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HYDE Valuations, Inc.

We Value Both Real Estate and Businesses
Including Machinery & Equipment

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Imperfect Data

An appraisal is, or at least it should be, an informed and supportable opinion of value. There are three basic concepts on which appraisals are based:

- 1) The principle of alternatives which states that in any contemplated transaction, each party has alternatives to consummating the deal.
- 2) The principle of substitution which states that a prudent buyer will pay no more for something than they would pay for an equally desirable substitute.
- 3) The principal of future benefits which states that value is based on anticipated future benefits.

If great data existed for each appraisal assignment, there would be no need for appraisers. For example, if the assignment were to appraise a 1,500 square foot house in a subdivision with 50 exact duplicate of each other homes with ten very recent sales each with a price of \$100,000, it would be relatively easy to determine the value of the 11th house. However, in practice, this seldom happens. Instead, appraisers have sales for three or four houses in the same town, one maybe a year ago, one that sold under pressure of an imminent foreclosure action, one that sold to a close relative, and one that may be a market sale but is 1,800 square feet and overlooks the river.

When valuing a business enterprise, the difficulties increase substantially. Each business enterprise is relatively unique although there are usually similarities to other businesses. There are a number of databases that contain sales information for businesses usually searchable by industry codes. It is impossible to know how similar or dissimilar the business in question is compared to sales data available. Since this is the case, appraisers typically compare the subject business to the industry by using industry financial data compiled by one of a number of sources and as part of the financial analysis determining whether the business is stronger, similar to, or weaker than the industry average. This analysis gives the appraiser an idea of how to adjust the market data when developing an indication of value for the business. This type of analysis also assists the appraiser to develop and income forecast or to evaluate management's income forecast and to assess the risk associated with receipt of the forecasted income stream; thus the business's indication of value from the income approach.

Many appraisal techniques and methods require considerable experience, education, and skill to be properly applied. The more imperfect the data, the greater need for a very experienced, skillful appraiser. Adjusting for differences between the subject of the appraisal and the comparable data is often based on limited data and is highly subjective.

Unless the subject of the appraisal is something quite easy to understand with lots of good data for sales comparables, the appraiser must use his or her experience and skill to develop a good, supportable, conclusion of value. I often laugh when I see someone make a determination of which appraiser to use for an assignment based solely upon the lowest price. Just because someone holds a license or appraisal designation does not mean he or she will develop a good, supportable opinion of value. Depending on the purpose and use of the appraisal, considerable care and investigation should be undertaken before selecting and retaining a specific appraiser. If all that is needed is a certain dollar amount for a loan, and

it is believed that the value is considerably higher than needed, then any appraiser will likely do. If, however, the appraisal is needed for litigation or potential litigation, for estate and gift tax purposes for example, then who performs the assignment may very well matter as the appraisal will almost certainly undergo intense scrutiny.

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 Agent – Enrolled to Practice Before the IRS
Master Certified Business Appraiser
Accredited Senior Appraiser – Business Valuations
Designated Member – Appraisal Institute (MAI)
Certified General Real Estate Appraiser
Senior Appraiser - Equipment & Livestock Appraisals

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