

Table of Contents

Introduction	v
Overview	vi
Seminar Schedule	xi

SECTION 1

Part 1. Introduction and Review

Brief overview of ownership forms	1
The levels-of-value concept	4
Standards and definitions	6
Other issues	13

Part 2. Partnership Valuation

Circumstances and history of Case Study 1	15
Overview of the valuation process	17
The valuation problem	17
Partnership description	25
Partnership operations	32
Partnership value analysis	45

Case 1

Real Property Information	55
Partnership Case	73

SECTION 2

Part 3. Discount for Lack of Control

Introduction	131
Levels of value.....	131
Market data.....	133
Control discount.....	145

SECTION 3

Part 4. Discount for Lack of Marketability

Overview	201
Market data.....	203
Value analysis	208

SECTION 4

Part 5. Common Tenancy Valuation

Overview.....	245
Case Study 2: Overview	247
Overview of the valuation process	249
The valuation problem.....	249
Description of the ownership interest	251
Property operations	255
Owner's equity analysis.	261

Part 6. Discount Analysis

Buying, selling, and rights	267
Levels-of-value revisited	273
Value analysis	275

Case 2

Common Tenancy Case	309
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Introduction

There are many ways that fee interest ownership of real estate can be divided. The fee holder is subject to the four powers of government: taxation, eminent domain, police power, and escheat; and it may also be subject to agreements, such as leases, that further divide the fee interest. Ownership may also be divided through corporate, partnership, or simply concurrent ownership of the fee or any other rights associated with the property.

Appraising interests in partnerships is typically within the scope of the business valuation discipline. When the partnership assets consist of only real property, however, the valuation problem becomes a specialized one in which understanding the real estate is a large part of the overall picture. Such interests are widely held, and their valuation is important for income, gift and estate taxation, internal sales and partner buyouts, and marital dissolution.

Appraising concurrent interests (common tenancy) is also within the scope of the business valuation discipline, but it is so closely wedded to the underlying real property that it is not typically addressed as part of business valuation education.

This seminar is an in-depth case study valuation of first, a minority interest in a real estate limited partnership that holds an office property, and then a common tenancy interest in the same property. It offers real estate appraisers the tools to become specialized in these types of valuations, as well as offering business appraisers an in-depth understanding of the effect of real property assets on value.

Its scope is restricted to situations where the principal determinant of value is the underlying real estate, and the appraiser should have the best understanding of the valuation problem. However, other issues involving state law, the legal position of the partnership or LLC, tax law, financial statement analysis, and valuation problems involving other assets and intangibles may be present. These issues may require the services of other experts, and/or further understanding of business valuation principles and techniques on the part of the appraiser.

Seminar Description

This seminar is an advanced treatment of valuation topics that are introduced in the Appraisal Institute's seminar entitled *Partial Interest Valuation—Undivided*. It is intended for appraisers who have taken that seminar or who have a background in business valuation and are familiar with limited partnerships.

This seminar is divided into six parts and presented over two days. Part 1 is a short review of fundamental valuation concepts. In Part 2, participants begin the limited partnership case study, which continues through Part 4.

Participants learn how to develop the discount for lack of control in Part 3. In Part 4, they develop the discount for lack of marketability and conclude the limited partnership valuation.

Part 5 begins the common tenancy case study by reviewing an abbreviated version of Part 2 as it applies to common tenancy. Part 6 concludes with the valuation analysis.

Real property as the underlying asset is emphasized throughout the seminar. Many of the business valuation concepts are tailored and simplified, which enables the seminar to provide a very specific and in-depth treatment of the valuation issues.

Part 1

- Reviews the ownership forms that give rise to undivided partial interests—partnerships or limited liability companies, corporations, and concurrent interests.
- Reviews the levels-of-value concept and how it varies depending on the ownership form being valued.
- Covers application of Revenue Ruling 59-60 to the valuation problem.
- Reviews interdisciplinary USPAP issues in detail.
- Discusses the market for undivided interest valuations.

Part 2

- Begins the limited partnership case study with an overview of the valuation/appraisal process and a definition of the valuation problem.
- Examines the approaches to value with careful attention to when and why each should be used.
- Presents the case study with a description and analysis of the partnership and its controlling agreement.
- Examines specific information needed from the real estate appraisal and reconstructs the income statement.
- Analyzes the balance sheet and concludes the net asset value of the partnership.
- Concludes with developing the net asset value of the whole.

Part 3

- The first of two steps in developing discounts associated with limited partnership interests.
- The discount for lack of control addresses the interest's reduced control and its effect on value.
- Begins with an expanded discussion of levels of value, a review of data sources, and then a detailed process for developing the discount using data taken from the public limited partnership secondary market.
- Demonstrate a graphic method for developing the discount for lack of control, and participants arrive at a value for the limited partnership minority interest *as if it were freely traded on the open market*. The interest is privately-held, however, causing its marketability to be impaired.

Part 4

- The second discounting step—the analysis of the discount for lack of marketability.
- Begins with an expansion on the earlier discussion of levels of value, and then reviews several valuation approaches that can be used and how they are related. Data sources consist largely of market impairment studies and are examined in detail.
- Breaks down the factors that most strongly influence value—expected holding time and investment risk—which have many contributing elements.
- Demonstrates an income approach in detail and then concludes value.

Part 5

- Repeats the topics of Part 2 with the same property, ownership, and other circumstances, but with the ownership structure changed to simple common tenancy.
- Begins with an overview of the valuation/appraisal process and a definition of the valuation problem.
- There is no entity to analyze, but the real estate appraisal is unchanged, and the income statement and balance sheet developed are based on the same principles that applied for the limited partnership case.

Part 6

- Explains the discounting process.
- Gives a good deal of attention to the rights and obligations of tenants-in-common, the reasons one may wish to buy or sell such an interest, and the right to bring a partition action, which figures so prominently in analysis of such interests.
- Revises the earlier discussion of levels of value.
- Explores the multiple data sources and valuation methods.
- Breaks down the factors that most strongly influence value—expected holding time and investment risk—which have many contributing elements.
- Demonstrates an income approach in detail and concludes value.

Learning Objectives

At the completion of this seminar, the participants will be able to

- State how USPAP applies to limited partnership and common tenancy interest valuations.

With respect to limited partnership interests in real property,

- Extract value-influencing elements from a limited partnership agreement and from the facts and circumstances of the case.
- Adjust a partnership's financial statement for valuation purposes.
- Understand how the different approaches to value apply to limited partnership analysis.
- Apply the net asset value method to limited partnership valuation
- Use and analyze limited partnership secondary market data and apply the results to a subject limited partnership.
- Demonstrate how the discounting process relates to various types of market data and to the analytical process, and demonstrate the relationship between marketability study data and the income approach.
- Apply the income approach to develop marketability discounts.
- Understand when other experts may be needed to assist with the valuation assignment.
- Value minority interests in real estate limited partnerships.

With respect to common tenancy interests in real property,

- Analyze the facts and circumstances of a common tenant's interest and extract the important value-influencing elements.
- Adjust appraised value and net income for common tenancy ownership.
- Demonstrate how the discounting process relates to various types of market data and to the analytical process.
- Review application of "partition time and cost" and the sales comparison approaches.
- Apply the income approach to estimate the discount.
- Value common tenancy interests in real estate.