THE APPRAISAL OF OFF-PREMISE OUT

By Rodolfo J. Aguilar, Ph.D., ASA, GAA, MAI, PE/PLS, AIA, SR/WA

DOOR ADVERTISING BILLBOARDS

An on-slaught of articles on the appraisal of billboard structures has recently hit the academic-trade press[1, 2, 3]. The acknowledged "bible" of billboard appraisal is the textbook by Donald T. Sutte, Jr., *The Appraisal of Outdoor Advertising Signs*[4], published by the Appraisal Institute in 1994[5]. Since its publication, praises and vituperations have been showered on Sutte's textbook. In my opinion, Sutte's theory and conclusions are correct and valid, and fairly outline a logical approach to the valuation of off-site outdoor advertising structures. However, one must not forget that the purpose of an appraisal is to develop the most reasonable estimate of the price (in terms of money) that a willing buyer would pay a willing seller as full compensation for the seller's property, that is, its market value. In the case of a billboard, the property rights appraised are the fee simple interest in the structure, usually located on leased land, i.e., a leasehold, the land lease, and the permits.

On-Premise Versus Off-Premise Advertising

On-premise and off-premise signs are defined as follows:

On-premise Signs. Any sign that disseminates information that directly relates to the use of the property on which it is located and is not a separate and distinct use.

Off-premise Outdoor Advertising encompasses any out-door sign, display, figure, painting, drawing, message, plaque, poster, billboard, or any other thing which is designed, intended or used to advertise or inform, any part of which advertising or information content is visible from any place on the main travel way of the interstate system or any thoroughfare. The term "off-premise outdoor advertising," however, does not include signs advertising or identifying on-premise activities, and such on-premise advertising or identifying structures shall not be considered "outdoor advertising" structures for any purpose.

The purpose of this article is to clarify and revisit the methods by which the market value of off-premise outdoor advertising structures is estimated.

The Plant

It is not uncommon for an outdoor advertising company to have an office and main shop facility in addition to its investment in the sign structures. The sign structures are commonly referred to in the industry as "The Plant." The plant consists only of the sign structures (the five basic types of advertising signs described below) which are normally located on leased sites. The plant does not include the company office(s) and main shop facility.

General Classification of Outdoor Advertising Structures

Outdoor advertising structures are generally classified as:

1. **Permanent Paints.** These structures frequently differ in size, shape and income. Usually, they have fixed term contracts for the advertising space. The message is permanently painted or printed on the physical substrate face of the sign or on a vinyl.
2. **Rotary Bulletins.** These signs have consistent face sizes with varying types of structures. The advertising copy is painted on panels or printed on vinyl, which are rotated or moved between several locations at frequent intervals during the term of the contract with the advertiser. The standard size of rotary bulletins is 14 feet by 48 feet, and may include cutouts or embellishments.

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3. **Spectaculars or Special Signs.** These are signs of unusual size and shape, located on prime sites. The displays are often specially treated.
4. **The Poster.** A standard advertising copy is printed on posting paper and pasted on the face of the sign. Poster copies are standard throughout the industry. They are approximately 12 feet high by 24 feet long. Several identical poster copies may be purchased by a single advertiser and displayed throughout the market to achieve a targeted showing or coverage.
5. **The Junior Poster.** This display is approximately 6 feet high by 12 fee long. It is small-standardized advertising copy, printed on posting paper and pasted on the face of the sign and used frequently to achieve a targeted showing or coverage.

Components of Individual Sign Structures

The typical components of an indivi ual sign are:

- Section
- Stringer
- Embellishment or extension
- Rails
- Base
- Catwalk
- Footings
- Illumination, type and description
- Uprights, super-structure (height measured as HAGL, height above ground level)
- Trim, etc.

Of course, the subject property also includes the right of possession (leasehold) and the right to operate (permits).

Outdoor Advertising Showing Strategies

Generally speaking, the advertiser is concerned with getting the message disseminated throughout a "geographic area," rather than in a single location. Consequently, the client normally rents several panels simultaneously to insure adequate area coverage. Due to their nature, rotary bulletins can be specifically designated because the display is moved from one location to another, thus allowing the advertiser maximum "showing" coverage.

Real Estate, Real Property and Personal Property

According to the Dictionary of Real Estate Appraisal[6], published by the Appraisal Institute, the following are the accepted definitions of real estate, real property and personal property:

Real Estate. Physical land and appurtenances attached to the land, e.g., structures. An identified parcel or tract of land, including improvements, if any.

Real Property. All interests, benefits, and rights inherent in the ownership of physical real estate. In some states, real property is defined by statute and is synonymous with real estate.

Personal Property. Identifiable portable and tangible objects that are considered by the general public to be "personal," e.g., furnishings, art work, antiques, gems and jewelry, collectibles, machinery and equipment; all property that is not classified as real estate (USPAP[7], 1999 edition). Personal property includes movable items that are not permanently affixed to, and part of, the real estate.

Off-site outdoor advertising signs are structurally secured to the land for strength and stability, which include such obvious considerations as resistance to wind and earthquake forces. Also, their value is preeminently location dependent. Therefore, sign structures and the bundle of rights that attaches to them amply qualify under the definition of real estate. Further, outdoor advertising signs are movable fixtures that become immovable by destination. *The Appraisal of Real Estate*[8] defines a fixture as "an article that was once personal property, but has since been installed or attached to the land or building in a rather permanent manner; it is regarded in law as part of the real estate..." [factors to consider are:]

• The manner in which the item is affixed. Generally, an item is considered personal property if it can be removed without serious injury to the real estate or to itself. There are exceptions to this rule.

• The character of the item and its adaptation to the real estate. Items that are specifically constructed for use in a particular building or installed to carry out the purpose for which the building was erected are generally considered parts of the building.

• The intention of the party who attached the item. Frequently, the terms of the lease reveal whether the item is permanent or is to be removed at some future time.

As correctly interpreted by Nation and Oehlrich[1], an off-site advertising structure clearly meets the criteria outlined above: 1.) For structural and practical reasons, the sign is permanently affixed to the ground; 2.) It is specifically constructed for displaying advertising at the chosen location-size, height above ground level (HAGL), right and left hand reads, illumination, structural foundation, etc.; and 3.) Undoubtedly the owner's intention is to make the structure a permanent fixture at the chosen location for the duration of his estate in the property, i.e., his lease term.

In *Department of Transportation v. Heathrow Land and Development Corporation et al*, the State of Florida Court of Appeal, construing the federal Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1971 (URA), ruled that the value of a sign taken for a federally funded project must be determined by: "considering its contributive value as an improvement to the condemned real property or the value of the billboard itself and compensation must be awarded by using the method, applying standard appraisal techniques, which provides the greatest compensation to..."9 the billboard owner. This decision also amply supports the conclusion that off-site outdoor advertising signs are real estate with their concomitant real property rights. Consequently, all three approaches to market value must be considered in accordance with the provisions of the Uniform Standards of Professional Appraisal Practice (USPAP)7.

Market Value

As defined by the Appraisal Institute, the American Society of Appraisers, the National Association of Independent Fee Appraisers and the Appraisal Division of the National Association of Realtors (the appraisal societies), market value is "...the most probable price in terms of money which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus."

Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

• Buyer and seller are typically motivated.

• Both parties are well informed or well advised, and each acting in what is considered in the best interest.

• A reasonable time is allowed for exposure in the open market.

• Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto.

• The price represents a normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

Takings Under Eminent Domain

In condemnation proceedings, the condemnor is required by law to offer the condemnee "just compensation" for the property being taken. Just compensation implies that the condemnor must pay market value for the property taken to compensate the owner for the damages suffered as a result of the taking. In addition, the Highway Beautification Act of 1965 (HBA) requires that just compensation be paid to the sign owner and landowner. The Federal Highway Administration (FHWA) policy is that just compensation be cash compensation, based on a bona fide appraisal.

When an outdoor advertising sign is being taken under eminent domain proceedings, a willing seller, an essential element of the definition of market value, is not part of the equation because the billboard owner would usually much rather keep the sign and its income stream, than to sell it.

Relocation Cost is "Cost-to-Cure"

If applicable, and only in two specific cases, the condemnor may validly choose to pay "cost-to-cure" damages to the condemnee. The condemnor selects this alternative when the cost-to-cure is less than the damages caused by the taking. In the outdoor advertising domain, cost-to-cure is otherwise known as "relocation cost," or "relocation benefits." This form of compensation is adequate, that is, equivalent to just compensation, only if either of the following two site conditions is present: 1.) The sign can be relocated within the remainder (residual) of the parent tract (on the same property); 2.) The sign can be relocated on another parcel within the same trade area of the property taken which was *not* previously available for an outdoor advertising structure, but became available as a result of the taking.

Relocation to a parcel in a different trade area would *not* adequately compensate the condemnee. The value of an outdoor advertising sign is preeminently location dependent, and therefore, different locations and face orientations generate markedly different income streams. The condemned sign's unique market would forever be lost to the condemnee.

Moreover, relocation to a site in the same trade area where an outdoor advertising sign could be erected unrelated to the taking, is an indication that the condemnee could have located an additional sign at the new site. Consequently, the net result of the taking is to deprive the condemnee of the current location within that market.

Therefore, for all other site conditions (other than the two mentioned above), relocation cost is not representative and/or the equivalent of just compensation and must not be used. Rather, full market value, developed in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP) standards employing the three traditional approaches to value: cost, income, and sales comparison, is the only valid just compensation alternative.

Cost Approach: Cost to Enter the Outdoor Advertising Market– Lowest Indication

The cost approach reflects the sign owner's cost to enter the local market or trade area. In general, it generates the lowest indication of value, as the investor's principal incentive is to develop a property with a cost lower than the capitalized income value of the billboard. In investment terms, this would yield a *positive* net present value. If the sign meets current industry standards and regulations, *reproduction cost* is the appropriate measure for this approach. If it is old, it would not meet current standards and regulations and if, for example, has been grandfathered in on its site, *replacement* cost is the correct estimate. In either case, not only the structure's construction cost, consisting of cost-in-place (labor and materials) of superstructure, foundation and all infrastructural requirements must be considered, but also all indirect expenses, as follows:

• **Site procurement cost:** The procurement of outdoor advertising sites is critical to the industry. Much time and energy are spent on identifying an appropriate location and, once identified, the person in charge of ground leasing must check property titles, zoning and construction ordinances, and must negotiate the lease agreement with the landowner. Generally, lease procurement costs, on a per face basis, can be substantial[10].

• **Indirect costs:** Overhead items include: 1) Checking zoning ordinances, legal constraints, building codes, etc.; 2) verifying approach, sign height and directional angle; 3) preparing site plan and structural preliminaries; 4) preparing a full set of plans and specifications and obtaining permits and approvals, etc. Construction period interest and interest accrued during rent up are also part of indirect costs. Because of the lower direct material and labor costs of outdoor advertising structures, overhead items range from 35 percent to 50 percent of direct costs[10].

• **Construction profit:** This item, also known as entrepreneurial profit, ranges in the construction industry from 10 percent to 20 percent of direct materials and labor, plus such indirect costs as site acquisition and overhead.

From the above computation of reproduction/replacement cost new, all elements of depreciation are deducted:

• Physical depreciation, can be divided into:

Curable physical depreciation which considers those items that are economically feasible to cure and, hence, customarily repaired or replaced by a prudent property owner. Outdoor advertising structures are generally well maintained and very little or no deferred maintenance is ever allowed to build up. The advertiser (client) demands adequate attention to this item by the outdoor advertising sign owner.

Incurable physical depreciation includes elements of physical deterioration, which either cannot be corrected or, if possible to correct, cannot be corrected except at a cost in excess of its contribution to the value of the property. The wasting components in outdoor advertising structures that cannot be corrected by the advertising company are typically not significant when compared to the substructure and the structure of the sign that are long lived. The wasting components are items such as wood platforms and wood rails, which generally are found only in older, grandfathered signs.

• **Functional obsolescence** is the measure of the inadequacy of a structure to perform the task for which it was built. Functional obsolescence can also be divided into the categories of curable and incurable. When obsolescence develops in outdoor advertising structures, industry standards demand immediate attention to correct the causes. Sometimes the problem can be corrected by, for example, increasing sign height to make it visible over a new nearby building, or by changing the direction of facing after a one-way street has been re-routed. In general, when any significant amount of obsolescence has taken place, the problem is corrected when the sign is taken down. Consequently, the signs that remain standing show very little, if any, obsolescence at any point in time.

– **Curable functional obsolescence** is the portion of the subject that inhibits it from performing the task for which it was constructed and can be feasibly corrected.

- **Incurable functional obsolescence** is the portion of the subject that inhibits it from performing the task for which it was constructed and would cost more to correct than the value added to the property from the correction.

• **External obsolescence** is the depreciation a property suffers from external causes. This can be due to economic factors in the area (poor economic standing of the city or state), or to locational factors (dramatic drop in average daily traffic).

- **Economic external obsolescence** is the depreciation experienced by a sign due to prevailing local, state and/or national and international economic conditions. Mostly, this effect will be reflected in the rent that the billboard can generate.
- **Locational external obsolescence** is the depreciation experienced by a sign due to changes in its trade area. As for economic external obsole cence, this effect will be reflected in the rent.

The reproduction/replacement cost of the subject billboard is its reproduction/ replacement cost *new less* the total amount of *accrued* depreciation.

To this figure, the market value of the land and miscellaneous site improvements must be added. Since most outdoor advertising structures are erected on leased land, the capitalized cost of the annual lease provides a fair measure of land value for the parcel directly related to the sign.

The sum of the reproduction/replacement cost of the improvements (the sign) and the capitalized value of the lease (or the market value of the land if owned in fee simple), provides the market value indication from the cost approach-generally the lowest of the three approaches.

Income Approach: Best Indication for a Single Sign

Some appraisers claim that the income approach is unwieldy for outdoor advertising billboards because income and expense data are difficult, if not impossible, to obtain. It appears that outdoor advertising companies may not be willing to release this information to the general public. Of course, difficulty in securing data is not a valid reason for excluding any approach from the computation of market value (USPAP[7]).

I am fortunate to have access to extensive data sources for income and expense figures and to other information that is critical to the development of a reliable valuation. One must never forget that regardless of the difficulties in securing data, the purpose of an appraisal is to estimate its open-market value. In my opinion, given adequate and reliable data, the income approach yields the best indication of the market value of a single billboard. This is particularly valid when a billboard cannot be relocated and is the approach espoused in *Nichols on Eminent Domain*[5], considered to be the means of awarding just compensation for condemned billboard leasehold interests.

It is also incorrect to assert that the income approach reflects the “business” value of a billboard. The expense data, which include all operating and management costs, effectively eliminate the “business” component from the income figures. Thus, the computed net operating income (NOI) applies entirely to the real estate, in the same manner that the NOI of a hotel, office building, or an apartment complex exclusively reflects the value attributable to the realty. An outdoor advertising structure is not a restaurant or a fast food outlet, where a separate and distinct business activity is conducted such as selling food and beverages. All activities of a sign owner relate directly to its being rented to a tenant-advertiser, a purely real estate related function.

The income approach is the procedure in appraisal analysis that converts anticipated benefits (dollar income or amenities) to be derived from the ownership of property into a value estimate. In the income approach, the gross annual income attributable to the subject is estimated. From this figure, all applicable expenses, including a reasonable allocation for vacancy and credit loss, are deducted. The anticipated future net operating income stream and the property reversion are then discounted to present value at a market rate.

The approach is dependent upon an accurate statement of economic rents; the deduction of all applicable expenses; and the conversion of net operating income into value through appropriate capitalization.

The driving force for investing in income producing property, such as outdoor advertising, is to attain an acceptable return on investment. Therefore, the appraiser must analyze the occupancy, rent and operating expenses of comparable properties to estimate the subject’s net operating income at stabilized occupancy. The net operating income is then capitalized at a market rate to compute the subject’s market value from this approach.

For outdoor advertising, operating expenses exclude debt service, depreciation, capital expenditures, income taxes, etc., but include land lease expense, equipment maintenance, property taxes, utilities, etc., and an allocation of management and general overhead expenses. Agency commissions are deducted from annual rent, after vacancy and rent loss, to compute effective gross income.

The capitalization rate is the sum of a discount rate and a capital recapture rate. It is a rate that represents the relationship between future income and value. The five recognized methods for deriving the overall capitalization rate are:

• Derivation from comparable sales,

• band of investment, mortgage and equity components,

• band of investment, land and building components,

• derivation from effective gross income multipliers, and

• debt coverage formula.

Capitalization is the procedure of expressing future benefits in dollars and processing them into a present value at a rate that attracts purchase capital for similar investments. The process involves dividing the annual net operating income by the estimated capitalization rate.

Sales Comparison Approach (Gross Rent Multiplier): Best Indicator for a Group of Signs

The sales comparison approach involves direct comparisons of the property being appraised to similar properties that have sold recently. Carefully verified and analyzed market data are good evidence of value when they represent typical actions and reactions of buyers, sellers, users and investors. The sales comparison approach, like the cost approach, is based on the "principle of substitution." The implication in this approach is that a prudent purchaser will not pay more to buy a property than it would cost to buy a comparable substitute property. The price a typical purchaser pays is usually the result of an extensive search process in which available alternatives are compared. The property purchased typically represents the best available balance between the buyer's specifications and the purchase price.

For outdoor advertising properties, the most applicable unit of measure in the sales comparison approach is the gross rent multiplier (GRM). This index is familiar to real estate investors and other real estate practitioners-appraisers, brokers, developers and managers. It is computed by dividing the sale price of the improved property by its annual effective gross income, or collected income from rents. The gross rent multiplier is self-adjusting to the market and further adjustments are not needed. It should be applied to the portion of the sale of the outdoor advertising locations only (structures, leases and permits), and should not include such items as company owned land, office buildings, chattel and personal property. The sales comparison approach (GRM) is the method most relied upon by purchasers of groups of signs (the plant) to establish purchase price. Consequently, this approach is most indicative of the market value of a group of off-site outdoor advertising structures, leases and permits.

Multiplying the annual gross income, net of vacancy and rent loss, by the gross rent multiplier, the indicated market value from the sales comparison approach is estimated.

Summary

Off-premise outdoor advertising billboards are real estate designed or used to advertise information visible from interstate system or any thoroughfare. With its concomitant real property rights, all three approaches to market value must be considered in accordance with the provisions of the USPAP.

The cost approach generates the lowest indication of value. For this approach, reproduction cost is the appropriate measure for billboards that meet current standards and regulations, while replacement cost correctly estimate old billboards. Moreover, the income approach yields the best indication of market value for a single billboard. The expense data eliminate the "business" component from the income figures; thus, the computed net operating income applies entirely to the real estate. Likewise, the sales comparison approach (GRM) is the best method for groups of signs (the plant) to establish purchase price. Consequently, this approach is most indicative of the market value of a group of off-site outdoor advertising structures, the leases and the permits. ■

Conclusion

I trust that the forgoing discussion of the principal issues involved in the appraisal of off-premise outdoor advertising structures will serve as a primer or guide for the appraiser who, being new to this specialized field, wishes to include it in his or her appraisal practice. For the appraiser experienced in valuing this type of property, this paper could serve as a source of thoughtful re-evaluation and continuing dialogue.

Rodolfo J. Aguilar, Ph.D., ASA, GAA, MAI, PE/PLS, AIA, SR/WA is chairman, president and CEO of Pyburn & Odom, Inc., and of The Aguilar Group, Inc., both located in Baton Rouge, Louisiana. He is also entrepreneur in residence and adjunct professor of finance at the AB Freeman School of Business, Tulane University, New Orleans. He has appraised numerous outdoor advertising structures in Louisiana, Mississippi, Kentucky, Texas and West Virginia; and has also appraised many properties for right-of-way acquisitions by the State of Louisiana, Department of Transportation and Development. An Active senior member of IRWA, he earned a BS in Architectural Engineering, a BA in Architecture and an MS in Civil Engineering from Louisiana State University, Baton Rouge; an MBA from the AB Freeman School of Business, Tulane University; and a Ph.D. in Civil Engineering from North Carolina State University, Raleigh. He is a Professional Engineer, a Professional Land Surveyor, a Registered Architect, a Certified General Real Estate Appraiser and a licensed Real Estate Broker in Louisiana. Contact: (225) 766-6330 Fax: (225) 769-7680. rudi92836 @aol.com.

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