INTANGIBLE VALUE - FACT OR FICTION
OUTLINE

- Define Intangible
- Outline Appraisal Concepts, Definitions and Issues
- Examine Legal Framework
- Examine Case Study
- Provoke Debate
- Declare Winning Argument (But the points don’t matter)
One of the clearest definitions of an Intangible is found in International Accounting Standards:

- **Intangible asset**: an identifiable non-monetary asset without physical substance. [IAS 38.8]
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**Asset:** An asset is a resource:

- controlled by the entity as a result of past events [for example, purchase or self-creation]; and

- from which future economic benefits [inflows of cash or other assets] are expected to flow to the entity.

[IAS 38.8]
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Intangible assets defined by three critical attributes:

- Identifiability
- Control
- Future Economic Benefits

[IAS 38.9 - .17]
Intangible Assets - Identifiability

- Separable from the entity & can be sold, transferred etc.
- Arises from contractual or other legal rights.

[IAS 38.12]
Intangible Assets - Control

- Power to obtain the future economic benefits flowing from the underlying resource
- Power to restrict access of others to those benefits

[IAS 38.13]
Intangible Assets - Future Economic Benefits

- Includes:
  - Revenues from sales;
  - Cost savings; and
  - Other benefits resulting from use of the asset.

[IAS 38.17]
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Recognition Criteria:

- An intangible asset shall be recognized if, and only if:
  - probable future economic benefits attributable to the asset will flow to the entity; and

- cost of the asset can be measured reliably.

[IAS 38.21]
Examples of Intangible Assets (Property):

- Franchises
- Brands
- Trademarks
- Patents
- Copyrights
- Contracts

*The Dictionary of Real Estate Appraisal, 5th ed., Appraisal Institute*
Closer to home, CUSPAP:

2.36 INTANGIBLE PROPERTY (INTANGIBLE ASSETS):
Non-physical assets, including but not limited to franchises, trademarks, patents, copyrights, goodwill, equities, mineral rights, securities, and contracts, as distinguished from physical assets such as facilities and equipment.

USPAP lines 81-83 reflect same language
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CUSPAP 2.56

REAL ESTATE: Land, buildings, and other affixed improvements, as a tangible entity.

USPAP Line 118

REAL ESTATE: an identifiable parcel or tract of land, including improvements, if any
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CUSPAP 2.57  (USPAP lines 119-122)

REAL PROPERTY: The interests, benefits, and rights inherent in the ownership of real estate.

Note: In some jurisdictions, the terms real estate and real property have the same legal meaning. The separate definitions recognize the traditional distinction between the two concepts in appraisal theory.
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If Real Property = Rights & Interests in Real Estate;

And Real Estate = Tangible Property;

Then Valuation of Real Property = Valuation of Tangibles?
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- Intangible assets include non-physical assets that are identifiable and separable from the entity or arise from contract.

- Ownership entitles use or alienation of rights and interests, e.g. to enter into leases, grant easements, execute licences.

- Do these represent intangible, inseparable incidents of real estate arising from contract?
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- Certain intangible assets are a subset of the umbrella category of real estate.
- Not all intangible assets are non-realty assets.
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Legal Context:

- Example: Assessment Purposes
  - Many jurisdictions permit assessment & taxation of land & improvements only.
  - What about the intangible aspects of land & improvements?
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Legal Context - British Columbia Assessment Act, RSBC 1996, c. 20:

- “actual value” = market value of the fee simple interest in land and improvements
Legal Context - cont.

- If intangible assets are not expressly excluded from land & improvements in legislation, are intangible land and improvements assets assessable?
Legal Context - *Fairmont Hotels v. Area 01* (2005 PAABBC 20040267)

- [81] ... The value of real estate may be enhanced or diminished by intangibles such as zoning, development potential, location, competition and stigma. These are not things that can be held or touched, but they are things that contribute ... to real estate. Such value is in our view intangible, but it is value that is part of the realty and not personal property ...
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Legal Context - *Fairmont Hotels* cont.

- [83] ... The factors of location, architecture, history and prestige all contribute to the experience that is the Empress Hotel. Certainly there is value in these things. Some of that value may be intangible personal property, but some of it will be intangible value that attaches to, and is inextricably intertwined with the realty.
Leases:

- A lease is a contract.

- What portion of the rent is attributable to the real estate? What part is non-realty?

- Is “excess rent” a separate, intangible realty asset?
“Excess Rent” Defined:

“The amount by which contract rent exceeds market rent ... created by a lease favorable to the landlord ... and may reflect unusual management, unknowledgeable parties, ... an earlier, stronger rental market, or an agreement of the parties ...”

- *The Dictionary of Real Estate Appraisal, 5th ed.*, Appraisal Institute
“Excess Rent” as an Intangible Asset:

- Looking back to IAS, three conditions:
  - Identifiable
  - Within control
  - Involves future benefit
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- Appraisers often look to the fact that a lease interest survives transfer of title.

- However, leases are defined in time.

- To capitalize in perpetuity may or may not be appropriate.

- Easy answer is contract rent = market rent. Cap it, call it “Leased Fee” and send out the report.
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Common examples of where this might not work:

- Tenants with specific space needs, that might not meet the needs of other tenants in the same sector:
  - Big Box Retail
  - Restaurants
  - Automotive
  - Food and Convenience
  - Specialized Use
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TYPICAL ASSET MIX

Restaurant  Fast Food  Pulp&Paper  Technology  Developer

- Land  - Buildings  - Non Realty  - Intangibles

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Intangible assets - When Identification is Appropriate

AIC Text:
Federal or Provincial law often requires appraisers to value properties as fee simple estates...e.g. for expropriation or ad valorem taxation

- Appraisal of Real Estate Appraisal, 3rd Canadian ed., AIC, p. 20.3
IVS also identifies: “A non-exhaustive list of examples of circumstances that commonly include an intangible asset valuation component is provided below”:

(a) For financial reporting purposes,
(b) For tax reporting purposes, including ad valorem
(c) Shareholder disputes, damage calculations and marital dissolutions (divorce), estate and gift tax planning
(d) Other litigation including compulsory acquisition,
(e) General consulting

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When required:

“Although the market values of the leased fee and leasehold positions are often said to be “allocated” between two (or more) interests, each interest must be valued on its own merit.”

*Appraisal of Real Estate Appraisal, 3rd Canadian ed.*, AIC, p. 20.3
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CUSPAP

6.2.17 analyze the effect on value, if any, of the terms and conditions of the lease(s) when developing an opinion of the value of a leased fee, leasehold estate; [see 7.17]

Note: Silent on valuing fee simple
6.2.20 analyze the effect on value of any *personal property*;

**QUESTION:**

Is an above-market lease, created by contract, personal property?
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CASE STUDY: EXCESS RENT?

INTANGIBLE ASSET?

REALTY OR NON-REALTY?
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ASSUMPTIONS

- 10 YEAR LEASE, 3 - 5 YEAR OPTIONS
- 5 YEARS REMAINING
- MARKET STABLE SINCE LEASE DATE
- ASKING $25, BEST CASE $30
- ACHIEVED $37.50, OPTIONS TO BE BASED ON MARKET
Questions:

- Excess rent?
- Intangible value?
- In what circumstances value separately?
Thanks y’all