



## CENTRAL CORRIDOR UNDERLYING VALUATION ISSUES

BY: JOHN T. SCHMICK

While most people are aware of plans to expand light rail service between Minneapolis and St. Paul, few understand how underlying zoning issues will impact property values in the new corridor. To accommodate the Central Corridor Light Rail Project, the Minnesota Department of Transportation (MnDOT) must acquire enough land to support construction and operation of the proposed light rail system. Property owners along the corridor, with land subject to the eminent domain process, will be asked to sell/rent land to MnDOT. While the process of determining a fair price for the prop-

erty rights acquired and quantifying the total impact on the property is always challenging, in this situation, it is further complicated by recent zoning changes.

In 2008, the city of St. Paul added a Central Corridor Overlay District to its zoning code. Establishing a short-term overlay district gives the city enough time to review and update its current zoning codes. The overlay district restricts new development in advance of the eminent domain process and actual construction of the light rail. Included in the Central Corridor Overlay District is a provision that the district will expire on

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## MARKET TRENDS AND INDICATORS

Office Buildings	→	0%
Retail Centers	→	0%
Industrial Buildings	↑	1%
Apartments	↑	7%
New Housing Starts	↑	1.8%
Productivity	↓	2.6%
Composite PE	↓	21.8
US Unemployment	↓	8.9%
Consumer Confidence Index	↑	65.0

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# MARKET TRENDS AND INDICATORS

## ECONOMIC INDICATOR

	2005	2006	2007	2008	2009	2010
New Housing Starts—Yearly Totals	357,400	279,500	211,700	137,700	97,600	99,400

## P/E RATIOS IN SELECT INDUSTRIES

Reporting categories changed in spring of 2006. Data for the current categories is presented for the Years: 2006, 2007, 2008, 2009, 2010, and Feb 2011.

INDUSTRY (YEAR END)	2006	2007	2008	2009	2010	FEB 2011
Basic Materials	13.7	14.1	15.2	21.6	27.4	28.6
Conglomerates	20.1	18.4	15.8	10.7	15.0	19.1
Consumer Goods	25.8	24.4	16.3	15.9	24.9	14.8
Financials	14.3	13.7	11.7	9.6	36.2	28.8
Healthcare	38.8	40.0	26.0	57.7	26.1	14.9
Industrial Goods	25.1	19.5	19.5	20.3	23.5	17.7
Services	25.6	28.7	24.2	20.1	26.6	33.8
Technology	26.3	38.4	23.8	16.4	45.2	24.9
Utilities	24.0	20.0	15.3	12.0	28.5	13.5
Composite	24.4	24.0	18.7	20.5	28.2	21.8

## ECONOMIC INDICATORS

INDICATOR (5 YR. AVG.)	2000	2005	2006	2007	2008	2009	2010	CURRENT
Inflation	3.4%	3.4%	3.2%	2.9%	3.8%	-3.0%	1.6%	1.6%
Productivity	2.9%	1.8%	1.5%	1.6%	2.8%	5.1%	2.6%	2.6%
GDP	3.9%	3.1%	2.7%	2.1%	.4%	-2.4%	3.2%	3.2%
Consumer Confidence	128.6	107.2	105.6	87.9	56.6	52.9	62.0	65.0

## UNEMPLOYMENT

	1990	1995	2000	2005	2007	2008	2009	2010	JAN 2011
US	5.4%	5.6%	4.0%	5.2%	4.6%	4.9%	8.1%	9.4	8.9
Northeast	5.0%	6.0%	4.0%	4.9%	4.4%	4.7%	7.7%	8.4	8.4
Midwest	5.7%	4.5%	3.5%	5.7%	5.0%	5.3%	8.6%	8.7	8.5
South	5.4%	5.4%	4.0%	5.2%	4.3%	4.6%	8.1%	9.3	9.2
West	5.1%	6.6%	4.6%	5.5%	4.5%	5.2%	9.2%	11.0	10.9
Minnesota	4.6%	3.6%	2.9%	4.5%	4.5%	4.8%	8.1%	7.0	6.7

## RATES OF RETURN AND RISK HIERARCHY

INVESTMENT	CURRENT	INVESTMENT	CURRENT
30 Year Treasury	4.5%	Equipment Finance Rates	10.0–12.0%
Aaa Bond	4.9%	S & P Equity (Ibbotson)	11.2%
Commercial Mortgage	6.0%	Speculative Real Estate	12.0–16.0%
Bbb Bond	6.35%	Land Development	12.0–20.0%
Institutional Real Estate	7.0–8.75%	NYSE/OTC Equity (Ibbotson)	15.27%
Non-Institutional Real Estate	9.5–11.5%	NYSE Smallest Cap. Equity (Ibbotson)	23.26%

Sources: Appraisal Institute, Business Week, Value Line, U.S. Chamber of Commerce, Standard & Poors, Investment Dealers Digest, U.S. Government Census, Yahoo Finance, Bureau of Labor Statistics, Ibbotson Associates.  
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June 20, 2011, roughly three years after its adoption. As a general rule, zoning codes are useful, necessary guidelines. They allow local officials to manage development and growth, avoid conflicting uses and maximize the economic potential of land. In this case, the overlay district effectively discourages the start of development projects that would later be subject to eminent domain litigation.

St. Paul recently published a draft of zoning code changes which will replace the CC Overlay District when it expires. While the proposed changes clearly benefit the city in the long term, it is important to consider how they will impact current property owners.

The CC Overlay District defines two general areas: station areas and non-station areas. Station areas include all properties within one-quarter mile of the center point of proposed (*light rail transit*) station platforms. Non-station areas

include properties outside that quarter-mile radius. The distinction is important because permitted uses are defined relative to station areas. For example, the CC Overlay District prohibits auto-related uses in station areas but allows them in non-station areas. Specifically, auto convenience markets, auto repair stations, auto sales and rentals, auto service

stations, auto specialty stores, and car washes are prohibited within one-quarter mile (1,320 feet) of a light rail station platform. Oddly enough, park and ride facilities are not specifically prohibited in the CC Overlay District, but it appears most other auto-related uses are prohibited. In Traditional Neighborhood Zoning, which is expected to replace much of the existing commercial zoning in the Central Corridor, auto-related businesses will be considered conditional use properties.

Although auto-related uses will be permitted as conditional uses in non-station areas, changes to specific performance standards within the zoning code make this type of use unlikely and impractical. Additionally, under the new performance standards, many conforming-use properties will be rendered non-conforming and vice-versa. New guidelines, such as those for setbacks, density, and parking, will have a significant impact on current and future uses.

**Building setbacks**  
Most zoning codes define building setbacks in terms of a minimum distance from the front

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property line to the street (public right-of-way). Parking is often permitted in this area. In some urban areas, such as the B-2 to B-5 zoning classes in St. Paul, there are no setbacks. The CC Overlay District defines the front setback as a *maximum* of ten feet from the front property line. This is consistent with the goals of the district to intensify land use, enhance pedestrian connections, and increase livability in a given area. Unfortunately, any existing building which is more than ten feet from the front property line is now a non-conforming use. More importantly, new developments must conform to the maximum setback. It is quite likely that any new construction will impair visibility for current buildings and contribute to the economic decline of those businesses.

## Density

Density refers to the size of building permitted on a particular site. Expressed as a ratio of total building floor area to land size, the floor area ratio (FAR) is an expression of the maximum density permitted. Some zoning codes use a site coverage ratio as an alternative measure of maximum density. The CC Overlay District provides for a *minimum* FAR of one (1.0) times land area for station areas and a minimum of one-half (0.5) times land area for non-station areas.



*Overlay District defines the front setback as a maximum of ten feet from the front property line.*



Under proposed Traditional Neighborhood Zoning guidelines, the rates change to 0.3 FAR minimum and 2.0 FAR maximum. Existing structures, which do not meet new FAR requirements, are now considered non-conforming. Additionally, Traditional Neighborhood Zoning requires that new buildings in station areas be a minimum of two stories. While changing zoning performance standards is consistent with the goal of intensifying land usage, it adversely affects existing businesses. Customers in automobiles form the economic base for auto-related business and fast food restaurants. Most of these businesses cannot meet the new standards and will, therefore, become non-conforming properties.

## Parking

Regulations governing parking in the CC Overlay District, and included in the proposed Traditional Neighborhood Zoning, address two items; the number of spaces and the location of those spaces. The total number of spaces can be reduced to a minimum of 60% and a maximum of 85% of the underlying zoning district requirements except for residential uses. As of now, parking is not required for residential uses. However, the city may provide for a maximum of one surface parking space per residential unit. New



*The District provides for a minimum FAR of one (1.0) times land area for station areas*



off-street parking requirements, as outlined in the proposed Traditional Neighborhood Zoning, also provide for reductions in parking spaces. In all cases, the maximum number of parking spaces may be exceeded but those excess spaces must be contained within a structure, such as an underground ramp, or considered part of a

building. Clearly, the intent is to reduce the number of vehicles in the area.



*While changing zoning performance standards is consistent with the goal of intensifying land usage, it adversely affects existing businesses.*



Another important aspect of the new parking regulations is location of parking on a site. The CC Overlay District requires all parking be located at the rear of the site or in interior side yards. For those lots which front

University Avenue or have frontage on other streets within the defined station areas, parking placement is limited to 60 feet of street frontage: the equivalent of two rows of perpendicular parking and a single drive lane. This requirement also appears in proposed traditional Neighborhood Zoning guidelines.

The move to place buildings at the front of the property and move parking to the rear or side of the property is a significant change for this area. The combination of new setbacks, density requirements and parking regulations suggests that future developments along the CC



Corridor will require larger land areas as well as larger buildings. Recent recommendations that customers and owners use alleys as “secondary circulation routes” have further increased confusion and concern among local merchants and residents.

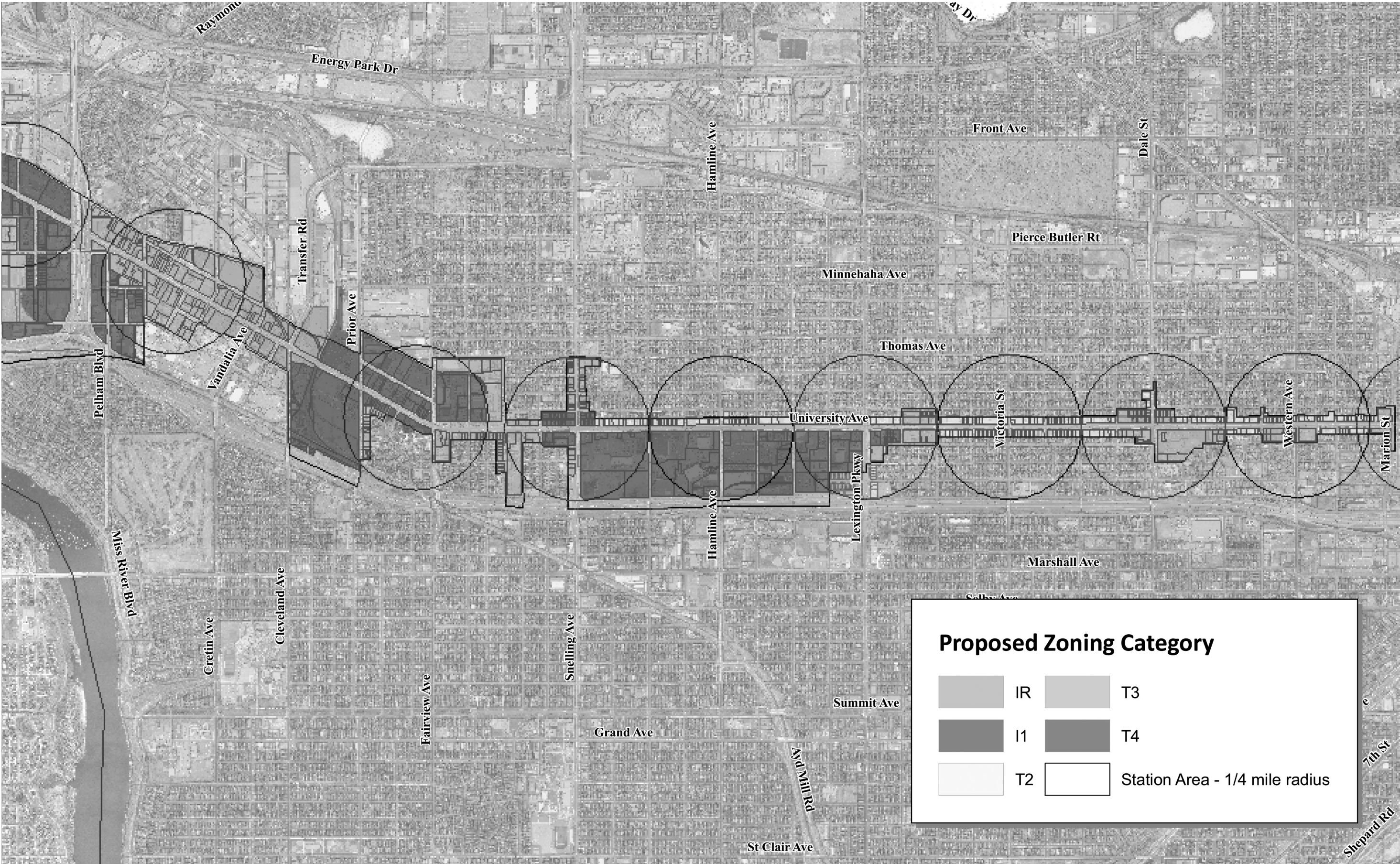
## Land Values

In the past year or two, the market began to anticipate the eventual construction of the central corridor light rail line. Several closed businesses and smaller buildings were demolished and there are a number of properties for sale. There is no question that the pending light rail project has influenced activity along the corridor. Some properties are being assembled into large devel-

### Valuation Viewpoint Volunteer Hours Report for 2010 Community Support Efforts

Shenehon Company encourages its employees to play active roles in their communities. Over half our staff members volunteer at local non-profits on a regular basis. In addition, everyone participates in some type of community or professional activity and the firm offers pro-bono services to a variety of outreach and educational organizations. We are pleased to announce that Shenehon employees provided service hours to churches, hospital outreach groups, professional groups, food shelves, social justice groups, schools, and social service mentoring groups during 2010. Additionally, our pro-bono service hours assisted educational institutions, park boards, professional standards groups, and legislative committee hearings. We are proud of our community outreach efforts.









opments, with various government and non-profit entities leading the way for housing and mixed use projects. Unfortunately, many small businesses will find their properties targeted for redevelopment, potentially with government support. In some cases, current land prices have exceeded the \$30 per square foot to \$40 per square foot price range typical in many parts of the corridor before the start of eminent domain takings. Many property owners and potential buyers are not aware that construction easements for the project will be in place until December 1, 2014. Consequently, purchasing a property or business at this time includes the risk of project

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*The CC Overlay District requires all parking be located at the rear of the site or in interior side yards.*

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delay or business interruption until the temporary easements expire or are released.

### Conclusion

St. Paul's CC Overlay District is a tool the government uses to encourage redevelopment in an area that needs new life. The Hiawatha Light Rail Line in Minneapolis is an example of how transit improvements can have a positive influence

on market activity. However, the Central Corridor Light Rail Line project involves large scale rezoning. While those zoning changes will have a positive result in the long term, it is important



to recognize how they affect current business owners and properties.

The cost of disruption and damage to small businesses and properties negatively impacted and/or destroyed to make room for larger pedestrian-oriented mixed-use developments is significant. The CC Overlay zoning is substantially anti-automobile and many of the CC Overlay requirements have been incorporated in proposed Traditional Neighborhood Zoning guidelines. Rather than accept and plan for park and ride facilities and other auto-related services, the density, setback and parking performance requirements discourage such uses. Businesses providing auto-related services are, in fact, pro-

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*The combination of new setbacks, density requirements and parking regulations suggests that future developments along the CC Corridor will require larger land areas*

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hibited in or near the corridor except in industrial locations. Established auto-related businesses are now generally non-conforming and, with multi-year constructions easements, many may not survive to the end of the project. Those that do survive must contend with new traffic patterns, reduced-access divided streets (one way each side) and closed cross streets. Furthermore, a property that becomes non-conforming under the city's new zoning code may no longer meet financ-

ing requirements or it may undergo a change in highest and best use. Either scenario may result in a loss to the owner.

With its new CC Overlay District, the city is actively encouraging higher density development. This, in turn, will change the overall character of the corridor. The anticipated outcome is a pedestrian-friendly area with a strong economic base. Unfortunately, this comes at the expense of existing property owners who may not realize the price they have paid until well after the light rail project ends. Long term construction easements across the front of many properties will negatively impact occupancy, rents and retail sales. While increased density and the creation of livable areas are laudable goals, the full impact of the project, under the existing CC Overlay District, must be recognized and property owners should be fully compensated for that impact. **VV**

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*Many property owners and potential buyers are not aware that construction easements for the project will be in place until December 1, 2014.*

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## CHARLES A. MILLER, CBA

**Shenehon Company is proud to announce that CHUCK MILLER was awarded the Certified Business Appraiser (CBA), Designation from the Institute of Business Appraisers in January of 2011.**

This premier designation is granted only to those IBA members who demonstrate the highest levels of professional competence and conduct. In addition to possessing a college degree, candidates must demonstrate active experience as a business appraiser, pass strict peer review and submit two formal, comprehensive business appraisal reports. These in-depth reports demonstrate the candidate's ability to perform original appraisal work of superior quality. Each candidate must complete over 90 hours of course work in appraisal theory and practice, as well as pass a proctored, comprehensive written exam.

The CBA designation grants its recipients prestige among fellow appraisers, the judicial system and the business appraisal community in general.

**CONGRATULATIONS, CHUCK!**



## MARKET TRANSACTION: BUSINESS VALUATION

### ABC Machine Shop

123 Main Street

Anytown, Midwest USA

The featured company is a machine shop specializing in the milling and turning of metal parts, primarily for the United States defense industry. We appraised the business as of year-end 2008 for a potential shareholder buyout, where the controlling shareholder wanted to buy out the large remaining shareholder. ABC Machine Shop is an established business with approximately 25 years in the industry. The subject's track record of high quality work has earned it a place on numerous approved supplier lists which enables it to effectively compete for new defense industry business. The revenues and adjusted EBITDA for ABC Machine Shop are listed in Figure 1.

In this case, the controlling shareholder wanted to buy out the large remaining shareholder and no discounts for lack of control or lack of marketability were contemplated. Figure 2 details our fair market value conclusion for December 2008 and the ultimate price per share of the minority interest when the sale was completed at the end of 2010. The price/revenue multiples and price/EBITDA multiples for the appraised value are based on the year end 2008 revenue and EBITDA, while the multiples for the sale value are based on the year end 2009 projected revenue and EBITDA, which was the data available at the time of the sale.

FIGURE 1 (IN THOUSANDS)

FISCAL YEAR END	DEC-2004	DEC-2005	DEC-2006	DEC-2007	DEC-2008	DEC-2009 PROJ
Total Revenue	\$1,388	\$1,724	\$1,657	\$2,594	\$2,922	\$2,981
Adjusted EBITDA	(\$20)	\$288	\$99	\$327	\$302	\$298
% EBITDA	-1.4%	16.7%	6.0%	12.6%	10.3%	10.0%

ABC Machine Shop has exhibited strong overall growth, although growth from year to year has varied. The adjusted EBITDA ranged from a low of -1.4% to a high of 16.7%, with an average over the most recent four year period of 11%. The subject business continues to exhibit solid performance despite the economic downturn, which is primarily due to a large, ongoing contract it has with the US government to supply a proprietary defense industry part. ABC Machine Shop benefits from its relatively low leverage position, with less than half the long-term debt of the industry norm. It also boasts high accounts receivable collectability as its government clients, however slow, have a solid payment history, while other machine shops have a significant percentage of accounts receivable from failing companies that will have to be written off. **VV**

FIGURE 2

FISCAL YEAR END	DEC-2008 APPRAISED VALUE	DEC-2010 SALE VALUE
Gross Business Value	\$1,340,000	\$1,486,531
Less: Estimated Long-Term Debt	(\$160,000)	(\$160,000)
Net Business Value	\$1,180,000	\$1,326,531
Per Share Value (Minority Int, No Discount)	\$11,800	\$13,265
<b>P/R &amp; P/E MULTIPLES BASED ON DATA AS OF:</b>		
	DEC-2008	DEC-2009 PROJ
Price/Revenue before debt	0.46	0.50
after debt	0.40	0.44
Price/EBITDA before debt	4.44	4.99
after debt	3.91	4.45



## MARKET TRANSACTION: REAL ESTATE



Property:	Former Church of Scientology Building
Buyer:	Target Corporation
Seller:	The Church of Scientology of Minnesota
Source:	Buyer and public records
Sale Date:	November 15, 2010
Sale Price:	\$3,000,000
Unit Price:	\$166.33 sf (building value); \$286.07 ac (land value)
Gross Building Area:	18,036 sf
Zoning:	B4-1
Utilities:	All available
Topography and Soil:	Level
Visibility and Access:	Good
Age:	1914
Land Size:	10,487 sf
Remarks:	A Target representative stated it has no immediate plans for this site. The current status of the subject real estate is long-term hold.



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## SCOPE OF SERVICES

**S**HENEHON COMPANY IS A REAL ESTATE AND BUSINESS VALUATION FIRM, serving both the private and public sectors throughout the United States. Our unique combination of real estate and business valuation expertise allows us to provide a wide range of services and to offer innovative solutions to difficult valuation issues. Obtaining accurate and reliable industry information and expertise should play a key role in any decision-making process, and Shenehon Company is dedicated to equipping its clients with the tools necessary to make informed and knowledgeable decisions regarding their capital investments.

### Areas of Expertise:

- Allocation of purchase price
- Asset depreciation studies
- Bankruptcy proceedings
- Charitable donations
- Commercial properties
- Condemnation
- Contamination impact studies
- ESOP/ESOT
- Estate planning
- Feasibility analyses
- General and limited partnership interests
- Gift tax evaluations
- Going public or private
- Highest and best use studies
- Industrial properties
- Insurance indemnification
- Intangible asset valuation
- Internal management decisions
- Investment counseling
- Land development cost studies
- Lease and rental analyses
- Lost profit analyses
- Marriage dissolution
- Mortgage financing
- Multi-family residential properties
- Municipal redevelopment studies
- Potential sales and purchases
- Railroad right-of-ways
- Special assessment appeals
- Special purpose real estate
- Tax abatement proceedings
- Tax increment financing
- Utility and communication easements

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