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Dirt first, blue second: 5 steps to realize full value from auto dealership buy/sells

By James Mitchell, Executive Vice President, CBRE Auto Dealership Capital Markets

Most auto dealership buy/sells leave money on the table. How can you avoid transaction missteps? An expert digs into a dirt-first approach to valuing dealerships, with insights on cash calculations, tax tactics, appraisal approaches and more. Discover five steps you can take to realize the full value of your dealership.

Dealership buy/sell activity is an at all-time high. Unprecedented earnings have emboldened consolidators as strong cash intersects with a generation of dealers who are thinking this is a good time to step back from the business. But even with record amounts being paid, sellers are leaving big money on the table. Why? Because so much focus goes to blue, while one of the biggest assets is overlooked. That asset is **real estate**—and neglecting it can cost millions.

Why the fixation on blue

So much attention goes to this area of the deal for two reasons. First, blue valuations have never been bigger. Once unheard-of considerations for stores are now commonplace. Second, the factors determining blue are fairly standardized. Sellers, brokers and buyers more or less agree on the multiples of pretax earnings for various brands: 5x to 7x for Honda, 3.5 to 4.5x for Chevy, 8x or more for Toyota and so on. Since that information is easy to find from many reports, blue sky has become the focal point for auto dealership value. Far less information is available on the other big asset, the real estate.

"The biggest mistake dealers make in a sale is overlooking the value of their real estate."

A word about 'dirt'

Real estate is just as big an asset as blue sky—often bigger. Why then is real estate overlooked? Because it's much more opaque. No one publishes the typical value for an image-compliant BMW dealership property. No report tells you how much it costs to build a dealership in line with Chevy's essential brand elements. It's different everywhere.

Yet property value directly affects blue sky. This is how the math works: Earnings drive blue sky. A key expense line on the income statement is rent. Rent is based on the real estate value capitalized at the current cap rate for car dealership properties. Those who don't know the property value are bound to charge too much or too little in rent. Either way, the wrong rent has a dramatic effect on blue. Undervaluing the property overstates blue. Overvaluing the property understates blue.

That's why it's critical to dig into the dirt and know the value of the real estate **before** going to market with the sale of a dealership.

"Know the value of the real estate before going to market."

The problem with appraisals

Ask most brokers about real estate value, and they'll say, "I guess we'll just get an appraisal." What could go wrong? Plenty.

Appraisals look at the value of an average dealership building plus what comparable pieces of land are trading for in the local market. But the building value is taken from an average of "dealership and auto-related" facilities across the United States. The data pool of comparables throws auto dealerships in with service centers, garages and other auto-related facilities that have something to do with cars but less to do with car dealerships, which really stand in a class of their own.

A typical appraisal will value building improvements at $110 a square foot. Even before current inflation, it was impossible to build an image-compliant facility for anything near that amount. In fact, the cost to build today's OEM-required facilities can easily exceed $400 per square foot. That's far above how most appraisers value improvements, let alone the dirt beneath them.

When pricing a dealership for sale, the appraisal is a starting point, but it should never be the last step in determining property value. To get the greatest value from a sale, dealers need to go the extra mile, step by step.

"An appraisal is not the final word on property value."

Five steps to maximize value

1. **Calculate the cash to carry the dirt.**

There's a direct relationship between franchise and property value. On average, a Toyota franchise generates more cash than a Mitsubishi franchise. So, the Toyota franchise can afford to pay more rent. Factor in the cap rate, and the higher rent translates into higher property value. An appraiser cannot take the financial health of the dealership into consideration when valuing the property. But smart buyers pay close attention to the dealership's performance relative to the rent burden it can carry—and, therefore, what the real estate is worth.

2. **Rebalance the real estate money.**

Prior to closing, a dealer often will take money out of real estate and put it into blue for tax purposes. A deal negotiated as $30 million for real estate and $60 million for blue could end up recorded as $20 million in property and $70 million in blue. The seller saves on taxes, which is smart. But the $20 million figure goes into the data pool appraisers use for future valuations—and skews the true value of the comparable property. An informed broker can tell appraisers where this shift has happened and make sure the appraisal is adjusted accordingly.

3. **Mind the moves in the market.**

What's going on in the local market can have ripple effects on property values. For example, when a big employer comes to town, the rising tide can lift all boats. As soon as Amazon announced its second headquarters was coming to the Washington, D.C., area, property values skyrocketed, long before the comparable sales data caught up. Stay informed about any big changes happening in the market and be ready to challenge a backward-looking appraisal.

4. **Leverage LOIs for true value.**

Conventional wisdom says to start the selling process with an appraisal. Conventional wisdom is wrong. Before an appraiser is engaged, prepare an offering memorandum. The OM should underwrite the real estate based on the intel from the previous steps, then right-size the blue based on a smart property value. Astute buyers will recognize when an OM sensibly positions the real estate and submit offers affirming that value. If the appraiser comes back with a lower value in the diligence period, present the offers as market comparables. The appraiser will have a difficult time arguing with what the market is willing to pay. An appraisal is not the final word on property value. 3 | PROPRIETARY & CONFIDENTIAL INFORMATION ©2023 CBRE, INC.

5. **Adopt the right advisor.**

The last step is the first step to take: Partner with an expert. Before going down the road of selling a dealership, look for an advisor who has better resources than the appraisers and understands the buy/sell market. Just as important, pick someone backed by a leading real estate company that knows what's going on in all markets with all property types— especially car dealerships. It's the surest way to realize full value from the two most important assets in the offering—the blue and the real estate

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James Mitchell leads CBRE's Auto Dealership Capital Markets team, focused on buy/sells, debt and equity procurements, workouts and real estate finance alternatives for automotive clients.

CONTACT

James Mitchell

Executive Vice President, CBRE

james.mitchell1@cbre.com

www.cbre.com/autodealerships

About CBRE Group, Inc.

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