

Intangibles and Caprice Can Confound Market Value

The impact of buyer or seller “caprice” in real estate transactions can confound the appraisal process in interesting ways. The presence of additional “intangibles” that are distinguished from realty or personal property, furnishings, fixtures or equipment can add another layer of confusion as to what is really being traded in the market and the value of the components. Is it “investment value” or “market value”. USPAP requires an appraiser to estimate and allocate total value to any components and recognize unusual buyer and seller motivations. This is far easier said than done and has been a contentious topic in the appraisal community.

First, consider a few important and relevant definitions from the Appraisal Institute’s Dictionary of Real Estate Appraisal. The definition of “market value” comes in several forms, but can be generically summarized as the most probable price that a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyers and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Alternatively, “investment value” to a particular buyer or seller is based on the investor’s specific requirements that comprise criteria not necessarily typical of the market. “Intangibles” are non-physical assets of a wide variety including franchises, trademarks, securities, goodwill and others. To complicate matters just a little more, terminology related to intangibles and business enterprise value (BEV) varies between The Appraisal Institute, USPAP, IAAO Glossary for Property and Assessment, Journal of Property Tax Management and International Valuation Standards.

Here is where it gets more interesting. The term “caprice” is not found in those alternative definition sources, but is

certainly present in the market. Webster's Dictionary defines it as a sudden, impulsive change in the way one thinks or acts; freakish notion; whim; quaint or curious notion. Investor specific criteria or caprice can drive a price for conventional real estate beyond market value. But, with some unique property types, like many Maine coastal islands, the often whimsical, even "eccentric" prices paid are due to caprice in this colorful niche... and they make the market. If a single transaction reflects whimsy, then it would reflect investment value. But, when most of the transactions in a niche reflect some caprice and a lot of subjective judgements, it seems to me that those sales are that market.

In my appraisal review practice, I've sympathized with the challenges facing appraisers searching for arms length, transactions in the oceanfront island market. It requires far more time and research than usual, and the data verification and valuation processes are difficult. Purchase and sale motivations are very varied and usually involve some caprice. Common unit denominators like price per acre, price per waterfront foot, waterfront feet per acre, subdivision potential, number of potential lots, do not create a reliable pattern for estimating island value. These properties are valued "as a whole" with "qualitative" adjustments for features having an impact on island utility, features like distance to a mainland launch lot, existing building improvements, waterfront quality and accessibility, viewshed, any existing conservation easement; and privacy and protection. Appraisers have persuaded me that the intangible motivations in this unique market make sales comparison and adjustments more of an exercise in judgment based on extensive experience.

Some other examples of properties that arouse capricious or intangible motivations are high value properties with architectural significance; unique locations with a "signature" address; family legacy properties encumbered with

fractional interests; and residential purchases providing an opportunity to make a “statement”, among others. We humans can be imaginative and impulsive, and “one person’s goose is another’s swan”.

The Appraisal Institute offers a fairly new course on the valuation and allocation of the components of a “going concern” or “total enterprise”. But, the semantic disagreements and ambiguities continue to confound practitioners. Analytical methods for attempting to quantify them do exist and are evolving. But, with regard to unique or special purpose properties, like islands and the examples above, caprice still abounds, defies widely accepted quantification, but has an undeniable impact on value.

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