Redevelopment Agencies;
Preliminary Goodwill Loss Analysis Can Save Time and Money

This article presents examples to illustrate how Agencies may improve budget management by retaining an experienced goodwill appraiser early in the process. However, applicability and results may vary by situation.

Redeveloping blighted areas within our communities can benefit residents and businesses alike, and can cause substantial economic improvement to surrounding areas. However, in order for a city or redevelopment agency ("Agency") to take commercial or industrial property for a redevelopment project, it must compensate the displaced businesses and property owners for three assets: real estate, unmovable fixtures and equipment, and business goodwill. Real estate and equipment are tangible and therefore easy to verify and value -- you can see, touch and count them. Goodwill, however, is trickier; you cannot see it and it requires a specialist to value it, yet it may be a business's most valuable asset.

An experienced, qualified goodwill appraiser can help Agencies during the planning stages of a redevelopment project by estimating potential goodwill exposure. With sound advice early in the process, an Agency may avoid making big payments for displacing large businesses and may accomplish early settlement with smaller "mom-and-pop" businesses.

EXAMPLE 1: MEASURE TWICE, CUT ONCE

An Agency is considering the purchase of a paved lot adjacent to a car dealership for the purpose of developing a retail strip mall. It appears to be a straightforward deal -- no building, no major fixtures or equipment -- just some parked cars on a paved lot.

Based on its preliminary inquiry, the Agency believes that the acquisition of the paved lot should be a relatively simple transaction to consummate. However, by retaining a goodwill appraiser to prepare preliminary budget estimates to "take" the property, the Agency learns that:

- The neighboring automobile dealership business requires a fleet of new and used cars available to show customers. The innocent-looking paved lot is the staging area for 80% of the dealership's new-car sales, and new-car sales have been growing by 10% per year recently.
- The dealership needs space to park cars being cycled through its service center.
- The dealership needs the cars parked near customer parking and the sales showroom.
- Replacement lot space cannot be found within two miles of the dealership.

The result of the goodwill appraiser's work is that what appeared to be an easy and affordable property take may, in fact, be very complicated and potentially expensive.

The Agency is faced with two options:

(1) Take the paved lot and face a substantial goodwill loss (or relocation) claim from the dealership.

(2) Consider an alternative parcel located elsewhere.

Finding an alternative site may be the most logical conclusion in this case, as it would allow the Agency to spend its dollars on the actual strip mall development as opposed to goodwill loss compensation and litigation expenses.

EXAMPLE 2: HOW BIG IS THE AGENCY'S PIGGY BANK?

Consider a second illustration. A neighboring city's redevelopment agency is considering taking several parcels occupied by a dozen small businesses to develop a city park and recreation area. As a first step, the Agency could obtain "preliminary budget estimates" from a goodwill loss expert to identify the following:

- its potential aggregate exposure for goodwill loss;
- businesses that may have relocation obstacles;
- possibly overlooked details (as demonstrated in Example 1 above);
- businesses with substantial goodwill (e.g., billboards); and
- whether the project is within the range of funds available.

Since it is not necessary to contact the property or business owners for preliminary budget estimates, the Agency can obtain valuable information that may make or break its piggy bank without informing the potentially displaced businesses of the planned project.

EARLY SETTLEMENT

Let's assume that the Agency determines that its piggy bank is big enough relative to the preliminary budget estimates, so it decides to move forward with the project. The Agency's goals are**:** **(i)** to use the least adversarial approach to take the properties; and **(ii)** to avoid litigation before filing for eminent domain, if possible. Under these circumstances, the goodwill appraiser can contact the business owners directly, often before the business owners' attorneys become involved.

The goodwill appraiser's job is to provide the Agency with an independent, third-party opinion of potential goodwill loss. If the business owner cooperates, the appraiser will have the opportunity to interview the business owner and obtain documents from the business (e.g., income tax returns, financial statements, and leases).

SP&H's experience has shown that this early step has several advantages:

(1) The business owner recognizes that an independent, professional, qualified third-party firm is performing the valuation analysis.

(2) The business owner's concerns about the relocation process and ability to find appropriate sites can be identified early. For example, the business may not be able to sustain any downtime due to deadlines and timing of projects. This should be identified and considered as early as possible.

(3) The appraiser can analyze hypothetical relocation scenarios and test the reasonableness of business owner claims.

(4) Possibly most importantly, with the calculations of goodwill and potential loss of goodwill in hand, the Agency may be able to negotiate a reasonable settlement with the business.

Since businesses and Agencies both are faced with limited funds and resources to cope with an eminent domain project, any of these factors can aid in project planning and budgeting before costly litigation. If parties cooperate, goodwill analysis can assist Agencies in directing resources toward efficient resolution and settlement of goodwill loss issues.

PLANNING CAN PROVIDE 20-20 VISION

Litigation involving business goodwill has at least two guarantees -- it takes a significant amount of time and energy, and it always risks being very expensive. Retaining experienced, qualified goodwill appraisers during the earliest stages of project consideration can provide an Agency with pragmatic advice about their potential risk and exposure for goodwill loss claims, benefiting both the Agency and the business owner by avoiding litigation.

However, if an Agency and business owner cannot resolve their terms to consummate a transaction and legal proceedings ensue, don't despair. The possibility of settling still exists, and will be discussed in the next edition of Valorem Prinicpia. For more information regarding goodwill valuation analysis, please visit our website, www.sphvalue.com, or contact us at bizval@sphvalue.com or (310) 571-3400.