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Appraising dev. sites: With vs. without entitlements - by Thomas Jensen

December 13, 2019 - Appraisal & Consulting

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Appraising a development site often requires “as is” and “as entitled” scenarios. However, larger sites tend to have a limited number of recent comparable transactions available for review. Therefore, a paired sales analysis of sites “with” and “without” entitlements is not always possible. In addition, changing market conditions have an immediate impact on land values making only recent transactions reliable indicators of market value.

Entitlements are one of the most important factors contributing to a site’s market value. Owners often seek Planned Development Area (PDA) or Planned Unit Development (PUD) status to permit higher intensity development typically making the site more valuable. These entitlements often require the developer to provide some form of impact compensation to the community such as a higher ratio of income-restricted residential units, community space, or off-site improvements. The cost of these special requirements needs to be verified and considered for later use as adjustments.

The first step would be to confirm whether or not the sales had permits in-place at the time of transfer. Assuming the most comparable transactions had entitlements, the subject’s valuation analysis would then estimate the value of the site, followed by expense deductions related to the entitlement process in order to arrive at an “as is, non-entitled” value.

The buyer would likely be required to make a good-faith deposit based on a percentage of the property sale price. The length of the entitlement process needs to be estimated based on the permitting time of similarly sized projects within the local municipality or submarket. The prospective buyer would likely require a certain annual return on their good-faith deposit during the entitlement process. The annual return on the good faith deposit would be considered necessary given the potential risk from potentially changing market conditions over that period. In addition, the outcome of the entitlement process would be unknown and may result in a less desirable mix and ratio of uses. The deposit amount, length of entitlement process and rate of return can be supported through conversations with real estate developers active in the local market for projects similar in size to what would be potentially approved on the subject site.

The soft costs related to the permitting process and infrastructure hard costs related to a project development need to be deducted. These estimated soft and hard costs can also be supported through conversations with real estate developers. It should be noted that infrastructure costs related to the Fan Pier and Seaport Square PDA's ran $10 to $15 per s/f of potential building area. Higher density projects typically incur lower infrastructure cost per square foot of potential building area than that of a lower density development.

Deductions made to the fully entitled site value typically indicate a reliable value estimate of a site without entitlements. It should be noted that the percentage difference in value between sites with and without entitlements diminishes in more desirable and higher value locations. Recent increases in construction costs would have typically diminished what a developer could pay for a site. However, increasing market rents and capitalization rate compression have compensated for these higher development costs. So what are entitlements worth after market conditions change and the permitted use is no longer financially feasible? The owner can hold the site until market conditions recover. However, there is no reliable method to support the required recovery time. In addition, holding costs will substantially diminish the site's current market value. The large number of variables make any value estimate for a non-financially feasible use unreliable. Assuming an alternative use may be currently financially feasible, it becomes necessary to restart the site's soft and hard cost deduction process for the alternative use. In other words, entitlements for a use that is not financially feasible add little to no value to the subject site. Having appraised several large development parcels in central Boston and Cambridge, consulting with brokers, developers, and municipal planners is vital to understanding the likelihood of project approvals, development costs, and a project's financial feasibility.

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