

Automobile Dealership

RESEARCH REPORT

Greystone Valuation Services

Appraisal & Counseling

Mid-Year 2015



Auto Sales and Profits

Demand for auto dealerships is ultimately a function of vehicle sales revenue, and the ability of buyers to purchase dealership properties is ultimately a function of profits.

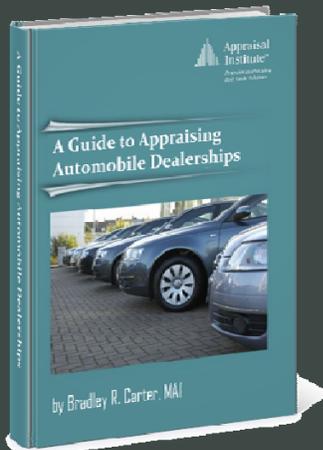
- **Vehicle Sales Trends:** Sales have increased in each year since the recession, and are now rivaling the 2006 record when 16.5 million units were sold.
 - 2014 light-vehicle sales totaled **16.4 million units, up 5.8% from 2013's** total of 15.5 million units.
 - Units sold per dealership hit an **all-time high** in 2014 – for the 3rd year in a row.

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Our Recent and Upcoming Publications

A Guide to Appraising Automobile Dealerships
by Bradley R. Carter (ISBN: 978-1-935328-64-3) - The appraisal profession's first major work on the valuation of auto dealerships, this book offers defining direction on significant and controversial issues; published by the Appraisal Institute in 2015. (Order here)



The Valuation of Automobile Dealerships; Appraisal Institute Class
(Upcoming - 2016)

Valuation Magazine (Upcoming - 3rd Quarter 2015) – “Face Value” column (Interviews with the appraisal profession's thought leaders)

“A Guide to Appraising Automobile Dealerships” – Featured topic in *The Appraisal Journal*, (Upcoming - Summer, 2015)

How online sales are changing dealership real estate value, image programs, and more” – *Automotive Buy Sell Report* (July, 2015 Interview)

Year-End 2014 Greystone Valuation Services Automobile Dealership Research Report

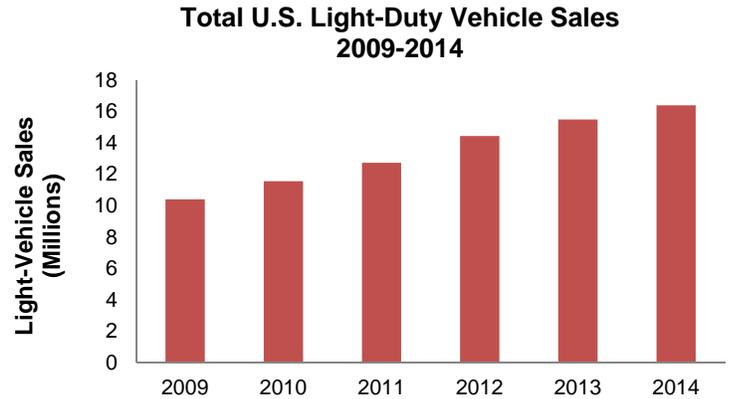
“The Rise of the Market for Auto Dealerships: Bad News for Landlords?” - *Real Estate Issues*, (Volume 39, Number 3, 2014)

“Auto Site Selection” – September/October 2014 issue of *Commercial Investment Real Estate* magazine

Greystone Valuation Services, Inc., an Atlanta-based real estate appraisal and counseling firm, has provided appraisal and/or counseling services related to approximately 300 automotive-related properties, including several of the largest and highest volume automobile dealerships in the southeast. Recent engagements include appraisals of single dealerships or dealership portfolios in the Southeast, Southwest, Midwest, and West Coast.

Auto Sales and Profits

- **Post-Recession Sales:** From the 2009 trough through 2014, unit sales volume increased by more than 60%, despite the decrease in the number of dealerships during that time; as a result, **sales per dealership spiked from 2009-2014 by almost 70%.**

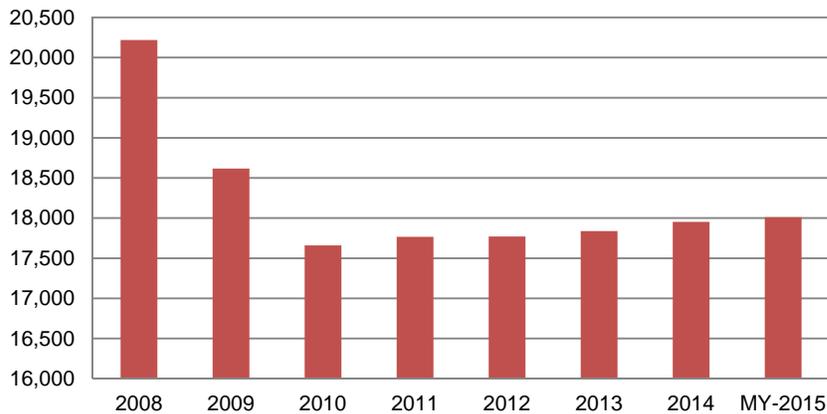


Source: WardsAuto, WWW.NADA.ORG

- **2015 Forecast:** Just revised from 16.9 million units up to approximately **17.2 million units**. Factors driving the increase include:
 - The relatively strong economy
 - Low unemployment
 - Some remaining pent-up demand, as the average vehicle in the U.S. is more than 11 years old.
- **2016 Forecast** - 17.6 million vehicles. If achieved, it will break the all-time record of 17.4 million units of (set in 2000) and represent the **7th straight annual increase**.
- **2017 Forecast** – A **modest decline** is predicted, due to:
 - A gradual increase in interest rates
 - Used-car prices easing off of today's high levels
 - The trend to keep cars longer
- **Indications From OEM's:** Aggressive growth is planned, particularly by foreign manufacturers helped by advantageous exchange rates.
 - The maker of Subaru vehicles reported in *Automotive News* that it would meet its North America sales target 5 years ahead of schedule and accelerate plans to increase local production capacity. Their business plan also calls for new products, better engines and more production.
 - Pricing could come under pressure from automakers in China. *Automotive News* reports that in 2017 GAC (Guangzhou Automobile) will test marketing vehicles in the U.S. priced 30% lower than competitors in the same segment. Other Chinese automakers have announced plans to enter the U.S. market, although none have materialized to-date.
- **Other Revenue Sources:** Service departments, which have long been the most profitable part of auto dealerships, were busier than usual in 2014 due to a record 63.9 million vehicles being recalled.
- **Auto Dealership Profitability:** The average auto dealership boosted its pre-tax profit in 2014 by 6.7% - the **5th straight year** dealers have increased net profits. However...
 - The margin of profit remained unchanged at 2.2%, reflecting the competitive environment for new vehicles.
 - More recently, the Q2 2015 earnings for each of the 5 publicly-traded dealership groups showed a **decline in profit margins** on new-vehicle sales.

Auto Dealership Real Estate Trends

Number of Dealerships
in U.S.



Source: Urban Science

National Inventory of Auto Dealerships

The number of automobile dealerships dropped by 8% from 2008-2009, and has been basically stagnant for the past few years.

Most of the small increase in dealerships from 2013-2014 occurred in just a few states; **Georgia ranked 4th in growth** with 12 new dealerships.

Real Estate Trends

Online marketing of vehicles is allowing dealerships with even marginal locations to prosper to an extent that would not have been possible before the internet.

Where do Sales Begin

- A June 9, 2015 article published by *Automotive News* reports that Costco's dealership referral programs led to sales of nearly 400,000 new and used vehicles in the U.S. in 2014. Programs that generate sales not initiated at a dealership advance the trend of **dealership location becoming less critical** than in the past.
- While online sales are growing, consumers still find shopping in a dealership to be "an emotional experience", says one dealer. "We don't want to take that away from them. This isn't like buying a five dollar case for an i-Phone."

Factory Image Programs

Factory image programs continue to dominate the real estate component of automobile dealerships.

- "Manufacturers want all their dealerships to have a similar look, **just like McDonalds.**"
- Facility improvements that the manufacture may require is "**the biggest risk out there**" – so the appearance of a dealership "may tell you what's coming down the road".
- "If it's been seven years" since re-imaging work last done, "**it's time to get nervous!**"
- Manufacturers can refuse approval of a sale, so if you are a dealer who wants to sell your dealership while resisting a factory image program, "**you're toast.**"

- Dealers with strong balance sheets who receive a costly facility upgrade mandate from the OEM are quicker than ever to relocate from their old facility to a new, modern, compliant building that they construct themselves in the immediate vicinity of their existing dealership. Therefore, **some of the strongest markets carry the greatest risk of having dealership properties go dark.**

Dealership Construction Standards

OEM's continue to uphold high standards for new dealership construction.

- NADA reports that the average new car buyer is now 51.7 years old and earns about \$80,000 per year, as compared with the average age of the general population of 36.8 years old and the median income of roughly \$50,000. The age and relative affluence of car-buyers is affecting real estate construction standards even for dealerships designed to market mid-priced vehicles and lower.

Brand's Influence on the Real Estate

The viability of the brand marketed continues to have an inseparable link with the value of the property.

- Mitsubishi recently shut its only U.S. plant. While they insist they will keep selling cars domestically, their pulling out of the market would almost certainly result in many dealerships closing (similar to Suzuki's recent departure from the U.S. market).

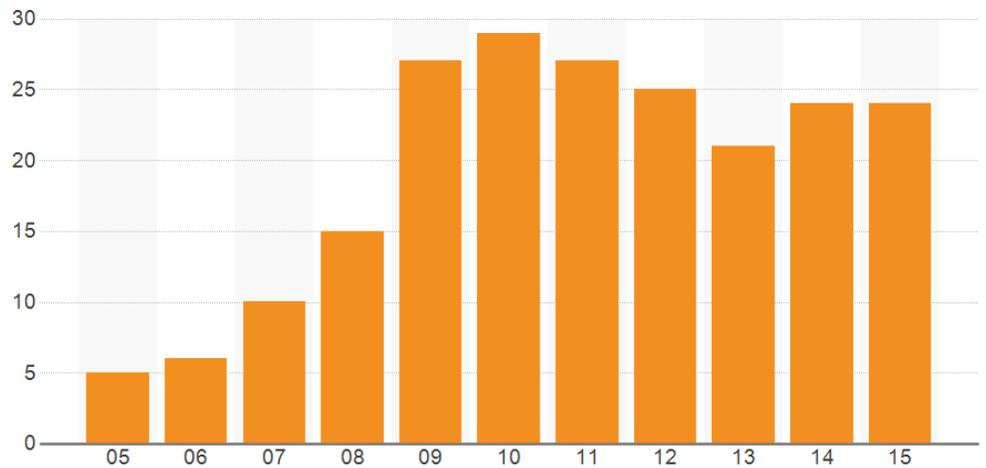
Auto Dealership Real Estate Trends

Atlanta's Auto Dealership Market

Inventory of Dealerships Listed for Sale

The number of dealerships that closed and/or reverted to the lender spiked when the recession hit, as did the inventory of such properties listed for sale. The 24 Atlanta MSA dealership properties on the market as of mid-year 2015 is much higher than the supply of dealerships listed for sale in the years preceding the recession; however, these properties consist mostly of closed dealerships and/or those with significant obsolescence.

Atlanta MSA Auto Dealerships for Sale (10,000 SF+)



Source: CoStar Group

Pricing of Available Dealerships

Brokers specializing in the sale of dealership businesses are reporting record-high pricing. Pricing for the real estate component of automobile dealerships has also been favorable to sellers, but is constrained by the modest recovery for land in many markets.

As of mid-year 2015, the average asking price was just under \$110.00/SF. However, the properties listed for sale are mostly of closed dealerships and/or those with significant obsolescence; pricing for modern, operating dealerships are faring much better.

Atlanta MSA Auto Dealerships Asking Price Trends



Source: CoStar Group

Auto Dealership Industry and Market Experts

We regularly interview automobile dealership brokers, operators and lenders. The following is a representative sample of views expressed during the past several months, as well as our regular review of various industry publications.

Dealership Marketability Trends

With the glut of closed dealerships re-opened or re-purposed, the general sentiment is very positive.

- The current supply of “available (vacant) dealerships is virtually depleted”. “The market has reached an inflection point” and is “**turning upward.**”
- Industry consolidation continues, with large dealerships increasing their presence. Unless it’s a rural area, “The days of the Ma and Pa entering this business” are “effectively over.”
 - A March 26, 2015 article published in the *NY Times* cited that the number of dealership groups with revenue of \$1 billion or more doubled from 2011 and 2014 (from 21 to 43). In 2011, only 13 dealerships in the country had more than 30 stores; by 2014, that number had risen by nearly 50%, to 19 companies.
- The nationwide consolidation of dealerships has “**significantly reduced competition.**”
- The industry’s recent prosperity has drawn considerable interest from Wall Street investors. However, the purchasing activity expected by these well-capitalized buyers does not seem to be materializing.

Technology’s Impact on Shopping Habits

While tensions continue between manufacturers and dealers, **the balance of power is shifting to consumers** - thanks to the internet.

- The internet is expanding trade areas beyond traditional geographic boundaries, but without compromising the need for physical dealerships.
 - Dealers report drawing shoppers from 25+ miles is becoming “the new normal”; sales to customers traveling 100+ miles are no longer uncommon.
 - The average number of customer visits to dealers before buying a car has dropped significantly. While 5 visits had not been uncommon, the number for some brands in some geographies is frequently now just 1.
 - Some dealerships with locations that would be considered inadequate by most conventional real estate metrics have been able to achieve robust unit sales by using the internet to draw customers from a larger area than ever before (and often driving past several competitors).

- Nearly 90% of customers use dealer or OEM web sites in the early steps of making a purchase decision.
- More than a third of buyers are attracted by online advertisements from a nearby competitor, underscoring **the importance of remaining close to the competition.**
- The Internet continues to grow in importance in the marketing process, but only to generate leads and begin the sales process; sales are still being closed and filled at dealerships.
- The intermingling of technology in the auto-buying process will put **further pressure on mom-and-pop dealers** who can’t afford the investment needed to keep pace.

Public Dealerships Respond to Changing Conditions

The publicly-traded dealership groups continue to develop their business plans in response to the changing economic and social environments. The following are some of the developments detailed in the April 27, 2015 *Automotive News* article “Public Dealerships Plan for Growth”:

- Sonic Automotive - **One Sonic-One Experience** is a concept designed to make car-buying easier using no-haggle pricing and use of an iPad intended to complete a purchase within 45 minutes. It was introduced in North Carolina in 2014 and the group expects to expand it to all their stores by the end of 2016.
- Asbury Automotive Group – Asbury continues to develop its used vehicles only “**Q auto**” store concept. There are 3 Q auto stores open, although they not have achieved profitability as of mid-2015. *Automotive News* reports that CEO Craig Monaghan is pleased with the progress made, and expects profitability by year-end. Q auto stores are distinctive in that they have one-price transaction on a car, a fixed price on the F&I product, and sales people are not paid commission.
- AutoNation - AutoNation has made a \$100 million+ investment in **AutoNation Express**, a digital storefront to transform the company’s websites from informational to transactional. *Automotive News* reports that AutoNation intends to eventually expand the digital storefront concept to handle trade-ins, give financing quotes, arrange service appointments, pay bills online and get online updates on vehicle repairs. AutoNation Express is operating in 5 states, and is expected to be in all markets by the end of this year.

Auto Dealership Industry and Market Experts

Risk Factors

- “Facility improvements is the biggest risk out there” (See *Real Estate Trends*).
- Good times aside, it remains “a **cycle business**”.
- It is growing increasingly **difficult for small operators** to compete with the larger dealership groups.
- The real estate has a “single use”, is “very expensive”, and “**it’s hard to get your money out in the event of a meltdown**”.
- Franchises can fall out of favor, and dealers can lose their marketing agreement.
- Secondary Markets: Dealerships in major metro areas have greater opportunity for success, and if they do get into trouble there is a greater opportunity to sell – but “**secondary markets don’t scare us**”.
- Long-Term: The introduction of driverless cars could cause **U.S. auto sales to drop by 40%** over the next 25 years (according to a Barclays Plc analyst, as reported in a May 19, 2015 *Automotive News* article).
 - Vehicle sharing will become far more common, as will families shifting to having just one car, along with “Robot taxis” summoned by smartphones.
 - Partially autonomous vehicles will become available in “large numbers” as early as 2017.

Assessing Appraisals of Auto Dealerships

- “The biggest issue is comp selection”, including using unfavorable comparables (from other markets) and “dark facilities”.
- Appraisers sometimes overstep their bounds by “Opining on viability of the franchises” (as opposed to focusing on the real estate).
- How to view mezzanine space is an area of some controversy.
- “When we are waiting for the appraisal to come back”, we just “**hold our breath**”.

Outlook

- **The market as a whole is on firm footing** as a result of:
 - Increasing auto sales
 - Fewer dealerships
 - The depletion of inventory of vacant and/or lender-owned dealership properties that had flooded the market
- 2015 should be another year of record sales per dealership, and is expected to be eclipsed by 2016.
- **The internet gives shoppers enough information to squeeze margins on new vehicle sales**; dealers will continue to adapt and look to service, used vehicle sales, finance, etc. to move from secondary income streams to their main sources of profit.
- Internet marketing is allowing dealerships with even marginal locations to prosper.
- Large dealership groups with the capital and expertise to make the most of technology and evolving shopping habits are poised to increase market share.
- Small dealerships in small and/or rural markets should continue to appeal to mom-and-pop operators; while their numbers are dwindling, **mom-and-pop operators are not going away**.
- Driverless cars could eventually impact car-buying habits to such a great extent that the entire auto dealership real estate model could be affected.
- Like all real estate, the outlook for auto dealerships will continue to be property-specific, with their marketability and valuations influenced by:
 - National job growth
 - The microeconomic conditions of their respective location
 - Continuously evolving design standards
 - Factory Image Program risk

Recent Transactions

CoStar Group reported there to be very limited activity in the first half of 2015 of arm's-length auto dealership transactions in the Atlanta MSA. Below is a representative sampling of information from transactions tracked by Greystone Valuation Services.

Sampling of Significant Auto Dealership Transactions

Name/Location	Price/ Date	Building Area (SF)/ Year Built	Land Area (AC)	Price/SF
Mercedes Benz of South Atlanta 3775 Royal South Parkway Union City, GA	\$7,500,000 April 2015	44,800 SF 2005	7.917	\$167.41
<p>Property Notes: Low traffic count. No traffic light. Approximately 1¼ mile from the defunct Union Station Mall, which is now being re-developed. No other dealerships in the immediate area, but a large concentration of automobile dealerships fairly close. Construction is steel frame, EIFS, masonry, decorative metal and metal columns. High level of finish. Two-story design. 32% of the building is finished office/showroom area; service area is air conditioned. Included in the calculation of net rentable area is a 1,237 SF mezzanine. Renovated in 2011 as part of the Mercedes-Benz Autohaus Program. The cost (excluding FF&E) was \$1,727,180.</p> <p>Transaction Notes: Purchased by VT Real Estate Acquisition Sub, Inc.; the property had not been marketed for sale. It was a sale-leaseback with the price established by a BPO upon which both buyer and seller agreed.</p>				
Nissan of Vidalia 1609 East First Street Vidalia, GA	\$1,625,000 January 2015	11,829 SF 1986	1.530	\$137.37
<p>Property Notes: Traffic count of 17,530 VPD. No traffic light. At the approximate center of Vidalia's "dealership row". Enamel steel, stucco, metal construction. One, single-story building (plus a mezzanine with limited utility). 40% of the building is finished showroom/office space; service area is not air conditioned. Up-to-date imaging. Multiple overflow lots are used to compensate for small site area.</p> <p>Transaction Notes: Purchased by Nissan of Vidalia, Inc., who exercised an option negotiated in 2009. The buyer purchased the Nissan franchise in 2013 in a separate transaction.</p>				
Former Frank Jackson Ford (Now Nalley Ford) 7555 Roswell Road Sandy Springs, GA	\$13,000,000 December 2014	54,566 SF 1985	6.69	\$238.24
<p>Property Notes: Traffic count of 28,640 VPD. Good commercial location in a cluster of dealerships. Three buildings; 33% is showroom/office space. Parking deck for vehicle storage.</p> <p>Transaction Notes: Purchased by Asbury Atlanta Ford, LLC. The property was not on the market. The sale reflected the transfer of real property only.</p>				
Sons Kia 100 Sons Drive (at State Highway 81) McDonough, GA	\$4,907,597* May 2015	28,429 SF 2015	5.470	\$172.63
<p>Property Notes: Low traffic count. No traffic light. Growing commercial location near a Toyota dealership and a Honda dealership. Concrete structure with an exterior of metal panels, storefront glass and concrete masonry. 53% of the building is finished office/showroom area.</p> <p>Transaction Notes: The buyer, Sons Hon Real Estate, LLC, was the tenant in a ground lease of the site, but did not have the Kia franchise secured at the time of development. A Kia franchisee who owned a dealership adjacent to this built the improvements and contracted to sell the improvements and FF&E for \$5,350,000, with a separate sale of the inventory for \$1,600,000.</p>				
<p>*The sale price reported of \$4,907,597 represents the cost new of real property improvements (\$5,350,000 minus FF&E of \$1,456,730) plus a 10% profit plus the land value of \$625,000.</p>				

Auto Dealership Construction Cost Trends

After virtually no new product added in the years immediately following the recession, many markets are now seeing a fairly aggressive rate of new dealership construction. Construction pricing is increasing rapidly as manufacturers continue to require costly features and finishes. Below are some examples of costs for specific projects either underway or recently completed.

Recent Georgia Auto Dealership Cost Comparables			
Vehicle Price Point	Manufacturer	Size	Cost/SF*
Mid-Priced	Domestic	60,040 SF	\$189.48
Mid-Priced	Foreign	30,502 SF	\$203.70
High End	Foreign	13,400 SF	\$186.57
Economy	Foreign	26,250 SF	\$163.05

*Includes both building and site improvements, but not land

