THIRD QUARTER 2008

THE INSTITUTE OF BUSINESS APPRAISERS

Business Appraisal Practice

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Editor's Column: Do Appraisers Report What the Market Actually Is Or What the Market Should Be?

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Appraisers, by their very nature, are opinionated people and they must be able to make decisions and support them. Appraisers that regularly do assignments for litigation are very opinionated people who must also be very confident and present their position well. These tendencies are very helpful to appraisers in doing their jobs; however, they can get in the way of doing what they should do in performing an appraisal. Appraisers **MUST** remember that it is their job to report the market for the subject of the appraisal, i.e. what a willing buyer would pay and a willing seller accept as of the effective date **NOT** to report what they personally believe the value should be!

There are many different standards of value that can be used in any given appraisal assignment, however, I have yet to see one that states the appraiser should state his or her opinion of what the value should be. All of these different standards of value relate to market participants. The most commonly used standards of value typically involve a hypothetical and knowledgeable willing buyer and seller each acting without any special motivations as of a specific date. In short, the appraiser's assignment is to "mirror the market".

With the help of computers and numerous software programs, appraisers can now apply many sophisticated methods and model innumerable scenarios as part of the appraisal process. It is not uncommon to see elaborate statistical models and other very complicated programs used to develop value conclusions for business entities or real estate properties. As programs and appraisal templates have become more complex and detailed, it seems to me that common sense is sometimes lost. Appraisers need to consider their value conclusions in the light of "does it really make sense?" I have an advantage that many appraisers do not share – I sold businesses and real estate as a broker for over twenty years. I have also owned and sold businesses, real estate, and developed real estate. Dealing with actual buyers and sellers instead of hypothetical individuals is a real awakening. Appraisers that have not had "real market" experience should consider talking to market participants, i.e. brokers, buyers, sellers, and/or developers to see if what they have concluded to as a value makes sense. Although I have real market experience, I practice what I preach – I verify my conclusions as it is so easy to impose your own beliefs while making what should be an objective analysis.

Real Estate Appraisal Example

I recently was asked to review a real estate appraisal of a subsidized housing apartment project. The appraisal assignment required the appraiser to determine numerous conclusions of value under a variety of scenarios. Of particular interest to my client was the Hypothetical Value "As Is" as if the property were rented to market tenants without benefit of the Government Subsidies versus the Hypothetical Value "As Renovated" as if the property were rented to market tenants without benefit of the Government Subsidies. Substantial renovations are required by the government entity; however, the property could be operated just fine "as is" if it were outside of

the subsidized housing program. The appraiser concluded a huge difference between these two values by crunching numbers without, in my opinion, considering real market evidence. Both of these scenarios were hypothetical as they did not exist and would likely never exist, thus complicating things. The underlying questions were "would a market tenant care whether or not the renovations being required by the Government entity providing the subsidy were made or not? Would the expenses of operating the property really be much different with or without the renovations outside of the subsidy program?" In my opinion, things really would not be much different in either scenario and thus the values should have been about the same. I checked with a few brokers in the area that were familiar with the apartment market and they concurred with me.

Business Appraisal Example

There are numerous business appraisal examples where what actual market participants would likely do is ignored. The best examples are those where minority interests in an operating business are being appraised. I often see appraisers calculate huge discounts for lack of control and lack of marketability for a minority interest without considering whether or not the willing seller would accept the concluded value. For example, let's consider a ten percent interest in an operating company that has been in existence for thirty years, is profitable, but does not distribute any cash to minority shareholders and is not likely to do so. The ten percent interest will only receive funds when the company is sold, which is not considered a likely option for many more years. If the company is valued at $1,000,000, clearly the ten percent interest is worth less than $100,000. However, how much less? Would a "typical willing buyer" pay $50,000 for the interest? How about $10,000? Would the "typical willing seller" accept $10,000? Probably not. What would the "typical willing seller" accept for the ten percent interest? The answer is dependent on many factors, all of which should be discussed in the appraisal assignment.

Summary

I suggest that all appraisers constantly remember that it is our job to report what the market actually is instead of what we may think the market should be.

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