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Valuing Weird / Unusual Real Property

There are some serious problems and major disagreements between appraisers and users of appraisals associated with the appraisal of many special purpose properties (a property with a unique physical design, special construction materials, or a layout that particularly adapts its utility to the use for which it was built) and real property going concerns (a type of real property that derives its income stream from the operations of a business rather than from the collection of rent). The BIG problem that often occurs is associated with the determination of just what is the market value of the real property in these cases.

Kerry Jorgensen, MAI in his article “Market Value in Use is Not an Oxymoron” published May 15, 2018 in *Real Estate Issues*, Volume 42, Number 7 presented what I consider the best explanation of the problem I have seen and offered a brilliant solution. He and I have discussed his article and I believe that he is correct. It should be noted that a number of senior real estate appraisers within the Appraisal Institute, the largest organization of real estate appraisers in the U.S., disagree. As a business, machinery & equipment, and real estate appraiser, I regularly appraise real property going concerns and see very strong evidence that supports Kerry’s points of view.

In his article, Kerry presents an example that illustrates the problem. A recently constructed Porsche automobile dealership cost \$4,000,000 to be built including land, building, and appropriate developer profit. Included in the construction are many brand specific specialties resulting in another brand dealership being unwilling to pay more than \$3,200,000 for the property. The question is what is the “market value” of this property?

1. Would it be valued at \$4,000,000 or \$3,200,000 for a lender to make a permanent loan?
2. What is the value for property taxes -- \$4,000,000 cost or \$3,200,000 price it could be sold for?
3. If the business including the auto dealership and the real property were sold, what value should be allocated to the real property?

The solution to the problem is understanding and properly applying the concept of Value in Use vs. Value in Exchange. Value in Use is the value derived from the use of an asset while Value in Exchange being the value derived from the exchange of an asset, usually in return for cash. Value in Use is NOT the same as Investment Value, which is the value of a property to a specific investor based on that investor’s specific requirements. Instead, Value in Use is defined as “The value the real estate contributes to the enterprise of which it is a part.” Value in Exchange is defined at “The value of a property on a stand-alone basis, separate and apart from other assets or the enterprise of which it is a part.”

It should be noted that Value in Use often exceeds Value in Exchange.

Value in Use is really a valuation premise. Business appraisers typically use one of two premises of value: going concern premise and the liquidation premise. When valuing a business, the business appraiser must consider which premise will result in the highest value; i.e. is the business worth more dead than alive? Should it be valued as an ongoing business or liquidated and its assets sold and liabilities paid?

Machinery & equipment appraisers have two specific Fair Market Value Premises of Value often used: Fair Market Value in Continued Use and Fair Market Value – Removed. Fair Market Value in Continued Use is defined as “an opinion, expressed in terms of money, at which the property would change hands between a willing buyer and a willing seller, neither under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts, as of a specific date and **supported by the earnings of the business.**” Fair Market Value – Removed is based on considering the removal of the property to another location, as of a specific date. These definitions help explain the difference between Value in Use and Value in Exchange.

Back to the Porsche dealership example – as long as the business generates sufficient cash flow to support the use of the real property, the Value in Use of the real property is and should be \$4,000,000. The Value in Exchange of the real property is \$3,200,000 – the amount that it could be sold for separate from the other business assets.

What about its property tax value? The answer is clearly dependent on what standard of value is mandated for use. Assessor’s would love to be able to use the Value in Use – the cost of the property for assessment purposes. Appraisers working for the taxpayer in an appeal would emphasize the Value in Exchange concept and argue that no subsequent buyer would pay \$4,000,000 – they would only pay \$3,200,000.

A new standard of value concept is beginning to emerge – Market Value in Use. This is based on the concept that the highest and best use of a real property going concern or a special purpose property is likely the continued use as part of an overall enterprise, i.e. the most likely buyer of real property that contributes more value to the enterprise than on a stand-alone basis, is the buyer of the entire enterprise.

Kerry Jorgensen suggests the addition of the following two definitions for real estate appraisers:

Market Value in Use – market value under the value in use premise; assumes the property is sold in combination with other assets as a group.

Market Value in Exchange – market value under the value in exchange premise; assumes the property is sold separate and apart from any other asset.

A couple of key points that should be considered are: Market Value in Use cannot exceed replacement cost minus physical depreciation because the value contribution of the property cannot exceed what a buyer of the enterprise would expect to pay for a replacement. If the property is vacant or not used for the purpose for which it was originally designed, it is unlikely that the current market value in use exceeds market value in exchange.

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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