|  |
| --- |
| Cost Approach |

Methodology

Typically under the Cost Approach: 1) the replacement cost new of the improvements is estimated; 2) accrued depreciation, if any, is deducted from this amount; and 3) the resultant amount is added to an estimated fee simple land value to equal the estimated improved property value via the Cost Approach. The market value of the subject site was estimated preceding, with the valuation of the improvements presented following.

Replacement Cost of the Subject Improvements

The replacement costs for the building and site improvements estimated using the Marshall Valuation Service, as well as an analysis of the subject’s construction cost budget. **Replacement cost** is defined as follows:

“The estimated cost to construct, at current prices as of the effective appraisal date, a substitute for the building being appraised, using modern materials and current standards, design, and layout." *[[1]](#footnote-1)*

Marshall Valuation Service Analysis

The following replacement cost new estimate is based on cost information obtained from the Marshall Valuation Service (MVS), a national cost guideline service that compiles construction costs on various structures from local contractors. The Service utilizes a calculator method. The estimate, using this service, **includes** interest as well as loan processing and service fees for building funds during construction; charges for workmen's compensation, fire, liability, and unemployment insurance; sales tax on building materials, if applicable; the cost for equipment rental, temporary facilities, and security; architect fees; permits, fees, and contractor's overhead; as well as direct labor and material costs of construction.

This service **does not include** site improvements, permanent loan costs, legal, appraisal, feasibility, consulting, planning, escrow, or other professional fees that may be charged in association with the project. Also not included are the costs of the property taxes during construction, taxes on land during the holding period prior to construction, interest costs or return on the land value prior and during construction, off-site construction costs, developer's profit, stabilized occupancy, and leasing or marketing costs.

Direct Costs: The subject’s building improvements are considered most similar to the Marshall Valuation's classification for the following separate components:

Class D Multiple Residences Building (Sec. 12, P. 16), which indicates a base cost of $71.55 per SF for an average quality, wood-frame / wood exterior building.

Add Ons: Adjustments to the preceding base unit costs include the following:

1. Fire sprinklers at $2.00 per SF.

Multipliers: Multipliers adjust for time, locality, floor area, building perimeter, and height/story multiplier. Please refer to the summary chart for a summary of the multipliers used, as well as reflective page number in the Marshall Valuation Service.

Site Improvements: Site improvements typically include grading, landscaping, asphalt paving, concrete curbing, sidewalks, and fencing. Based on analysis of several recent cost comparables, site improvement costs for typical commercial sites (1 to 10 acres) range from $5.00 to upward of $15.00 per SF of total site area depending on the building site coverage, quality of the paving, number of parking spaces, amount of landscaping, topography, and location of the on-site utilities. Note that the smaller parcels tend to exhibit the highest unit costs as certain construction costs remain fixed (mobilization, site supervision, etc.) regardless of the site size. A review of the subject general contractor’s bid indicates the total site work at $\_\_\_\_\_ per SF (${grosssf} SF gross land area). Given the subject’s average site characteristics with good quality of landscaped areas and asphalt paving, and full half-street improvements already in place, a similar mid-range cost of $\_\_\_\_\_\_ per SF is applied to the gross land area (${grosssf} SF).

Additional Soft Costs: Additional soft costs include taxes during construction, and miscellaneous costs, plus professional services. Professional services, which include legal, accounting, appraisal, environmental, consulting, title, etc., are estimated at $\_\_\_\_\_\_\_\_ (rounded), based partially on the actual soft cost budget provided by the developer (see Addenda), as well as similar project costs we’ve reviewed from our own files. Assuming a \_\_\_-month construction period, project related taxes are concluded at $\_\_\_\_\_\_ (rounded). Miscellaneous costs are estimated at an additional 20% of these two costs, or $\_\_\_\_\_\_\_\_\_. Absorption / lease-up costs for the project to lease is estimated at the end of this report at $\_\_\_\_\_\_\_\_\_\_\_\_. The total of these addition soft costs amounts to $\_\_\_\_\_\_\_\_\_\_\_.

The following page is a summary chart of the respective refinements and calculations included in the Marshal Valuation Service Calculator Cost Method. In summary, a replacement cost of **$\_\_\_\_\_\_\_\_\_**, or $\_\_\_\_\_\_\_\_ per SF of gross building area is calculated, which is reasonable for the subject’s building type and site coverage.



Cost Comparable Analysis

None available.

Contractor's Cost Estimate

The owner/developer has included an estimated bid for the subject project and it has been included in the addenda. Randy Killen (360.834.1240) is a local developer with ample multi-family construction experience and his total cost estimate is $8,562,250. The appraiser has added in our absorption costs estimated of $230,000 to his estimate. It is noted that the developer’s costs include a land value of $1,100,000 which needs to be subtracted, but is missing absorption costs or as we estimated $230,000. After adding absorption and deducting the land value a total cost estimate of $7,692,250 is indicated or $88.42 per SF. The owner/developer’s budget is presented in the Addenda of this report. Overall the budget is very similar to Marshall estimate.

Improvement Cost Conclusion

In review, the owner’s actual hard / soft construction budget ($\_\_\_\_\_\_ per SF) is somewhat higher than the Marshall Valuation Service ($\_\_\_\_\_\_\_ per SF). Overall, while primary emphasis is placed on the borrower / developer’s adjusted cost estimate, with strong secondary consideration given to the MVS cost estimate. Therefore, based on the preceding analysis, an mid-range **total direct & indirect cost conclusion** of $\_\_\_\_\_\_\_ per SF GBA is used in this analysis. This equates to a total of **$\_\_\_\_\_\_\_\_\_** ($\_\_\_\_\_\_\_ / SF x ${gba} SF GBA).

Developer's Profit & Overhead

This cost component compensates the developer for project risk and management. It is unlikely that a developer would proceed with a development unless adequate profit is available to justify the effort. This cost includes office overhead, staff, profit, and absorption costs during rent-up. The profit component is typically used to cover excess holding costs. According to various developers active in the market, profit and overhead generally ranges between 5% and 20% of the improvement costs, depending upon project value, size, location, and marketability.

Developer's profit and overhead is best extracted from the sale of newly improved properties which have sold a short time after completion. With no recent comparables available, general analysis will be used. The subject is a being developed for profit and would most likely sell to an investor for a moderate level of profit should be considered. Therefore, **a 15.0% allocation** for **developer’s profit and overhead** has been included in this analysis.

Replacement Cost New

With no allocation for developer's profit and overhead, direct and indirect costs for the subject improvements result in a **total replacement cost new** of **$\_\_\_\_\_\_\_\_\_\_\_\_**.

Accrued Depreciation

From the improvement cost new, a dollar amount of depreciation is deducted. There are three types of depreciation: physical, functional, and external. Physical deterioration is the result of physical wear and tear on the improvements. Functional obsolescence is the result of design or physical problems which reduce the income-producing ability or desirability of the subject property. External obsolescence is the result of outside influences (economic, neighborhood) which decreases the value of the property.

Depreciation does not typically occur on a straight-line basis in the marketplace. As a general rule, a property will experience the least amount of depreciation in the first few years of operation. As the improvements become older the physical deterioration becomes more apparent. In addition, the design and style of the building may become obsolete and suffer from functional obsolescence. Finally, when the improvements provide no additional value to the land, the economic life of the improvements is considered to have ended.

Physical Deterioration

This form of depreciation from physical causes is a measure of the deterioration of the improvements caused by wear and tear over time. The deterioration is generally divided into two categories: Curable and incurable. However, the subject improvements will be new at completion and in excellent condition with no deferred maintenance. Thus, no physical depreciation is applicable.

Functional Obsolescence

Functional obsolescence includes curable and incurable defects in the structure, materials or design of the subject. To be curable, these repairs to the defects must be financially feasible, with cost to repair not exceeding the value contribution. In the case of the subject property, the proposed improvements should be generally functional as an apartment project, of reasonably modern materials and generally of good quality construction. Furthermore, our analysis is based on replacement costs, which assumes a building and site improvements with functional utility and no noted items of obsolescence. Based on these considerations, there is no market evidence to support functional obsolescence for the subject property

External Obsolescence

The subject property is located near an established, commercial - residential area, with good general and immediate access in desirable, expanding suburban area. The local apartment market is in an expanding mode with limited new development occurring incrementally to meet the needs of the expanding population. There are no known adverse environmental concerns impacting this neighborhood or the subject property. Based on these considerations, there is no market evidence to support external obsolescence for the subject property.

Accrued Depreciation Conclusion

Based on the previous analysis, no incurable physical depreciation will be deducted from the replacement cost new of the improvements. This results in a **depreciated value of the subject improvements** of **$\_\_\_\_\_\_\_\_\_\_\_\_**.

Concluded Market Value Via The Cost Approach

**Option 1 – No Surplus / Excess Land**

Combining the concluded land value with the estimated depreciated replacement cost new of the subject improvements indicates a **concluded prospective stabilized market value** of the fee simple interest in the **subject property** via the **Cost Approach** as follows (rounded to the nearest $5,000):

|  |  |
| --- | --- |
|  |  |
| **Concluded Stabilized Market Value Via the Cost Approach:** | **$\_\_\_\_\_\_\_\_\_\_** |

Our analysis of the subject property via the Cost Approach is presented on the following page.

**Option 2 – Add Surplus Site / Excess Land**

Combining the concluded subject primary site value with the estimated replacement cost new of the subject improvements indicates a **concluded prospective stabilized market value** of the fee simple interest in the **subject property** (excluding excess land) via the **Cost Approach** is **$\_\_\_\_\_\_\_\_\_\_\_**.

Previously at the end of the Site Valuation section, it was determined that the excess land is $\_\_\_\_\_\_\_\_. Adding this to the preceding concluded value of $\_\_\_\_\_\_\_\_\_\_ for the primary site / building results in a **total concluded prospective stabilized market value** of the **subject property** via the **Sales Comparison Approach** as follows (rounded to the nearest $5,000):

|  |  |
| --- | --- |
|  |  |
| Concluded Primary Site / Building Value: | $\_\_\_\_\_\_\_\_\_\_ |
| Add: Excess LandValue: | $\_\_\_\_\_\_\_\_\_\_ |
| **Concluded Stabilized Market Value Via the Cost Approach:** | **$\_\_\_\_\_\_\_\_\_\_** |

Our analysis of the subject property via the Cost Approach is presented on the following page.



1. Source: The Dictionary of Real Estate Appraisal, 6th Edition, 2015, The Appraisal Institute, Page 197. [↑](#footnote-ref-1)