

# ALLOCATION OF GOING CONCERN VALUE

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# INTRODUCTION

- Two Issues:
  1. The allocation of value between assessable property and non-assessable contributors to going concern value, and
  2. The court's role in that allocation.

# ALLOCATE – WHEN?

- Where market comparisons are to entities that include but are not limited to real estate.
- Where there is “Business Enterprise Value”.

# ALLOCATE – WHEN?

- Hotel
- Restaurants
- Care Facilities
- Manufacturing Plants
- Golf Courses

# ALLOCATE - WHY?

- **Because:** The whole is equal to the sum of the parts.  
*Assessment Act, ss. 19(3)*
- **But:** The market ignores the value of the parts.
- **And:** “Facts do not cease to exist because they are ignored.”  
- Aldous Huxley

# ALLOCATE – HOW?

Residual?

- Assessables
- Non-assessables
- Proportional?
- Allocation is a theoretical construct.

# ALLOCATE - WHAT?

## - YES

### - Tangibles:

- FF&E
- Machinery

## - NO

### - Intangibles

- Working capital
- Inventory

## - MAYBE

### - Intangibles

- Franchises
- Patents
- Copyrights
- Contracts
- Assembled workforce
- Brand



*"I love real estate. It's so tangible."*

# THE EMPRESS HOTEL CASE

- Furniture, Fixtures & Equipment (FF&E)
  - *Fairmont Hotels v. Area 01* (2002 PAABC 20039104)
  - *British Columbia (Assessor of Area #01 – Capital) v. Fairmont Hotels & Resorts*, 2005 BCSC 468
  
- Intangibles
  - *Fairmont Hotels v. Area 01* (2005 PAABBC 20040267)



# THE EMPRESS AT THE BOARD -FF&E

- Only FF&E at issue – other issues remain open
- “No commonly accepted method for extracting the value of FF&E from the overall value of a hotel....”



# THE EMPRESS AT THE BOARD -FF&E

- ◆ 2 Steps:
  1. Value the going concern, deducting a **reserve for replacement** of FF&E, then,
  2. Value the FF&E in order to extract it from going concern value.
  
- Step 2 must reflect
  1. **“Return of”**, and
  2. **“Return on”**capital investment in FF&E



# THE EMPRESS AT THE BOARD -FF&E

- **Return of FF&E**  
Absent an appraisal – assumed 50% of replacement cost new
- **Return on FF&E**  
CSB rate of 6%, capitalized at “chattel rate” of 18%



# THE EMPRESS STATED CASE -FF&E

- 3 Questions - 1 Issue
  - ◆ Is the reserve for replacement + the return of FF&E double counting?
- Decision
  - ◆ Not questions of law
    - ★ They looked like questions of fact
    - ★ Not binding precedent



# THE EMPRESS STATED CASE -FF&E

“...it would not have the immutable and binding quality of law.... If the method adopted for accounting FF&E in the assessment of hotel property is flawed, it is for a witness...to so instruct the Board on a future occasion.”

- Paris, J



# THE EMPRESS AT THE BOARD -INTANGIBLES

- The Board accepts that some intangibles may be personal property but finds that some attaches to the realty:
  - “...is the value inextricably intertwined with the realty?”
  - “...there is no evidence that these components actually have value that can be identified and separated from the value of the realty.”

# THE EMPRESS AT THE BOARD -INTANGIBLES

- Accepted the agreement of the appraisers to extract an amount for Brand/Goodwill, but found
  - Dubious choice of comparables
  - Subjective ranking
  - Illogical analysis
- Rejected deductions for
  - Assembled workforce
  - Pre-opening start up costs and initial losses
  - Working capital

Because “inextricably intertwined with the  
reality.” 16

# JASPER PARK LODGE

- *CP Hotels Real Estate Corporation v. Municipality of Jasper, 2005 MGB 002/05 (Alberta)*
- FF&E and Intangibles
- Decision based on equity
- Concerns about extracting non-assessables in the income approach



# JASPER PARK LODGE

## ■ What Concerns?

### ◆ Brand and goodwill

- ★ Flawed methodology
- ★ Subjective ranking
- ★ Unsubstantiated assumptions

### ◆ Start-up costs

- ★ Lack of evidence
- ★ Properly accounted for as expended
- ★ Inappropriate to deduct years later

### ◆ Working capital

- ★ Not usually part of sale price
- ★ No evidence of its value

### ◆ Licenses and permits

- ★ Deducted annually
- ★ No evidence of value above cost



# A MOVING TARGET

- **1995 – *Equitable Life v. County of Hennepin*, 1995 Minn. Tax Lexis 75, (Minn. TC):**

“Dr. Kinnard was reluctant to describe this increment value as business enterprise value or to give it any name. He is sure it exists and he is confident that it can be **measured. We are not so sure.**”

- **1996 - *Appraisal of Real Estate*, 11<sup>th</sup> Ed. p.579:**

“The concept of business enterprise value is... very controversial. As the body of knowledge relating to this issue expands, techniques currently in development may achieve greater definition and acceptance.”

- **1997 – *Merle Hay Mall v. City of Des Moines*, 564 N.W.2d 419 (Iowa SC):**

“The business enterprise value theory is not a generally recognized appraisal method.”

# A MOVING TARGET

- **2001-2 – *Appraisal of Real Estate*, 12<sup>th</sup> Ed.**  
pp.641-2, and 2d Cdn. Ed, p.27.10-12

“The existence of a residual intangible personal property component has been widely recognized for years. Among the many terms used to describe this phenomenon, business enterprise value is the most widely used.”

- **2003 – *Essex House Condo Corp. Case*,**  
Tenn. Board of Equalization, Minsky, Ad.J:

“...although Mr. Lehnnhoff’s methodology [business enterprise value] may not be universally accepted, it is in accord with the position of the Appraisal Institute....”

# A MOVING TARGET

- **2004 – “Total Assets of the business” and Lodging Facilities**, Journal of Property Tax Assessment and Administration, Vol. 1, Issue 4 at 43-44:

“These theories and methodologies are merely contrived academic constructs which have been developed to reduce hotel property tax burdens.”

- **2005 – Wolfchase Galleria Case**, Tenn. Board of Equalization, Minsky, Ad.J:  
Judge Minsky says that when he “issued his decision in *Essex House*, he was not aware of various articles taking issue with Mr. Lehnnhoff’s approach.” He rejects the business enterprise value methodology.

# CONCLUSIONS

- Non-assessable business enterprise value is real
- It is difficult to quantify – an evidentiary challenge
- The methodology to extract it is not settled
- The choice of methodology isn't likely to give rise to a question of law

# FINAL CONCLUSION

It ain't over yet.

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