

# Business Valuations vs. Real Property Appraisals:

## *Business Valuation Safari - It's a Jungle Out There*

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# Who is Shawn Hyde?

started appraising businesses at the tender age of 21

have been in the Business Valuation (BV) industry for over 20 years now

have worked for several different valuation firms, and now have my own BV company

am also the Executive Director of one of the four US organizations that trains and certifies business appraisers

enjoy talking about BV related topics!

recently had a book published on building business valuation templates in Excel



# What Am I Talking About Today?

- You are all real estate appraisers
- I am mainly a business appraiser
- As real estate appraisers, you are well positioned to appraise businesses that have real property as an operating asset.

# More About What I Am Talking About

- Wait a minute, Shawn, what kind of businesses are you talking about?
- Great question, glad you asked!
- I have some examples, but first let's give some background

# Business Valuation vs. Real Property Appraisals

- There are some significant differences between the two appraisal disciplines
- There are also some significant similarities, but first, some of the differences

# Let's Look at Real Property Assignments

- These are assets that you can physically measure, see and touch
- Rarely will you appraise anything other than a 100% interest
- Uses a less detailed financial analysis than BV
- Focus on a pretax income stream
- Generally, have similar market data for use
- Have good support for the selected capitalization rate

# Let's Look at Business Valuation Assignments

- These include assets that you cannot physically measure, see and touch
- Often appraise less than a 100% interest
  - (Undivided interests in real property are also a thing)
- Detailed analysis of financial statements and tax returns
- Focus on an after-tax income stream (net cash flow)
- Struggle to find similar market data for use
- The selected capitalization/discount rate is subjective

# Standard and Premise of Value

- Business Appraisers
  - Most Commonly Use “Fair Market Value”
  - Occasionally Use “Fair Value” or Some Other Defined “Value”
  - Premise of Value is Generally “Going Concern” – Can be Liquidation
- Real Estate Appraisers
  - Most Commonly Use “Market Value”
  - Occasionally Use “Value in Use” or “Value of a Going Concern.” However, Most RP Appraisers are NOT familiar with how to do these types of assignments
  - Premise of Value can be “As Is”, “As Completed”, “At Stabilization”, “As Gone Dark”, or “Value in Use”



# What Similarities Do We Have?

- We both use the same approaches
  - Cost, Market and Income
- We both analyze data and draw conclusions
- We both do work for lenders, attorneys, and other individual clients for a variety of purposes

# Special Purpose Properties (Weird/Unusual Properties)

- When there is a business involved, the intangible operation that provides goods or services in order to generate an income stream, that exists in conjunction with real property, what is that called?
- Real Property Going Concern?

# What are Real Property Going Concerns?

- Definition – there isn't one that everyone agrees on!
  - Real estate appraisers typically call them "Going Concerns"
  - Business appraisers refer to a "Going Concern" scenario premise of value vs. a "Liquidation" scenario premise of value
  - The Appraisal of Real Estate, 13<sup>th</sup> Edition defines Going Concern as "All tangible and intangible assets of an established and operating business with an indefinite life."

# Real Property Going Concern

Paul Hyde's (Yes, we are related) definition of a Real Property Going Concern:

"A type of real property that derives its income stream from the operations of a business rather than from the collection of rent"

# An Excerpt from an Article Published by the ASA

## “Valuing Real Property Going Concerns”

Most everyone agrees that valuing real property falls under the purview of real estate appraisers and requires a real estate appraisal license in the jurisdiction in which the property is located. Many people agree that valuing a business entity (often referred to as a going concern) requires special skill and expertise possessed by qualified business appraisers. The problem occurs when the need arises to value a business enterprise that is difficult to distinguish from real property. The majority of licensed real estate appraisers do not have the education, training, and experience to value a business and business appraisers do not have the license, education, training, and experience to value the real estate component.

# Simple Real Property Going Concerns — could be

done by a competent real estate appraiser - gray line dividing the types; it should be noted that some of these fit into both categories

- Assisted Living Facilities
- Auto Dealership
- Auto Repair or Tire Center
- Bowling Center
- Coin Operated Self-Serve Car wash
- Fast Food Restaurants
- Full-Service Car Wash
- Full-Service Restaurants
- Gas Station – Convenience Store
- Golf Courses
- Hotels
- Mini Storage Facilities
- Mobile Home Parks
- Motels
- Movie Theaters
- Nursing Homes
- Recreational Vehicle Parks

# Complex Real Property Going Concerns — requ

both a real estate & business appraiser

- Amusement Parks
- Auto Dealership
- Bowling Center
- Assisted Living Facilities (typically larger facilities)
- Convenience Store (particularly with a fast food restaurant)
- Convention Centers
- Fast Food Restaurants
- Full-Service Restaurants
- Hotels with Restaurants
- Movie Theaters
- Nursing Facilities (typically larger facilities)
- Restaurant business entities that also own the real property
- Truck Stops
- And many other properties with integrated real property and businesses

# Asset Approach for RP Appraisals?

- Real estate appraisers look at the cost to build the real estate
- Can use data from Marshal & Swift
- Use the Market Approach to determine the land cost
- Arrive at a value of just the land and improvements  
(However, determining estimated depreciation can be fun.)



# Income Approach for RP Appraisals?

- Real estate appraisers estimate potential gross income (rents)
- Less: an estimated vacancy collection rate (between 3 and 30%)
- Less: estimated operating expenses (between 20 to 45%)
- Select from a range of potential commercial cap rates (5 to 12%)
  
- Depending on what variables are selected, low or high end, the concluded value could vary significantly.

# Is There Generally a Significant Difference Between those Two Indications of Value?

- Does the market value of real estate change if the property is vacant, or if it is occupied?
- If so, what causes that change in market value?
- Is it possible that difference is attributable to an intangible asset such as goodwill?

# The Management Fee Method – Promoted by Steve Rushmore

- Can all intangible value really be captured by a 5% adjustment?
- What if there are multiple operations inside the property such as multiple restaurants as part of a hotel property?
- Would it make a difference to the conclusion of value, if one of the restaurants were much more profitable than the other?
  - Why?

# What is Goodwill?

- Goodwill is an intangible asset that exists when an investment generates an additional return to the owner, above and beyond the ROI the physical assets bring in.
- Example: A commercial property is leased at a market rate, but continues to generate additional profits for the owner above and beyond a reasonable return on the equipment and furniture.

# I Want to Explain More About Business Appraisal

- And about how a real estate appraiser could benefit from adding it to their skill sets

# What is a Business Valuation / Appraisal?

The image shows a Google search interface. The search bar contains the text "appraisal definition". Below the search bar, there are navigation links for "All", "Books", "News", "Shopping", "Images", and "More". The search results show "About 218,000,000 results (0.37 seconds)". A dictionary entry for "appraisal" is displayed, including its pronunciation, part of speech, and definitions.

Google

appraisal definition

All Books News Shopping Images More Settings Tools

About 218,000,000 results (0.37 seconds)

Dictionary

Search for a word

ap·prais·al  
/ə'praɪzəl/  
noun

an act of assessing something or someone.  
"the report has been subject to appraisal"

Similar: assessment evaluation estimation judgment rating gauging

• an expert estimate of the value of something.  
"the final figure is just a little more than triple the appraisal"

Translations, word origin, and more definitions

Definitions from Oxford Languages

Feedback

# What is a Business Valuation / Appraisal? – Con't

- Both of those definitions are good, but let's focus on the second one.
- “an **expert estimate** of the value of something.” Emphasis added.
- Notice that in nowhere in this definition does it say the expert must have any sort of certification. More on this later.

# Back to the Jungle Analogy

- Think of your Charles Schwab investment advisor as a game warden
- Publicly traded stocks, bonds, REITs these are all managed game animals
  - You can travel on a safari and see them in the wild, but mostly you won't get eaten because your investment advisor understands most of their behaviors
- Privately held businesses are running wild in the jungle and there are no stock exchanges tracking their behaviors





Many of you may  
not remember  
John Wayne in  
Hatari, but there  
is this one  
scene.

# Public Company Stock Valuation

- Publicly traded companies are valued every day on the stock market
- People are buying and selling shares all the time at these listed prices
  - Each party to the transaction knows what the associated costs are
  - Each party to the transaction knows what the associated income will be
  - The transaction occurs on a known schedule

Google stock price

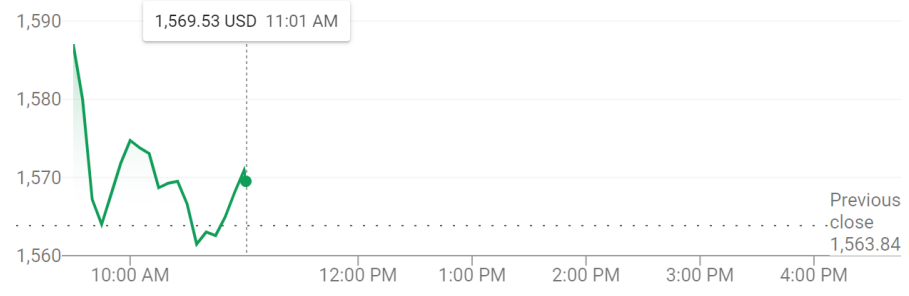
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About 2,840,000,000 results (0.56 seconds)

Market Summary > Alphabet Inc Class A  
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1,568.24 USD +4.40 (0.28%) ↑  
Jul 21, 11:05 AM EDT · Disclaimer

1 day 5 days 1 month 6 months YTD 1 year 5 years Max



Open	1,585.03	Div yield	-
High	1,587.05	Prev close	1,563.84
Low	1,558.34	52-wk high	1,587.05
Mkt cap	1.07T	52-wk low	1,008.87
P/E ratio	32.10		

# I Googled Google's Stock Price

# Private Company Stock Valuation

- There is no stock exchange where prices can be looked up
- There is no collection of interested buyers lining up to purchase a couple hundred shares in the subject Company
- But if there were an interested party, say a spouse getting a divorce...
  - Each party to the transaction has no idea what the overall associated costs will be
  - Each party to the transaction has no idea what the associated income will be
  - There may never be a transaction at all, and if there is, how long will it take to find a buyer and at what price...?

# How Does One Determine a Business' Value

- There is a process one can go through
- But, first ... remember that slide where we talked about certifications and I promised you more on that later?
- It's now later

## One Thing to Watch Out For

- There are no regulations or restrictions on who can offer their opinion as to the value of any privately held business
- My 8 year-old daughter could hang out a shingle, written in crayon offering her BV services



Business  
Appraisal

# One Thing to Watch Out For - Con't

- There are many people who may have taken a few BV classes,
- There are many CPAs who may or *may not* have taken any BV classes,
- There are many consultants who have taken lots of classes,
- There are a few people who have taken classes and have actually obtained BV certification

# One Thing to Watch Out For - Con't

- Here are the BV designations available in the US
  - Certified Business Appraiser (CBA)
  - Accredited Senior Appraiser (ASA)
  - Certified Valuation Analyst (CVA)
  - Accredited in Business Appraisal (ABV)
  - Business Certified Appraiser (BCA)
- In Canada
  - Chartered Business Valuator (CBV)



# Determining the Fair Market Value of a Business

- To appraise a business, a business appraiser needs a lot of documentation
- Real estate appraisal data requirements are easier for the client. Mostly a RP appraiser just needs the address, and you can obtain publicly available data
- Businesses however, tend to incorporate assets that cannot be seen or touched, and their (**not** publicly available) documentation is necessary for their measurement.

# Document Request List

- Tax returns
- Financial statements (yes, tax returns and financial statements are different, and we want them both)
- Depreciation schedules
- Leases
- Other appraisals
- Other items

# How Long Does it Take?

- The answer to many BV related questions is, “It depends”.
- I have waited nine months for data to be delivered.
- Without the requested documents, the BV appraiser cannot complete the valuation.

# Interview Questions

- After the initial list of documents have been delivered to the appraiser, often the appraiser will have follow-up questions
- Why? You may ask. Great question!
- A privately held business incorporates certain strategies to minimize its taxable income. The BV appraiser tries to identify them, and gain a greater understanding of the business' risk profile.

# Some Questions an Appraiser Should Ask

- What are the job descriptions of the owners?
- How much time does the key owner spend engaged in the business' operations?
- What would be the salary the business would have to pay to a third party to do the same job currently performed by the owner? (Assuming someone had the equivalent skills.)
- Who owns the real property the business operates out of?

# What is the Process to Appraise a Business?

- Understand the nature of the operation
- Analyze historical results
- Compare historical results with industry averages
- Make certain adjustments
- Predict the future
- Apply methods
- Communicate the results of the analysis

# Understand the Nature of the Operation

- Not all businesses operate just like any other business
- Industry classification codes such as NAICS codes are often reported incorrectly on tax returns
- What is the associated risk of the income stream continuing?  
(Remember the word, 'Risk'. We'll come back to that.)

# Analyze Historical Results

- What has the business done historically?
- Are there any identifiable trends?
- Has the business evolved over time?
- As of the effective date, what was known or knowable?

(Was the business opening a second location? Adding a new product line?  
Moving to a bigger building?)



# Compare Historical Results with Industry Averages

- A business whose operations are stronger than the industry average, might very well be worth more than an average company.
- The reverse is also true
- If the appraiser does not complete such an analysis, how will that appraiser be able to determine risk?

(There is that word, again.)

# Make Certain Adjustments

- Certain expenses are “non-operating” or “discretionary” in nature and can be added back. These are often referred to as Normalization Adjustments
- Other incomes or expenses are non-recurring and must also be adjusted.
- What about when a spouse mentions unreported income?

# Predict the Future

COVID-19?

- Why?
- Does the future always resemble the past?
- Here is one area where trained accountants may have a hard time transitioning to a BV role.

# Apply Methods

- Just as in any appraisal, there are three different approaches
  - Asset, Income, and Market
- Unlike real estate appraisal, there are multiple methods under each approach
- Not all methods are appropriate for all valuations

# Communicate the Results of the Analysis

- This is where the report comes in.
- The report can be in a written format, or it can be delivered orally.
- There are multiple versions of a written report and not all of them are equally appropriate for use.

Value	=	<u>Income</u>
		Risk

**It's Been a  
While Without  
an Image**

# Valuation is Based on Simple Math

- However, the two variables can be quite difficult to figure out.
- We've talked a bit about how the income is determined
- We have not talked about how the risk rate is determined

# The Build-Up Method

- This method looks at rates of return different types of investors accept in the public markets
- One of the easiest mistakes an appraiser can make is to apply this Risk rate to the wrong Income stream



# Another Method to Measure Risk

- The Weighted Average of the Cost of Capital (WACC)
- This method generates a lower risk rate, based on the theory of investing with OPM
- The lower the risk rate, the higher the value
- This method is used more often than I think it should be

# Reviewing a Sample Valuation Report

- I have a report I wrote for a divorce engagement that I have sanitized (removed client information from) that I can show and point out some interesting things in.
- I changed the Company name to Generic Diesel Repair Shop, LLC.

# Check out the ISBA's Learning Management System

- <https://learning.intlbca.com/>
- There are samples, pre-recorded webinars, monthly live webinars, two versions of the training for the BCA designation, and additional training courses are coming.

# Thank you!

- If you have any other BV related questions, or if you want to earn your own Business Certified Appraiser (BCA) designation, you can reach me by email or telephone
- [shyde@intlBCA.com](mailto:shyde@intlBCA.com)
- 469-412-9935
- Yes, that is a Texas number, but I live in Idaho.

ISBA

INTERNATIONAL  
SOCIETY OF  
BUSINESS  
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