

VALOREM PRINCIPIA

The Principles of Value

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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.

Since 1975, California Eminent Domain Law has allowed business owners to recover lost "goodwill" when a public agency has pursued condemnation.

- ◆ 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.

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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:

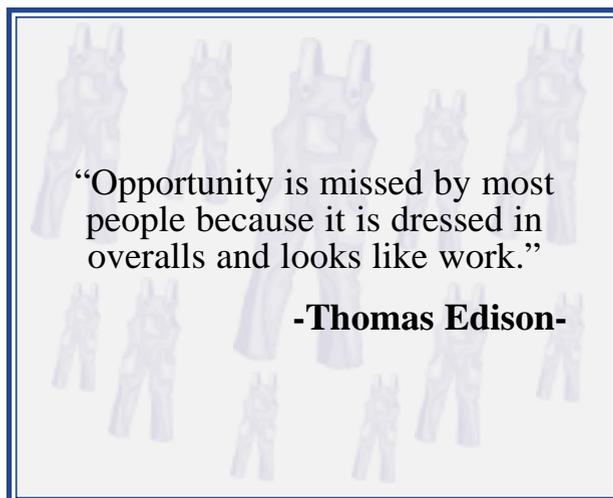
- ◆ its potential aggregate exposure for goodwill loss;
- ◆ businesses that may have relocation obstacles;
- ◆ possibly overlooked details (as demonstrated in Example 1 above);
- ◆ businesses with substantial goodwill (e.g., billboards); and
- ◆ whether the project is within the range of funds available.

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).



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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 Principia. 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. ◆



Joel J. Berman

Joel J. Berman is a partner with the Los Angeles-based law firm of Jeffer, Mangels, Butler & Marmaro LLP. A corporate attorney with 17 years of experience, Joel proactively adapts his practice to meet the changing needs of his clients, and deservedly has earned a reputation for his responsiveness and personal attention. SP&H recently sat down with Joel to discuss his growing practice and the characteristics that differentiate him from the crowded field of corporate lawyers.

SP&H: Joel, you mentioned that your responsiveness, detailed attention to your clients' needs and "proactivity" separate you from other attorneys. What do you mean by proactivity?

Berman: "Proactivity" is what I do to serve the best interests of my clients and potential clients. My goal is not to bill the most hours, but to build the best relationships. My willingness to ask questions and offer business advice is a service I provide my clients beyond the legal questions that arise. I regularly introduce my clients to business opportunities and other service providers whom they need to know.

SP&H: How do you go about these introductions?

Berman: I am very active in several local networking groups. I meet a lot of people and always ask myself, "Which of my clients needs to meet X," and "How can I help X." For instance, a local middle-market manufacturing client recently asked me about their lender's request that the principals sign a guaranty. I encouraged the client to refinance. Because of my suggestion and subsequent introduction, the client refinanced, resulting in a savings of \$250,000 in annual interest and the elimination of required guarantees. That's part of the "package" I offer my clients, and these introductions are without charge.

SP&H: Your commitment to provide more than just on-the-clock legal advice to your clients is impressive. What types of challenges are your clients facing today?

Berman: My clients are generally small or middle-market businesses who constantly are looking for money and ways to keep pace with the Internet revolution. Some of the ways I help my clients include connecting them to others -- such as service professionals and finance sources -- and buy/sell opportunities. I also encourage my clients to visualize the "big picture" -- where they want to be five years from now and how to get there.

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www.atomica.com

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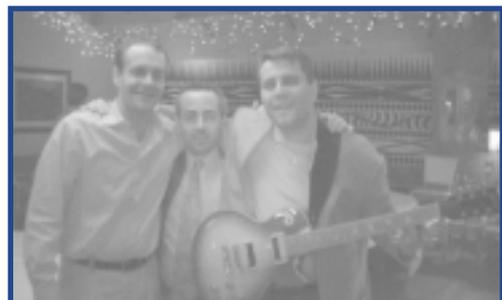
The Acronym Finder is a world wide web (WWW) searchable database of more than 180,000 abbreviations and acronyms about computers, technology, telecommunications, and military acronyms and abbreviations.

Fun Website:

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Offers more than 100 games, free of charge, and prizes to users. Covers all content categories of online interactive entertainment, ranging from family entertainment like card, casino and board games, to hardcore games where players experience the best in action, strategy, and simulation software technology.

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SP&H: As one of Los Angeles' top-10 law firms, JMBM has large corporate clients. How do small and middle-market businesses clients maintain their identities at JMBM?

Berman: My clients want personal attention from an experienced business lawyer, but need the benefits provided by a full-service business law firm. I act as the principal contact at JMBM for my clients so they get that personal attention, and I have the luxury of introducing them to my JMBM colleagues as needed.

SP&H: How do you position yourself and your practice within JMBM, and how have you adapted your practice over time?

Berman: I have been with JMBM for over 17 years and have seen it grow from 20 attorneys to over 140 attorneys with offices in Los Angeles and San Francisco. When I first started practicing law, I focused on commercial finance. Over the years, I expanded my practice to meet the needs of my clients. In recent years, I have emphasized three different areas: representing buyers or sellers in mergers and acquisitions; acting as overall outside counsel for companies; and, representing lenders or borrowers in commercial finance transactions, including loan organizations, work-outs and foreclosures. Additionally, to keep in step with the growth of JMBM, I have served as chairman of the Firm's Marketing Committee for the past five years.

Joel and his wife, Jamie, have two young daughters. They enjoy traveling, and Joel is a baseball and classical music fan. Joel, a graduate of Harvard College and Harvard Law School, can be reached at (310) 201-3508 or jjb@jmbm.com.

SP&H Welcomes to the firm:



- ◆ **Laura Barrantes**, *Research Analyst*
- ◆ **Ron Miller**, *Senior Financial Analyst*
- ◆ **Kim Pisapia**, *Executive Assistant*

SP&H Calendar

Recent & Upcoming Events

January 16th - 18th - Los Angeles, California
53rd Annual Institute on Federal Taxation
SP&H was an Exhibitor at this event.

January 22nd-23rd - San Francisco, California
Valuing New Economy Companies II

Nevin Sanli spoke on Valuation Metrics and presented a hands-on Workshop on Valuing a New Economy Company.

January 25th - Los Angeles, California
February 8th - Sacramento, California
Goodwill Loss Seminar Level I

An overview of salient topics related to eminent domain and goodwill loss issues.

February 22nd - Beverly Hills, California
Strategic Directions for the Entrepreneurial Venture
Nevin Sanli will be a panelist presentation

February 28th-March 2nd - Monterey, California
CRA Conference and Expo
SP&H will be a Presidential Exhibitor.

April 5th - Los Angeles, California
April 19th - Sacramento, California
Goodwill Loss Seminar Level II
Advanced Concepts and Analysis.

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