|  |
| --- |
| 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 are estimated using the Marshall Valuation Service and cost comparables. **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)*

Special Note: **Reproduction Cost** is defined as “The estimated cost to construct, at current prices as of the effective date of the appraisal, an exact duplicate or replica of the building being appraised, using the same materials, construction standards, design, layout, and quality of workmanship and embodying all of the deficiencies, super-adequacies, and obsolescence of the subject building." *[[2]](#footnote-2)*

The preceding is an important distinction in that the typical buyer would pay no more than the cost constructing a similar project with equivalent utility. Therefore, any superadequate or deficient finishes of the building and/or site improvements would likely receive some level of discount. Furthermore, most churches and schools are non-profit organizations that do not tend to generate large amounts of excess cash flow. This means that many potential buyers who might otherwise prefer to buy a brand new facility sometimes lack the financial means to pay a price equivalent to construction cost new. Accordingly, financial constraints can also result in "obsolescence" concerns. More on these issues is provided in the Depreciation segment of this section.

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 various components of the church/school improvements are considered most similar to the Marshall Valuation's classifications as follows:

Building 1 – Main Sanctuary … average quality, Class D Church / Sanctuary (Section 16, Page 9). The main level of 7,686 SF has a Base Cost = $125.32 per SF, or $101.99 per SF allocated to this building’s GBA. In addition, the subject includes a 1,758 SF, average quality choir balcony which as reported by MVS to have a replacement cost of $43.85 per SF, or $7.07 per SF allocated to this building’s GBA. This equates to a total adjusted cost of $110.15 per SF.

Building 2 – Preschool … average quality, Class D Daycare Center (Section 18, Page 13). Base Cost = $115.00 per SF.

Building 3 – Office / Multi-Purpose Facility … low cost to average quality, Class D Office Building (Section 15, Page 17). Base Cost = $69.29 to $103.31 per SF. Overall, a cost near the lower-middle portion of the range is considered most applicable considering the subject’s lower quality physical characteristics, or a rough MVS cost of $80.00 per SF.

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

Building 1 – Main Sanctuary … Includes a 1,758 SF, average quality choir balcony which as reported by MVS to have a replacement cost of $43.85 per SF, or $7.07 per SF allocated to this building’s GBA. This equates to a total adjusted cost of $110.15 per SF.

Building 2 – Preschool … required no further adjustments.

Building 3 – Office / Multi-Purpose Facility … required no further adjustments.

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 exterior fencing. Based on analysis of several recent cost comparables, site improvement costs for typical industrial and commercial sites (1 to 10 acres) range from $3.00 to upward of $8.00 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. Overall, a cost of $\_\_\_\_\_ per SF is applied to the subject site due to its good average quality landscaped areas, mostly asphalt paved paving, curbing, and good signage / ample pole lights. This is applied against the overall site area of ${primsf} 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 owner (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 $800 (rounded). Miscellaneous costs are estimated at an additional 20% of these two costs, or $20,200. As the subject is a build-to-suit owner-user, church/school facility, lease-up and absorption cost estimates are not appropriate. 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.

Improvement Cost Conclusion

**Option 1 – MVS Only**

Based on the cost service analysis, the **total direct/indirect cost new** is still reasonably concluded to be in-line with MVS at **$\_\_\_\_\_\_\_ per SF** **GBA**, or **$\_\_\_\_\_\_\_\_\_\_\_\_\_** ($\_\_\_\_\_\_\_ / SF x ${gba} SF GBA; rounded).

**Option 2 – MVS & Cost Comps**

In review, the cost service analysis ($\_\_\_\_\_\_\_ per SF) is generally supported near the lower end of the range indicated by Cost Comps 1, 2, 3 and 7 ($160.02 to $190.62 per SF). Hence, the **total direct/indirect cost new** is still reasonably concluded to be in-line with MVS at **$\_\_\_\_\_\_\_ per SF** **GBA**, or **$\_\_\_\_\_\_\_\_\_\_\_\_** ($\_\_\_\_\_\_\_ / SF x ${gba} SF GBA; rounded).

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 build-to-suit, owner-occupied, church/school facility. Such projects are usually constructed for business profit, and not to earn a developer's profit on the real estate. Therefore, **no allocaton** for **developer's profit and overhead** has been included in this analysis.

Replacement Cost

In aggregate, 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.

Curable Physical Deterioration: This form of deterioration is the result of deferred maintenance which require immediate repair, such as roof repair, painting, landscaping maintenance, or replacement of broken components. To be curable, these repairs must be financially feasible, with cost to repair not exceeding the value contribution. In the case of the subject property, as the improvements are in average to above average general condition with no noted significant items of deferred maintenance.

Incurable Physical Deterioration: The total incurable physical deterioration will be estimated by using the economic age-life method. To determine the incurable physical deterioration, the ratio of the effective age divided by the total economic life of the improvements is applied to the replacement cost.

The subject improvements are currently in average condition with a varying levels of depreciation. The following chart summarizes the major components of the subject property with their age, effective age, and total economic life. The total economic life is the period of time over which improvements to real estate contribute to property values. The economic lives of properties observed in the market vary depending on market conditions, maintenance levels, and frequency of renovation.

|  |  |  |  |
| --- | --- | --- | --- |
| **Improvement Component** | **Year Built** | **Effective Age** | **Total**  **Economic Life** |
| Building Improvements | 1967 to 1981 | 15 (Average) \* | 50 |
| Site Improvements | 1980s / 2017 | 5 (Average) \* | 15 |

\* Effective age estimate assumes curing of deferred maintenance for the site improvements and Building 3.

Based on the previous segregated effective ages and lives of the various subject improvements, the following chart summarizes the calculation of the incurable physical deterioration and total accrued depreciation for the subject property.

|  |  |  |  |
| --- | --- | --- | --- |
| **Cost Item** | **Replacement**  **Cost New** | **Incurable**  **Physical**  **Depreciation** | **Total**  **Depreciation** |
| Building Improvements | $2,675,000 \* | 15 / 50 = 30% | $803,000 |
| Site Improvements | $436,000 | 5 / 20 = 25.0% | $109,000 |
| **TOTAL** | **$3,111,000** | (Rounded) | **$910,000** |

\* Total RCN for Buildings, including $75,000 for additional soft costs.

Based on the previous analysis, the estimated total **physical deterioration** of the existing subject improvements is estimated at **$\_\_\_\_\_\_\_\_\_\_\_\_\_\_** (\_\_\_\_\_.\_\_% of RCN).

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. With regard to the subject church/school facility, there is most likely to be significant incurable forms of functional obsolescence associated with either superadequacy and/or loss in functional utility (deficiency), as regarded by other potential users of the subject improvements. In spite of the subject’s generally functional design, the market invariably tends to assign some level of functional obsolescence to church/school improvements which is recognized as a discount against the cost to construct the property by potential purchasers in the market.

Measuring the amount of this functional obsolescence is problematic at best. This is due to the fact that the amount of obsolescence depends on how well matched the eventual buyer would be to the subject facility. It would also depend upon the financial ability or purchasing power of this same buyer. In other words, different buyers would bring different degrees of physical and financial compatibility to the subject property, resulting in widely varying degrees of obsolescence from one potential transaction to another.

In attempting to quantify functional obsolescence, we have analyzed (6) improved sales that occurred since 2015 (see Sales Comparison Approach - Improved [Church / School] Sales). None of the properties were considered to suffer from economic obsolescence. Hence, after deducting for physical depreciation, our analyses indicate functional obsolescence ranging from 19.6% to 25.8%, or an average discount of 22.2%.

Though the subject’s building and site improvements are generally functional in design for church/school use, their fair to average architectural design and fair to average quality of interior and exterior finishes would reasonably tend to result in an average level of functional obsolescence. However, given the strong market demand recently placed on nearby Improved Sale 1 (inferred functional obsolescence of 19.6%), a low end conclusion is used in this analysis. Hence, a **20.0%** **discount** is considered reasonably to account for functional obsolescence (both for superadequacy and deficiency). Based on our replacement cost conclusion, this would indicate total potential **functional obsolescence** of **$\_\_\_\_\_\_\_\_** ($\_\_\_\_\_\_\_\_\_\_\_\_ x 20%; rounded).

External Obsolescence

The subject property is located in an established residential neighborhood with very convenient access to major transportation routes. There are no known adverse environmental concerns impacting this neighborhood or the subject property. There are no known adverse environmental concerns impacting the immediate neighborhood or the subject property. Based on these considerations, there is no market evidence to support external obsolescence for the subject property.

Total Accrued Depreciation

Combining the preceding allocations for physical depreciation and functional obsolescence, this results in **total accrued** **depreciation** of **$\_\_\_\_\_\_\_\_\_\_\_\_\_\_** (rounded).

Accrued Depreciation Conclusion

Based on the previous analysis, the estimated total accrued depreciation will be deducted from the replacement cost new of the improvements. This results in a **depreciated value of the subject improvements** of **$\_\_\_\_\_\_\_\_\_\_\_\_\_\_** (rounded).

Concluded Market Value Via The Cost Approach

Combining the concluded land value with the estimated depreciated replacement cost new of the subject improvements indicates a **concluded 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 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, Sixth Edition, 2015, The Appraisal Institute, Page 197. [↑](#footnote-ref-1)
2. Ibid, Page 198. [↑](#footnote-ref-2)