What's That Sign Out Front Really Worth?

It's key to reaching your full economic potential

By Jim and Tom Claus

Summary: *A good, effective business sign has value far beyond the cost of the materials and labor used to create it. Done correctly, a sign can represent as much as a quarter of the total value of your carwash. Follow along as a veteran appraiser explains how a professional determines that value - and how you can maximize it.*

A properly designed and placed sign is the most effective advertising investment a carwash owner will make. Without it, a site cannot function at its full economic potential, which in valuation terms means the site cannot reach its "highest and best use."

Generally, appraisal of commercial real property addresses three locational factors - visibility, accessibility and parking.

Since the sign's contributory value to its site is the concern, determination of that value will concentrate on the so-called visibility factor.

For our purposes, we break the visibility factor into two components: (1) the site's overall visibility, and (2) how useful the sign is to passing motorists - how easily it can be seen, understood and safely reacted to from the road.

For a carwash, the on-premise sign provides a great number of "message" exposures to potential customers driving by--usually at a fraction of the cost of other advertising media.

Signage appraisal usually is concerned most about the cost to replace the visual messages or exposures provided by a sign. As part of the valuation, the appraiser eventually must answer three related questions:

- What percentage of the sign's target market is exposed to the message?•
- How many repetitions of the message are seen by the viewer?•
- How much does it cost to reach a given number of people? • Answer these questions and you generally can determine a sign's cost-effectiveness compared with other media and establish its true value based on net revenues attributable to its presence.

To determine the value of the sign to your business and use the information to the best advantage, consider the case study of two carwash signs as you learn about three traditional approaches to valuation.

Income Approach

This approach involves anticipating the revenues a property interest can conceivably generate and relating the income stream to value.

In most cases, it begins with an inquiry designed to show what percentage of customers in a given period were prompted to stop simply because they saw the sign.

This information usually is gathered from point-source surveys. Here, however, we rely on the case study to demonstrate the approach.

Income analysis utilizes capitalization rates, which work much like the interest on a bank

deposit. If you want to earn $10,000 in interest and the bank offers a 10 percent "cap rate," you must deposit $100,000. If the bank offers only 5 percent, you have to deposit $200,000 to get the same return.

In the example of the case study, the increase in annual income demonstrably attributable to the sign is $135,000. An operator looking to raise that amount through a one-year investment paying 9 percent interest would need $1.5 million in principal.

However, we are appraising this sign not for investment purposes but to determine its present worth to the business.

The value of the sign to the business can be calculated by determining how much additional revenue is generated each year because customers patronize the business because they saw the sign.

In the case study used here, the wash generated an additional $135,000 annually once the sign was in place. We assume the net before tax dollars is half of this, or $67,500 annually. If you consider the sign has a life span of seven years, you might be tempted to just multiply $67,500 by 7 to get the total value of the sign during its lifetime.

However, the sign is paid for today. Therefore, the value of the money earned by the sign must be calculated in the value of the money today, even if the money is not earned for years to come.

The present value of money earned in the future is calculated using the following formula:

PV = FV/(1 + CAP)n

Where PV is the present value of money earned in the future, FV is the future value of the money or what it is worth when it is actually earned, CAP is the capitalization rate or interest rate (in this case it is 9 percent or 0.09) and n is the number of "periods" from now until the money is earned. In this case, the periods are years.

One year from now, the wash will earn an additional $67,500 because of the presence of the sign. What is the value of that money today?

PV = $67,500/(1 + .09 1) = $61,926.61

If you invested $61,926 today at 9 percent annual interest, you would have $67,500 in one year. Therefore, the $67,500 earned one year from now is worth less than $62,000 today. The $67,500 earned in the second year only has a value of $56,813.40 today. The calculation should be repeated for each year in the life of the sign. Each year, the value of "n" increases in the formula.

After you obtain the present value of the additional revenue generated by the sign each year, all the values are added together to get the total value of the sign today.

During the seven years of its life, the sign will generate the equivalent of approximately $340,000 in the value of money today.

Market Comparison

Using this approach to determine what the market will bear for similar property, the appraiser inspects sites with varying street-exposure potentials, obtains square-foot rental

figures and makes comparisons.

The value of a site's "visibility" is reflected in the fair market value of its real property or the rental or lease rates it commands. Location, parking and accessibility also are dominant appraisal factors, but visibility considerations can be extracted from other valuation indicators.

Under the basic formula for this approach, Annual Square Foot Rentals Based on Street Exposure is divided by the Cap Rate (Life of Business) to get the Present Value of Street Exposure.

Looking again to the case study, the lease rate for the 5,000-square-foot facility is $2 per square foot, which amounts to a $2,000-per-month visibility premium over medium- to low-visibility sites in that area that lease for $1.60 per square foot.

High-visibility site: $2 per sq. ft. x 5,000 sq. ft. = $10,000/mo

Low-visibility site: $1.60 per sq. ft. x 5,000 sq. ft. = $8,000/mo

Difference: $2,000 per month or $24,000 per year

Applying the formula to this information and assuming a capitalization rate of 9 percent and a 25-year life for the business, we can establish the value of the visibility component of the subject site.

Using the same formula used to determine the value of the sign we can determine the value of the high visibility of the location over the course of the 25-year life of the carwash. In this case, however, the future value of the high visibility is $24,000 annually, while the capitalization rate is still 9 percent. Repeating the formula for each of the 25 years, (and increasing the value of n correspondingly each year) and summing together the present value for each of the 25 years gives you a total present value for the price of the high visibility of the location of nearly $236,000 during the life of the business.

Although the carwash is located on a busy arterial, it's set far enough away from the road that without its sign much of the premium visibility component would be lost. For all intents and purposes, the sign is the visibility component of this site.

If a sign visible to the street could not be placed on the site, the landlord could no longer command premium rental rates, and would need at least $236,000 in the bank earning 9 percent interest over a period of 25 years to recoup rents lost to the substantial impairment of the site's visibility.

Conversely, the lessee would require the same amount and same interest rate deposited over the same period of time to recoup sales lost because of a lack of signage optimally visible to the street.

Copy Of Replacement Or Substitution

This approach to valuation estimates the cost of replacing or substituting an existing property interest with another of equal value.

In signage appraisal terms, you're not considering the cost to replace the sign itself, but rather to replace the sign's communication abilities by using other media.

To arrive at comparable costs per 1,000 exposures for signage, and other advertising media - television, radio, newspapers, yellow pages and direct mail - you primarily rely on "frequency" measures. Frequency data addresses how many times a viewer, reader or listener is exposed to an advertiser's message. A newspaper advertiser, for example, can accurately determine how many people were exposed to an ad, based on the number of newspapers sold.

It is harder to determine exposure frequency for on-premise signage because drivers who are just passing through may see the sign only once, while drivers living or working close by are exposed to the sign many times.

Although traffic counts reflect the number of vehicles daily passing a sign, this number must be adjusted, using tested formulas, to account for the infrequent passerby or viewers who may see the sign but are not potential consumers. Origin/ destination studies offer reliable data in these circumstances.

Replacement cost analysis for signage is one of the more complicated evaluations. However, a reasonable estimate can be made based on original costs (design, production and placement), plus maintenance costs and depreciation.

The two-sided sign in the case study, for example, originally cost $25,000. With an amortization/depreciation period of seven years, its monthly cost is $298.

The estimated traffic count is 60,000 cars per day or 1.8 million per month. Divide that monthly count into the monthly cost and you get a figure of $0.00016 per 1,000 exposures.

The cost to replace the sign with a double-faced billboard can be estimated easily from a billboard directly across the street. The local commercial rate to lease the billboard is $500 per face per month for "posters" and $2,500 per face per month for "painted bulletins." Using the formula above, the cost per 1,000 exposures for a poster is $0,00055 - five times higher than the on-premise sign.

The "painted bulletin" cost of $0.0028 is 15 times higher than the cost of the sign. Suppose the carwash in the case study suddenly lost its sign and had to lease the billboard across the street? Assuming a 25-year remaining life for the business, the owner would need $595,000 in the bank at 9 percent in order to fund the $60,000 annual lease rates for billboard space necessary to replace the communication and design power of the on-premise sign.

Without such an investment, the cost of billboard replacement signage eventually would erode profits to the point of business failure. (If the owner went to a less expensive poster, the amount needed to fund annual lease rates would be $120,000 at 9 percent, but the exposure would not be as effective as that of a painted bulletin.)

If you find the cost of replacement billboard signage untenable, the cost per 1,000 exposures of other possible substitutes is even less palatable. Given the costs of other media - all off the premises - it is easy to see that the on-premise sign is an effective and inexpensive way to expose a carwash to potential customers who can immediately accept its invitation to stop.

But even the most successful operators sometimes fail to fully utilize the visibility component of their site. They spend lots of money on architecture, color schemes, landscaping and window displays, then forget that a well-designed and appropriately placed

sign provides more visibility and "street expression" than all other visibility factors combined. And the sign does it at a fraction of the cost and with a maximum return on investment.

The appraisal methods and results outlined here clearly show that the study sign, which represents most of the visibility component of the site, has a minimum present worth of $250,000. With a total assessed value of $1.5 million for the site - real property and improvements - the sign represents early 20 percent of total value.

The savvy landlord knows visibility translates to higher rents. When you as an operator are paying a premium for visibility, the site must be brought to its maximum visibility potential.

That task can be accomplished, for less than pennies a day, through a reusable resource that just keeps on giving - the on-premise sign.

Case Study : Creating A Standout Sign

The “Car Wash” sign above is visually attractive and well-placed next to the right-of-way of a busy arterial. The site has sufficient access and parking, and its neighbors – a gas station, fast food restaurant, coin-operated laundry and liquor store – are compatible land uses. Yet the business was not generating the kind of revenue its new owner expected, given the location and demographics. So, what was the problem?

The sign, while tasteful, doesn’t stand out from its background. The unfamiliar or infrequent passerby could neither detect the sign nor read its message in time to maneuver safely into the lot. Failure to capture impulse business was holding down revenues. With all other locational factors remaining equal, how did the owner fix the situation? With a new sign.

The new sign cost the owner $25,000. Only its total square footage remains the same as the original. It is a pole sign, and because it’s similar to neighboring pole signs, it is in keeping with driver expectation – in type, size and height the sign is exactly what the driver anticipates in that area. Contrasting and vibrant colors make the sign more conspicuous, and large print assures the message is readable and easy to use.

Specials can be advertised on a changeable message reader board, and state-of-the-art graphics reinforce the message that this establishment can make your car look like new. Because the sign stands out from its background and imparts a clear message, lead time to make safe driver choices to enter the premises is increased vastly.

In the first year it was installed, gross revenues increased by $135,000 – nearly five-and-a-half times the cost of the sign.