

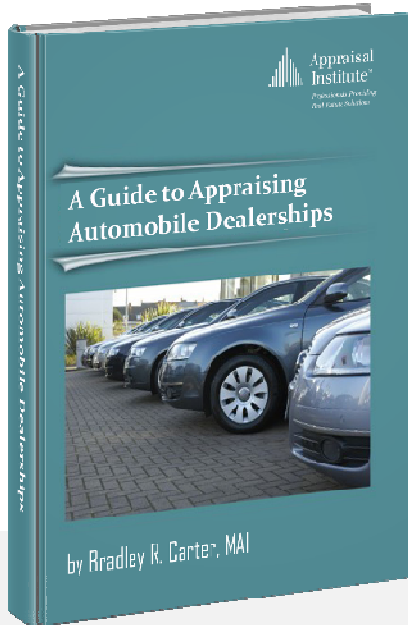
Automobile Dealership

RESEARCH REPORT

Greystone Valuation Services

Appraisal & Counseling

Year-End 2015



Now Available!

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)**

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Recent and Upcoming Publications

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

Valuation Magazine (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*, (Summer, 2015)

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

“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

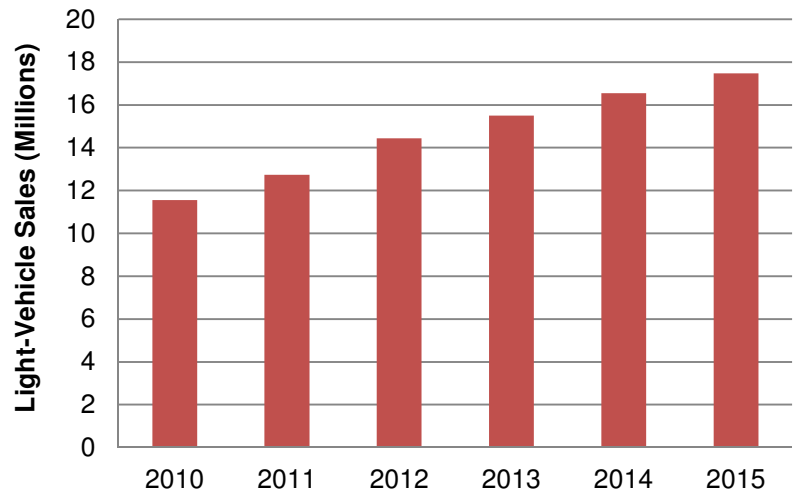
Greystone Valuation Services, Inc., an Atlanta-based real estate appraisal and counseling firm, has provided appraisal and/or counseling services related to 300+ automotive-related properties, including several of the largest and highest volume automobile dealerships in the southeast. Recent engagements include appraisals of single dealerships or dealership portfolios in Arkansas, California, Colorado, Florida, Georgia, Kansas, Illinois, Indiana, Louisiana, Nevada, Minnesota, Mississippi, Ohio, Pennsylvania and Tennessee.

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 at a **record level**.
 - 2015 light-vehicle sales totaled almost **17.5 million units, up 5.7% from 2014**.
 - Due to a strong December, sales in 2015 were the highest ever (eclipsing the mark of 17.4 million units sold in 2000)
 - Units sold per dealership hit an all-time high in 2015 – for the 4th year in a row.
- **Post-Recession Sales:** From the 2010 through 2015, unit sales volume increased by almost 50%, despite the decrease in the number of dealerships during that time; as a result, **new units sold hit 966 per “rooftop” and 550 per franchise** (or brands sold at dealerships).
 - **Near-Term Outlook (2016):** NADA forecasts 2016 U.S. auto sales at around **17.7 million units**. Factors driving the modest increase include:
 - Low unemployment
 - Some remaining pent-up demand (as the average vehicle in the U.S. is still relatively old)
 - **Long-Term Outlook:** Many experts predict that sales will peak in 2016 or 2017, with U.S. sales then experiencing a moderate dip and drift back down to around 17 million by 2022.
 - Banks are already reporting that **demand for auto loans is starting to taper off**.
 - Pricing could come under pressure from automakers in China. Automotive News reports that in 2017 Guangzhou Automobile will begin test marketing vehicles in the U.S. priced 30% lower than competitors in the same segment.
- **Indications From OEM’s:** Continued 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.
- **Auto Dealership Profitability:** The average auto dealership boosted its pre-tax profit in 2014 by 6.7%...the 5th straight year dealers had increased net profits. However, while complete information for 2015 is not yet available, there is anecdotal evidence that it was not as prosperous. Dealers we have spoken with tell us that profit margins on new-vehicle sales continue to decline, and some report declining margins for their entire operations.

Total U.S. Light-Duty Vehicle Sales
2010-2015



Source: WardsAuto, WWW.NADA.ORG

Auto Dealership Real Estate Trends

National Inventory of Auto Dealerships

The last major change in the inventory of automobile dealerships is when it dropped by 8% from 2008-2009; since then the number of automobile dealerships has remained basically stagnant.

Real Estate Trends

Factory Image Programs

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

- The November 2015 issue of The Blue Sky Report echoed a sentiment we hear regularly:

“Most buyers are not looking for real estate development projects.”

- Manufacturers want all their dealerships to have a similar look,
“Just like McDonalds.”
- Facility improvements that the manufacturer 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”

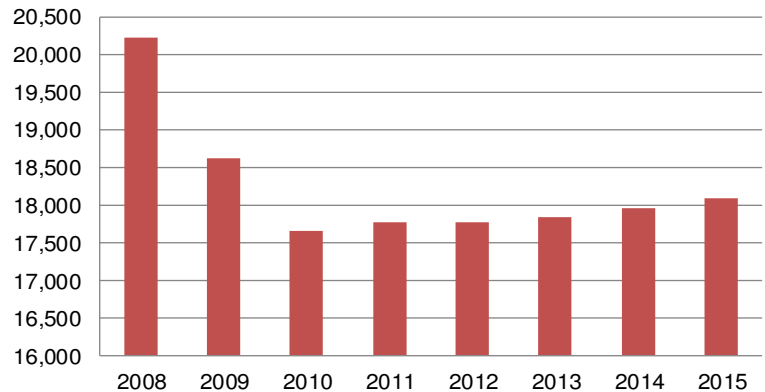
- Dealers with strong balance sheets who receive a costly facility upgrade mandate from the OEM are quicker than ever to relocate from their old facility to a new, modern, compliant building that they construct themselves in the immediate vicinity of their existing dealership. Therefore, **some of the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

Hologram Technology Could Minimize the Need for Large Showrooms

One of the most common re-imaging projects that auto manufacturers require is an expansion of the showroom so buyers can look at more cars. However, Microsoft has developed a technology that could replace the need for costly expansions, and possibly even alter showroom design in new construction going forward.

Microsoft’s HoloLens augmented-reality goggles allow shoppers to

Number of Dealerships in U.S.



Source: Urban Science

see full-size, three-dimensional holograms of cars and cross-sections of their parts. The device can even accommodate a **holographic test-drive** and demonstrate safety features. With this hologram technology, viewers can see a full selection of colors, available trims and options, all in the smallest of showrooms.

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.

- Some OEM’s are concerned about any single franchisee becoming too large.
 - Lexus, for example, limits the number of stores any particular dealer can own to eight.
 - Mercedes-Benz is considering implementing a cap on the number of stores a single franchisee can own as well.

These limitations directly influence the real property component of a dealership enterprise since franchisees that already operate stores of a given brand are the most likely purchasers of a dealership property.

- According to the December 7, 2015 article Automotive News article Frustration flares for VW dealers as sales nosedive, “dealer frustrations are bubbling to the surface”, with one large franchisee noting, “The reputation of Volkswagen is spiraling towards worthlessness.” The Volkswagen emissions scandal (see *Brand’s Influence on the Real Estate*) would seem to have not only a negative influence on VW franchises, but also on the dealership properties designed to comply with VW requirements.
- 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

Auto Dealership Pricing

Rising prices and increasing transaction activity resulted in **record volume for sales of auto dealership properties** in 2015.

How Prices are Established

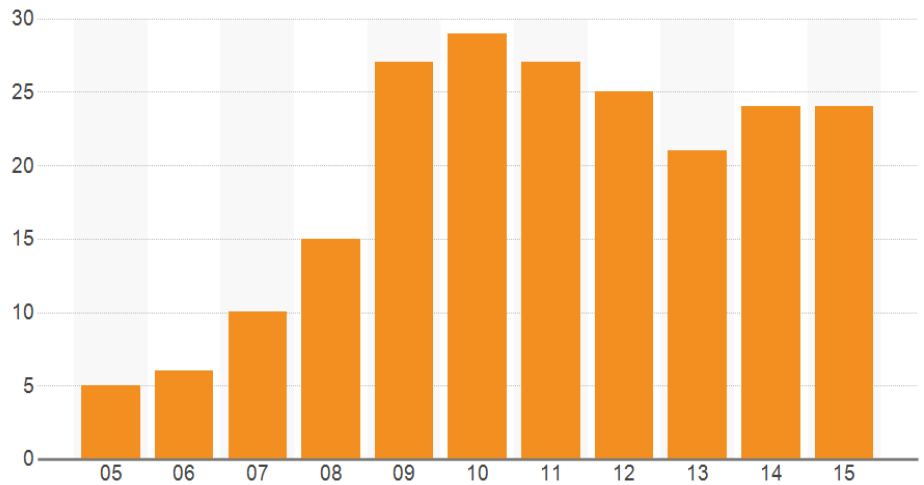
When operating dealerships are sold, it is usually a sale of the entire enterprise and what is reported as the “price” for the real estate is actually an allocation of the total price to the real property component. *Greystone Valuation Services* conducts an ongoing survey of auto dealership buyers and sellers regarding how these “allocations” (or the prices for the real estate that supports dealerships) are established. The most common responses are:

- Appraisal
- Depreciated cost
- “Whatever number minimizes the tax liability”
- “Whatever number maximizes the leverage of financing”

Other most common responses include:

- Book value
- Tax value
- Broker’s opinion
- Advice of the OEM
- “Arbitrary”

Auto Dealership Sale Volume



Source: CoStar Group

2015’s Most Interesting Transaction

The most interesting method of pricing we found this year (or any other) was when a very savvy buyer and seller decided to price the real property at about half what they agreed it was worth with an increase to the amount paid for blue sky by an equal amount. Since the OEM had a right of first refusal to purchase the business but not the real estate, the inordinately high price for the business was described as a “**poison pill**” to deter the OEM from exercising their option (which apparently worked).

Such examples demonstrate the peril of relying on a comparable sale price when the details of the transaction are unknown.

Price Increases and Transaction Activity

Rising prices and plateauing new-car sales are expected to constrain transaction activity as buyers are no longer willing to accept the increases that sellers are likely to continue to anticipate. According to McLarty Automotive Group founder Mark McLarty, as reported in Automotive News:

“The peak of it being a seller’s market is behind us.”

Many believe that appreciation will stall; some predict that they will retract.

Auto Dealership Industry and Market Experts

Greystone Valuation Services regularly interviews automobile dealership brokers, operators and lenders. The following is a representative sample of views expressed, as well as our regular review of various industry publications.

Dealership Marketability Trends

After several consecutive years of sales increases and the glut of closed dealerships re-opened or re-purposed, the sentiment is generally positive.

- Prices generally rose in 2015; however, the outlook for **continued appreciation is uncertain.**
- The nationwide consolidation of dealerships has “significantly **reduced competition.**”
- Lenders, largely blamed for worsening the last downturn by not making credit available, are now helping fuel the strength of the current market with **relaxed lending standards** for both dealership properties and vehicles themselves.
- 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.”
- Dealerships in rural areas and small towns can be hard to market, even when they are performing well. Automotive News reports, “The hard part is finding good people. And a lot of these **GMs don't want to live in these little communities.**”

Impact of Rising Interest Rates

The Federal Reserve's December 2015 interest rate increase along with its long-term course toward further tightening is not expected to slow consumer demand. However, it is likely to “**pinch profits**” as dealers, lenders and automakers all absorb higher financing costs.

While the small increase in interest rates is not expected to have much impact on auto sales, dealers will be impacted in another way. Their floor plan cost, or what they pay to carry inventory, will increase as interest rates rise, which should have a correspondingly downward effect on profits. Lower profit expectations have a downward effect on what dealers can/will pay for a dealership enterprise, which could constrain the amount that they can/will pay for an enterprise's real property component. There is no indication that the nominal increase in interest rates has affected dealership property values to this point; however, industry experts note that continued rate increases, along with the likelihood that the volume of new units sold will moderate,

should result in prices going through “a normal cycle of cooling.”

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 reporting 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 marginal 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).
 - 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 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.
- 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 [buying a car] **isn't like buying a five dollar case for an i-Phone.**”

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Risk Factors

- Challenges that suddenly face the VW brand underscore the importance of diversity.
 - Dealers can protect themselves from economic fluctuations and shifts in market preference by marketing a variety of brands at a variety of price points.
 - However, if a lender holds mortgages on a portion of a dealer's real estate portfolio, the **lender can remain at risk** even if the portfolio as a whole is well diversified.
 - Not only can franchises fall out of favor, but dealers can also lose their marketing agreement.
- Good times aside, it remains "a **cycle business**."
- It is growing increasingly **difficult for small operators** to compete with the larger dealership groups.
- 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.
- "Facility improvements is the biggest risk out there" (see *Real Estate Trends*).
- 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:
 - Job growth
 - The microeconomic conditions of their respective location
 - Continuously evolving design standards
 - Factory Image Program risk

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
- 2016 should be another year of record sales per dealership, although gains are expected to be small.

Auto Dealership Property Transactions

The following is a representative sampling of information from transactions tracked by *Greystone Valuation Services*.

Sampling of Significant 2015 Auto Dealership Transactions

Brand(s) Marketed/Metro Area	Price/Date	Building Area (SF)/Year Built	Land Area (AC)	Price/SF
Confidential (Mid-priced, Foreign) Little Rock, Arkansas Metro Area	\$2,800,000 December 2015	18,096/ 2002	2.015	\$154.73
Property Notes: Traffic count of 13,000 VPD from a surface street, but with visibility from a highway (82,000 VPD). Corner location; no traffic light. Outdoor display area is somewhat cramped. High density of dealerships in the area. Demographics (5-mile radius): median income, \$43,835; population, 88,776. Pre-finished composite metal panels with some EIFS. Two buildings. 22% of the building area is finished office/showroom area and 89% of the service area is air conditioned. Dated design and appearance; not OEM compliant.				
Transaction Notes: The property had not been marketed for sale. Reported to be an arm's-length transaction reflecting real property only.				
Confidential (Economy, Foreign) Knoxville, Tennessee Metro Area (outskirts)	\$2,070,000 December 2015	12,759/ 1988-2006	4.49	\$162.24
Property Notes: Traffic count of 20,345 VPD. Corner location; no traffic light, and access is somewhat difficult from the main road. Moderate density of dealerships in the area. Demographics (5-mile radius): median income, \$39,424; population, 27,725. Stucco and metal construction. Two buildings. 60% of the building area is finished office/showroom area; service areas are not air conditioned. Fairly modern appearance, with some risk evident of a facility upgrade being required.				
Transaction Notes: The property had not been marketed for sale. The parties agreed to a range of prices from greater than \$1,750,000 to less than \$2,250,000, with the exact price being determined by an appraisal (if the value conclusion was in the range negotiated). Reported to be an arm's-length transaction reflecting real property only.				
Confidential (Mid-priced, Foreign) Little Rock, Arkansas Metro Area	\$7,500,000 December 2015	29,010/ 2002	11.73	\$258.53
Property Notes: Traffic count of 19,000 VPD from a surface street, but with visibility from an interstate highway (80,000 VPD). Corner location; no traffic light. Abundant vehicle display, parking and vehicle storage area. In a strong dealership market with a high density of dealerships in the area. Demographics (5-mile radius): median income, \$43,980; population, 125,562. Construction is pre-finished composite metal panels with EIFS. Modern appearance and design with little risk evident of a facility upgrade being required.				
Transaction Notes: The property had not been marketed for sale. Reported to be an arm's-length transaction reflecting real property only.				
Off Lease Only (used vehicles) Ft. Lauderdale/Miami, Florida Metro Area	\$7,500,000 September 2015	49,413/ 1989	14.440	\$151.78
Property Notes: Traffic count of 47,500 VPD. Access is partially restricted by a median. Demographics (5-mile radius): median income, \$43,397; population, 429,376. Busy commercial area, but no other dealerships nearby. Two buildings formerly used as a new vehicle dealership. Ratio of finished office/showroom area is "typical"; service area is not air conditioned. Stucco and block construction. "Usable" condition with the buyer investing \$300,000 in capital improvements after the purchase.				
Transaction Notes: The property had been listed for sale; the purchase reflected an arm's-length transaction of real property only.				
Chrysler-Dodge-Jeep Columbus, Ohio Metro Area (outskirts)	\$3,500,000 August 2015	19,418/ 2002	6.050	\$180.25
Property Notes: Traffic count of 32,290 VPD. Corner location at a traffic light. Median income (5-mile radius): \$68,906. Low density of dealerships in the immediate area. 60% of the building is finished office/showroom area; service area is not air conditioned. OEM compliant. Masonry, Brick, and EIFS construction.				
Transaction Notes: The property had not been marketed for sale. The real estate and the business were purchased separately, allocated as follows: real estate, \$3.5 million; business, \$4.5 million (for a total of \$8.0 million). In January 2014 the dealership enterprise was purchased for \$8.5 million, allocated as follows: real estate, \$3.4 million; business, \$5.1 million.				

Auto Dealership Property Transactions

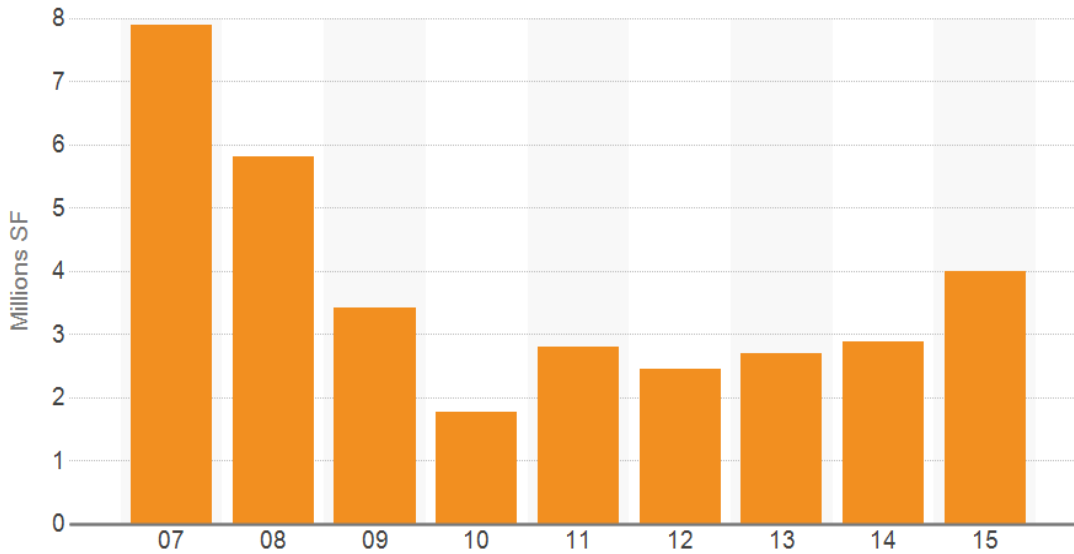
The following is a representative sampling of information from transactions tracked by *Greystone Valuation Services* (continued from previous page).

Sampling of Significant 2015 Auto Dealership Transactions

Brand(s) Marketed/Metro Area	Price/ Date	Building Area (SF)/ Year Built	Land Area (AC)	Price/SF
Toyota Knoxville, Tennessee Metro Area	\$1,900,000 July 2015	15,238/ 1968	2.830	\$124.69
<p>Property Notes: Traffic count of 25,575 VPD. Moderate density of dealerships in the area. Demographics (5-mile radius): median income, \$40,362; population, 66,926. Stucco and metal construction. 40% of the building is finished office/showroom area. Dated design and appearance; not OEM compliant.</p> <p>Transaction Notes: The seller constructed a new, much larger Toyota dealership next door to replace this non-compliant facility. The buyer uses this property to sell used vehicles. The property had not been marketed for sale; the buyer and seller, who knew each other, negotiated a price they believed to be market value. The price reflected real property only.</p>				
Mercedes Benz Atlanta, Georgia Metro Area	\$7,500,000 April 2015	44,800/ 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: 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. The price reflected real property only.</p>				
Mazda, Subaru, Volkswagen Omaha, Nebraska Metro Area	\$9,930,000 January 2015	101,724/ 1973	13.090	\$97.62
<p>Property Notes: Low traffic count from a surface street and 42,040 VPD from an interstate highway. Moderate density of dealerships in the area. Demographics (5-mile radius): median income, \$52,475; population, 258,558. Concrete block and metal construction. Seven buildings. 30% of the building is finished office/showroom area; service area is air conditioned. Some functional concerns.</p> <p>Transaction Notes: The property had been on and off the market for two years. The price was based on a recent appraisal and reflected real property only.</p>				
Confidential (Mid-priced, Foreign) Southeast Market (Confidential)	\$7,250,000 Current Contract	34,946/ 1986	4.77	\$207.46
<p>Property Notes: Traffic count of 27,500 VPD (main road) and 8,700 VPD (secondary road). Double road frontage; no traffic light. In a strong dealership market with high land values and a moderate density of dealerships in the area. Demographics (5-mile radius): median income, \$49,405; population, 140,717. Concrete with painted stucco. Two buildings. 55% of the building area is finished office/showroom area; the service area is not air conditioned. Dated design with a worn appearance; not OEM compliant.</p> <p>Transaction Notes: The property had not been marketed for sale. The price had been established 2½ years ago and does not reflect subsequent appreciation. The price reflected real property only.</p>				
Confidential (Luxury, Foreign) Southeast Market (Confidential)	\$13,500,000 Current Contract	48,883/ 2008	10.93	\$276.16
<p>Property Notes: Traffic count of 33,000 VPD. Corner location at a traffic light. In a strong dealership market with high density of dealerships in the area. Demographics (5-mile radius): median income, \$45,451; population, 157,406. Masonry construction with an EIFS exterior. 69% of the building area is finished office/showroom area; the service area is air conditioned. Modern design and appearance and OEM compliant.</p> <p>Transaction Notes: The property is being sold as part of a portfolio of dealerships that had not been marketed for sale. The price for each property was established individually based on appraisals. The price reflects real property only.</p>				

Auto Dealership Construction Cost Trends

Auto Dealership New Construction Deliveries



New construction deliveries still lag pre-recession levels, although there have been progressive increases since 2012.

Source: CoStar

Criteria: Auto dealership properties 10,000 SF+

Recent Auto Dealership Cost Comparables

Vehicle Price Point	Building Size	Cost/SF-Building*	Improvement Cost/SF**
High-End	94,623 SF	\$133.68	\$148.67
Mid-Priced	30,502 SF	\$128.65	\$203.70
Economy	25,822 SF	\$152.79	\$209.14
Mid-Priced	20,537 SF	\$125.55	\$161.10
Mid-Priced	66,040 SF	\$148.43	\$189.48

Price fluctuations for raw materials have had a significant impact on the cost of new dealership projects. **Copper and PVC, for example, have increased in cost by as much as 20% over the past year.** However, pricing for many other construction components has been more stable, and the cost for some has not changed at all.

* Building cost only; excludes land and site improvements

** Includes site improvements, but not land

What's Ahead

For what's ahead, we looked to the auto dealership construction experts at **TallyCM**, who shared that many industry leaders predict that 2016 will be a robust year for the industry. Dodge Data & Analytics' 2016 Construction Outlook reports 6% industry growth, with estimated value of construction starts reaching \$712 billion.

TallyCM expects to see the following automotive facility construction space trends for 2016:

- Skilled labor shortages are present and General Contractors face pressure to retain experienced tradesman.
- Higher land costs in urban and metro markets lead operators to build multi-storied facilities.
- Dealers struggle to find secondary parking and storage space for excess product.
- Continued growth in the Western states like Texas, Utah, Colorado and California.
- Ground up facility cost per square foot **increase of 5.5% - 7% vs. prior year.**
- Architectural fees and billing rates (ABI) closed 2015 on a positive note and are expected to trend upward for Q1 2016.
- **OEM's are consistently enforcing their facility design plans** and have set clear expectations for dealer compliance.

TallyCM provides owner's representation and general construction management services for the automotive industry. TallyCM's core services include:

- Placement of TCM certified construction managers to oversee program/projects.
- Complete owner's representation through the planning, design, construction and post construction phases of a new build and re-image projects.
- Long term facilities maintenance service contracts and warranty assurance products.
- Site assessments and property inspection reports for Buy/Sell scenarios.

TallyCM has experience with a wide variety of manufacturers and has built a proven track record with established groups like Larry H. Miller Auto Group, Penske Automotive Group, Earnhardt Auto Centers, Pierce/John Elway Automotive, Mike Shaw Automotive, Avondale Automotive Group, Hardin Automotive and many more dealership groups.

For more information about TallyCM visit www.TallyCM.com.



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