Intended Use: How Could You Get This So Wrong?

by Sharon Desfor, ASA

Once upon a time (as all good stories begin), before anyone knew that SARS-COV-2 was going to blow apart the entire social/business environment, I attended my last live conference in London. At this conference was a panel of aircraft appraisers and brokers discussing value and markets. There were an awful lot of questions and comments that day centered around Intended Use, and eventually one of the younger appraisers blurted out, "But the value is the value!"

Oh, honey, no. Just no.

I took the young'un aside after the panel for a little private talk, and it went something like this:

"Hey, Addison[1], I didn't want to say anything to embarrass you up on the stage, but Intended Use makes an incredible difference in the value of the aircraft. Intended Use is EVERYTHING.

"Let's imagine I'm a financier. I call you up and say, "Addison, I'd like to hire you for a valuation of the current value of a 2013 Leonardo AW189 helicopter for the Intended Use of portfolio review. You do the work and issue the report with a Market Value[2] of $16,000,000."

"Now what happens if I go to the other appraisers on your panel and ask for an appraisal of the same helicopter, but for different Intended Uses? You assume they're all going to come up with a similar value and the only differences are going to be due to minor differences in their databases and the type of calculations each appraiser uses. Let me show you there's more to it than that.

"I go to Kirk and ask him for a valuation of the same helicopter for the Intended Use of my annual FASB portfolio compliance check. He gives me a report with one of its pages entirely filled with columns of annual prospective values in a declining curve over the next ten years (the remaining term of the lease on this helicopter), both Fair Market Values and Orderly Liquidation Values for each year, to match FASB audit requirements.

> Note that under USPAP the "purpose" on an appraisal is always the same, to arrive at an opinion of value. USPAP defines the "Intended Use" as "the use(s) of an appraiser's reported appraisal or appraisal review assignment results, as identified by the appraiser based on communication with the client at the time of the assignment". See ADVISORY OPINION 36 for more clarification.

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[1] No, of course that's not the young appraiser's real name. I'm here to teach you something, not to embarrass or denigrate another appraiser. So, to be fair, I changed all the other names, too.

[2] Addison is an ISTAT appraiser, not an ASA. They have a slightly different vocabulary, but the definition is basically the same as our FMV.

"I go to Brenda and ask her for a valuation of the same helicopter, plus 5 identical helicopters, for the Intended Use of buying the entire parcel of 6 AW189s. She gives me a FMV range of $12,400,000 to $13,950,000 each, because each one has to be significantly discounted to sell that many in a limited resale market.

"Now do you see why Intended Use matters?"

Addison thinks a moment and says, "I hadn't really thought of it like that."

Sadly, an awful lot of appraisers – and not just the young'uns – haven't thought of it like that. But that's a huge part of our job – we're investigative reporters at times. And like that of a journalist, sometimes our job is even harder and requires more digging.

It's not only USPAP that requires you to identify the Intended Use, but IVS as well.[3] USPAP is just a bit more adamant about it, saying, "The credibility of assignment results is always measured in the context of the Intended Use."[4]

APPRAISER VS APPRAISER

Even the most experienced appraisers have differences of opinion, or different interpretations of a comment or point. We thought it mght be valuable for you to see behind the scenes to learn how the author and reviewer of this article differed.

There used to be a paragraph here that said:

"I go to Fasir and ask him for a "reality check" because the lease has just terminated, and I want to sell the helicopter. He gives me a BPO (broker price opinion) of $15,300,000 for one (if I can hold out for a good offer), but only $10.5 million each if I'm looking to sell all 6. And even less than that if I put all six on the market at the same time."

We took it out, and here's why:

Ray
In one case, the asset is a single helicopter. In other cases, the asset is a group of six helicopters. I'd argue that the value difference in that case primarily relates to the different assets (one vs. a group of six) much more than the intended use. There could be two issues driving the value differences.

Sharon
I think what I was trying to say is that the "Intended Use" is an informal "reality check" BPO from a broker who trades in that market regularly, so I can make an informed decision whether sell one or more from that parcel.

Ray
On the issue of valuing one vs. six helicopters, it's not the intended use driving the value change as it is the number of helicopters. I think this should be made clearly so that astute readers think we don't understand the difference. It is a valuable insight to know that "blockage" can have an impact on value. The number of helicopters is a unit of account issue. The unit of account can have significant implications on valuation as the example indicates.

Sharon
I'll give Ray this point. I was thinking that asking a broker for a BPO to use as a "reality check" is still a different bird than asking an appraiser for an FMV for the intended use of a parcel purchase, but it's not really a different intended use, just someone in a different role offering an opinion of value.

[3] IVS 101 Scope of Work, 10.1
[4] USPAP AO-36

Let me elaborate.

Those questions from the audience to the appraiser panel about Intended Use were probably my fault. I had brought up Intended Use the previous day, during an "emergency" slot for which I specifically called the event organizer and begged, because I had noticed a significant problem with some of my own clients, some of whom were in that audience. I'd been noticing "portfolio review" becoming the constant catch-all Intended Use for most of the financiers for whom we do regular work.

Now, portfolio review is a fine Intended Use, don't get me wrong; it's extremely useful for annual reports, 10-K filings for public companies, and internal reviews. But I was seeing it in reports ALL THE TIME. Eventually I was bothered enough to ask one of our clients to walk me through what his particular portfolio review process looked like. He said, "Oh, you know, for our bank audit, and for our accounting department to do the impairment testing on our collateral."

SCREECH! Pull that rotor brake all the way down! Impairment testing? Oh, no! Impairment testing requires Fair Value for financial reporting, as defined in ASC 820 and IFRS 13. And to quote our own Chris Mercer,

APPRAISER VS APPRAISER

Ray

There are quite a few appraisers that believe that the basic premises of fair value and fair market value are essentially the same. I think that is now the majority opinion. I'd gladly get on a stage with Chris to argue whether the general definitions of FV and FMV are really different and I'm guessing I could find hundreds of senior appraisers at accounting and other firms that would be glad to debate the point with him.

Sharon

And that argument would bring you both a massive audience! I'd come watch for sure!

I guess my opinion has been driven by the phrase "exit price." For tangible assets, wouldn't that imply a deduction for the costs of sale if the seller is the one bearing those costs? In aviation sales AND leases, most times the contract will outline which party is responsible for which sales costs.

Ray

Exit price in financial reporting is not the same as net realizable proceeds which is the FMV of an asset less its disposal costs. In financial reporting, a house that has a correct appraised value of $1mm has an FMV of $1.0mm. The fact that it is sold and the broker gets 5% does not mean FMV is $950,000 for financial reporting – the fair value is $1.0mm.

> If I am the optimal buyer for an asset and my investment value if $1.1mm and the next highest buyer is $1.0mm, in financial reporting the FV of the asset is $1.0mm. If I was smart, I'd pay $1,000,001 to the seller and outbid the other buyer. I would not want to pay $1.1mm although I could do so and still earn a return consistent with my requirements.

I really would delete the Mercer reference the FV for financial reporting and FMV for tax are different – they really aren't.

Sharon

For arguments' sake, I think I'll leave it all in, and let the reader consider for themselves. As much as I deeply respect Ray's knowledge and wisdom, I feel the same about Chris Mercer's.

"Fair value is different than other standards of value[5] such as fair market value or the legally-defined statutory fair value.[6]"

I am certainly not going to start a lesson in Fair Value here, so let it suffice it to say that it's not necessarily the same as FMV. Or OLV. Or FLV. (Nor is it Market Value if you're an ISTAT, and it is most certainly nothing even remotely resembling Base Value.) It is Fair Value, as defined in ASC 820 and IFRS 13.

In this case, the Intended Use doesn't just indicate a format to follow or an aspect to include, nor highlight a discount that needs to be taken; instead, it *absolutely dictates* the definition of value to be used.

"But the value is the value!"

Or is it?

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[5] Standard of value is BV-speak for definition of value
[6] Mercer Capital Value Added™, Vol. 22, No. 1, May 2010