

Commentary

Defining the "Finished Lot"

by Andrew Brooks

The term "finished lot" is commonly used in the sale and valuation of developable land, yet is rarely precisely defined. "Finished lot" or "finished condition", generally implies a physical and legal condition in which a property is available for issuance of building permits. However, use of the term should be accompanied by a precise definition of what is, and is not, included. While there are generally accepted components which comprise a finished lot, there is no correct or absolute definition. This commentary emphasizes the importance of a clearly defined and consistently applied definition of the "finished lot".

"Finished lot" generally implies a condition where all regulatory approvals required for issuance of building permits have been granted, all necessary grading and off-site improvements are completed, and any development fees have been paid, exclusive of the actual building permit fees. The completion of approvals and off-site improvements are generally well understood and can usually be verified through the municipality, the engineer and a physical inspection of the property. Verification of the requirement and payment status of development fees can be elusive.

Variations in the definitions of finished lot are typically attributable to the inclusion, or exclusion, of certain development fees. Development fees have become a more significant portion of completion costs, and their consideration can therefore have a substantial impact on a reported finished lot value. What fees are, or are not, included within a finished lot tends to be influenced by general practices in a market area. However, to be consistent with the concept that a finished lot is available for issuance of building permits, all fees required for permit issuance, exclusive of building permit fees themselves (permit and plan check fees are typically related to the size and/or cost of the improvements, and are generally small in comparison to development fees), should be included within the definition of a finished lot when appraising land. Inclusion of all development fees is also considered preferable to achieve a more accurate comparison of properties in municipalities with differing fees structures.

Inclusion of development fees which are based on building characteristics, or closely aligned with building costs, tends to be somewhat debatable. An example would be school fees which are based on the square footage of proposed improvements. Without improvement plans, an estimate of actual fees is premature. However, if these fees are quite substantial (i.e. \$2.65 per sq. ft. or \$5,300 for a 2,000 sq. ft. unit) and vary between districts, exclusion of these fees can have a significant impact on reported finished lot values. Another example of a fee closely aligned with building costs would be water connection and/or meter fees. These fees can sometimes be deferred until improvements are completed and occupancy permits are issued. In general, it is preferable to include all development fees which are required for issuance of building permits, so as to arrive at a finished lot value which is best comparable with properties in municipalities with differing fee schedules.

Another area of discrepancy in finished lot costs is the inclusion of on-site improvements which are a required condition of development. For example, a municipality may require new single family residential units to have front yard landscaping and rear yard fencing installed by the builder. A builder may include these costs within their estimate of finished lot cost to get a true comparison to properties without this requirement. This results in a lower value to the existing condition of the property. It can be argued however that these improvements create additional value to which a builder would be compensated for, and should therefore be excluded from finished lot costs. Parties to a transaction predicated on finished lot value obviously have incentive to load-up or pare-down the costs associated with achieving a finished lot condition. Estimated completion costs may also include

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unreasonable contingencies (either too small or too large) in an attempt to favor a party's position.

In theory, there could also be a component for entrepreneurial profit within an estimated finished lot value. The amount of the profit would be dependent upon the extent of work required to achieve the finished lot. In practice however, there is rarely recognition for any entrepreneurial profit, unless a property requires additional entitlement approvals or substantial grading work. In those cases, the amount of entrepreneurial profit would be related to the risk and time for completing the additional items.

Another consideration in the comparison of properties in a finished lot condition is the impact of any special tax assessment districts. Special assessment districts essentially defer payment on a portion of the costs to finish a property into the future, in the form of special taxes. In practice, the finished lot condition typically does not incorporate the impacts of special tax assessments on a property. However, any difference in required special taxes between properties must be properly accounted for to obtain an accurate comparison (see past commentary entitled "Calculating The Market Value For Land Encumbered By Special Taxes").

A finished lot condition could be defined as having no special tax assessments. In this case an estimate of the special assessment obligation for the property would need to be made. In an Assessment District the remaining assessment obligation for an individual property can be determined, yet an individual payoff is normally not possible within a Community Facilities District. It is considered preferable to exclude the effects of special tax assessments from a finished lot condition, and adjust for their impacts separately. It should be realized then, that the finished lot value of a property within a special assessment district could be significantly different than a comparable property not within an assessment district.

While there are generally accepted components which comprise a finished lot for developable property, there is no absolute definition. The important issue is to clearly define and state the definition which is being employed. An example definition for "finished lot", as utilized in a single family residential lot subdivision, is set out as follows:

"Finished lot condition is defined as having all developmental entitlements, infrastructure improvements completed, finish graded, all in-tract utilities stubbed to each lot, street improvements completed, common area improvements and landscaping completed, and all development fees, exclusive of building permit fees, paid."

Comparing properties on a "finished lot" basis is a logical and appropriate valuation technique. However, finished lot values can vary significantly depending on exactly what is, or is not, included in a finished lot condition. A clearly stated and consistently applied definition of the "finished lot" condition is essential to the accuracy of a valuation analysis.

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