

VALUATION OF PARTIAL/MINORITY INTERESTS

In Entities that Own Real Property

TYPES OF PARTIAL INTERESTS APPRAISED

Delta Associates is a leader in this specialized field – the valuation of partial interests in real property and related entities. Clients seek Delta Associates’ assistance for a variety of ownership forms:

- Stock in a Corporation
- Limited Partnership Interest
- General Partnership Interest
- Tenants in Common
- Family Trusts
- Units of Ownership in a Limited Liability Company

CIRCUMSTANCES THAT CALL FOR THIS SERVICE

The firm’s services are sought under a variety of circumstances, including but not limited to:

- Estate planning
- Estate tax appraisals as of date of death
- Gift tax management
- Collateral evaluation for underwriting
- Partner/stockholder buyout
- Bankruptcy
- Minority shareholder freeze out
- Sale of minority interests in a business or real property

SERVICES OF THE FIRM

Principals of Delta collectively have the background in real estate and capital markets, valuation services, business planning and deal structures that make the firm an expert in this specialized field. They are supported by a professional staff practiced in data gathering and analysis, preparation of valuations, financial analyses, statistical modeling and sampling, market studies, document review, and general business research.

Steps in the process of estimating the value of a partial interest include:

- **Appraisal of real property by an MAI** that is the primary or sole assets of an entity in which there is a partial interest. Delta can arrange this appraisal or client provides.
- **Restatement of the entity’s balance sheet** to (1) Current Value Accounting and (2) to reflect Net Asset Value.
- **Estimate of pro rata interest in the entity** by interpretation of the partnership agreement or other documents.
- **Partial Interest Value: Estimate of discount off pro rata**, if applicable, which an independent buyer would pay for the partial interest. Considered are illiquidity, degree of control, inability to leverage, complexity of asset and deal structure, etc. Considered here also are (1) governing partnership/shareholder documents, which may specify or impact method of valuation and (2) governing state business law, which may bear on these considerations if the transaction is governed by state business law.

The three primary approaches to valuing illiquid fractional interests are considered (net asset value, market, income). Before these three approaches are developed, indivisibility is tested and concluded. Then, the most applicable one or two approaches are utilized and correlated.

Additionally, the firm routinely relies upon the following three methods of analysis:

- **Market Maker Survey:** Principals dealing in partial real estate transfers are surveyed as to the appropriateness of a fractional interest discount for the subject and why.
- **Sales Comparison Approach:** Sales of similar fractional interests are analyzed and compared to the subject. Adjustments are made for differences in scale, control, complexity, etc.
- **Income Approach:** The cash flow reasonably expected to be distributed to the fractional interest owner is projected and discounted to present value or capitalized into value. In this approach, it is important to note that unless a minority interest is a publicly traded REIT or obligated by legal agreement, distributions to the minority interest owner are not mandatory.

ILLUSTRATIVE OF RECENT ASSIGNMENTS

- **Value of Collateral:** Appraisal of 250,000 S.F. office building in downtown Washington, DC and developer's 40% interest in same. Client: A national bank.
- **Partner Buyout:** Appraisal of 65,000 S.F. office building in Georgetown and developer's minority interest in same. Client: The majority owner – an offshore fund.
- **Gift Tax Management:** Appraisal of 40 acres of prime residential land in McLean, VA and value of interest-in-common in same. Client: Law firm specializing in estate and gift tax planning.
- **Estate Tax/Date-of-Death Valuation:** Appraisal of 32 real estate assets owned in 15 corporate and non-corporate entities. Valuation of the entities, some of which owned fractional interests in each other, raised the key issue of layering discounts in this portfolio. Valuation of General Partnership Interests in negative cash flow entities was an interesting element of this estate. Client: Counsel for executor of the estate.
- **Annual Fiduciary Requirement:** Appraisal of two Class A garden apartment properties in the Washington, DC metro area and the managing partner's minority interests in each. Client: A major insurance company acting as pension fund manager.
- **Valuation of a minority participation in a mortgage** collateralized by a major Florida resort. Key issue: Degree of discount for minority position in a non-performing loan. Client: Counsel to lead lender.

PUBLICATIONS OF THE FIRM FOR THIS SERVICE

Gregory H. Leisch, CRE, director of the firm's partial interest valuation practice, was asked in 1995 to author a position paper of the National Council of Real Estate Investment Fiduciaries (NCREIF) on the subject of valuing partial interests in real estate. In addition, Mr. Leisch authored an article in Real Estate Journal Interactive: "Using Partial Interests in Real Estate to Reduce Your Tax Burden," March 17, 1995.

CLIENTS/REFERENCES FOR PARTIAL INTEREST SERVICES OF THE FIRM

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