FORCED AND LIQUIDATION SALES OF AGRICULTURAL PROPERTY

VÂNZARILE SILITE ŞI DE LICHIDARE ALE PROPRIETĂȚII AGRICOLE

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Abstract: *Liquidation literally means the conversion of assets to cash. Unlike cash or securities, real estate often requires a period of several months in order to obtain their fair market value in a sale, and will generally sell for a significantly lower price if a sale is forced to occur in a shorter time period. At the same time it is also necessary to analyse the reasons owners liquidate real estate and why the liquidation price is often less than market value given reasonable market-oriented exposure time. In present study the basic definitions and approaches have been demonstrated as well as the way how the liquidation value can be modelled generally and in the case of agricultural companies when basic data are taken from bookkeeping. According to my model calculation which can considered as typical after liabilities have been paid off from the asset liquidation, farmers are left with serious loss.*

Keywords: *forced sales, liquidation value, agricultural property, profitability*

INTRODUCTION

Most companies are funded by a combination of debt and equity. Debt can be in the form of loans from a bank or other financial institution. Equity is in the form of an ownership stake held by certain individuals or institutions. Holders of both debt and equity have certain rights regarding the company they help to fund. Among these rights is the right, in certain situations, to force the liquidation of the company. Liquidation literally means the conversion of assets to cash. For example, a building is liquidated when it is sold for cash; a liquidation sale is a means by which a company lowers the

prices of its products to more quickly convert them into cash by selling them to customers. Unlike cash or securities, real estate often requires a period of several months in order to obtain their fair market value in a sale, and will generally sell for a significantly lower price if a sale is forced to occur in a shorter time period.

MATERIAL AND METHODS

In present study the definition and different approaches of forced and liquidation value have been identified on the basis of several literature sources. It also has been demonstrated how the liquidation value can be modelled generally and in the case of agricultural companies when basic data are taken from bookkeeping. A real Hungarian example has been shown which can be considered as typical instance of liquidation value calculation.

RESULTS AND DISCUSSION

The Commission White Paper (2007) emphasises the importance of common European standards for property valuation. European Valuation Standards (2009) apply to the assessment of the maximum price that an investor might pay to purchase a property, taking account of the benefits the specific investor will receive by holding it and his operational objectives. Market value means the price at which land and buildings could be sold under private contract between a willing seller and an arm's length buyer on the date of valuation, it being assumed that the property is publicly exposed to the market, that market conditions permit orderly disposal and that a normal period, having regard to the nature of the property, is available for the negotiation of the sale (Directive 91/674/EEC).

At the same time it is also necessary to analyse the reasons owners liquidate real estate and why the liquidation price is often less than market value given reasonable market-oriented exposure time. One of the most frequent reasons is bankruptcy. According to Stam and Durst (2012) bankruptcy is the state or condition of being unable to pay one's debts as they are, or become, due (equitable definition of insolvency), or when debts exceed assets (bankruptcy definition of insolvency). While court-ordered

liquidation by absolute auction is the most obvious evidence of liquidation, there are also semi-forced sellers whose actions result in hurried liquidation. More generally, potential buyers may be aware that the seller is under constraint and so moderate their bids from those they may otherwise have offered. The nature of these specific constraints determines the situation in which the hypothetical transfer takes place – without those constraints, it would simply be market value. Forced sale value can only be a basis of value once all the relevant constraints are identified. They describe the situation in which the hypothetical transfer takes place. It may also be seen as a market value assessment on special assumptions. The appraiser needs to know and state the time allowed and the relevant constraints on the seller. Such a value will reflect those very specific circumstances. It will not be a market value as there is no hypothetical willing seller but a real one under actual constraints.

In order to agricultural companies can reach such performances which ensure their competitiveness in long run several farming factors must be analysed. Competitiveness and income-generating capacity of farms are closely connection with the value of their property. Traditionally, economic analysis and research into regional development tended to be based on factors such as natural resources and infrastructure (Olah, 2009). Competitiveness requires continuous monitoring of expenses in enterprises. Human resource expense reduction is one way of cost reduction to enhance profitability. This can be achieved only with the adequate quantity and quality of agro technical factors (Vantus, 2009). Komarek (2010) also emphasises that application of advanced techniques and technologies may expand the activities and the competitiveness of the companies. Bodnar (2006) analysed the expenditures of the production and he found that they decreased almost in all technological elements which did not make impossible the cereal production due to the lack of capital in agriculture and the liquidity troubles of farms.

Internationally, there are some well-known methods by which property and company value can be estimated. Those are as follows:

A **Going-Concern Business Valuation** is based on the assumption that the company will continue to operate profitably indefinitely. It calculates the value of a company based on its projected future cash flow streams.

A **Discounted Cash Flow Business Valuation** is generally used by investors to calculate the Return on Investment (ROI) they would receive if

they purchased the company. It is based on the present value (PV) of future cash flows.

A **Book Value Business Valuation** is an asset-based method that is simply calculated based on the Balance Sheet. It is simply the asset total less liabilities to arrive at the net worth or book value. While it is a simple calculation, the assets need to be valued correctly in order to arrive at an accurate number.

There seems to be various schools of thought on how best to calculate a company's liquidation value from basic accountancy headings. Here is one of the options which can be applied to calculate conservative liquidation value in the case of appraisal of shareholder companies:

Liquidation Value = Total Assets - X*(PPE) - Y*(Inventory) - Z*(Accounts Receivable) - Intangibles - Total Liabilities)/Total number of Shares

where X equals impairment on Proven Share Price (PPE), Y equals impairment on Inventory and Z equals the % of Accounts Receivable that are uncollectible.

Obviously, these parameters and values change wildly with business cycles and sectors. According to most of the experts in US "X" can be taken between 2 and 25%, "Y" can be taken between 5 and 50% and "Z" can be taken between 5 and 15% (AFN Group, 2010).

Table 1: Example of how the Liquidation Value can be Calculated at an Agricultural Company in Hungary (in thousand HUF)

Heading	Book Value	Liquidation Value
Assets		
Fixed Assets	22000	11000
Inventory	22000	11880
Accounts Receivable	15400	10120
Cash	6600	6600
Total Assets	66000	39600
Liabilities		
Equity	46200	19800
Long-term Debt	13200	13200
Short-term Debt	6600	6600
Total Liabilities	66000	39600

Source: own calculation

It can be seen that the asset values dropped considerably up revaluation based on their worth on the open market. After liabilities have been paid off from the asset liquidation, shareholders are left with a 26400 HUF loss which is 40% of the original value.

CONCLUSIONS

The above calculated loss can be considered as typical in agriculture when farmers are forced to sell their property. On the other hand firm having poorer possibility to generate an adequate income which is usual in the given enterprises its value calculated by discounted cash flow will be also lower. Even if the farmer has different assets having a certain value which comes from bookkeeping, inadequate profitability may significantly reduce the value of the whole property.

The problems can be more serious when appraiser tries to find the fair market value from which liquidation value can be originated. Moreover, buyers and sellers often have emotional value attached to a property or are unaware of the market. There is no reason to assume the contract price is the correct or fair price simply because it is lower or higher than the appraisal. Reliable, credible opinions of value help stabilize real estate loans and investments in agriculture as well, promoting socially desirable real estate and thereby rural development.

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