Benchmark AGRIBUSINESS
Advice & Insights

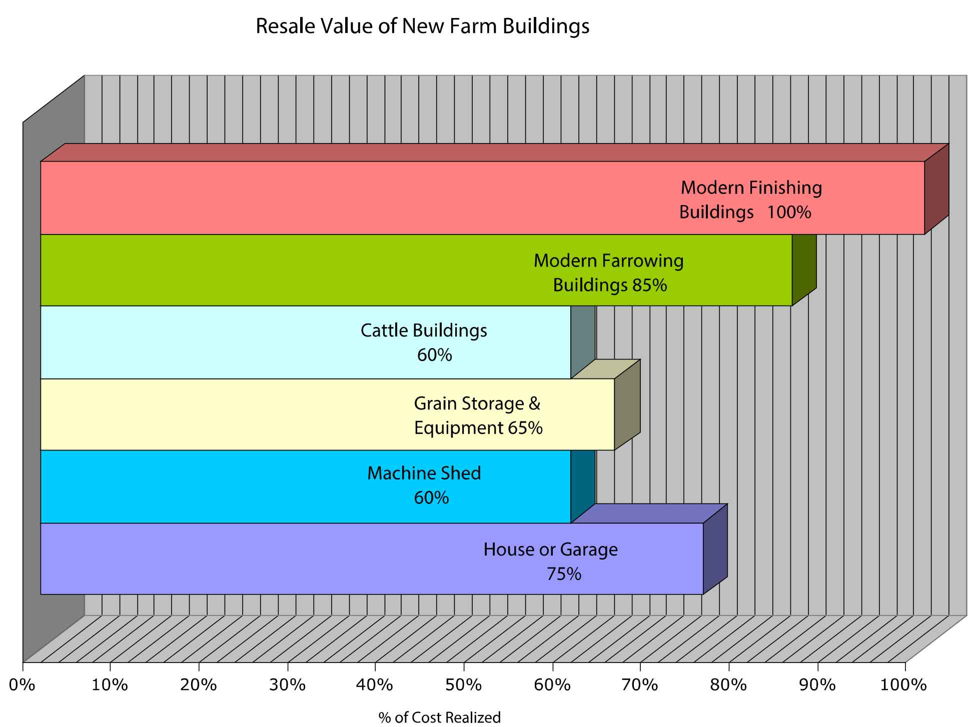
Don't bank on new buildings

Benchmark Agribusiness was contacted a couple of years ago by a very successful local operator to do a real estate appraisal. He wanted the appraisal because he was thinking about retiring, and he wanted to know the right sale price to sell his grain and machine storage and livestock facilities to his main hired man.

That's a normal situation. This is where it got interesting. Then, he said his plan was also to spend about $500,000.00 on a new grain storage complex before he retired. He was also going to sell the new complex to the hired man.

I had to tell him that all of the sales of grain storage complexes in my files only added about 65% of the replacement cost to the sale price. In other words, his hired man was going to have to pay 50% more than the proposed complex would sell for. Or, the retiree would have to take a $175,000 discount if he sold to the hired man at market value.

Not surprisingly, the client hasn't called back and he hasn't yet built a grain storage complex.



New buildings on a farm rarely add 100 cents on the dollar to the value of the building site.

The appraisal textbooks call the 35% discount mentioned before "external obsolescence." Don't tune me out yet. I promise to only use those two words one more time and that will be in the next sentence. I don't know how the glossaries in those textbooks define "external obsolescence" but my definition is ***the difference between retail and resale.***

We're all familiar with the phenomenon—you know that your new car will probably drop 10-20% in value before it has even lost that new car smell. I'm afraid I have to report the same thing almost always happens with farm buildings, too. It is similar to making home improvements prior to selling your house: the selling price of the home seldom goes up by the full amount invested in that new bathroom.

I remember eons ago when I was still a loan officer and one of my farm borrowers would come in with a loan request for a new building. He may have already negotiated hard with the contractor, and he probably had already been encouraged by his tax professional to go forward because of the income tax advantages associated with the deal. Then I would come along and have to be the bad guy because the upfront slippage in the collateral value would have thrown the debt ratios out of whack.

Don't you hate it when that happens? Most of the building improvements that are made on a farm won't add dollar for dollar to the market value.

Below are some basic rules of thumb. The column to the right is the percentage of the replacement cost that the new building will add to the value of the building site.

HOUSE &/or GARAGES*	75%
MACHINE SHEDS	60%
GRAIN STORAGE BINS & EQUIPMENT	65%
CATTLE BUILDINGS	60%
MODERN FINISHING BUILDINGS*	100%

** There is actually a two-tiered resale market for both houses and hog facilities.*

If a building site is primarily residential, the difference between resale and retail is usually less than 10%, depending on the various features. However, if the building site is agriculturally oriented, the discount from the full cost to build the house will usually fall within a range of 20%-30% because the buyers are mainly attracted by the outbuildings.

They probably already have their personal residence at their headquarters site, and this site is just being bought for expansion or for a second generation being brought into the operation.

There is also a two-tiered market for hog buildings. If the site would most likely appeal to an operation that is dependent upon family labor, the resale value will fall within a range of 30%-50% below the cost to build new. This is due to the ever-present consolidation of the hog industry.

On the other hand, newer large commercial hog set-ups will sell much closer to the actual cost to build the facilities—usually less than a 10% discount.

The market value of hog facilities is evolving. First, it appears that too many hog finishing buildings have been built, at least temporarilty. It is common for those confinement buildings that you see from the highway with curtains on both sides to be empty right now.

The California Proposition 12 issue is going to disrupt the confinement industry until the pending congressional legislation stops Proposition 12.

Finally, there are ways to minimize the slippage. The percentages quoted above are in relation to the full cost of materials and labor. The difference between the resale value and the out-of-pocket expenses will not be as wide if the operation can keep the out-of-pocket expenses down by providing some or all of the labor or by using salvage lumber for the framing as an example.

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