

Guide Note 5

Appraisals of Real Estate with Related Personal Property, Business Property or Intangible Assets



Introduction

Real property sometimes has associated with it certain items of personal property, business property or intangible assets. This is the case when real property is an essential component of an operating business entity such as a fast food restaurant, convenience store, hotel or nursing home (among others). Real property appraisers may be requested to appraise non-realty assets in conjunction with the real

property. The valuation of personal property, business property, or intangible assets requires specific expertise. Before accepting an appraisal or appraisal review assignment involving such assets, an appraiser must first ascertain that he or she has the expertise to complete the assignment competently. The expertise of a personal property or business appraiser may be needed in some cases.

GUIDE NOTE 5

Basis for Proper Evaluation

In developing a real property appraisal, appraisers are required by S.R. 1-2(e) (iii) to identify “any personal property, trade fixtures, or intangible items that are not real property but are included in the appraisal.” S.R. 6-2(g) (ii) makes the same requirement regarding mass appraisals. Further, S.R. 1-4(g) requires that when the scope of work warrants such analysis, the appraiser must analyze the effect on value of any personal property, trade fixtures, or intangible items that are not real property but are included in the appraisal. The Comment to S.R. 1-4(g) states:

When the scope of work includes an appraisal of personal property, trade fixtures or intangible items, competency in personal property appraisal (see STANDARD 7) or business appraisal (see STANDARD 9) is required.

Personal Property

Fixtures that are not real estate include trade fixtures, domestic fixtures, and leasehold improvements.

Usually, trade fixtures for business and domestic fixtures, for residences, are installed by or for occupants who at conclusion of occupancy may forfeit them, sell them, remove them, or abandon them, depending upon 1) the lease or sale contract; 2) the contribution made when installed; 3) their investment value to the departing occupant; 4) custom; and 5) other considerations.

Examples include cash registers and refrigerators in convenience stores, and window treatments in residences.

Leasehold improvements (or tenant improvements) are items put in place specifically for use by a tenant. They differ physically from trade/domestic fixtures in that they are constructed on site rather than merely installed (or modified and installed).

Examples include the build-out of a reception area or an office space with partitions, cabinets and countertops.

A securely affixed item may revert to realty at occupancy-termination, if its relocation requires prohibitively expensive damage to itself (e.g., partitioning) or to the building in which it is located (e.g., a wall safe or cooler/freezer box). The value contribution at that time may be negative or positive, depending upon the nature of the item and demand for it at its location.

Appraisals of single-family dwellings, factories, amusement facilities, farms, and ecclesiastical properties, and many office and retail buildings generally include some personal property. But in some assignments, the appraiser may be asked to exclude such items. In all cases, the appraisal report must be clear about which items are included – and which items are excluded – from the value opinion.

If the value opinion is to include personal property that is either superior or inferior to that typically found in competing properties, allowance for the difference, on a contributory basis, should be considered in each of the valuation approaches (cost, income or sales comparison) applied in the valuation process.

If the value opinion is to omit personal property that is integral to operating the real estate for its highest and best use, then comparable sale adjustments, cost summations, and income stream analyses should reflect that fact.



Business Property/Intangible Assets Relating to Going Concerns

A going concern is an established and operating business with an indefinite future life. For certain types of properties (e.g., hotels and motels, restaurants, bowling alleys, manufacturing enterprises, athletic clubs, landfills), the physical real estate assets are integral parts of an ongoing business. The value of such a property (including all the tangible and intangible assets of the going concern, as if sold in aggregate) is commonly referred to by layman as “going concern value”, “business value” or “business enterprise value.” However, these terms are often misapplied. The more accurate terminology is “value of the going concern” including real property, personal property, and the intangible assets of the business.

Appraisers may be called upon to develop an opinion of the investment value, use value, or some other type of value of a going concern, but most appraisals of going concerns require a “market value of the going concern”. Due to the nature of the different types of value included, the appraiser should be careful that he or she has the competency to complete this type of valuation assignment. It may be necessary for the real property appraiser to collaborate with a personal property appraiser or a business appraiser or both on such an assignment.

The value of a going concern includes the incremental value associated with the business operation, which is distinct from the value of the real property. The value of the going concern includes an intangible enhancement of the value of the operating business enterprise, which is produced by the assemblage of the land, buildings, labor (including trained workforce), equipment, and the marketing operation. This assemblage creates an economically viable business that is expected to continue. The value of the going concern refers to the total value of the entirety, including real property, personal property and intangible assets.

A division of realty and non-realty components of value may be required given the intended use of the appraisal. For example, assignments for ad valorem taxation, eminent domain, and real estate lending usually require the appraisal to isolate the values of the separate components. In such cases, the appraiser must ascertain whether the assignment calls for a mere allocation of the value of the entirety among the various components, or whether value opinions are to be developed separately for each component. If value opinions are being developed separately for each component, careful consideration must be given to the type and definition of value being used in each case. The type and definition of value needs to be appropriate for the intended use, but it also needs to be appropriate for the asset type. For example, the intangible assets would not have a “market value” separate from the entirety if they could not be marketed separately. Further, the values of the various assets upon liquidation of the business could be quite different from the values of those assets as part of the on-going business operation. These issues must be considered carefully when identifying the problem to be solved by the assignment.

Summary of Standard Practices

- 1.** Develop an appraisal of real estate and related personal property only after ascertaining adequate knowledge and experience to complete the assignment competently (Competency Rule).
- 2.** Identify any personal property, trade fixtures, or intangible items that are not real property but are included in the appraisal (S.R. 1-2(e) (iii)). Analyze the effect on value of any personal property, trade fixtures, or intangible items that are not real property but are included in the appraisal, when the scope of work for the assignment warrants such analysis (S.R. 1-4(g)).

(Please Note: The purpose of the Guide Notes to the Standards of Professional Appraisal Practice is to provide Members with guidance as to how the requirements of the Standards may apply in specific situations.)