|  |
| --- |
| 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 S Light Industrial / Warehouse Shell Building (Sec. 14, P. 35), which indicates a base cost of $52.50 per SF for a good quality, CMU / steel-frame / metal-clad shell.

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

Light Industrial / Warehouse Shell Building - base cost was initially adjusted upward for fire sprinkler systems ($2.50 per SF) and heating systems ($2.65 per SF). Additional adjustments were required for the proposed wash bay (1,517 SF x $30 / SF ÷ 11,400 SF GBA = $3.99 per SF), as well as the craneway ($100 per lineal foot x $250 / LF ÷ 11,400 SF = $2.19 per SF). Hence, the total base shell cost is adjusted to $\_\_\_\_\_ per SF.

Industrial Interior Office Space (Sec. 14, P. 35) which indicates a base cost of $\_\_\_\_\_\_\_ per SF for good quality build-out.

Mezzanine Storage Space (Sec. 14, P. 27) which indicates a base cost of $\_\_\_\_\_\_ per SF for average quality, storage space (the category most closely matching this enclosed, light duty mezzanine area).

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 industrial and 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).

**Option 1 – Owner-User**

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 $\_\_\_\_\_\_ (rounded). Miscellaneous costs are estimated at an additional 20% of these two costs, or $\_\_\_\_\_\_\_\_\_. No absorption / lease-up costs are included as the subject will be 100% owner occupied. The total of these addition soft costs amounts to $\_\_\_\_\_\_\_\_.

**Option 2 – Speculative Investor**

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 tenant spaces to lease is estimated at the end of this report at $\_\_\_\_\_\_\_\_\_\_\_\_ (excluding the $\_\_\_\_\_\_\_\_ in TI’s on the remaining \_\_\_\_% tenant space to lease, but including full tenant leasing commissions of $\_\_\_\_\_\_\_\_\_\_). 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.

**Option 1 – Owner-User Project**

Contractor's Cost Estimate

The general contractor for the subject project is Walen Construction, a local Wilsonville, OR-based commercial / industrial construction company. The full contractor’s construction budget (dated March 24, 2020) is presented in the Addenda of this report. In addition, the owner / developer provided a brief summary of overall development costs (also provided in the Addenda). A summary chart of the cited construction and development costs was prepared by the appraiser and is provided on the preceding page.

The contractor estimates a total hard or direct cost of $3,973,887 ($343.59 per SF GBA). This estimate does not include engineering and architecture / engineering, city fees, as well as building permits and miscellaneous soft or indirect costs, which were provided by the owner (see Addenda) at an actual cost of $1,235,127 ($108.34 per SF GBA, or an unreasonably high 31.1% of hard or direct costs). This results in a total hard & soft cost budget for the owner of $5,209,014 or $456.93 per GBA. However, this cost includes the costs attributable to the surplus yard area, which must be deducted in order to arrive at the subject’s construction budget allocable to the primary site / building.

An analysis of the subject’s site work costs indicates a total of $1,302,773 ($12.72 per SF site area – including both the primary site & surplus land). In the preceding chart, the surplus yard area improvements were allocated at $10.00 per SF, which resulted in a site work allocation to the primary site of $15.48 per SF.

Based on the preceding discussion and summary cost chart on the prior page, the developer’s total hard & soft costs allocable to the primary site / building was estimated at $4,532,596 ($397.60 per SF GBA). As will be discussed on the following paragraph, this budget appears to be far above market. We interviewed the owner – Dave Nicoli who indicated that the high cost(s) of subject project’s development had even surprised him. In this regard, there are a few items of both the construction and development budget that require mentioning, and these are discussed as follows.

One item driving upward costs were allocations included for contingency. The contractor’s budget includes contingency at $189,233, while the development budget adds another $380,059 for the same item. This equates to total contingency of $569,292 (10.9% total hard & soft costs). While some level of contingency (say 5.0%) is considered reasonable, this category does appear very strong.

Finally, while many of the individual cost items in the budget appeared relatively reasonable or near the high side for such items, it was not possible to determine to a more exact degree which items appeared unreasonably high. However, in total – the subject’s total development costs – particularly for the primary site / building at $397.60 per SF, is most certainly well above market and falls far above the estimate resulting from our MVS analysis.

**Option 2 – Investor Development**

Developer's Cost Estimate

The general contractor for the subject project is Sierra Construction Company, a Seattle, WA / Portland, OR based company with substantial industrial construction and development experience. The full contractor’s construction budget (dated December 11, 2019) is presented in the Addenda of this report, with reported hard shell / sitework costs of $11,378,782 ($59.13 per SF GBA). In contrast, the developer’s pro forma budget (also contained in the Addenda – not dated) is slightly higher at $11,558,504 ($60.07 per SF GBA), which will be relied upon as more conservative for purposes of this report. The developer’s budget also allows tenant improvements at $1,924,240 ($120.27 per SF office build-out assumed at 16,000 SF), plus minor off-site costs of $288,636, permits and fees of $769,696, and a hard cost contingency of $727,054 (4.8% of total estimated hard costs). These combine to an total developer hard cost estimate of $15,268,130 ($79.35 per SF GBA).

In addition, the developer forecasts soft costs for the project at $2,721,124 (17.8% of hard costs). These include financing, miscellaneous and administrative costs, carrying costs until stabilization, and leasing commissions. In addition, we have adjusted these costs upward for rent loss during lease-up estimated by the appraiser at $321,594, or adjusted soft costs of $3,042,178. Combining the developer’s projected hard costs and adjusted soft costs equates to a total construction cost of $18,310,848 or $95.16 per GBA.

Improvement Cost Conclusion

In review, the owner’s actual hard / soft construction budget ($\_\_\_\_\_\_ per SF) is significantly higher or approximately 2.0x higher than the Marshall Valuation Service ($\_\_\_\_\_\_ per SF). Overall, primary emphasis is placed on the MVS cost estimate with some consideration given to the borrower / developer’s cost estimate due to large number of items which appear out of sync with other similar light industrial projects. Therefore, based on the preceding analysis, a lower-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 primarily a build-to-suit, owner-occupied facility. Such projects are usually constructed for the use of the owner's business, not to earn a developer's profit. Therefore, **no allocaton** 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 a warehouse / shop / office building, 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 as analyzed in this report.

External Obsolescence

The subject property is located in a newer, established, industrial / flex neighborhood with good general and immediate access in a desirable, expanding suburban area. The local industrial and flex market is in a stable to expanding mode with only limited new development occurring incrementally to meet the needs of the expanding population and business environment. 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 surplus land / site improvements) via the **Cost Approach** is **$\_\_\_\_\_\_\_\_\_\_\_**.

Previously at the end of the Site Valuation section, it was determined that the surplus land / site improvement value 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: Surplus Land / Site ImprovementValue: | $\_\_\_\_\_\_\_\_\_\_ |
| **Concluded Stabilized Market Value Via the Cost Approach:** | **$\_\_\_\_\_\_\_\_\_\_** |

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)