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Intangibles in Real Estate Tax Appraisals: They Shouldn't be!

Presented by James D. Vernor, Vice Chair
DeKalb County Board of Tax Assessors

At CAVEAT 2017

I. Definitions

Tangible property. Property that can be perceived with the senses; includes land, fixed improvements, furnishings, equipment and physical supplies, inventory, and merchandise. Some accounting sources indicate that tangible property includes all property not properly classified as identifiable intangible assets or goodwill.

On that basis, tangible property includes real estate, personal property, and working capital assets such as cash, cash equivalents, accounts receivable, supplies, and inventory, although cash and accounts receivable are not themselves tangible per se. (Per USPAP 2016-17)

Intangible property (Intangible assets)

"Nonphysical assets, including but not limited to franchises, trademarks, patents, copyrights, goodwill, equities, securities, and contracts as distinguished from physical assets such as facilities and equipment." (USPAP, Definitions section).

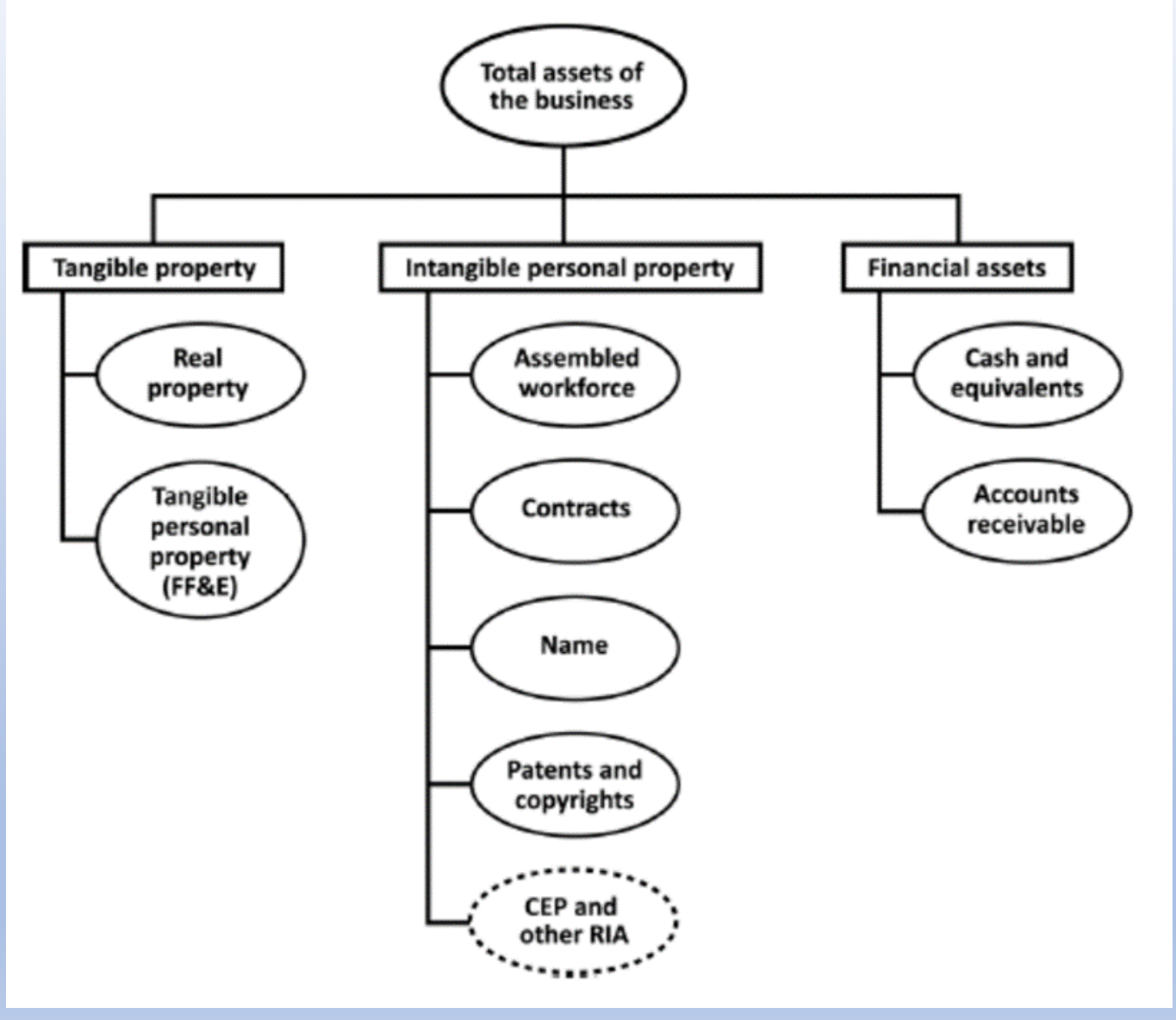
Sometimes tax credits.

Per 560-11-10 (GA) DOR Appraisal Procedures Manual: "…real property…shall not include the value of any intangible assets used by a business, wherever located, including patents, trademarks, trade names, customer agreements, and merchandising agreements." https://dor.georgia.gov/appraisal-procedure-manual

Going concern. An established and operating business having an indefinite future life. *(USPAP)*

Going concern. All tangible and intangible assets of an established and operating business with an indefinite life. (AI)

Going-concern value. An outdated label for the market value of all the tangible and intangible assets of an established and operating business with an indefinite life, as if sold in aggregate; more accurately termed the market value of the going concern or **market value of the total assets of the business.**


Total assets of the business
Tangible property
Intangible personal property
Financial assets
Real property
Tangible personal property (FF&E)
Assembled workforce
Contracts
Name
Patents and copyrights
CEP and other RIA
Cash and equivalents
Accounts receivable

II. Situations where the distinctions matter:

A. Property tax – according to state laws

B. USPAP Standards Rule 1-4(g) (2016-17: When personal property, trade fixtures, or intangibles items are included in the appraisal, the appraiser must analyze the effect on value of such non-real-property items.

Comment: 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. See also Standard 6 Rule 6-2g.

C. Deed transfer taxes (L.A. vs Edison)

D. Eminent Domain

E. Partitioning a Tenancy in Common with Undivided interests (see “Interesting Holes in the Ground”)

F. Successful entrepreneurship producing value in excess of all other input factor costs; generally resulting from sale of goods and services

G. Establishing basis for capital gains taxation
H. Favorable contracts
I. A trained and assembled workforce

III. What types of property are thought to have them?

A. Hotels

B. Continuing Care Retirement Communities; compare to apartment properties and calculate ratios of employees to units; could be 10 per 300 apartment units or 100 per 300 CCRC units.

C. Named chef restaurants
D. Golf courses
E. Power generating plants
F. Shopping Centers
G. Healthcare facilities;
H. Recreational facilities such as theme parks, theatres, sports venues

I. Billboards
J. Car washes
K. Management abilities in excess of normal (as envisioned in “Market Value”)

L. Goodwill
M. Historically significant properties?
N. Convenience store

IV. What are some counter-arguments?

A. Intangibles, to be ‘assets’ must be separable from the other assets and salable alone.

(But the Financial Accounting Standards Board, FASB, now recognizes them)

B. FASB doesn’t typically provide for a separate and valuable workforce (but it is recognized in goodwill)

C. Some assets charges are deducted in the operating expenses and need no further treatment. (they may have value to the user in excess of their cost to him)
The accounting books do not support the calculations for intangible value (this can be true; good financial records are key.)

D. Some business assets are “inextricably linked“ to the real estate and cannot be analytically separated”. (But apartments have furniture, golf courses have carts.)

V. Legal insights:

In one court case the appropriate base for imposition of a real property transfer tax in a bulk sale of power generating plants was to exclude intangibles such as a work force in-place, open purchase orders and existing obligations, contracts, a multi-plant premium, a rapid market entry premium, favorable financing, and emissions credits (i.e. pollution rights). (County of Los Angeles, et al. v. Edison International et al.; Superior Court of the State of California, No BC238277, 2002)

A recent task force of the IAAO has generated a paper on this topic: *Understanding Intangible Assets and Real Estate: A Guide for Real Property Valuation Professionals*; by IAAO Special Committee on Intangibles

A Business Enterprise Value Anthology, second edition; The Appraisal Institute; ISBN 978-1-935328-20-9; (2011) Softcover, 328 pages; David C. Lennhoff, MAI, SRA, Editor; A marvelous source for cases, articles and opinions. Also see the 1st edition in the Anthology series.

Interview with appraiser and memoir-author Hank Wise and his unpublished collection with LJS Grease and Tallow [Carroll County Water Authority v**. L.J.S. Grease & Tallow, Inc**., 274 Ga. App. 353; decided July 12, 2005]

and a senior CCRC [**Parkside at Stone Mountain, LLC FKA Stone Mountain CCRC LLC**, Plaintiff vs. DeKalb County Tax Assessors, Defendant; Civil Action File Number 05cv9893-1, decided 11/24/2008.]

Wise, Henry J. **"*Appraising interesting holes in the ground*"**, Appraisal Journal, March, 2009.

VI. Methods for appraising such assets

A. Individual assets may lend themselves to one or more of the three traditional approaches: sale of a license or copyright; cost to train the workforce;

B. Relief from Royalties method (An income approach)

C. The 25% “rule” (based on a study of expected profits.)

D. The Rushmore management fee method

E. Sometimes the whole Going Concern must be valued and allocated.

1. The private transaction comparison method
2. The comparable companies approach (similar to our sales comparison approach)
3. The income approach (similar to our DCF approach)

Please see: “MAINSTREAM METHODS FOR VALUING A GOING CONCERN” below

F. Parsing the income method

1. See the CaveWorld example below

G. Consider identifying the next most feasible use of the property as real estate only and use as an analogue. Think ‘branch banks’ or CCRCs compared to apartments.

VII. Who is qualified to undertake these valuations?

A. The competency provisions of USPAP: bone up or affiliate

B. Refer to list of appraisal organizations, ASA, NACVA and AI specializations and resources at the last page

VIII What data sources are used and where to get them?

Please see MAINSTREAM METHODS FOR VALUING A GOING CONCERN below.

11.1 Table. Separating Real Property from the Total Assets of a Business

	Going Concern	Percent of Total	Real Estate x	Retail Activities y	Food & Beverages z
Gross revenue			59.2%	23.0%	17.9%
Admissions	$532,653	x	$532,653		
Retail	206,633	y		$206,633	
Food and beverages	160,714	z			$160,714
Total revenue	$900,000		$532,653	$206,633	$160,714
Cost of goods sold					
Retail operations	$82,653			$82,653	
Food and beverage	40,179				$40,179
Total costs of goods sold	$122,832		0	$82,653	$40,179
Gross profit	$777,168		$532,653	$123,980	$120,536
Less operating expenses					
Retail payroll	$47,840			$47,840	
Food and beverage payroll	65,780				$65,780
General payroll	110,032		$110,032		
Management and admin. payroll	110,032		65,121	25,262	19,649
Affiliation fee	27,000		15,980	6,199	4,281
Professional fees	5,000		5,000		
Building services	30,000		25,000		
Repairs and maintenance payroll	28,704		28,704		
Supplies	9,000		9,000		
Utilities	36,000		35,000		
Insurance	12,000		12,000		
Real estate taxes	0				
Reserves - structural	27,000				
Total operating expenses	$508,388		$338,837	$79,301	$90,250
Net operating income	$268,780		$193,816	$44,678	$30,286
Adjusted for imputed rent					
Retail as % of sales	10%		$20,663	($20,663)	
Food and beverage as % of sales	8%		$12,857		($12,857)
Reconstructed net income	$268,780		$227,337	$24,015	$17,429
Loaded capitalization rate			12.5%		
Indicated value			$1,818,695		
Effective tax rate			0.02		
Implied property taxes			$36,374		

Case Study 4, Exercise 1

Assessor's Property Tax Calculation	
Estimate of value	$2,150,000
Times effective tax rate	0.020
Property taxes	$ 43,000

1. *What interest has been appraised at $2,150,000?*

   The market value of the going concern or the market value of the TAB (total assets of the business).

2. *Why might an objection be raised here?*

   In most jurisdictions, the property tax is specified for application to real property only, not including non-tangible assets. This can often be true for other types of taxes (such as deed transfer taxes) and eminent domain appraisal.

Case Study 4, Exercise 2

1. Separate, or parse, the subject property's operating business income from the income to the total business assets.
   - Capitalize the residual real property income with a loaded capitalization rate to produce a revised value estimate for the real property only.
   - Allocate expenses according to the proportion of revenues from each source and also indirect overhead not otherwise allocated.
   - Assign imputed incomes for the use of real estate by the two business centers. Use the worksheet in the handbook.

11.2 Table Valuation and Taxes after Parsing Income—Worksheet

Page 177

	Going Concern	Percent of Total	Real Estate x	Retail Activities y	Food & Beverages z
Gross revenue			59.2%	23.0%	17.9%
Admissions	$532,653	x	*$532,653*		
Retail	206,633	y		*$206,633*	
Food and beverages	160,714	z			*$160,714*
Total revenue	$900,000		*$532,653*	*$206,633*	*$160,714*
Cost of goods sold					
Retail operations	$82,653			*$82,653*	
Food and beverage	40,179				*$40,179*
Total costs of goods sold	$122,832		*0*	*$82,653*	*$40,179*
Gross profit	$777,168		*$532,653*	*$123,980*	*$120,536*
Less operating expenses					
Retail payroll	$47,840			$47,840	
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Affiliation fee	27,000		*15,980*	*6,199*	*4,281*
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Reconstructed net income	$268,780		*$227,337*	*$24,015*	*$17,429*
Loaded capitalization rate			*12.5%*		
Indicated value			*$1,818,695*		
Effective tax rate			*0.02*		
Implied property taxes			*$36,374*		

Questions and Answers…

Thank you for attending.

MAINSTREAM METHODS FOR VALUING A GOING CONCERN				
Name	Real Estate approach	Major metrics	Data Source names	
Comparable companies approach	Sales comparison approach	Market multiples	Mergerstat (searchs filings of	
including the		GRMs, and Cap rates;	traded companies)	$439/yr
"Guideline publicly traded companies"		Sales of company stock are USED;		
"Private transaction comparison method"			BizComps	
		Price/Earnings (PE) ratios		
			Pratts Stats	$749/year
		value to earnings before interest, depreciation, taxes and amortization (V/EBITDA)		
		Discounts for lack of		
		Marketability or		
		controlling interest		
Income Approach	Discounted Cash Flow	The Capital Asset Pricing Model "CAPM"		
		uses a weighted average cost of capital (WACC)		
		similar to Band of Investment		
The Asset Approach	Cost approach	Useful for comparing approaches in test		
aka the adjusted bok value approach)		of reasonableness.		
		May be combined with an "excess earnings approach" to value intangibles.		
		business appraisers may use 'look back' incomes instead of prospective.		
		business appraisers may use 'mid-period discounting'		
In summary, business asset appraisers use different variations on common themes, with reliance on accounting, and different, expensive data.				

	Designated Appraiser Groups with Possible Interest in Business Enterprise Value Assets					
	Compiled by J D Vernor	5/2/2017				
	Names and contact information		Designations	HQ		
ASA	American Society of Appraisers	http://www.appraisers.org/FAAResults	AM	Reston, VA 20190		
	800-ASA-VALU	search "Find an Apprasier' by specialties:	ASA		GA membership unk.	
	Email at: ASAinfo@appraisers.org	A wide range of speciaizations!	CEIT			
			means Certified in Entity and Intangible Valuation			
ABA	"American Business Appraisers National Network"					
	http://www.businessval.com/	Specializing in business appraising; not a professional association.				
			NA	Unk. Call a member		
ISA	International Society of Appraisers			Mid South Chapter		
	https://www.isa-appraisers.org/find-an-appraiser/results/List?specialties=116			Selma Paul, ISA CAPP	770-888-8808	
	Chicago, Il. (312) 981-6778	Machinery and equipment; art, jewelry.		7625 Yacht Club Drive		
				Atlanta, GA 30041		
				appraiser@selmapaul.com		
NACVA	National Association of Certified Valuators and Analysts					
	http://www.nacva.com/	awards the Certified Valuation Analyst (CVA);	CVA			
	Intangibles; litigation.	Appears to be heavy emphasis on financial analysis; practice mgmnt;				
AI	Appraisal Institute	http://www.myappraisalinstitute.org/findappraiser	MAI,			
	mostly real estate	search "Find an Apprasier' by specialties,	RM, SRA	Chicago; chapters in Atlanta, Savannah		
	888-756-4624	including 'business valuation and consulting'	AI-GRS and AI-RRS			
	Over 90 members are shown in the Professional Program Development Registry for Valuation of the Components of a Business Enterprise.					