,255
		\$25,965	\$26,159	\$26,355	\$17,702
		\$6,491	\$6,540	\$6,589	\$4,426
		\$11,897	\$8,652	\$5,408	\$2,163
		\$109,264	\$106,749	\$104,241	\$68,546
		\$1,188,964	\$1,201,215	\$1,213,533	\$816,559
		\$0	\$0	\$0	\$0
		\$1,188,964	\$1,201,215	\$1,213,533	\$816,559