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Buyer Profile

Investor-driven transactions dominated bulk lot sale activity in 2008. Investor types range from institutional investors looking for a very specific internal rate of return, to less sophisticated investors simply seeing value in properties selling below cost. A limited number of transactions have involved builders or developers looking to acquire lots at a discounted basis for the next residential cycle, with no intent to build or develop in the near term. Far and wide, institutional investors have exhibited a strong preference for finished lots at primary, non-commuter market areas that are anticipated to have a shorter holding period and less risk.

Homebuilding under Current Market Conditions

The preponderance of national, or public, builders in the Northern California region has led to sharp and accelerated price declines over this down cycle. Although non-public (private) builders haven't fared particularly well, the housing market in Northern California and the Central Valley may recover sooner with home prices marching toward affordable levels. Even so, at present, the general consensus is that the housing market will continue to languish through 2009 and possibly through 2010. A minority of participants has leaned more heavily on broader economic concerns and has forecasted recovery to occur in 2012.

Note that certain communities lack a preponderance of public homebuilders, and accordingly, price declines in recent months have been less dramatic. In Redding, the demand preferences of local private builders, coupled with a limited inventory of finished lots, have led to recent transactions where the builders purchased lots with the intent to build in the near term. Such instances involving builders buying land under the present market is the exception, not the rule. Each of these cases involved builders paring down product lines, shifting to smaller, more affordable product with modest interior amenities.

In general, there is a definite trend across the Central Valley of active projects shifting to more affordable product, with builders altering product lines in mid-construction. Among national builders, KB Home has attracted attention with its 1,100 SF homes priced as low as $120,000 in certain market areas. However, the success of this practice largely hinges on the resale supply. Projects located in areas dominated by REO transactions (fueled by creative forms of financing) have been less successful with smaller product lines, albeit they may produce a cost savings in cases where the builder would rather continue building and endure home losses rather than stop building and be required to pay back its loan. With less significant price adjustments, fewer public builders, more limited supply, and the expectation to build in the near term, finished lots sold at generally higher prices in Redding than in the Sacramento region.

Recent Finished Lot Prices

Area	Date	Finished Lot Price
Antioch, Contra Costa County	Dec-08	$20,000
Clovis, Fresno County	Dec-08	$75,000
Elk Grove, Sacramento County	Nov-08	$43,000
Fresno, Fresno County	Jan-09	$30,000
Redding, Shasta County	Jun-08	$66,000
Rocklin, Placer County	Oct-08	$35,000
Sacramento, Sacramento County	Feb-09	$15,000
Stockton, San Joaquin County	Nov-08	$21,000
Vallejo, Contra Costa County	Dec-08	$25,000
Visalia, Tulare County	Jan-09	$26,000
Woodland, Yolo County	Dec-08	$40,000

Note: Prices are approximated

Through 2008, many projects in urban areas across the Central Valley firmed their pricing, possibly refusing to go any lower with projects being sold at or very near the vertical construction cost. With Option Arm loans resetting in November 2008, and with Alt A loans anticipated to reset next, the real estate community braces to endure the next wave of foreclosures. Also, broad economic declines in the last 60 days have contributed to rising unemployment; consequently, more foreclosures will emanate from properties with conventional loans.

Northern California/Nevada
3825 Atherton Road, Suite 500 Rocklin, California 95765
P: (916) 435-3883 F: (916) 435-4774

Central California
4260 Sisk Road, Suite C Modesto, California 95356
P: (209) 545-1489 F: (209) 545-1568

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The rate of foreclosures is anticipated to tick upward in the first half of 2009. It is not clear whether increased demand emanating from falling prices will offset the urge among banks to discount prices further with rising REO inventory. If credit markets do not improve and investors continue to make up the predominant buyer profile of REO properties, then further price declines can be expected. If so, it will be interesting to see if homebuilders will adjust pricing downward further, or be content to hold their properties while they wait for the market to recover and REO inventories to decline.

Factors Affecting Land Pricing

Market conditions in the region remain dynamic; at this point, there is no clear pricing trend. However, finished lot prices under present market conditions are a clear function of (1) the anticipated holding period, (2) holding costs, (3) the anticipated lot resale price, and (4) fees due at building permit. Many investors project the holding period for finished lots in core urban areas as the amount of time needed for new home absorption rates to recover to at least four units per month, which tends to be the threshold absorption rate preferred by merchant builders in lot acquisitions with the intent to immediately build thereafter. Current new home absorption rates remain between one and two units per month on a pro-rata basis. Many unimproved subdivisions, except for select properties with favorable locations, will not be developed until the finished lot inventory is absorbed and largely ultimately developed with completed homes. Paper lots appear to be selling with greater price discounts due to greater risk associated with longer holding periods.

Holding Period

Opinions vary among market participants how the holding period affects a return expectation and ultimately land pricing. The traditional perspective, which is still largely held by institutional investors, is that a longer holding period warrants a higher return: more time means more risk and more uncertainty. This axiom does not always hold true, however, particularly in instances where the buyer is less sophisticated and is not using cash flows to analyze land value. For instance, an owner-user- investor looking to farm a property on an interim basis while waiting for market recovery may pay just slightly more than agricultural value in an outlying market, while an institutional investor, with elevated return expectations over an extending holding period, would, perhaps, assign no value at

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About Seevers Jordan Ziegenmeyer

Seevers · Jordan · Ziegenmeyer (***SJZ***) is a commercial real estate appraisal and consulting firm with offices in Rocklin (headquarters) and Modesto. SJZ services California markets from Redding to Bakersfield, as well as Northern Nevada.

- General commercial properties (retail, office, shopping centers, industrial)
- Multi-million dollar Class A properties
- Portfolios
- Community Facilities Districts (CFDs) and Assessment Districts (ADs)
- Master planned communities
- Right of Way
- Partial Acquistion

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all. Knowing the buyer profile for the market area is critical to land valuation.

Holding Costs

Holding costs—namely Special Taxes or Mello Roos Bonds—have greatly influenced investor price expectations under the present market dynamic. In 2003, 2004 and 2005, the development community looked to mitigate rising costs by financing certain site development costs with land secured financing vis-à-vis Community Facilities Districts. Continued price declines since late 2005 have left homeowners, and builders with lots,
with Special Tax payments that are disproportionately high, commonly as high as $1,500 per lot and sometimes exceeding $3,000 in cases with overlaying Special Tax debt. Many participants cite the present value of the holding costs over the projected holding period has a dollar-for-dollar affect on the finished lot price, while other participants indicate no desire to discount the costs at all. Typically, Special Taxes were levied at the point developers recorded final subdivision maps and individual Assessor parcel numbers were assigned to each lot. However, in 2005 certain municipalities and developers levied elevated Special Tax amounts before site improvements were completed. Thus, the extended holding period of unimproved lot subdivisions, coupled with the Special Taxes, have led to steep, theoretical price discounts. The severe price discounts are theoretical because there have been no unimproved lot transactions at the select properties where the unimproved lots are encumbered by Special Taxes. Some market participants suggest these properties have zero or negative value,

The General Consensus is...

- Cost does not equal value: finished lots are selling below the cost of site development, and homes are selling below the cost of construction.
- Unimproved lot prices have neared agricultural prices ($5,000 to $10,000 per acre) in many outlying, commuter based markets.
- Finished lots in some markets have fallen below $5,000/lot.

Investor driven transactions have led to deeply discounted finished lot prices. Shown: finished lots in Rocklin, CA.

which may explain why no such transactions have yet occurred. Yet other participants claim there is a positive value, as primary fundamentals such as location and incomes remain favorable.

Anticipated Lot Resale Price

Methods of calculating lot resale prices after anticipated holding periods vary among investors. Regardless, the anticipated resale lot prices are some function of area incomes, rents, historical pricing and/or costs. Many communities in the region have homes selling below construction costs. National builders have the accounting flexibility to write down lot values, reflecting the write downs in quarterly losses that lead to stock price declines. With land values written down to nominal levels, these nationals can sell homes for just slightly more than the cost of completing vertical construction and still show a profit on the following tax year. Private builders do not have the flexibility to write down

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land values and are more reluctant to adjust prices downward, especially in instances where the land basis is high. Also, non-public builders are subject to loan to value requirements, and as prices and values trend downward, they find it harder to stay afloat.

Permits and Fees

Another primary factor influencing lot pricing among investors are the permits and fees that the builder pays when it pulls a building permit. Given anticipated holding periods of three to five years for finished lots in the Sacramento region, this factor generally has a less significant affect on lot pricing among investors. However, certain municipalities in the Sacramento region aggressively increased fees as home prices accelerated upward. In Ranch Cordova, for instance, fees due at building permit commonly total $60,000 per unit, which is approximately twice that of homes in the City of Sacramento or unincorporated Sacramento County. Significant new home price declines have left the fees in this community (much like the Special Taxes in other communities) disproportionately high. Historically, finished lots in the region have sold for approximately 30% the anticipated base new home price. With municipalities unlikely to lower fees, finished lots in Rancho Cordova--upon market recovery--may very well be sold by investors to builders for approximately 15% of the anticipated base home price. Thus, the permits and fees ultimately affect the lot price the investor can obtain after a holding period, as well as its projected Internal Rate of Return. Further, in market areas where permits and fees are exorbitant and homes are selling below construction costs, the elevated permits and fees will lead to longer holding periods among investors (since prices must appreciate before new home construction becomes feasible) and less new home construction and fees collected for parks, roads, etc.

Sample List of Fees Due at Building Permit

Area	Typical Fees Due at Building Permit* (Per Unit)	Median Sale Price^	Building Permit Fees to Median Price (Percentage)
Brentwood, Conra Costa County	$40,000	$317,000	13%
Chowchilla, Madera County	$18,000	$162,000	11%
Elk Grove, Sacramento County	$55,000	$245,000	22%
Fresno, Fresno County	$20,000	$130,000	15%
Galt, Sacramento County	$35,000	$134,250	26%
Lincoln, Placer County	$40,000	$280,000	14%
Madera, Madera County	$17,969	$140,000	13%
Rancho Cordova, Sacramento County	$60,000	$251,000	24%
Roseville, Placer County	$35,000	$302,000	12%
Sacramento, Sacramento County	$25,000	$130,000	19%
Stockton, San Joaquin County	$40,000	$118,000	34%
Tulare, Tulare County	$15,000	$139,750	11%
Visalia, Tulare County	$25,000	$160,000	16%
West Sacramento, Yolo County	$45,000	$275,000	16%
Woodland, Yolo County	$60,000	$234,500	26%

*Excludes development impact fees due at final map; based on records from prior appraisals.
^New and resale homes; based on January 2009 figures published by DataQuick.

Paired Sales - Finished Lot Prices

Area	Sale Date	Price	Home Price Ratio*
Rancho Cordova, Sacramento County	Sep-05	$183,000	41%
	Mar-08	$27,500	8%
Visalia, Tulare County	Feb-06	$126,000	39%
	Dec-07	$38,000	15%
Fair Oaks, Sacramento County	Aug-06	$147,000	37%
	Aug-08	$47,000	16%
Fresno, Fresno County	May-06	$115,000	32%
	Jan-09	$30,000	12%

*Approximate

Underlying Land Value and Measured Returns

Many market participants describe instances where the lots "sold at a fraction of the replacement cost, with no land value." Contrary to this misinformation, paired sales of paper and finished lot transactions in the region provide evidence that the underlying value of the land in finished lot transactions is positive. For instance, paper lots may transfer at $5,000 per lot, while finished lots in the same area may transfer at $15,000 per lot, where site development costs were known to total approximately $40,000 per lot. The difference between these two values is a function of the anticipated holding period and IRR expectation of
the investor. Or said another way, the present value of the site improvements of the finished lots is only $10,000 per lot. If someone wanted to transform unimproved lots to finished lots, they would incur $40,000 per lot, yet would only end up with lots worth $15,000 per lot. The dollar-for-dollar value
added by completing site improvements would not

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be realized until market conditions stabilize, at the end of the holding period.

In Plumas Lake (Yuba County), which is a commuter-based market of the Sacramento region, lots recently sold for approximately $13,000 per finished lot, and an offer was made on a nearby property for approximately $2,450 per paper lot. In this market area, site development on the finished lots exceeded $65,000 per lot. The heavily discounted site development costs reflect the elevated risk associated with the Plumas Lake submarket, which is largely commuter dependent and not apt to recover until sometime after the Sacramento region (possibly five years or longer).

Further, it is worth noting that IRR expectations under present market conditions vary by buyer type. More sophisticated investors express IRR expectations ranging from 20% to 40%, while some homebuilders have indicated they would accept lesser amounts. Also, as stated before, some investors are less sophisticated and don't have an IRR expectation; they just know the lots are being sold below cost and see value.

It's difficult to test the IRR expectations with actual sales observed in the market because, at this point, there is no known resale lot price. That is, with lots being purchased today to be held for generally three years or more, it is challenging to forecast what price the investors can achieve when they elect to resale the lots at a later date. Some investors may look to area income levels and affordability, while others may look to historical pricing or costs. Each method may yield a different resale lot value. However, using reasonable assumptions, the blended IRR expectation of two buyers can be imputed by looking at paired sales of paper lots and finished lots. For instance, using paper lots in Plumas Lake at $2,450/lot and finished lots at $13,000/lot, the IRR that translates $65,000/lot in site development costs to the difference between these two indicators ($10,550 per lot) is 43.9% assuming a five year holding period. This assumes that the buyers expect the site improvements and land to appreciate at 43.9% per year over the holding period. Thus, paper lots at $2,450/lot today would appreciate to $15,095/lot (assuming a five year hold) and finished lots at $13,000/lot today would appreciate to $80,095/lot (assuming a five year hold), with the difference between these two values roughly representing the cost of completing site improvements (the dollar-for-dollar benefit of completing site development is fully realized). This assumption may not be reasonable in market areas like Plumas Lake, where it is not financially feasible to develop. In such cases, the underlying land value would seem to appreciate at a lesser rate, if at all, than the rate of appreciation on the improvements.

Moving Forward

Finished lot prices in most markets will be lower in 2009 than 2008.

Management Profile

SJZ's senior partner, P. Richard Seevers, has over 28 years of real estate appraisal and consulting experience, and is a Member of the Appraisal Institute, holding both the MAI and SRA designations. Lance Jordan and Kevin Ziegenmeyer began working for Richard (Dick) in the early 1990s and the three formed a partnership in 1998. Eric Segal and Nelson Wong have since assumed executive positions within the firm. The company steadily expanded for several years, with a full-time staff of over 20 today.