Dennis Webb's
Multidisciplinary Guidance & Insights Newsletter #8

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How can they help if you never ask?

An interest in a partnership that holds real estate needs to be valued. The general partner hires a real property appraiser, who proceeds to appraise the partnership's real estate. A business valuer is then hired to value the interest, and receives the appraisal report. Many of the facts that are important to the partners—and to the value of a partner's interest—are contained in the real estate appraisal report, so the valuer now has all the facts they need, right? Not by a long shot.

It starts at the beginning

The scope of any real property appraiser's work is determined by the parameters of the assignment and the question(s) that the appraiser is tasked with answering; the usual one being, "what would a specific property sell for on a certain date, given adequate market exposure?" Market value. It is almost automatic. This is fine for collateral lending, for example, and correct for most instances when whole-property value is needed. So far so good. However, in multidisciplinary applications such as fractional interest valuation, the scope of work almost always needs to be expanded because additional and important real estate-related facts will also be needed.

Such a situation is created when a real property appraiser is hired to provide an opinion of market value that will be included in a business valuer's partnership interest valuation. The appraiser would almost certainly be aware of many facts concerning long-term property ownership. Such facts are not often needed to support market value, but they would definitely be important for partners who are bound together in a long-term relationship with the property. But is the appraiser asked to help with this information? Not usually. This omission creates major blind spots, which can hurt the credibility of the partnership interest valuation. There is an easy fix, but it is not automatic. The right questions must be asked.

The right questions and blind spots

Although I am a business valuer who is also a real property appraiser, I still mostly hire outside appraisers to value properties when I value partnership interests. This is simply because they are masters of local market knowledge, and there are only a few markets that I know well. But I do know what is needed to properly analyze partnership operations—now and in the future—and I always ask the appraiser for help, since they already know the answers.

A partnership usually expects to hold its assets for a long time, but market observations are normally short-term. Long-term fact can include expected value growth, cash flow growth, long-term market trends, potential changes in highest and best use (based on changed market conditions or lease expiration, for example), major but distant capital expenditure requirements, and any management challenges, among others. Even though the future is baked into all market data, specific facts are only made explicit when the appraiser uses a discounted cash flow (DCF) model. Otherwise, they remain hidden.

Understanding long-term issues would definitely be important to partners who expect to be in their positions for a long time. Accordingly, they are important input for credible valuation models, and the valuer's work cannot be complete without their consideration. So please, valuers! Just ask the appraisers. They know. Really.

Starting off on the right foot

An engagement that involves two or more appraisers/valuers creates its own complexity. The client will often hire the real property appraiser first, receive the completed work product, *then* hire the business valuer to take care of the partnership part. *Then* the valuer either gets all of their information from the market value appraisal report—remaining blind to potentially important facts that can strongly bear on value—or contacts the appraiser, effectively asking them to expand their scope of work after the fact, which can be really annoying.

As you might suspect, I have a few recommendations for avoiding the obstacles in this process that make it easier for all and strengthen the overall valuation:

1. The appraiser and business valuer should communicate about the scope of the assignment *at the beginning*. My personal preference is that the appraiser be hired directly *after* the client's engagement with the business valuer, but that isn't always possible. Either way, the real property appraiser would certainly appreciate knowing the entire scope of work before beginning the assignment so they can work efficiently, and charge appropriately.

2. The appraiser should be asked to look for the items mentioned above (long term growth, etc.), and to consider whether they should include a DCF model, even if the market would not necessarily use it (preferring direct capitalization, for example). If not, or if the property is not income-producing, long-term growth rates and expected change in market conditions could still be considered and

reported. For an owner-occupied single-family residence, a rent survey and expense analysis would still help the valuer a great deal. I ask for all these things.

3. Because the real estate appraisal is effectively part of the overall partnership interest valuation, I always request that the appraiser include me and my firm as intended users of their report. Otherwise, we have no legal relationship to each other, which is just not a good way to do business.

4. A real property appraiser who is hired by the client first should definitely have a clear understanding of how the appraisal will be used, and then advise the client that they would prefer to consult with the business valuer before beginning the assignment.

5. The purpose of engaging the appraiser and the valuer in this way is to remove as many potential blind spots as possible from the overall valuation, which smooths the process for everyone involved.

Succeeding with multidisciplinary valuations

Multidisciplinary valuations all but guarantee that blind spots will be created throughout the process, and there is a very good chance that these blind spots will undermine the credibility of the overall work. Such is the nature of multidisciplinary valuation. I believe the above steps can go a long way toward making sure that doesn't happen.

It is my intention that these articles provide ideas that are useful and directly actionable, and that will improve the credibility of multidisciplinary valuations. For detailed guidance like this and more helpful tips than you can imagine, you might also find *Valuing Fractional Interests in Real Estate 2.0* to be an extremely useful reference.

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