

## Shopping Mall Valuation: Is There Intangible Value to Extract?

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Application of the Business Enterprise Value (BEV) concept in general, and intangible assets in particular, depends on the property type being appraised. Many business properties are involved in generating degrees of BEV based on their internal workings, which have traditionally been hotels, motels, assisted care facilities, retirement homes, hospitals, landfills, and others. All of these property types have several components in common: furniture, fixtures and equipment (FF&E), franchises, significant licenses or exclusive business permits, on-site business services, assembled highly-trained workforce, business management, intangible assets, and real estate.

Shopping centers and malls deviate from this grouping in many respects, including long-term leases for real estate, investment management as opposed to considerable on-site service management, no real estate-related franchises, and questionable business-oriented revenue. Even within the shopping center industry, shopping malls have very different revenue streams than do typical neighborhood and strip shopping centers.

Real estate appraisers have been interested in the BEV issue as it relates to shopping centers and department stores for over 20 years, and even longer for hotels and other properties. Proof of this is the dates of the many articles written in the late 1980's and early 1990's. However, court decisions have not supported this concept.<sup>1</sup> As in the past, it will continue to be problematic for BEV and intangible asset proponents to overcome reasonable anti-BEV arguments and legal precedent.

Intangible assets not found in shopping centers are not relevant for a discussion of shopping centers and malls, and tend to muddy the thinking on this subject. The inclusion of customer lists, customer relationships, copyrights, product brand, favorable contracts, assembled workforce, naming rights, trade secrets and other intangible asset types only causes confusion. Simply because certain intangible assets are discussed in the realm of general business and accounting does not mean that these assets apply to long-term leased real estate assets, and in particular shopping center or mall assets. However, certain asset types have been posited as shopping mall-related, non-realty assets, including anchor department store favorable contracts and incentives, cart rental income, monopoly value, percentage rent above market rent, permits and licenses, profit center revenue, start-up cost investment return, sponsorship income and stroller rental income.

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<sup>1</sup>See David C. Lennhoff and James D. Vernon, *Intangible Assets in the Shopping Center: Identification and Valuation*, • *A Business Enterprise Value Anthology*, 2<sup>nd</sup> ed., (Chicago, Illinois: Appraisal Institute, 2011): 290-292.

The so-called intangible assets related to shopping mall real estate can be better understood by considering revenue, expense and related impacts on NOI and property value. Many of these shopping mall characteristics have already been thoroughly discussed in the appraisal literature.<sup>2</sup>

One of the arguments for a lack of intangible assets in shopping mall properties has been that an intangible, for it to have market value, must be to be sold separately. Based on writings from the field of accounting, especially related to corporate business, federal gift and estate tax valuation, the reverse argument was recently made that intangible assets within an enterprise do not need to be sold separately. ■There is no valuation principle, literature, or course material that indicates that the intangible asset must be able to be sold **separately** from any other assets.<sup>3</sup> [Emphasis added]

Another argument is that rents for mall tenants are based on expectations of future business rather than real estate.<sup>4</sup> Therefore, only mall base rents for new tenants represent the true return to real estate, and any overage rents collected represent a partnership between the landlord and tenant. In fee simple property tax states, overage rent is not an issue because only market rents are utilized as measured by comparable market rents and recent contract rents at the subject property, when available.

Contract rent and percentage rent above market rent, if they exist, are two of the three identifiable intangible asset categories at shopping centers and malls. Overage rent (derived from the percentage rent clause in leases) is usually only a rent kicker, or inflation hedge, above an existing ■below market• contract rent. Logically, market rent sets the upper limit for ■fee simple• market value, although there remains debate in the appraisal profession about the ■contract rent above market rent• issue (i.e., is contract rent above market rent real estate or an intangible?).

Despite court decisions which have almost universally ruled against the concept of BEV in shopping malls, many authors still argue that intangible assets are included in mall sale transactions. One author explains the reality of these transactions as follows:

These specific intangible items may be regarded as business value, but in aggregate they represent **only a small portion** of a shopping center's total value. As is the

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<sup>2</sup>See Mark T. Kenney, ■s There a Business Component in Shopping Mall Revenue?,• *Assessment Journal* (September/October 1996): 45-53.

<sup>3</sup>Lenhoff and Vernon, 285.

<sup>4</sup>Michael J. Kelly and William J. Townsley, ■Quantifying Business Value at a Regional Mall,• *Journal of Property Tax Management* (2:3, 1991): 19-32.

case with many income-producing properties, it is **difficult to measure** and separate tangible and intangible components in terms of their value contributions because **the components are all integrated.**<sup>5</sup> [Emphasis added]

The most recent thinking on this subject is based heavily on accounting standards, from both the Financial Accounting Standards Board (FASB) and the International Valuation Standards Council (IVSC), as it relates to business acquisitions. In particular, two FASB statements, FAS 141 (revised by 141R) and 142, which provide for GAAP accounting for asset valuation and allocation of the purchase price of a company, are the focus of this effort.<sup>6</sup> Clearly, these FASB statements appear to apply to the valuation of assets in corporate mergers and acquisitions, although the SEC has reportedly applied them more broadly to real estate acquisitions. Of course, in the property tax realm, applicable state statute and case law will be the ultimate determining factors.

It can be misleading to broadly discuss the topic of intangible assets in relation to real estate across disciplines. Real estate appraisers and business appraisers may have differing views of the same topic. In identifying intangible assets, one business enterprise author made the following statements:

A real property asset is an intangible asset. The value of intangible real property comes from the legal rights it grants to a physical asset ■ not from the ownership of the physical asset itself. Examples of real property assets include leases, occupancy permits, building permits, surface rights, air rights, mining rights, water extraction rights, drilling rights, and so forth.<sup>7</sup>

Regardless of how business appraisers define real property, for real estate tax purposes, the underlying real estate is considered a taxable tangible asset. No doubt efforts will continue to explore and properly analyze the asset-based nature of shopping centers and malls. For now, both property types have been interpreted by the courts as tangible assets subject to real estate tax.

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<sup>5</sup>Richard C. Sorenson, *Appraising The Appraisal: The Art of Appraisal Review* (Chicago: Appraisal Institute, 2006), 107.

<sup>6</sup>See Lennhoff and Vernon, 292-296.

<sup>7</sup>Robert F. Reilly, ■Valuation of Commercial Intangible Assets for Ad Valorem Tax Purposes, • *Journal of Property Tax Assessment and Administration*, Volume 6, Issue 1, and published in *A Business Enterprise Value Anthology*, David C. Lennhoff, ed., 2<sup>nd</sup> ed., (Chicago, Illinois: Appraisal Institute, 2011): 98.

### **About the Author**

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