

THE ENTERPRISE

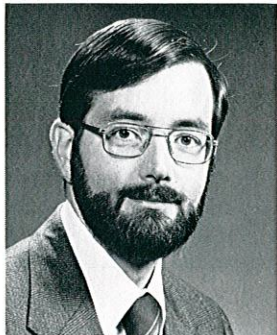
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THE SYNERGISM OF MULTIPLE PURPOSE APPRAISALS



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It is common knowledge that many of the largest corporations employ full-time appraisers on their staff. Through their combined expertise, these appraisers insure the financial well-being of the firm with regard to its Real and Personal Property. Such expertise is not beyond the need for the services of a reputable appraisal firm at times. The involvement of a qualified independent appraiser can add depth to the corporation's forthcoming documentation, accelerate the appraisal process to meet a deadline, and reduce litigation expenses by serving in an independent capacity to the firm. Generally, the independent appraiser can offer expertise in the area of intangible assets since this classification of assets is seldom valued by corporate staff appraisers.

At other large and most small corporations, the concept of staff appraisers is virtually non-existent. Yet, the comptroller, treasurer, or vice-president for finance must shoulder similar responsibilities as his counter-part in the largest corporation. For all practical purposes, he must seek the same tax advantages, respond to the same needs created by governmental regulations, maintain an inventory control, and often acquire additional financing. In effect, he too must be concerned with his firm's Real and Personal Property, and Intangible Assets.

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THE HISTORY OF APPRAISAL SERVICE TRENDS

Prior to the turn of the century, appraisal firms were essentially unknown. What few firms that did exist conducted appraisals for the purposes of insurance, sale price, or financing.

The need for appraisal services increased significantly with the passage of the nation's first income tax law in 1913, and continued to grow as numerous public agencies, which imposed various regulations and provisions, were founded.

As World War II drew to a close, and the country moved towards the 1950's, the need for appraisal services became more apparent as the number of excess profit tax cases increased. The decades of the fifties and sixties, with the advent of condemnation cases brought about by the creation of the interstate highway system expansion program, resulted in an accelerated need for appraisal services.

During the 1960's many corporations began actively to expand through acquisitions of other enterprises. The creation of corporate conglomerates, trading in such acquisitions, further accelerated the need for independent qualified appraisal firms.

The 1970's have shown an awareness on the part of corporations of the value of employing the services of appraisal firms for ad valorem tax purposes. In addition, the recent Securities and Exchange Commission's adoption of replacement cost new disclosure requirements has created a new need for appraisal services.

The last eighty plus years has seen the greatest number of increased needs for appraisal services occur over the last two decades. The acceleration of these needs indicate that the appraisal industry has an obligation to potential users of their services to prepare now to meet their client's greater needs of the future.

The Synergism of Multiple Purpose Appraisals

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Today, the appraisal industry is looked upon by corporations as a management tool not only because of the need for maximizing income or savings through appraisals, but for assisting businesses of all sizes in monitoring the numerous laws, provisions, and options available to the business sector of our society.

Recognizing the complexities of our current society, the more responsible appraisal firms are acting as consultants first and appraisers second, in order to serve their clients' best interest.

What is it then that the financial officer should seek in selecting an appraisal firm? He should be certain that the firm is capable of valuing Real and Personal Property as well as Intangible Assets at a competitive fee level. He should ascertain that the appraisal staff is a seasoned group of professionals, that the firm has produced accurate well documented valuations which stand in a court of law, and that the firm has excellent reaction time in preparing valuations. He should also be sure that the appraiser responsible for the valuations will be available for future testimony. Other points of consideration are that the firm maintains its professional integrity yet can relate to the client in a personal manner, and that a member of the firm will visit periodically with the financial officer.

Most often a corporation will employ the services of a reputable appraisal firm for one of the following purposes: acquisitions or sales requiring an allocation of the lump sum price, ad valorem taxes, insurance, financing, sale price substantiation, or replacement cost disclosures. Before reviewing the synergism of multiple purpose appraisals, which can be of particular value to any business, let's review some of the key points of the above mentioned purposes for appraisals.

Acquisitions or Sales: Thousands of acquisitions involving more than one class of tangible property or intangible assets occur annually. These require an allocation of the lump sum price. Generally the assets of the firm to be purchased have only marginal significance to the negotiations since price will usually be related to its actual and anticipated earnings. Accounting for the agreed upon price results in a meaningful financial statement and is the next critical step, particularly when a premium or bargain price is involved. The necessity for having the objective expertise of a capable independent appraiser in determining the allocation of a purchase or sale price cannot be over-emphasized, particularly since one can readily assume that the Internal Revenue Service will challenge the allocation costs of individual assets.

Generally the subject of Intangible Assets is considered relatively unimportant until the time of a purchase or sale. Intangible assets can reduce the seller's gains from ordinary income to capital gains. For the buyer, they can represent a loss in his depreciable value base. If the intangible assets which have a determinable life can be separated from the lump sum of all intangibles in a purchase, the qualified appraiser can be a tremendous value in assisting both seller and buyer in achieving their respective aims if both parties select the same appraisal firm.

A well documented appraisal for an allocation of the purchase or sale price is in the best interest of the buyer or seller, will reduce litigation expenses, and will diminish general frustrations for the party obtaining the appraisal.

Ad Valorem Taxes: The basis for taxation of Real Estate and Personal Property is the assessed value, which is usually some percentage of fair market value. Tax increases are usually effected by either an increase in the rate, or the assessments, or a combination of both adjustments.

Since our economy is dynamic, the age of the assessment is not a guarantee of fairness. Real estate values are changing rapidly due to current socio-economic-political conditions, and technology is advancing so rapidly, that machinery and equipment can depreciate quickly in value yet still serve its intended function well.

An appraisal by an independent appraiser for ad valorem tax purposes may be beneficial to the corporation in determining an over-assessment of real or personal property, and to assist a company in its decision to appeal an inequitable assessment.

Insurance: Large, medium, and small firms are constantly faced with the question of how much insurance coverage is necessary to protect their real and personal property assets.

With the rapid increase of the inflation rate experienced in this country during the past few years, the replacement costs for real property and personal property can best be determined by the firm conducting a periodic appraisal of its assets. To rely solely on an inflation index could result in excessive coverage or under insurance of the firm's assets.

In addition, an appraisal of the corporation's assets for insurance purposes can be beneficial in assisting the firm to avoid co-insurance clauses for partial losses, and to substantiate values for overall proof of loss.

The Synergism of Multiple Purpose Appraisals

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Financing: Regardless of the size of their businesses, financial officers are often seeking funds for re-financing purposes to improve the firm's working capital position, or for plant and equipment updating and expansion purposes. The prime interest rate, while relatively stable at the time of this writing, has fluctuated enormously during the past five years and will probably continue to do so.

For the firm which needs immediate financing, the appraisal conducted for financing purposes is a valuable tool and is often required by the lender. For the firm which is planning its financing program on a long range basis, a periodic financial appraisal can be of significant value in enabling the firm to present its request to the lender at the most advantageous time for the borrower.

Sale Price Substantiation: When companies embark on new marketing ventures, consolidate plant locations, and relocate their corporate headquarters, the need to substantiate the disposition of excess real estate at fair market value is of prime importance. A corporation can benefit from an appraisal of this nature because it reduces litigation possibilities with minority stockholders.

In the case of real or personal property being transferred to a profit sharing or pension trust, an appraisal is a necessity to insure that the value is fair to both the company and the trust.

Replacement Cost Disclosures: The Securities and Exchange Commission has adopted new disclosure requirements which it feels will highlight the role inflation plays in the largest corporations. All public corporations with an original cost before depreciation on inventories, property, plant, and equipment in excess of \$100 Million that make up 10% of total assets are being required to make these disclosures. The replacement cost disclosures are required in financial statements for fiscal years ending on or after December 25, 1976. In addition, the corporation must disclose how the replacement cost figures were computed.

It is expected that all public firms will be covered by this ruling within two or three years as the Securities and Exchange Commission reduces the \$100 Million asset level.

The larger corporations usually have the staff ability to conduct their replacement cost disclosures. Nonetheless, many of these firms have employed an appraisal firm to develop the replacement cost disclosures so as not to disrupt their staff's other responsibilities, and to insure the objectivity of the valuations since the Securities and Exchange Commission may well challenge the valuation. Other

corporations do not have the internal capabilities for producing replacement cost disclosures initially or on an annual basis. The qualified appraisal firm can play an important role for management of these firms.

The Synergism of Multiple Purpose Appraisals

The preceding six areas briefly described the purposes for an appraisal. Many companies will employ an appraisal firm for one of the six areas not realizing that the opportunity exists for multiple purpose appraisals. This can reduce the corporation's appraisal expenses in the long run while producing a comprehensive valuation of the firm's assets.

Consider the following examples:

- An allocation of purchase price readily provides a basis for ad valorem tax equibility and collateral evidence for a lender should financing be required. This same appraisal can provide the essential information needed for replacement cost disclosures and insurable values at very minimal additional cost. Essentially, this one appraisal survey could encompass one to five different purposes if required.
- Surveys and inventories of the properties for replacement cost disclosure appraisals are almost identical to insurance appraisals. The only difference is the insurance exclusions.
- In the process of making an appraisal for financing purposes, separate appraisals for insurance and replacement cost disclosures can be made for a modest additional cost.
- An appraisal for the substantiation of a sale price to an intra-company trust could provide benefits to the company still responsible for insurance and taxes in measuring the equitableness of the ad valorem tax assessment. In addition, the survey and inventory of the subject property is helpful in providing the data necessary for an insurance appraisal.

The reader should be cautioned that an appraisal for one purpose does not mean that the appraisal can be used for another purpose. However, the physical data gathered for one use offers synergistic applications to additional uses, thereby reducing the time needed for conducting the desired appraisals, and the client's appraisal fees.

CHANGING FACT CORNER

	<u>9/77</u>	<u>Year Ago</u>	<u>5 Yrs. Ago</u>	<u>10 Yrs. Ago</u>
Prime Rate %	6.0	5.4	4.9	6.0
Dow-Jones Ind's	850	1010	950	930
Mfg. Corp's % on Sales	5.5	5.1	5.1	5.6
Steel Prices ¢/Lb	16.0	14.6	10.0	6.5
Copper Prices ¢/Lb	60.6	74.6	51.0	38.6
Aluminum Prices ¢/Lb	53	48	25	25
Gold \$/Oz	151	118	65	35
Machy. Whol. Price Index	184	173	118	100

NEWS ITEMS

Due to the enthusiastic response from our clients and other readers, the Enterprise Reporter will be published quarterly beginning, January, 1978.

Ad Valorem Tax Appraisals will be the subject for the January, 1978 Enterprise Reporter. Pertinent information presented at this December's Institute of Property Taxation's Symposium in Houston, Texas will be included. Mr. Jack Emery, President of Enterprise Appraisal Co. will be one of the speakers.

Enterprise Appraisal Co. has restructured its geographic coverage to insure that our expanding clientele receives complete expeditious quality valuation services.

Two new offices have opened. Our Southeastern Regional Office is in Atlanta, Georgia, and our Pacific Coast Regional Office is in Los Angeles, California.

In addition, the Enterprise Communications Systems, located in other cities where we regularly conduct appraisals, enables our clients and prospective clients to call our Executive Office toll free.

This expands the coverage of Enterprise Appraisal Co. to 17 major cities.

DOLLAR CONVERTER

The Dollar Converter is based on national averages for Replacement Cost New, and our interpretation of normal composite market indications. The Replacement Cost and the Market Value factors are multipliers to be applied to historical original cost. These factors should not be used in specific cases as many variables make up the averages indicated. Your mix of the variables may produce a very different answer.

EXAMPLE APPLICATION OF THE DOLLAR CONVERTER

Our sample Enterprise completed their present plant in 1958 at costs of:

LAND	\$ 50,000
BUILDINGS	750,000
MACHY. & EQUIP.	<u>1,700,000</u>
	\$2,500,000

The Replacement Costs New of this original investment are:

LAND	\$ 200,000
BUILDINGS	1,980,000
MACHY. & EQUIP.	<u>3,553,000</u>
	\$5,733,000

The Resale or Used Market Values are respectively:

LAND	\$ 200,000
BUILDINGS	690,000
MACHY. & EQUIP.	<u>731,000</u>
	\$1,621,000

Your dollar spent in earlier years is estimated at the following values today:

	INDUSTRIAL BUILDINGS		MACHINERY & EQUIPMENT	
	Repl. Cost New	Resale Value	Repl. Cost New	Used Market Value
9/77	1.00	—	1.00	—
1976	1.07	0.86	1.08	.73
1975	1.12	0.86	1.13	.68
1974	1.23	0.91	1.29	.67
1973	1.36	0.97	1.49	.67
1972	1.48	1.01	1.54	.66
1971	1.60	1.04	1.58	.64
1970	1.76	1.09	1.65	.63
1969	1.87	1.10	1.75	.62
1968	2.02	1.13	1.81	.60
1967	2.12	1.12	1.87	.59
1966	2.20	1.12	1.94	.58
1965	2.29	1.12	2.01	.56
1964	2.34	1.10	2.03	.55
1963	2.40	1.08	2.05	.53
1962	2.45	1.05	2.05	.52
1961	2.50	1.03	2.06	.50
1960	2.53	0.99	2.06	.47
1959	2.57	0.95	2.07	.45
1958	2.64	0.92	2.09	.43
1957	2.70	0.89	2.16	.43
1956	2.81	0.90	2.33	.42
1955	2.96	0.92	2.53	.41
1954	3.07	0.92	2.61	.40
1953	3.14	0.91	2.64	.38
1952	3.21	0.90	2.69	.37
1951	3.29	0.89	2.69	.34
1950	3.62	0.94	2.95	.32
1949	3.76	0.94	3.07	.30
1948	3.79	0.91	3.11	.28

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