

# VALUATION Viewpoint

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**SHENEHON**  
BUSINESS & REAL ESTATE VALUATIONS

## New Legislation Allows Appraisers to Perform Evaluations

by Natalie Mandley and Christopher Stockness

The State of Minnesota recently passed legislation that allows appraisers to provide evaluations in addition to the appraisals they are already licensed to provide to the public. What does this legislation mean and how does it impact you?

### What has changed?

The Appraisal Institute provides this explanation of what this legislation means: "In most states, a state-licensed or state-certified real estate appraiser is required to comply with USPAP [Uniform Standards of Professional Appraisal Practice] when developing an opinion of the value of real estate, as is required by the IAEG [Interagency Appraisal and Evaluation Guidelines]. Many financial institutions do not want a USPAP-compliant appraisal when they are permitted to use non-USPAP compliant evaluations. Instead of using the most competent and qualified professional to obtain a market value opinion, financial institutions go to other non-

appraiser professionals (i.e., internal bank staff, financial analysts, accountants, brokers/salespersons, etc.) to obtain real estate valuation information. This results in greater risk to the banking system and lost business for appraisers."

Appraisers in the State of Minnesota may now provide evaluations. Previously, all opinions of value prepared by appraisers had to comply with USPAP, thus excluding them from providing evaluations which do not comply with this set of standards. Non-appraisers, typically financial professionals, could prepare evaluations, as the development and presentation of the opinion of value in an evaluation; however, until August 1, 2021, appraisers could only prepare appraisals (opinions of value that comply with USPAP). When providing an evaluation, an appraiser does not have to comply with USPAP, but must disclose it is not an appraisal when providing the evaluation to the client.

### What is an evaluation?

Simply put, appraisals must comply with USPAP, while evaluations do not. In addition, evaluations are restricted to properties below a particular value threshold (less than \$500,000 in value), or to opinions of value in certain circumstances. An evaluation is an opinion of value that must follow Interagency Appraisal and Evaluation Guidelines imposed by the federal government, but does not have to comply with USPAP, which governs the opinion of value presented in an appraisal.

### What is an appraisal?

Appraisals must comply with the Uniform Standards of Professional Appraisal Practice and, in Minnesota, can only

*continued on page 3*

### National Market Trends & Value Indicators

High Qual. Institut'l Grade	Value Δ Over Past 12 Mo.
Office	1%
Mall	3%
Strip Retail	10%
Industrial	27%
Apartment	12%
Health Care	7%
Lodging	24%
Manufactured Home Park	18%
Self-Storage	30%
Student Housing	16%
	<b>YoY Change</b>
New Housing Starts - Q2 Midwest*	31.9%
Productivity**	1.9%
U.S. Unemployment***	-47%
Consumer Confidence Index****	34.20%

Real Estate Indicators from Green Street Advisors CPPI Report,  
\*Source: St. Louis FRED, \*\* 2Q 2020/2Q 2021 – Source: Bureau of  
Labor Statistics, \*\*\* Jul 2020/Jul 2021 – Source: Bureau of Labor Statistics,  
\*\*\*\* Aug 2020/Aug 2021 – Source: The Conference Board

### More in this Issue:

Controlling Interest Transactions.....	2
Inflation Update.....	4
Real Estate Transaction.....	6
Business Transaction.....	7

## Comparing Controlling Interest Transactions

### Common Mistakes Valuation Analysts Make When Using the Controlling Interest Transaction Method to Value a Business

by Cody Lindman

When valuing a business, valuation analysts consider three approaches to value: the income approach, the market approach, and the asset approach. Two of the most common valuation methods within the market approach are the guideline public company method and the controlling interest transaction method. When utilizing the controlling interest transaction method, the most frequently used transaction database is DealStats. Below are some of the most common mistakes we see other valuation analysts make when utilizing a transaction database such as DealStats.

#### Searching the Incorrect Industry for Comparable Transactions

When utilizing the controlling interest transaction method, the first step is to search for comparable transactions. It should be easy, right? All you have to do is search by the subject company's SIC or NAICS industry code. The process should be easy given that companies list the NAICS code most applicable to their business on their federal tax return, right? **Wrong.** Although some valuation analysts may not admit it, determining the correct SIC and NAICS code for a business is a critical part of the valuation process and more difficult to get right than you would think. One of the reasons for the difficulty is the fact that most businesses do not fit cleanly into a particular SIC or NAICS code. In these instances, it is up to the appraiser to determine what they believe is the most appropriate SIC or NAICS code. As for the NAICS code listed on the subject company's federal tax return, we have found that the code listed is incorrect approximately half of the time. When this occurs, the valuation analyst must research the subject business, examine the possible NAICS codes, and select the most accurate one.

#### Including Transactions Involving Companies Dissimilar to the Subject Company

After some difficulty, the valuation analyst has now determined the subject company's SIC and NAICS code. After searching by either the subject's SIC or NAICS code, the valuation analyst now has a list of comparable transactions. Now all they need to do is multiply one of the subject company's financial metrics by the analogous median multiple of the comparable transactions to determine the value of the subject company, right? **Wrong.** The most important and often overlooked step in utilizing the controlling interest transaction method is to attempt to fully

understand and question each of the comparable transactions. As we discussed previously, determining the correct SIC or NAICS code for a business is difficult. Therefore, it should not be a surprise that the people who categorize

the comparable transactions sometimes make mistakes and mis-characterize the industry in which a business operates. Additionally, some of the transactions may involve businesses that are significantly smaller or larger than the subject company. Lastly, each transaction is subject to different terms, such as how the transactions will be financed, what is transferred, etc. It is up to the valuation analyst to look at the financial metrics, read the description of the acquired business, and understand the terms of the transaction to determine whether the transaction should be included as a comparable.

#### Failing to Account for the Differences in Asset and Stock Transactions


One of the most important things to note when analyzing a transaction pulled from DealStats is whether the transaction is characterized as either an "asset sale" or a "stock sale." In a typical asset sale, the transaction is structured whereby the buyer acquires the inventory, furniture, fixtures, and equipment (FF&E), and intangible assets while the seller retains the company's cash and receivables and pays off the company's debt. A stock sale is considerably more straightforward; a buyer purchases all of the target company's shares that are issued and outstanding. Although both types of transactions can be used to value a business, valuation analysts should be aware of the differences between the two structures. One way to handle the differences is to separate asset sales and stock sales into two different groups and then apply the corresponding



## Comparing Controlling Interest Transactions

*continued from page 2*

multiples separately. However, this can be challenging if there are only a few asset sales or stock sales. Alternatively, a valuation analyst can restate the selling price of asset sales to convert them into a stock sale equivalent or vice-versa. This is normally the approach that valuation analysts at Shenehon undertake because it allows us to consider all of the comparable transactions on an apples-to-apples basis. To convert an asset sale to a stock sale equivalent, a valuation analyst would add net working capital to the asset sale price (however, if inventory changed hands in the asset sale, it should be subtracted from net working capital so as to

not double count it). Converting a stock sale to an asset sale equivalent can be more difficult, as the process requires that a purchase price allocation (PPA) was performed. If specific allocation information is not available, it may be impossible to convert a stock sale to an asset sale equivalent, potentially making it necessary to eliminate that particular transaction. The general process for converting a stock sale to an asset sale equivalent is to determine the total asset value of the acquired business and then subtract the value of all assets acquired except for inventory, FF&E, and intangibles. The resulting value is an asset sale equivalent value. 

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## New Legislation

*continued from page 1*

be provided by licensed appraisers. Appraisals generally are more thorough and in-depth than evaluations and are required in most situations involving commercial real estate.

### When can an evaluation be used?


For commercial real estate, which is our focus, evaluations are typically allowed if 1) the transaction value is less than \$500,000; 2) an appraisal is not required by federal law. Additionally, one may use an evaluation when a recent appraisal has been done and 1) related market conditions have not changed in the interim; and 2) the purpose is refinancing only, with no new funds being loaned. For almost everything else in commercial real estate – transactions with values over \$500,000 for which an appraisal has not been recently provided, or where required by federal law – an appraisal is needed.

Although evaluations may be appropriate and cost effective in certain situations, our experience is that most of the valuation work completed at Shenehon Company would not be considered a candidate for an evaluation. However, in instances where an evaluation may be a permitted option, it is our opinion that an appraisal that complies with USPAP is still the appropriate valuation service for clients. Estimating a reasonable and well-supported opinion of value through an evaluation still requires a level of analysis that is consistent with an appraisal and compliance with USPAP is not a significant hinderance in the process but instead aids in providing consistent valuation methodology, allowing appraisers to maintain

the trust of clients and the public. Furthermore, in arenas such as the court of law or the Internal Revenue Service, appraisals remain as the accepted form of valuation.

Although this legislation allows appraisers the opportunity to be engaged in assignments that may have otherwise been completed by a less qualified evaluator, we believe there is potential for confusion in the marketplace. For instance, we anticipate there may be confusion about the difference between an appraisal and an evaluation, particularly in terms of the quality of analysis received. Appraisers that choose to take on both evaluations and appraisals will need to take extra care in educating their clients on the differences and to make certain, particularly in performing evaluations, that their role is clearly understood.

We will also be watching to see what role evaluations will have in the marketplace in instances where a valuation is not required by federal law. Valuation work for purposes not regulated by federal law can comprise an extensive amount of potential assignments and it will be interesting to see how appraisal professionals will choose to determine when an evaluation is appropriate rather than appraisal.

We will be monitoring how evaluations will be utilized by appraisers and the valuation industry as both adjust to this change in legislation. A primary concern that we have is that evaluations tend to be a way of providing valuation services at a low-cost point with the tradeoff being that the accuracy and quality of valuation may be sacrificed at the hands of time and money. 

## Inflation Update

by Emma Niemela

Following the report of 5.4 percent inflation for the trailing twelve months ended June 2021, the Federal Reserve is predicting elevated inflation to be a temporary phenomenon, normalizing after the “perfect storm of high demand and low supply” ceases. However, multiple chief executives have differing opinions.

According to the latest Bureau of Labor Statistics (BLS) update, the seasonally adjusted Consumer Price Index (CPI) for all urban consumers rose 0.9 percent in June, the largest one month change since the 1.0 percent increase in June 2008.

Notable category increases in the month of June, included used cars and trucks increasing 10.5 percent, food increasing 0.8 percent, energy increasing 1.5 percent, gasoline increasing 2.5 percent, and the index for all items less food and energy increasing 0.9 percent. These increases show recovery from the price declines due to COVID last year. A chart containing comprehensive BLS data is shown below.

Inflation reflects rising prices for goods and services and often happens when a nation’s money supply is growing

faster than the economy; however, there are multiple triggers. Demand-pull inflation happens when an increase in the money supply creates demand for additional goods and services, the effect is accentuated when there is limited supply of those goods and services. Forgivable loans and personal stimulus checks given during the COVID-19 Global Pandemic triggered this type of inflation, increasing the money supply and creating demand while many supply chains were experiencing disruption due to the Pandemic.

Cost-push inflation results from input price increases. Increased cleaning costs and increased material prices as a result of supply shortages have contributed to increased overall costs for producing goods and services during the Pandemic. Supply shortages are expected to alleviate as the impact of COVID-19 fades; in fact, lumber prices are reaching pre-Pandemic norms. Lumber futures closed at \$634 on July 23rd, down from a high of \$1,711 on May 10, 2021, as shown by data from Yahoo Finance in the chart on the following page.

Built-in inflation is driven by expectation that prices will continue to increase in the future. Companies such as PepsiCo, Conagra, and Fastenal voiced plans to increase prices because of expected inflation at their most recent earnings calls. Fastenal already raised prices in the second quarter and intends to continue this trend, as the initial increases were well received.

However, as reported by the Wall Street Journal,

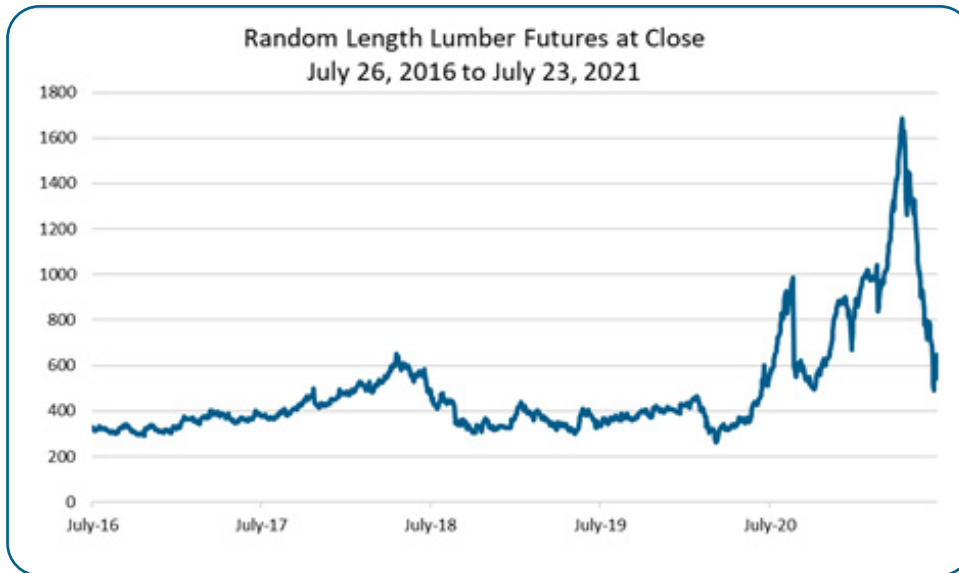
Percent changes in CPI for All Urban Consumers (CPI-U): U.S. city average								
Seasonally adjusted changes from preceding month								
	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	12 mo. ended Jun-21
<b>All Items</b>	<b>0.2%</b>	<b>0.3%</b>	<b>0.4%</b>	<b>0.6%</b>	<b>0.8%</b>	<b>0.6%</b>	<b>0.9%</b>	<b>5.4%</b>
Food	0.3%	0.1%	0.2%	0.1%	0.4%	0.4%	0.8%	2.4%
Food at Home	0.3%	-0.1%	0.3%	0.1%	0.4%	0.4%	0.8%	0.9%
Food Away From Home*	0.4%	0.3%	0.1%	0.1%	0.3%	0.6%	0.7%	4.2%
Energy	2.6%	3.5%	3.9%	5.0%	-0.1%	0.0%	1.5%	24.5%
Energy Commodities	5.1%	7.3%	6.6%	8.9%	-1.4%	-0.6%	2.6%	44.2%
Gasoline (all types)	5.2%	7.4%	6.4%	9.1%	-1.4%	-0.7%	2.5%	45.1%
Fuel Oil*	10.2%	5.4%	9.9%	3.2%	-3.2%	2.1%	2.9%	44.5%
Energy Services	0.2%	-0.3%	0.9%	0.6%	1.5%	0.7%	0.2%	6.3%
Electricity	0.4%	-0.2%	0.7%	0.0%	1.2%	0.3%	-0.3%	3.8%
Utility (Piped) Gas Service	-0.4%	-0.4%	1.6%	2.5%	2.4%	1.7%	1.7%	15.6%
All Items Less Food and Energy (F&E)	0.0%	0.0%	0.1%	0.3%	0.9%	0.7%	0.9%	4.5%
Commodities Less F&E Commodities	0.1%	0.1%	-0.2%	0.1%	2.0%	1.8%	2.2%	8.7%
New Vehicles	0.4%	-0.5%	0.0%	0.0%	0.5%	1.6%	2.0%	5.3%
Used Cars and Trucks	-0.9%	-0.9%	-0.9%	0.5%	10.0%	7.3%	10.5%	45.2%
Apparel	0.9%	2.2%	-0.7%	-0.3%	0.3%	1.2%	0.7%	4.9%
Medical Care Commodities*	-0.2%	-0.1%	-0.7%	0.1%	0.6%	0.0%	-0.4%	-2.2%
Services Less Energy Services	0.0%	0.0%	0.2%	0.4%	0.5%	0.4%	0.4%	3.1%
Shelter	0.1%	0.1%	0.2%	0.3%	0.4%	0.3%	0.5%	2.6%
Transportation Services	-0.6%	-0.3%	-0.1%	1.8%	2.9%	1.5%	1.5%	10.4%
Medical Care Services	-0.1%	0.5%	0.5%	0.1%	0.0%	-0.1%	0.0%	1.0%

\*Not Seasonally Adjusted

Source: Bureau of Labor Statistics, July 13, 2021

## Inflation Update

*continued from page 4*



not all companies are following this pattern; FreshDirect is currently lowering prices on berries, salmon, and ground beef. The online grocery delivery company is looking to attract more customers by absorbing inflation for the time being. This varied approach is a good signal, as it shows not all companies are raising prices in expectation of future inflation, a move which would add fuel to the inflation cycle.

Wages are tied to built-in inflation, as employees demand wages to maintain their cost of living. As wages rise, costs and prices of products and services also rise, continuing the cycle. Many employers have raised wages to attract employees as the labor market has become more competitive. However, these labor cost increases motivate investment in automation. For example, Applebee's has recently implemented tablets which allow customers to pay at their table without a waiter. John Peyton, CEO of Applebee's parent company, Dine Brands Global, Inc., called this move a hedge against labor inflation in a recent earnings call.

The Federal Reserve's dual mandate is to aim for price stability and maximum sustainable employment. The recent developments in wages and employment discussed above

add complexity to these goals, as it can be hard to determine adequate benchmarks. The Fed has been using pre-pandemic employment levels to define "maximum employment," but with automated labor hedges making certain roles smaller or obsolete and many people re-evaluating their lifestyle and leaving the workforce early, it may be necessary to use a new benchmark. Employment and inflation go hand in hand, and so long as the labor market is transitioning, there will be an effect on inflation.

Last August, the Federal Reserve communicated inflation expectations slightly above two percent following periods of inflation below two percent, resulting in a long-term average of two percent. Even though current inflation is well above two percent, the Federal Reserve has stated that it does not plan to raise interest rates in the short-term as it attributes current inflation to one-time price increases due to the re-opening of the economy. So long as businesses and consumers are not acting as if they altogether expect high inflation, the Federal Reserve will maintain its stance. 📊



# Market Transaction

## Real Estate

<b>Buyer:</b>	Pentagon One LLC (Solhem Companies)
<b>Seller:</b>	Pentagon North LLC (Hillcrest Development)
<b>Property:</b>	Two Office Buildings in the Pentagon Park Development 4660 West 77th Street, Edina, Minnesota
<b>PID:</b>	31-028-24-34-0007
<b>Sale Price:</b>	\$4,690,000 (\$17.79 per square foot of land)

### Sale of the Pentagon Park Land for Redevelopment

In July, two aging office buildings in Edina sold for \$4,690,000, according to public records. These buildings are located at 4660 West 77th Street, Edina, Minnesota and were part of the Pentagon Park development which has been undergoing redevelopment over recent years. Solhem Companies through Pentagon One LLC purchased the property from Pentagon North LLC acting for Hillcrest Development. Hillcrest had acquired the property in 2012 for \$2,665,000 and has been renovating neighboring properties in the same development. Although this property sold with improvements - two office buildings, each three stories and built in the 1960s - the property traded for its underlying land value. Rather, Solhem purchased the property to acquire the land and intends to demolish the current improvements to make way for a 408-unit residential project that should break ground in coming months and be finished sometime in 2023. The sale price for the land works out to approximately \$17.79 per square foot.

According to the City of Edina, Solhem received approval from the city on July 21, 2021, for the property to be rezoned to its current zoning of PUD (Planned Unit Development) from its prior zoning of MDD-6 (Mixed Development District). The zoning change will allow necessary flexibility for Solhem to construct apartments in place of the two office buildings they had purchased. The Rezoning Applicant submission documents Solhem filed with the city revealed plans for a single multi-family residential building of 400+ units, some of which can be expected to be affordable units in compliance with the new zoning. The seven level building will also include two levels of parking above ground with a potential of one level of parking that is partially underground. It will also include approximately 400 stalls for bikes and feature landscaped connections to the adjacent Fred Richards Park to the north of the parcel. The rendering below was taken from the rezoning application submitted by Solhem to the City of Edina. 🏡



# M&A Market Insights

## Business Valuation

by Jim Clancy, Managing Director, Hennepin Partners

### Robust M&A Activity in Post-COVID Landscape

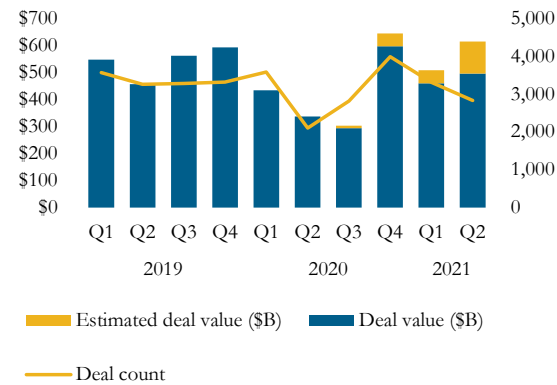
US M&A activity has witnessed a strong recovery in the first half of 2021, with both deal count and value in line to surpass record highs. The first three quarters of 2020 saw significant declines in M&A activity as COVID-19 spread throughout the US. Numerous factors are driving increased M&A activity as the pandemic subsides throughout the fourth quarter of 2020 and year-to-date 2021, including increasing vaccination rates and favorable economic policies from the US government. Additionally, the potential threat of an increased capital gains tax appears to be motivating business owners to sell this year – accelerating their previous plans by as much as one to three years in hopes of closing before new rates apply. Strong momentum from the fourth quarter of 2020 through the second quarter of 2021 should drive continued M&A activity throughout the remainder of 2021.

### Sector Spotlight: Technology & Software

While there is increased growth across all sectors in the US M&A market, the Technology & Software sector continues to occupy a large portion. In 2011, Technology & Software accounted for only ~13% of deal count for the year, which has increased to nearly 21% in Q2 of 2021. As compared to the broader M&A landscape, the Technology & Software sector has remained incredibly resilient throughout the pandemic as illustrated in the chart below. The pace of deal volume has continued into 2021, largely driven by the demand for quality assets in the sector. Emerging as particular areas of focus, Internet of Things (IoT) coupled with artificial intelligence (AI) are paradigms that enable communication between internet linked devices and smart manufacturing learning. Hennepin recently advised Savigent, an Industrial Internet of Things (IIoT) provider, on its sale to Symphony Industrial AI. As software applications become omnipresent in our increasingly digitized world, competition for tech acquisition targets should continue to increase, further accelerating M&A volume and increased multiples.

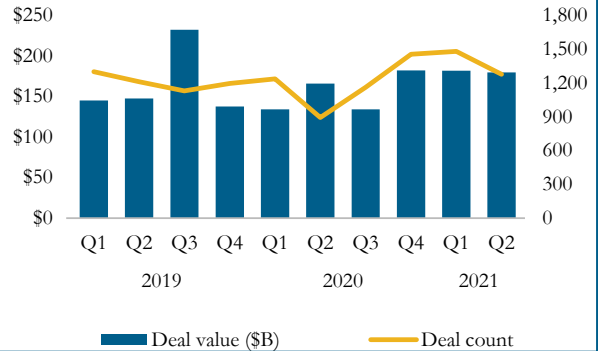
Quarterly M&A Deal Volume & Value

Source: PitchBook



Global Software & Tech M&A Activity

Source: PitchBook



### Hennepin Partners' Recent Technology & Software Deals

 HAS BEEN ACQUIRED BY <b>COREL</b> A PORTFOLIO COMPANY OF <b>KKR</b>	SaaS provider of an intuitive in-browser extension and mobile app that blocks online ads and activity trackers	 HAS BEEN ACQUIRED BY <b>SYMPHONY INDUSTRIAL AI</b> A PORTFOLIO COMPANY OF SymphonyAI	Leading IIoT provider of next generation digital manufacturing software	 HAS BEEN ACQUIRED BY <b>omnigo</b> A PORTFOLIO COMPANY OF Riverside	Provides incident command software that includes tools and guidance for on-scene incident commanders
 HAS RECEIVED A GROWTH INVESTMENT FROM <b>HTG CAPITAL</b>	Leading provider of technology consulting and digital transformation services	 HAS BEEN ACQUIRED BY <b>TECH SOLVER II</b> HAS BEEN ACQUIRED BY <b>AFFINIFY</b> A PORTFOLIO COMPANY OF TA ASSOCIATES	Powerful payment processing software solution serving the professional services vertical	 HAS BEEN ACQUIRED BY <b>IRIDIUM TECHNOLOGY</b> A PORTFOLIO COMPANY OF PGP polarispartners	SaaS-based provider of time and billing solutions to law firms

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- Allocation of purchase price
- Asset depreciation studies
- Bankruptcy proceedings
- Charitable donations
- Commercial properties
- Condemnation
- Contamination impact studies
- ESOP/ESOT
- Estate planning
- Feasibility analyses
- General limited partnership interests
- Gift tax evaluations
- Going public or private
- Highest and best use studies
- Industrial properties
- Insurance indemnifications
- Intangible asset valuation
- Internal management decisions
- Investment counseling
- Land development cost studies
- Lease and rental analyses
- Lost profit analyses
- Marriage dissolution
- Mortgage financing
- Multifamily residential properties
- Municipal redevelopment studies
- Potential sales and purchases
- Railroad right-of-ways
- Special assessment appeals
- Special purpose real estate
- Tax abatement proceedings
- Tax increment financing
- Utility and communication easements

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