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Useful Life Issues

Merry Christmas!



There are a number of important issues dealing with the useful life of an asset or investment. A “normal” useful life is the estimated period of time (usually in years) that an asset is expected to be used before it is “retired” from service.

For example, a good way to think about useful life is to examine life expectancies for various aged individuals using life insurance company prepared tables. According to one such table, the average life expectancy for a human male is 72 years and for a human female is 79 years. However, if you look at the remaining life expectancy for a 60 year old man, it is 18 years, six years beyond the average of 72 years. The remaining life expectancy for a 80 year old woman is nine years – ten years beyond the average of 79 years. The reason for these differences likely include such things as the tables were constructed including infant mortality rates, teenage drug, alcohol and traffic or crime related deaths. In similar fashion, many assets can have their useful lives extended, or shortened, depending on a number of factors.

A typical backhoe which could be used in the construction or farming industry, has an “average useful life” of twelve years. When appraising equipment, such as a backhoe, the amount of use, i.e. hours of operation, the maintenance schedule followed (or not followed), as well as the type of use – used in a gravel pit versus digging in softer dirt, and general care of the machine can drastically affect its remaining useful life – which impacts its value at any given time. Machinery & equipment appraisers are very interested in the condition, age, and amount of useage of assets when determining the value. Adjustments for differences to sales comparables found are made to arrive at the value conclusion.

A typical new residence has an expected useful life of about sixty years (depending on the type of construction and a few other factors). However, there are many examples in certain parts of this country or in Europe, of some very old residences that are still in use today and look great. Remodeling or maintaining a property in good repair can extend its useful life. Conversely, ignoring required maintenance or taking poor care of a property can shorten its useful life. Appraisers periodically are asked

to estimate the remaining useful life of an asset. They typically do so by gathering and analyzing statistical data from similar assets.

An economic life is the estimated time period that an asset may be profitably used for the purpose for which it was intended. Some intangible assets of great value may have a very short useful economic life. For example, in various high-tech industries, some medical fields, etc., technology is changing so rapidly that make a very profitable asset today worth nothing in a few years or even, in some cases, a few months. I remember a few years ago valuing a business in the medical industry that used a very expensive piece of equipment to generate substantial revenues and earnings. I was challenged on my value conclusion by a few of the owners because they thought my value conclusion was too low. When I asked them to provide assurances that my useful life estimate for the equipment was too short, given the rapid changes in the medical industry, they saw my point and agreed that my conclusion was reasonable.

The term for a patent is usually seventeen years for technical inventions or fourteen years for design patents. However, due to technological changes, many patents have a useful life considerably shorter than the term given them. Estimating a patent's remaining useful life is very important in the determination of its value. One of the best ways to value a patent is to use what is called the relief from royalty method. Essentially, this involves researching royalty rates paid for the use of a similar patent, developing a forecast of revenue associated with the patent, and then determining the present value of the royalty stream to value the patent.

Everything in life is expected to last only so long. Based on various factors this number may vary and it is the appraiser's job to utilize market data to make the appropriate adjustments in any given situation.

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.**



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