Adapting Old Theories for New Applications:
A New Approach to Church Valuation
By John T. Schmick

Religious facilities are typically classified as special purpose properties or limited market properties. Their unique design is intended to meet the needs of a specific group or purpose, they lack adaptability to other, more conventional uses, and their title is transferred infrequently which results in few comparable property sales. The most common reasons for churches to change ownership are that the congregation has outgrown the facility or has declined in membership/financial capability and can no longer support the facility. Since there is no recognized income approach for valuing church property, most appraisals of religious facilities incorporate only the traditional cost approach to value and the sales comparison approach to value. Given the limited market sales data and the declining reliability of estimating depreciation as the property age increases, the overall range of value estimated by professional appraisers on a specific church property tends to be broad, creating question concerning the reliability of the value estimate process. It is doubtful that any appraiser would take the position that limited church market data would produce the same level of value estimate reliability that is attainable in the appraisal of a standard office/warehouse with abundant industrial market data available. The question is, can the reliability of church value estimates be increased using new methods or techniques?

In general, the appraiser's role is to research, interpret, and report on the available evidence that supports a value estimate equivalent to the future benefits potential from a specific property. Despite numerous guidelines and standards, the appraisal process leaves room for professional differences of opinion that arise from the individual appraiser's research and interpretation of market data. One would expect that the more abundant the available data, the narrower the range of professional value opinions. It follows then that if additional data is available for the church valuation process, or new techniques and methods can be employed, the appraiser's opinion of value should be more reliable and the differences in these professional value opinions should be narrower. In this article, I propose a new approach to value for church property that can be used in conjunction with the traditional approaches to value in order to increase the reliability of the appraiser's estimate of property value.

Our research into valuation methodologies for church property grew out of an eminent domain case in which a highway expansion project resulted in the partial taking of approximately thirty percent of the land area for an established suburban church. The land taken extended from the property boundary to the edge of the existing parking lot and covered the entire parking lot setback distance requirement (previously established by municipal zoning codes). This resulted in a non-conformity with zoning code requirements. Furthermore, the city communicated their intention to enforce zoning code requirements, stating that the setback must be reestablished (brought back into conformity) at the time any repairs were made. This included seal coating and re-striping. Bringing the property back into compliance with these zoning codes would lead to a thirty percent loss in parking spaces. The appraisal problem revolved around what impact a loss of parking would have on a church property. For the purpose of this article, the reader should assume that no alternative parking is available to replace the lost parking spaces.

The simplistic approach to solving this appraisal problem typically has been to make adjustments to comparable sales and increase accrued depreciation in the cost approach to value. But with limited comparable sales data, on what basis would adjustments be made in these approaches for such a radical change to the property? The inability of these traditional approaches to reasonably and rationally measure the impact of significant changes in a given property suggested a void in the typical analysis and valuation of church property. Eventually, it was the owner's concerns for future operations of the property that suggested a need for a new approach to this problem.

How does church property function?

Church property operations are, in effect, a reflection of the religious group that occupies the property and the environment needed to attract visitors and membership to the property.

The relevant physical components relate to the seating capacity of the sanctuary and the related parking requirements. 'Sanctuary' is used herein as a generic term for the seating area for worshipers/members/ visitors during worship services. Most municipal zoning codes require a minimum parking relationship to the number of fixed seats in the main place of worship. Typically this ranges between one parking space for every three to four seats. In facilities that have no fixed seating, or a significant number of movable seats, the appraiser should focus on the maximum room capacity permitted by the local fire marshal. For example, a church property with seating capacity of 320 in the sanctuary could be expected to have a parking requirement, based on a three per one ratio, or 107 parking spaces. Where seating capacity is unknown, a local church architect can provide an estimate of seating capacity. Typically, one seat is defined as between 20 to 24 inches wide. Thus, an eight foot long pew would provide between four to five seats.

Adequate parking is just as necessary for a church property as it is for any other property type. If parking is too inconvenient or difficult to use, church leaders will acknowledge that people will leave the congregation with more accessible facilities. They will go to another church property and congregation of the same faith. In downtown areas where churches seldom own enough land to support their parking needs, church groups are more dependent on neighboring businesses and street parking to meet their parking needs. In these situations, it is not uncommon to find neighboring businesses charging a nominal fee for use of parking areas on Sunday mornings. Service times other than Sunday morning can prove very difficult, in terms of parking, for a downtown church.

Parking is important to a church property because it is often the first impression of the church that a visitor develops. Architects emphasize the need to have a friendly and inviting impression. Therefore, visitor parking is often placed near the front of the church's main entrance to increase convenience for a visitor. Furthermore, all parking should be easily identifiable and accessible to building entrances. This sends the message to visitors that there is room for them to attend services/functions with the religious group within that facility.

Economic Profiles

The economic profile of church property is often overlooked by appraisers because few people consider church property to be ‘income producing’. Aaron and Wright addressed this issue in “The Appraisal of Religious Facilities” when they state:

> “Lenders attempt to view loans to religious facilities from a cash-flow standpoint, which is difficult for appraisers for a variety of issues. The cash flow that lenders focus on is related to collections, and appraisers are generally focused on a rental rate or an income stream generated by the real estate. Dividing the two is generally impossible.”

However, it is important for the appraiser to understand that churches tend to be community based facilities and they do have an economic profile; both for the current occupant and as it relates to the local community. On the church level, this relates to membership and revenue while on the community level, this relates to median community income.

Church membership generally does not have a consistent definition across the different religious groups. One group may count only adult members of a family, another may count the family unit as one member while still others may count every member of a family as a church member. Therefore, the first task for the appraiser is to define the church membership in a manner that is comparable to other churches (ie. a common unit of measurement). Church leaders from the subject property will need to be interviewed to obtain their definition of membership as well as their estimates of conversion factors to the appraiser’s common unit of measurement. For example, if church membership is defined by the church as one family equals one member, then what does the church leadership estimate for number of adults and children in each family and what is an average family unit for the entire congregation. If this is a growing church with a higher proportion of younger families than older members, we can expect a higher conversion factor. On the other hand, if this is a stagnant church with a high proportion of older members, we would expect a lower conversion factor. The number of children enrolled in Sunday school programs can provide some insight into the age make-up of the congregation. Once a common unit of membership is defined, it can then be compared to that of other congregations involved in church property sales.

An issue often raised in discussions of membership growth is the ability of the clergy to attract new members. Do the abilities of a particular minister/priest attract more new members than an average minister/priest? What the appraiser needs to keep in mind is that churches are usually governed by some type of board such as a board of elders, church council, etc. Much like the board of directors of a corporation, they have the duty and responsibility to prudently manage the finances of the group and to hire and/or dismiss their employees, including clergy. The problem for the appraiser is how to identify and/or quantify the impact of a particular clergy on the operations and growth of a church. In the absence of any significant evidence of this situation, the appraiser is left with the assumption of prudent management, or in this case, prudent clergy leadership, just as in the appraisal of other types of property.

After membership data, the church budget/revenue is reviewed. On a macro level, the appraiser should examine the trend in revenues. If this church body is growing in membership, we should expect to find this growth reflected in a growing budget or revenue. Conversely, if the church body is declining in membership then there should be a corresponding decline in the budget or revenue. In one respect, the budget/revenue profile is a reflection of how well the facility is meeting both the individual member's need and the more general community needs. For example, if the community is growing with many new families moving to the area but church membership is stagnant or declining, this may be an indication that the church facility may not be consistent with community needs for building size, design, location, condition or features. These are all issues that can affect value. Within this macro budget/revenue review, large special capital funds campaigns should be excluded because they do not reflect the normal, or stabilized budget/revenue patterns for the church. A capital funds campaign can be viewed as a special short term savings account in anticipation of a major purchase such as a new addition or a new building. Smaller capital funds programs for maintenance or repair issues should be included in the revenue/budget analysis because they are similar to a reserve for short life components of the property.

On a micro level, church budgets/revenue should be reviewed on a per member basis which is again, a common unity of expression that can be compared with that of other congregations involved in church property sales. Differences in growth rates on a per member basis versus the total budget/revenue can provide indications of success or problems in meeting individual needs as well as market penetration the church has achieved when compared to the median income in the area. While there is a range of factors that can influence per member giving, our research of thirteen sales over four years and nine communities indicated a range of per member giving as a percentage of community medium income of between 0.45% to 3.96% with an average of 2.07%. An individual church's ability to achieve per member giving relative to community median income can be a reflections of the segment of the community the church attracts and/or its ability to capture market share or penetrate the market of potential members up to its capacity to service those new members.

<u>Revenue Capitalization Theory</u>

The appraisal process has been described and defined by many writers over the years. Earlier in this article I defined the appraiser's role as research, interpretation, and reporting on the available evidence that supports a value estimate equivalent to the future benefits potential from a specific property. A broader definition of appraisal is simply the study of relationships. In comparable sales we study the relationship of sale prices in terms of location, size, topography, access , economic rents, etc.. We then express this relationship as a value per some common unity of measurement. For income producing property, we study the relationship of some type of cash flow to an individual investor/buyer required rate of return and express the results mathematically in the form of a value estimate. It follows that if appraisers study relationships, then we must identify what relationships exist for church property.

Aaron and Wright's work on the valuation of church facilities discuss the dilemma for appraisers in that, as an industry, we are focused on net income or rent and do not know how to apply this concept to a non-income producing church property. There does not appear to be consistency in the reporting of financial statements of churches in terms of categories of expenses and priority of expenses. One church may be more focused on mission work and have large expenditures to support that function. Another church may have a strong emphasis on music and education but engage in little mission work. Affiliation with national organizations may require more or less contributions to the parent affiliate based on the religious group. Each may have a different clergy and staff structure and more or less volunteer support. The result is an inability to separate the cash flow attributed to the operation of the property only. Thus, a true income approach, as commonly understood by appraisers, has yet to be developed for church property.

In the course of our research, we theorized that there were economic characteristics in church property that were similar to other real property situations whereby we could draw on other techniques, methods or theories to develop an economic approach to the problem of church valuation. Two areas that seemed relevant were the profile of church property buyers/sellers and the gross revenue concept.

In the case of buyers of church property, we were cognizant of the similarity between an ordinary home buyer and congregations that buy church property. As mentioned above, lenders for churches approach the issue from the a similar cash-flow viewpoint as they do with home buyers. They look at the ability of the congregation to make payments on a loan and the size of their down payment. If their budgets do not have room for the loan payment, the congregation needs to re-prioritize it's spending to support the loan request. Similarly, a home buyer bases his/her purchase of property on the ability to provide a down payment and to make loan payments. Loans to home buyers are also evaluated on the basis of gross borrower's reported income (gross revenue or revenue from all sources). While not a strong indicator, this was the first hint that there was a relationship between gross revenue and sale price.

More importantly, the appraisal industry already recognizes the relationship between gross income/rent and sale price as it is applied to apartment buildings in the form of the Gross Rent/Income Multiplier (GRM or GIM). It is an easy step in apartment valuation to expand the GIM or GRM to include all revenue and measure the Gross Revenue Multiplier. This is nothing more than the mathematical expression of the relationship between sale price and gross revenue. It follows then that if this relationship already exists, it can be applied to other property types, like church property.

Our research into this revenue/price relationship started with the development of a database of sale property. In the Minneapolis/St. Paul metropolitan market we found approximately twenty-seven sales of church property over ten years, or an average of 2.7 sales per year. Within this database, we found that sale activity ranged from one to five church properties per year. Further analysis on location and size identified distinct patterns. In terms of size, 23 of the 27 sales were properties under 20,000 square feet in size and only one property was over 40,000 square feet in size. In terms of locations, ten sales were in suburban Hennepin County (largest and wealthiest geographic area), ten sales occurred in the core cities of Minneapolis and St. Paul, and there were one to two sales each in Anoka, Ramsey, Dakota and Washington Counties. From this database, were we able to confirm financial and membership data on thirteen buyers and sellers, presented below.

REVENUE CAPITALIZATION RATES							
Sale S/B	Property	Date	Members	Budget	Per Mem.	Sale Price	Revenue Cap Rate
S-1	Free Church	3-96	30	$40,000	$1,333	$800,000	5.00%
S-2	Lutheran	11-95	1650	$544,000	$330	$975,000	55.79%
S-3	Covenant	8-97	320	$365,000	$1,141	$612,500	59.59%
S-4	Temple	1-98	100	$100,000	$1,000	$155,900	64.14%
S-5	Lutheran	8-97	1550	$525,000	$339	$900,050	58.33%
B-6	Episcopal	11-95	450	$88,000	$196	$975,000	9.03%
B-7	Cathedral	5-93	300	$380,000	$1,267	$1,300,000	29.23%
B-8	Fellowship	3-94	160	$85,000	$531	$391,000	21.74%
B-9	Christian	1-90	275	$80,000	$291	$575,317	13.91%
B-10	Bible Chapel	10-90	65	$50,000	$769	$235,155	21.26%
B-11	Temple	8-97	100	$100,000	$1,000	$612,500	16.33%
B-12	Missionary	1-98	75	$50,000	$667	$155,900	32.07%
B-13	Alliance	8-97	140	$200,000	$1,429	$900,050	22.22%
						Average Seller Revenue Capitalization Rate: (S-2 to S-5)	59.47%
						Average Buyer Revenue Capitalization Rate: (B-7 to B-13)	22.39%

The hypothesis in the revenue/price relationship is that church property sellers should have a high revenue to price relationship while buyers should have a lower revenue to price relationship. Typically sellers have outgrown the facility and are at, or above, ninety percent seating capacity during peak service time. A buyer, on the other hand, is purchasing a facility to grow into over time and can be expected to be at or below forty percent seating capacity at peak service times. This relationship is express mathematically as gross revenue/budget divided by the property sale price, equaling a gross revenue capitalization rate.

The chart above indicates five sellers (S-1 thru S-5) and eight buyers (B-6 thru B-13). In some cases, the buyer and seller in the same transaction are represented. Within the seller data, transaction S-1 was a congregation that was disbanding and had few members remaining to support the church. In transaction S-2 thru S-5, the seller’s side of the relationship indicated a seller revenue capitalization rate ranging from 55.8% to 64.1%. Within the buyer data, transaction B-6 was a congregation that used the national organization to purchase the property because it was a newer congregation and did not have enough members to support the church. It planned to purchase the property from the national organization after it had grown in size. In transaction B-7 thru B-13, the buyer’s side of the relationship indicated a buyer revenue capitalization rate ranging from 13.9% to 32.1%, with an average of 22.39%

Clearly the range for both buyer and seller revenue capitalization rates is wider that appraisers normally expect to find. Capitalization rates for other, more common types of property are the results of thousand of transactions and national publications of data. In contrast, church sale data is limited and, until now, not followed by any analyst or publication to report on revenue capitalization rates. In addition, market participants for this type of property have not yet been educated to the potential for economic analysis to evaluate (in support of other approaches to value) the market value of church property. In many respects, religious groups that purchase existing church property are similar to the typical home buyer in that they do not know how to value a property. Unlike the home buyer, there are few comparable church properties on the market at a given time for comparison pricing. And those that are available for sale may not be geographically acceptable to a given buyer. Professional appraisers should be capable of comparing the suggested economic profiles related to comparable church property sales data and make a reasoned judgment to an appropriate revenue capitalization rate for their subject property.

Relationship to Other Approaches

As with any appraisal assignment, the revenue capitalization approach for church property is not intended to be the sole determinant of value. It should be use in conjunction with the cost approach and the sales comparison approach to value as a third approach or methodology for estimating market value. And as with all appraisal assignments, the three approaches to value are interrelated.

The relationship of the a church property's revenue/budget to the cost approach focuses on accrued depreciation. We can hypothesize that a larger budget/more revenue increases a property owner's ability to maintain his/her property while a smaller budget/less revenue makes maintenance more difficult. Many smaller churches receive some portion of their property maintenance from congregation volunteers. Therefore, we can anticipate less deferred maintenance, and perhaps more modernization, as the economic profile of the church increases. This, in turn, can reduce the deductions for both physical and functional obsolescence. Consequently, the revenue/budget capitalization approach should provide a measure of support for the cost approach to value.

The relationship of the a church property's revenue/budget to the sales comparison approach to value is one of confirmation of value within the broad range of market sale prices. Keeping in mind that the revenue capitalization rate for churches is the mathematical express of the gross revenue, or budget, to sale price relationship, the appraiser can use economic profiling to better understand how the church functions in the community and its potential for growth or further market penetration. An economic analysis of the church provides the appraiser with the basis for reasoned judgement to know where within the range of reported sale prices, or even outside the range of reported sale prices, the subject property's value estimate value is most likely to be found. The economic profile of the church can be used as a basis for adjustment or selecting comparable sales data. Consequently, the revenue/budget capitalization approach can be expected to provide a measure of support for the comparable sales approach.

Conclusions

At the beginning of this article, it was suggested that when more data is available to the appraiser, the valuation process and valuation conclusion will increase in reliability and tend to be more consistent across a group of professional appraisers. In this article, I proposes a new use of an existing methodology to explain the relationship of a church's economic profile to it expected market value. By understanding that a church body/congregation is similar to a combination of home buyer and apartment buyer, a Gross Revenue Multiplier can be converted to a revenue capitalization rate that mathematically expresses the relationship of a church's revenue/budget to expected value. This approach becomes another tool for the appraiser to use in the overall valuation process and should lead to a more reliable value estimate.

In terms of problem solving analysis, the revenue capitalization approach becomes a useful tool for quantifying changes in a church property. In this case, a church property was impacted by a loss of parking. This parking loss can be followed through occupancy level and the impact to the economic profile of the church, which can then be converted into a dollar estimate of impact.

The test of any new methodology or new technique is whether or not it can be repeated in other markets with similar results. I would encourage appraisers in other metropolitan markets to research church property sales to determine if similar results are evident in their data.

MEMORANDUM

DATE: November 11, 1999

TO: Bob S.

FROM: John Schmick

RE: Article for Publication

If this article is acceptable to you, I would like to submit it to the American Real Estate Society to be presented as a paper at their annual meeting, March 29 to April 1,2000 in Santa Barbara. If not accepted by ARES, then I will submit it to the Appraisal Journal.

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A NEW APPROACH TO CHURCH VALUATION

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