Dennis Webb's
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Intangible Value in Real Estate Partnerships

Fair market value's hypothetical buyers and sellers are not real people. They are composites, stripped of all personal attributes; useful but fictional characters. Once the valuer's assignment involves actual people, say for increasingly common internal buyouts, that picture is only useful if none of the parties cares about anything except future returns, risk and how long they will be in the deal (whether they are acquiring those things or trading such a position for cash). This is an extreme situation, and lies at the maximum end of the discount spectrum. The other end is no discount. The in-between is represented by intangible value attributed to the buyer and/or seller, and is usually where the deal will be struck. After all, all transactions are made at *investment value*, based on the buyer's and seller's view of the worth of the investment to themselves. Fair market value gives way to some form of *fair value*. A valuer who can quantify the effects of any intangibles and come up with one or more fair value conclusions will be genuinely useful to the parties trying to make the deal.

Is it Still There?

Intangible value has to have been present at the time a shared ownership arrangement is entered into, since fractional ownership is necessarily created at a time when there are substantial benefits to be realized by the parties. Many of these benefits—pooling resources for purchasing and improving property, sharing use of a property that would otherwise be prohibitively expensive, or maybe just being in business together because of mutual trust—are intangible. Presumably these effects are uniformly positive. After all, would you go into a deal if you didn't agree with your partners' objectives? How about someone with whom you had strong disagreements? Of course you wouldn't.

It would be unusual, though, for the original good feelings to persist unimpaired over the years, through personal and economic changes and with generational changes as well. The new car has been "driven off the lot" so to speak and isn't going back. It is definitely "used" at that point. Of course, if the valuation is for litigation, good feelings (and intangible value) are likely to be entirely absent anyway.

Years later, a family's real estate business may be harmonious, or it may not. The family members in charge of management may be highly regarded, but this is not always the case. The level of trust and confidence in the future could be very high, or it could be very low. In any such case, fair value could be strongly affected in either direction by these intangible elements.

Setting up for Success

When it comes time to get all the partners to agree on a buyout process and its pricing mechanism, these issues could easily be in the forefront of matters that must be resolved. If things are not going well, then there are many ways that problems could be properly reflected in value. If, on the other hand, trust and confidence levels are high, then the partners might be more comfortable with reducing the yield (or discount) required for exit pricing. Analytical methods for handling this are presented in Valuing Fractional Interests in Real Estate 2.0.

Even if not completely supported by the facts, it may be necessary to reduce the discount somewhat to get all parties to agree on any buyout process or formula. The partners can do anything they collectively wish to do, and a good understanding of their special circumstances, as well as the trust and confidence they share, might be required to get to agreed-upon pricing and a workable buyout plan. Fair value needs to be seen as fair by all parties.

Let's Make a Deal

The list of possible intangible and investment benefits and detriments is long. Fortunately, the valuer can usually interview the parties to a buyout transaction and determine what needs to be considered. Since there are two parties, the valuer may not be able to come up with a point-value conclusion, and a range of values may be more appropriate. But at least the issues associated with the position and views of each of the parties will have been "placed on the table" by the valuation report, and they will at least have a more objective basis for arriving at a transaction price that is seen as fair to all. Of course, such special conditions are discussed in Valuing Fractional Interests 2.0 with respect to risks associated with minority ownership and buyouts.

Yes Dorothy, it's Personal

The business of a family partnership can be quite personal, and the specific degree of internal trust and confidence can be an important intangible element in crafting workable buyout provisions that will benefit future generations. Determining price is, of course, a key element of any buyout, and lawsuits over exit p ricing are hardly uncommon.

Conceptual buy-in is normally achieved when all parties believe that they are being treated fairly, and market-level discounts can challenge that perception on both sides. Fair value should definitely be fair to all, but the process of finding it may require that the parties consider intangible circumstances that a market-value analysis deliberately ignores.

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