



# ADU Valuation Challenges and Solutions

Northwestern Branch SCCAI

CHARLES BAKER, SRA, AI-RRS

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# Residential Market Snapshot

Southern California Region

December 2021 to December 2022

## ▶ Quick Facts:

- ▶ -29.3% Change in New Listings
- ▶ -45.1% Change in Pending Sales
- ▶ -46.3% Change in Closed Sales
- ▶ -2.8% Change in Inventory of Homes for Sale
- ▶ +52.0% Change in DOM
- ▶ -5.5% Change in Median Sales Price
- ▶ +31.3% Change in Months Supply
- ▶ -26.1% Change in Housing Affordability Index



# Nationwide Demand/Supply

(as of June 2023)

- ▶ 330 million population
- ▶ Anywhere between 3.8 and 7.3 million units undersupplied
- ▶ 6.5 million units undersupplied (Realtor.com)
- ▶ 4.4 million units undersupplied (FNMA)
- ▶ 16 million homes sit vacant
- ▶ 70,000 new homes available for sale
- ▶ 582,000 active listings
- ▶ MBA Purchase Index: -3% weekly, -31% annual decline.
- ▶ MBA Refinance Index: -7% weekly, -45% annual decline.



Housing Inventory: Active Listing Count in the United States



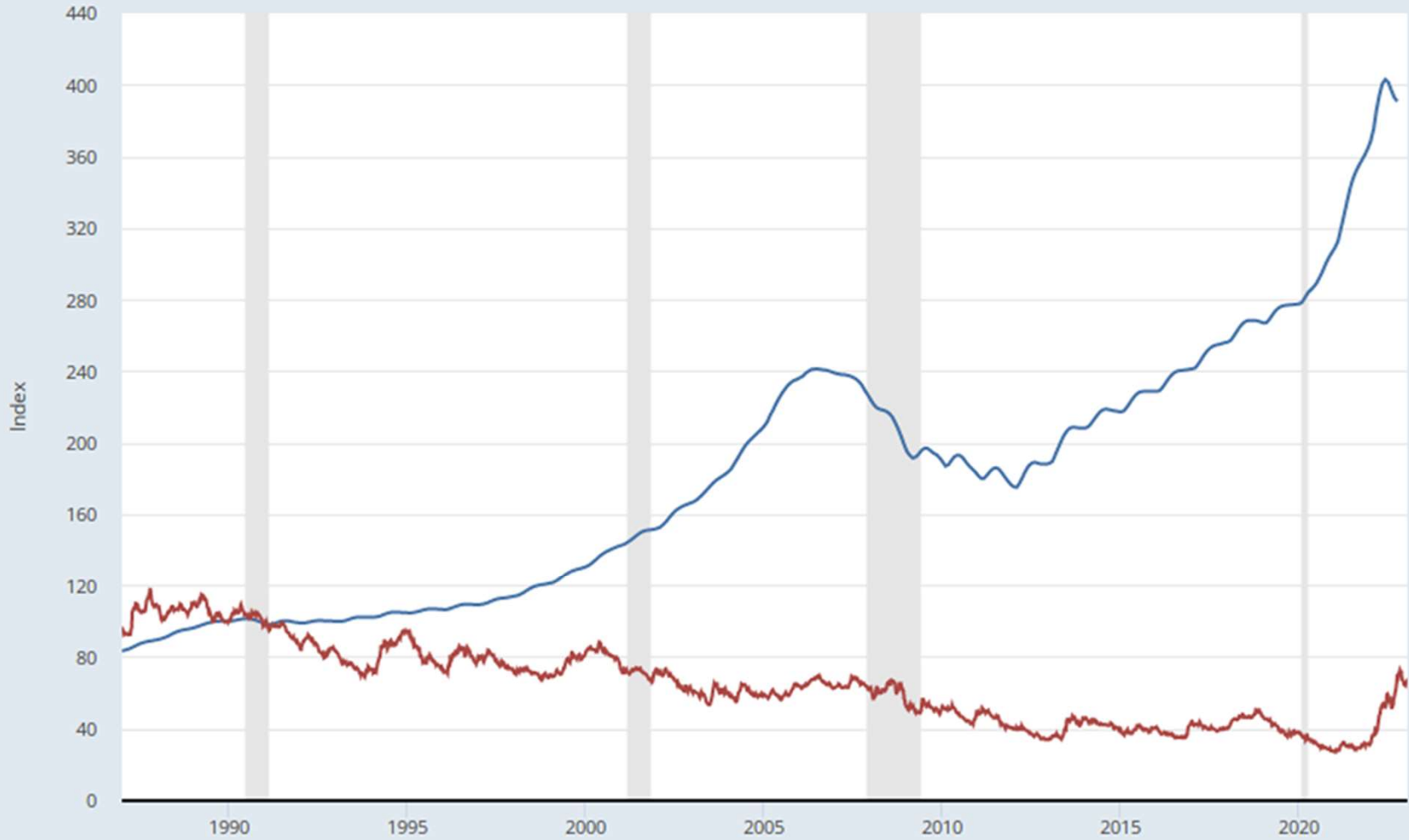
Source: Realtor.com

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FRED



— S&P/Case-Shiller U.S. National Home Price Index, Jan 1990=100  
— 30-Year Fixed Rate Mortgage Average in the United States, 1990-01-01=100

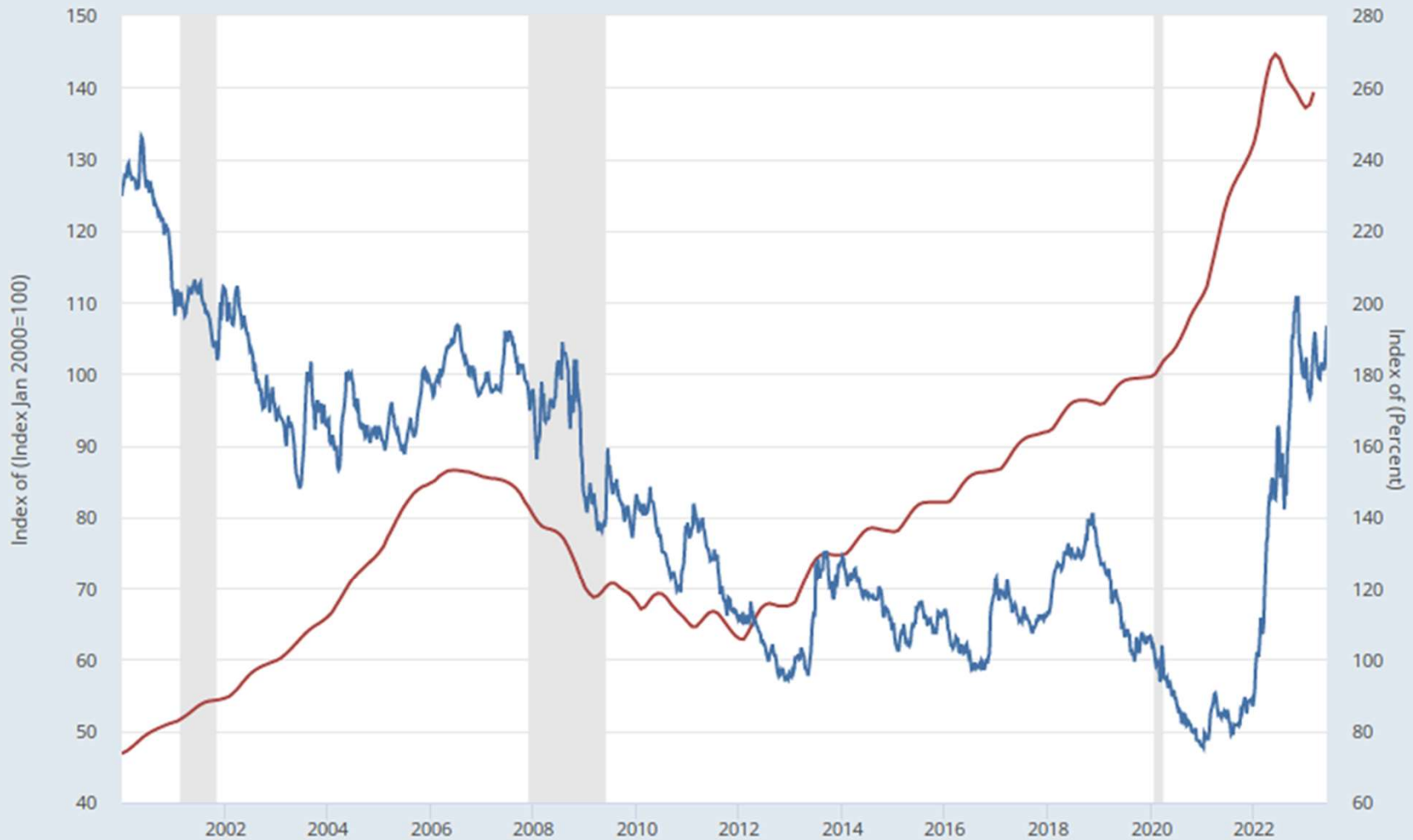


Sources: Freddie Mac; S&P Dow Jones Indices LLC

[myf.red/g/YGjz](https://myf.red/g/YGjz)

**FRED**

— (30-Year Fixed Rate Mortgage Average in the United States), 2020-02-01=100 (right)  
— (S&P/Case-Shiller U.S. National Home Price Index), Feb 2020=100 (left)



Sources: Freddie Mac; S&P Dow Jones Indices LLC

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# Residential Market Snapshot

Los Angeles County

June 2022 to June 2023

## ▶ Quick Facts:

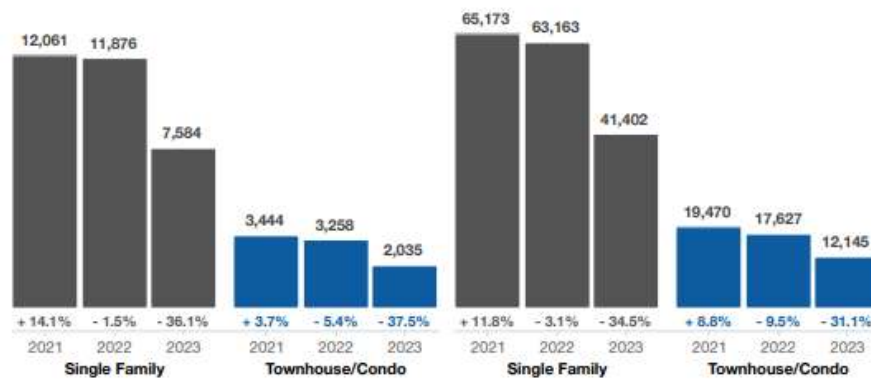
- ▶ -33.8% Change in New Listings
- ▶ -24.6% Change in Pending Sales
- ▶ -18.3% Change in Closed Sales
- ▶ -36.0% Change in Inventory of Homes for Sale (10,362 vs 6,632 units)
- ▶ +47.4% Change in DOM (19 days vs 28 days)
- ▶ -4.5% Change in Median Sales Price
- ▶ -7.7% Change in Months Supply
- ▶ -5.6% Change in Housing Affordability Index

# New Listings

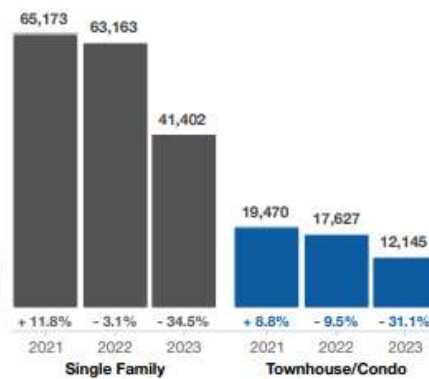
A count of the properties that have been newly listed on the market in a given month.



## June

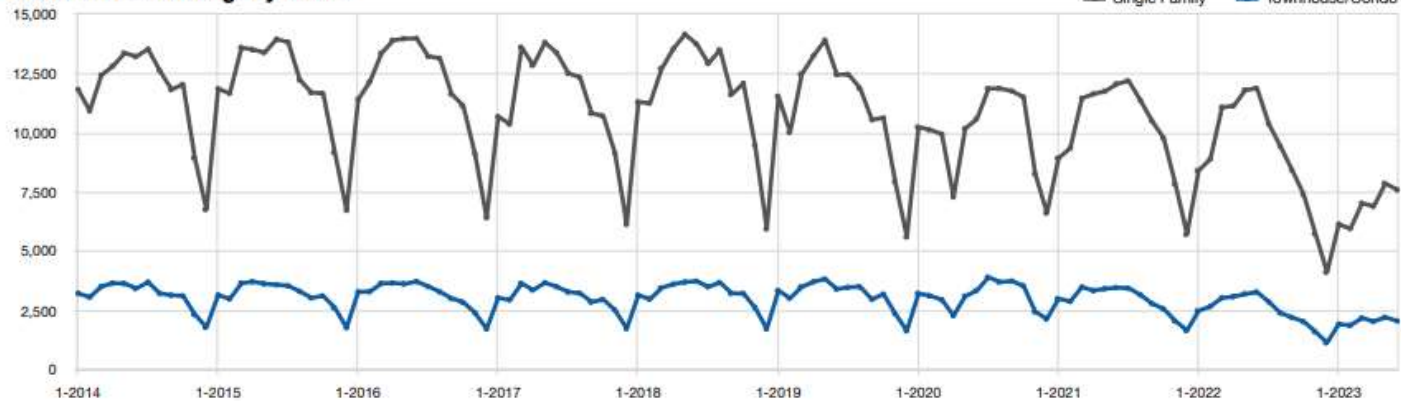


## Year to Date



New Listings	Single Family	Year-Over-Year Change	Townhouse / Condo	Year-Over-Year Change
Jul-2022	10,374	- 14.9%	2,846	- 16.9%
Aug-2022	9,424	- 17.2%	2,374	- 24.5%
Sep-2022	8,423	- 19.8%	2,182	- 21.3%
Oct-2022	7,383	- 24.5%	2,010	- 21.1%
Nov-2022	5,727	- 26.9%	1,584	- 22.1%
Dec-2022	4,096	- 28.1%	1,113	- 31.8%
Jan-2023	6,125	- 27.1%	1,899	- 23.0%
Feb-2023	5,941	- 33.1%	1,846	- 30.3%
Mar-2023	7,016	- 36.6%	2,160	- 28.3%
Apr-2023	6,884	- 38.1%	2,015	- 34.2%
May-2023	7,852	- 33.5%	2,190	- 31.1%
<b>Jun-2023</b>	<b>7,584</b>	<b>- 36.1%</b>	<b>2,035</b>	<b>- 37.5%</b>
12-Month Avg	7,236	- 28.0%	2,021	- 26.9%

## Historical New Listings by Month



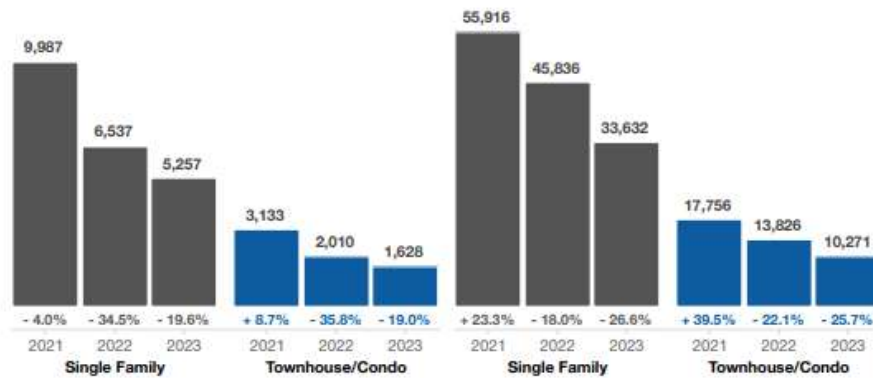


# Pending Sales

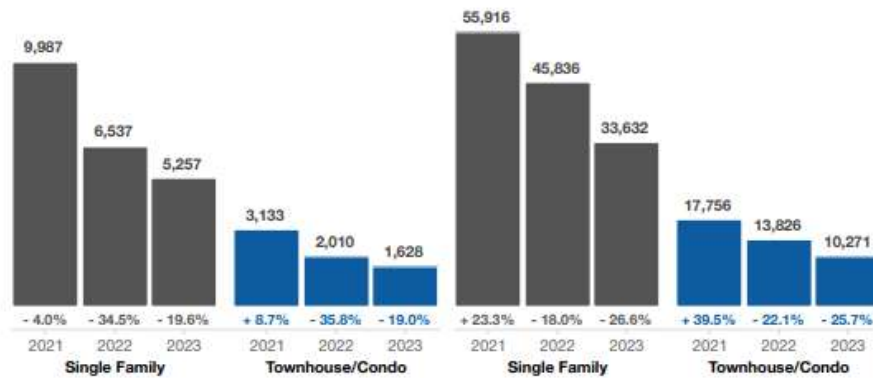
A count of the properties on which offers have been accepted in a given month.



## June

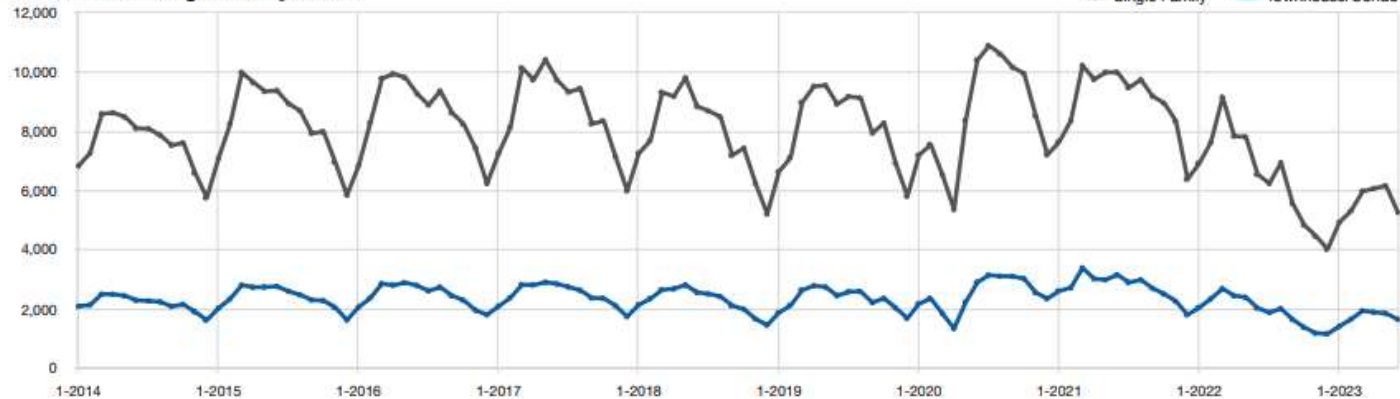


## Year to Date



Pending Sales	Single Family	Year-Over-Year Change	Townhouse / Condo	Year-Over-Year Change
Jul-2022	6,226	-34.2%	1,860	-35.3%
Aug-2022	6,927	-28.9%	1,991	-32.8%
Sep-2022	5,550	-39.6%	1,625	-39.4%
Oct-2022	4,818	-46.1%	1,355	-45.5%
Nov-2022	4,445	-46.7%	1,158	-48.4%
Dec-2022	4,001	-37.2%	1,138	-36.2%
Jan-2023	4,913	-28.9%	1,394	-31.1%
Feb-2023	5,297	-30.5%	1,629	-29.9%
Mar-2023	5,962	-34.8%	1,920	-28.0%
Apr-2023	6,056	-22.6%	1,868	-23.0%
May-2023	6,147	-21.2%	1,832	-22.8%
<b>Jun-2023</b>	<b>5,257</b>	<b>-19.6%</b>	<b>1,628</b>	<b>-19.0%</b>
12-Month Avg	5,467	-33.0%	1,617	-32.8%

## Historical Pending Sales by Month

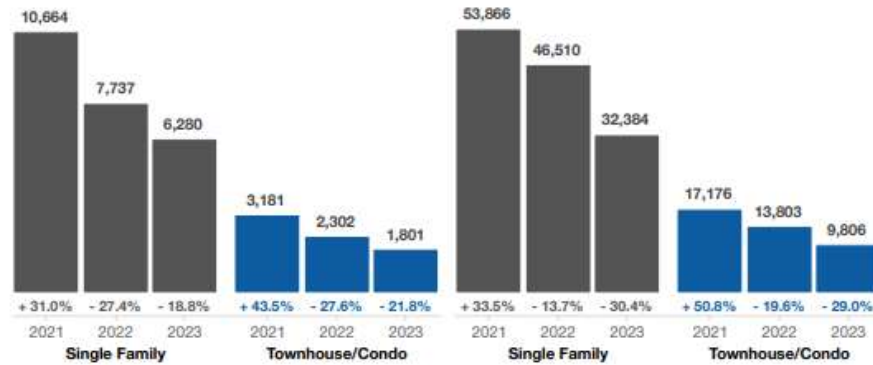


# Closed Sales

A count of the actual sales that closed in a given month.



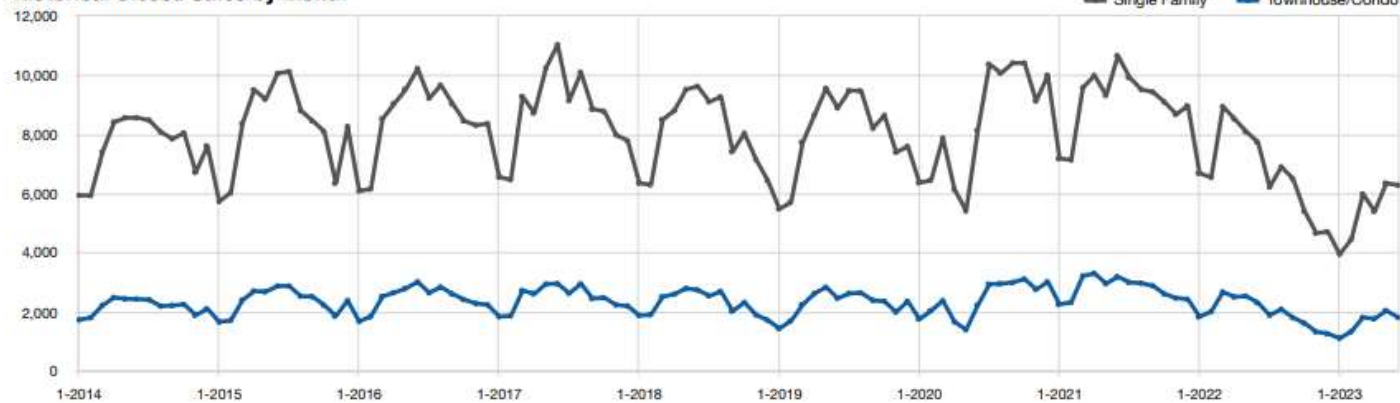
## June



## Year to Date

Closed Sales	Single Family	Year-Over-Year Change	Townhouse / Condo	Year-Over-Year Change
Jul-2022	6,213	-37.4%	1,877	-37.2%
Aug-2022	6,897	-27.6%	2,076	-29.8%
Sep-2022	6,501	-31.1%	1,794	-37.5%
Oct-2022	5,395	-40.7%	1,607	-38.1%
Nov-2022	4,656	-46.3%	1,315	-46.5%
Dec-2022	4,700	-47.6%	1,250	-48.3%
Jan-2023	3,941	-41.0%	1,098	-39.7%
Feb-2023	4,442	-32.1%	1,318	-34.2%
Mar-2023	5,980	-33.1%	1,801	-32.3%
Apr-2023	5,392	-36.7%	1,755	-29.7%
May-2023	6,349	-21.5%	2,033	-19.3%
<b>Jun-2023</b>	<b>6,280</b>	<b>-18.8%</b>	<b>1,801</b>	<b>-21.8%</b>
12-Month Avg	5,562	-34.6%	1,644	-34.4%

## Historical Closed Sales by Month

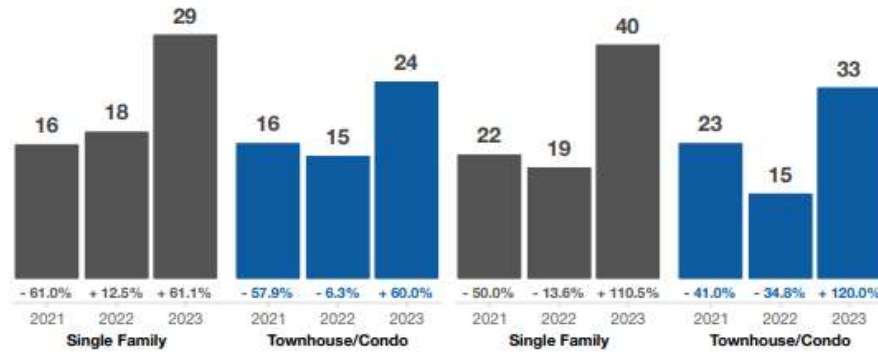


# Days on Market Until Sale

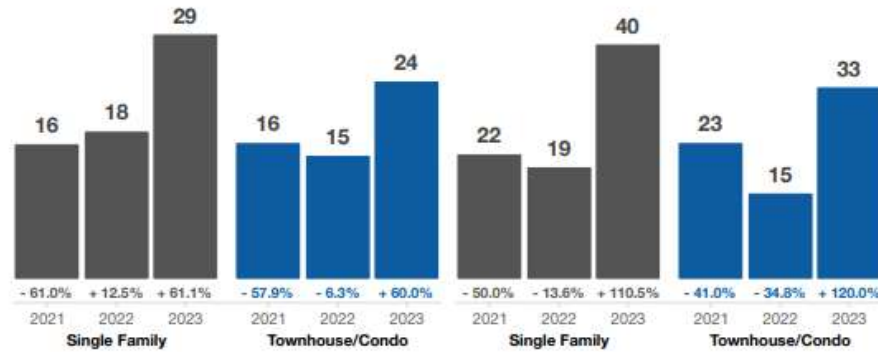
Average number of days between when a property is listed and when an offer is accepted in a given month.



## June



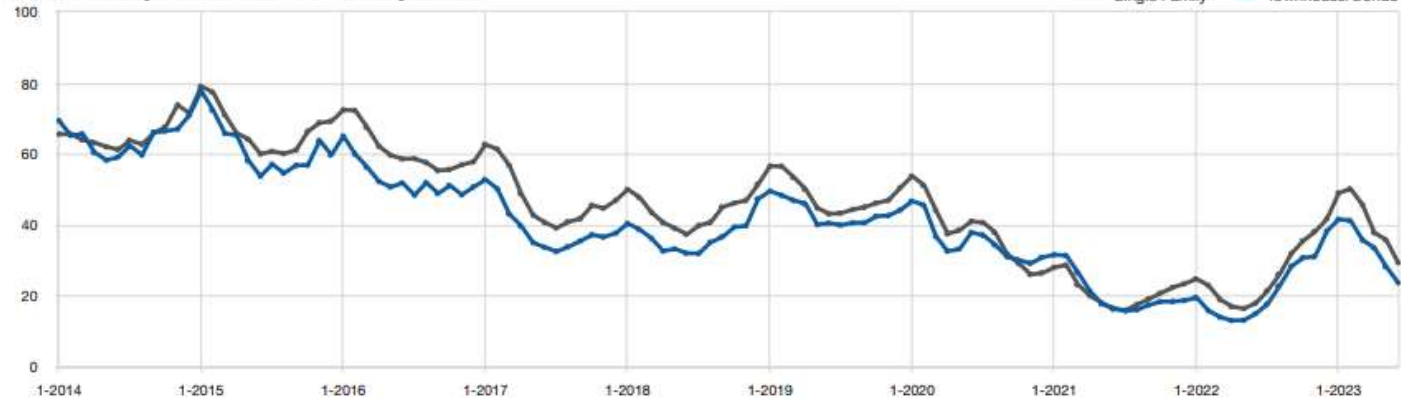
## Year to Date



Days on Market	Single Family	Year-Over-Year Change	Townhouse / Condo	Year-Over-Year Change
Jul-2022	21	+ 31.3%	18	+ 12.5%
Aug-2022	26	+ 44.4%	23	+ 43.8%
Sep-2022	32	+ 68.4%	28	+ 64.7%
Oct-2022	35	+ 66.7%	31	+ 72.2%
Nov-2022	38	+ 72.7%	31	+ 72.2%
Dec-2022	42	+ 82.6%	38	+ 100.0%
Jan-2023	49	+ 96.0%	42	+ 110.0%
Feb-2023	50	+ 117.4%	41	+ 156.3%
Mar-2023	46	+ 142.1%	36	+ 157.1%
Apr-2023	38	+ 123.5%	34	+ 161.5%
May-2023	36	+ 125.0%	28	+ 115.4%
<b>Jun-2023</b>	<b>29</b>	<b>+ 61.1%</b>	<b>24</b>	<b>+ 60.0%</b>
12-Month Avg*	36	+ 82.9%	30	+ 85.6%

\* Days on Market for all properties from July 2022 through June 2023. This is not the average of the individual figures above.

## Historical Days on Market Until Sale by Month



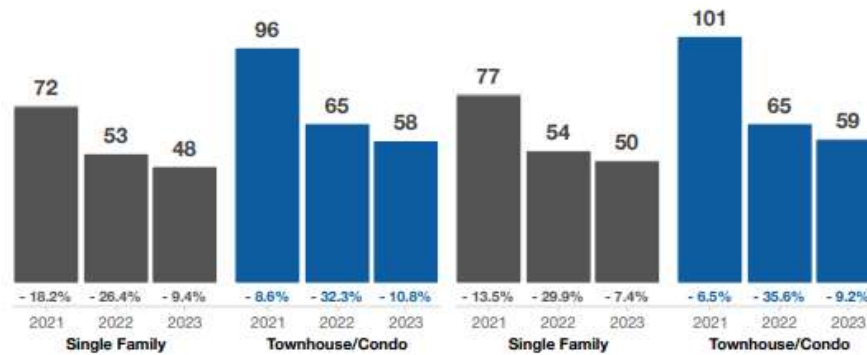
# Housing Affordability Index

This index measures housing affordability for the region. For example, an index of 120 means the median household income is 120% of what is necessary to qualify for the median-priced home under prevailing interest rates. A higher number means greater affordability.



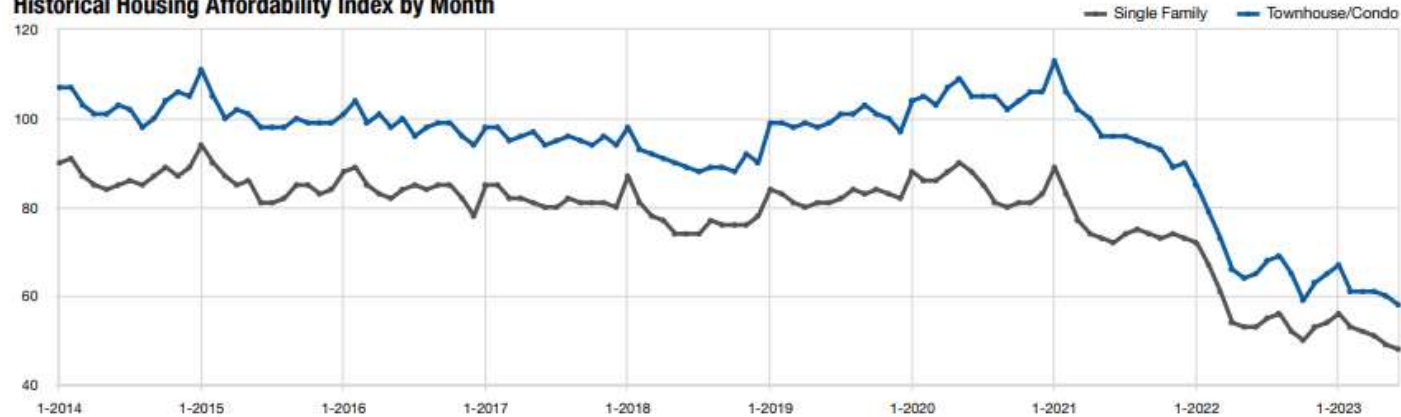
June

Year to Date



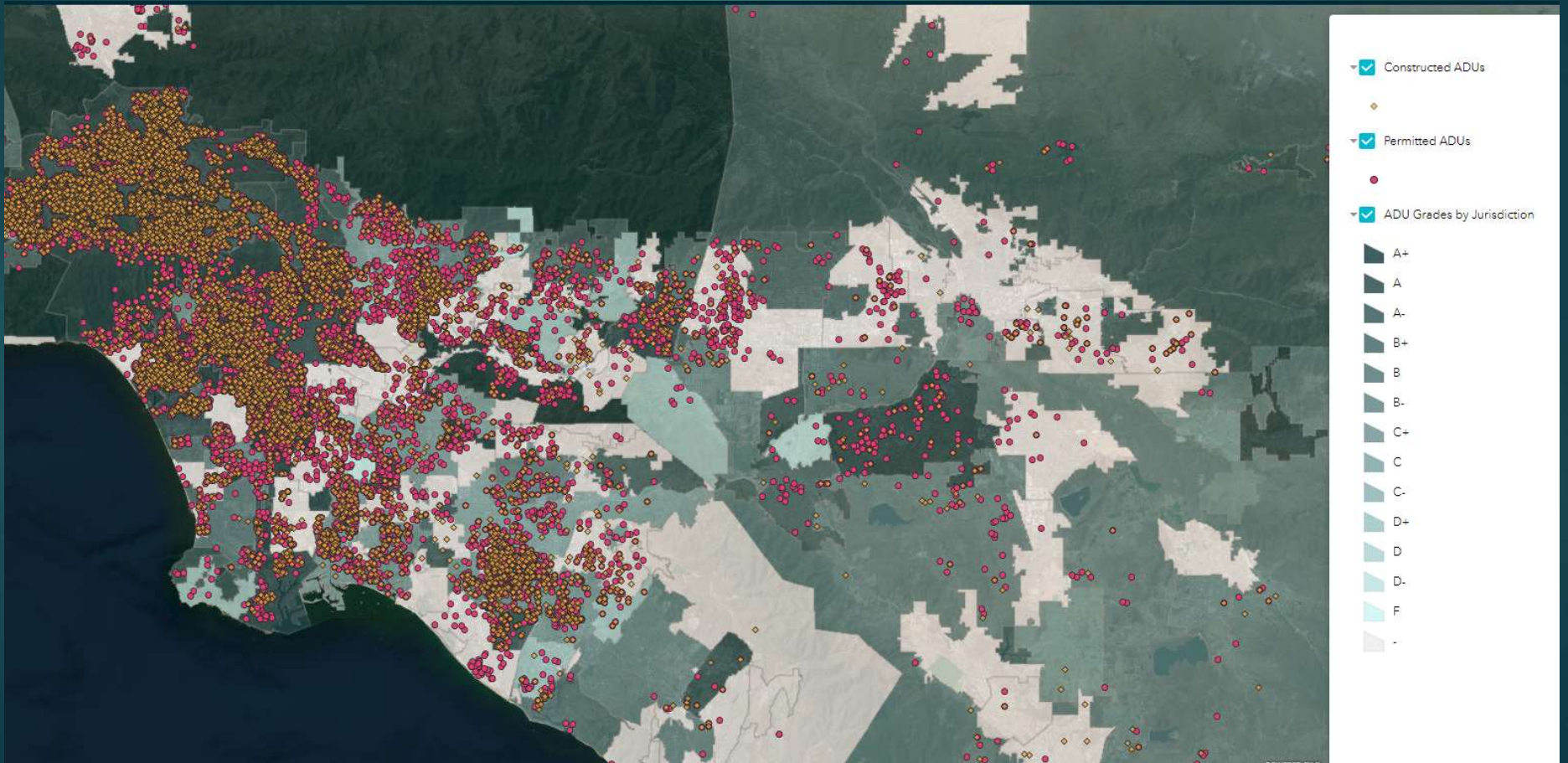
Affordability Index	Single Family	Year-Over-Year Change	Townhouse / Condo	Year-Over-Year Change
Jul-2022	55	-25.7%	68	-29.2%
Aug-2022	56	-25.3%	69	-27.4%
Sep-2022	52	-29.7%	65	-30.9%
Oct-2022	50	-31.5%	59	-36.6%
Nov-2022	53	-28.4%	63	-29.2%
Dec-2022	54	-26.0%	65	-27.8%
Jan-2023	56	-22.2%	67	-21.2%
Feb-2023	53	-20.9%	61	-22.8%
Mar-2023	52	-14.8%	61	-16.4%
Apr-2023	51	-5.6%	61	-7.6%
May-2023	49	-7.5%	60	-6.3%
<b>Jun-2023</b>	<b>48</b>	<b>-9.4%</b>	<b>58</b>	<b>-10.8%</b>
12-Month Avg	52	-22.4%	63	-23.2%

## Historical Housing Affordability Index by Month



# ADU Trends

80 permits in 2016. 5064 permits in 2021.



## L.A. Neighborhoods with the most certified ADUs in 2021



Source: Department of Building and Safety Dataset

# ADU Law FAQ's

- ▶ SB-897, AB-2221 & SB-9
- ▶ Permitted in any residential or mixed-use zone.
- ▶ May exceed general plan and zoning densities.
- ▶ Local governments may apply design and development standards.
- ▶ Permitted ministerially, without discretionary action.
- ▶ Applications shall be considered and approved within 60 days.
- ▶ Permitted on existing multi-family uses.
- ▶ Allowed in HPOZ (Historic Preservation Overlay Zones).

# ADU Types

- ▶ Detached: The unit is separated from the primary structure.
- ▶ Attached: The unit is attached to the primary structure.
- ▶ Converted Existing Space: Space (e.g., master bedroom, attached garage, storage area, or similar use, or an accessory structure) on the lot of the primary residence that is converted into an independent living unit.
- ▶ JADU: A specific type of conversion of existing space that is contained entirely within an existing or proposed single-family residence. JADU's allowed only when main house is owner-occupied (carries forward to future buyers).



# ADU size, parking, fees and property taxes.

- ▶ Maximum unit size at least 850 square feet, or 1,000 square feet for an ADU with more than one bedroom.
- ▶ Up to 50% of the floor area of an existing primary dwelling for an attached ADU.
- ▶ Conversion of existing structure (barn, garage, etc.) not subject to unit size requirements.
- ▶ Setbacks can be required but not if it precludes an ADU of up to 800 square feet.
- ▶ Exempt from parking requirements if within ½ mile of public transit.
- ▶ No impact fees on ADU's less than 750 square feet.
- ▶ Property tax assessment based on the value of the ADU. No change to primary dwelling assessment.

# FNMA ADU Requirements

- ▶ Only one ADU is permitted on the parcel of a primary unit dwelling
- ▶ ADU's are not permitted with a 2-4 unit dwelling.
- ▶ Must be subordinate to the primary dwelling.
- ▶ Must be accessible separately from the primary dwelling.
- ▶ Borrower must qualify for the mortgage without considering any rental income from the ADU. If both primary dwelling and ADU are rented, combined rents can be used for qualifying.
- ▶ ADU square footage cannot be included in the reported gross living area. Must be reported separately.

# Valuation Considerations

- ▶ Highest & Best Use
- ▶ Marketability, Conformity and Acceptability
- ▶ Zoning – Legal, Legal Non-Conforming
- ▶ Paired Sales
- ▶ Income Approach
- ▶ Cost Approach

# Highest & Best Use – Four Tests

- ▶ Legally Permissible
  - ▶ Zoning
  - ▶ TOC Incentive Program
- ▶ Physically Possible
  - ▶ Topography
  - ▶ Lot size and shape
- ▶ Financially Feasible
  - ▶ Does market value increase exceed cost?
- ▶ Maximally Productive
  - ▶ ADU's under 750 square feet are exempt from bulk and massing development limits

# Marketability, Acceptability and Conformity

- ▶ Is there a market for residential properties with ADU's? Consider location – central city versus conforming tract neighborhood.
- ▶ ADU vs STR. (assignment of rents)
- ▶ Do ADU's add value to the property? Yes or No? Are there negative impacts?
- ▶ Are ADU's being welcomed or merely tolerated into the community? Infrastructure, schools, utility loading, etc.
- ▶ Are ADU's being designed to conform to the neighborhood vis-à-vis height, setbacks, style, quality and utility?

# Zoning – Legal or Legal Non-Conforming

- ▶ R1 zoning example. SFR with ADU versus duplex.
- ▶ R2 zoning example. SFR with ADU or duplex with ADU.
- ▶ Metering and addressing considerations.
- ▶ Rebuild question.

# How much does an ADU add to home value?

- ▶ 30%, RENOFI
- ▶ \$200,000 to \$500,000, Backyard Unlimited
- ▶ Up to \$600,000, United Dwelling
- ▶ \$614,000 (1,000 sf ADU), CaliADU
- ▶ \$100,000, Bigger Pockets
- ▶ ADU's are valued like swimming pools . . .

# Valuation Examples

## ▶ Paired Sales / Sales Comparison Approach

- ▶ SFR sales without ADU's, mean price/SF = \$650
- ▶ SFR sales with ADU's, mean price/SF = \$865
- ▶ Difference = \$215/SF x 800 SF ADU = \$172,000.

## ▶ Income Approach

- ▶ Mean rental rate for a sample of ADU's = \$1,800/month
- ▶ Mean gross rent multiplier: 120 x \$1,800 = \$216,000

## ▶ Cost Approach

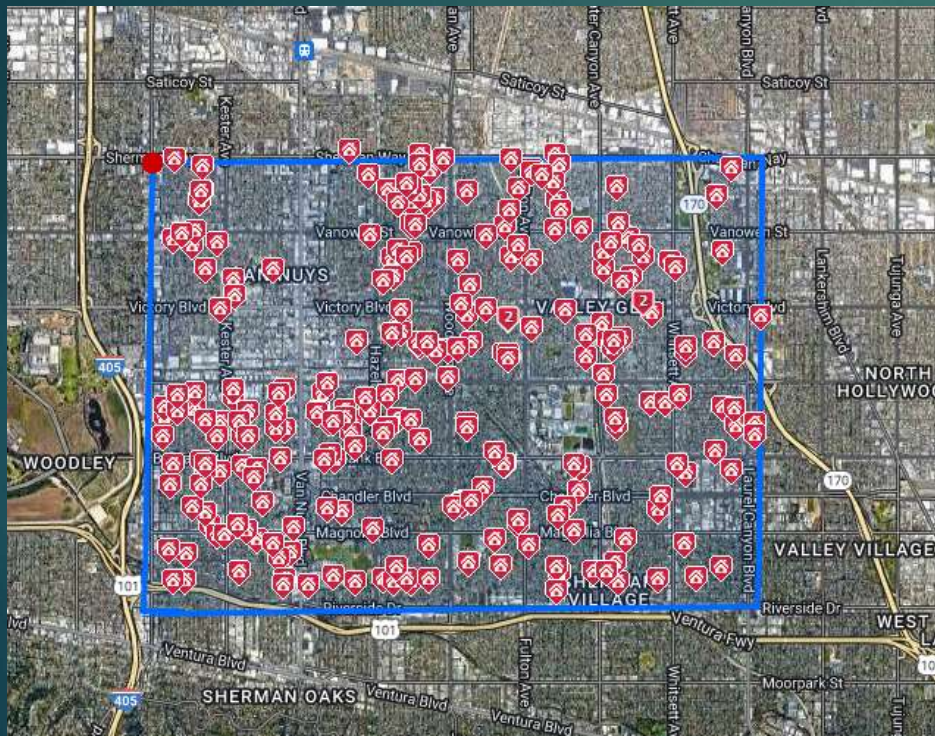
- ▶ Hard cost: \$365/SF x 400 square foot ADU = \$146,000
- ▶ Soft cost: \$15,000
- ▶ Incentive: \$24,000
- ▶ Total cost: \$185,000 (\$460/SF)



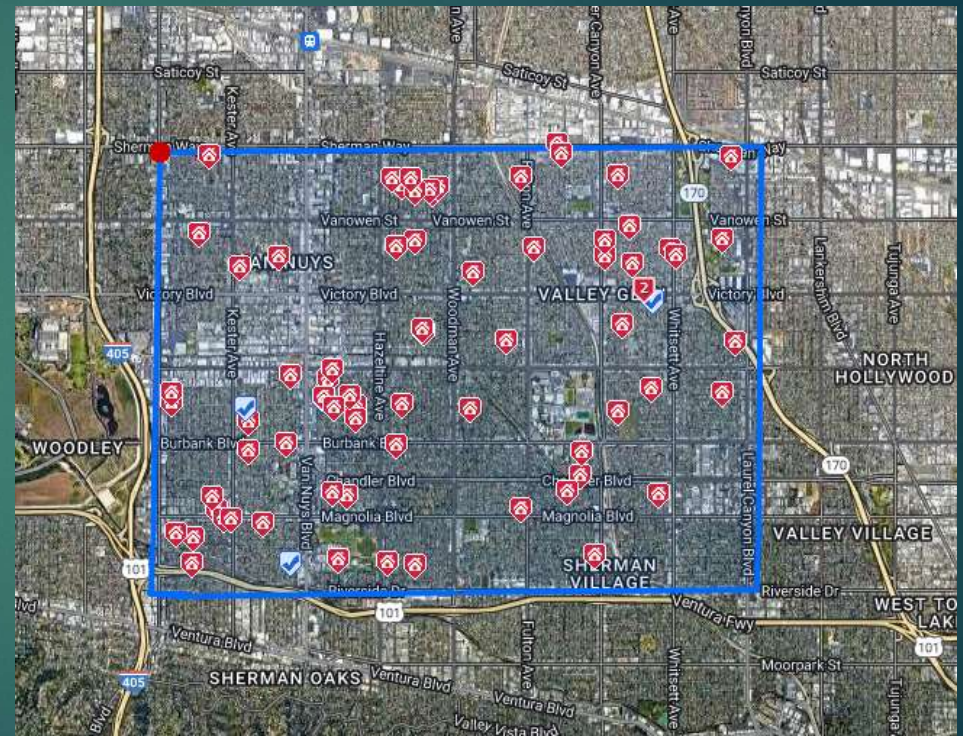
# Paired Sales / Sales Comparison Approach

- ▶ Gather sale data of homes without ADU's. Calculate median price/SF, median price, etc.
- ▶ Gather sale data of homes with ADU's. Challenge is to filter by keyword – “ADU”, “accessory”, “guest house”, etc.
- ▶ Another challenge is to scrub the GLA cited in the MLS. Is it based on the primary dwelling size (assessor, owner, builder, 3<sup>rd</sup> party)? Is it based on the combined area (primary plus ADU)?
- ▶ Compare the two. Calculate the difference. Apply adjustment to the appraisal.
- ▶ Weakness. Most agents use price/SF, which includes the land. Must deduct land value from sale price to arrive at residual value of improvements.

# Real world Sales Analysis - San Fernando Valley



12-month of sales, SFR use, 1,000-2,000 SF, 5000+ SF lot size (261 count)



Same search criteria with "ADU"  
keyword search (76 count)

# San Fernando Valley – dataset pairing

All sales back 12 months (1,000 to 2,000 SF)

## Standard Status: Closed (257)

	List Price	ADOM	Close Price	BR	BA	Lot Sqft	SqFt	\$/SqFt	Built
Min	673,000	0	635,000	2	1	5,025	1,012	403.41	1921
Max	2,049,000	209	2,025,000	5	4	33,574	1,998	1,104.91	2015
Avg	1,094,680	25	1,097,647	3	2	7,048	1,546	718.06	1950
Median	1,089,000	13	1,085,000	3	2	6,752	1,543	707.07	1950
Sum	281,332,883		282,095,254					184,540.70	

All sales back 12 months with confirmed ADU in comment field

## Standard Status: Closed (4)

	List Price	ADOM	Close Price	BR	BA	Lot Sqft	SqFt	\$/SqFt	Built
Min	1,199,000	9	1,140,000	3	2	6,050	1,533	701.37	1947
Max	1,590,000	80	1,550,000	4	4	7,525	1,937	807.29	1950
Avg	1,408,250	33	1,374,250	4	3	6,683	1,804	760.16	1948
Median	1,422,000	20	1,403,500	4	3	6,578	1,873	765.99	1948
Sum	5,633,000		5,497,000					3,040.63	



Criteria	Avg sale price	Square footage			
All closed (w/o ADUs)	\$1,098,000	1546			
Closed (w/ADU)	\$1,374,000	1804			
Delta	<b>\$276,000</b>	258			
Address (ADU sales)	Sale Price	GLA (main)	GLA (ADU)	Combined GLA	Price / SF
1) 6255 Beeman	\$1,280,000	1465	360	1825	\$701
2) 14405 Miranda	\$1,550,000	1520	400	1920	\$807
3) 4841 Vista Del Monte	\$1,140,000	1158	375	1533	\$743
4) 5706 Bevis Ave	\$1,527,000	1249	688	1937	\$788
Mean			<b>456</b>	1804	<b>\$760</b>
			<b>\$276,000 / 456 =</b>	<b>\$605/SF</b>	
			<b>\$605 / \$760 =</b>	<b>80%</b>	

# Real world Paired Sales Analysis

## 90402 zip code – Santa Monica

- ▶ 707 11<sup>th</sup> Street, Santa Monica
  - ▶ Sold for \$6,650,000 on 5/05/2022 or \$1,734.03 per SF
  - ▶ 3,352 square feet main house; 483 square foot ADU
  - ▶ Assume land value = \$4,500,000
- ▶ 330 22<sup>nd</sup> St, Santa Monica
  - ▶ Sold for \$4,600,000 on 7/19/2022 or \$1,815.31 per SF
  - ▶ 1,937 square feet main house; 600 square foot ADU
  - ▶ Assume land value = \$3,250,000

# Real world Paired Sales Analysis 90402 zip code – Santa Monica

- ▶ Sale #1 -  $\$6,650,000 - \$4,500,000 = \$2,150,000$  improvement value
  - ▶  $\$2,150,000 - \$500,000$  site improvements =  $\$1,650,000$  dwelling value
  - ▶  $\$1,650,000 / 3,835$  square feet (total) =  $\$430/\text{SF}$
  - ▶ ADU (483 SF x  $\$430$ ) =  $\$208,500$
  
- ▶ Sale #2 -  $\$4,600,000 - \$3,250,000 = \$1,350,000$  improvement value
  - ▶  $\$1,350,000 - \$250,000$  site improvements =  $\$1,100,000$  dwelling value
  - ▶  $\$1,100,000 / 2,537$  square feet (total) =  $\$434/\text{SF}$
  - ▶ ADU (600 SF x  $\$434$ ) =  $\$260,000$

# Income Approach

- ▶ Analyze income and rental terms of the ADU.
- ▶ Search the market for “rental comparables” of ADU’s.
- ▶ Develop fair market rent for subject ADU. Is it equivalent to the actual rents?
- ▶ Analyze sales of income property, preferably single-family residences with ADU’s or duplexes.
- ▶ Calculate the GRM (gross rent multiplier) from the comparables.
- ▶ Apply the GRM to the subject.
- ▶ Limitations of this method. FNMA won’t qualify a borrower based on income from an ADU, unless entire property is tenant-occupied.

# ADU rental examples

- ▶ 1) 14713 Archwood, Van Nuys; 400 SF ADU; \$1,800/mo (\$4.50/SF)
- ▶ 2) 12620 Collins St, Valley Village; 634 SF ADU; \$2,000/mo (\$3.15/SF)
- ▶ 3) 5506 Bevis Ave, Sherman Oaks; 750 SF ADU; \$3,200/mo (\$4.27/SF)
- ▶ 4) 12217 Hartsook St, Valley Village; 400 SF ADU; \$2,200/mo (\$5.50/SF)
- ▶ 5) 5432 Kester Ave, Sherman Oaks; 320 SF ADU; \$1,900/mo (\$5.94/SF)
- ▶ 6) 6211 Ventura Cyn, Valley Glen; 448 SF ADU; \$2,245/mo (\$5.01/SF)
  
- ▶ Mean = \$4.06/mo x 400 SF (hypothetical S/P ADU) = \$1,625/mo
  
- ▶ 5346 Bellaire, Valley Village; sold for \$1,550,000; \$6,850/mo rents = 226.28 GRM x \$1,625 (subject) = \$367,500.



# Cost Approach

- ▶ Hard cost (construction, overhead, contingency)
- ▶ Soft cost (permits, architectural, insurance)
- ▶ Carrying costs (interest on loan during construction)
- ▶ Entrepreneurial profit (incentives to builder and homeowner/investor)
- ▶ Obsolescence factor. Privacy, exclusivity, yard space, etc.

# Cost Approach – case study #1

- ▶ Proposed SFR & ADU – Mount Washington
- ▶ 4 levels over garage / steep upslope
- ▶ 1,062 SF conditioned GLA
- ▶ 337 SF ADU
- ▶ \$648,000 hard cost = \$543.17 per SF
- ▶ 25% functional obsolescence (non contiguous living area)
- ▶ \$400/SF ADU adjustment carried forward to SC grid

# Cost approach – case study #2

- ▶ Proposed luxury-quality SFR and ADU in Beverly Hills
- ▶ 28.71 acres / hilltop / panoramic views / 2+ acres usable
- ▶ 56,400 square foot main dwelling
- ▶ 24,300 square foot ADU
- ▶ \$88,100,000 hard cost = \$1,091 per SF.
- ▶ 25% functional obsolescence (superadequacy)
- ▶ \$818/SF ADU adjustment carried forward to SC grid

# Thank you!

## **Charles Baker, SRA, AI-RRS**

**AppraisalPros.com, Inc.**

155 N Lake Ave, 8<sup>th</sup> Floor, Pasadena, CA 91101

Off: (626) 431-2862 Cel: (310) 592-0942

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