P H C R E N E W S L E T T E R

POPP | HUTCHESON PLLC

The Property Tax Firm

CRE Quarterly

A Quarterly Newsletter Q2 - 2014

Letter from the Editor

Dear Readers,

In this issue of the Popp Hutcheson CREQ we explore the Appraisal Institute's latest edition of *The Appraisal of Real Estate, 14th Edition* and focus on the addition of an intangibles section to their industry guide. Mike Shalley gives us a book report of the pros and cons of the new chapter in our *Expert Opinion*.

Following our *Expert Opinion* section we announce our speakers for upcoming conferences this season and the Popp Hutcheson recipient of a Special Award from IPT.

We hope you enjoy Popp Hutcheson's CRE Quarterly and as always thank you for reading.

- PH Editor

Identifying Intangibles

EXPERT OPINION

by Michael Shalley

Reprinted with permission from April 2014 CPExecutive.com

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

Continued on page 2

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 follow-up 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.

For more information on this article please contact Mike Shalley, mike.shalley@property-tax.com

Popp Hutcheson Events and Announcements

IPT 2014 Annual Conference Special Award Recognition

We are pleased to announce that Popp Hutcheson's Mark Hutcheson will be recognized by the Institute for Professionals in Taxation for his leadership within the organization on the CMI Professional Designation Property Tax Committee. Mark has actively participated on the CMI Professional Designation Property Tax Committee since 2009 and assumed the chair position in 2012. Mark will be awarded with the *Special Award* at the upcoming IPT Annual Conference in Phoenix, AZ on July 1, 2014. The award will be presented to Mark in recognition of his integral role in furthering the Institute's goals and educational objectives and for his continuation and enhancement of the the Property Tax Professional Designation Program.

A&M Real Estate Center's 28th Annual Legal Seminar on Ad Valorem Taxation

Jim Popp and David Hugin present at the upcoming A&M Legal Seminar on Ad Valorem Taxation, August 27th - August 29th, in San Antonio, TX. Darlene Sullivan and Mark Hutcheson will present as Moderators at the seminar. David Hugin will sit on the Annual Case Law Update Panel, for the seventh consecutive year and Jim Popp will present on the Equal and Uniform Panel this year.