



Residential Carve-Outs

Uncovering the Mystery

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The term “carve-out” is commonly used to describe the method for determining what portion of property occupied by a residential owner of 180 days or more is to be used in computing a purchase differential, which is one of the three components of a replacement housing payment. The other two are incidental expenses and mortgage interest differential.

Although the term carve-out does not appear in the Federal regulations implementing the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, as amended (URA), it does accurately describe the process. Regulatory guidance can be found in several subsections of 49 CFR Part 24, which are listed in the regulatory references at the end of this article.

The purpose of the regulations is to level the playing field for the displaced person in seeking a comparable replacement dwelling.

Carve-out Basics

There are three basic steps required to determine whether a carve-out is appropriate and what the resulting purchase differential will be:

1. First, the agent must determine that the subject property warrants a carve-out. There are four situations which may require a carve-out:
 - a) When the displacement dwelling is part of a property that contains another dwelling unit.
 - b) When the displacement dwelling contains space used for non-residential purposes.

- c) When the lot on which the dwelling is situated is larger than typical for residential purposes.
- d) When the displacement site contains a major exterior attribute, such as a garage or swimming pool, and that feature is not present in the comparable used to compute the purchase differential.

2. Next, for situations 1(a), 1(b) and 1(c), the agent must determine what constitutes a tract that is “typical in size for residential purposes” in the area. The first step is to look for tracts that are located in the same neighborhood or area and are primarily residential in use. If the carve-out is required because of situation 1(d), it may not be necessary to determine a “typical tract” size.
3. Finally, for situations 1(a), 1(b) and 1(c), the agent must apply the tract size that is derived from step 2 to the displacement site and carve-out the portion of the acquisition price that represents a property that is “typical for residential purposes.” The value of the carved-out site, and the portion of the improvement(s) applicable to the owner-occupant’s residence, will be used in computing the purchase differential. For situation 1(d), the agent must carve-out the value of the major exterior attribute from the acquisition price of the displacement property when computing the purchase differential.¹ In any case, the acquisition price established through the carve-out process must come from the total acquisition price of the property. Unless otherwise defined in Federal, state or local law, the acquisition price consists of up to three elements—land, improvements and damages/cost-to-cure. At least two of these (land and improvements) typically apply when doing a carve-out. As described later in this article, damages may also apply.

To illustrate how the carve-out basics are applied in real world situations, two examples are provided. The first is a simple carve-out based on 1(b). The second is a more complex carve-out based on 1(c) and includes damages.

Example 1: Mixed-Use Property

This property, which is being acquired as a full-take for a highway interchange project, consists of a 2,500 sq ft commercial/residential structure situated on a 10,000 sq ft parcel of land. One portion of the structure, comprising almost 1,100 sq ft, is used as the residence. The remainder of the structure, approximately 1,400 sq ft, is used by the owners for a furniture refinishing business.

The total appraised value of the property is \$255,000, which consists of a land value of \$80,000 (10,000 sq ft @ \$8/sq ft) and a mixed residential/commercial structure with a contributory value of \$175,000 (broken down by the appraiser as \$115,000 attributable to the commercial portion and \$60,000 attributable to the residential portion).

The relocation agent determined that this property was eligible for a carve-out, as it is a mixed residential/commercial use. Consequently, the agent searched the local area for tracts that are typical in size for residential use. In this instance, the relocation agent found that, while there is some variation in size in residential dwelling sites in that neighborhood, most of the sites range from 3,500 to 7,000 sq ft, with several in the 5,000 sq ft range. Using this information, the agent concluded that 5,000 sq ft was "typical in size" for residential use in the neighborhood. The agent also searched for comparable replacement dwellings currently available on the market and found one with the residential features of the displacement dwelling listed at \$112,500.

Next, the relocation agent carved out the value of the residential portion of the displacement dwelling and site using the appraiser's valuation of the residential portion of the improvement (\$60,000) and the appraiser's unit value of land (\$8/sq ft). Having determined that the typical tract for the area is 5,000 sq ft, the agent derived a total carve-out value of land at \$40,000 (5,000 sq ft at \$8/sq ft) which, when added to the residential improvement's appraised value of \$60,000, yielded a total carve-out value of \$100,000.

The resultant purchase differential computed for the displacee in this case was \$12,500:

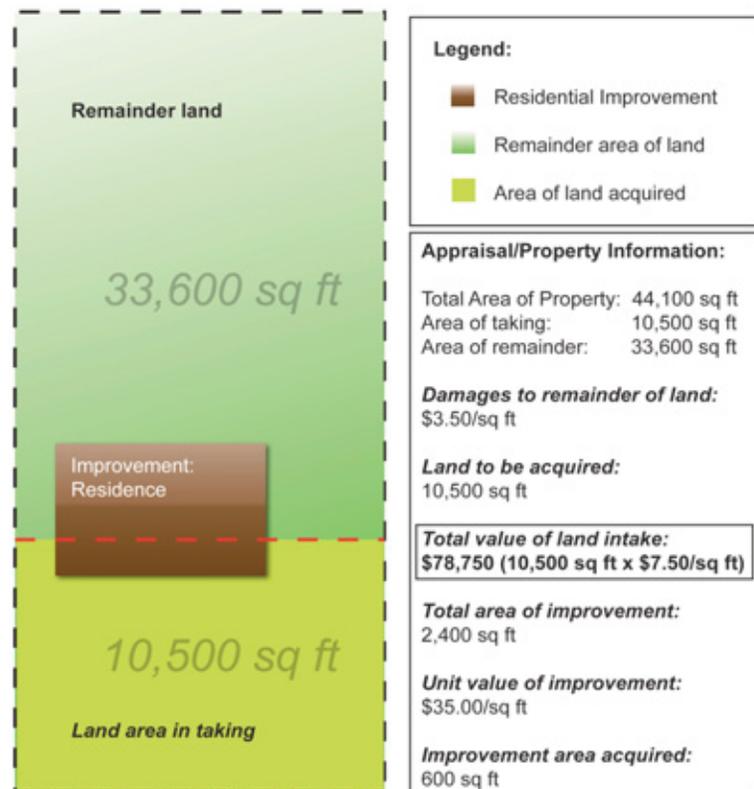
Comparable Replacement Dwelling	\$112,500
Residential Carve-Out	<u>- 100,000</u>
Purchase Differential	\$ 12,500

A key point in this example is that, since the displacees were using part of the property for a business, the value of the non-residential portion of the property could not be used in the purchase differential computation. While the displacees have a right to relocate and

reestablish their furniture refinishing business, if any portion of the land and improvements attributable to the business is used for the purchase differential computation, it could affect their ability to reestablish the business. In effect, it could penalize them by forcing them to use the acquisition proceeds from the business for a different purpose, such as a residence.

Example 2: Larger-than-typical Tract with Damages

In this example, the subject property contains 44,100 sq ft, or slightly more than an acre. The property is improved with a residential dwelling containing 2,400 sq ft. The land area that will be acquired for the project is 10,500 sq ft. The area of the remainder is 33,600 sq ft.² The appraiser's unit value for the land in the before situation is \$7.50/sq ft. The after value of the remainder is \$4/sq ft. Damages to the remainder are \$3.50/sq ft. The appraiser established a value of \$84,000 for the improvement, which will need to be acquired.



The first thing the relocation agent noticed about this parcel is that, while it may contain more land than what is typical for residential use in the area, a carve-out is not immediately indicated. The agent had to move to the second step of the carve-out basics to determine whether a carve-out is necessary. In searching the area near the displacement property, the agent determined that a preponderance of residential properties was situated on half-acre sites. Consequently, the agent determined that a carve-out is necessary for the subject, since it contains over an acre of land.

To complete the carve-out determination, the relocation agent applied the tract size that is typical for residential use in subject property area. Recall that the displacement property in Example 1 was a total take, so the typical tract size (5,000 sq ft) fit within the total acquired property site of 10,000 sq ft. It was then relatively easy to carve-out the value of the typical tract from the total tract value.

However, Example 2 is a different circumstance. The area of land actually being acquired for the project is smaller than the tract size that the relocation agent determined to be typical for residential use in the area. Therefore, only a portion of the typical tract is available from the area being acquired. In order to complete the carve-out, the agent may use the damages attributable to that portion of the remainder property that completes the typical tract. In this example, the typical tract is a half-acre, or 21,780 sq ft, and the area being acquired is 10,500 sq ft. Consequently, the difference of 11,280 sq ft can be included by using the unit value of damages which the appraiser established as \$3.50/sq ft.³

To complete this scenario, the comparable located by the agent, which was used to compute the purchase differential, is priced at \$220,000. Below is a recap showing how the relocation agent established the carve-out acquisition price for the subject property and computed the purchase differential:

Appraised Value of Improvement	\$ 84,000
Carved-Out Value of Land in Taking (10,500 sq ft x \$7.50/sq ft)	+ 78,750
Carved-Out Damages to Remainder (11,280 sq ft x \$3.50/sq ft)	+ 39,480
Total Carved-Out of Acquisition Price for Typical Tract	<hr/> \$ 202,230
Comparable Replacement Dwelling	\$ 220,000
Carve-out Acquisition Price	<u>- 202,230</u>
Purchase Differential	\$ 17,770

Summary of Carve-out Basics

Whether the need for a carve-out occurs as a result of excess land, multiple residences, mixed use (residential/commercial) or a major exterior attribute, the same process can be used. To determine whether a carve-out is appropriate and the amount of the resulting purchase differential, simply start by determining whether the subject property includes land and improvements excess to the owner occupant's residential use. Then, determine what constitutes



a tract typical in size for residential use in the area. And finally, when applying the area of the typical tract to the subject, use only that portion of the total acquisition price (land, improvements, damages) which represents the dwelling and typical tract. ⚙

References

¹ There is a difference in the use of the term carve-out for computation purposes in situation 1(d). In situations 1(a), (b) and (c), the carved-out value of the residence and site is subtracted from the price of the comparable replacement dwelling to yield a purchase differential eligibility amount. In situation 1(d), the value of the major exterior attribute (such as a swimming pool, garage or outbuilding) is subtracted from the total acquisition price of the owner's residence (site and improvements) and the value of the owner's residence minus the value of the major exterior attribute is subtracted from the price of the comparable replacement dwelling to yield a purchase differential.

²For purposes of this example, the appraiser considered the remainder to be economic, but it is not a "buildable lot" as described in 49 CFR 24.403(a)(3).

³NOTE: While the appraiser established an after value of the remainder at \$4/sq ft, that represents the value of the property to the owner who, in this case, will be retaining the remainder. The agency is only paying damages (\$3.50/sq ft) for that remainder. Therefore, in doing the carve-out, the agent can only draw from the acquisition price established by the appraiser. In this example, the unit value of the damages to the portion of the remainder constituting the rest of the typical tract is \$39,480 (11,280 sq ft x \$3.50/sq ft).

Regulatory References

49 CFR 24.2(a)(11) -- definition of "dwelling site" as "...typical in size for similar dwellings located in the same neighborhood or rural area."

49 CFR 24.401(c)(1) -- price differential based on a "dwelling site" per 24.2(a)(11).

49 CFR 24.403(a)(3) -- "buildable residential lot" may be added to the acquisition cost.

49 CFR 24.403(a)(7) -- "on a lot larger than typical for residential use" explained.