# VALUING REAL ESTATE IN CLOSELY-HELD ENTITIES

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When was the last time your client presented marital asset of equity in an operating company that also held real estate? In small real-estate centered businesses, this is fairly common. There is some risk that an unsophisticated appraiser or accountant may have undervalued or overvalued the equity because of a lack of real world experience. Too often, narrow definitions and formulas of business or real estate valuation numbs the minds of analysts, giving the deceptive illusion of objectivity and completeness simply because numbers foot. In fact, if calculated value and real world value is large, claims of misrepresentation and incompetence could arise.

What types of entities are these that deserve special consideration? Consider a few:

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| Restaurant | Motel |
| Gas station / C-Store | Marina |
| Car washes | Cemeteries, Mortuaries |
| Amusement parks | Golf courses |
| Grains mills and elevators | Airports |
| Mobil home parks | Recycling centers, landfills |
| Ski resorts | Theatres |

These types of businesses operate with the real estate as special purpose property. Unique problem – dangers for the unwary attorney in configuring the valuation work because the special purpose property may be the major asset of the business in which your client holds equity.

Many times the real estate is separate, held in a corporate wrapper such as an LLC, a partnership, or an S-Corporation. The appraisal process is a bit more direct in this situation: is the operating business paying a fair market rent? These structures are common is small businesses and can be a source for sucking out the earnings with a higher-than-normal rent. Conversely, rent can be "waived" if the operating business is in trouble. Most of the time, the accountant will *accrue* the rent as owed, or a liability. However, you may find sloppy accounting where the actual rent payment is hidden or not recorded properly.

Potholes appraiser or analyst

Transaction databases (Pratt's Stats, BizComps) exclude real estate property. But in the case of the business owning the real estate, no adjustment for reasonable rent is made. So, the transactions themselves must be carefully scrutinized and adjusted if necessary.

Real estate in a desireable location-baed business may include some intangible value for customer patronage. Think of a coin-operated car wash – customers flow into the business because of the location and the need to have their car washed. Locational advantage will be picked up by the real estate appraiser in databases summarizing transactions of going-concern car washes.

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Assumptions of value may be determined by your state law.

<u>In Conclusion</u>

The next time your client presents a marital asset that includes a going-concern real estate centered business, your antennae should stick up! No formula or magic wand will give you a quick answer of value.

Real danger that appraiser (or analyst) may miss or double-count some elements of intangible value. Beware!

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