

# Best Practices for Property Appraisals within a Bankruptcy Context

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*This discussion considers the reasons why an appraiser may be asked to develop a debtor entity property appraisal within the context of a bankruptcy proceeding. For purposes of this discussion, the term property includes (1) real estate and real property, (2) tangible personal property, and (3) intangible personal property. This discussion focuses on defining the scope of the bankruptcy-related property appraisal. And, this discussion also considers best practices with regard to the development of—and the reporting of—the bankruptcy-related property appraisal.*

## INTRODUCTION

There are many reasons why an appraiser may be asked to value debtor entity property within a bankruptcy environment. While the focus of this discussion is on property appraisal, there are also many reasons why an appraiser may be asked to develop a property damages analysis or transfer price analysis within a bankruptcy environment.

Before the appraiser is retained, the party-in-interest to the bankruptcy (and, typically, the party's counsel) should carefully define the property appraisal assignment. Based on that assignment definition, the appraiser, the client, and counsel can all agree on the objectives and the scope of the property appraisal.

This discussion summarizes the generally accepted property appraisal approaches and methods that appraisers typically consider in a bankruptcy-related assignment. This discussion also describes the property appraisal synthesis and conclusion process.

Due to the litigious nature of a bankruptcy proceeding, bankruptcy-related property appraisals are often subject to a rigorous contrarian review. Therefore, this discussion recommends best practices related to the attributes of an effective (i.e., persuasive) bankruptcy-related property appraisal report.

## A PROPERTY APPRAISAL

First, let's define the term "property" within the context of this discussion. Second, let's define the term "appraisal" within the context of this discussion.

For purposes of this discussion, let's define the term "property" within a bankruptcy context. Unfortunately, the U.S. Bankruptcy Code does not define either the term "property" or the term "asset."

For purposes of this discussion, "property" is a legal term and "asset" is an accounting term. In general conversation, even in appraisal-related conversation, these two terms are treated as synonyms. However, they do not mean exactly the same thing. Not all types of property are considered to be assets. And, not all types of assets are considered to be property.

*Black's Law Dictionary* defines property as:

1. Collectively, the rights in a valued resource such as land, chattel, or an intangible. It is common to describe property as a "bundle of rights." These rights include the rights to possess and use, the right to exclude, and the right to transfer.
2. Any external thing over which the rights of possession, use, and enjoyment are exercised.<sup>1</sup>

So, typically, in order for something to be considered property, there should be an identified bundle of legal rights (including the legal right to transfer) associated with it.

While the term property has a legal definition, the term assets has an accounting definition. The term assets is generally defined by reference to the Financial Accounting Standards Board Statement of Concepts No. 8, *Conceptual Concepts for Financial Reporting* (“CONS”).

According to CONS, “Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.” CONS also states, “An asset is a present right of an entity to an economic benefit.” And, CONS continues as follows:

An asset has the following two essential characteristics:

- (a) It is a present right.
- (b) The right is to an economic benefit.

Both the legal definition of property and the accounting definition of assets focus on the concept of a bundle of rights. The result of something being considered to be property is that the property rights can be legally protected. The result of something being considered to be an asset is that it is recognized on an entity’s balance sheet prepared in accordance with U.S. generally accepted accounting principles (“GAAP”).

However, not all legally protected property is recognized on a GAAP balance sheet. And, not all assets recorded on a GAAP balance sheet are legally protected property.

This discussion focuses on the concept of property within a bankruptcy context. However, this discussion recognizes that (rightly or wrongly) the term assets is frequently referred to within the bankruptcy context.

This discussion will adopt the definition of “appraisal” provided in the *Uniform Standards of Professional Appraisal Practice* (“USPAP”). USPAP defines appraisal as, “(noun) the act or process of developing an opinion of value; an opinion of value; (adjective) of or pertaining to appraising and related functions such as appraisal practice or appraisal services.”<sup>2</sup>

This USPAP definition of the term “appraisal” is applicable to most bankruptcy-related issues. Unfortunately, the U.S. Bankruptcy Code does not provide a definition of value—or of any particular standard of value. In other words, the Bankruptcy Code does not define fair value, fair market value,

market value, or any other standard (or definition) of value. And, the Bankruptcy Code does not inform us as to which standard of value is relevant to which type of bankruptcy question.

## TYPES OF PROPERTY

This discussion is generally applicable to most categories of debtor entity property that may become an issue in a bankruptcy proceeding. Specifically, this discussion generally encompasses the following categories of debtor entity property:

1. Real estate and real property
2. Tangible personal property
3. Intangible personal property

For purposes of this discussion, the real estate property category includes the tangible elements of land and the structures affixed to land, including, for example, the following:

1. Land
2. Land improvements
3. Buildings and building components

For purposes of this discussion, the real property category includes the intangible elements of real estate, including, for example, the following:

1. Lessor and lessee interests
2. Easements and rights of way
3. Air, water, and subsurface rights

For purposes of this discussion, tangible personal property includes, for example, the following property categories:

1. Office furniture and fixtures
2. Manufacturing machinery and equipment
3. Processing machinery and equipment
4. Trucks and automobiles
5. Computers and information technology equipment

For purposes of this discussion, intangible personal property includes, for example, the following property categories:

1. Identifiable intangible assets
2. Intellectual property
3. Personal and institutional (business) goodwill

We note that the U.S. Bankruptcy Code does not include trademarks or trade names within its definition of intellectual property. However, for purposes of this discussion, the term intellectual property is intended to include all of the following categories: trademarks and trade names, patents, copyrights, and trade secrets.

Unless specifically noted, most of the following discussion will apply to each of the above-listed categories of debtor entity property.

## THE BANKRUPTCY VALUATION ASSIGNMENT

A statement of the purpose and the objective of the appraisal is a best practice at the outset of any bankruptcy-related valuation assignment.

Such a statement requires the appraiser, the client, and legal counsel to carefully think through all of the so-called elements of the valuation assignment. Such a statement also mitigates the possibility of any misunderstandings about the bankruptcy-related valuation assignment.

Whether tangible property or intangible property is the subject of the appraisal, it is a best practice to consider all of the elements of the assignment. When parties need to know the value of property that is either owned by or operated by a debtor entity, the party-in-interest to the bankruptcy should carefully define the elements of the valuation.

Bankruptcy law seeks to preserve the ongoing value of—and to maximize the economic stake of—the creditors to the debtor entity. Typically, in the bankruptcy environment, contracts, leases, and licenses can be assumed, rejected, or assigned. This fact may complicate the appraisal when the debtor in possession (“DIP”) is either a property lessor/licensor or a property lessee/licensee.

For example, let’s assume that the debtor entity is an intellectual property licensor and that the license may be assignable by the bankruptcy estate to the licensor’s competitor. In that case, the appraiser may have to consider whether the intangible property appraisal should be based on the expectation that the licensor is required to continue to support (e.g., make improvements to) the intellectual property (even if it is in the hands of a competitor).

Defining the assignment is a first best practice in the property appraisal process. This definition may influence many of the appraiser’s considerations and procedures. The assignment definition may influence many of the decisions to be made in

the appraisal. The time spent by the appraiser, the client, and legal counsel to define the purpose and the objective of the valuation assignment is time well spent.

There are many possible clients for a bankruptcy-related appraisal assignment. This is because there are typically many parties-in-interest to a commercial bankruptcy. These various parties may include the debtor entity, the debtor entity directors, the court-appointed bankruptcy trustee, the individual secured creditors, a secured creditors committee, an unsecured creditors committee, the individual contract counterparties (e.g., a labor union), and the debtor entity equity holders.

Each of these parties may have an interest in some valuation (or damages or transfer price) aspect of the bankruptcy proceeding.

Regardless of who the client is, the valuation assignment is typically provided by the client to the appraiser. The valuation assignment should describe the objective of the appraisal by considering these elements of the appraisal:

1. Definition of the subject property
2. Description of the ownership characteristics subject to appraisal
3. Decision of the appropriate bundle of legal rights
4. Decision of the appropriate standard of value
5. Decision of the appropriate premise of value
6. Specification of the “as of” valuation date

Before these elements are defined, the purpose of the valuation assignment should be agreed to. That is, the elements of the valuation assignment may also be influenced by the stated purpose of the appraisal. The purpose of the valuation assignment should describe the following:

1. Why the property appraisal is being prepared
2. Why the appraisal is being prepared
3. Who may (and may not) rely on the property value conclusions

## THE BANKRUPTCY VALUATION PURPOSE

There are many reasons why an appraiser may be asked to value the debtor entity property within a bankruptcy context. For this purpose, the subject property can include both:

1. the property owned by the debtor entity and
2. the property operated by the debtor entity (including inbound and outbound leases and licenses).

The property could serve as collateral for either the debtor entity's pre-bankruptcy financing or the DIP financing. A debtor property sale or license could serve to generate needed cash flow for the financially troubled DIP.

The appraiser may be asked to opine on the fairness of the consideration or terms of a property sale, lease, or license. The appraiser may be asked to opine on the impact of an assignment or a rejection of a lease or a license. The appraiser may assess this transactional fairness to the creditors or to other parties-in-interest.

The property value often affects the debtor entity solvency (or insolvency) at various dates prior to the bankruptcy filing.

These debtor entity solvency issues become relevant with regard to allegations of fraudulent conveyance or preference payments. Such solvency issues also may be relevant when the pre-filing debtor entity is operating within the so-called zone of insolvency.

The debtor entity property commercialization potential (or the associated spin-off opportunities) could affect the reasonableness of a proposed plan of reorganization. And, the fair value of the property may be recognized in the fresh start accounting when the debtor entity emerges from bankruptcy.

Under GAAP, the fresh start accounting fair value measurement guidance is provided in the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 852.

Counsel is often involved in the bankruptcy-related property appraisal. This is because counsel is involved in assisting the party-in-interest client in structuring transactions, complying with taxation and accounting requirements, negotiating and arranging financings, litigating claims, and defending and commercializing the debtor entity property.

Within a bankruptcy context, counsel may become involved in the process of:

1. identifying the debtor entity property;
2. performing the related due diligence procedures;
3. interviewing and selecting the appropriate appraiser;
4. defining the appraiser's assignment;

5. helping to assemble valuation-related data and documents;
6. providing legal instructions to the appraiser;
7. reviewing and challenging the property appraisal work product;
8. interpreting and relying on the property appraisal report; and
9. defending the appraiser—and the value conclusions—during any administrative, regulatory, or judicial proceeding.

The appraiser may value the debtor entity property in a bankruptcy proceeding without legal advice from, or assistance by, counsel. However, due to the special nature of the bankruptcy-related engagement, the appraiser and counsel will often work closely in several phases of the bankruptcy-related appraisal.

The following list summarizes some of the many reasons why an appraiser may be asked to value debtor entity property in a bankruptcy environment. Such assignments may come directly from a party-in-interest to the bankruptcy. However, such assignments may also come from counsel to one of the parties.

1. Transaction pricing and structuring
  - Pricing the sale of a DIP's individual property or of a portfolio of two or more property assets
  - Pricing the license of the DIP's individual property or of a portfolio of two or more property assets
  - Valuing the equity allocations in a DIP joint venture when one or more parties contributes property
  - Valuing the asset distributions in a debtor entity liquidation when one or more parties receives distributed property assets
  - Transferring a property between a parent company's subsidiaries (when one subsidiary has filed for bankruptcy protection and another subsidiary has not filed for bankruptcy protection)
2. Financings collateralization and securitization
  - Use of the property as collateral for cash-flow-based or asset-based pre-bankruptcy debt financings
  - Sale/leaseback financing of the (pre-bankruptcy) debtor entity property
3. Taxation planning and compliance

- Effect of the property value on the Internal Revenue Code Section 382 limitation on the debtor entity's use of a net operating loss
  - Effect of the property value on the Section 108 discharge of indebtedness income exclusion related to the debtor entity amount of insolvency
4. Adequate consideration for DIP transactions
- Use of debtor entity property as collateral for a secured creditor's position
  - Use of debtor entity property as collateral for a new secured financing for the DIP
  - Fairness of the sale or lease of property as a DIP cash generation spin-off opportunity
  - Use of the property in the assessment of the debtor entity's solvency or insolvency with respect to alleged fraudulent transfers and preference actions
  - Impact of the debtor entity property on the reasonableness of a proposed plan of reorganization
5. Financial accounting and fair value measurement
- Fair value measurement impairment testing of debtor entity tangible property, intangible property, and goodwill
  - Post-bankruptcy fresh start accounting for the tangible assets and intangible assets of the reorganized debtor entity emerging from bankruptcy
6. Debtor entity strategic planning and management information
- Formation of a DIP property joint venture, joint development agreement, or joint commercialization agreement
  - Negotiation of a DIP inbound or outbound property use, development, commercialization, or exploitation agreement, lease, or license
  - Identification and negotiation of a DIP property license, spin-off, joint venture, and other commercialization opportunity
7. Other bankruptcy considerations
- Prosecution or defense of secured creditor claims that the debtor entity property collateral had "inconsequential value"

- Assessment of the impact on the DIP's decision to reject property inbound/outbound lease or license agreements
- Assessment of the impact on a counterparty of the DIP's decision to reject property inbound/outbound lease or license agreements

Defining the purpose of the assignment may influence the form or the format of the property appraisal work product. The appraisal report can be oral, written, or a combination of the two. The appraisal report should be prepared for a specified purpose and for a specified audience.

The property appraisal should consider all of the appraisal approaches and methods that are relevant for the intended audience. And, the appraisal report should include all of the information appropriate to the intended audience.

The assignment should describe the purpose of the appraisal. And, that assignment purpose should consider the following elements of the appraisal:

1. How will the property appraisal be used?
2. Who will rely on (or receive a copy of) the appraisal report?
3. What form and format of appraisal report is appropriate?
4. Are there any legal instructions (e.g., specific statutory definitions, judicial precedent, or reporting requirements) that the appraiser should consider?

In addition to understanding the reason for developing the property appraisal, it is a best practice for the appraiser to understand exactly what the appraisal objective is. The client or counsel should specifically define which of the following opinions the appraiser is being asked to render:

1. Estimate a value (as specifically defined) for the debtor entity property
2. Measure lost profits or some other damages measurement related to a tort or breach of contract related to the debtor entity property
3. Conclude an arm's-length price for the intercompany transfer of the property
4. Estimate a fair lease or license agreement royalty rate between independent arm's-length parties
5. Conclude the fairness of a property, sale, lease, license, or other transfer transaction from a financial perspective

6. Estimate the debtor entity property useful economic life (“UEL”)

## THE BANKRUPTCY APPRAISAL OBJECTIVE

The first element of the appraisal objective is a definition of the debtor entity property. That definition should specify exactly what property is the subject of the appraisal.

This definition should describe all of the tangible property and intangible property that are included as the subject of the appraisal.

In a bankruptcy-related environment, there may be uncertainty—or controversy—as to exactly what bundle of property—and property rights—should be included with (or excluded from) the assemblage of property that is the objective of the appraisal.

For example, in the property appraisal, there may also be controversy as to whether to include future access to the assets that are not in place as of the valuation date.

The second element of the appraisal objective is a description of the ownership characteristics of the property rights, including any lease, license, or contract in effect.

When a debtor entity operates within the so-called zone of insolvency, that condition may undermine the incentives for the debtor to (1) lease or license any property and (2) make investments to exploit any lease or license agreements that have already been entered into.

When a bankruptcy petition is filed and the bankruptcy stay has been entered, the debtor (as property licensor/lessor or licensee/lessee) cannot pursue a breach of contract action without authorization from the bankruptcy court.

If there is a lease, license, or other agreement associated with the debtor’s property, then the appraiser should be made aware of all relevant contract terms, such as the following:

1. Licensor/licensee responsibility contract terms
  - Legal protection requirements
  - Maintenance expenditures
  - Development expenditures
  - Licenses, permits, or other regulatory approvals
2. Other contract terms
  - Minimum use, production, or sales
  - Minimum marketing or commercialization expense

- Property development payments, completion payments
- Party responsible to obtain the required approvals
- Milestone lease or license payments

The third element of the appraisal objective is a description of the bundle of legal rights. The assignment should specify which of the following (or which other) bundles of rights should be included in the appraisal:

1. Fee simple interest
2. Term/reversion interest
3. Licensor/licensee interest
4. Lessor/lessee interest
5. Territory (domestic/international) interest
6. Product line/industry interest
7. Sublease or sublicense rights
8. Development rights
9. Commercialization/exploitation rights

The fourth element of the appraisal objective is the standard (or the definition) of value. The standard of value typically relates to the question: Value to whom? Different standards of value often correspond to different reasons to conduct the appraisal.

The standard of value may be determined by a statutory, judicial, regulatory, or administrative requirement. Therefore, the client (or counsel) should instruct the appraiser as to the appropriate standard of value.

Some of the alternative standards of value that may be concluded in a debtor entity property appraisal include the following:

1. Fair value
2. Fair market value
3. Market value
4. Use value
5. User value
6. Owner value
7. Investment value
8. Acquisition value

The fifth element of the appraisal objective is the premise of value. The premise of value considers the assumed set of transactional circumstances under which the property transfer (i.e., sale or license) will take place.

Some of the alternative premises of value that may be applied in a debtor entity property appraisal include the following:

1. Value in continued use
2. Value in place (but not in use)
3. Value in exchange—orderly disposition basis
4. Value in exchange—voluntary liquidation basis
5. Value in exchange—involuntary liquidation basis

The selected premise of value is typically an assignment instruction from the client (or counsel) to the appraiser. If the client (or counsel) does not instruct the appraiser as to the appropriate premise of value, then the appraiser may select the premise of value that concludes the highest and best use (“HABU”) for the debtor entity property.

The tests for HABU are based on an analysis of what is physically possible, legally permissible, and financially feasible with regard to the subject property.

In selecting the appropriate HABU of the subject property, the appraiser may consider the following alternatives:

1. Current owner/operator HABU
2. New owner/operator (marketplace) HABU
3. Licensor/lessor and licensee/lessee HABU

The sixth element of the appraisal objective is the valuation date. The client (or counsel) will instruct the appraiser as to the appropriate “as of” date on which to conclude the defined value.

The date, or dates, as of which the property is valued may be important to the value conclusion. This is because circumstances can cause values to vary materially from one date to another, and the valuation date directly influences data available for the appraisal.

Many internal and external factors can influence property value. A sudden change in the debtor entity earnings, especially if unanticipated, can have a material effect on value. Also, the property value can vary with the debtor entity’s cost of capital, a factor that can vary over time. Major events, such as the signing or the termination of a license agreement, can also affect the property value.

In order to serve the information needs of the client, the appraiser should have a clear understanding of the assignment. In a bankruptcy-related assignment, counsel is typically responsible for ensuring that the appraiser develops that understanding.

## APPRAISAL DATA GATHERING AND DUE DILIGENCE PROCEDURES

Before selecting and applying any of the generally accepted property appraisal approaches, methods, and procedures, the appraiser performs due diligence with respect to the debtor entity property.

Counsel may participate in this due diligence process. That counsel participation may particularly occur if the appraisal relates to a property transaction, financing, or litigation.

These due diligence procedures relate to identifying and obtaining information for the property appraisal. The appraiser’s due diligence process is a supplement to—and not a substitute for—counsel’s legal due diligence process.

First, the appraiser typically gathers and analyzes information related to the current owner/operator (i.e., the debtor entity). The information typically relates to the property’s historical development and current use.

Such information may include the following:

1. Owner/operator historical and prospective financial statements
2. Owner/operator historical and prospective development/maintenance costs
3. Current and expected owner/operator resource/capacity constraints
4. Description and estimate of the property’s economic benefits to the current owner/operator
  - Associated revenue increase (e.g., related product unit price/volume, market size/position)
  - Associated expense decrease (e.g., expense related to product returns, cost of goods sold; selling, general, and administrative, R&D)
  - Associated investment decrease (e.g., inventory, capital expenditures)
  - Associated risk decrease (e.g., the existence of a property lease, license, or other contract, decrease in the cost of capital components)

The appraiser may consider the property’s market potential outside of the debtor entity. For example, the appraiser may consider the following factors from the perspective of an alternative (e.g., hypothetical willing buyer/willing lessee or licensee) owner/operator:

1. Change in the market definition or in the market size for an alternative owner/user

2. Change in alternative/competitive uses for an alternative owner/user
3. The property's ability to create inbound/outbound lease or license opportunities to an alternative owner/user
4. Whether the debtor entity can operate the property and also outbound lease or license the property (in different products, different markets, different territories, etc.)

The appraiser may also review and challenge any debtor-prepared financial projections and any debtor-prepared measurements of property's economic benefits. The appraiser may test such financial projections and economic benefit measurements against industry, guideline company, and other benchmark comparisons.

For example, the appraiser may perform the following comparative benchmark analyses:

1. Compare prior debtor entity projections to prior debtor actual results of operations
2. Compare current debtor management projections to the debtor's current capacity constraints
3. Compare current debtor management projections to the current total market size
4. Consider published industry average comparable profit margin data
5. Consider selected guideline publicly traded company profit margin data
6. Consider the quality and the quantity of available guideline or comparable property lease or license data
7. Perform a debtor property UEL analysis, with consideration to the following:
  - Physical life
  - Legal/statutory life
  - Contract/license life
  - Technology obsolescence life
  - Economic obsolescence life
  - Lives (i.e., ages) of any prior generations of the subject property
  - Position of the subject property in its life cycle

In addition to comparing the debtor entity's historical and projected results of operations to those of selected guideline public companies (described below), the appraiser may compare the debtor entity results of operations to published industry data sources.

## GENERALLY ACCEPTED PROPERTY APPRAISAL APPROACHES AND METHODS

The three generally accepted property appraisal approaches are the cost approach, the market approach, and the income approach. These appraisal approaches apply generally to real estate, to tangible personal property, and to intangible personal property.

Appraisers typically consider, and attempt to apply, all three generally accepted property appraisal approaches in each debtor entity property appraisal. Practically, however, many industrial or commercial property appraisals are based primarily on the application of one or two of the property appraisal approaches.

For each property appraisal, the appraiser selects the generally accepted approach (or approaches):

1. for which there is the greatest quantity and quality of available data,
2. for which the appraiser can perform the most comprehensive due diligence procedures,
3. that best reflect the actual transactional negotiations of market participants in that industry,
4. that best fit the characteristics (e.g., use, age, etc.) of the debtor entity property, and
5. that are most consistent with the professional experience and informed judgment of the appraiser.

Within each property appraisal approach, there are several appraisal methods that the appraiser can select and apply. And, within each method, there are numerous appraisal procedures that the appraiser can perform. Appraisal procedures are performed within a method to conclude a value indication. The appraiser may perform two or three appraisal methods within a single appraisal approach.

For example, the appraiser may develop two different income approach methods and reconcile the three value indications in order to conclude a single income approach value indication.

The appraiser reconciles the various value indications (if more than one approach is used). This synthesis of the various value indications results in a final value conclusion for the debtor entity property.

All of the cost approach appraisal methods are based on the principle of substitution. That is, the



value of the actual property is influenced by the cost to create a substitute property.

All cost approach appraisal methods apply a comprehensive definition of cost, including consideration of an opportunity cost component during the property development stage. In addition, the cost of the substitute property should be reduced (or depreciated) in order to make the substitute property comparable to the actual property.

All market approach appraisal methods are based on the principles of (1) efficient markets and (2) supply and demand. That is, the value of the debtor entity property may be estimated by reference to prices paid in the marketplace for the arm's-length sale, lease, or license of comparable (or guideline) property. Comparable sale data are analyzed in order to extract pricing multiples or other metrics that can be applied to the debtor entity property.

All income approach appraisal methods are based on the principle of anticipation. That is, the value of any income-producing property is the present value of the income that the owner/operator expects to receive from owning or operating that property. All income approach methods involve a projection of some measure of owner/operator income over the property's expected UEL.

Such income measures may relate to:

1. the income earned from operating the property in the owner/operator business enterprise and/or
2. the income earned from leasing or licensing the property from the owner/licensor to an operator lessor/licensee that will pay a lease payment or a royalty (or some other fee) for the use of the property.

This income projection is converted to a present value by the use of a risk-adjusted present value discount rate (or an annuity direct capitalization rate).

Cost approach appraisal methods may be particularly applicable to the valuation of a recently developed debtor entity property. In the case of relatively new property, the debtor entity development cost and effort development data may be available (or may be subject to accurate estimation).

In addition, cost approach appraisal methods may be applicable to the appraisal of in-process property, special purpose property, or noncommercialized property.

In all cases, the appraiser should realize that the debtor entity property value is not derived from the cost measure alone. Rather, the property value is derived from the cost measure (however defined)

less appropriate allowances for all forms of depreciation and obsolescence.

Market approach methods may be applicable when there is a sufficient quantity of comparable (almost identical) or guideline (similar from an investment risk and expected return perspective) property transaction data. These transactions may relate to either sale, lease, or license transactions.

The appraiser attempts to extract market-derived valuation pricing indications (e.g., pricing multiples or other metrics) from these comparable transaction data to apply to the corresponding metrics of the subject property.

Income approach appraisal methods may be applicable in situations where the debtor entity property is used to generate a measurable amount of income. This income can either be:

1. operating income (when the property is used in the owner's business operations) or
2. ownership income (when the property is leased or licensed from the owner/licensor to an operator/licensee) to produce rental or royalty income.

Income approach appraisal methods may be applied when the owner/operator has elected to not currently commercialize the property. An example may be when this forbearance of use is for the purpose of protecting the income that is produced by the owner/operator's other property.

## FOR FURTHER REFERENCE

The following discussion summarizes the generally accepted property appraisal approaches and methods. This discussion is intended to be general and apply to all debtor entity property categories. There are both professional literature and valuation professional organization ("VPO") professional standards related to the appraisal of the individual categories of debtor entity property.

For example, for a more comprehensive discussion of real estate appraisal approaches, methods, and procedures, readers are referred to *The Appraisal of Real Estate*, 15th edition, published by the Appraisal Institute in 2020.

For a more comprehensive discussion of tangible personal property appraisal approaches, methods, and procedures, readers are referred to *Valuing Machinery and Equipment: The Fundamentals of Appraising Machinery and Technical Assets*, 4th edition, published by the American Society of Appraisers in 2020.

And, for a more comprehensive discussion of intangible personal property appraisal approaches, methods, and procedures, readers are referred to *Guide to Intangible Asset Valuation*, revised edition, published by the American Institute of Certified Public Accountants in 2014.

## COST APPROACH APPRAISAL METHODS

There are several generally accepted property appraisal methods within the cost approach. Each of the appraisal methods applies a particular definition of cost.

These definitions of cost include the following:

1. Reproduction cost new (“RPCN”)
2. Replacement cost new (“RCN”)
3. Historical cost (or original cost) (“HC” or “OC”)

RPCN is the total cost, at current prices, to develop an exact duplicate of the actual property. RCN is the total cost, at current prices, to develop an asset having the same functionality or utility as the actual property.

Functionality is an engineering concept that means the ability of the property to perform the task for which it was designed. Utility is an economics concept that means the ability of the property to provide an equivalent amount of satisfaction.

Historical cost is less frequently applied in cost approach property appraisals. However, it is sometimes applied in the development of unit principle property appraisals developed for property tax purposes.

And historical cost is sometimes applied in the appraisal of public utility or other regulated-industry property. Historical cost considers the cost of the subject property when it was originally purchased, constructed, or developed.

In contrast, original cost considers the cost of the subject property when it was purchased, constructed, or developed by the current property owner. So, historical cost considers the price paid by the very first property owner—when the property was first placed in service. Original cost considers the price paid by the current owner to the previous property owner. In a business combination (e.g., a merger or acquisition transaction), the original cost may be influenced by the transaction purchase price allocation.

There are other cost definitions that may be applicable to a cost approach property appraisal.

Some appraisers consider a measure of cost avoidance as a cost approach method. This appraisal method quantifies either historical or prospective costs that are avoided because the debtor entity actually owns (and does not have to lease or license) its own property.

Some appraisers consider historical cost or trended historical cost as a cost measure. In the trended historical cost method, historical development costs are identified and trended to the valuation date by an inflation-based index factor.

Regardless of the specific cost definition applied, all cost approach appraisal methods include a comprehensive definition of cost.

The cost measurement (whether RCN, RPCN, or some other cost measure) typically includes the following four cost components:

1. Direct costs (e.g., materials)
2. Indirect costs (e.g., engineering and design labor)
3. The property developer’s profit (on the direct cost and indirect cost investment)
4. An opportunity cost/entrepreneurial incentive (to motivate the property development process)

The property construction or development material, labor, and overhead costs may be easy to identify and quantify. The developer’s profit may be estimated using several procedures. It is often estimated as a percentage profit margin on the developer’s investment in the material, labor, and overhead costs.

The entrepreneurial incentive may be measured as the lost profits during the replacement property development period. Alternatively, entrepreneurial incentive is sometimes measured as a fair rate of return on investment during the duration of the property development process.

For example, let’s assume it would take two years to develop a replacement property. If the buyer buys the seller’s actual property, then the buyer can start earning income (either operating or license income) immediately.

To illustrate entrepreneurial incentive, let’s consider the development (or replacement) of a property. If the property buyer “builds” its own hypothetical replacement property, then the property buyer will not earn any income (operating or license) during the two-year development period.

The two years of lost profits during the hypothetical property development period represents the opportunity cost of developing a new replacement

property—compared to buying the debtor entity’s actual property.

All four cost components—that is, direct costs, indirect costs, developer’s profit, and entrepreneurial incentive (or opportunity cost)—should be considered in the cost approach analysis. While the cost approach is a different set of analyses from the income approach, there are economic analyses included in the cost approach.

These cost approach economic analyses provide indications of both:

1. the appropriate levels of opportunity cost (if any) and
2. the appropriate amount of economic obsolescence (if any).

The current cost metric (however measured) should be adjusted for losses in value due to:

1. physical deterioration,
2. functional obsolescence, and
3. external obsolescence.

Physical deterioration is the reduction in property due to physical wear and tear. While it is unlikely that an intangible property will experience physical deterioration, this type of appraisal depreciation should be considered in every property appraisal.

Functional obsolescence is the reduction in value due to the property’s inability to perform the function (or yield the periodic utility) for which it was originally designed. The technological component of functional obsolescence is a decrease in value due to improvements in technology that make the actual property less than the ideal replacement for itself.

External obsolescence relates to a decrease in property value due to influences external to (or outside of) the subject property. The economic obsolescence component of external obsolescence is a reduction in value due to the effects, events, or conditions that are external to—and not controlled by—the property current use or condition.

The impact of economic obsolescence is typically beyond the control of the debtor entity.

In any cost approach analysis, the appraiser typically estimates the amounts (if any) of the property physical deterioration, functional obsolescence, and economic obsolescence. In this estimation, the appraiser typically considers the property’s actual age—and its expected UEL.

Appraisers sometimes apply the following cost approach formula to quantify RCN:  $RPCN - \text{curable functional obsolescence} = RCN$ .

To estimate the debtor entity property value, analysts often apply the following cost approach formula:  $RCN - \text{physical deterioration} - \text{economic obsolescence} - \text{incurable functional obsolescence} = \text{property value}$ .

In summary, in the application of the cost approach to value debtor entity property within a bankruptcy context, the appraiser should recognize the following misconceptions regarding the cost approach:

1. The cost approach value indication does not equal accounting net book value (and the cost approach does not include the so-called net book value method).
2. The cost approach to property valuation is not the asset-based approach to business valuation.
3. The cost approach only considers future costs. That is, the cost approach considers the costs that would be measured on the valuation date to replace or reproduce the subject property. The cost approach is not a backward-looking analysis.
4. The so-called cost savings method is an income approach valuation method, not a cost approach valuation method.
5. The cost approach considers capitalizable expenditures, and not current period expenses.
6. The cost approach should consider an opportunity cost component (as part of the entrepreneurial incentive cost component).
7. The cost approach should consider all forms of obsolescence.
8. The cost approach does not typically consider any income tax considerations.

## MARKET APPROACH APPRAISAL METHODS

Appraisers often attempt to apply market approach methods first in the debtor entity property valuation process. This is because the market—that is, the economic environment where arm’s-length transactions between unrelated market participants occur—often provides the best indicator of value.

However, the market approach will only provide meaningful appraisal pricing evidence when the actual (i.e., the debtor’s) property is sufficiently similar to the guideline properties that are transacting (by sale, lease, or license) in the marketplace. In that case, the guideline transaction (sale or license)

prices may provide market-derived evidence of the expected price for the debtor entity's property.

The generally accepted market approach property appraisal methods include the following:

1. The comparable transaction (or comparable sales) method (principally applied to tangible property)
2. The relief from royalty method (principally applied to intangible property)

In the comparable transaction method, the appraiser searches for arm's-length sales, leases, or licenses of either comparable or guideline property.

In the relief from royalty ("RFR") method, the appraiser recognizes that the debtor entity in fact owns the subject intangible property. However, the appraiser assumes that, if the debtor entity did not own the intangible property, then the debtor would have to inbound license the use of that property from a third-party licensor.

Therefore, because the debtor does own the actual property, the debtor is "relieved" from having to pay a royalty payment on the inbound license of the property. The appraiser values the subject intangible property as the present value of the license royalty payment that the debtor entity is "relieved" from paying.

In the application of the comparable transaction method, the appraiser often relies on comparable or guideline sale transactions related to real estate or tangible personal property. This is because third-party sales of tangible property are more typical than third-party sales of intangible property.

In the comparable transaction method, first, the appraiser researches the appropriate exchange markets to obtain information about sale transactions, involving either guideline (i.e., similar from an investment risk and expected return perspective) or comparable (i.e., almost identical) property that may be compared to the debtor entity property.

Some of the comparison attributes may include characteristics such as property type, property use, industry in which the property operates, date of sale, and so on.

Second, the appraiser verifies the transactional information by confirming that (1) the transactional data are factually accurate and (2) the sale exchange transactions actually reflect arm's-length market considerations.

If the guideline sale or license transaction was not at arm's-length market conditions, then adjustments to the transactional data may be necessary.

This verification procedure may also elicit additional information about the current market conditions related to the potential sale of the actual debtor entity property.

Third, the appraiser typically selects relevant units of comparison (e.g., income pricing multiples or dollars per unit—such as "per horse power" or "per square foot"). And, the appraiser develops a comparative analysis for each selected unit of comparison.

Fourth, the appraiser compares the selected guideline or comparable property sale or license transactions with the debtor entity's actual property, using the selected elements of comparison.

Then, the appraiser adjusts the sale price of each guideline transaction for any differences between (1) the guideline property and (2) the actual property. If such comparative adjustments cannot be measured, then the appraiser may eliminate the sale transaction as a guideline for future valuation consideration.

Fifth, the appraiser selects pricing metrics to apply to the actual property from the range of pricing metrics indicated from the guideline or comparable transactions.

The appraiser may select pricing multiples at the low end, midpoint, or high end of the range of pricing metrics indicated by the transactional sale data. The appraiser selects the subject-specific pricing metrics based on the appraiser's comparison of the actual property to the guideline property.

Sixth, the appraiser applies the selected subject-specific pricing metrics to the debtor entity's financial or operational fundamentals (e.g., revenue, income, amount of motor horsepower, amount of building square feet, etc.). This procedure typically results in several market-derived value indications for the debtor entity's property.

Seventh, the appraiser reconciles the various value indications produced from the analysis of the guideline sale transactions into a single market approach value indication. In this final reconciliation procedure, the appraiser summarizes and reviews (1) the transactional data and (2) the quantitative analyses (i.e., various pricing multiples) that resulted in each value indication.

Finally, the appraiser resolves these multiple value indications into a single market approach value indication.

The appraiser may confer with the debtor entity management to explore whether the debtor itself has entered into any property sale agreements. These debtor entity agreements may relate to sale of operating property or surplus property—either before or during the bankruptcy proceedings.

The RFR method also relies on arm's-length transactional data—in this case, the inbound or outbound license of comparable or guideline intangible property. Some appraisers consider the RFR method to be an income approach valuation method. This is because a projected royalty expense savings is capitalized in order to reach a value indication.

Other appraisers consider the RFR method to be a cost approach appraisal method. This is because the “cost” of the royalty (i.e., the expense of the license payment) is avoided because rights associated with the intangible property is owned by the debtor owner/operator.

However, this intangible property valuation method is typically considered to be a market approach appraisal method. This is because the RFR method relies on market-derived, empirical transaction data.

In applying the RFR method, the appraiser assumes that the debtor entity does not own the actual intangible property. Without this ownership, the debtor entity would have to license the intangible property from a hypothetical licensor.

So the debtor entity becomes a hypothetical licensee that licenses the intangible property from a hypothetical third-party licensor. In that scenario, the debtor entity or licensee would have to pay a royalty payment to the hypothetical owner or licensor. The royalty payment would be for a use license to use the intangible property in the debtor's business operations.

In reality, the debtor entity does own the intangible property. Because of that ownership, the debtor entity avoids the cost of having to pay a use license royalty payment to a third-party licensor. Therefore, the debtor's intangible property can be valued by reference to this hypothetical royalty payment that the debtor is relieved from making.

The hypothetical royalty payment is often calculated as a market-derived royalty rate multiplied by the debtor entity's revenue. So the application of this method requires (1) an analysis of comparable property license royalty rates and (2) a projection of the debtor entity revenue related to the use of the actual intangible property.

In this appraisal method, the revenue expected to be generated by the intangible property (from all sources) during its UEL is multiplied by the selected royalty rate. The product of the multiplication is a projection of the royalty expense that the owner/operator is relieved from paying because of its ownership of that intangible property.

This projected royalty expense is capitalized over the intangible property's UEL. The result of

this capitalization process is the intangible property value indication.

Although the projected royalty expense is typically based on a royalty rate multiplied by the debtor's entity's revenue, it could also be based on a royalty rate multiplied by gross profit, net income, number of units produced, number of units sold, or some other owner/operator metric.

The royalty expense should be the amount of the net royalty expense that the debtor entity is relieved from paying. Therefore, if the debtor entity would have to pay for intangible property development, maintenance, promotion, or legal protection expenses (as part of its licenses agreement), then these expenses should be subtracted from the royalty expense projection.

The objective of the analysis is to measure the net benefit to the debtor from not having to inbound license the intangible property. So when analyzing the transactional data, the appraiser should consider which party would be responsible for these intangible property maintenance expenses: the actual owner or licensee or the hypothetical owner or licensor.

In the application of the RFR method, the appraiser typically performs the following procedures:

1. Select and document the criteria to be used for selecting the comparable license agreements; such criteria could include type of intangible property, type of owner/operator, type of industry in which the property is used, size of the market in which the property is used, and dates and term of the license agreements.
2. Assess the terms of each selected intangible license agreement with consideration of:
  - the description of the bundle of legal rights for the licensed comparable property,
  - the description of any maintenance or other expenditures required for the comparable property (for example, product development, advertising, product promotion, or legal protection),
  - the effective date of the comparable license agreement,
  - the termination date of the comparable license agreement, and
  - the degree of exclusivity of the comparable license agreement.

3. Assess the current status of the industry and the associated relevant market and prospective trends.
4. Estimate an appropriate market-derived capitalization rate for the royalty expense projection; the capitalization rate considers the risk of the royalty expense projection and the UEL of the intangible property.
5. Apply the market-derived capitalization rate to the royalty expense avoidance projection in order to conclude a value indication.

The RFR method has particular application for the type of intangible property that is typically licensed between licensors and licensees. This method is also applicable when there are a sufficient number of comparable license agreements related to sufficiently similar intangible property.

The RFR method may be especially applicable when the intended standard of value is fair value or fair market value. That is because this valuation method is based on actual arm's-length transactions (licenses) between independent parties.

It may be applicable when the appraiser has access to the debtor's financial projections, especially debtor revenue projections. It may also be applicable when the appraiser has developed an estimate of the intangible property's UEL.

The RFR method may be less applicable in the following circumstances:

- In the analysis of intangible property that is not typically licensed between a licensor and a licensee
- When there is not a sufficient quantity of comparable license agreements or if the licensed intangible property is not sufficiently similar to the actual intangible property
- When the appraiser does not have access to the debtor's financial projections or cannot estimate the subject intangible property's UEL
- When the appraiser does not have sufficient information about which comparable transaction party (licensor or licensee) is responsible for the intangible property maintenance and protection expenses

## INCOME APPROACH APPRAISAL METHODS

In the application of the income approach, value is estimated as the present value of the future income

from the ownership/operation of the debtor entity's property.

The present value calculation has three principal components:

1. An estimate of the duration of the income projection period, typically measured as the debtor property's UEL
2. An estimate of the property-related income for each period in the UEL projection, typically measured as either (a) owner income (e.g., lease rent or license royalty income), (b) operator income (e.g., some portion of the total business enterprise income), or (c) both
3. An estimate of the appropriate present value discount rate or direct capitalization rate, typically measured as the required rate of return on an investment in the debtor's property

For purposes of the income approach, the property UEL relates to the period of time over which the debtor entity expects to receive the income metric related to the subject property:

1. lease,
2. license,
3. operational use, or
3. forbearance of operational use.

In addition to the term of the UEL, the appraiser may also be interested in the shape of the UEL curve. That is, the appraiser may be interested in the annual rate of decay of the debtor property's expected future income.

For purposes of the income approach analysis, many different income measures may be relevant. If properly applied, these different income measures can all be applied in the income approach analysis to conclude a value indication.

Some of the different income measures that may be applied in the income approach analysis include the following:

1. Gross or net revenue
2. Gross income (or gross profit)
3. Net operating income
4. Net income before tax
5. Net income after tax
6. Operating cash flow
7. Net cash flow

8. Incremental income
9. Differential income
10. Rent or royalty income
11. Excess earnings income
12. Several others

Because there are different income measures that may be applied in the income approach, it is important for the capitalization rate (either the present value discount rate or the direct capitalization rate) to be derived on a basis consistent with the level of income measure applied in the appraisals.

Regardless of the measure of income considered in the income approach, there are several categories of appraisal methods that may be applied to value the debtor entity's property:

1. Appraisal methods that quantify an incremental level of property income—that is, the debtor entity may expect a greater level of revenue (however measured) by owning/operating the property as compared to not owning/operating the property.

Alternatively, the debtor entity may expect a lower level of costs—such as capital costs, investment costs, or operating costs (expenses)—by owning/operating the property as compared to not owning/operating the property.

2. Appraisal methods that estimate the present value of actual or hypothetical lease or rent license royalty income—that is, these methods estimate the amount of actual or hypothetical lease or royalty income that the entity company (as licensor) would generate from the outbound license of the use of the subject property.
3. Appraisal methods that estimate a residual measure of property income—that is, these methods typically start with the debtor entity overall business enterprise income. Next, the appraiser identifies all of the tangible property and routine intangible property (other than the subject property) that are used in the debtor entity's overall business.

These other properties are typically called “contributory assets.” The appraiser then multiplies a fair rate of return times the value of each of the contributory assets. The product of this multiplication is the fair return on all of the contributory assets.

The appraiser then subtracts the fair return on the contributory assets from the debtor business enterprise total income. This residual (or excess) income is the income related to the subject property.

4. Appraisal methods that rely on a so-called profit split—that is, these methods typically also start with the debtor entity's business enterprise total income.

Typically applied to the appraisal of intangible property, the appraiser then allocates or “splits” this total income between (a) the entity's tangible property and routine intangible property and (b) the subject property.

The profit split percent (e.g., 20%, 25%, etc.) to the subject property is typically based on the appraiser's functional analysis of the debtor entity's business operations. This functional analysis identifies the relative importance of:

- a. the subject property and
- b. the routine (or contributory) assets—to the production of the debtor entity's business total income.

5. Appraisal methods that quantify comparative income—that is, these methods compare the debtor entity's income to a benchmark measure of income that, presumably, does not benefit from the use of the subject property.

Such benchmark income measures typically include (a) the debtor entity's income before the subject property development, (b) industry average income levels, or (c) selected guideline publicly traded company income levels.

One typical measure of income for these comparative analyses is the EBIT margin.

When publicly traded companies are used as the comparative income benchmark, the method is sometimes called the comparable profit margin method.

All of these income approach property appraisal methods can be applied using either:

1. the direct capitalization procedure or
2. the yield capitalization procedure.

In the direct capitalization procedure, the appraiser:

1. estimates a normalized income measure for one future period (typically, one year) and
2. divides that measure by an appropriate investment rate of return.

The appropriate investment rate of return is called the direct capitalization rate. The direct capitalization rate may be derived for:

1. a perpetuity time period or
2. a specified finite time period.

This selection of the capitalization period depends on the appraiser's estimate of the subject property's expected UEL.

Typically, the appraiser concludes that the subject property has a finite expected UEL. In that case, the appraiser may use the yield capitalization procedure. Or, the appraiser may use the direct capitalization procedure with a limited life direct capitalization rate.

Mathematically, the limited life capitalization rate is typically based on a present value of annuity factor ("PVAF") for the subject property's expected UEL.

In the yield capitalization procedure, the appraiser projects the appropriate income measure for several future time periods. The discrete time period is typically based on the subject property's expected UEL. This income projection is converted into a present value by the use of a present value discount rate.

The present value discount rate is the investor's required rate of return—or yield capitalization rate—over the expected term of the income projection.

The result of either the direct capitalization procedure or the yield capitalization procedure is the income approach value indication for the debtor entity's property.

## APPRAISAL SYNTHESIS AND CONCLUSION

In the appraisal synthesis and conclusion, the appraiser considers the following question: Does the selected property appraisal approach(es) and method(s) accomplish the appraiser's assignment?

That is, does the selected approach and the selected method actually quantify the intended objective of the debtor entity property analysis, such as:

- a defined value,
- a transaction price,
- a third-party license rate,
- an arm's-length intercompany transfer price,
- a damages measurement,
- a property bundle exchange ratio, or
- an opinion on the property transaction fairness.

With regard to a bankruptcy-related appraisal analysis, the appraiser also considers if the selected appraisal approach and method analyzes the appropriate property bundle of legal rights. The appraiser also considers if there were sufficient empirical data available to perform the selected appraisal approach and method.

The appraisal synthesis considers if there were sufficient data available to make the appraiser comfortable with the analysis conclusion. The appraiser may also consider if the selected approach and method will be understandable to the intended audience for the property appraisal.

The appraiser also considers which appraisal approaches and methods deserve the greatest consideration with respect to the subject property's expected UEL. The subject property's expected UEL is an important consideration in each appraisal approach.

In the income approach, the expected UEL affects the projection period for the property income subject to either yield capitalization or direct capitalization.

In the cost approach, the expected UEL affects the total amount of obsolescence, if any, from the estimated cost measure—whether that be the property reproduction cost new or the property replacement cost new.

In the market approach, the expected UEL affects the selection, rejection, and/or adjustment of the comparable or guideline sale, lease, or license transactional data.

The following factors influence the appraiser's consideration of the debtor property's expected UEL:

- Physical factors
- Legal factors
- Contractual factors
- Functional factors
- Technological factors



- Economic factors
- Analytical factors

Each of these factors is normally considered in the appraiser's UEL estimation. Typically, the life factor that indicates the shortest UEL conclusion deserves the primary consideration in the bankruptcy-related appraisal synthesis and conclusion.

Ultimately, the appraiser applies professional judgment to weigh the various appraisal approach and method value indications in order to reach a final value conclusion.

The appraiser's weighting of the value indications (whether quantitative or qualitative) is based on the following:

- The appraiser's confidence in the quantity and quality of available data
- The appraiser's level of due diligence performed on those data
- The relevance of the valuation method to the debtor entity property's life cycle stage and degree of marketability
- The degree of variation in the range of the value indications

Based on the appraisal synthesis, the debtor entity property final value conclusion can be (1) a point estimate (which is typical for fair market value valuations) or (2) a value range (which is typical for transaction negotiations or proposed license/lease/sale transaction fairness opinions).

## ATTRIBUTES OF AN EFFECTIVE BANKRUPTCY APPRAISAL REPORT

There are numerous objectives of any property appraisal report that is prepared within a bankruptcy environment.

First, the appraiser wants to persuade the appraisal report reader (whether the reader is a potential transaction participant, the DIP management, a creditor, counsel for any party, a judge or other finder of fact, etc.).

And, second, the appraiser wants to defend the property value conclusion.

In order to accomplish these objectives, the content and the format of the property appraisal report should demonstrate that the appraiser:

1. understood the specific property valuation assignment;

2. understood the debtor entity's property and the subject property's bundle of legal rights;
3. collected sufficient debtor entity financial and operational data;
4. collected sufficient industry, market, and competitive data;
5. documented the specific property's economic benefits to the debtor entity;
6. performed adequate due diligence procedures related to all available data;
7. selected and applied all applicable income approach, market approach, and cost approach appraisal methods; and
8. reconciled all value indications into a final value conclusion.

The final procedure in the entire bankruptcy-related analysis is for the appraiser to defend the value conclusion in a replicable and well-documented property appraisal report.

The written property appraisal report will typically:

- explain the debtor entity property appraisal assignment,
- describe the debtor entity subject property and the subject bundle of legal rights,
- explain the selection of (and the rejection of) all generally accepted property appraisal approaches and methods,
- explain the selection and the application of all specific appraisal procedures,
- describe the appraiser's data gathering and due diligence procedures,
- list all documents and data considered by the appraiser,
- include copies of all documents that were specifically relied on by the appraiser,
- summarize all of the qualitative appraisal analyses developed,
- include schedules and exhibits documenting all of the quantitative appraisal analyses developed,
- avoid any unexplained or unsourced appraisal variables or appraisal assumptions, and
- allow the appraisal report reader to be able to replicate all of the appraisal analyses developed.

In order to encourage the reader's acceptance of the appraisal report conclusion, the appraisal report should be:

- clear, convincing, and cogent;
- well-organized, well-written, and well-presented; and
- free of grammatical, punctuation, spelling, and mathematical errors.

In summary, the effective (i.e., persuasive) debtor entity property appraisal report will tell a narrative story that:

1. defines the appraiser's assignment;
2. describes the appraiser's data gathering and due diligence procedures;
3. justifies the appraiser's selection of the generally accepted property appraisal approaches, methods, and procedures;
4. explains how the appraiser developed the appraisal synthesis and reached the final value conclusion; and
5. defends the appraiser's property value conclusion.

## SUMMARY AND CONCLUSION

This discussion considered the various types of debtor entity property analyses that an appraiser may be asked to develop within a bankruptcy environment. For purposes of this discussion, the term property includes real estate and real property, tangible personal property, and intangible personal property.

For all debtor entity property appraisals, it is a best practice for appraisers to consider all of the generally accepted property appraisal approaches—including the cost approach, the market approach, and the income approach.

Each of these property appraisal approaches has the same objective: to arrive at a defined value indication for the debtor entity's property.

Within each of the generally accepted appraisal approaches, there are generally accepted appraisal methods and procedures that may be appropriate for the particular debtor entity property appraisal assignment.

As a best practice, the appraiser's selection of the specific appraisal approaches, methods, and procedures for the debtor entity's property is based on:

1. the particular characteristics of the debtor entity property,
2. the specific bundle of legal rights subject to appraisal,
3. the quantity and the quality of available data,
4. the appraiser's ability to perform sufficient due diligence related to that data,
5. the purpose and the objective of the specific appraisal, and
6. the relevant professional experience and the informed judgment of the individual appraiser.

The final value conclusion is typically based on the appraiser's synthesis of the value indications from each applicable property appraisal approach and method.

The generally accepted appraisal approaches, methods, and procedures summarized in this discussion are generally relevant to bankruptcy-related property appraisals performed for transaction, financing, strategic planning, taxation, accounting, litigation, and other purposes.

Accordingly, it is a best practice for both the bankruptcy party-in-interest and the counsel to the bankruptcy proceeding to be familiar with the generally accepted property appraisal approaches and procedures for purposes of:

1. selecting the appropriate appraiser,
2. relying on the appraiser's value conclusion, and
3. defending the appraiser's value opinion and appraisal report and any other work product.

### Notes:

1. *Black's Law Dictionary*, 10th edition (Thomson Reuters, 2014).
2. 2020–2022 *Uniform Standards of Professional Appraisal Practice* (The Appraisal Foundation, 2022).

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