Market Value *Is* Market Value, Right?

Opinion of market value is an item that appears in every appraisal ordered by a financial institution. Almost always we will see market value "as is," and sometimes we also will be given prospective market value "at completion" or "at stabilization." In appraisals of industrial, office, and retail buildings, there is rarely a question of what market value pertains to. Market value in these cases represents real estate (or, more specifically, real property) only.

But what does market value represent when an apartment complex or going-concern operation is appraised? Financial institutions often make loans on and obtain appraisals for adult-care facilities, car washes, convenience stores, hotels and motels, marinas, restaurants, and many other going-concern property types. All contain tangible and intangible assets that are not classified as real property.

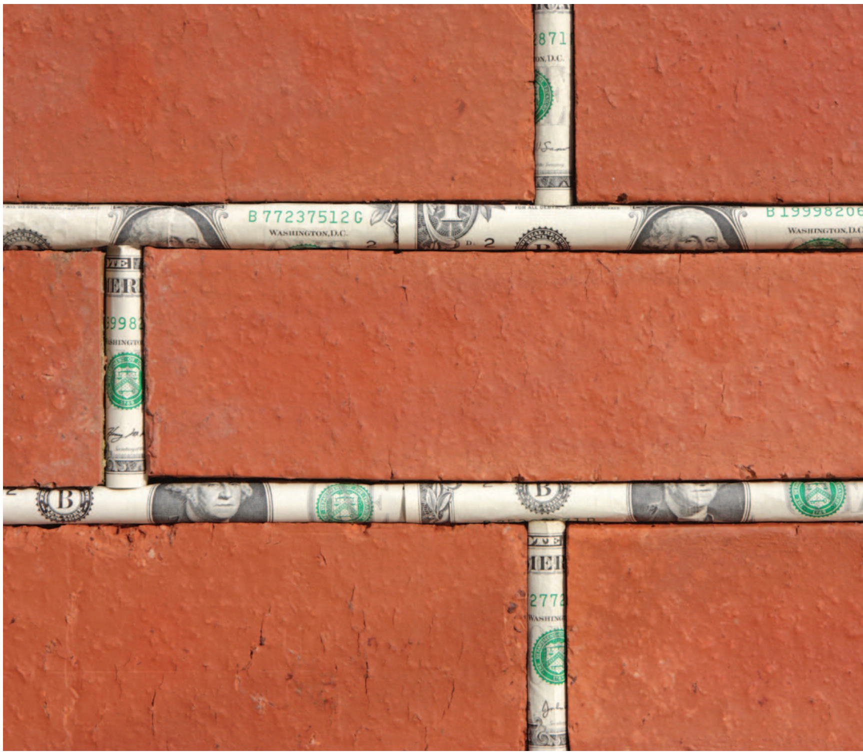
Recently this author reviewed an appraisal of a skilled-nursing facility. The letter of transmittal had the following conclusion:

The as-is market value of the fee simple estate, as of January 1, 2011, was $19,000,000.

We know the date of value and the value conclusion—and also that this is market value of the facility in its current condition. But what does this market value represent? Is this real property only, as is typical in an appraisal of an industrial or office building? Or are there other components of value that were not disclosed? And is it fair to ask: Why do we care?

We should care for the sake of prudent lending and also because we have several federal regulations to address. Though not a loan officer, I recall from RMA's Commercial Lending School and Advanced Commercial Lending School that the term of the loan should match the life of the asset.

After informing the appraiser that federal regulations require separate opinions of value for the components making up the $19,000,000 value conclusion, I received a revised report that concluded as follows:



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The as-is market value of the fee simple estate, as of January 1, 2011, was $19,000,000.

This value is allocated as follows:

Real property – $14,000,000

Furniture, fixtures, and equipment (personal property) – $1,000,000

Business value – $4,000,000

Obviously, the useful life of the real property components (land and buildings) is far longer than the useful life of the furniture, fixtures, and equipment (beds, kitchen equipment, televisions, and so on). The life of business value is difficult to determine but it could end tomorrow, as happened to a nursing home facility, now vacant, located across the street from the property described above!

In this example, the collateral value difference for a real property loan is $5 million—that is, $19 million versus $14 million. This difference could significantly affect the borrower's ability to cover debt service, loan covenants, and the overall transaction.

Prudent lending issues aside, we also have to comply with federal regulations. In December 2010, the five federal banking authorities issued a statement entitled "Interagency Appraisal and Evaluation Guidelines." This statement addresses market value as follows:

Each appraisal must contain an estimate of market value, as defined by the Agencies' appraisal regulations.... Value opinions such as "go-

ing concern value," "value in use," or a special value to a specific property user may not be used as market value for federally related transactions. An appraisal may contain separate opinions of such values so long as they are clearly identified and disclosed.

This same guidance provides the following pertinent definitions:

Going concern value: *The value of a business entity rather than the value of the real property. The valuation is based on the existing operations of the business and its current operating record, with the assumption that the business will continue to operate.*

Value of collateral (for use in determining loan-to-value ratio): *According to the Agencies' real estate lending standards guidelines, the term "value" means an opinion or estimate set forth in an appraisal or evaluation, whichever may be appropriate, of the market value of real property, prepared in accordance with the Agencies' appraisal regulations and these Guidelines….*

Thus, each appraisal of a going-concern property must delineate the value attributable to real property, to furniture, fixtures, and equipment, and to the business itself (if, in fact, any such value exists). Other property types, such as apartment complexes, also may require this breakdown of values because they also contain furniture, fixtures, and equipment (kitchen appliances, washers and dryers, fitness center equipment, and so on).

With the value of each component provided in an appraisal, separate loans can be made on these components to match the term of the loan with the life of the underlying collateral. Understanding exactly which market value is being provided is important to sound lending practice. ❖

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