Valuing for the Future—Shared Real Estate Ownership is in Trouble

Dennis Webb (USA)

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SUMMARY

We know that the built environment needs maintenance, upgrades and use changes over time. But shared ownership arrangements—partnerships and other fractional (undivided) ownership structures—need attention. Owners, their perspectives and their intangible benefits also change over time; such changes can generate conflicts that threaten their investment's viability. This does not have to be. Valuers should play a key role in settling conflicts, but we have been faced with combining real estate appraisal and business valuation knowledge to do it, and we are not ready. Fortunately, help is at hand.

Fractional interests in real estate have a distinct lifecycle. Owners enter into partnership arrangements to own property when they see intangible benefits from doing so: capital access, sharing others' talents, acquiring larger properties, personal use and more. The going-in cost is at least 100% of each partner's share. But these intangible benefits dissipate over time. Their loss reduces each share's fair value, a confusing and troubling circumstance that can make future partner buyouts difficult. That buyouts will be necessary is a consequence of management disagreements, changing personal circumstances, and simply generational change.

Generational change is upon us, and it is huge. A great deal of real estate was developed post WWII, creating fortunes and supporting families ever since. Many partnerships were created, but operations were generally in the hands of the original grandparents, who are now passing, and the transition to the second or third generation is happening on a large scale. There is a strong need to buy out dissenting partners and consolidate ownership, but this requires a shared understanding of fair value that does not exist.

Fair buyout pricing requires that valuers understand and communicate why the interests—that were initially worth 100% of their share of net asset value—are now to be valued at 80% down to 60% or even less. But valuing fractional interests in real estate is multidisciplinary and the number of qualified practitioners is limited, leaving the public stranded.

Fortunately, the valuation process has now been made easy and accessible by advances in technology. This paper details the transition from mainstream valuation practice (version 1.0), to the much easier to understand version 2.0. This easy version is now accessible to valuers, advisors and property owners alike in PrimusPVX© online valuation software, and it companion text, Valuing Fractional Interests in Real Estate 2.0. It is the solution to sustaining ownership benefits for future generations.