

land-fall: an approach to or sighting of land

Can Future Land Values Be Predicted?

By Dan Flanagan

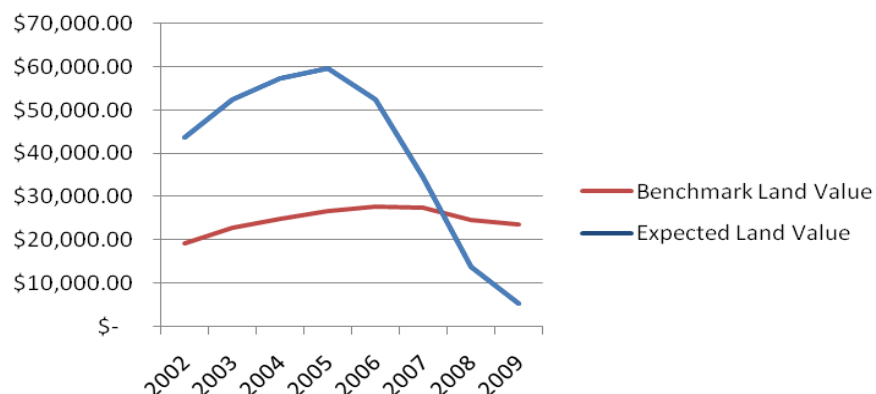
In past issues of this newsletter, we have examined a number of factors that impact the current value of residential land. To date, our discussions have been retrospective and have examined median income and home prices in order to consider what impact these factors have on residential land values. This time, I'd like to take a look forward and see if we can shed some light on what the future might look like for residential land values.

Market participants are generally rational, and their response is usually predictable if the key factors influencing value and the relationships between those factors are known. With that in mind, I wanted to explore whether there is a viable method for predicting future residential land values or value trends. The key factors influencing value are generally apparent in the residential land market (see the presentation entitled "11 Key Factors Impacting Chicago Residential Land Values" on our website) so the challenge is to understand the interrelationship between each of these factors.

In developing a method to predict land values, a "typical" land development pro-forma was prepared using common rules of thumb and ratios. This pro-forma was adjusted each year based on median home prices, lot inventory, and other market conditions to determine a baseline price that would be paid for raw land. The raw land price was then adjusted using a present value calculation based on the anticipated holding time required given the market conditions in each year. The result is an expected price per acre that would be paid for raw land under current market conditions.

The following graph shows the baseline and expected price per acre predicted by this method for each year from 2002 to 2009.

Expected and Benchmark Land Values



From 2002 to 2005 the high rate of new housing starts and relatively low inventory of fully improved lots compared to the number of starts helped drive the expected land value higher, largely because the hold time was considerably less than "typical." However, beginning in 2006, as lot inventories grew and the rate of starts declined, predicted land prices dropped. Currently, the predicted price per acre of land is below agricultural land prices, which have now become the floor for land values.

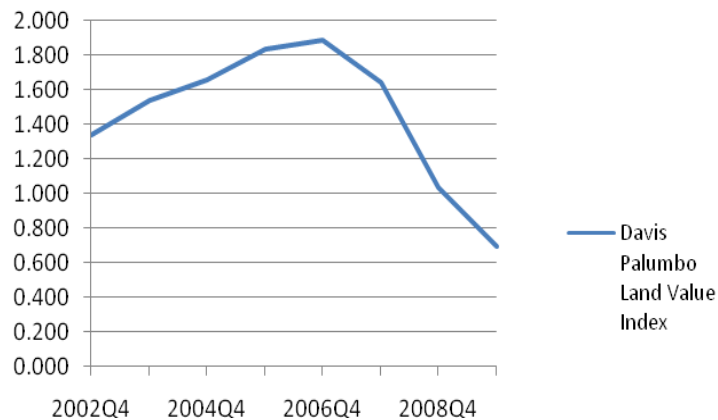
What is especially interesting is that the “baseline” value varies only slightly from year to year. It is not until we attempt to replicate the impact of the holding time (either positively or negatively) that the value begins to swing dramatically.

This approach yields results that are consistent with observed market conditions in past years. During the peak years of 2003-2006, transactions with sale prices between \$40,000 and \$60,000 per acre for well-located development land were pretty typical. In today’s market, the price range is generally settling between \$7,000 and \$15,000 per acre for residential land, with a median price around \$10,000 to \$11,000 per acre.

These results also match closely with a published index of residential land values. In a 2007 paper entitled “The Price of Residential Land in Large US Cities” authors Morris A. Davis and Michael G. Palumbo of the Lincoln Institute of Land Use Policy present an analysis of land prices in 46 major U.S. Metropolitan areas, including Chicago. The authors recently released an update to the data they used in their 2007 paper that includes an estimation of land values as a component of the value of homes through the 1st quarter of 2009.

The following graph provides a summary of Davis and Palumbo’s residential land value index for the Chicago market from 2002 to the 1st quarter of 2009.

Davis-Palumbo Land Value Index

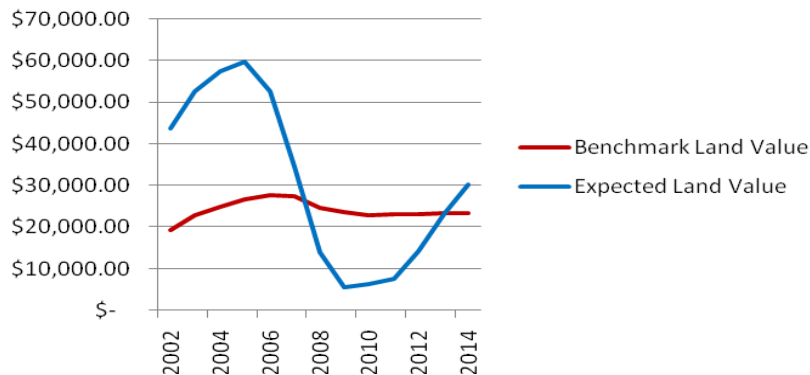


In general, the curve of our graph of expected land values follows closely with the curve of the graph of the Davis Palumbo data. So, if this method of predicting expected land values appears reasonably accurate retrospectively, we should be able to apply the same methodology looking forward.

For future land value predictions, the median home price was held at the current level of \$216,000, with 0.5% annual price increases. An annual rate of 3,500 new housing starts was assumed for 2010 (about the same as 2009) with the rate of starts increasing to 5,000 in 2011, 7,000 in 2012, 9,000 in 2013 and 12,000 in 2014. It was also assumed a negligible number of new finished lots would be delivered to the market during this time period.

The results are interesting and reveal a great deal about how the market perceives the value of residential land. Based on this analysis, land values remain very low through 2009 and 2010, with a slight improvement in 2011. Thereafter, values increase at a more dramatic rate with prices nearly doubling from 2011 to 2012, and again from 2012 to 2013 as the market reacts to a decreasing inventory of lots and land.

Expected and Benchmark Land Values



Obviously, this analysis is a broad generalization of how the market perceives the value of residential land. **However, assuming the trend represented by this analysis is accurate it seems like now is a great time to buy land....**

AVAILABLE PROPERTIES (OTHER PROPERTIES ALSO AVAILABLE – CALL FOR DETAILS)

Finished Lots & Homesites

- 12 Lots – Hidden Creek of Shorewood. Great location. Minooka Schools.
- 15 Lots – Riverbend of Genoa. Additional Lots Available. **100% USDA Financing for Homebuyers!**
- 9 Lots – Maple Hill of Lockport. Close to I-355 extension!
- 7 Lots – Sonatas of Woodstock. Beautiful setting!

Industrial Land

- +/-100 Acres – Gilberts, annexed, zoned, and engineered for light industrial. Offers considered!
- +/-8.58 Acres – Orchard Road, Montgomery. Near I-88 and Route 30. Warehouse/industrial, Motivated!

Commercial Land

- +/-2.5 Acres on Route 53 in Romeoville. Additional land available. Great traffic and visibility.

Investment Land/Farms

- +/-137 Acres – Davis Junction. Annexed, zoned, platted, engineered. Bring offers.
- +/-101 Acres – Davis Junction. Annexed, zoned, platted, engineered. Excellent Soils, Bring offers

FLANAGAN REALTY NEWS

We're busy with several pending deals, and our advisory and consulting business is growing rapidly. We are working with lenders, appraisers, investors and builders on a wide variety of land, entitlement, market analysis, and valuation related projects. We are pleased to be able to help provide clarity during these difficult times. On September 16 we were quoted in a Crain's Chicago Business News article on the housing market! We have recently been asked to be a guest host on Real Estate Radio on WLS Radio on Saturday Mornings. The show will feature a wide range of real estate related topics and special guests. We hope you'll listen!

FAMILY FUN

A few weeks ago my 5 year old son returned home after playing at a neighbor's house. After coming inside, he turned to me with a very serious look on his face and asked "Do you want to hear the noise a cat makes when you are about to drop it in the toilet?" I think we may owe the neighbors (and their cat) an apology....

Flanagan Realty, LLC is a real estate brokerage and advisory company focusing on residential, commercial, and industrial real estate, land and farms. For more information about our services or available properties, please contact us by telephone at (630) 388-8522, or by email at flanaganrealty@yahoo.com.

We also invite you to visit our website at www.flanaganland.com



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