



How to Appraise Your Convenience Store Yourself

Robert E. Bainbridge, MAI
C-STORE VALUATIONS

A STEP-BY-STEP GUIDE

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Introduction

The purpose of this guide is to help you produce a credible and reliable estimate of the market value of your convenience store. You should be able to complete your appraisal in less than two hours. The following chapters include just enough valuation theory to help you correctly use and understand the tools and methods to appraise your store. Custom worksheets are also included for each step so that you can gather the necessary information and process this data into a value estimate.

Chapter 1 describes the difference between the valuation estimate you can produce with this guide and a professional appraisal. The three asset classifications of a convenience store business are described



in Chapter 2. We will be estimating the value of the assets separately in later chapters. Appraisal theory as applied to convenience stores is explained in Chapter 3. Chapter 4 helps you to identify your real estate and other assets, while Chapter 5 begins the valuation analysis with identifying the important characteristics of your trade area. Professional appraisers use three valuation approaches and these are introduced in Chapter 6. Chapters 7, 8 and 9 take you step-by-step through the Cost Approach, Sales Comparison Approach, and Income Approach. These three approaches are applied to the real estate. Worksheets and examples are provided in each of these chapters. We reconcile the three approaches in Chapter 10. Chapter 11 shows you how to estimate the value of your personal property (Furniture and Equipment) and intangible business value. When the value of the three asset categories are added together, this total is the *Going Concern* value of your business. Finally, Chapter 12 gives you further direction once you have completed your valuation.

If you only have a few minutes, it is suggested that you use the Income Approach in Chapter 9 to quickly estimate the value of your store.

Chapter 1

What is a Professional Appraisal?

The procedures in this book are the same as those used by professional appraisers. So, in making your own appraisal you will also gain important insights and be better informed as to how a professional appraiser goes about the process of making a valuation should you ever need an expert appraisal of your property.

Professional appraisals prepared by licensed appraisers are frequently necessary in course of owning and operating a convenience store. If you borrow money from a Federally-insured lender, say for a mortgage to build a new store, banking regulations require that an appraisal be completed by a State-Certified Appraiser. If your store becomes involved in a condemnation taking because of a street improvement project, a state-certified appraisal will be prepared by the condemning agency to show the market value of your property. Many times, leases will include appraisal clauses for rent renewals or purchase options and these appraisals will be completed by state-certified appraisers. Professional real estate appraisers must follow rigid guidelines for completing their appraisal reports. These guidelines are set forth in the Uniform Standards of Professional Appraisal Practice (USPAP) and include minimum requirements for valuation analysis and content. USPAP is part of State law in all 50 states and professional appraisers are licensed by the states they work in.

The appraisal you prepare yourself when using this book is not a professional or state-certified appraisal. But, the methodology here is the same and your valuation results should be similar to those obtained by a professional appraiser.

Knowing the market value of your assets is critically important to managing your business. Your store, including the real estate, equipment and intangibles, are in most cases the most valuable assets you own. Your net worth is shown on your balance sheet and the real estate is often your largest single asset on your financial statements. Your return-on-investment or return-on-equity cannot be accurately measured without first knowing the market value of your property. You need to know the value of your property if you decide to sell or lease to another operator. This book will help you understand what your property is worth and why. You can use these procedures again and again to update your value estimate.

Chapter 2

Convenience Stores as an Operating Business

Trade-Related Property is a classification of commercial, income-producing real estate that is different from other types of income property. The real estate of Trade-Related Property (TRP) is designed to generate income and profit from a single, business-related use. We have all seen examples, such as convenience stores, gas stations, car washes, movie theaters, and bowling alleys. TRPs are distinct from other income-producing property where their profit is part of the rental income from the real estate. Non-TRPs include apartments, shopping centers and office buildings. With these, no business income is generated for the property owner.

Convenience stores are Trade-Related Property.

Because your convenience store is an operating business, it is a collection of different assets. All of these assets are used for the purpose of creating income. The income you produce is your gross sales; and out of this you must pay for all of the expenses of operating the business. These expenses include your cost-of-goods-sold, labor, credit card fees and utilities and other expenses. Also included as a cost of business is the economic requirements of the assets employed in the business. For example, the real estate is one of these assets used to produce your gross sales. If you lease your real estate, then the economic requirement is the annual lease payment. If you own your real estate, the economic requirement is the annual mortgage payments plus a return to your equity. Once all of your operating expenses and asset allocations have been paid the amount left over is your profit.



Where do you get the money to pay for your business expenses?

The assets of your convenience store business fall into three categories:

- (1) Real Estate
- (2) Equipment (moveable personal property)
- (3) Business Value (intangible, goodwill)

The real estate and equipment are *tangible* assets, while the business value is an *intangible* asset. All of these assets of your business have value.

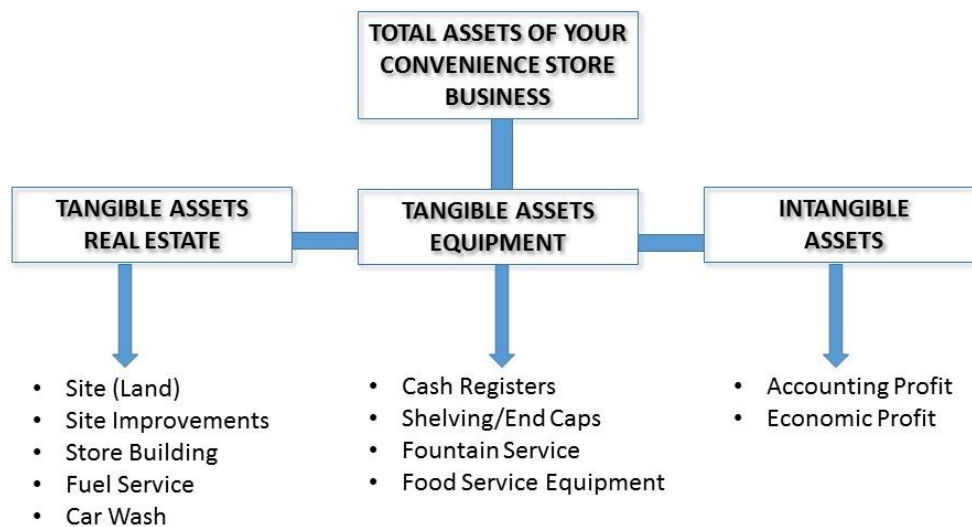
For our purposes here, the real estate includes the site, site improvements (such as paving and landscaping) and the store building. If you have a car wash, this is also part of the real estate. The fuel service including the dispensers, underground tanks and electronics and piping, and canopy are part of the real estate. These are all tangible assets.

The equipment is the moveable personal property commonly called F&E, or *Furniture & Equipment*. This is also a category of tangible assets. Your cash register, shelving, gondolas, beverage fountain, and food service equipment are part of the F&E.

The third category, intangible assets, is any value to the business over and above the tangible assets. If you make a profit every year, then you have intangible business value in addition to the value of your tangible assets. Sometimes this is called *Goodwill*.

The diagram below summarizes how the assets of a convenience store are classified.

Figure 2-1



Chapter 3

Appraisal Theory Applied to Your Convenience Store

For any asset to have value, it must have scarcity, utility and transferability. In other words, there must be a limited supply, the asset must be useful, and we must be able to exchange title or ownership of the asset.

We need to distinguish between two different concepts of value; one is the fair market value of your store if it were under typical management and the other is its value under your management. These can be two different numbers.

Fair Market Value under Typical Management

You may have heard of the term “fee simple”. It refers to an ownership interest in real estate that is full and complete without regard to any existing mortgage, lease or limitations of ownership. This is the value interest that will be estimated by professional appraisers when preparing an appraisal for a bank, or when a property is in condemnation, or for property tax assessment. The market value of this interest reflects typical management and operations of your store, not necessarily the way you operate or management the business. For example, let’s say your store is identical to one across the street. You may decide that you only want to be open one day a week and the other store is open seven days a week. That does not mean that the fee simple market value of your store is only one-seventh of the value of the other store. Under the fee simple interest both stores are worth the same because they would both be appraised under the assumption that they had typical management as defined by current industry standards.

The fee simple market value does not consider your branding, supply contracts or operating agreements. Likewise, the fee simple market value does not consider whether you own or lease the store. The fee simple market value is an important measurement of value that reflects the amount you could sell the store to another operator. That operator may do better or worse than you after purchasing the business. But, that does not change the fee simple value. For most commercial transactions and financial reporting, the fee simple value under typical management is the proper measure of market value for your convenience store.

On the other hand, the value of your business assets under your management may be higher or lower than its fee simple value.

Value under Current Operations

The value under current operations does not necessarily reflect transferable market value because a buyer may not be able to exactly duplicate your business operation. For example, you may have a specific store manager and trained workforce that are efficient at doing their job within your management structure. These personnel may not remain with the store if it is sold, or they may require re-training under a different ownership. Likewise, your oil company branding agreement is not part of the title to the real estate and a new buyer may change to a different brand after the purchase.

A bank will not normally make you a mortgage loan based on the value of the property under current operations because in the event they must foreclose, they want to know what amount the property could be sold to another operator. This is the fee simple market value described earlier.

The value under your current management in most cases is not transferable, therefore it is not a measure of fair market value.

A professional appraiser will usually appraise the fee simple value of the property and this is the true measure of market value. In the following chapters, this book will help you do both.

How Market Value is Created for a Convenience Store

A convenience store business has value because of the income it is capable of producing. This is different from other types of the real estate, say your home, which may have value because of its amenities. The amenities of a home may include the number of bedrooms, the desirability of the neighborhood and the architectural appearance. A convenience store is designed to make money from a narrow business model: fuel sales, quick turnover merchandise, and possibly food service, or a car wash. A convenience store cannot be easily adapted to other uses. The amount of earnings and value any store can generate is a function of how well it performs for that use for which it is designed.

In the last chapter we asked the question, *“Where does the money come from to pay the expenses of the business?”* For your convenience store, the answer is it comes from the cash drawer. Whether your store generates a lot of sales or little is the ultimate economic principle determining its worth.

The amount of gross sales your store can earn depends on the trade area that your store operates within and the specific physical characteristics of your property. In the next two chapters we will talk about both of these considerations.

The diagram below (Figure 3-1) shows how your convenience store business creates value to these three asset categories. Gross sales, which is primarily driven by fuel sales, is determined by supply and demand within the trade area where you operate, along with the number of fueling positions and the size of your store, and the access and visibility of your location.

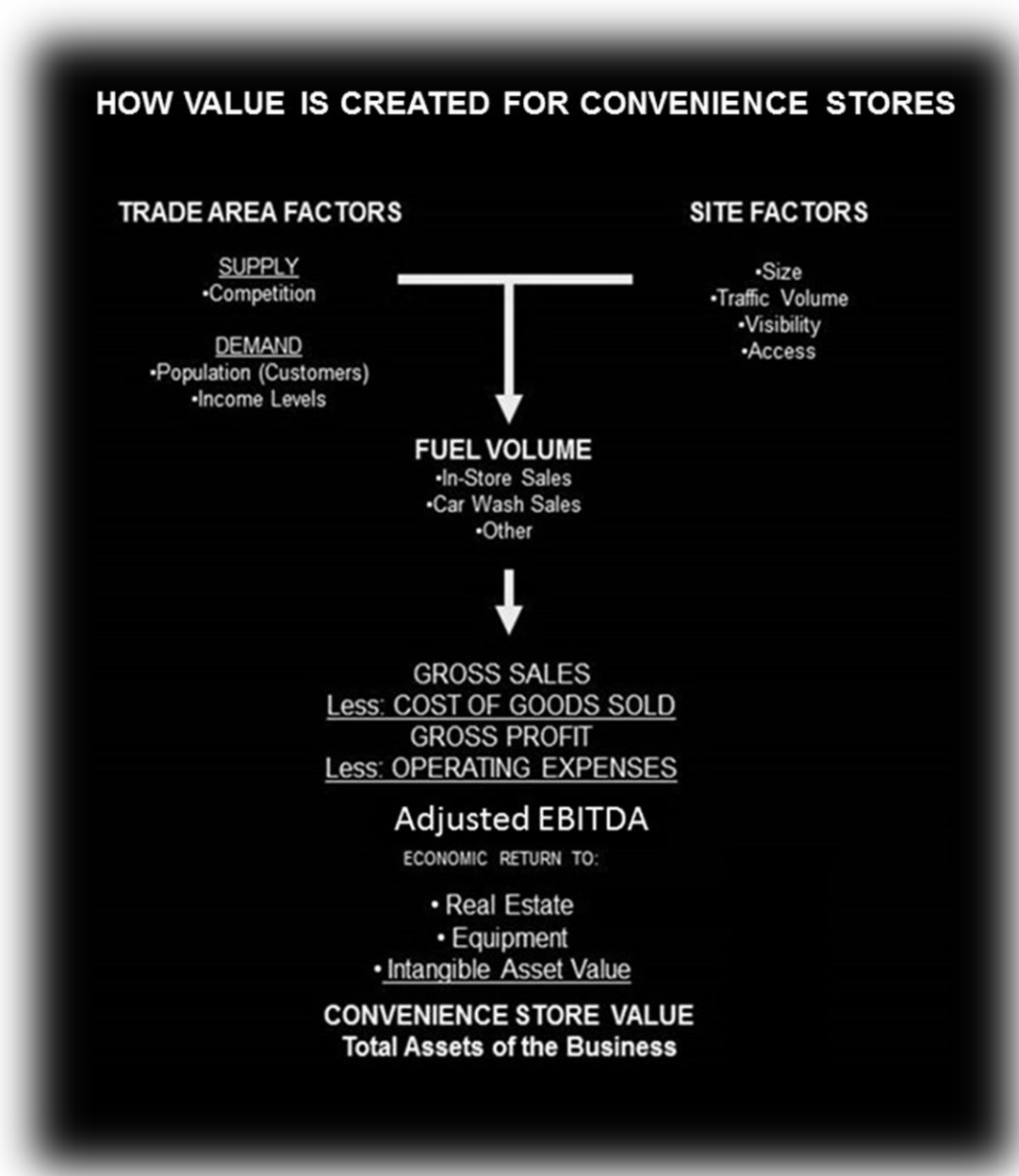
As the gross sales flow into your cash register, you pay your wholesalers and suppliers (cost-of-goods-sold) and the difference is your gross profit. Today, fuel sales have a gross margin of about 6% and inside sales have a margin of about 27%. The overall gross profit margin of both fuel and inside sales is about 12%.

From gross profit you must pay all of the store operating expenses. These include labor, credit card fees, utilities and miscellaneous expense that total about 60% of gross profit. Under store operating expenses no deductions are made for real estate or equipment expenses.

Subtracting store operating expenses from gross profit leaves Adjusted EBITDA which is the amount of money covering the economic requirements of the three asset categories we talked about in Chapter 1: the real estate, equipment and intangibles. EBITDA is an acronym for *“earnings before interest, taxes, depreciation and amortization”*.

If these earnings for your store are high then your business assets are worth more. The reverse is also true.

Figure 3-1
How Value is Created for Convenience Stores



Chapter 4

Identifying Your Real Estate and Other Assets

Professional appraisers usually perform an on-site inspection of your property when beginning the appraisal. This inspection often requires one to two hours and the appraiser will measure the size of the improvements, note the construction materials and the condition of the property. Rather than survey the land boundaries, the appraiser relies on the public records from the assessor or tax office to determine the size of the land parcel.

In any appraisal it is essential to know the size of the store, the number of fueling positions, and the details about any other improvements or buildings.

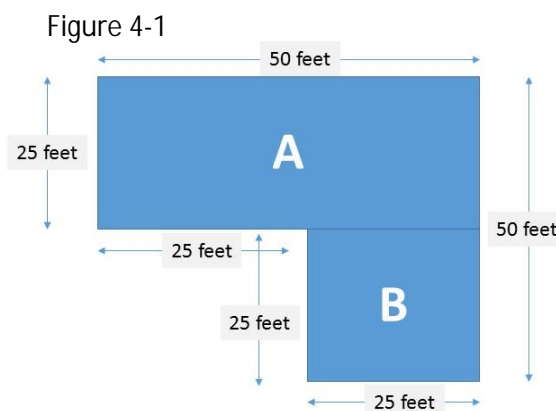
Measuring Your Site

In most cases, it is impossible to locate old survey pins or any markers on the ground around the boundaries of your property. So, you will not be able to reliably measure the size of your land parcel. Because surveys and plats are recorded at the time they are made, the size of your land parcel is a public record. You may obtain the size of your parcel from your property tax assessment notice.

Measuring Your Store

The assessment records on your property will also show the size of your improvements. Most jurisdictions are required to make physical inspections at least once every five years. However, it is best to take the measurements yourself. Using a measuring tape, separately measure the distance along each outside wall and take notes as you proceed around the perimeter. Do not take the measurements from inside the store.

For example, in measuring the outside walls in Figure 4-1 the dimensions can be added in two parts. Part A is 25 feet by 50 feet, which equals 1,250 square feet and Part B is 25 feet by 25 feet, or 625 square feet. The total area of the store is A+B, or 1,875 square feet (1,250 + 625).



To double check your measurements, the overall length of each side should be equal. Here, the north side is 50 feet and the south side is 25 feet plus 25 feet. And, the west side is 25 feet plus 25 feet compared to the east side of 50 feet.

The Fuel Service

For appraisal purposes we need to know the total number of fueling positions. This is the total number of vehicles that can fuel at one time. Typically, a double-sided dispenser equals two fueling positions.

If the dispensers are placed so close together that two or more dispensers serve just one vehicle, say in an in-line configuration, then still count it as one fueling position regardless of the number of dispensers.

Estimated Effective Age

Because improvements, such as the store building and fuel dispensers can wear out and age, appraisers calculate or estimate effective age of the improvements. The current condition of the improvements is more important than how old they are. For example, the chronological or actual age may be high, say 20 years since they were built or installed. But, upgrades and repairs may reduce the effective age to 10 years.

You should think about effective age as reflecting the current utility or usefulness of the improvement as opposed to its actual age. Generally, for our purposes here, you can use five-year increments for this estimate, such as 5 years, 10 years, 15 years, 20 years, and so on. If you believe the improvements are near the beginning of their life cycle, then an effective age of 5 years is usually appropriate. For improvements in the middle of their life cycle, 15 to 20 years is a good estimate. And, if the improvements are nearing the end of their useful life and will soon require replacement, then 20 years or more is a reasonable estimate of effective age.

Access, Visibility and Day Parts

Access, visibility and day parts are rated as characteristics of your site and location. You can assign a rating of “1”, “2” or “3” for each, with “1” being the lowest and “3” being the highest.

Access reflects the ease that a customer can get out of traffic, drive onto your site, make the purchase, and return to the direction of travel. NACS estimates that the average time for this at 4 minutes. If your store is about average, then assign it a “2” rating access. If it takes your customers longer to complete this cycle, then your property would have a lower rating of “1”. A “3” rating reflects superior access characteristics. Making right turns is easier for your customer than making left turns across on-coming

traffic. Being located at a far corner of an intersection is usually better than the near corner on streets with high traffic volume.

Visibility is also rated numerically. Visibility is how well a customer can see your property from the driving lanes on the adjacent road. Generally, at least seven seconds are required for adequate visibility, for the customer to see your signage and make a safe driving maneuver out of traffic into your access point.

You may be located on the “going-to-work” side of a street. Perhaps you are located near many workplace destinations, say a factory where workers go off-site for lunch. These types of considerations determine the strength of your day parts. Day parts are classified as morning, noon and evening. Which is your strongest? Give “day parts” a one to three rating. Two or more strong day parts is considered above average for most stores.

Worksheet 4

Worksheet 4 on the following page allows you to record the important information from this chapter.

Your Property Details Worksheet

Worksheet 4

Property Details

1. Site

Site Size

Access (1 = Poor, 2=Average, 3-Good)

Visibility (1 = Poor, 2=Average, 3-Good)

Day Parts (1 = Poor, 2=Average, 3-Good)

2. Store Building

Merchandise Area

Add: Dedicated Food Service

Total Store Size

Age

Condition (1 = Poor, 2=Average, 3-Good)

3. Fuel Service

Number of Fueling Positions

Age

Condition (1 = Poor, 2=Average, 3-Good)

4. Other

Car Wash (Yes/No)

Other

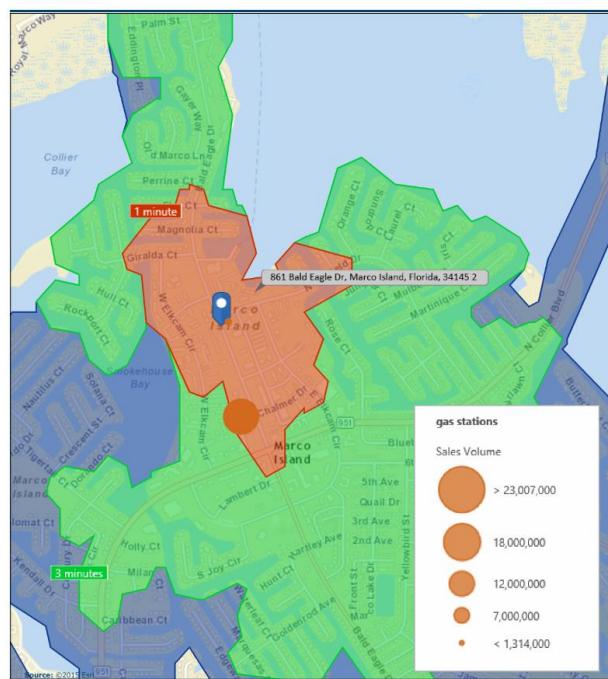
Chapter 5

Identifying Your Trade Area

Other than the property itself, the single most important factor affecting your property's market value is the characteristics of the trade area within which your store operates. Specifically, we will look at three trade area influences: supply and demand, hypermarket competition, and customer demographics.

The primary trade area is the geographical area from which you draw 80% of your customers. For most stores this is normally considered as a drive-time, or the amount of time required for a vehicle customer to drive to your site. In most urban areas a three-minute drive-time is an average trade area. In small towns or sparsely developed rural areas, the drive-time is usually larger at 5 minutes to 7 minutes. The 3-minute drive-time will be about one to one and one-half miles from your store if you are located in an urban or suburban area. An example of a trade area map with color-coded drive-times is shown in Figure 5-1. The 1-minute drive-time is shown in brown and the 3-minute and 5-minute boundaries are shown in green and blue, respectively.

Figure 5-1 Typical Drive-Times



The number of competing stores within your primary trade area is supply. The resident population or traffic volume is demand. The average store today requires about 2,000 people for each store. This is when supply and demand are balanced.

Professional appraisers use demographic software to estimate the population within a given trade area. Unless you have access to Claritas® or ESRI® demographic software you will have to estimate whether your trade is over-supplied or under supplied based upon the ratio of 2,000 persons-per-store. Most stores in larger cities will have at least two or three direct competitors. Do you believe sufficient population exists in your

trade area to give adequate demand to your store and each of the competitors? If you are the only store in a small town of only 1,000 residents, demand may still be insufficient even though you have no competitors. For your appraisal, you simply have to make a realistic assessment as to whether your trade area is “over-supplied”, “in-balance”, or “under-supplied”. Across America today, it is unusual to find trade areas that are under-supplied.

Hypermarket competition is an important consideration of your trade area. Because hypermarkets, such as Walmart, Costco and others, sell motor fuel at a lower price than most convenience stores, they should be considered as a separate competitive element. In most cases, if a hypermarket is located within two miles of your store, you should consider it a direct competitive threat. Do not include mass merchandisers that are not selling motor fuel. For instance, a Walmart not selling gasoline located a mile away should not be counted.

Rate your trade area as to the likelihood that the resident customers will shop at a convenience store. Certain demographic groups patronize customers more than others. This can depend on income levels and household size. Do you believe your store’s trade area is low, average or high? More affluent customers are more likely to shop at a convenience store.

Worksheet 5

Worksheet 2 on the following page allows you to record the important information from this chapter.

Your Trade Area Worksheet

Worksheet 5

Trade Area

1. Supply

Number of Competitors within 1-Mile

Number of Competitors within 2-Miles

2. Demand

Nearby Residents (1 = Poor, 2=Average, 3-Good)

Traffic Volume on Adjacent Streets (1 = Poor, 2=Average, 3-Good)

Nearby Work, Shopping Destination (1 = Poor, 2=Average, 3-Good)

Nearby Recreation Destinations (1 = Poor, 2=Average, 3-Good)

3. Trade Area Balance

Supply and Demand In-Balance (Yes, No)

Over-Supplied - too many competitors (Yes, No)

Under-Supplied - fewer than normal competitors (Yes, No)

4. Hypermarket Competition

Hypermarket within 2 miles (Yes/No)

5. Customer Demographics

Income Levels (1 = Poor, 2=Average, 3-Good)

Favorable Age Groups (1 = Poor, 2=Average, 3-Good)

6. Beer/Wine Sales

Wet or Dry

Chapter 6

Introduction to the Three Approaches

Once the information about your property, such as the store size and number of fuel positions, has been determined and the trade area has been evaluated, we are ready to begin the valuation process. Professional appraisers use three approaches. Each of these three approaches is a separate and independent method of estimating the value of your property based on different valuation principles. In other words, we will obtain three slightly different estimates of what your property is worth. In the end, we will reconcile the three indications and select the value estimate that is the most reliable based on the strengths and weaknesses of each of the three approaches.

The question of value can be thought of in different ways, and each of the three approaches reflects how value can be measured from different points of view. These three approaches are the Cost, Sales Comparison and Income Approaches.

The Cost Approach asks, *What would it cost today to build the property?*

The Sales Comparison Approach asks, *What are similar stores selling for?*

The Income Approach asks, *What will I earn from the property?*

Anyone of these questions is a valid consideration of market value. Professional appraisers will examine all three. We will begin in the next chapter with the Cost Approach.

Chapter 7

The Cost Approach

The theory of the Cost Approach is that a property's market value should approximate the cost to build it today less any depreciation. Depreciation is any loss in value caused by age, wear and tear, outdated design, or negative factors outside the property.

The cost approach is completed in three steps:

1. Estimate the cost to build all of the improvements
2. Subtract estimated depreciation
3. Add the land value

In Step 1, estimating the cost to build your property today includes the store building, fuel service, parking, sidewalks and landscaping. The most accurate cost estimates are obtained from contractors specializing in the construction of convenience stores. Professional appraisers often use a subscription cost service, such as *Marshall Valuation Guide*, which lists updated construction costs on dozens of different types of buildings.

For your appraisal we will use reasonable national averages.

Average Construction Costs

	<u>Cost to Construct</u>
(a) Store Building, fully finished including beverage cooler	\$250 per square foot
(b) Fuel Service including dispensers, USTs canopy, electronics and piping	\$60,000 per fueling position
(c) Site Improvements including parking, concrete and landscaping	\$3.00 per square foot

When multiplied and totaled the cost above shows how much your improvements are worth if they were new and built today. If your store is not new, then we subtract depreciation to reflect the effects of aging and normal deterioration. A quick way to estimate overall depreciation is to divide the effective age by the expected economic life

of the improvements. For our purposes here, we will use 40 years as the overall expected economic life. The result is the percentage of total depreciation. For example, if the effective age as estimated in Chapter 4 is 10 years, the calculation for depreciation would be:

Estimating Overall Depreciation

$$\begin{aligned} & 10 \text{ years Effective Age} \\ & 40 \text{ years Expected Economic Life} \\ & = 10 / 40 \\ & = 25\% \text{ Depreciation} \end{aligned}$$

This 25% estimate of depreciation is then subtracted from total cost of the improvements. In other words, a ten-year old store would be worth 25% less than a new store of the same size. The reason being, an older store will require repairs or replacement sooner than a new store.

The last step in the cost approach is to add the value of the land. Sometimes the land value can be estimated from the property tax assessor's records, but often this figure is low. You may have a good idea of the value of your land. If not, call one or two real estate brokers in your area and ask them what commercial land in your location is selling for. They will probably respond with a price per square foot. You can multiply this by the size of your land parcel to estimate the value of the land. Let's say local brokers tell you that land in your area is selling for \$15.00 per square foot. Your site is one-half acre. An acre is 43,560 square feet. So, the value of your land is $43,560 / 2 * \$15$, or \$326,700.

In larger metro area across the country it is common to see land prices for convenience store sites in the \$18.00 to \$21.00 per square foot range. In small towns, the price might be much lower, say in the \$5.00 per square foot range.

Example: Worksheet 7 Cost Approach

Before completing the cost approach for your store, an example is given below showing each of the three steps. After reviewing the example, you can use the information from Worksheet 1 to complete the Cost Approach Worksheet for your store.

For the example, let's assume the store is 3,000 square feet and has an estimated effective age of 15 years. This property has four dispensers with eight fueling positions. The land is 30,000 square feet and is worth \$18.00 per square foot.

Notice the site improvement cost of \$3.00 per square foot is applied to the total site area less the land area occupied by the building.

The estimated market value of the real estate from the cost approach is \$1,398,000. This does not include the equipment (moveable personal property) or business value.

A cost approach worksheet is provided on the following page so that you can complete these four steps for your store.

Sample Cost Approach Worksheet

Worksheet 7

Cost Approach

1. Cost of Construction Today

Store Building Size (Sq. Ft.)	3,000
Multiply by \$250	\$250.00
Equals: Cost of Store Building	\$750,000
Fuel Service (Fueling Positions)	8
Multiply by \$60,000	\$60,000
Equals: Cost of Fuel Service	\$480,000
Site Improvements Area (Sq. Ft.)	\$47,600
Multiply by \$3.00	\$3.00
Equals: Site Improvements	\$142,800
Sub-total Cost of Improvements	\$1,372,800

2. Subtract Depreciation

Estimated Effective Age	15
Divide by Expected Economic Life	40
Equals: Percentage of Depreciation	38%
Subtract:	
Percentage of Depreciation x Total Cost of Improvements	\$514,800
Equals Depreciated Value of Improvements	\$858,000

3. Add Land Value

Site Area (Sq. Ft.)	30,000
Estimated Value of Land per Square Foot	18
Sub-total Land Value	\$540,000
Total Indicated Value of the Real Estate	\$1,398,000

Your Cost Approach Worksheet

Worksheet 7

Cost Approach

1. Cost of Construction Today

Store Building Size (Sq. Ft.)

Multiply by \$250

Equals: Cost of Store Building

Fuel Service (Fueling Positions)

Multiply by \$60,000

Equals: Cost of Fuel Service

Site Improvements Area (Sq. Ft.)

Multiply by \$3.00

Equals: Site Improvements

Sub-total Cost of Improvements

2. Subtract Depreciation

Estimated Effective Age

Divide by Expected Economic Life

Equals: Percentage of Depreciation

Subtract:

Percentage of Depreciation x Total Cost of Improvements

Equals Depreciated Value of Improvements

3. Add Land Value

Site Area (Sq. Ft.)

Estimated Value of Land per Square Foot

Sub-total Land Value

Total Indicated Value of the Real Estate

Chapter 8

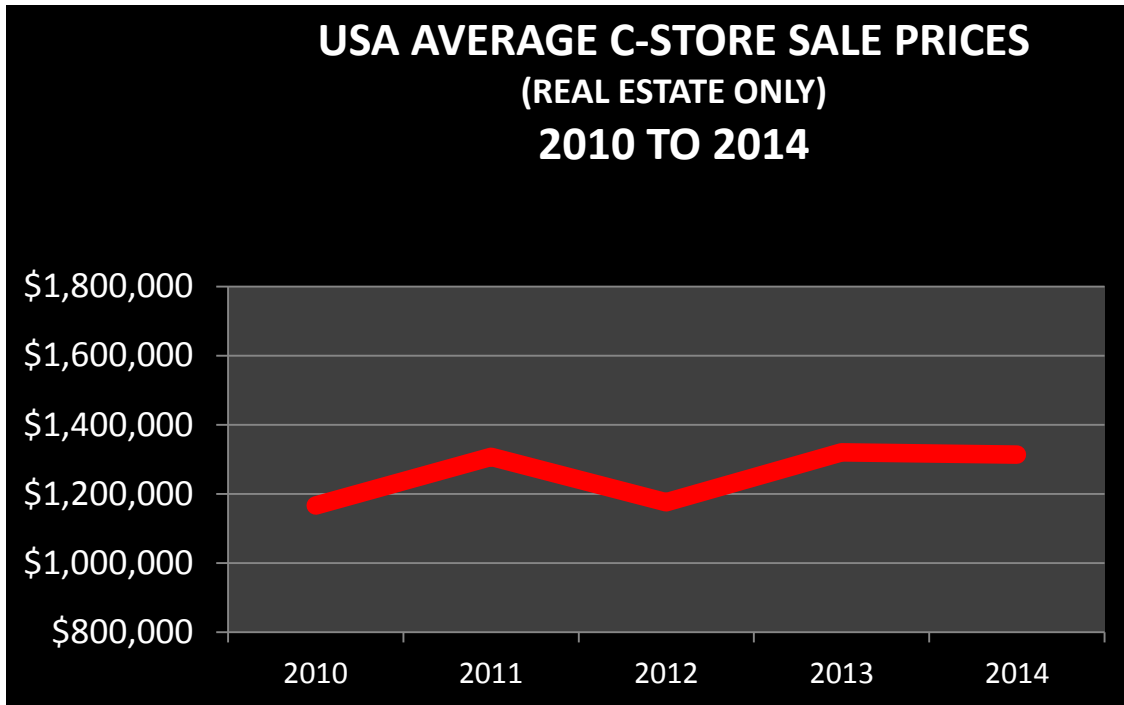
The Sales Comparison Approach

What other people are paying for similar properties is the core principle of the sales comparison approach. In this approach an appraiser will compare the property being appraised to other convenience stores that have recently sold. Properties that have sold represent the market and show what sellers are taking and what buyers are paying for similar properties. Usually, an appraiser will obtain information on three to five other properties that have sold to compare these to the one being appraised. Adjustments will be made to the individual sale prices of the sold properties to equalize them to the property being appraised. These adjustments include such factors as: location, store size, age and physical condition, accessibility, and competition. For example, if the store being appraised is 2,000 square feet the sale comparison property has a store of 2,200 square feet, the appraiser might adjust the sale price of the comparison property downward by 10% because of the larger size. The adjustment equalizes the sale property to the subject.

Appraisers access proprietary data bases, the assessor's records, multiple listing services, and interview brokers to obtain sales. Often, these sources are not available to the convenience store owner. For this reason, we will use national averages to process the sales comparison approach.

According to Costar, a commercial real estate data provider, convenience store real estate prices are rising. In the first half of 2014, the average price of the real estate associated with convenience stores was \$1.3 million. This includes the site, store building, and fuel service. This is an increase of 13% from the 2010 average price. The median price showed a similar increase over the same period of 9%.

CoStar's Commercial Property Resale Price Index (CPRPI) indicates that retail property prices began stabilizing in 2012 after the national recession. The chart below shows the trend in convenience store real estate prices over the last few years.



The 3-year rolling average price per square foot is \$546. This \$546 is the total price of the real estate divided by the size of the store. So, this figure includes the value of the site, store building and fuel service, not just the store value.

This price per square foot applies to the gross area of the store building using the outside dimensions. Let's assume, for example, that our store building measures 50 feet by 60 feet. This is 3,000 square feet. Using the national average price per square foot of \$546.00, multiply this by 3,000 square feet. The total value of the real estate is estimated at \$1,638,000 ($\$546 \times 3,000$). This includes the value of the site, store building, and fuel service.

Adjustments to the Base Price per Square Foot

If we consider the national average sale price per square foot to be the base price, or the average for our property, we can then make adjustments to give us a more accurate value estimate. We want to think in terms of how our convenience store compares to the national average. According to *Convenience Store News Annual Industry Report*, the average store is 3,207 square feet, the average land size is 27,685 square feet, or 0.63 acre, and the average size of the fuel service is eight fueling positions, or four dispensers.

National Average Convenience Store Characteristics

Store Size	3,207 SF
Site Size	27,685 SF
Fuel Service	8 Fueling Positions

Ask yourself how your store compares to the national average store, is it better or worse? Some of the factors you should consider are:

Trade Area

- **Supply/Demand** Over-supplied is negative, under-supplied is positive
- **Hypermarket Competition** If within 2 miles is negative.
- **Customer Demographics** Higher household income is positive.

Site

- **Access/Visibility** Higher traffic count is positive.
- **Site Size** If greater than 28,000 SF is positive, if smaller is negative.
- **Neighborhood Conflicts** If present, then negative.

Store

- **Building Size** No adjustment. See example.
- **Age/Condition** If older than 10 years, then negative, if less, then positive.
- **Quality** If better than average then positive, if worse, then negative.
- **Dedicated Food Service Space** If present, then positive.

Fuel Service

- **Fueling Positions** If more than 8, then positive, if less then negative.
- **Age/Condition** If less than 10 years, then positive, if more the negative.

Other

- **Car Wash** If present, then positive.
- **Other**

Often the appraiser will use the price-per -square-foot of the store area in making these calculations. Let's use a worksheet example to illustrate the sales comparison approach. You can then apply the sales comparison approach to your own store with the blank worksheet.

Example: Worksheet 8 Sales Comparison Approach

Let's assume your store building is 3,000 square feet, the site is 30,000 square feet and you have eight fuel fueling positions. The store was built five years ago, so it is new and modern. You do not have a car wash.

Although you do not know specifically, you believe the trade area characteristics are typical. Supply and demand seem in-balance and no competing hypermarkets are located nearby.

Since we are using the price-per-square-foot of store area as our unit of comparison we will not adjust for store building size because the size of our building is already included in the calculation. Although we are considering many individual factors, we will limit our adjustments to either +10% or -10% for each one of the five overall categories: 1. Trade Area, 2. Site, 3. Store Building, 4. Fuel Service, and 5. Other.

The Sample Worksheet 8 shows that we have a single adjustment for the newer age and condition of our store building. Our base value is \$546 per square feet. Multiplying this by 3,000 square feet for our store size and the adjustment factor of 1.10 (which is +10%), indicates a market value of \$1,801,800. This value estimate includes the site, store building and fuel service. It does not include moveable personal property or intangible business value.

Sample Sales Comparison Approach Worksheet

Worksheet 8
Sales Comparison Approach

COMPARE YOUR STORE TO THE NATIONAL AVERAGE CONVENIENCE STORE.

1. Trade Area

Supply/Demand	POSITIVE	NEGATIVE
Hypermarket Competition	POSITIVE	NEGATIVE
Customer Demographics	POSITIVE	NEGATIVE

Overall (+10%/-10%)

2. Site

Access/Visibility	POSITIVE	NEGATIVE
Site Size	POSITIVE	NEGATIVE
Neighborhood Conflicts	POSITIVE	NEGATIVE

Overall (+10%/-10%)

3. Store

Building Size	No Adjustment	
Age/Condition	POSITIVE	NEGATIVE
Quality	POSITIVE	NEGATIVE
Dedicated Food Service Space	POSITIVE	NEGATIVE

Overall (+10%/-10%)

4. Fuel Service

Number of Fueling Positions	POSITIVE	NEGATIVE
Age/Condition	POSITIVE	NEGATIVE

Overall (+10%/-10%)

5. Other

Car Wash	POSITIVE	NEGATIVE
Other	POSITIVE	NEGATIVE

Overall (+10%/-10%)

TOTAL OVERALL ADJUSTMENT

Estimated Value

Your Store Size	3,000
Multiplied by \$546	\$1,638,000
Multiplied by Overall Adjustment (1+Overall Adjustment)	1.10
Equals: Estimated Value	\$1,801,800

Your Sales Comparison Approach Worksheet

Worksheet 8

Sales Comparison Approach

COMPARE YOUR STORE TO THE NATIONAL AVERAGE CONVENIENCE STORE.

1. Trade Area

Supply/Demand	POSITIVE	NEGATIVE
Hypermarket Competition	POSITIVE	NEGATIVE
Customer Demographics	POSITIVE	NEGATIVE

Overall (+10%/-10%)

2. Site

Access/Visibility	POSITIVE	NEGATIVE
Site Size	POSITIVE	NEGATIVE
Neighborhood Conflicts	POSITIVE	NEGATIVE

Overall (+10%/-10%)

3. Store

Building Size	No Adjustment	
Age/Condition	POSITIVE	NEGATIVE
Quality	POSITIVE	NEGATIVE
Dedicated Food Service Space	POSITIVE	NEGATIVE

Overall (+10%/-10%)

4. Fuel Service

Number of Fueling Positions	POSITIVE	NEGATIVE
Age/Condition	POSITIVE	NEGATIVE

Overall (+10%/-10%)

5. Other

Car Wash	POSITIVE	NEGATIVE
Other	POSITIVE	NEGATIVE

Overall (+10%/-10%)

TOTAL OVERALL ADJUSTMENT

Estimated Value

Your Store Size	<input type="text"/>
Multiplied by \$546	<input type="text"/>
Multiplied by Overall Adjustment (1+Overall Adjustment)	<input type="text"/>
Equals: Estimated Value	<input type="text"/>

Chapter 9

The Income Approach

Just as the name implies, the Income Approach estimates market value based upon the income or earnings of the property. For income-producing properties, such as convenience stores, this is the most important valuation approach and usually the most reliable. Convenience stores are bought and sold based on the income they can produce. The market value of the real estate depends on how much of this income is available to paying for the real estate. Stores that produce a lot of income are worth more. All of the factors we talked about in Chapter 8 on the Sales Comparison Approach are reflected in the amount of income the store receives. A good location, with high visibility and few competitors, for example, allows a store to earn more income than a store in a poor location.

Your store's income or earnings begins with fuel gallonage and inside sales. Together, these are the gross sales of the business. Before any of these earnings can be applied to the assets of the business, several deductions for expenses must be made, as shown in the chart below.

Convenience Store Earnings

Fuel Gross Sales	
Add: Inside Sales	
Add: Other	
Equals:	Gross Sales
Less:	<u>Cost-of-Goods-Sold</u>
Equals:	Gross Profit
Less: Store Operating Expenses:	
Labor	
Utilities	
Credit Card Fees	
<u>Miscellaneous</u>	
Equals:	EBITDA
Less: Return to F&E	
Less: <u>Return to Real Estate</u>	
Equals:	Business Profit

EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) is the gross return, or the portion of earnings available, to the assets of the business. The assets of the business are in three categories:

- (1) Real Estate
- (2) Personal Property
- (3) Intangible Business Value

Professional appraisers will often calculate the portion of EBITDA going to the real estate. Once this has been determined, the income to real estate is capitalized (divided by a capitalization rate, say 7%) to estimate the value of the real estate.

To process the Income Approach, we can use some simple multipliers.

Estimating Your Store's Income

To apply our multipliers, we must have a reasonable estimate of Gross Profit. Gross Profit is gross sales less cost-of-goods-sold. It is a common measure of profitability. Gross profit equalizes for volume and per-unit margin and is a better measure of economic performance than gross sales. For example, a business decision to lower the retail price of gasoline in hopes of achieving a higher volume is equalized at the gross profit line with a decision to increase the retail price where the margin is higher but the fuel volume declines. Gross profit will accurately reflect both no matter what the pricing philosophy. According to *Convenience Store News Annual Report*, in 2014, average Gross Profit Per Store across the nation was \$541,000, or 11.3% of gross sales.

In estimating Gross Profit we want to smooth out any unusual experiences rather than just use the most current year. We are striving for what is typical or what can be expected in a normal year. Often a professional appraiser will do this by averaging or sometimes trending the last three years' performance. If road construction, for example caused customer counts and sales to be unusually low, we would not count this.

If on the other hand gross profit over the last few years shows a pattern of trending higher or lower, we want to know why. Can this trend be expected to continue?

We also want to consider if the estimate of Gross Profit is what a typical operator could expect from operating your store. In most cases, this is the figure we want to use.

Applying Income Multipliers to Your Store

To keep the income approach simple and workable for you as a store owner, we will use two multipliers. Both will be applied to gross profit.

Nationally, over many years the value of the real estate of a convenience store has averaged about 3 times the expected annual Gross Profit. If Gross Profit were \$500,000 per year, then the market value of the real estate is estimated at \$1,500,000 (\$500,000 Gross Profit x 3). This estimate includes the site, store building, and fuel service, but not the movable personal property such as shelving and cash registers. It also does not include intangible business value.

National Average Gross Profit Multiplier

3.0

Another way to estimate the value of the real estate for a convenience store is to multiply Gross Profit by 21% and then divide that answer by a capitalization rate. An advantage is that this method shows you the estimated net operating income for the real estate, which is an important number to know for obtaining a mortgage loan or leasing the property.

Let's say, for illustration, that your expected annual Gross Profit is \$500,000. Multiplying this by 21% is \$105,000. This is the estimated net operating income to the real estate that the store can economically justify based on earnings. Capitalization rates range from about 7% to 8%. If we divide \$105,000 by say 7%, the estimated value of the real estate is \$1,500,000. Notice this is the same estimated value of the real estate we had before using the Gross Profit Multiplier of 3. But, here we know that the expected net operating income to the real estate is \$105,000 per year. This can be an important number for a lender when calculating your potential debt service. Also, this \$105,000 is equivalent to the net rent the store is capable of leasing for. If the store building is 3,000 square feet, the equivalent net rent per square foot is \$35.00 per square foot per year (\$105,000 divided by 3,000 square feet), or \$2.92 per square foot per month.

The sample worksheet on the following page illustrates the figures above, starting with \$500,000 as the expected gross profit. The sample worksheet is followed by a blank worksheet that you can use in estimating the value of your own store.

Sample Income Approach Worksheet

Worksheet 9

Income Approach

1. Estimated Value by Gross Profit Multiplier

Your Expected Annual Gross Profit

\$500,000

Multiplied by 3.0

3.0

Equals: Estimated Value

\$1,500,000

2. Estimated Value by Capitalization

Your Expected Annual Gross Profit

\$500,000

Multiplied by 21%

21%

Equals: Net Operating Income to Real Estate

\$105,000

Divided by 7%

7%

Equals: Estimated Value

\$1,500,000

Your Income Approach Worksheet

Worksheet 9

Income Approach

1. Estimated Value by Gross Profit Multiplier

Your Expected Annual Gross Profit

Multiplied by 3.0

Equals: Estimated Value

2. Estimated Value by Capitalization

Your Expected Annual Gross Profit

Multiplied by 21%

Equals: Net Operating Income to Real Estate

Divided by 7%

Equals: Estimated Value

Chapter 10

Reconciliation

The three approaches we have covered, the Cost Approach, the Sales Comparison Approach, and the Income Approach, each provide an independent estimate of value. Theoretically, all three approaches should indicate the same estimate of market value. However, because markets do not operate with perfect efficiency, often slightly different results are obtained. For example, we might find the value estimates:

Cost Approach	\$1,400,000
Sales Comparison Approach	\$1,800,000
Income Approach	\$1,500,000

Normally, a professional appraiser does not want the spread from high-to-low to more than about 20%.

In choosing the best estimate of value you should choose that approach which has the best supported data that was used in that approach. If good information is available for deriving Gross Profit, then the Income Approach is almost always the most reliable appraisal method for a convenience store. After all, a convenience store is an income-producing property and income is the reason people buy convenience stores. If, on the other hand, if no income information was available and the store is more than a few years old, then the next best appraisal method is the Sales Comparison Approach.



On the other hand, if no income or earnings data is available and the store is new, then the Cost Approach can provide a reliable indication of value. But, the Cost Approach is mostly theoretical and it is difficult to estimate depreciation, especially with older stores. So, this approach is usually less reliable for convenience stores.

Chapter 11

Your Personal Property, Business Value and the Going Concern

The previous chapters have focused on the real estate value of your store. Usually, the real estate (site, store and fuel service) make up at least 90% of the total value of your convenience store business.

Your Personal Property

Your personal property includes the shelving, ice machine, registers, fountain service, display cases and other physical items that can be easily moved. Sometimes this is called the *Furniture and Equipment (F&E)*. Also included is any food preparation equipment, such as stainless steel ranges, griddles and free-standing refrigerators. Usually the value of the personal property can be estimated at the cost less depreciation.

For an older store without food service equipment it is usually too time-consuming to make an inventory and a separate calculation for each item. Often, a professional appraiser will use a lump-sum estimate of \$10,000 for moveable personal property if expensive food service equipment is not included. You can modify this figure upward if you recently purchased a large-ticket item, such as a new ice machine.

Your Intangible Business Value

A trained workforce, negotiated supplier contracts, in-place management, customer loyalty, and assumption of risk are some of the elements that produce intangible asset value for your business. Your intangible business value is that portion that generates earnings over and above the economic requirements of the real estate and personal property.

Intangible business value only exists if the business is profitable. The average profit in 2014 for a convenience store was \$45,000, according to *Convenience Store News Annual Report*.

The measure of profit in the convenience industry is often referred to as “pretax profit”. This is the amount of earnings left over to the store owner/operator after all expenses have been paid.

Over the last several years the ratio of pretax profit-to-gross profit has averaged about 8.3%. You can use this ratio to easily estimate the profit of your store. For example, if your gross profit is \$500,000, then the expected pretax profit is \$41,500 ($\$500,000 \times 0.083$).

Your intangible business value can then be figured by dividing the expected pretax profit by an appropriate capitalization rate for the business value. Professional appraisers usually use capitalization rates of 30% to 50% for this part of the income. The capitalization rates here are much higher than the 7% to 8% rates we used for the real estate income because, from an investment standpoint, the profits are riskier than the real estate. A 30% capitalization rate implies that the profit is expected to last for about 3 years, or at least that is all the duration that typical buyers are willing to pay. A 50% capitalization rate implies a 2-year duration or credit of business profit.

Dividing the expected pretax profit of \$41,500 by 30% indicates a value of \$138,000 for the intangible assets of the business.

BizComps® is one of the nation's largest publishers of business sale transactions. Of over 200 convenience store sales, most reported an average value of the intangible asset component of \$150,000. This is the reported part of the sale price that was over and above the real estate and equipment when an existing store passed from seller to buyer.

Going Concern Value

Your Going-Concern value is the total value of all the assets. For example, if your real estate was worth \$1,500,000 and the moveable F&E is \$10,000 and your intangible business value is \$138,000, then your Going Concern Value is \$1,648,000.

Real Estate	\$1,500,000
F&E	\$10,000
Intangible Business Value	<u>\$138,000</u>
Total Going Concern Value	\$1,648,000

The typical percentage breakdown of the Going Concern is:

Real Estate	90% to 91%
F&E	1% to 4%
Intangible Business Value	<u>6% to 8%</u>
Total Going Concern Value	100%

Chapter 12

Where to Go from Here

The U.S. Small Business Administration estimates that 75% of businesses do not know what they are worth.

Knowing the market value of your property is one of the most important insights you can have in managing your business. The market value of your property is the single largest asset on your balance sheet and financial statements. Whether you are getting a loan, leasing the business, or considering selling, you cannot make good financial decisions without knowing what your property is worth.

The principles in this book will help you make a credible estimate of the market value of your convenience store. Often though, a professional value estimate is needed and we can help. **PetroREPORT**® is a special valuation tool designed just for convenience stores and gas stations. We develop a complete analysis of your trade area and look at 21 key variables. Our 40-page valuation reports will give you a professional, documented estimate of market value. These reports are relied upon by national banks, attorneys and convenience store owners, just like you.

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Robert E. Bainbridge is a nationally-recognized expert on the appraisal of convenience stores and gas stations. A professional appraiser for over 35 years, he is the author of *Convenience Stores and Retail Fuel Properties: Essential Appraisal Issues*, published by the Appraisal Institute.

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