VOLUME 11, NO. 1 BUSINESS AND REAL ESTATE APPRAISERS 2002 ANNUAL REPORT

Valuation Issues

EXCESS AND SURPLUS LAND

by John R. German

To paraphrase The Appraisal of Real Estate, 11th edition, the portion of a property's land area that represents an appropriate site for the existing improvements will reflect a typical land-to-building ratio for that particular property type. The amount of land required to support the existing building improvement is considered *utilized land. "Excess land*, in regard to an improved site, is the land over and above that required to serve or support the existing building improvement". If this land may be used to allow for future expansion or may have its own highest and best use, such as to be split off and developed as a separate site, it is considered excess land. If the land may not be separated from the existing site and does not have its own independent highest and best use, it is considered *surplus land.*

If the excess land is to be appraised as part of the economic unit, consideration must be given to what a market participant would pay for this extra land. Typically, he will not pay full value because he must pay for the costs to split out and market this excess land.

MOBILE HOME PARK VALUATION

by John A. Harmon

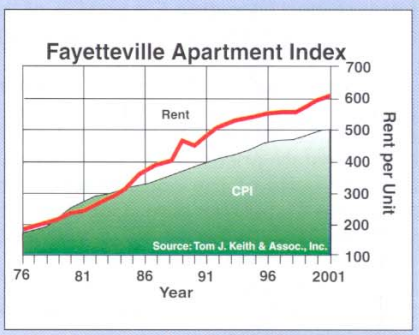
Our firm recently analyzed about 100 sales of mobile home parks in the Cumberland and Harnett County area and found some interesting facts worth noting. The Multiple Regression Statistical Analysis of the data produced the following averages over the past 12 years:

Average Number of Spaces in the parks	80.35
Average Age of the parks	13.65
Average Effective Gross Income Multiplier (EGIM)	4.60
Average Price per Space	$5,716

The Data also indicated the following trends over the past 12 years:

Average increase in Value per year	3.92%
Average decrease in value due to one year of age	2.84%
Average amount one unit change in EGIM makes	$973

In other words, parks are increasing in value at a rate of 3.92% per year while they are decreasing 2.84% in value per year due to depreciation. This indicates that parks increase in value due to inflation faster than they lose value due to depreciation caused by age by about 1.08% per year. The EGIM, a multiple developed by dividing the sales price by the revenue the park produces, ranged from about 2 to 8.



The Fayetteville Apartment Index is based on data collected as of December 31st of each year. The survey includes two bedroom units less than 20 years old. The average rate for the last five years was $560, $558, $575, $598, and $608 for 2001. During the last 10 years rental rates have closely tracked the rate of inflation. The vacancy rate for the past few years beginning in 1994 was 2.9%, 4.0%, 4.18%, 5.82%, 2.6%, 6.6%, 5.3%, and 2.9% in 2001. Last year's rental rate survey was performed by staff member Joe Potts.

The Residential Price Index is based on the average square foot price for dwellings ranging in value from $50,000 to $100,000 as of 1997 that are less than 20 years old and situated on sites contributing about 18% to the total selling price. The building boom of 1993 brought about an 11.9% increase in the prices of homes from 1992 to 1993. The 1994 prices moderated some with a 5% increase over the 1993 prices. The 1995 prices leveled off at the 1994 prices with no increases. During 1996, prices increased 7.8% to $62.44 per square foot, but the slow market of 1997 brought about a 6.13% drop to $58.61 per square foot in prices. Prices in 2000 decreased 1% to $63.56 per square foot from the 1999 price of $64.11. Prices in 2001 decreased 1.62% to $62.53 per square foot. The Fayetteville Board of Realtors reported the most activity during 2001 in residential sales since 1995, which may signal an improving market. John Harmon compiled the 2001 residential data.

PRESIDENT'S CORNER

by Tom J. Keith, MAI, CBA

Over the past year, our staff has been busy appraising Industrial properties, land tracts, medical clinics, commercial land and buildings and some residential development tracts. Investor's money appears to be moving from the fragile and volatile stock market to asset preserving, more stable real estate, which has increased in value since the 1930's. In the late 1980's many pension funds started allocating 5% to 10% of their portfolio's to land and timber funds to add long-term stability.

Since about 1990, I began to see investors buying land tracts at increasing prices for hunting, recreation, country estates, tree farming, and speculation. It appears as though the real estate prices in the South are catching up with those in other parts of the country where hunting land sells for $1,000 to $1,500 per acre. Our study of woodland and cropland prices shows an 8.5% compound rate of increase in woodland during the past 6 years. That's above our 100-year trend of about 6% per year. Small tracts of 100 acres or less typically sell at "retail" prices while the larger tracts sell at "wholesale" prices.

The low interest rates have spurred some renewed interest in real estate development. Some overbuilding of retail and office space in less competitive locations, typical of an end to the commercial building cycle, is observed. When recession arrives, these less competitive sites are the first to experience problems.

The demand for dwellings below $120,000 has been good during the past year as evidenced by the absorption rate for this product.

We have been busy appraising a number of industrial facilities that are closing. The industrial market has been flat since the late eight's and NAFTA zapped much of the remaining strength from this market. I hear much talk of NC's furniture manufacturing going overseas to China and Japan.

Retail and office rates have moderated some over the last year. It is too early to determine if this is a trend. Staff member John German compiled the data for this report.

ACCOUNTING CHANGES AFFECT BUSINESSES

by Joe L. Potts, CBA
and
Thomas Bell, MBA

In 2001 the Financial Accounting Standards Board (FASB) issued two pronouncements to standardize the treatment of Goodwill and make it easier to compare different entities' financial statements that will have a direct impact on business value. The first, FASB 141, Business Combinations, requires that all future business combinations use the Purchase Price Allocation Method rather than the Pooling of Interest Method. The basic difference between the two methods is that in the Pooling Method, the premium paid over book value (goodwill or other intangibles) is never recorded. For example, let's assume that Company A buys Company B for $650, a $600 premium over the book value of $50. It is determined that the FMV of assets owned by Company B is $150. Therefore, $100 ($150-$50) of the premium paid is allocated to FF&E. The additional premium is recorded as goodwill. The additional FF&E has a depreciable life of 10 years while the goodwill is amortized over 20 years.

Balance Sheet

	A	B	A+B (Pooling)	allocation	A+B (Purchase)
Current assets	200	100	300		300
FF&E	500	50	550	100	650
Intangibles				500	500
Total Assets	700	150	850	600	1450
Liabilities	300	100	400		400
Equity	400	50	450	600	1050
Total Equity + Liabilities	700	150	850		1450

Income Statement

Revenue	100	60	160		160
Expenses	50	30	80		80
Net Income	50	30	80		80
Depreciation					-10
Amortization of goodwill (if impaired)					-25
Net Income			80		45

With the adoption of FASB 142, Goodwill and Other Intangible Assets, goodwill is now defined as the difference between the purchase price and the fair market value of the assets of the acquired company. These acquired company assets include intangible assets as well as tangible assets. Examples of intangible assets include trademarks, customer lists, secret formulas, broadcast rights, patents, and licensing agreements. Some intangible assets such as goodwill or trademarks do not have a defined life and, therefore, will not be amortized, but will require a lower of cost or market impairment test each year. Other intangible assets such as patents have a useful life and therefore are subject to amortization.

RETURN ON APARTMENTS

by Brad M. Martin

In 2001 we analyzed our database of apartment project sales in North Carolina and found that the older apartment complexes offered a higher rate of return for the investor. In many cases, the higher rate of return carries a higher risk rate due to the project being less competitive in the market and the higher degree of management and repairs. Our statistical analysis indicates a 56% correlation between age and overall rate (OAR); and a 40% correlation between age and effective gross income multiplier (EGIM). The lower correlation between Age and EGIM may be due to the increased expenses of ownership as the project gets older. The actual data show that new apartments generally carried an OAR of less than 9% and an EGIM of over 7. For 80 year old apartments, the OAR was over 30% and the EGIM less than 3.

The value of a project is determined by dividing the Net Operating Income (NOI) by the OAR. For example, if the NOI is $100,000 and the OAR is 10%, then the value of the project would be $1,000,000.

Similarly, the value of a project can be determined by multiplying the Effective Gross Income (EGI) from a project by the EGIM. For example, if the EGI is $200,000 and the EGIM is 5.0, the value of the project is $1,000,000.

Usually, the OAR method will produce the more accurate value since investors must consider the cash flow from an investment to make mortgage payments.

MANUFACTURED HOME VALUATION

by Paula L. Mitchell

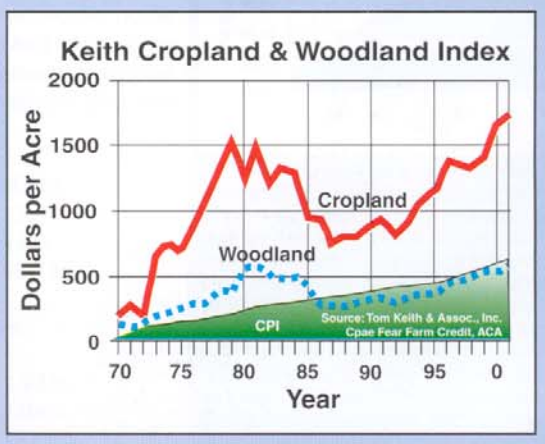
Our firm recently studied over 250 sales of Manufactured Homes in the Cumberland County market and extracted the following facts by Multiple Regression Statistical Analysis. The data showed that the condition of the home accounted for over 60% of its value. Other factors such as age, date of sale, extras, and fireplaces had minor influence. The data are summarized below:

Average price of Manufactured Home	$60,262
Average price of Manufactured Home	$44.55 per foot
Average price of Stick Built Home	$63.56 per foot
Average condition	very good
Amount one unit change in condition makes	$8,405
Homes with fireplaces	55%
Average size of home	1367 square feet
Homes with extras	77%
Average value contribution of fireplace	$722
Average contribution of extras	$1,782
Average value of one square foot	$27.37
Average decline in value over last 4 years	2.21% per year
Average increase in value of Stick Built (10yrs)	3.15% per year

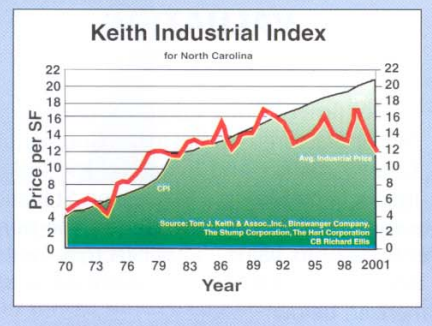
The data indicates a strong need to keep the home in good condition if the sellers want to get their money back out of the home when they sell it. Condition - not age affects value the greatest.

The Cropland & Woodland Index is an average of extracted cropland and woodland prices of farm and woodland comparable sales from 27 southeastern North Carolina counties collected by our firm and Cape Fear Farm Credit, ACA. The average per acre price of cropland for each of the last seven years from 1995 to 2001 amounted to $1,111; $1,349; $1,325; $1,311, $1,390, $1,651, and $1,720 in 2001.

The average price per acre for woodland since 1995 amounted to $353, $447, $461, $496, $533, $519, and $575 in 2001, an 11% increase over 2000. The CPI increased 1.29% last year. Tobacco Allotment prices for 2001 ranged from $2 to $4 per pound sold and rent averaged between $0.35 and $0.70 per pound rented. Over the last 28 years, woodland prices have kept up with inflation.



Only rural farm sales, which were purchased for row crop farming and outside of any urban influence, were selected for this analysis. An increasing number of sales purchased for poultry and swine facilities, investment, development, residential estates, and hunting were noted but not used in the study. The sample size is greatly reduced this year due to the large number of tracts under urban influence. Tom Keith compiled the data for this report.



The Industrial Index is based on the average price paid for existing industrial buildings in North Carolina from 1970 to 2001. The sources of data included Binswanger Company, The Stump Corporation, The Hart Corporation, CB Richard Ellis, NC Department of Commerce, and Tom J. Keith & Associates, Inc. Sales of distribution facilities and manufacturing plants dominated the 1996 market while warehouse space dominated the rental market. The years 1997 and 1998 seemed to be a mixed bag of distribution, warehouse, and manufacturing facility sales. Limited 1996-1997 market data tends to show that prices in Eastern North Carolina are catching up with those prices in the Piedmont. The average price paid for industrial buildings in the last 5 years were as follows: 1997 - $13.11/sf; 1998 - $12.93/sf; 1999 - $16.61/sf; 2000 - $13.67/sf; 2001 - $11.77/sf. Starting in 1987, industrial building prices fell below the 31-year inflation trend. To have kept up with inflation, building prices would have had to be $19.77 per square foot today. The NAFTA agreement with many countries caused many industries to move out of the USA resulting in many vacant buildings. This may account for the drop in prices during the past two years. Prices have not been this low since 1987.

CONTINUING TO IMPROVE

by Joe L. Potts, CBA

Our firm's continuing education class for August included the proper use of soil maps, how the information on the maps is derived, and what it means. Mr. Willie Spruill of the Natural Resource Conservation Service in Whiteville, NC assisted by Mr. John Ray of the USDA Soil Conservation Service gave us outstanding classroom hands-on training and an actual field demonstration. We learned what a soil map can and cannot tell someone about the land. We also learned how the different types of soil can affect land management and what the land can support. This training will help us prepare better appraisals of various types of land for our clients.

Member of the Financial Consulting Group, LC

TOM KEITH ASSOCIATES, INC.
121 S. Cool Spring Street
Fayetteville, NC 28301
(910) 323-3222
(910) 323-1180 Fax
email: info@keithvaluation.com
www.keithvaluation.com