Identifying Intangibles

The Appraisal Institute Resolves Some Debates About Nonphysical Assets

By Michael Shalley

After decades of debate in the marketplace and legal battles over the role of intangibles in commercial property valuation, the Appraisal Institute has published a detailed treatise intended to clarify many of the issues in question. For the first time, the organization has devoted an entire chapter to these nonphysical assets in the latest edition of its industry guide, *The Appraisal of Real Estate*.

There were plenty of reasons for the Appraisal Institute to weigh in on the subject. Intangibles are a familiar concept for anyone involved in property taxation, eminent domain or financial reporting, but have been a longstanding source of disagreement among appraisers, taxpayers and tax assessors. Arguments frequently arise over the allocation of intangibles—or how to determine the portion of value that intangibles contribute to the total assets of a business. In earlier years, some appraisers and market participants even questioned the very existence of intangibles within real estate.

In many states today, intangible assets are exempt from taxation under specific exclusions for property tax valuation. Therefore, intangible assets—and more important, the appropriate methods for allocation—have become critical to the appraisal assignment and to the final tax liability.

Over the years, The Appraisal Institute has offered specific seminars, courses and some collections of articles on intangibles, but nothing as specifically on point as Chapter 35 in *The Appraisal of Real Estate*, 14th Edition, published in late 2013. This chapter, titled "Valuation of Real Property with Related Personal Property or Intangible Property," defines intangible property as nonphysical assets including but not limited to contracts, franchises, trademarks and copyrights, as well as goodwill items such as a valuable trade name and a trained workforce.

For some property types, the real property usually trades as part of an ongoing operation that includes all of the assets of that business. Examples include healthcare facilities, assisted living and skilled nursing centers, hotels, convenience stores and car washes. In sales of those assets, the total sale price represents the overall value to all the assets of the business, which makes parsing the value among the tangible and intangible components a challenge for appraisers and assessors. The new chapter attempts to clarify when appraisers should be on the lookout for intangibles, stating, "As the proportion of income attributable to non-real estate sources increases, the potential for the property to include intangible assets also rises."

Additionally, the publication cites some existing requirements under Standards Rule 1-4(g) of the Uniform Standards of Professional Appraisal Practice, which states: "When personal property, trade fixtures or intangible items are included in the appraisal, the appraiser must analyze the effect on value of such non-real property items." The chapter goes on to define the three general classes of property as real property, personal property and intangible property, further breaking down each general classification into individual components for each.

It appears the Appraisal Institute is finally comfortable with confirming the existence of intangibles within certain property types, and with describing how to define them and when to look for them. Unfortunately, that is about where the clarity ends.

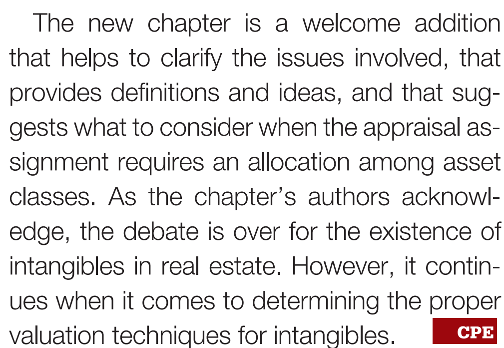
The chapter continues with an explanation of two different premises for valuation used by

business appraisers. Under the going concern premise, the ongoing business is assumed to continue operations indefinitely, and the liquidation premise assumes the business is closed and the assets are sold. The premise that produces the highest-value conclusion is used to develop a final-value opinion. Assuming the going concern premise is used, however, that is just the starting point to develop a total value for all assets. The chapter fails to provide guidance for properly breaking out the value components of each asset.

One logically would expect the next section of the chapter to contain a how-to discussion for developing a supportable allocation value for the intangible components of the total assets. The chapter does offer some suggestions under the three general valuation approaches: income, cost and sales. Regrettably, each approach is delivered with cautious statements and vague examples, with a point-versus-counterpoint followup for each method.

It is understandable that the Appraisal Institute is reluctant to state an absolute preference for one method over another when dealing with intangibles. But with this intensely debated issue, a more in-depth discussion with practical recommendations to make credible conclusions would be more useful.

The new chapter is a welcome addition that helps to clarify the issues involved, that provides definitions and ideas, and that suggests what to consider when the appraisal assignment requires an allocation among asset classes. As the chapter's authors acknowledge, the debate is over for the existence of intangibles in real estate. However, it continues when it comes to determining the proper valuation techniques for intangibles. CPE



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