

Chapter 7: Asset Valuation (Real Estate)

Real estate may be the largest fixed asset on the balance sheet. The two most important items to consider are either the market value of the building if it is owned by the business operator, or the lease if the building is not owned by the business operator.

Introduction

When valuing a movie theater and reviewing the real estate component, you need to look at one of three things, depending upon whether the seller owns the facilities or leases:

- (1) The value of the facility (if the seller owns the building/buildings).
- (2) The value and duration of the lease (if the seller does not own the building).
- (3) Some combination of the two (if the facility will be leased by the seller, then the fair rental rate should be determined).

The lease and real estate facilities of a movie theater are the most important items to review before valuing or purchasing a movie theater. It is critical to know: (1) how much land there is, (2) how much building space there is, (3) where it is, (4) whether the property is owned or leased, and (5) whether the appraisal is for a market value or a liquidation value. The building and land characteristics of the property, as well as its market supply and demand, should be accurately determined.

Valuing A Movie Theater Real Estate Assets

The best way to understand real estate valuation is through the use of an example. Throughout this chapter, we will present a quick valuation of a movie theater building. This analysis will assist the reader in understanding how this asset fits into the overall business valuation. Many steps have been skipped, but the issues and analysis will give a buyer/seller or analyst a good “back of the

Valuation Example

envelope” indication. The most important specifics of this building can be seen in Table 7-1.

Table 7-1: Land/Improvement Statistics of an Example Theater

Item	Statistic
Location	12125 Day Street Moreno Valley, CA
Interest Valued:	Fee simple interest (company owns building and does not lease)
Land Size and Shape:	2.07 acres, 90,169 sq. ft.
Zoning	C18
Tax and Assessment Data	1.04541% of assessed value, plus \$141 in special assessments
Gross Building Area:	27,844 square feet
Year Built	1995
Construction Type:	Good, Class C Construction See Table 7-24 on page 186 for Classifications
Parking	300 spaces
Theater Type	Multiplex
Number of Screens	8
Amenities	Access to Freeway, Arcade

Before reviewing the different techniques of valuing a movie theater or a building, it is important to understand the various ownership interests in real estate, as well as the critical and unique building and land statistics.

Ownership Interests

There are four general interests in real estate:

- (1) fee simple
- (2) leased fee
- (3) leasehold
- (4) partial interest

Fee simple interests are the most common, meaning that the property is not encumbered by any other interest or lease. This interest is most used when valuing an owner user property where there are no tenants, and the owner (seller) also owns both the land and building.

A leased fee interest means an ownership interest held by a landlord, but leased to others; the rights of the lessor (landlord) or the leased fee owner and leased fee are specified by contract terms contained within the lease. This interest is involved mostly when valuing income producing property with leases such as industrial, office buildings or retail centers.

A leasehold interest is defined as the right to use and occupy real estate for a stated term and under certain conditions, conveyed by a lease. This interest is generally involved when valuing a land lease or the lease of a tenant.

Finally, a fractional interest is an interest in either of the three interests seen above but is less than 100%. An example of this would be a house in which three people have one third interests.

Table 7-2: Important Land Characteristics

Item	Description/Comments
Location:	Get the address (look at title report/tax bill)
Assessor's Parcel Number:	Needed to establish basic tax identification and other statistics. Generally found on the tax bill.
Size and Shape:	There are 43,560 sq ft in one acre. This is a critical factor since you need to know if there is enough room for expansion, if your parking is less than the overall market, or if there is excess land which is an additional asset for the balance sheet.
Ingress/Egress and Exposure:	If you cannot access the property, or are subject to a short term easement, then the value is much lower.
Adjacent Properties:	Is the property next to other retailers?
Topography:	Are there problems here? A hard rain or earthquake may make a building slide down a hill. Some buildings gradually shift down a slope.
Drainage and Storm Water Control:	Will the building float away? You may need flood insurance.
Hazards:	What was the building previously used for? Is it on top of a fault line (earthquake)? Is it contaminated by toxins (lead, methane)?
Easements, Restrictions, and Encroachments:	Does the title report flag any issues? The seller may not even know about these, such as the right of a neighbor to drive across your property.
Utilities:	Will you have to dig a ditch for sewage, water, or electricity, and pay for two miles of digging and engineering to make the building operational?
Zoning Provisions:	This is critical. It is absolutely critical to find the existing zoning code. If your building burns down can you re-build the same structure? In most cases you can't. Check to see if you need a conditional use permit (CUP) for your business.
CC&Rs/Private Restrictions, Governing Use:	Nail these down. These usually appear in the title policy and show any restrictions on the use of the property.
Tax and Assessment Data:	Are you being over assessed or under assessed? Also, you want to find out when the next assessment is for the county. Your taxes may double.

General Land and Building Analysis

Before valuing anything, one must know the movie theater building and land parcel sizes. First, the site improvements need to be reviewed. The general characteristics for a land parcel can be seen in Table 7-2 on page 163. Critical improvement characteristics are seen in Table 7-3 listed below.

Table 7-3: Important Movie Theater Building Characteristics

Item	Comments
Gross Building Area:	Get the correct square footage.
Exterior:	Concrete, wood?
Foundation:	Is it flat?
Roof:	Do you need a new one? This can be expensive! How old is it?
Air-conditioning/Heating:	Same as the roof.
Plumbing:	Do you need new plumbing? Is there sufficient plumbing for restrooms? Are there plumbing and drains available for multiple concessions stands?
Electrical:	Is the wiring sufficient to run the necessary amperage for all the theater equipment? Do you need to replace or install additional circuit boxes? Do you need additional transformers?
Fire System:	Will the fire department allow you to operate in the existing facility as a movie theater?
Parking:	Critical! Are there enough spaces for the use of the movie theater. Is the parking being shared with any other businesses?
Construction:	Are the interior walls strong enough for sound proofing? Will sound vibrations cause severe structural damage?
Environmental:	Asbestos, etc.? Are you purchasing an off balance sheet liability?
Age:	Is the building about to fall over, or has it been maintained?
Functional Obsolescence:	Are there problems with the building which impact the operation of the business? For example, if you are to lease or buy a building and there is no air conditioning system, then this is a problem.
Deferred Maintenance:	This is critical. You want to know going into a deal whether you need to pull out your checkbook for a new roof, electrical wiring, earthquake retrofitting, asbestos abatement, plumbing etc. Get a good structural engineer and contractor when in doubt (even when not in doubt).
Auditoriums:	What is the condition of the auditorium? How is the lighting? Is the carpet in good condition? Are there the necessary fire exits in the auditorium?
Screens:	Do the screens need to be replaced? Are there any tears? Are the screens large enough for the auditoriums?
Seats:	This is critical. Comfort is very important to moviegoers. Is there stadium seating? Are the seats high back? Are there removable arm rests between the seats? How is the cushioning? Have the seats been cleaned regularly? Are there cupholders?
Venue:	Is the theater located in a shopping center or mini-mall? Is there going to be any foot traffic? Is the theater a standalone facility? If so, marketing will be very important to the theater's success.
Amenities:	This is critical. Since typically a third of a theater's profits are typically from concession sales, it is very critical to evaluate the concession area thoroughly. What is the condition of the concessions stands? How has the history been with the health inspection office? Are there sufficient wash rooms? What is their condition?
Signage:	Are there signage posts with good exposure to traffic? Can the building be clearly seen by the public?
Flooring:	Can the floors sustain the required design loads for seating 150 plus people?
Capital Expenditure:	What is the most recent capital expenditure? Any future expenditures?

The analyst should then determine the vacancy rates in the area, the amount of space which is being built or planned, and whether vacancy rates and rental rates are decreasing or increasing as a result of supply and demand imbalances. This information may be obtained from real estate brokers or from appraisers. Also, contact the city planning department for additional information on future development. One should not get into a long term lease, only to learn that better and new space is about to be built, or a competitor is about to locate next to you.

Market Analysis

You can get much of this information on-line from commercial real estate brokerage companies. These companies and their respective websites can be seen in Table 7-4.

Table 7-4: Market Analysis Sources

Commercial Real Estate Company	Web Site
CB Richard Ellis	http://www.cbrichardellis.com
Cushman & Wakefield	http://www.cushmanwakefield.com
Grubb & Ellis	http://www.grubb-ellis.com

Different Types of Movie Theaters

Movie theaters are generally broken down into traditional, outdoor, IMAX, multiplex and megaplex formats. These different theater types are characterized by description and function below.

A conventional movie theater, like a stage theater, consists of one to four auditoriums with rows of comfortable seats, as well as a lobby area containing a box office for purchasing tickets, a counter or self service facilities for buying snacks and drinks, and washroom facilities. Traditional theaters have relatively flat to slightly sloped seating floors, often obscuring the view of patrons. Some of the older theaters contain a balcony, an elevated platform above the theater's rear most seats. Today, traditional theater operators have become mainly discount movie theaters showing second run, classic, art and independent films. Table 7-5 on page 166 lists the typical real estate features found in a traditional movie theater.

Traditional Movie Theater