|  |
| --- |
| 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 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)*

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:

Building 1 - Showroom / Service Facility … excellent quality, Class C Complete Auto Dealership (Sec. 14, P. 30), which indicates a base shell cost of $\_\_\_\_\_ per SF;

Building 2 – Detail Shop / Storage … average quality, Class C Service (Repair) Garage (Sec. 14, P. 32), which indicates a base shell cost of $\_\_\_\_\_\_ per SF;

Building 3 – Office (Former Internet Sales) … average quality, Class C Office Building (Sec. 15, P. 17), which indicates a base shell cost of $\_\_\_\_\_\_ per SF; and

Building 4 – Office (Former Corp. HQ) … good quality, Class D Office Building (Sec. 15, P. 17), which indicates a base shell cost of $\_\_\_\_\_\_ per SF.

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

Building 1 – Showroom / Sales / Service … is initially adjusted upward for the mezzanine office (3,978 SF) which has an estimated RCN of $51.50 per SF. Divided by the Bldg. 1 footprint of 36,098 SF, this equates to a mezzanine office add-on of $5.68 per SF. The average quality, front showroom entry canopy (342 SF) has a cost at $71.00 per SF, and divided by the same footprint area equates to a canopy add-on of $0.67 per SF. The entire building has fire sprinklers which at an add-on cost of $3.15 per SF. Hence, the total adjusted cost is $196.50 per SF which is applied to this building portion’s footprint area.

Building 2 – Detail Shop / Storage … required no further adjustments.

Building 3 – Office (Former Internet Sales) … required no further adjustments.

Building 4 – Office (Former Corp. HQ) … 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 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. Overall, a cost of $\_\_\_\_\_ per SF is applied to the dealership 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 ${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 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. No absorption / lease-up costs are included as the subject will be 100% owner occupied. 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 types and site coverage.



Cost Comparable Analysis

A limited number of recent or reasonably similar automobile dealership cost comparables for analysis were found in our survey which reflected five recent cost comparables of relatively recent constructed automobile dealerships. These properties reflected somewhat similar construction materials and traditional style dealerships, but had varying offsetting quality items (glass curtain walls, etc.) and site coverages that will be discussed following. The cost comparables will be analyzed on the basis of the subject’s dealership / showroom / service areas of ${showsf} SF total. Note that the comparables are confidential, with their identities undisclosed in this analysis. A summary of their related direct construction costs (excluding developer’s profit) is provided following:

**Dealership Cost Comparables**

|  |  |  |  |
| --- | --- | --- | --- |
| **General Location** | **Direct Cost /**  **Completion Date** | **Building Area**  **% Office** | **Land-To-Bldg. Ratio**  **Construction** |
| 1) Medford, OR | $163.95 / SF \* Winter 2014 | 38,175 SF \* 41.2% | 6.3 to 1 \* Steel / CTU / Metal |
| 2) McMinnville, OR | $160.02 / SF \* Spring 2009 | 27,488 SF 35.0% | 5.8 to 1 CTU |
| 3) Gladstone, OR | $175.60 / SF \* Winter 2008 | 61,505 SF 48.9% | 3.5 to 1 CTU |
| 4) Wilsonville, OR | $110.01 / SF \* January 2005 | 39,022 SF \* 44.6% | 4.8 to 1 \* CMU / Steel |
| 5) Wilsonville, OR | $136.01 / SF \* Summer 2005 | 32,925 SF 44.6% | 4.5 to 1 CMU / Steel |
| 6) Gresham, OR | $148.12 / SF \* February 2007 | 41,960 SF 46.4% | 6.7 to 1 CTU |
| 7) Wilsonville, OR | $190.62 / SF \* March 2007 | 34,520 SF 43.7% | 5.6 to 1 CMU |

\* Allocation to primary dealership building and site improvements.

The recent cost comparables range between $110.01 to $190.62 per SF, and are similar to the subject with respect to construction and general overall quality and appeal. The general overall quality, size, and appeal of this turn-key full service auto dealership are relatively similar to the subject.

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, auto dealership with full service 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 New

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.

Due to the relatively recent 2013 renovation of the showroom / office / vehicle drop-off improvements (Bldg. 1), they are considered to be in good, well maintained condition with an overall effective age estimated at 7.5 years (total economic life = 50 years). In contrast, the detail shop / storage structure (Bldg. 2) is in below average, adequately maintained condition, and has a much higher concluded effective age of 25 years (total economic life = 50 years). The former internet sales office (Bldg. 3) is in average, adequately maintained condition with an effective age estimated at 20 years (total economic life = 50 years), while the former corporate HQ office (Bldg. 4) is in average, well maintained condition with a newer effective age of 10 years (total economic life = 50 years). Finally, the site improvements have an effective age of 7.5 years and an economic lifespan of 20 years. Hence, these are the periods 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.

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.

|  |  |  |  |
| --- | --- | --- | --- |
| **Improvement Component** | **Year Built**  **(Renovated)** | **Effective Age** | **Total**  **Economic Life** |
| Bldg. 1 - Showroom / Sales / Service | 1997 (2013) | 7.5 | 50 |
| Bldg. 2 - Detail Shop / Storage | 1970 | 25 | 50 |
| Bldg. 3 - Office (Former Internet Sales) | 1976 (1997) | 20 | 50 |
| Bldg. 4 - Office (Former Corp. HQ) | 1998 | 10 | 50 |
| Site Improvements | Various | 7.5 | 20 |

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** | **Allocated**  **Replacement**  **Cost New** | **Incurable**  **Physical**  **Depreciation** | **Total**  **Physical**  **Depreciation** |
| Bldg. 1 - Showroom / Sales / Service | $8,825,000 \* | 7.5 / 50 = 15.0% | $1,324,000 |
| Bldg. 2 - Detail Shop / Storage | $383,000 \* | 25 / 50 = 50.0% | $192,000 |
| Bldg. 3 - Office (Former Internet Sales) | $658,000 \* | 20 / 50 = 40.0% | $263,000 |
| Bldg. 4 - Office (Former Corp. HQ) | $1,006,000 \* | 10 / 50 = 20.0% | $207,000 |
| Site Improvements | $1,885,000 \* | 7.5 / 20 = 37.5% | $707,000 |
| **TOTAL:** | **$12,757,000** | (Rounded) | **$2,685,000** |

\* RCN for the building components include pro rata share of 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. In the case of the subject property, most of the improvements are considered functional for their intended use, and consists of modern materials and 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 was concluded for Bldgs. 1 and 2 – dealership showroom / service and detail shop / storage buildings.

In contrast, Bldgs. 3 and 4 – these two office buildings are both currently vacant and considered superadequate to the needs of most dealership users. This is not to say that another dealer might not find a use for these structures, but the fact the existing user leaves this buildings unoccupied lends support as to their superadequate nature. A survey of special use properties indicates typical functional obsolescence discounts in the range of 15% to 40% of the physically depreciated RCN. In this analysis, we have assumed a reasonably conservative 33.3% **functional obsolescence discount** of **$400,000** as applicable to the depreciated RCN of these buildings ($1,664,000 RCN - $464,000 physical depreciate = depreciated RCN of $1,200,000 x 33.3%).

External Obsolescence

The subject property is located in an established, newer commercial retail area, with very good general and immediate access / exposure in a larger sized suburban metro market area. The local new auto dealership market is generally in a stabilized to 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.

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 $10,000):

|  |  |
| --- | --- |
|  |  |
| **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, 6th Edition, 2015, The Appraisal Institute, Page 197. [↑](#footnote-ref-1)