

Machinery & Equipment (M&E) Appraisals for SBA Loans

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For technical assistance, call the AT&T Help Desk at 888-796-6118



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Acknowledgement

*We would like to thank **Mike Size** for his time and providing information regarding his experiences in lending and working on SBA loans from his perspective.*

All opinions, conclusions, and/or recommendations expressed herein are those of the presenter and does not necessarily reflect the views of the SBA.



What is an M&E Appraisal?

- M&E = Machinery & Equipment
- Substantiated opinion of the value of tangible assets
- Thorough analysis using vast quantity of data using appropriate methods and sources



Options to Value Fixed Assets

- Take the owner's word for it
- Others' opinion (auctioneer, retail store)
- Lender's Guess
- Book value
- Certified M&E appraisal



SBA statements on M&E Appraisals

- SBA has two statements regarding M&E appraisals in the latest SOP.
 - in order to satisfy SBA collateral requirements, a certified equipment appraisal report conducted by a qualified appraiser is necessary.
 - M&E appraisals reduce the required cash injection for businesses with intangible assets > \$500,000
- AICPA requires a valuation depend on substantiated relevant data by a qualified, substantiated and certified USPAP compliant value



What are Intangible Assets?

- Intangible Assets include:
 - Goodwill
 - Client/customer lists
 - Patents, copyrights, trademarks
 - Non-compete agreements



Intangible Asset Calculation

- Determined by Book Value on the Balance Sheet
- Business Valuation minus working capital assets and fixed assets being purchased
- Separate appraisal for particular asset(s)



Requirements for Equity Injection

- Undefined Equity Injection Required when Intangible Assets less than \$500,000
 - Size of Equity Injection not outlined in SOP
 - Left to the discretion of the Lender
- Specific Equity Injection Required when Intangible Assets greater than \$500,000
 - By Seller and/or Borrower of at least 25%
 - Seller equity defined as seller take-back
 - How much equity is an agreement between Buyer and Seller



Example

Business Value	\$600,000	Business Value	\$600,000
Book Value of Assets	\$50,000	Market Value of Assets	\$200,000
Intangible Asset Value	\$550,000	Intangible Asset Value	\$400,000
Equity Injection required	25%	Equity Injection required	15%
Equity Required	\$150,000	Equity Required	\$90,000



What is a qualified source?

A “qualified source” is an individual who regularly receives compensation for business valuations and is accredited by one of the following recognized organizations:

- MCMEA, CMEA – NEBB Institute
- PPS - International Association of Assessing Officers
- ASA, AM – American Society of Appraisers
- CEA/ AEA - Association of Machinery & Equipment Appraisers



What is the difference between a Certified Appraiser and a Non-Certified Appraiser?

- Training in the methodology of appraisal and knows the guidelines for determining values
- Follows ethics requirements
- Reports appraised values in a format acceptable to the client, the industry and the financial world
- Follow the Uniform Standards of Professional Appraisal Practice (USPAP), which has been endorsed by the Appraisal Foundation and the United States Congress

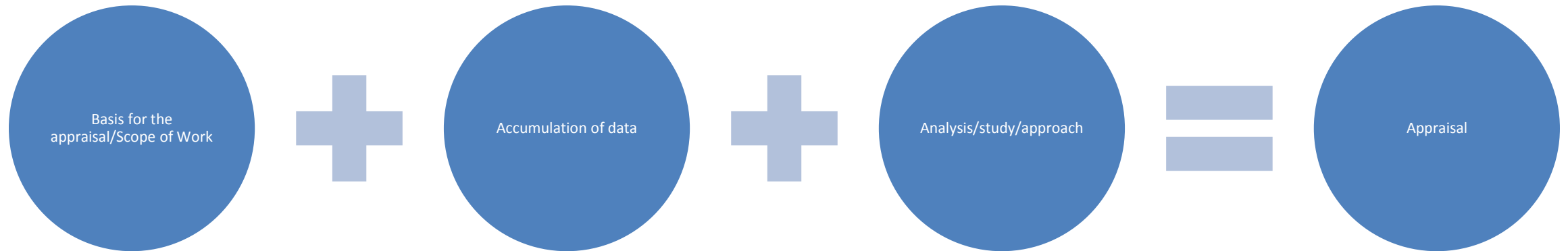


Appraisal Definition

- Investigation into the law of probabilities with respect to valuation
- Through experience, training, and integrity, we are able to project the activities of buyers and sellers in the marketplace into an estimation of value
- Requires unique adjustments
- Impartial



Process



Cost Approach (Asset Approach)

The Cost Approach Analysis is defined as a "method in which the value of a property is derived by estimating the replacement cost of the improvements and deducting therefrom the estimated depreciation." There are three primary forms of depreciation: physical, functional and economic. Physical depreciation is often curable and may involve cosmetic appearance (but, in fact, could go deeper). Functional depreciation means that the machinery has had a loss in productivity due to wear and tear. Economic depreciation (sometimes referred to as External Depreciation) occurs outside of the subject property which results in a loss of value. In determining depreciation, the appraiser has used his judgment and prudence in determining the depreciation factor which could be a combination of all three forms described in total. Experience with this type of equipment has proven the use of a formula, which is as follows:

$$\begin{array}{r} \text{Fair Market Value} = \\ \text{Remaining Life} \\ \hline \text{Normal Life} \\ \times \text{Cost New} \end{array}$$

This formula again has proven to be effective on numerous occasions.



Market Approach

This approach is an appraisal technique in which the market value estimate is predicated upon prices being paid in actual market transactions and current listings, the former fixing the lower limit of value in a static or advancing market and fixing the higher limit of value in a declining market; and the latter fixing the higher limit in any market. It is a process of correlation and analysis of similar recently sold properties. The reliability of this technique is dependent upon:

1. The degree of comparability of each property with the property under appraisal;
2. The time of the sale;
3. The verification of the sale data;
4. The absence of unusual conditions affecting the sale.



Income Approach

The Income Approach to value is used only when solid data involving income and expenses for a particular item can be established. It is considered hypothetical in most situations involving machinery and equipment, and though while considered, has not been applied in the final value estimate.



Fair Market Value

Fair Market Value is the estimated amount, expressed in terms of money, that may reasonably be expected for a property in an exchange between a willing buyer and a willing seller, with equity to both, neither under any compulsion to buy or sell, and both fully aware of all relevant facts, as of a specific date.

- As defined by Valuing Machinery and Equipment: The Fundamentals of Appraising Machinery & Technical Assets, Third Edition, by the American Society of Appraisers.



Orderly Liquidation Value

Orderly Liquidation Value is the estimated gross amount, expressed in terms of money, that could be typically realized from a liquidation sale, given a reasonable period of time to find a purchaser (or purchasers), with the seller being compelled to sell on an as-is, where-is basis, as of a specific date.

- As defined by Valuing Machinery and Equipment: The Fundamentals of Appraising Machinery & Technical Assets, Third Edition, by the American Society of Appraisers.



Forced Liquidation Value

Forced Liquidation Value is the estimated gross amount, expressed in terms of money, that could typically be realized from a properly advertised and conducted public auction, with the seller being compelled to sell with a sense of immediacy on an "as is," "where is" basis, as of a specific date.

- As defined by Valuing Machinery and Equipment: The Fundamentals of Appraising Machinery & Technical Assets, Third Edition, by the American Society of Appraisers.



Definitions of Condition

- Very Good Condition
- Good Condition
- Fair Condition
- Poor Condition
- Scrap Condition



Considerations

If the inutility calculation is utilized to quantify economic obsolescence remember to ask questions:

- Calculate the Replacement Cost New (RCN) for the subject M&E
- calculate the effective age of the M&E
- Did the market approach corroborate the obsolescence?
- The source documents which depict the plant capacity and the plant utilization
- Perform the analysis to determine what are customary utilization rates for the subject Company's industry
- Attempt to find comparables to verify the presence of economic or functional obsolescence



Caveat Utilitor

- Caveat Utilitor – User Beware
- There are plenty of good M&E appraisers
- Perform some due diligence to ascertain the validity of the M&E appraisal
- To corroborate the veracity of an M&E appraisal ask for these items:
 - Data collection forms or their equivalent
 - Conversation notes and contact information to ascertain the RCN and market approach
 - Ask the appraiser for the contact information of the expert who gave him/her the tour at the subject company



Credentials at Portside SBA Valuation

- Certified Machinery & Equipment Appraiser (CMEA) with the NEBB Institute
- Accredited Senior Appraiser (ASA) with the American Society of Appraisers (ASA) – Business Valuation
- Certified Valuation Analyst (CVA) by the National Association of Certified Valuators and Analysts (NACVA) – Business Valuation
- Completed 2,000+ business valuations to date



When in doubt

- Contact the Lender Relations Specialist at your SBA District Office - <https://www.sba.gov/tools/local-assistance/districtoffices>
- Contact Mike Size, Portside SBA Valuation, at (406)493-1651 or mike@portsidesba.com

