



PAUL R. HYDE
EA, MCBA, ASA, MAI

HYDE Valuations, Inc.

**We Value Both Real Estate and Businesses
Including Machinery & Equipment**

APPRAISERS:
PAUL R. HYDE
BRIAN D. HYDE
JOSEPH PHELON

November 2012

Risks & Rewards

We have all heard the term “Risk versus Reward” but, I often wonder if this concept is really understood. Everyone looks at the risk of an investment a little differently depending on individual circumstances. There appears to be quite a difference between how a multi-millionaire and a low income earner view the investment of \$1,000 in a specific stock. To the individual with large amount of funds to invest and regular substantial earnings, a \$1,000 investment in highly speculative stock with the possibility of a huge return versus the likelihood of a total loss may not be a big deal. However, to the person whose total savings it may represent, it would be viewed a huge risk.

Appraisers must attempt to view the ‘investment’ they are appraising “as if” it were contemplated by a “typical” investor. Generally, the standard of value used dictates the view of the hypothetical seller and buyer we consider as we prepare the appraisal.

Let’s consider the following possible scenarios illustrating risk vs. returns. What these scenarios indicate is that a “typical” investor would be equally comfortable with \$1,000 in one year as the amount shown as “Amount Now” in cash – based on the described risk:

Amount Now	Amount in One Year	Probability of Receipt/Type of Investment	Meaning
\$971	\$1,000	Certain – 3% interest rate	Rent Value for the money is three percent – cover inflation
\$952	\$1,000	Money tied up in a bank certificate of deposit – Insured by the FDIC – 5% rate	Interest on CD of five percent – two percent over the rent value for the money
\$926	\$1,000	Money invested in AAA Corporate Bonds – 8% rate	A little higher return due to the little higher risk
\$893	\$1,000	Money invested in Good Quality Corporate Stocks – 12% rate	A higher return due to increased risk, but the investment is still liquid
\$870	\$1,000	Money invested in commercial real estate – 15% rate	A higher return is required due to less liquidity and higher risk
\$741	\$1,000	Money invested in a small business – 35% rate	The increased risk requires an increased reward
\$588	\$1,000	Money loaned to a “friend” to start a new business – no matter the stated rate; actual rate probably 70%	The chance of getting the money back – can be called “fat chance”

The risk rates illustrated in this table include the differences in liquidity of the funds as part of the risk. Also included in the risk is the possibility that the return will not be received at all as well as the risk that the principal may be lost as well.

Another factor that must be considered in the appraisal of specific business or real estate interests is the likelihood of future price appreciation and the likely holding period of the investment. Each of these criteria can and does affect the risk versus return.

The result of an appraisal of anything should be the point where the buyer and seller would just as soon take the investment described or the amount of cash shown as the value. They should be ambivalent as to which they would take.

Valuations play a part in all strategic transactions, tax, and many litigation matters. For additional information or advice on a current situation, please do not hesitate to call. **We value real estate, businesses, and personal property including livestock and machinery & equipment.**

Sincerely,



Paul R. Hyde, EA, MCBA, ASA, MAI
Enrolled to Practice Before the IRS (Enrolled Agent)
Master Certified Business Appraiser
Accredited Senior Appraiser – Business Valuation
Designated Member (MAI) - Appraisal Institute
(Real Estate Appraiser)
Senior Appraiser – American Society of Agricultural
Appraisers (Machinery & Equipment and Livestock Appraiser)



504 Grove Avenue • P. O. Box 9 • Parma, Idaho 83660 • (208) 722-7272
www.hydevaluations.com Email: prh@hydevaluations.com