

Purdy's Method of Land Valuation New Form

Instructions

Step 1) Enter values for questions A-G in Section One. Refer to pages 2 and 3 for directions on how to find the value for each question.

Step 2) Once all values have been found in Section One, solve the equation from top to bottom in Section Two.

Section One

- | | | |
|--|----|-------|
| A) Project Value | \$ | _____ |
| B) Desired Developer Profit | % | _____ |
| C) Real Estate Commissions | % | _____ |
| D) Opportunity & Carrying Cost | % | _____ |
| E) Term of Project | # | _____ |
| F) Total SF/Lots/Units within Project | # | _____ |
| G) Per SF/Lot Construction Cost All In | \$ | _____ |

Purdy's Logic

Projected Value ÷ (Developer Profit + (Opportunity and Carrying Cost x Term) + Real Estate Commissions + 1) – (Per SF/lot Construction Cost x Total SF/lots within Project) = Land Value

Section Two

Solving For Value

- | | | |
|---|-------|-------|
| 1) Multiply "D" x "E" to get "H" | H) % | _____ |
| 2) Total of "H" + "B" + "C" + 1 to get "I" | I) % | _____ |
| 3) Multiply "F" x "G" to get "J" | J) \$ | _____ |
| 4) Divide "A" by "I" and Subtract "J" to
Get Your Land Value | = \$ | _____ |

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Purdy's Explanations

Projected Value:

Lease: Start by calculating the NOI (Net Operating Income.) NOI can be determined by multiplying the total projected SF of the project by the area market rental rate. (Make sure to gather good market rent comps to insure the success of the project.) Next, determine the market cap rates for the area. Cap Rates are typically about 1% to 2% higher than a benchmark, such as the 10 year average of the Muni Bond. Cap Rates do not represent return on investment, but work more as a measurement tool to compare investments.

SF x Net Market Rental Rate = Projected NOI Projected NOI ÷ Market Cap = Value.

Sales: In this scenario start with calculating the number of units and or lots in the project.(Make sure to check with local municipalities to ensure accurate information on density, height restrictions, setbacks, and other issues.) It is best to work with a professional land planner or civil engineer. Once the correct information has been gathered and verified, multiply the number of units/lots by the average sales price to be sold in the project, or total the sum of all the units/lots to be sold.

In some cases you may have many different prices because of the diversity of a project in reference to location or types of product (i.e. waterfront, interior or penthouse.) Once again, it is important to gather good comps for the products you plan on selling. Also, if you are putting information packets together to help sell the property, make sure you include this comp data, as it is the most important data in the entire packet.(Make sure your comp data is up to date and that the comps have matching amenities with your projects.)

Example: Don't compare a golf community to a waterfront one, or a tower with pool, shops, and concierge services to one without. Once you have all the projected sales prices of all the different units/lots add all of them together to get to the Projected Value.

Example: (Unit A \$300,000 x 6) + (Unit B \$500,000 x 2) + (Unit C 1,000,000 x 3) = Projected Value of \$5,800,000

Total Number of Units/Lots x Average Sales Price = Projected Value

Developer Profit:

Desired Developer profit will vary depending on the individual developer, but typically it is much like any other business and will be in the neighborhood of 20% to 25%. In some cases for end-users, the developer's profit may be very low as they look more at the opportunity a location will provide for their business, than the amount of developer profit they will gain. Another thing to keep in mind is the average business cannot pay more than 10% of its gross revenues toward real estate.

Example: If a company grosses \$500,000 per year it typically can not pay more than \$50,000 per year in total rent, real estate taxes, and insurance or pass-through.

When evaluating land, always use a developer profit because in most parts of the country businesses usually prefer to lease instead of own. Some of the largest organizations that lease are; Wall Mart, Walgreens, CVS, Taco Bell, and many others. Remember leasing offers much more flexibility with regards to tax breaks, as well as flexibility in terms of growth or downsizing. So remember, Developer Profit is important because no one wants to build an establishment without capital gain.

Real Estate Commission and Marketing:

Although commissions have been steadily decreasing over the years, you still need to include them into the mix as they are a real cost to be considered. Typically you need to have enough money for the listing agent, selling agent, and the marketing firms.

When calculating marketing budgets you can use the most common assumption of 1% to 3%, but it is much better if you use hard quotes from the publications and services you plan to advertise with. High end projects can go as high as 3% of the total projected value. Do not discount your commissions as it can be the death of a project.

Listing Agent Commission + Selling Agent Commission + Marketing Budget = Total Commission Needed

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Opportunity and Carrying Cost:

In reality, both opportunity and carrying cost have different definitions, however, for my methodology of evaluation they encompass the same meaning. It is important to understand the difference, and how and why they should be factored in.

Opportunity Costs can best be described as a loss to the investor since their money is in the project, as opposed to investing money somewhere else where it will earn interest. Even if the investor pays cash for a property, thus having no interest payments to the bank, the project is still costing the investor money.

Carrying Costs are the costs associated with taking the project through the entitlement process, building, and selling out. These costs include interest payments to lending institutions, taxes, and insurance. Time is the worst enemy of carrying cost, and can bankrupt a project quicker than anything.

Term of Project:

This is one of the most overlooked aspects of land evaluation. The term is determined by three main elements; the design and permitting process, the construction, and the sales. Make sure you understand the time periods associated with these elements. Pay close attention to absorption rates in the local market and give yourself sufficient time for sales. Do not forget that even though a property is suitable for use, obstacles (i.e. strong willed neighbors, schools, infrastructure, and many others) may prevent you from continuing forward, because of the cost of time. This time element is another reason to have all entitlements and permits in place before closing on a property.

Opportunity and Carrying Cost x Term = Total Cost of Carrying the Project

Total SF/Lots:

Make sure you research the total SF and/or number of units or lots allowed on the property. Usually, you can estimate by just talking to the governing authority. In most municipalities you will find references to land coverage ratios, floor area ratios or lots per acre. Although this information is available, you should always seek the help of a qualified engineer or land use expert, to ensure you have interpreted the zoning codes correctly.

You can use the formula below to calculate projected building size. (This is just an estimate.) Remember the only way to be sure of your figures would be to go through the site plan and permitting approval process. As a general rule of thumb you should never close on a property based on a projected value, unless the property is guaranteed for that use. If the property is not guaranteed for that use, make sure you use the current use to determine the value. **LCR x Total Land SF or FAR x Total Land SF.**

Per SF/Lots Construction Cost All In:

This is an estimate and you can usually get this data from other builders or developers who have constructed similar projects in the area. Keep in mind that costs may vary from town to town and state to state. Also, make sure you are using data from the projects that were built within the last six months as markets tend to change rapidly. Remember also that costs for a high-rise are going to be different from a retail center, freestanding building, etc. Finally, do not limit yourself to speaking with one or two builders/ developer. Try to gain as much information from as many sources as possible.

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Example

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Step 1) Enter values for questions A-G in Section One. Refer to pages 2 and 3 for directions on how to find the value for each question.

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Section One

A) Project Value	\$	<u>10,000,000.00</u>
B) Desired Developer Profit	%	<u>25%</u>
C) Real Estate Commissions	%	<u>8.00%</u>
D) Opportunity & Carrying Cost	%	<u>8.00%</u>
E) Term of Project	#	<u>2</u>
F) Total SF/Lots/Units within Project	#	<u>40,000</u>
G) Per SF/Lot Construction Cost All In	\$	<u>98.00</u>

Purdy's Logic

Projected Value ÷ (Developer Profit + (Opportunity and Carrying Cost x Term) + Real Estate Commissions + 1) – (Per SF/lot Construction Cost x Total SF/lots within Project) = Land Value

Section Two

Solving For Value

1) Multiply "D" x "E" to get "H"	H) %	<u>16%</u>
2) Total of "H" + "B" + "C" + 1 to get "I"	I) %	<u>149%</u>
3) Multiply "F" x "G" to get "J"	J) \$	<u>\$3,920,000.00</u>
4) Divide "A" by "I" and Subtract "J" to Get Your Land Value	= \$	<u>\$2,791,409.00</u>

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