CHAPTER 11

Residential Land Uses

CHAPTER PREVIEW

The process of real estate development is one that requires extensive knowledge and practice of all aspects of real estate: legal, financial, and markets. Because of the special characteristics of real estate improvements—large size, long life, and long gestation period—success in real estate development is in large part determined by the accuracy of forecasts of long-term market potential for the project.

This chapter and Chapter 12 examine the real estate development process. In this chapter, we focus on residential land development, while Chapter 12 deals with various types of commercial development.

Residential development takes various forms: single-family and multifamily dwellings, primary and secondary homes, custom-built and factory-built houses. Whatever form a development is to take, successful developers must study carefully the market for the type of housing they contemplate and analyze carefully the financial feasibility of the proposed project.

The topics to be covered in this chapter are

- types of residential development, including (1) single-family detached houses, (2) single-family attached houses, (3) multifamily residences, (4) manufactured homes, and (5) second homes;
- time-sharing;
- market and feasibility analysis; and
- financial feasibility analysis.

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TYPES OF RESIDENTIAL DEVELOPMENT

Although the single-family home on its own lot remains the ideal of most American families, other forms of single-family dwellings are becoming increasingly popular. Multifamily residences, too, take various forms. The five principal types of residential development are

1. single-family detached houses,
2. single-family attached houses,
3. multifamily residences,
4. manufactured homes, and
5. second homes.

Single-Family Detached Houses

The single-family house separated from any adjoining house with at least some open land on all four sides remains the dwelling type most sought after by American families. Many will accept a very basic house on a very small lot simply to attain this goal. The reason often given is that the detached house provides more privacy than an attached dwelling, though this is not always the case, especially if lots are small. Nevertheless, because of this perception, detached houses often have the best resale value.

Single-Family Attached Houses

The attached row house is a form of housing that goes back to colonial times. This type of dwelling, on its own fee simple lot but sharing common walls with its neighbors, was quite common in cities of the East and in San Francisco.

The first association of homeowners who owned streets and parkland in common was founded in Boston in 1826. Louisburg Square, which contains 18 row houses and a common park on a 2.3-acre site on Beacon Hill, remains a very desirable residential area even today.

The rise of the suburbs shortly after the turn of the 20th century led to the domination of the detached house. The suburban form of the row house, the town house, was a rarity until the 1960s; the overwhelming majority of such dwellings have been built since 1970. For projects that are owner-occupied, almost all have used the condominium form of ownership, with a community association managing common areas.

The single-family attached dwelling has several advantages over the detached project. Clustering requires less road frontage and shorter utility lines, resulting in lower development costs per unit. The higher density of houses also permits lower land costs, further reducing cost per unit. This type of development also can result in less adverse ecological impact, with more of the site being left in its natural state and with more useful open space. A frequent complaint in conventional subdivisions is "I have to spend my weekends cutting all that grass, but there's no place for the kids to play." In a well-designed single-family attached project, yard maintenance by the homeowner is reduced greatly or eliminated, and there is a place for the children to play.

Single-family attached housing can be of several types, including the town house, the plex, and the patio house.

Town Houses

The **town house** is similar to the old row house. Each unit has its own front door that opens to the outdoors, but it shares one or both side walls with adjacent houses. Although the town house has no side yards, it may have front and rear yards. Town houses may front on the street or may be built in a series of five to ten units fronting on a common area.

Plexes

The **plex** shares the characteristics of the town house and the single-family detached house. Each building in a plex contains two or more units, each with its own outside entrance. A duplex is for two families; a triplex, for three families; a quadruplex, for four families; and so on.

Patio or Zero-Lot-Line Houses

The **patio house,** or zero-lot-line house, is very similar to the detached house except that construction is from lot line to lot line, with an outdoor living area in an interior garden court.

The garden court is normally enclosed by the house or by the house and walls. Although small compared to the yard of the usual single-family detached house, the secluded area provides a great deal of privacy. The houses are usually one story, are often L-shaped, and may have one small side yard to provide passage to the rear court area.

Multifamily Residences

Although the single-family home is still preferred by most families, it is too expensive for an increasing portion of the population. Multifamily housing may be the best alternative for such families, as well as for young couples who lack the down payments necessary to purchase their own homes, "empty nesters" who no longer need or desire as large a home as they did when their children lived with them, and single-person households. Where land prices are extremely high, rental or owner-occupied apartments may be the only feasible type of new housing available.

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Civita: An Urban Green Village

In the 1920s, the Grant family started a quarry and concrete business that produced stone and concrete for many of the major construction projects in San Diego for over 70 years. Finally, the quarry was entering the end of its life cycle, leaving a 230-acre developable site in the heart of the Mission Valley district. It presented quite a challenge both to potential developers and to the city.

Sudberry Properties, a San Diego-based commercial real estate developer, proposed a mixed-use, walkable, transit-oriented, infill community called Quarry Falls, which included 4,500 diversely priced residences and more than 1 million square feet of office and retail space for shops and restaurants. The project was designed to follow an urban master plan endorsed by the city called the City of Villages that envisions mixed-use, sustainable communities. The plan placed almost 50 percent of its land area in some type of open space and was designed to be walkable with easy access to public transit facilities. The plan received Gold Certification from the Leadership in Energy and Environmental Design (LEED) neighborhood development pilot program.

Despite depressed economic conditions, the first phase of the project, renamed Civita, broke ground late in 2010. One factor that made this possible was the land-owning Grant family's willingness to remain in the development, greatly reducing the need for developer financing. It is scheduled to be built in four phases over 12 to 15 years and require a total investment of approximately $1.5 billion.

Ownership Alternatives: Condominiums and Cooperatives

As noted in Chapter 2, many potential homeowners look to condominiums and cooperatives as ownership alternatives. To review these concepts very briefly, the owner of a condominium (condo) holds title in fee simple to the particular unit occupied and shares ownership in common areas such as recreational facilities, lobbies, and parking lots. The owner of a cooperative (co-op) owns stock in a corporation that actually holds title to the property, but the individual has the right to live in a particular apartment. The condominium, which in the United States is a relatively recent development, is far more common than the older cooperative form; most cooperatives are located in New York City. Almost all condos and co-ops are attached or multifamily units.

Condominiums and cooperatives offer several economic advantages to the buyer when contrasted with renting. Like other homeowners, the owner of a condo or co-op can deduct property taxes and mortgage interest from taxable income for income tax purposes. Second, and perhaps of even greater importance, condominium

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Do "Green" Buildings Sell?

Increasing environmental awareness in recent years combined with greatly increased energy costs has led to a movement towards "green" buildings that use less energy and are more environmentally sound. This is an admirable goal, but will it sell in the marketplace?

The Solaire, a 27-story glass-and-brick luxury apartment building at Battery Park City in New York City's financial district, has been recognized for its many "green" features. It was designed to consume 35 percent less energy, reduce peak demand for electricity 65 percent, and require 50 percent less potable water than conventional residential high-rise buildings. A storm water catchment system provides irrigation to both a rooftop garden and a green roof. An on-site black water treatment and reuse system supplies the cooling tower and the building's toilets with water. The building also incorporates an advanced heating and air-conditioning system fueled by natural gas and free of ozone-depleting refrigerants. Multilevel humidification and ventilation systems supply filtered fresh air to each residential unit.

While these features are quite impressive, how would they fare in the marketplace? Quite well, as it turned out. The leasing agents quickly found that the green elements were extremely attractive to prospective renters, even surpassing the building's great location and luxury features. Prospective tenants liked the reduced utilities costs and the healthier interior air. Its 293 units were leased within five months of its opening in 2003 at a 10 percent premium in rents, and rents have risen 15 percent since the building's opening.

or cooperative ownership serves as a hedge against potential inflation, enabling the owner to accumulate an equity position. Conversely, of course, it also exposes the owner to potential declines in housing prices.

The demand for condos and co-ops has increased during the past several decades, primarily in response to demographic trends and rapidly rising home prices. Many first-time buyers were forced out of the single-family detached market, but they still could afford a condominium or cooperative. The market was also helped by the growth in the number of households, by the smaller size of families and the increase in single-member households, by growing preference for in-town living, and by increasing commuting costs.

Besides these demographic trends, economic factors affecting the rental market have also helped increase the popularity of condos and co-ops. Owners of rental property have been caught in a serious cost squeeze. Operating costs in many cities have increased far more rapidly than rents, and in cities with rent controls, the squeeze has been much worse. This has led to a large number of conversions from rental units to condominiums and cooperatives. The large-scale trend began in Chicago, then spread rapidly across the country.

Manufactured Homes

A **manufactured home,** or *mobile home,* is a dwelling that is manufactured in a factory and then moved to a particular site. The traditional image of mobile homes has been that of cheap, tacky, and high-density housing in sleazy "shantytown" trailer parks. Unfortunately, in the past, much of this reputation was richly deserved. In contrast to the resale value of conventional site-built houses, which has generally appreciated, the value of a mobile home generally fell each year. This caused many lenders to treat mobile homes as personal property, much like automobiles, and to provide only relatively short-term, high-interest installment loans. In many areas, it was impossible to obtain a single mortgage that would cover the purchase of both a mobile home and its site. Opposition to mobile-home developments led many communities either to zone them out completely or to limit them to generally undesirable or rural areas.

The image is changing, however, because the design and construction of manufactured homes has been greatly improved. With the introduction of new materials and designs, the "oversized aluminum shoebox" has been replaced by a structure much closer to a conventional house in appearance. Part of this process has been the trend toward wider units and the double-wide and triple-wide units that are assembled on site into 24-foot-wide to 36-foot-wide homes. Construction quality also has improved tremendously with the introduction of required national construction standards.

The economies of scale and the controlled construction environment give manufactured homes a definite price advantage over conventional site-built homes. Although direct comparisons are difficult because conventional homes usually contain more luxury features, U.S. Department of Commerce data show that the average price of a multisection manufactured home is about $40 per square foot, compared to over $90 for the average site-built home.

These factors, plus the trend toward owner-occupied manufactured-home subdivisions instead of rental parks, have led lenders to liberalize financing and make it more comparable to that for conventional homes. In the past, mobile homes were considered personal property and were financed with 10-year to 15-year consumer installment loans that generally carried an interest rate approximately 2 percentage points above conventional mortgage rates. Today, however, owners of manufactured homes located permanently on their lots can obtain 30-year, FHA-insured mortgages.

Second Homes

By their very nature, second homes are very different from primary homes, and second-home markets are quite different from primary-home markets. The principal

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Five Historic New Towns: Savannah, Riverside, Radburn, Levittown, and Reston

Although we tend to think of large-scale planned developments and "new towns" as being relatively recent developments, they are not. This Close-Up examines five historic examples: Savannah, Georgia, a new town from the colonial era; Riverside, Illinois, a railroad suburb begun in the 1870s; Radburn, New Jersey, a 1920s "city for the motor age"; Levittown, New York, which introduced mass home building; and Reston, Virginia, one of the most successful of recent years.

Savannah, Georgia

Quite a few cities in this country were planned communities, including New Haven, Philadelphia, Detroit, Williamsburg, Mobile, New Orleans, and, of course, Washington, D.C. One of the most innovative was Savannah, Georgia, planned in 1730s by James Oglethorpe. His basic unit was a ward, consisting of 48 lots grouped around public squares. For over 100 years the city expanded by adding such cellular units until there were 26 squares.

Savannah became an economic backwater when the cotton economy collapsed, protecting most of the old plan from redevelopment until its historic and economic potential was realized. Two of the squares were destroyed to make way for a road, and one was covered over by a hideous parking garage. The remainder, with their homes restored, make Savannah one of the unique cities of the United States.

Riverside, Illinois

Adoption of the rectangular survey system for the western lands stretched the grid system across the country, and almost all new communities were laid out in this fashion. A notable exception was Chicago's most famous suburb, Riverside. Riverside was designed in 1869 by the nation's leading landscape architect, Fredrick Law Olmsted, who rejected the conventional grid pattern and developed a curvilinear street system. Open parkland straddled the Des Plaines River, and a park surrounding the railroad station provided a focus for the town government and business activities. The railroad made commuting the ten miles to Chicago feasible and allowed the town to develop as a bedroom community.

Over 130 years after it was first developed, Riverside is still an outstanding town that contains the best features of "modern" planning. It also remains an economically viable community in which property values bring a premium.

Radburn, New Jersey

Radburn, New Jersey, was designed as a "city for the motor age." It was originally conceived as a town for 25,000 residents located on 1,300 acres in then-rural Bergen County. Ten miles from mid-Manhattan, Radburn was designed as a series of "superblocks." Traffic was routed around these neighborhoods, and houses were located on cul-de-sacs, oriented toward interior parks of four to six acres. A system of pedestrian walkways and underpasses achieved complete separation of vehicular and pedestrian traffic.

The Great Depression, which hit only five months after the first houses were completed in May 1929, aborted Radburn's growth, and only 150 acres, containing two superblocks, were developed according to the original plan. Even so, Radburn is a viable community today and has served

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Five Historic New Towns: Savannah, Riverside, Radburn, Levittown, and Reston

as a planning example for developments in many countries, particularly in recent years.

Levittown, New York

Following World War II, there was tremendous pent-up demand for housing, particularly among the returning veterans. William Levitt, who was already an experience mass builder of war-time housing, bought 1,000 acres of potato farms on Long Island and set out to build a new town, Levittown.

Levitt's homes won no awards for architectural excellence. They were 750 square foot, two-bedroom Cape Cods on 60 by 100 foot lots. The houses were built in assembly line fashion, with specialized crews for each step of the process. For example, one man's sole job was to bolt washing machines to the floor. Using these techniques, Levitt was able to turn out 30 to 40 houses a day, and sell them for only $7,990. Even in 1951, this was a very attractive price, and he ended up selling 17,400 homes in Levittown.

Many predicted that Levittown would turn into instant slum, but the town has since surprised many of its critics. The modest standardized houses have been modified over the years to reduce the sameness, and the saplings that were set out fifty years ago are now mature large trees. The homes, which sold for about $8,000, now sell for an average of near $155,000, some reaching more than $200,000.

Reston, Virginia

Reston was the first of the modern new towns in the United States and owed much of its inspiration to Radburn. The town was begun in the early 1960s by Robert E. Simon, who used his initials in naming the town. Simon purchased 6,750 acres of Virginia countryside near Washington, D.C., and planned a complete city for approximately 70,000 residents.

Reston was officially dedicated in May, 1966, just in time to have its sales severely affected by the tight-money conditions accompanying the Vietnam War buildup. Land development requires relatively large up-front investment before sales generate adequate cash flow. In a large undertaking such as Reston the up-front costs were massive, and the sales slowdown forced Simon to sell Reston to Gulf Oil Company, which already had made an investment in Reston and had the financial resources to sustain a long-term development.

Reston has met Simon's original vision and has been a financial success, even if not for him. The town now has a population of about 60,000. Six of the village centers have been completed, along with the town center which serves as Reston's "downtown." Reston straddles the Dulles Technology Corridor and is the home of three Fortune 500 companies, the National Wildlife Association, a regional governmental center, and the U.S. Geological Survey.

reason for owning a second home is the desire to use it for leisure-time enjoyment, and certain amenities are ordinarily the main factors in its location: beaches, mountains, golf courses, tennis courts, ski lifts, and so on.

Most second-home owners occupy their dwellings for only a small portion of the year, often because of the seasonal nature of many resorts but also because the owners are unable to get away from their jobs or other responsibilities for extended periods. Hence, many units are bought at least partially for their investment potential and rented for much of the year. As landlords, owners enjoy various tax benefits, including depreciation allowances and deduction of maintenance costs, but changes in tax laws and regulations have greatly reduced potential tax advantages in recent years. For example, there are limits on the time the owner can occupy the dwelling and still claim it as rental property.

Because ownership of a second home is so expensive, many buyers in recent years have turned to resort **time-sharing,** a concept discussed in Chapter 2. Under time-sharing, a single dwelling is sold to a number of buyers, each of whom receives exclusive ownership of the dwelling for a specified time period each year. Like other forms of fee simple ownership, this ownership interest can be willed, leased, or sold.

The time-sharing concept of vacation property first appeared in the 1960s, and today there are about 1,600 timeshare resorts in the United States. Over three million consumers own time-share units.

MARKET AND FEASIBILITY ANALYSIS

We have covered in previous chapters some of the factors that determine the demand for housing at the national, regional, and neighborhood levels. All such factors must be considered when analyzing the market for a particular project. Both developers and lenders need to know what the market will be for a project in order to determine its feasibility. Essentially, they must determine what market conditions have been in the recent past and which factors that would affect the market for the project are likely to change in the near future. The steps in such a market analysis are

1. delineation of the market area;
2. analysis of recent economic trends in the local market area;
3. determination of possible changes in demand factors, such as employment, disposable income, population, household characteristics, and the **absorption rate** (the number of units that are being absorbed by the market); and
4. analysis of the potential supply, including other possible competing projects.

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Highlands Falls Country Club

It was not an outstanding golf club community or real estate development. In fact, the Highlands Falls Country Club was a failure. Located near the western North Carolina mountain resort town of Highlands, the club was first opened as the nine-hole Skylake golf course in the 1960s. It was a shoestring operation, with golfers depositing their greens fees in an honor box, where the money was picked up at the end of the day. Several developers worked on the project, the last adding nine more holes and a clubhouse. By 1980, there were about 85 homes, but the sales were slow and the project's mortgage was foreclosed.

The mortgage on the Highlands Falls Country Club was held by two real estate investment trusts. They had to decide whether the development could be made economically viable.

Not only was Highlands Falls Country Club a failed project with a poor reputation, it also came with about 85 very disgruntled and suspicious existing homeowners. Thus, the new development firm was faced with the daunting task of not only developing a high-quality golf club that could yield a development profit but also handling a near revolt of existing club members. It was no small task.

Noted golf architect Joe Lee completely redesigned the golf course, building several new holes and combining others to create longer ones, and the entire course was refurbished. While this made Highlands Falls a much better and more challenging golf course, it also made some of the old club members unhappy because they preferred the shorter course. A tennis and swim center was added, and extensive additions and renovations were made to the clubhouse.

The developer worked very hard to upgrade the image of Highlands Falls, but this was a slow, uphill process. Both the members and the community had seen too much mediocre development and failure in the past. Rumors persisted that the club would soon be foreclosed again. Gradually, however, the sweeping physical facility improvements, increasing lot and home sales, and small but important touches such as extensive landscaping and masses of flowers turned the country club's image around.

Today, Highlands Falls Country Club has a deserved reputation as one of the premier clubs in an area of very exclusive golf courses. Lots, which in 1980 ranged in price from $10,000 to $15,000, now range from $80,000 to $300,000, with one exceptional view lot selling for $650,000. There are now more than 375 homes in the development, with only a few lots available. Club memberships, which in 1984 sold for only $1,100, now sell for $45,000. Home prices range from about $340,000 for some of the older homes to $2 million for some of the newer ones.

The story of the Highlands Falls Country Club shows that even a failed development can be turned into an outstanding and profitable one if the basic elements for success are present and the project is managed by a knowledgeable developer with sufficient resources and a sincere desire to create a quality development.

Delineation of the Market Area

To begin with, the project's *market area*—that is, the extent of the housing submarket in which it will compete—must be described. The market area is determined largely by employment opportunities and commuting ranges. In smaller communities, of course, all of the local employers will be within the market area, but local workers also may commute to jobs in nearby communities.

In larger urban areas, the analyst must determine the extent of employment available within relevant commuting ranges. Public transportation facilities can extend the commuting range and expand the market area.

Analysis of Recent Trends

What has been the demand for housing within the market area during the past few years, and what economic factors lie behind recent trends? What are the vacancy rates for local rental housing and the absorption rates for new owner-occupied units? Such data usually are available and are essential for an analysis of the market potential of a new project.

Determination of Future Demand

After past and present housing market conditions have been determined, the most important part of the analysis remains—the estimation of future demand. How much unfulfilled demand remains in the market? What changes in the economic base or in national or regional economic conditions will affect demand in the local area? Are new transportation facilities or other public facilities being completed that will influence demand? The developer must analyze such factors carefully to make a reasonably accurate estimation of potential demand for the project.

Of course, not even the most keen and careful analyst can always accurately prophesy the future. Indeed, one would need almost supernatural powers to totally forecast the impact on real estate of the interactions of international political and economic intrigues, tax changes coming from Congress or state and local governments, the expansion or contraction plans of large corporations, and the complexity of business locational decisions.

Analysis of Future Supply

Many developers correctly analyze demand factors but then court disaster by ignoring competitive projects. One of the primary characteristics of real estate improvements is their long gestation period, and developers must estimate both demand and supply conditions during that period.

Suppose, for example, there is a potential demand for 500 new apartment units in a community within the next two years. If three developers respond to this potential demand by constructing three 500-unit complexes, it is impossible that each will be successful in the short run unless the market expands more than anticipated. At best,

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CASE STUDY

Milford Hills Saga

The Milford Hills saga is an interesting tale, and one that incorporates many of the varied aspects of real estate development we have studied in this book. (This example is based on a true case.)

When Charles and Becky Barr moved to Lower Nowhere they wanted privacy and place for their dog Puddy to run. They were able to achieve these objectives by buying 56 acres on the edge of town and building their home in the middle of it. After enjoying the land for 35 years, however, they wanted to retire, sell the land, and spend their retirement years elsewhere.

Charles and Becky's economic objective, of course, was to get the maximum value for their house and land. This was a much more complex problem than merely selling a house in a subdivision. It involved determining the highest and best use of the property, possibly securing a zoning change to enable them to sell the property for this use, and then finding a developer-buyer.

Although the area was undeveloped when the Barrs built their house, in the intervening years their land had become an island of greenspace surrounded by residential subdivisions, a school, and a church. As might be expected, the residents of these new subdivisions had come to enjoy the Barrs' open space and didn't want to see it developed, particularly at a higher density than the two units per acre permitted by the Rowan County zoning ordinance.

The Land Planning Process

Much of the Barr land was heavily wooded, with steep slopes and two small rocky-bottom streams. Not only did these features create natural beauty for the property, they also made the land unfeasible for a half-acre, "cookie-cutter" subdivision. In fact, Mr. Barr's preliminary investigations convinced him that it would not be feasible to develop more than 75 conventional lots on the property. Both good development practices and practical economics called for a conservation subdivision on the property. In other words, the homes would be clustered on relatively small lots, with large areas left in permanent open space.

Because Rowan County did not have provisions for conservation subdivisions in its zoning code, it was necessary for the Barrs to apply for a Planned Development. Because this type of zoning required specific plans, the Barrs hired land planner Ron Meislar. After going through several iterations, he and the Barrs agreed on a plan that clustered 125 homes within a 22.5 acre "building envelope." The remainder of the land, 34 acres, approximately 60 percent of the total land, would be left in permanent open space. Mr. Barr named the development after the area where he grew up, Milford Hills.

Dealing with the Neighborhoods

The Barrs knew their land would be much more valuable if they could secure a zoning change to permit their proposed development. They were also realistic enough to know that the plan had little chance of approval without neighborhood support. Accordingly, they held a number of meetings over a 12-month period with small groups of neighborhood leaders to explain details of the plan and to gain their input.

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The Conservation Easement

At one of the meetings the view was expressed that although the open space was desirable, there was no guarantee it would not be disturbed and possibly developed in the future. When Mr. Barr proposed putting a large portion of the open space in a conservation easement, this gained immediate neighborhood support. Thus, working with the Yadkin River Land Trust, the Barrs agreed to place 24 acres in a conservation easement. The terms of the easement limited use of this area to walking trails and prohibited cutting any of its large hardwood trees. The agreement did permit an easement for a sewer line, as this was the only way to tie in with the county's sewerage system.

The conservation easement gave the adjoining homeowners significant benefits, providing them with open space area they knew would remain undisturbed forever. The conservation easement also provided significant benefits for the Barrs. Not only did it gain vital neighborhood support for their rezoning effort, it improved the marketability of the property and also provided tax benefits.

The Rezoning Process

After two years of formulating the land plan and gaining neighborhood support, and spending more than $20,000 on the planning effort, the Barrs applied to Rowan County for a Planned Development. The planning staff suggested a few changes, and these were incorporated into the plan. They then recommended to the Planning Commission that the plan be approved. At the public meeting, a number of nearby neighbors spoke in favor of the plan, expressing the view that although they would naturally prefer the land to remain undeveloped, they felt the conservation subdivision was a "best-case" alternative. Only two people spoke in opposition. The Planning Commission praised the plan and voted unanimously to recommend approval by the County Commission.

At this point the Barrs were introduced to the ugly side of land planning politics. One of the county commissioners who was aspiring to be elected mayor decided to oppose the plan for perceived political advantage. He organized a public meeting to try to organize neighborhood opposition. Happily for the Barrs, however, this effort backfired and helped solidify support from residents who felt the plan was as good as they were likely to get and who wanted to secure the benefits of the proposed conservation easement. They worked to inform other residents, and Mr. Barr hand-delivered a copy of the plan to 185 nearby neighbors so they would know exactly what was being proposed.

These efforts bore fruit. At the public hearing, another commissioner who was opposed to any new development joined in trying to defeat the plan. Despite this, in a close vote the County Commission voted to approve it.

Selling the Land

With approval of the Planned Development zoning, the Barrs were no longer simply selling a house and 56 acres. Now they were selling 56 acres and the right to develop a 125-unit conservation subdivision. It was no longer necessary for a potential developer to spend a year or more in the uncertain process of trying to secure a rezoning while interest and other costs kept accumulating.

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The Barrs signed a six-month exclusive-listing agreement with broker Frank Glover to sell the property for $900,000. This worked out at $5,600 per unit plus $200,000 for the existing house. The house could be used as a clubhouse for the development, or sold as a residence.

Mr. Glover prepared a comprehensive sales package that included the developmental plan, a copy of a letter from the county engineer stating that water and sewer capacity was adequate to serve the development, and other supporting documents. He sent this package to commercial brokers in the area, as well as potential developers. He also placed an advertisement in an area business magazine to try to attract buyers from outside the immediate Lower Nowhere locale.

The old adage that "real estate is easy to buy but hard to sell" proved true for the Milford Hills project. Unlike stocks, bonds, or other financial instruments, real estate markets can grind very slowly, particularly for complex properties. Ten months after placing the property on the market the Barrs had received several serious expressions of interest, but nothing that resulted in a sales contract. They did receive three "letters of intent," but quickly learned these meant little or nothing. The potential buyer was merely expressing interest, but this expression of interest was not binding in any way.

Then a local developer, Mr. Mayer, presented a sales contract to Mr. Glover. He offered $562,500, or $4,500 per unit for the land but did not want to buy the house. The Barrs would be forced to sell this separately. Mr. Mayer also wanted five months to close on the property, and his contract provided him the opportunity to withdraw if he did not secure what he considered to be adequate financing. The Barrs rejected this offer.

Mr. Tom White, a developer in a nearby area, was seeking to find suitable land for a residential development in Rowan County. His broker earlier had received a sales package on the Milford Hills development from Mr. Glover. He presented this to Mr. White, and he felt Milford Hills might be what he was looking for.

After conducting market and financial feasibility studies, Mr. White offered the Barrs $800,000 for the property, with a 120-day closing date. This offer was contingent on the Barrs's securing an updated letter from Rowan County verifying that adequate water and sewer capacity was available for the development and providing a Phase 1 Environmental report certifying there were no environmentally hazardous materials on the property. It was also contingent upon Mr. White's being able to secure a development loan.

The Barrs countered with a price of $850,000 and a deposit of $15,000 earnest money that would go to them in the event that Mr. White did not close on the property for any reason other than the contingency factors. Mr. White came back with a revised offer of $825,000, and the Barrs accepted. The closing took place in late December in the office of attorney Bill Berryfield.

Market Analysis

To determine the feasibility of the Milford Hills project, and before he made his offer to the Barrs, Mr. White conducted a market analysis study. Although Milford Hills would be the first conservation subdivision in the Lower Nowhere area, he determined there was a strong market for single-family houses

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in the $160,000–$185,000 range. From this study he felt it would be feasible to sell 40 homes a year at an average price of $175,000. From this sales price he felt that the value of each lot was $30,000.

Developmental Analysis

Mr. White then had his engineer, Bevan Barringer, make an estimate of the expenditures that would be necessary to develop the Milford Hills project. (See Table 11.1.) Assuming that land and house could be purchased for $825,000, the following table shows that total developmental expenses would be $2,287,050, compared to an assumed lot sales yield of $3,750,000. In addition, there would be interest expense on the development loan.

vacancy rates in the local market probably will rise to a high level, and the general profitability of all complexes will be reduced, or perhaps will be nonexistent, resulting in foreclosure and failure.

The second step in the analysis—determining what lies behind recent trends—sometimes is not given enough emphasis, much to the subsequent regret of the developer. Suppose that housing markets in a particular community have been very tight during the past five years; that is, there has been excess demand. Without proper analysis, this might indicate a continuing strong demand for housing in the next few years.

On more thorough investigation, however, the developer might determine that the tight market conditions resulted from an influx of workers to a major new

TABLE 11.1 Milford Hills Project—Projected Development Expenses

Purchase of Land and House	$825,000
Clearing, Grubbing, Grading, and Drainage	368,550
Curb, Gutter, and Paving	516,900
Water Mains and Sanitary Sewer	357,500
Landscaping, Entrance Signs, and Nature Trail	86,100
Engineering, Permits, and Survey	133,000
Total	$2,287,050

TABLE 11.2 Milford Hills Development—Pro Forma Cash Flow Statement

	Quarter					
	1	2	3	4	5	6
Sale of Lots			$300,000	$300,000	$300,000	$300,000
Use of Funds:						
Land and House	$825,000					
Clearing, Grading, etc		$275,000				93,880
Curb, Gutter, Paving		350,000				166,900
Water and Sanitary Sewer		268,125				89,375
Landscaping, Entrance			50,000			36,100
Engineering, Surveying	65,000	68,000				
Interest Expense		22,250	46,841	41,762	35,306	28,688
Net Cash Flow	(890,000)	(983,625)	203,159	258,238	264,694	(114,913)
Cumulative Cash Flow	(890,000)	(1,873,625)	(1,670,466)	(1,412,228)	(1,147,534)	(1,262,447)

	Quarter					
	7	8	9	10	11	12
Sale of Lots	$300,000	$450,000	$450,000	$450,000	$450,000	$450,000
Use of Funds:						
Land and House						
Clearing, Grading, etc						
Curb, Gutter, Paving						
Water and Sanitary Sewer						
Landscaping, Entrance						
Engineering, Surveying						
Interest Expense	31,561	24,850	14,221	3,327		
Net Cash Flow	268,439	425,150	435,779	446,673	450,000	450,000
Cumulative Cash Flow	(994,008)	(569,858)	(133,079)	313,594	763,594	1,213,594

manufacturing plant, which now operates at its designed level. Unless growth occurs in either the plant or some other part of the community's economic base, the absorption rate—and, therefore, absolute demand for new housing—will decline.

The analyst also must carefully evaluate potential demand in the particular submarket at which the project is aimed. For example, it may be that the new plant mentioned above caused a significant expansion in demand for rental housing. The future demand for this segment of the market may decline, even though demand in other segments may expand, if the new workers move out of the rental units to owner-occupied houses.

FINANCIAL FEASIBILITY ANALYSIS

In addition to a market analysis, the developer should conduct a financial feasibility analysis of the proposed project. Such an analysis may be quite sophisticated in the case of a large and complicated development or relatively simple for a small one. In either case, the purpose is to determine—on paper, at least—the probable success of the project.

Finally, bank financing, which is usually essential, also helps to reduce the developer's risk because a large amount of the developer's own or company funds are not involved. On the other hand, any delays can be quite expensive when the interest-rate meter is running. For example, if the site improvements cannot be constructed as rapidly as the developer anticipates or if the houses do not sell as rapidly as expected, the result could be a greatly reduced profit or even default on the loan.

THE IMPORTANCE OF MARKET ANALYSIS

If the three most important factors in real estate are "location, location, and location," it should be clear to the readers of this book that the three most important factors in real estate development are "the market, the market, and the market." Real estate developers who forget this lesson usually fail; those who carefully and correctly analyze the market usually succeed.

CHAPTER REVIEW

- The five principal types of residential development are (1) single-family detached houses, (2) single-family attached houses, (3) multifamily residences, (4) manufactured homes, and (5) second homes.
- The single-family detached home has dominated the housing markets for the past 50 years and remains the most sought after type of dwelling. Escalating land costs and growing environmental and energy concerns have made this type of housing less attractive than it once was, however.

- Types of attached housing include (1) the town house, (2) the plex, and (3) the patio house.
- Condominium and cooperative ownership of multifamily and attached housing is increasing because of the economic benefits of such ownership, favorable demographic trends, and the declining profitability of rental housing.
- Manufactured or mobile homes gradually are moving toward greater acceptance by consumers, financial institutions, and communities. As a result of improvements in design and quality, the availability of financing, and the rising cost of conventional housing, manufactured homes probably will capture an increasing share of the single-family market.
- Amenities are the primary factors leading to the purchase of a second home. Because most buyers cannot occupy their units for much of the year, many units are purchased for their investment potential.
- Time-sharing enables buyers to purchase the use of a second home for a specific time period each year. Buyers thus protect a large portion of their future vacation costs from inflation and benefit from any appreciation in the value of their interest.
- The steps in analyzing the market for a residential project are (1) delineation of the market area, (2) analysis of recent trends in the local market area, (3) determination of possible changes in the demand factor of the project, and (4) analysis of the potential supply, including other possible competing projects.
- The market area is determined largely by employment opportunities within the relevant commuting range.
- The market analyst essentially determines what market conditions have been in the recent past and which factors that would affect the market for the project are likely to change in the near future.
- The developer should conduct a financial feasibility analysis that projects the probable cash flow and profit or loss of a proposed project.

KEY TERMS

absorption rate	patio house	time-sharing
manufactured home	plex	town house

STUDY EXERCISES

1. What are the five principal types of residential developments?
2. What are the differences between condominium and cooperative ownership? What are some of the advantages of these types of ownership over renting?
3. What are the three types of single-family attached housing? What are the differences among the three?
4. What are the three types of multifamily residential housing? What are the differences among the three?
5. Discuss some of the factors that are leading to greater acceptance of manufactured or mobile homes.
6. What are the principal reasons for owning a vacation home, and how do they differ from the reasons for owning a principal residence?
7. Discuss the use of time-sharing in the marketing of vacation homes.
8. Describe the steps in analyzing the market for a residential project.
9. What factors determine the market for a residential project?
10. Describe the process of financial feasibility analysis for a proposed residential project.

FURTHER READING

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