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Real Estate or Business or ???

I recently became involved in an appraisal assignment through back channels. A real estate appraiser acquaintance of mine regularly appraises marinas. These are definitely a special property type as things such as the fee simple ownership of the real estate, inclusive of uplands, fee-owned tidelands, and marina real property improvements are real property. Most of the time, the vast majority of the revenue for the marina comes from boat slip rentals, i.e. rental income. Properties with primarily rental income are clearly real property and a real estate appraisal license is required to appraise them --- obviously, experience with marinas is also a very good idea.

Most of the assignments my real estate appraiser acquaintance performs are for banks – this means that the total market value, i.e. the amount the assets that would normally transfer in a sale is the subject of the valuation.

In this case, the assignment taken on by this real estate appraiser is a marina as of the date of death of a 50% owner for Estate Tax Purposes. An additional complication, is the fact that this particular marina also is a boat/yacht dealer with full repair facilities and annual boat sales in the millions of dollars. There clearly is a real property component; the marina with its 100 plus boat slips, docks, and other buildings are real property. However, there is also clearly a business component – one that cannot be appraised as a simple real property going concern. The real estate appraiser called me and asked for help.

First, I pointed out to him that the assignment called for the fair market value of 50% of the issued and outstanding common stock of the corporate entity that owned the enterprise, not the market value of the real property as a going concern (a 100% value of the assets that would normally transfer in a sale as typically requested by a bank).

Second, I pointed out that the real property and the business entity have very different risk factors and they are both valued very differently. Real property is typically valued using net operating income before income taxes and without regard for any non-cash expenses such as depreciation or amortization and “as if” debt free; i.e. without any debt. All of the capitalization rates, etc. that are derived from the market are based on this type of income stream. All of the sales comparable data for improved properties are also based on only the real property selling—not a boat dealership with its associated assets and liabilities. Valuing an operating business requires developing a different income stream; typically net cash flow to equity which is an after-tax, after adding back non-cash expenses, deducting required capital expenditures, adjusting for changes in working capital and changes to long-term debt. Since these two components of the entity must be valued differently, typically the real property is valued using the value of the land and the value of the real property improvements (typically using a cost approach and a sales comparison approach), then the market value of a real property lease is determined. The market value lease is including in the business income statement as an expense, and the business entity is valued. The combined value of the real property and the business entity equity with the real property leased less any long-term debt associated with the real property yields the value of the stock.

Third, I pointed out that valuing the fair market value of a 50% interest in the stock of a corporation requires discounts for lack of control and lack of marketability. Further, when valuing a 50% interest, since a 50% interest has both aspects of control and non-control, special consideration must be made while developing the magnitude of the discounts.

My real estate appraiser acquaintance realized that he was not competent to complete this assignment. He has valued the real property and retained me to value the business enterprise. Together, we are competent to complete the assignment and the resulting conclusions meet the client's needs.

This incident brought to mind again the importance of making sure that the assignment is clear and that the appraiser has the knowledge, experience, and licenses required to complete the job before engaging him or her. Occasionally, a unique circumstance arises in which no one can be found with the needed credentials or experience – in those circumstances, it is incumbent on the appraiser to do whatever is necessary to produce a credible report.

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,



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Enrolled to Practice Before the IRS (Enrolled Agent)
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