

REAL ESTATE APPRAISAL & BUSINESS VALUATION

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BC EXPROPRIATION ASSOCIATION

PRESENTATION GOALS

Improve our understanding of:

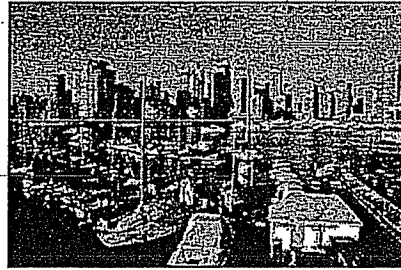
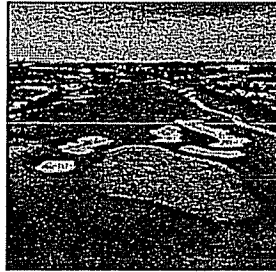
- the capabilities of both professions
- the similarities and differences in valuation approaches
- how real estate appraisal can dovetail into business valuation
- pitfalls for clients, appraisers, & business valuers

Case study approach

CASE STUDY – PUB & LRS

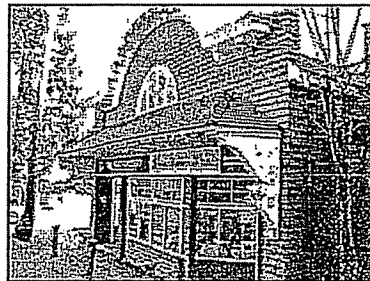
Our focus is on hospitality property since:

- common area of overlap between professions
- high level of management expertise required
- potential for non-realty or business value to exist



CASE STUDY OVERVIEW

Appraiser to determine Market value of the real estate including the going-concern.



CASE STUDY OVERVIEW

Property Summary:

- Located on Lougheed Highway
- 120 seat liquor primary licence & free standing LRS
- 2 residential suites above LRS
- Large site area: 37,400 ft²
- Buildings constructed at various dates: 1893 to 1990
- Heritage theme to exterior & interior improvements
- Owner occupied
- Improvements in good condition



APPRAISAL ASSIGNMENT

An appraiser's focus is Market

- pre-tax departmental cash flow in relation to market norms
- condition of improvements
- legal conformity & probable use
- competitive environment
- sales and leases of comparable properties



Property Details

Pub Constructed in early 1900s with additions over the yrs
3,400 ft² on main & 1,800 ft² on 2nd flr
Full commercial kitchen
Enclosed patio (20 licenced seats)
Roof replaced in 2007
up to date mech & electrical systems

LRS Constructed in 1990
3,000 ft² on main & 1,600 ft² on 2nd flr
2 (760 ft²) self contained res suites on 2nd flr



All improvements in good condition
Zoned C-1 Commercial

VALUTION METHODOLOGY

Two common approaches to value the going concerns:

- Income method – EBITDA or cash flow approach
- Direct comparison

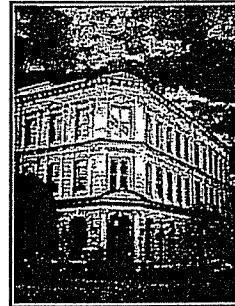
The Cost Approach is not generally applicable since:

- Pubs don't trade on this basis
- Economic life and depreciation are difficult to reliably estimate

INCOME METHOD

Step 1 Review financial statements

- Review most recent 3 yrs of financials (calendar FY)
- Re-state in Dept Rev and Exp if necessary
- Determine impact of trends & events
- Compare actual outcomes to benchmarks
- Determine stabilized Dept Rev and Expense



We have 2005 & 2006 financials & interim financials to June 30 2007.

INCOME METHOD

Department	Pub	Food	B&W Store	Total
Year ending December 31st.	2006	2006	2006	2006
Revenue	\$832,245	\$885,330	\$2,056,714	\$3,774,289
Cost of Sales	\$261,896	\$399,652	\$1,520,135	\$2,181,683
Gross Profit	\$570,349	\$485,678	\$536,579	\$1,592,606
Gross profit %	68.53%	54.86%	26.09%	42.20%
Other income	\$33,951	\$0	\$35,011	\$68,962
Total gross profit	\$604,300	\$485,678	\$571,590	\$1,661,568
Total gross profit %	69.76%	54.86%	27.33%	43.23%
Direct expenses				
Wages and benefits	\$258,624	\$196,451	\$106,327	\$561,402
Other	\$17,691	\$29,095	\$7,674	\$54,460
	\$276,315	\$225,546	\$114,001	\$615,862
Departmental Revenue (loss)	\$327,985	\$260,132	\$457,589	\$1,045,706
Percentage of Total	37.86%	29.38%	21.88%	27.21%

Income Method – Trends 2005 to June 2007

- Pub Sales - increase + 11.2%
- Food Sales - increase + 14.7%
- Store Sales - increase +7.6%

Trends indicate steady growth in sales

The June 2007 (most recent) data is factored forward for the remainder of the FY.

Pub	\$ 925,000
Food	\$1,015,000
Store	<u>\$2,210,000</u>
Total	\$4,150,000

Misc. income is consistent at \$21,000 to \$25,000 per year

Departmental Cost of Goods Sold

- We repeat this analysis for each dept
- Our focus is cost of goods as a % of gross sales
- Beverage, food, and LRS % cost of good sold are consistent except for LRS sales in 2nd half of 2006.

% Cost of Goods Sold			
Department	2005	2006	2007
Beverage	31.43%	31.47%	31.51%
Food	44.09%	45.14%	45.78%
LRS	72.88%	73.91%	72.75%

Expenses

Adjustments to Dept and Admin Expenses are required for...

- payments to family members who don't have day to day duties
- family related cost items related to automobile expense, insurance.
- A \$30,000 fee is included in Repairs for family member oversight of the business.
- mgmt fees are excessive in relation to size of business



Summary – Stabilized I & E

STABILIZED INCOME AND EXPENSES

DEPARTMENT	Pub	Food	LRS	TOTALS
Year ending Stabilized	Forecast	Forecast	Forecast	Forecast
Revenue	\$925,000	\$1,015,000	\$2,210,000	\$4,150,000
Cost of Sales	\$291,375	\$466,900	\$1,602,250	\$2,360,525
Gross Profit	\$633,625	\$548,100	\$607,750	\$1,789,475
Gross profit %	68.50%	54.00%	27.50%	43.12%
Other income	\$0	\$0	\$24,000	\$0
Total gross profit	\$633,625	\$548,100	\$631,750	\$1,813,475
Total gross profit %	68.50%	54.00%	28.28%	43.70%
Direct expenses				
Wages and benefits	\$231,250	\$257,810	\$111,000	\$600,060
Departmental Revenue (loss)	\$402,375	\$290,290	\$520,750	\$1,213,415
Percentage of Total	43.50%	28.60%	23.31%	29.24%

Summary – Stabilized I & E

General & Administrative Expenses			
Year ending Stabilized		Forecast	% of Rev
Accounting		\$26,000	
Advertising and promotion		\$15,000	0.36%
Automotive		\$2,000	0.05%
Bad Debts		\$0	
Bank and merchant discounts		\$37,500	
Consulting Fees		\$5,000	
Insurance		\$25,000	
Licences and dues		\$5,200	
Management salaries		\$0	
Office and miscellaneous		\$7,500	
Professional fees		\$10,000	
Property taxes		\$28,500	
Repairs and maintenance		\$100,000	2.41%
Supplies and Freight		\$20,000	
Telephone and Utilities		\$75,000	
Unaccounted Expenses		\$5,500	
Wages and Benefits-Admin. Dept.		\$35,000	
Total Administration Expenses		\$395,200	9.57%



Summary – Net Cash Flow

Year ending Stabilized		Forecast	% of Rev
Net Cash Flow Before Mgmt fee		\$818,215	
Management Fee		\$120,000	2.89%
Net Cash Flow (pretax)		\$698,215	16.82%

SELECTION OF THE OVERALL CAP RATE

- The OCR is market based
- OCR reflects all market dynamics of risk, profit, etc.
- Comps should have comparability
- Need to understand cash flow for each comp & market trends
- Requires judgment & understanding of industry



SELECTION OF THE OVERALL CAP RATE

OCR Indicators

Sale #	1	2	3	4	5	6	7
Gross Income	\$1,375,000	\$1,040,000	\$2,060,000	\$2,405,000	\$2,255,000	\$4,300,000	\$2,255,000
GIM	0.98	0.94	1.12	1.33	0.58	0.81	0.98
Gross Profit	\$479,375	\$342,700	\$770,000	\$1,150,000	\$695,389	\$1,720,000	\$695,389
GPM	2.82	2.85	2.99	2.78	1.87	2.03	3.16
Net Income	\$166,775	\$95,863	\$225,000	\$312,131	\$155,890	\$408,500	\$155,890
OCR	12.35%	9.83%	9.78%	9.75%	11.99%	11.67%	7.08%

We will adopt 10.75% as the appropriate OCR

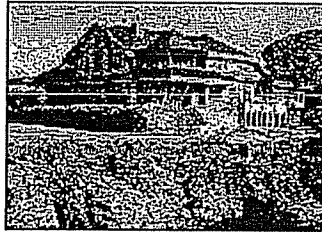
Final Estimate Going Concern Value

Net Cash Flow (pretax)	\$698,215
OCR	0.1075
Value	\$6,495,023.26

Other Market Based Valuation Methods

Direct Comparison \$PSF

GIM or GPM



Extracting Value of Intangibles

- What intangible assets exist?
- Are these assets measurable?
- No generally accepted appraisal methodology
- Some evidence from full service hotel assessment appeals
- Dangerous area for appraisers – we are rarely called on to apportion realty and non-realty assets.



Don

Business Valuation

- Examine the Components of Overall Value
- Business Valuers are not Real Estate Appraisers
- Value the Business

Business Valuation Steps - Summary

1. Review and analyze financial statements of business
2. Both External and Internal financial statements
3. Reconcile Internal to External – often do not reconcile
4. Management meetings
5. Industry research (regulatory, economic, micro, macro, etc)
6. Comparable transaction research
7. Income statement Analysis (non-recurring revenues/expenses)
8. Maintainable Earnings
9. Economic rent (real estate appraiser)
10. Capitalization rate selection
11. Conclusion

Financial Statement Analysis

	6 mos.					
	2007	2006	2006	2005	2004	2003
Pre-tax Income Analysis						
Pub	\$ 320	\$ 293	\$ 588	\$ 551	\$ 619	\$ 490
B&W Store	237	198	457	464	330	322
Pre-tax Income Before Administrative Expenses	\$ 557	\$ 491	\$ 1,045	\$ 1,015	\$ 949	\$ 812
Annualized	\$ 1,185	\$ 1,045				

The Balance Sheet

Current Assets	
Accounts Receivable	\$ 38
Inventory	163
Prepaid Expenses	66
	<u>267</u>
Current Liabilities	
Accounts Payable	1
Working Capital	266
Capital Assets	
Furniture and Fixtures	200
Land and Building	1,800
	<u>\$ 2,266</u>
Financed By:	
Mortgage	\$ 2,000
Shareholder Loans	82
Retained Earnings	184
	<u>\$ 2,266</u>

Maintainable Earnings Analysis

	Peebles	Annualized	
	<u>Stabilized</u>	<u>2007</u>	<u>2006</u>
Revenue	\$ 4,150	\$ 4,156	\$ 3,774
Cost of Sales	2,361	2,364	2,182
Gross Profit	1,789	1,792	1,592
%	43.1%	43.1%	42.2%
Other Income	24	78	68
	1,813	1,870	1,660
Wages and benefits	600	685	615
	<u>\$ 1,213</u>	<u>\$ 1,185</u>	<u>\$ 1,045</u>

Business of Pub vs. Business of Beer and Wine Store

- They are DIFFERENT !
 - Substantially different risks
 - Different growth factors
 - Business complexities (opposite ends of scale)
 - Business Valuation Perspective – They should be valued separately

Selection of Maintainable Operating Cash Flow

Maintainable Pre-tax Earnings Before the Following	\$ 1,100	\$ 1,200
Less:		
Normalized Admin Expenses	395	425
Economic Management Expense	115	130
	510	555
	\$ 590	\$ 645
Say,		\$ 625

Reconciliation of Real Estate Appraiser Value to Business Valuator Value

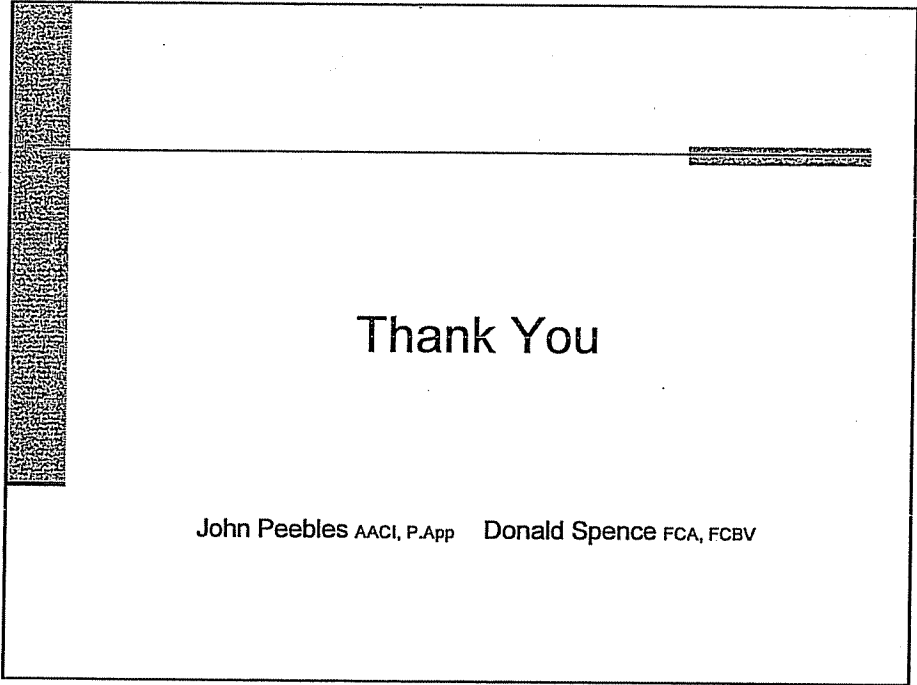
Total Value as Estimated by Real Estate Appraiser		\$ 6,500
Less:		
Depreciated Replacement Value of Real Estate - As Determined by Real Estate		
Land	\$ 1,685	
Buildings	3,665	5,350
	5,350	5,350
Implied Business Value		\$ 1,150

Determination of Business Value

Maintainable Pre-tax Earnings Before the Following	\$ 625	\$ 625	\$ 625	\$ 625	\$ 625
Economic Rent (Land and Buildings)	(225)	(225)	(225)	(225)	(225)
	400	400	400	400	400
Less Income Taxes	(112)	(112)	(112)	(112)	(112)
	288	288	288	288	288
Less Sustaining Capital Reinvestment	(35)	(35)	(35)	(35)	(35)
	253	253	253	253	253
Say,	250	250	250	250	250
Capitalized at %	12.5%	14.3%	20.0%	22.2%	25.0%
Multiple	8.0	7.0	5.0	4.5	4.0
Business Value	\$ 2,000	\$ 1,750	\$ 1,250	\$ 1,125	\$ 1,000

Allocation of Value to Real Estate and Business Assets

Real Estate Value	\$ 5,350
Business Value	
Working Capital	\$ 266
Furniture and Fixtures	200
Goodwill	684
	1,150
Say,	\$ 6,500



Thank You

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