



# Appraisals and Evaluations

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## IV. Applying Part 323 / Other Topics

# Residential Tract Developments

- Defined as five or more units constructed or to be constructed as a single development.
- The amount of time estimated to develop and sell a residential tract development project determines the type of market value to be used – either the bulk sale market value or the sum of the retail sales market value

# Residential Tract Developments

- Projects that are not likely to be constructed and sold within one year must be valued using the bulk sale market value.
- The bulk sale market value incorporates appropriate deductions and discounts for holding and marketing costs, and for developers' profit.
- Projects that are likely to be constructed and sold within one year can be valued at the sum of retail sales values. Refer to Financial Institution Letter 90-2005 for more information.

# 80-Lot Tract Development Example

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Lot Sales (\$80,000 per Lot)	\$800,000	\$800,000	\$1,600,000	\$1,600,000	\$1,600,000
Less: Selling Costs 10% per Lot	-80,000	-80,000	-160,000	-160,000	-160,000
Less: Developer Profit 15% per Lot	-120,000	-120,000	-240,000	-240,000	-240,000
Less: Development Cost	-2,500,000				
Net Proceeds	-\$1,900,000	\$600,000	\$1,200,000	\$1,200,000	\$1,200,000
Present Value @ 13%	-\$1,681,416	\$469,888	\$831,660	\$735,983	\$651,312

Total Net Present Value \$1,007,427

# Frequently Asked Questions

- Can an appraisal of a model home be used to estimate the value of a tract development?

**Yes. An appraisal of a model home can be used to determine the market value for the development. The file should contain adjustments to the value conclusion based on differences in market value of the lots and any options or upgrades relative to the appraisal of the model home. Refer to Financial Institution Letter 90-2005 for details.**

# Frequently Asked Questions

- Is a bulk sale market value needed for a loan on over five units that are not residential in nature, such as six industrial condominiums?

**It depends upon the timeframe in which the project is likely to be constructed and sold. Further, the definition of tract development is not limited to only residential projects. Refer to Financial Institution Letter 90-2005 for details.**

# Rental of Single-Family Residences

- The appraisal must consider it as rental property. This can be satisfied by using:
  - **Income approach;**
  - **Sales comparison approach - use of comparable rental property sales, if available; or**
  - **Cost approach.**

# Modifications

- No appraisal/evaluation is required for a modification involving a limited change in note terms/loan agreement if there is no adverse effect on the bank's real estate collateral protection.
- Policies should provide guidance on when real estate collateral protection is adversely affected that considers:
  - **Changes in the interest rate, payment schedule, maturity date, collateral, obligors, and guarantors,**
  - **A modification is part of a workout program,**
  - **The loan is adversely classified internally, and**
  - **Market trends.**



# Frequently Asked Questions

- Is an evaluation necessary when a balloon payment structure is used so the interest rate can be reset at periodic renewals? Or, would this type of modification be considered a “limited change of terms” and not need an evaluation?

**In this example, the interest rate reset is not a modification during the term of the note or an extension of a limited or short-term nature. The renewal constitutes a subsequent transaction to an existing credit and the bank needs an appraisal or evaluation if a valid appraisal or evaluation does not exist.**

# Added Collateral for Problem Loans

- If adding real estate to strengthen a problem loan, and the addition of the collateral is not part of a subsequent transaction, an appraisal or evaluation is not required.
- However, if the loan is impaired, a current market value of the added real estate collateral will be needed to calculate the amount of impairment.

# Business Enterprise Value

- Pertains to income-producing properties, such as hotels or motels, mini-warehouses, convenience stores, retail strip centers, office buildings, etc.
- Business Enterprise Value should be valued separately from the value of the real property and improvements thereto.

# Business Enterprise Value

Going-concern value of \$1,370,000 is allocated as follows:

\$360,000	Land
\$750,000	Building and Site Improvements
\$140,000	Furniture, Fixtures, and Equipment
<u>\$120,000</u>	Business Enterprise Value
\$1,370,000	Total Going-Concern Value

Total room revenue:  $\$430,954 \times 5\%$  (mgmt fee) = \$21,548

\$21,548 capitalized at 18% = \$119,711, rounded to \$120,000

# Engagement Letters

- Engagement letters should specify what values the appraisal should provide, for example:
  - Real property and improvements,
  - Personal property, and
  - Intangible assets, such as business enterprise value (going concern).