

## Assets Subcommittee of the Relocation committee

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We were asked to review how assets of the association were controlled. The Bylaws are the source document for this control and the pertinent passages are below.

From Section 4, Subheading A, Duties of Officers.

3. Treasurer: Under the direction of the Board of Trustees, he shall oversee the financial affairs of the Association and shall perform such other duties as may be delegated to him by the Chairman or the Board of Trustees.

From Section 4, Subheading A, Duties of Trustees.

1. The Board of Trustees shall have the power and authority to make, amend, repeal and enforce such rules and regulations not contrary to law or the Certificate of Incorporation or these By Laws as they may deem expedient concerning the conduct, management and activities of the Association, the fixing and collecting of dues and fees, regulations regarding registration, the expenditure of money, the auditing of books and records, the awarding of performance and progeny test awards and other details relating to the general purposes of the Association.

From Section 5, Subheading A, Committees.

8. Finance Committee. This committee shall consist of five members of the Board of Trustees of which no more than three can be currently sitting on the Executive Committee. This committee shall monitor the investment program of the association on a periodic basis, review the income and expense reports monthly, prepare and submit to the Board of Trustees for approval an annual operating budget, and review proposed capital expenditures for approval or recommendation to the Board.

Don Vaniman, former EVP of the ASA was suggested as a source about background on the Bozeman property owned by the ASA. Although several members have suggested that the land was a gift to the Association, Don recalled that the Association purchased the property from an investment group. Although he did not recall the exact terms, he believed that ASA paid about \$78,000 for each of the two parcels of approximately 10 acres each. The southern parcel was sold to the Ford dealership a few years ago.

To get an idea of the potential advantages and disadvantages of moving our headquarters to another location in the Bozeman area or to a different region of the country, I talked to Mike Basile, the owner of Prudential Realty in Bozeman, one of the largest commercial brokers in the area. Mike reports that leasing office space in the Bozeman area, including in outlying areas, would currently cost \$14-18 per square foot per year, with an additional \$3-4 per ft. for taxes, up keep etc in a "triple net" type lease, which is the most common. That would make total costs to lease run

from \$17-22 per foot per year.

Dr. Lipsey believes that about 9,000 square feet are currently needed for our office operation, plus space for long-term storage of documents, etc. Mr Basile reports there are currently two 10,000 foot buildings for lease in the area, which he believes could be rented for \$15-16 per foot, plus taxes, etc for a total cost of \$18-20 per foot, or for 9000 square feet, \$162,000-180,000 per year.

If our current property is worth 2.5 million dollars, with annual maintenance costs and taxes of \$25,000, then if we were to sell the property and use investment proceeds from the sale to finance a leased property, we would need to earn \$137,000-155,000 per year from that investment. That is an annual return on 2.5 million dollars of 5.5-6.25%.

If we look at buying or building a new building in the area, according to Basile, cost will run \$200-220 per square foot of office space, including land cost of \$65-85 per buildable foot. So a new 9000 foot building on just enough land to accomodate that building and associated parking, landscaping etc., would cost \$1.8-2 million, or about \$1.1-1.3 million for the building, with land costs extra. That scenario would give ASA approximately \$500,000 to invest for purposes other than office space, and we would have a modern, efficient building that should reduce maintenance and utility costs for some time.

If we were to buy or build a new building and property, another option would be to overbuild for our current needs, with the idea of leasing out excess space for income, as well as giving us an option to expand in future years if necessary. According to Basile, vacant office spaces of 1000-1200 square feet as well as those around 5000 feet are relatively easy to lease. If we were to build a 12,000 foot building, essentially using all of the proceeds from the sale of the existing property, we could initially lease out 3000 square feet. If we were to get \$15 per foot for 3000 feet, with an occupancy rate of 80%, that would provide investment income of \$36,000 per year, or a return of 7.2% on the added \$500,000 investment.

For comparison purposes, Nancy Ericson reports that our return on our investments since moving them to Edward Jones are:  
ASA - Agency Account Annualized return as of 8/19/08: 6.3% /  
January 2008: 8.52%  
ASA - Land Sale Account Annualized return as of 8/19/08: 8.13% /  
January 2008: 9.93%

For comparison purposes, I talked to some Kansas City area brokers. The most helpful was Patrick Meraz at the Harbinger Property Group in Leawood, Missouri. According to Patrick, the commercial office market in Kansas City is very soft right now. Class A office space is available in the area between downtown and the airport for \$15-16 per square foot per year, full service.

That includes taxes, janitorial, maintenance, utilities etc., so net cost of leasing in the KC area might be \$1-5 lower than in Bozeman. Johnson county Kansas would likely be somewhat higher. There are few if any existing properties available in outlying areas of the size we need.

Building costs for Class A office space would run from \$150-250 per square foot depending on amenities. Land costs in areas like the North KC area would run \$2.50-4 per foot, with suitable land in outlying areas closer to \$1 per ft. The higher priced land would already have sewer and utilities built to the property line, with connection costs extra. Some of the lower priced ground in outlying areas might require more utility work.

Because of the soft market in KC currently, the chances of overbuilding for our needs and leasing out extra space is probably not a smart move, at least in the short-term.

It does appear that office costs in the area, whether we leased or built, would probably be somewhat less than in Bozeman, possibly saving anywhere from \$9000 to \$56,000 per year. If we use a mid-range savings of \$30,000 per year, then we need to compare that to the costs of moving the headquarters. Dr. Lipsey estimated costs of moving or rehiring staff to be from roughly \$270,000 to \$540,000 for the first year. At a savings of \$30,000 per year, it would take from 9 to 18 years to pay off the moving costs.

We were also tasked with developing a forecast of future values on the Bozeman property. Frankly, if you ask 10 experts for the value of the property in 10 years, you will likely get 10 different answers with a wide range of values. I have appended an article below that is a good summary of real estate appreciation.

#### Appreciation - Real Estate Appreciation

What is appreciation? Why do property values go up? Appreciation is the increase in value of a property over time due to inflation, supply and demand, capital improvements and other factors. Most real estate investors purchase income property for cash flow and capital appreciation. When weighing the benefits of purchasing a home or renting, many people opt to buy because they can increase their net worth via appreciation. The real estate investor should therefore have a good understanding of the factors that cause real estate to appreciate in value. Understanding why real estate goes up in value can help you make more profitable investment decisions. Properties appreciate in value for many reasons. The seasoned real estate investor will look for a combination of factors that will result in high appreciation growth rates

Property values appreciate in value over time due to inflation. Inflation is caused by an increase in the amount of money in circulation. The value of money declines when the supply of money increases and the end result is increased retail prices. The cost of the land, construction materials, labor costs, building permits and fees, etc. go up over time making it more costly to replace an existing property. These factors alone do not guarantee that an income property will increase in value. Factors such as poor upkeep, the general decline of an area, economic obsolescence, reduced demand, increased crime levels, etc. can cause properties to decline in value even when replacement costs are increasing. In summary, personal residences and income property usually appreciate in value over time due to inflation because the cost to replace them has increased.

You can increase the value of real estate by making cost-effective improvements. Improvements such as siding, a new roof, a new addition, new carpeting, landscaping, paint, etc. can increase the value of both personal residences and income property. Some improvements, dollar for dollar, will result in a greater increase in value than others. You should plan carefully and make improvements that result in the highest level of appreciation for the dollars that you spend. Keep in mind that if you make too many costly improvements, you might not recover those costs when you sell. Small improvements can sometimes deliver the greatest bang for your bucks.

Supply and demand can cause the value of real estate to go up or down. Over supply can cause real estate values to fall and undersupply can cause prices to appreciate. Demand for real estate can vary greatly in different areas of the country and in different areas of a city. The demand for real estate is affected by the availability of jobs, the level of interest rates, availability of land, proximity to shopping, schools, parks, churches, etc., infrastructure improvements, population changes, desirability of an area, crime levels, property tax rates, zoning changes, etc.

- Over supply of a particular type of income property can result in high vacancy rates and reduced cash flows making it difficult for property owners to meet their financial obligations. The end result is lower prices. Ineffective property management and poor property upkeep can also result in high vacancy rates. Correcting managerial problems that improve operational efficiency and increase the bottom line can have a positive impact on the value of an income property. Be sure you understand your local real estate market place before you buy. You can correct a mismanagement problem, but you have little to no control when an oversupply problem exists.

- Is the job base in your community growing or is it declining? The availability of high paying jobs can greatly impact appreciation growth rates. If good job opportunities are available in an area, the demand for real estate will be high. People will move to the area to take advantage of job opportunities. The end result will be increasing real estate prices.

- The location of a property can affect how fast it appreciates in value. Water properties have been increasing in value at a fast pace. There is a finite amount of water property available in the United States and demand has been increasing. More and more people are reaching retirement age fueling the demand for recreational property.

- The proximity to recreation such as golf courses, cultural facilities, parks, universities and colleges can result in a higher rate of appreciation.

- Low property taxes can increase demand for real estate. Many areas of the country that have low property taxes are experiencing high population growth rates and high appreciation rates.

- Is the local economy expanding? Changes in the infrastructure of an area can have a large impact on the demand for property. Proximity to shopping centers, schools, hospitals, jobs, police and fire protection, public services, etc in most cases will increase the demand for real estate. An increase in infrastructure in a town or city usually translates into more jobs and greater demand for real estate. The smart investor will take advantage of infrastructure changes.

■ Is the population growing in your area? Population increases usually translate into higher real estate prices. The demand for real estate in general has been increasing over time due to population increases. The population of the United States has been increasing every year. The amount of land is not increasing and the number of people looking to buy is.

■ The level of new housing starts is a good indicator of the demand for single-family homes. If the level of new housing starts in a particular area of the country is high, home prices will likely be increasing. To understand the long-term picture, the investor should determine what is driving the demand and if will it continue. Note that the level and direction of interest rates have a big impact on new housing starts.

■ Economic conversion which results in a change of use for a property can have a positive or negative impact on the value of real estate. Several examples of changes in use would include the conversion of apartments to condominiums, the construction of a restaurant bar in place of a commercially zoned personal residence and the conversion of a personal residence to a bed and breakfast.

I have listed a few of the reasons why real estate appreciates in value. As a real estate investor, you should be looking for a combination of the above factors that will result in a high level of future appreciation. Be sure to take advantage of leverage to compound the affects of appreciation. Leverage is the use of borrowed money to increase real estate profits. You can compound your real estate gains by using leverage effectively. For example, you put \$40,000 down on a \$200,000 income property. It goes up 10% in value in one year. You have a gain of \$20,000 and a before tax profit of 50% on your initial investment amount of \$40,000.

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On another note, Jerry found some investment numbers from other breed associations for us to compare to.

Red Angus has about \$750,000 tied up in land and buildings, with \$2.5 million other investments, or 23% in real estate.

Charolais has one million in real estate and 3 million invested elsewhere, for 25% in real estate.

Limousin has 1.3 million in real estate, with only 750,000 invested, equating to 63% in real estate.

American Angus has a 4 million dollar property, with another 22.5 million dollars in investments for 15% in real estate.

The property values below are book values. Depending on the dates of acquisition and method of bookkeeping, the actual current values of the real estate may be quite different.

If we value our current property at \$2.5 million and we currently have about \$2.7 million in investments, that equates to 48% invested in real estate. That is more in pure dollars than any of the comparable associations except Angus, and more in percentage than anyone except Limousin.

Linda Kesler also checked with our auditors on tax consequences to the ASA for various scenarios. Linda's questions and the auditors response are below.

What tax consequences would ASA have if they sold their property?  
There will be a gain on the sale (a very large gain!) but it will not cause tax consequences since ASA is not in the business of buying and selling real estate. It will be reported on your tax return but no taxes will result. It does not matter if a new building is built immediately or if ASA leases something for awhile.

Situations that they may consider:

1. Rebuilding in the Bozeman area
2. Rebuilding in a different state
3. Leasing and not owning property for an extended period of time - Money would be invested funds.

What tax consequences would a non-profit organization have if we considered:

1. Demolishing the existing building and re-building on the current spot for ASA and Pub use only

The old building would be disposed of on your depreciation schedule and removed from the fixed asset accounts. There would be a loss on the disposal but the loss would just be taken off of the cost value of the new building. For example, if the current building has a cost of \$662,036 and accumulated depreciation of \$500,000, the loss would be

\$162,036. This loss would not be recorded on the books however. If the actual costs to construct the new building would be \$1,000,000, then the building would be placed in ASA's fixed assets at \$837,964 (\$1,000,000 less the loss of \$162,036). The new building would be depreciated using \$837,964 as the cost. This is considered an exchange of like-kind assets so a gain or loss would not be recognized. Again, no tax consequences because ASA is not normally in the business of buying, demolishing and rebuilding buildings.

2. Building a larger building or several buildings and leasing out office space

The new buildings would be added to your depreciation schedule at cost to construct and then depreciated. The only tax consequences would come if office space is rented out. This would be considered unrelated business income tax (like with the current rent collected from ASA Pub) and ASA would be taxed on the net profit from the rent.

3. Adding on to the existing building and leasing out office space.  
Same answer as number 2

Our current building is more than 30 years old, but in recent years a number of improvements have been made to maintain the utility of the building. These include:

Expected Improvements for the next 5 years:

1. Air Conditioning
2. Parking lot reseal/resurface

In conclusion, there are a number of good financial reasons to consider a headquarters relocation, either within the Bozeman area or to a different region of the country. These include:

1. Investment of proceeds from sale of property to increase investment income.
2. Leasing of office space provides more flexibility if the association expands or if downsizing of office space is possible due to increased use of technology for telecommuting.
3. Capture the huge increase in value of the current property
4. Save money on costs and management headaches associated with owning office property.
5. Rebalance our investment portfolio.

There are also disadvantages, including:

1. Cost of relocation, including training of new staff if move is made outside of Bozeman area.
2. Loss of possible further appreciation of property.
3. Loss of history.

Thank You.