



# BEFORE YOU START

This document is intended to be your offline reference. You may want to download and print a copy to keep as a handy reference. The Document and Information Checklists pertaining to each dashboard section (starting on p. 6 below) are also available by clicking the blue “Documents Checklist” button in each of the expansion windows on the PVX Dashboard.

## Contents

Overview .....	1
Three Levels of Analysis .....	2
Special Situations .....	3
Common Tenancy Transactions .....	4
Court Decisions .....	4
Legal Opinions .....	4
Documents and Information Checklists .....	5
Level 1 Analysis .....	5
Level 2 Analysis .....	6
Level 3 Analysis .....	6
Helpful References .....	9

## Overview

Fractional interest valuation covers a lot of territory—territory that is now accessible to you regardless of whether you are an appraiser (or valuer), a property owner, a partner, a CPA, or an advisor. All users have different abilities and levels of experience, as well as differing degrees of connection to the interests being valued, the parties involved, and the real estate. PVX is designed to be an educational tool, so you can readily understand what the dashboard is asking of you at each step, regardless of which category of user you fall into. And as you become more familiar with PVX over time, your process will become very much simplified.

PVX allows you to do valuations at different levels of reliability depending on your use for the concluded value. As you progress through the questions, you will find many links, which have been provided to help increase the depth of your understanding. Some of the links lead to articles or other pages in the site, but many of them take you to the on-site textbook (*Valuing Fractional Interests in Real Estate 2.0*, by Dennis A. Webb) for in-depth background, theory and further insight.

Any user can get a quick idea of value in about 10 minutes at the first level. You can level up by following the instructions for refining specific inputs to improve the reliability of your concluded value in as little as 20 minutes if you are experienced, or in an hour or so if you are not. The third level, which has the highest reliability, will take longer, depending on the complexity of your project, your experience level, and your familiarity with PVX.



## Three Levels of Analysis

**Level 1** only requires that you fill in the fields in the Create New form and accept the system defaults, which are based on typical ownership structures, default market data, and other facts and circumstances. The resulting value and discount are not 100% reliable at this point, but they are a good starting point.

**Level 2** leads you to address the most relevant questions for refining the facts and guides you in making the necessary adjustments. You might be able to do this by just discussing the case with the client, a general partner, or an attorney or CPA who has been involved with the property and owners. PVX will tell you exactly which questions are important to ask for Level 2, and the resulting value and discount will be more reliable than Level 1 at this point.

**Level 3** is an in-depth analysis of all facts, circumstances, and supporting information and will result in the most reliable value indication.

It is usually most logical to progress through the Properties Windows from left to right. This is not absolutely necessary, but you will find that information developed in one window is needed for the next, and such a progression will be the easiest.



## Special Situations

PVX is designed to work for the vast majority of fractional ownership situations, but there are some facts and circumstances that it cannot accommodate. It is a good idea to review the case for any such special situations that might be beyond the capabilities of PVX or that might require a professional valuer and customized valuation models. It is best if you know that your situation is an unusual one at the outset, and formulate a plan to accommodate its characteristics before you work through the entire valuation process. If your circumstances seem to fall into one of the categories below, then please consult the complete, detailed list of Special Situations, which can be found via the Resources tab in the top menu.

### **LLC, LP or S-Corp with Short Restriction Period**

An LP or LLC structure contemplates a fairly long restriction period. Accordingly, the time setting must exceed four years. If you are valuing an LP, LLC or S-Corp for which the subject interest-holder is “trapped” in its position for less than four years, you will need to analyze it using the General Partnership setting, which allows the restriction period to be reduced to 0.5 years,

### **Backend Splits, Classes and Preferences**

Some entities have complicated allocations of cash flows, including back-end proceeds and different classes of partners with distribution preferences. These conditions cannot be accommodated by PVX at present but will be in a future release.

### **Large Percentage Interests**

If the subject is one of only two common tenancy interest-holders and if the interest is larger than 50%, the discount could be capped because of the logic that buying out the smaller interest at a premium (and then controlling the entire property) could cost less than selling the interest at a heavy discount. This situation is highly fact-dependent and must be analyzed separately.

### **Multiple Properties**

When the partnership holds more than one property, consider splitting the partnership or value-weighting cap and growth rates.

### **Significant Other Assets**

Other assets, especially securities portfolios, can change the risk profile of the partnership, but cannot be valued by PVX. Others, such as nonoperating assets or personal property, may require the services of a specialized asset appraiser.

### **Tiered Entities**

A partnership that holds a fractional interest in real estate (common tenancy or interest in another partnership or LLC), rather than a 100% fee interest in the property, is part of a “tiered” or “layered” entity structure. It can almost always be valued by PVX but can also be complicated and requires separate, advanced modeling.

### **Underwater Financing/Negative NAV**

PVX can accommodate situations where property value has dropped, and net asset value is negative. This requires analyzing several scenarios, only one of which can be analyzed by PVX. This situation requires special consideration.



## Common Tenancy Transactions

The PVX algorithm does not use transactional data for common tenancy interests. Such data is very particular to location and property type, and it may be affected by local market practices. It can also be quite difficult to confirm and apply to the subject interest. PVX instead uses valuation models that are proxies for common tenancy interests and have been proven over 20 years of professional practice.

However, you may be valuing an interest in a market where such transactions may be common. (Examples include farmland and timberland, but also recreation area condos and the like.) If such an active market does exist, then its transactions must be considered by the appraiser, in addition to the results produced by PVX. If you are not a professional appraiser, you will need one to analyze and apply such data. Appraisers may also have usable fractional interest transactional data, in which case they should certainly use their own database of transactions in addition to PVX. In either case, appraisers and other users should carefully assess how such data can be used reliably.

## Court Decisions

Fractional interest discounts are often decided by the tax court and other courts, and practitioners sometimes use decisions to support their case. This is decidedly the province of counsel rather than an appraiser. Court decisions are not a dataset, and they cannot be reliably used by an appraiser to support an opinion of value. Memoranda and discussions about court decisions are compiled by Business Valuation Resources and others and the user is encouraged to learn about case decisions as they can be quite interesting. However, the court's decision in any case is only as good as the work provided by experts, and most of that work is not readily available for analysis. Accordingly, PVX does not concern itself with court decisions.

## Legal Opinions

Valuers are called upon to interpret legal agreements with regard to their influence on value and are arguably experts with respect to the value of certain provisions. However, unless they are also members of the bar, they cannot be considered experts with respect to the law. While they can be quite useful to their property owner (and even lawyer) clients, valuers should know the scope of their responsibilities, and where their competence and legal expertise ends.

Partition analysis, in particular, may require legal advice since the law, court procedures and costs are all specific to the local jurisdiction. Whether such analysis is necessary for your case will depend on a) whether partition is feasible in the first place, b) whether likely costs are a significant proportion of the value of the interest, c) how much weight is given to the discount determined by the partition method, and d) the purpose and use of the concluded value. In many cases a phone call may be sufficient, but in others a formal legal opinion may be required.

It is important to ask for help when it is needed.



## Document and Information Checklists

Any successful fractional interest valuation requires documents that identify and support the owned assets, the organization structure, and the operating history and forecasts. It also requires a good understanding of the relationships of the parties involved. This is really the (hypothetical) buyer's due diligence, and the guidance below helps you to identify the types of documentation and information you will need at hand for your particular level of analysis.

Not all items are required for every case.

Some of the required information might not exist in document form, in which case you will need to obtain the information with a more detailed request. The sections below will help you formulate your document request.

If you have access to someone who is very familiar with the property and its ownership, you may be able to obtain enough information for Level 1 and Level 2 analysis through a simple interview. For the Level 3 analysis, you must obtain the source documents.

PVX is not intended to provide guidance on real estate appraisal. While an appraisal by a qualified appraiser is essential to support the PVX analysis for many purposes, users might also want to have on hand a copy of the current edition of *The Appraisal of Real Estate*, published by The Appraisal Institute, at [www.appraisalinstitute.org](http://www.appraisalinstitute.org).

### **Level 1 Analysis**

The six items below constitute the bare minimum of information needed to begin a valuation project. Please be sure to refer to the additional guidance provided for you in the PVX Dashboard for each item.

- ☐ Entity type
- ☐ Property type
- ☐ Percent of interest held
- ☐ Number of parties
- ☐ Estimated value of the real estate
- ☐ Date of value

Issues that require more in-depth consideration:

- ☐ Are you valuing a very large (over 70%) tenancy-in-common interest? (See Special Situations: Large Percentage Interests.)
- ☐ Does the property produce cash flow? If not, go to Level 2.
- ☐ Can the interest-holder cause sale of the property and distribution of the proceeds? If so, the discount might be zero. (See book, p. 169, Control Classifications: 5<sup>th</sup> Degree.)
- ☐ Does the entity hold a non-controlling interest in another entity? (See Special Situations: Tiered Entities.)
- ☐ Does the entity hold significant non-real estate assets? (See Special Situations: Significant Other Assets.)
- ☐ Is the entity type tenancy-in-common with an operating agreement that prohibits partition? If so, you may need to select general partnership as the entity type if the agreement still allows limited control, or



limited partnership if the agreement severely limits control. For either case, it is best to go to at least Level 2.

### **Level 2 analysis**

In addition to the facts for Level 1, you will need at least some idea of the following:

- ☐ Estimated capitalization and growth rates for the property
- ☐ Whether cash flow is being distributed, or whether any is being withheld for some purpose
- ☐ Details of the mortgage financing, if any
- ☐ The degree to which the interest-holder can influence operations (if not tenancy-in-common)
- ☐ The degree to which the interest-holder can influence sale of the property (if not tenancy-in-common)
- ☐ Whether bringing a partition action is a realistic option for the interest-holder (for common tenancy and sometimes for a general partnership interest)
- ☐ Whether a partition action would be opposed by the other common tenants
- ☐ How long the new (hypothetical) interest-holder might have its position before obtaining the full percentage (pro rata) share of the underlying asset. (Note: 15 years is the maximum period that should be considered for analysis. (See book, p. 186, Estimating the Restriction Period.)

### **Level 3 analysis**

For a Level 3 analysis you will need all of the foregoing, plus a few more sources of information, which are detailed below.

### **Real Estate Section**

This section concerns the real property asset and the cash flow it generates. The facts for this section should be obtained from a real estate appraisal, although for an initial analysis and planning purposes, the required information may be obtained more informally. You may also wish to read about how to use (and prepare) a real estate appraisal for our fractional interest valuation purpose. (See book, chapter 4.)

Documents needed:

- ☐ A copy of the real estate appraisal\*
- ☐ Copies or detailed summaries of any leases
- ☐ Historic operating statements (3–5 years if available) and pro forma (12 months after the date of value)
- ☐ A schedule of any extraordinary repairs or capital replacements needed over the next 10 years

\*If you don't have the real estate appraisal (yet), you should at least have some idea of the following:

- ☐ Whether any leases are significantly above- or below-market
- ☐ What the market capitalization and growth rates are for the property



- ☐ Whether there are any major property or tenancy changes likely to occur in the next 10 years (such as loss of a major tenant, redevelopment, or change in highest & best use)

## Entity Section

Documents needed:

- ☐ Historic income statements (3–5 years if available) and pro forma (12 months after the date of value). Both apply for the entity and might include real estate operations, but will also include entity administrative expenses, debt service and other non-real estate items.
- ☐ Historic balance sheets (3–5 years if available, up to and including Date of Value). For unstructured entities (tenancy-in-common) you may have to construct a balance sheet from bank account balances, security deposits held and any other shared assets or obligations.
- ☐ Entity cash flow pro forma
- ☐ Financing documents. The note is the most important, but it is advisable to get all documents. You are looking for terms, prepayment penalties, guarantees and any special or unusual conditions.
- ☐ Detail for any significant balance sheet items like other assets and liabilities including notes to/from partners, cash in excess of reasonable working capital and other assets (securities, for example).

## Control Sections

Documents needed:

- ☐ Copies of operating or partnership agreements and all amendments
- ☐ Property and entity management agreements
- ☐ Documents detailing the current distribution of ownership (from management and/or the most recent tax returns/K-1s)
- ☐ Transfer documents, if applicable

In addition to the above, you also need to know the following:

- ☐ When, and by whom, the property was originally acquired
- ☐ The history of ownership—when, and by whom, the current holding entity was formed
- ☐ Whether management currently faces any particularly difficult challenges with the property
- ☐ Whether management's challenges are likely to change in the foreseeable future
- ☐ Whether there are plans for management succession
- ☐ Details about any past partner buyouts, if applicable
- ☐ Details about any historic dealings between the parties that may affect control or cooperation in the future



## Partition Section

The cost of partition is usually relatively low, although it can vary considerably with little effect on value. Sometimes this is not the case, though, and further documentation might be needed. Level 2 interview questions are also important. The following will only be required for complex cases or physical partition:

- ☐ An opinion from a real estate lawyer regarding likely costs and time required to pursue a partition action in the specific jurisdiction
- ☐ An analysis by the real estate appraiser of how an equitable physical partition could be accomplished, and whether it would result in a change in highest & best use
- ☐ An analysis by the real estate appraiser of short-term growth (over the selected partition period) which often differs from the long-term growth estimate used in Real Estate Properties

## Restriction Period Section

The following list is intended to help you determine the most likely period during which the holder of the subject interest will be restricted from an exit, as well as the interest-holder's risk during that period.

- ☐ The age and general health of any principals (general partner, manager) or the other common tenants or other partners in a general partnership, as well as succession plans
- ☐ Management's future plans for the property
- ☐ At least a general outline of the history and current status of the property
- ☐ Whether any of the owners/partners/cotenants occupy the property
  - ☐ If a vacation property, what is the usage program?
  - ☐ Does the holder of the subject interest have any right or ability to occupy?
- ☐ Any other conditions, facts or circumstances that might affect the property, the operating entity, future distribution of ownership or sale and termination. What would you want to know if you were buying the interest that is being valued?