

PURCHASE PRICE ALLOCATION AND INTERNATIONAL FAIR VALUE ACCOUNTING AND REPORTING

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[International Financial Reporting Standards \(IFRS\)](#) are standards and interpretations adopted by the [International Accounting Standards Board \(IASB\)](#). The objective of these Standards that are applicable to leases, property, plant and equipment, investment properties, and intangible assets are to prescribe the proper accounting for reporting purposes and the related disclosure statements in order for users of the financial statements to obtain information about an entity's investments. The primary purpose in accounting for real property and intangible assets is to identify the assets and their estimated values and the depreciation charges and any impairment that result in losses. When a foreign investor acquires partial interests in real property, the valuation issues can be extremely complex which, if not calculated correctly, can result in inaccurate results that can impact the income and financial statements of the reporting entity.

For example, a foreign investor acquires a retail condominium unit or a penthouse office unit in New York City. How does one estimate the contributory value of the site for purchase price allocation purposes if the retail unit is on the first floor or if an office unit is on the top floor overlooking the Hudson River? What is the contributory value of the common elements? For tax purposes, all investors want a lower site value and a higher value associated with the improvements in order to maximize depreciation which will lower the tax bill due to Uncle Sam and, possibly foreign taxing authorities.

Recent transaction prices for development sites in prime locations in New York City ranged from \$400 to \$875 per square foot of floor area permitted as of right for high rise mixed-use projects. Clearly, the contributory value of the site for the first floor retail use on Madison Avenue would be substantially higher than the average price paid per square foot of floor area permitted since the rents obtained for first floor space can be sky high in comparison to the rent per square foot collected for the upper floors for office or residential use. The following chart summarizes the average asking retail rent for selected locations in Manhattan in early 2007 in comparison to 2006 as reported by The Real Estate Board of New York:

		<u>Median</u>		<u>Average</u>		<u>Range</u>	
East Side Manhattan		Mar-07	Mar-06	Mar-07	Mar-06	Mar-07	Mar-06
Third Avenue	60th-72nd St	\$220	\$250	\$218	\$243	\$175-\$300	\$114-\$350
Madison Avenue	57th-72nd St	\$1,098	\$905	\$1,158	\$902	\$1,000-\$1,667	\$555-\$1,250

The asking office and residential rents in the same locations for the upper floor space are well below the rents that can be achieved for the first floor space. The average asking rent for office space in Midtown was approximately \$79.00 per square foot in February 2007. In addition, many retail tenants are paying all expenses while tenants on the upper floors may only be paying an increase in operating expenses. The construction costs associated with retail space are also generally lower. As a result, the residual income to

the retail site component after allowing for a proper return on the invested capital in the retail improvement component would be substantially higher than the residual income to the office or residential site component after allowing for a proper return on the office or residential improvement component.

The [Appraisal Institute](#) indicates that there are six methods that are available to estimate the contributory value of the site to the total value. These include the following:

- Sales Comparison Approach
- Extraction
- Allocation
- Land Residual Technique
- Ground Rent Capitalization
- Subdivision or Development Method

The methods to estimate site value are more fully described in the article [Land Valuation and Purchase Price Decision](#) but it is clear that in cities such as New York, Chicago, Washington, D.C. and San Francisco it is extremely difficult to apply any of these approaches to allocate the purchase price between the various components in a condominium project. The land residual technique, **if correctly applied**, may provide a reasonable indication of the contributory value of the site to the overall value on an individual condominium unit. Alternatively, the estimated contributory value of the site might be estimated by the relative undivided interest in the condominium based on relative sale prices of the various units. If this is the case, then, the value contributed by the site to the retail unit is clearly different than the average price paid per square foot of floor area permitted as of right.

The United States standards are developed by the [Financial Accounting Standards Board](#). The objective is similar and numerous standards have been issued to provide guidance to practitioners which is clearly a duplication of efforts to protect investors and the general public. These pronouncements include the following: [FAS 141](#), [FAS 142](#), [FAS 144](#), and [FAS 157](#) with more to follow I'm sure to confuse the general public and the investors even more. Be that as it may, the appraisers that are involved in preparing and reviewing real property valuations, including the [I.R.S.](#) and taxing authorities, for purchase price allocation and other purposes should be careful. Because of the intricacies involved, the calculations may affect all taxpayers, investors and the general public.

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