

{ GAS STATION/ C-STORE GOING-CONCERN VALUATION }



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PRESENTED BY STEVE MORSE, FOUNDER & CHIEF APPRAISER

Focused on **quality**, **innovation**, and **differentiation**:



2003



2014



TODAY

Stephen J. Morse, Founder and Chief Appraiser of Retail Petroleum Consultants, began his appraisal career as an intern, while attending Fresno State University. After graduating in 1993, he quickly ascended through the ranks to an appraiser role, giving him the opportunity to master the craft, while bringing his keen level of insight to a company that would be his home for several years.

Wanting to expand upon both his valuation and geographic expertise, Stephen went on to work for several national firms, including Landauer (Atlanta, GA), PriceWaterhouseCoopers (Atlanta, GA), and American Appraisal Associates (AAA), where he built upon his knowledge of gas station and convenience store appraisals. During his time at AAA, Stephen created and managed the Petroleum Valuation Group based in Irvine CA, prior to realizing his own vision and forming Retail Petroleum Consultants (RPC) in 2003.

Since its founding, Retail Petroleum Consultants has provided over 6,000 going-concern valuations and special use appraisals to hundreds of financial clients, oil companies, gas station operators, attorneys, and the like. Today the RPC team led by Mr. Morse continues to provide the highest quality service while maintaining strict ethical standards. The firm is currently expanding Nationwide, with coverage to all 50 states.

GAS STATION/C-STORE VALUATION

Information Request List

1. **Copy of any leases encumbering the subject**, including any renewals, amendments and exhibits. These may include ground leases, QSR leases, service bay leases, etc.
2. Individual store contacts (to schedule inspections)
3. **Detailed Profit and Loss statements for the past three years plus current year-to-date**
4. Future sales projections and/or budget
5. **Fuel Supply Contract, Volume Incentive Plans, Rebates, Forgivable Loans, or any related dealer-supplier agreements**
6. Copy of current tax bills (both secured and unsecured) and details of any tax appeals in progress
7. Details and costs of any recent capital improvements completed or proposed (i.e.; roof repair, parking lot resurfacing, etc.).
8. Approximate year building(s) was constructed. Year of any addition or major renovation (i.e. new roof, exterior remodeling, asphalt paving, replacement of major mechanical systems)
9. **Fueling Equipment Information- Pumps, Dispensers, USTs, etc., Date installed**, manufacturer, type, size, etc.
10. Any previous appraisals or market studies
11. **Historical Fuel sales volumes, past three years on an annual basis, and trailing 12 months or year to date, # of car washes annually**
12. Construction details and costs - necessary for newly constructed or proposed projects, not required for older properties
13. Site and building plans, ALTA survey (if available)
14. Title report
15. List all ownership changes in the last three years, both real estate and/or business.
16. **If the facility is being acquired, or is currently under contract, please include a copy of that contract which includes all terms and conditions of the transaction, listing package if property is for sale, sales information if property recently sold, land acquisition information if relevant (new construction)**
17. Please identify any known environmental issues or remediation, responsible parties, etc.
18. A schedule of any furniture, fixtures, and equipment to be included. Please provide date acquired, cost, manufacturer and model number and book value if available.

GAS STATION/C-STORE VALUATION

Appraising Gas Station & C-Stores

The first step in undergoing a gas station going-concern appraisal is understanding the interest appraised.



Fee Simple

Lease Fee

Leasehold

The market data considered for each ownership interest is different. It's crucial the data considered matches the interest appraised. An appraiser's competent with fee simple valuations may not be competent to appraise leasehold or leased fee interests. Note SBA's current "Qualified Source" for 7a Loans:

"If an applicant business operates from a Special Purpose Property (for example, car washes, hotels, gas stations with or without a convenience store, golf courses, medical facilities or bowling alleys), the going concern appraisal must be completed by a Certified General Real Property Appraiser with experience appraising the specific business/property type. Such appraisals must allocate separate values to the individual components of the transaction including land, building, equipment and intangible assets. Finally, the Certified General Appraiser must have completed no less than four going concern appraisals of equivalent special use property as the property being appraised, within the last 36 months, as identified in the qualifications portion of the Appraisal Report."

GAS STATION/C-STORE VALUATION

Gas Station/ C-Store Ownership

Fee Simple

Ownership unencumbered by lease, often referred to as owner occupied. Operator owns all components of the going-concern including land, buildings, removable and permanently attached Machinery and Equipment (M & E), and any business and or intangibles as applicable. Historical Profit and Loss statements including fuel gallons sold are critical for a credible valuation. Lenders will typically underwrite real estate and a portion if not all permanently attached M & E. Business value as applicable may be underwritten separately.

Leased Fee

Gas station is leased arms-length with landlord receiving rental payments for land and buildings. Here we are appraising the landlord's position. Fueling improvements are typically included but generally maintained by tenant. Tenant owned business and *removable* M & E items are excluded from the leased fee valuation. Tenant credit rating and lease terms are necessary for a credible valuation. Lenders generally underwrite leased real property assets including fueling improvements. Short lease terms, inadequate tenant cash flow, and poor tenant credit rating may impact valuations.

Leasehold

Also referred to as a business only valuation. Here we are appraising the tenant's position. Business cash flow and lease terms are necessary for a credible valuation. Landlord may be Major Oil Company or individual. Major Oil Companies must abide by PMPA (Petroleum Marketers Practices Act) whereby leases are renewed at market rates into perpetuity with tenant having first right of refusal if landlord sells their assets. Lenders underwrite tenant's business cash flow and any leasehold real property assets.

GAS STATION/C-STORE VALUATION

Fee Simple (Going-Concern Valuation)

Going-Concern cash flow converted to value factoring gross profit by a GPM (Gross Profit Multiplier) or applying an OAR (Overall Capitalization Rate) to NOI (Net Operating Income). Average GPMs for modern branded urban located gas stations in California generally range between 3.00 and 5.00. Average OARs are generally between 8.00% and 12.00%. GPMs are at very high levels while overall rates remain low similar to trends observed in the NNN market.

The Cost Approach is used to allocate going-concern assets by residual technique; if residual is positive business value is present, if negative no business value is realized and the subject likely suffers from functional and or external obsolescence.

Gross Profit X GPM = \$ Going-Concern Value

NOI ÷ OAR = \$ Going-Concern Value

Going-Concern Value - Cost Approach = \$ Business Value (Functional/External Obsolescence)

GAS STATION/C-STORE VALUATION

Leased Fee (Real Estate Only Valuation)

Annual income received from tenant (rent) less expenses is converted to value by dividing net income by an OAR. Long term triple net (NNN) leases of improved real estate to National credit rated tenants such as Chevron or Shell trade for the lowest risk support current OARs generally in the 4.00% to 6.00% range as these tenants will pay rent regardless of whether or not the service station cash flows. Overall rates appear to have bottomed out and will likely increase as interest rates rise in the coming years.

Leases to individual dealers that are not credit rated have much greater risk and support higher OARs at 6.00% to 9.00% or more depending on the perceived tenants credit rating and spread between their cash flow and rental payments.

Lease terms, environmental and maintenance responsibilities, removal of improvement(s) and or USTs (Underground Storage Tanks) at lease termination, branding, age and condition, etc. may effect OAR selection. Leased fee value is arrived at by dividing net annual rental income by the selected OAR, when tenant cash flow exceeds rental payments.

$$\text{Net Annual Rental Income} \div \text{OAR} = \$ \text{ Leased Fee Value}$$

(When Tenant Cash Flow > Rent)

GAS STATION/C-STORE VALUATION

Leasehold (Business Only Valuation)

Here we are valuing the tenant's ownership interest or business only. Simply stated the tenant's annual NOI is divided by an OAR. This analysis works well when there is ample comparable sales data available with known lease terms. Unfortunately, most business transaction data readily available to appraisers (BizComps, Pratt Stats, BVR, etc.) fails to report underlying lease duration and related terms making the comparable's OAR meaningless. Often it is the terms of the lease that drive the sale, short term leases above market tend to reflect higher rates than long term leases below market. OARs for business only transactions are typically higher than leased fee or fee simple OARs beginning near 12.00% to as high as 30.00% or more.

Additionally, a DCF (Discounted Cash Flow Analysis) may be employed, especially with short lease terms. Though difficult to extrapolate from the market, discount rates tend to reflect a 200 to 500 basis point premium to fee simple OARs for the increased risk of having to "hand back the keys" and perform any UST removal or related environmental work.

$$\text{NOI (Business Income)} \div \text{OAR} = \$ \text{ Leasehold Value}$$

GAS STATION/C-STORE VALUATION

Analyzing Financial Statements

- Preferably 3 complete years of detailed annual P & L Statements
- Tax returns are of little use and should only be considered as a last resort
- Avoid annualizing due to seasonality and inventory (fuel) fluctuations
- Adjust for add backs (depreciation, amortization, interest, pocket to pocket rent, etc.)
- Be consistent with comparables and subject's ownership interest
- Watch for fuel taxes incorrectly categorized as COGS (Arco AM/PM)
- Credit card fees as Operating Expense (NACS)
- UST fees as Operating Expense (RPC)

General Rules of Thumb

- C-Store Gross Profit 30% to 35%
- Fuel Margins vary greatly and are at all time highs. In California \$0.15 to \$0.40
- QSR (Quick Serve Restaurants) and Repair gross profit (includes labor) 40% to 60%
- Small Automatic Car Washes gross profit 85% to 95%
- Operating Expense as % of Gross profit 50% to 70% (NACS 56.56% 2014)

SBA 25 Year Loan Maturation

Aside from allocations of real estate versus intangibles where there will always be differing points of views, the major concern we see with SBA lenders and special use gas station and car wash properties is that of remaining economic life. Since loan maturities are tied to economic life, appraiser's estimated remaining economic life is critical to the success of the loan. **SBA recognizes maximum loan maturities for real estate at 25 years and equipment at 10 years.** This poses special problems for gas station and car washes that have significant amounts of "equipment" included in the assets to underwrite. If the fueling improvements (USTs, dispensers, canopy, signage, EVR, etc.) or attached car wash conveyor system are considered as "equipment" it would be difficult to qualify borrowers given such a significant portion of their loan would be collateralized by short lived assets. However, because these "equipment" items are permanently attached RPC allocates them as real estate. However, these items have much shorter lives than buildings alone and when all real property is blended together, blended or weighted economic life as if new is only 20 to 27 years for gas stations and even less for car washes. This leaves little room for age life depreciation as a gas station older than 2 years may not have enough remaining economic life to meet the 25 year maturity threshold, considering all real property. With the abundance of short-lived items comprising a significant portion of the overall value, these properties generally need substantial renovation every 15 to 20 years or so not to mention the ever-changing regulatory landscape, which adds another unknown wrinkle to the effective life of the fueling improvements.

REMAINING ECONOMIC LIFE (REL) CALCULATIONS							
Component	% of RCN				Weighted Avg Life ¹	Weighted Avg Age ²	Weighted REL ³
	Total	Total Life	Age	REL			
C-Store	21.57%	40.00	10.00	30.00	8.63	2.16	6.47
Removable M & E	10.61%	15.00	8.00	7.00	1.59	0.85	0.74
Site Costs	13.54%	22.42	6.24	16.18	3.04	0.85	2.19
Car Wash	15.99%	20.00	8.00	12.00	3.20	1.28	1.92
Fueling Improvements	38.28%	15.61	8.00	7.61	5.98	3.06	2.91
Total					22.43	8.19	14.24

¹Weighted Average Life = % RCN X Total Life
²Weighted Average Age = % RCN X Weighted Average Life
³Weighted REL = % RCN X REL (Weighted Average Life - Weighted Average Age = Weighted REL)

GAS STATION/C-STORE VALUATION

Economic Life Vs. Physical Life

Unlike most commercial properties where it is commonplace to put aside replacement reserves, this is not the case with gas station and car wash operators. The wear and tear and these property types is perhaps greatest of all with expensive government regulations and compliances that often require significant upgrades and capital outlays that are unforeseen. For these reasons economic lives for car wash buildings, gas stations, and c-stores are accelerated. This is proven by the appraiser relied upon cost manual published by Marshall and Swift that shows most commercial buildings with 35 to 55 year lives while gas station, car washes, and c-stores have reduced economic lives between 20 and 45 year lives.

Simply stated, economic life is how much longer the improvements will contribute value to the underlying land whereas physical life is how much longer the improvements will last. In many cases existing gas stations are razed for new development, their existing improvements still had physical age left, but economically the improvements were at the end of their lives. Physically, a c-store building or UST for that matter could physical remain in place (physical life) well in excess of its economic life, but due to changes in technology, government compliance, and competition these improvements will likely be replaced and or modified long before they physically wore out. Generally speaking economic life is shorter than physical life, especially for aged special use properties.

Gas stations and car washes depreciate faster than other commercial property types, though SBA seems to treat them no differently than a restaurant or industrial building. RPC uses 40 year economic life for a typical c-store building and will report shorter lived fueling improvements and site improvements separately. When remaining economic life is below SBA thresholds there are options available to the appraiser that adhere to USPAP or SBA guidelines while maintaining appraisal reliability.

GAS STATION/C-STORE VALUATION

Economic Life Vs. Physical Life (Continued)

Replacement Reserves If gas station operators put aside replacement reserves economic lives of the buildings and equipment would be increased, while in response cash flow would be reduced. The operator is simply trading cash flow for extended economic life of their real property. We have provided just such an analyses to assist with insufficient remaining economic life.

Remaining Physical Life We have been asked by some lenders to add narrative stated, when appropriate, that the remaining physical life of the building exceeds the 25 year threshold, though it may not in terms of remaining economic life. Providing this type of language has allowed SBA some leniency as to remaining economic life. This may be due to SBA's interpretation of what they deem to be economic and physical life. However, we could not find SBA referenced definition of these terms.

Renovation and Upgrades A final option when remaining economic life thresholds cannot be met though timely and costly is renovating or upgrading the facility such that economic life is extended to meet and or exceed loan maturity thresholds. This is particularly attractive for buyers of older facilities that may not qualify under current SBA guidelines.



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