EXCLUDING INTANGIBLES FROM PROPERTY

The title of this presentation suggests that an exclusion of intangibles from property will necessarily include a determination of the tangible portion of real estate. Since this determination is usually made on the basis of the property owner’s interest or in the interest of the appraisal district, the opportunity for disagreement is apparent. The Dictionary of Real Estate Appraisal, Appraisal Institute, 3rd Addition, defines these terms as follows:

Intangible Property -
1. Non-physical items of personal property, e.g., franchises, trademarks, patents, copyrights, goodwill
2. Deferred items such as a development or organization expense

Tangible Property -
1. Property than can be perceived with the senses; includes land, fixed improvements, furnishings, merchandise, cash, and other items of working capital used in an enterprise.
The Texas Property Tax Code defines as follows:

“Tangible personal property” means personal property than can be seen, weighed, measured, felt, or otherwise perceived by the senses, but does not include a document or other perceptible object that constitutes evidence of a valuable interest, claim, or right and has negligible or no intrinsic value.

“Intangible personal property” means a claim, interest (other than an interest in tangible property), right, or other thing that has value but cannot be see, felt, weighed, measured, or otherwise perceived by the senses, although its existence may be evidenced by a document. It includes a stock, bond, note or account receivable, franchise, license or permit, demand or time deposit, certificate of deposit, share account, share certificate account, share deposit account, insurance policy, annuity, pension, cause of action, contract, and goodwill.

There seems to be only minor debate that other properties such as golf courses, hotels, motels, and health care facilities, have recognized intangible value. Regional shopping centers frequently are the battleground in ad valorem tax cases.

Since, for ad valorem tax purposes, these factors must be defined and valued separately, the methodology of evaluation has also had equal opportunity for disagreement. In order to present an understanding of the evaluation methods, a review of the legal foundation for the exclusion of intangibles follows:

**Constitutional and Statutory Framework**

Under the Texas Constitution, all real property and all tangible personal property is taxable, unless specifically exempted by the
The constitution authorizes, but does not mandate, taxation of intangible property. TEx.CONST.art.VIII, § 1(c).

The legislature elected to not tax intangible property. TEx. Tax CODEANN. § 11.02 (Vernon 1992).

Taxpayers and tax authorities are taking a keen interest in the valuation of intangibles. Because the value of intangible personal property is not taxable, when its value is intertwined with the value of taxable property, the value of the intangible property must be excluded. Gregg County Appraisal District v. Laidlaw.

Moreover, the statutory standards for appraisal practice in Texas require that the value of intangibles be recognized and quantified. USPAP --. The USPAP was adopted by the Texas Legislature in 1991 and its use is required in all appraisals.

Thus, this paper examines how to identify, quantify, and exclude the value of intangible property in valuing property that is otherwise taxable.

Some recent cases include:

1. Simon Property Texas, L.P. vs. Travis Central Appraisal District
2.
3.
4.

Excluding Intangibles - Two Schools of Thought

Some of the arguments against recognizing business value are as follow:

- Mall land prices uniquely make up the difference between sales price and the depreciated replacement cost of the buildings and other improvements because the sites are monopolistic and unrelated to surrounding retail site prices.
• Appraisers and investors have traditionally not recognized shopping malls as businesses.
• Mall businesses have not been sold, exchanged or valued outside of a tax appeal assignment.
• Mall management does not conduct itself in a manner separate from a specialized real estate management team, is unlicensed, and doesn’t consider itself as a taxable revenue entity.
• Malls are really only comprised of a large group of individual businesses and as such are only a means for these businesses to succeed and contribute to the economic health of the community.¹

Others argue that any excess of contract rental over market rental is an intangible. This is supported by Standard Rule 1-2(e), USPAP.

Shopping Center, Appraisal and Analyses, Appraisal Institute, 1st Edition, 1993, discusses the business value component and presents the opinions of noted appraisers that have concluded that business value does indeed exist in the shopping malls as well as those commonly thought to be combined with business value.

Valuation - Excluding Intangibles

1. Intangible Value will be the difference between the Market Value and the Depreciated Cost of the real estate.

<table>
<thead>
<tr>
<th>Calculation of Business Enterprise Value by Extraction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total market value of subject property (as indicated by the income and/or sales comparison approaches)</td>
</tr>
<tr>
<td>Less real property value</td>
</tr>
<tr>
<td>Land (by cost approach)</td>
</tr>
<tr>
<td>Building and site improvements (by cost approach)</td>
</tr>
<tr>
<td>Total</td>
</tr>
<tr>
<td>Indicated business enterprise value</td>
</tr>
</tbody>
</table>
Valuation - Excluding Intangibles

2. Intangible Value will be the difference in value of the income stream capitalized by a market rate not subject to operating agreements and a typical rate for shopping malls.

<table>
<thead>
<tr>
<th>Determining Value of Intangibles by Difference in Capitalization Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Operating Income</strong></td>
</tr>
<tr>
<td><strong>Capitalization Rate</strong></td>
</tr>
<tr>
<td>(Based on analysis of the market for typical shopping centers)</td>
</tr>
<tr>
<td><strong>INDICATED VALUE</strong></td>
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<td><strong>INDICATED VALUE</strong></td>
</tr>
</tbody>
</table>

**INDICATED INTANGIBLE VALUE**  | **$16,666,000**
Valuation - Excluding Intangibles

3. Intangible Value is excluded by deducting from the net income the specific amount attributable to the value of the business.

An additional deduction is made for the return on and of personal property.

<table>
<thead>
<tr>
<th>Estimation of Business Enterprise Value by Residual Income Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net operating income to subject property</td>
</tr>
<tr>
<td>Less return on hotel business</td>
</tr>
<tr>
<td>0.05 x $30,000,000 business revenue</td>
</tr>
<tr>
<td>Less return on personal property</td>
</tr>
<tr>
<td>0.11 x $1,500,000</td>
</tr>
<tr>
<td>Less return of capital in personal property with estimated remaining economic life of 10 years</td>
</tr>
<tr>
<td>1/10 x $1,500,000</td>
</tr>
<tr>
<td>Total</td>
</tr>
<tr>
<td>Income allocated to hotel real property</td>
</tr>
<tr>
<td>Capitalized at indicated market rate for real property only</td>
</tr>
<tr>
<td>$1,185,000/.105</td>
</tr>
</tbody>
</table>
ADDENDA


12."The Valuation of Regional and Super-regional Malls", Assessment Digest, September-December 1991, pp. 2-13


14."The Operation of a Regional or Super Regional Shopping Center: Management-Intensive Operational Business Entrepreneurialship", Presented at SREA 22nd Annual Symposium, San Antonio, Texas by Stephen R. Wheelock, CRE, MAI and Dr. K. Edward Atwood, September 13, 1990


16."Appraising Golf Courses for Ad Valorem Tax Purposes", The Appraisal Journal, October 1993, pp. 611-616

17."Myths about Hotel Business and Personality Values", The Appraisal Journal, October 1993, pp. 608-611

18."Considerations in the Valuation of Hotels", The Appraisal Journal, July 1993, pp. 348-356
