

The Webb Discount Chart: A Simple *Fast Method for Valuing Fractional Interests*

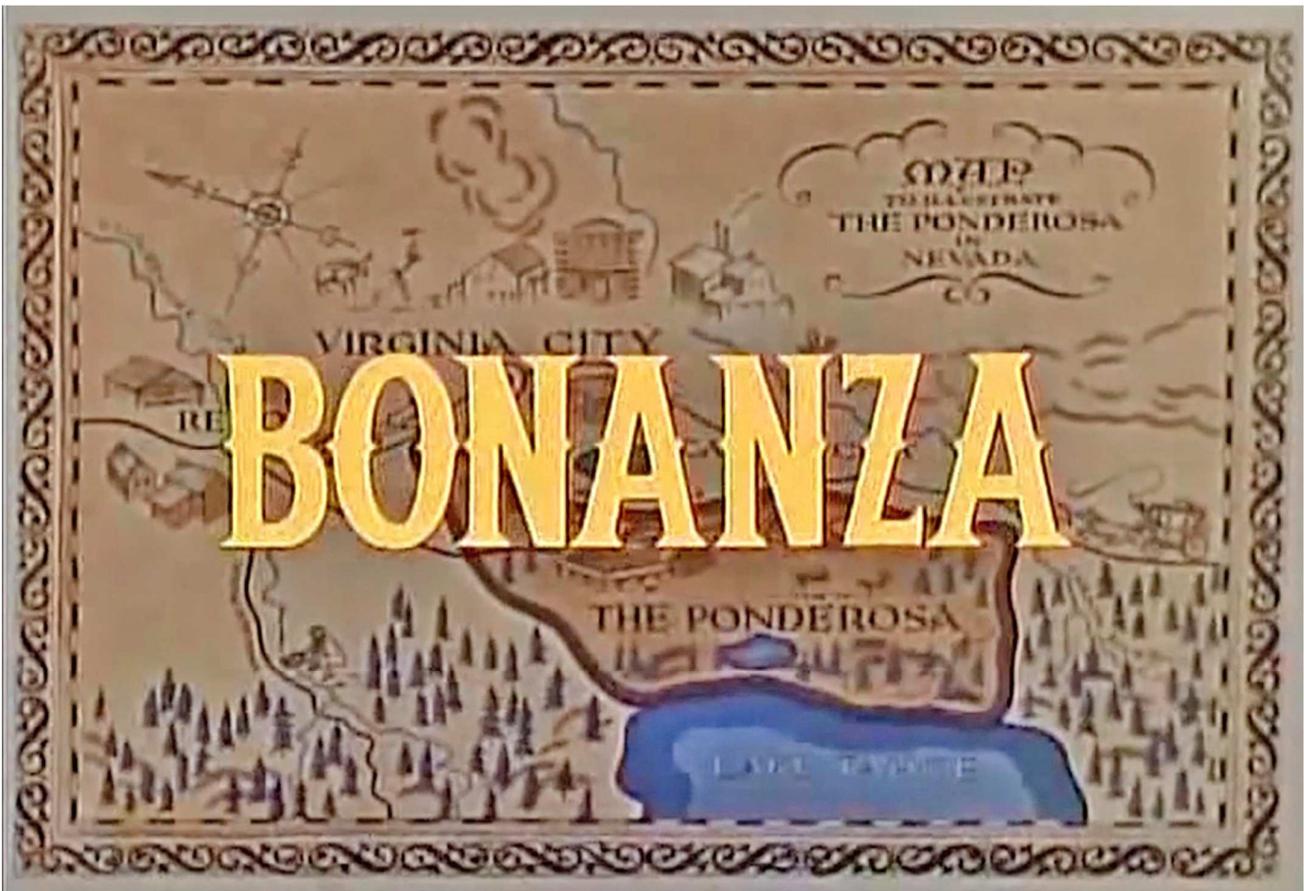
*Produce easily-agreed results through
true interdisciplinary collaboration*

Dennis A. Webb, ASA, MAI, FRICS

FIG Congress 2014

Kuala Lumpur, Malaysia 16-21 June 2014

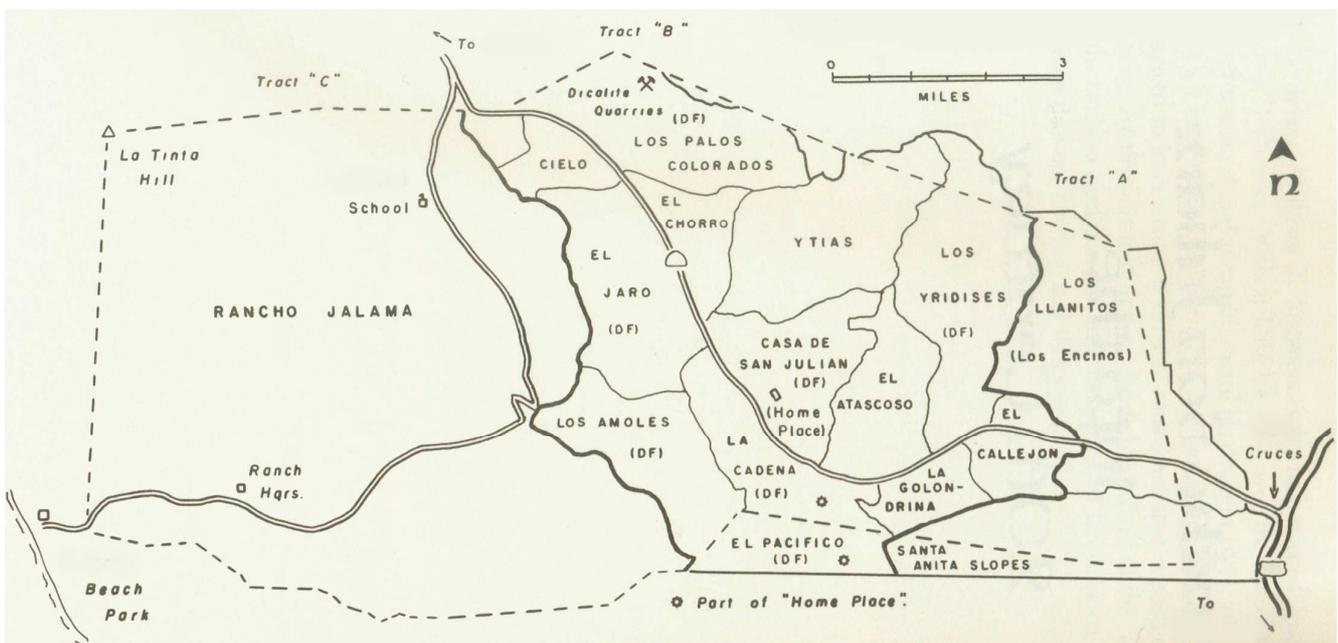




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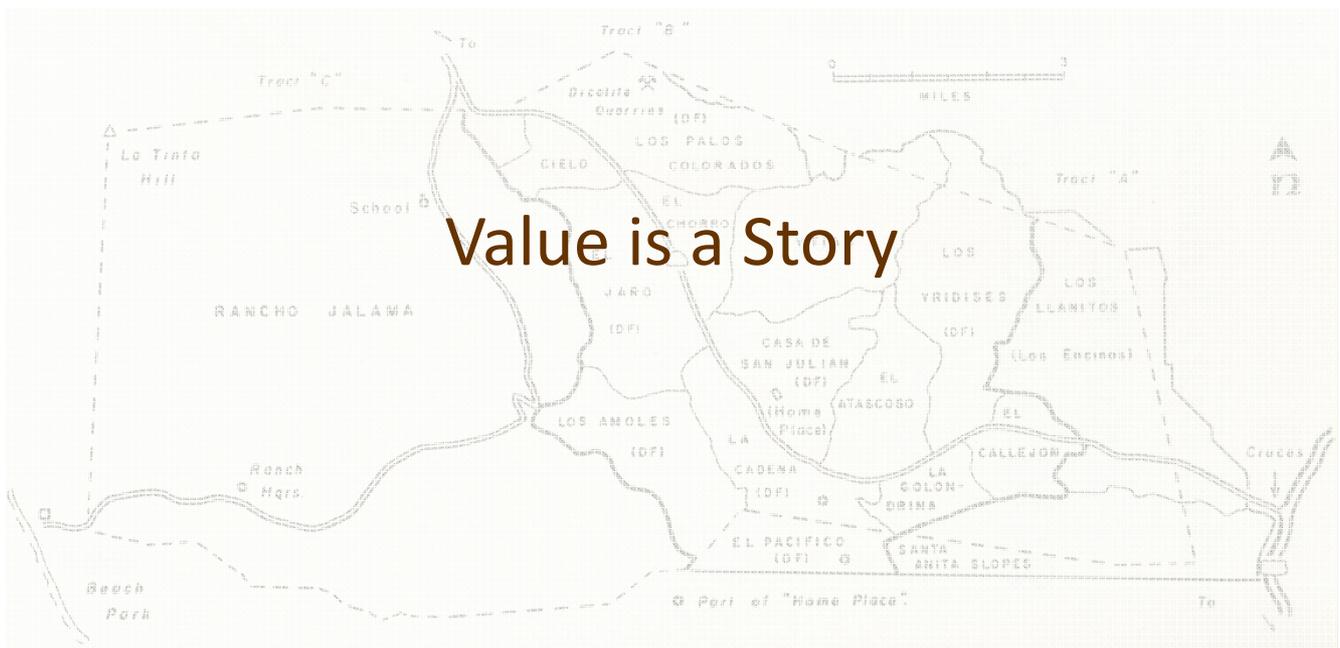
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California Rancho 1837



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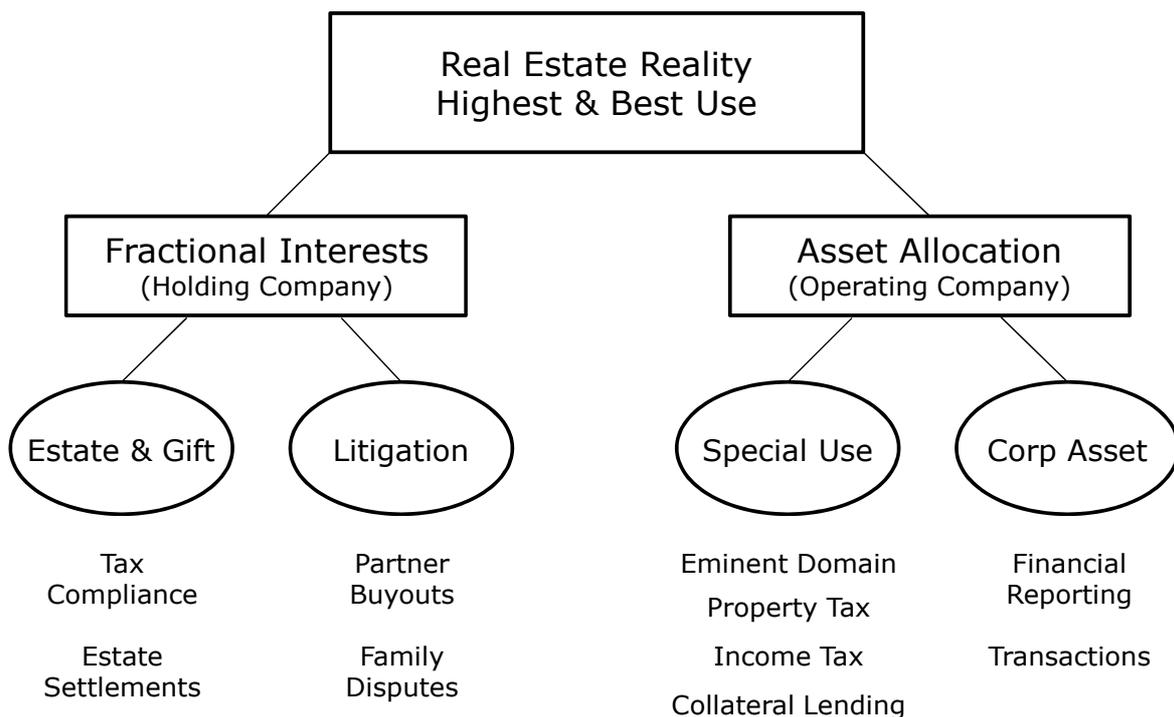
The Land Underlies All

- Real property is $\frac{3}{4}$ of wealth in developing world and $\frac{1}{2}$ of wealth in developed world
- Land is our home, security and true source of capital
- This conference is about the land and legal, policy structures, surveying and valuation practices that are absolutely necessary to support capital development

Something is Missing

- The real estate appraisal profession we know began in the 1930s; business valuation formalized in 1970s
- Well-established bodies of knowledge, being adopted by developing countries, but...
- They don't work together, the don't collaborate
- The story suffers, valuations that need both do not work; the result is disaster

Holding & Operating Real Estate



Disaster Waiting to Happen

- These practice areas require collaboration, but it does not happen!
- Valuer and appraisal user risks are huge:
 - Tax compliance: the undoing of many family estates
 - Disputes: unfair outcomes for family members, partners
 - Courts: unacceptable evidence, failed proceedings
 - Eminent domain: endless litigation, huge and unfair costs
- Valuers and policy makers don't see the risk

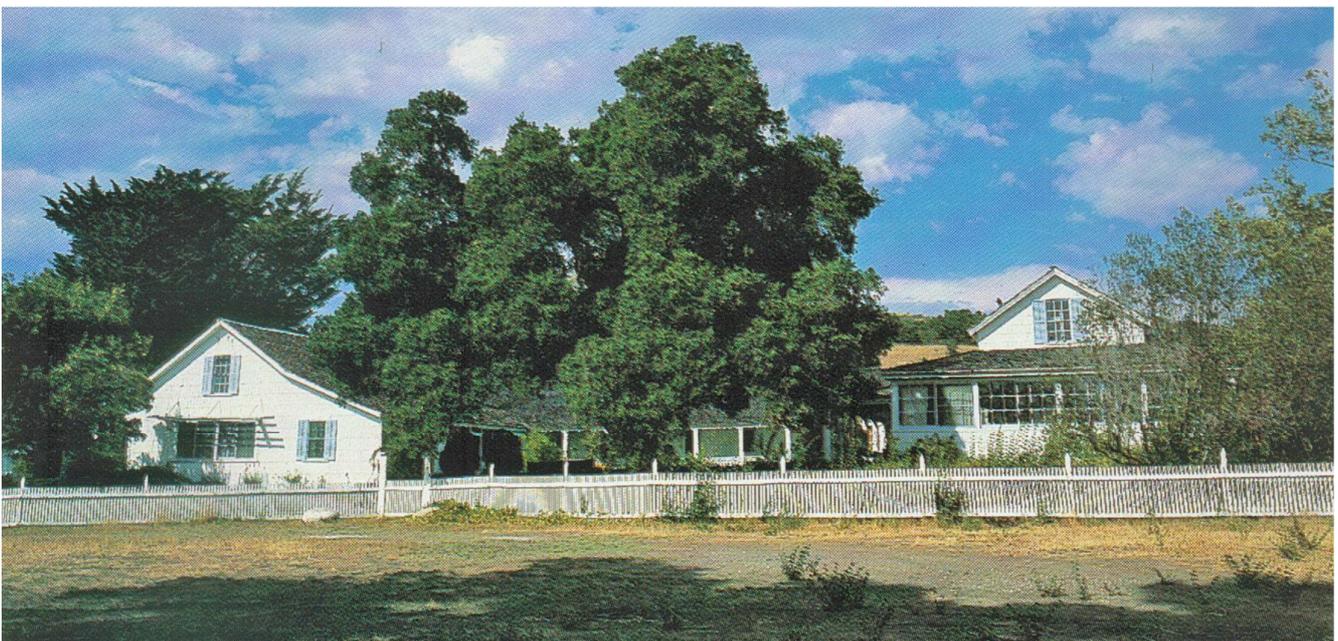




The Land Mine Went Off!

- US 2006: New powers granted to tax collector to deal with valuation and compliance disaster
- Sanctioning appraisers in US for improper valuations
- Risk is huge, for appraisers and for public policy, partners and families
- Developing an integrated valuation practice, with true collaboration, has been very difficult ... *until now*

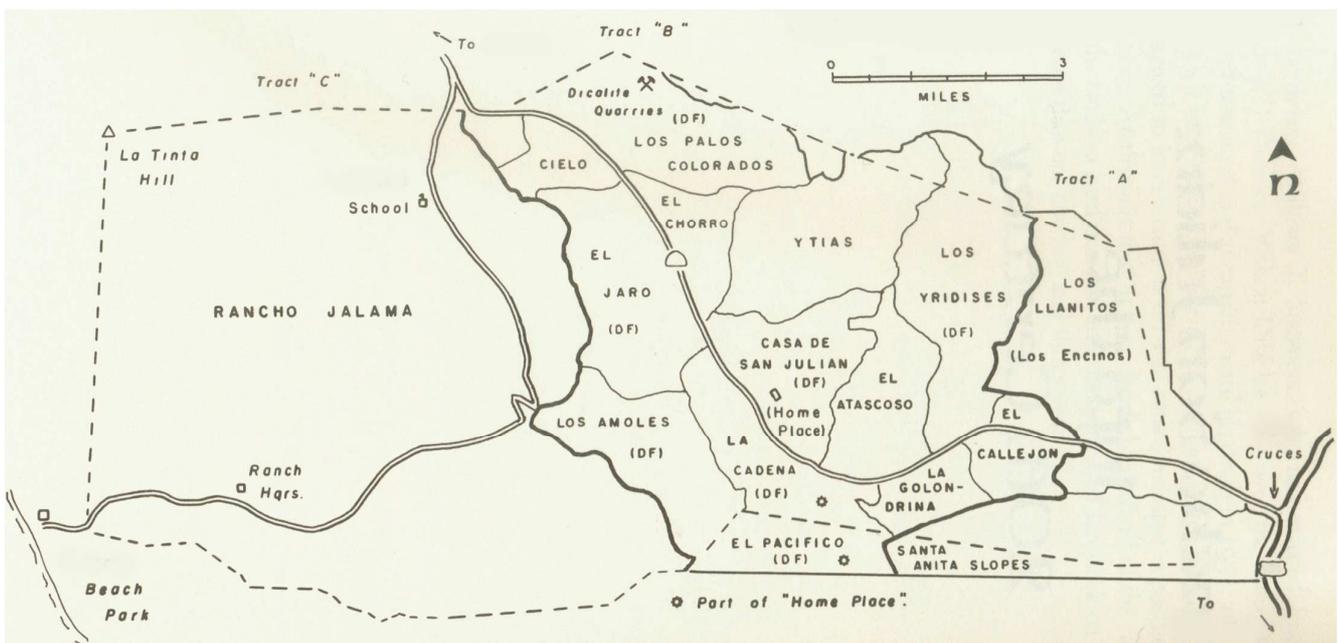
Saving the Ranch



Saving the Ranch



Saving the Ranch



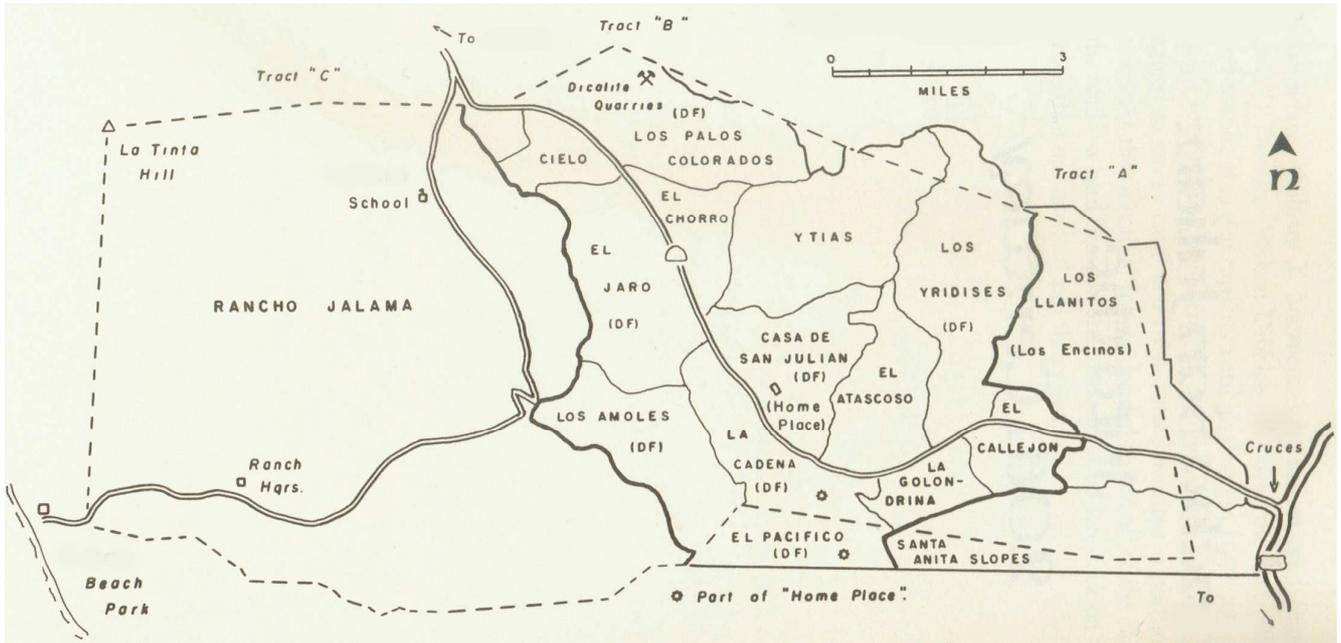
Saving the Ranch

- Original Spanish land grant 1837
- Treaty ended Mexican War in 1848
- California admitted as a State in 1850
- The U.S. was a developing country – not so long ago
- Alfred Marshall – published the basis for value theory *Principles of Economics* in 1890
- Valuation was not yet developed as a profession

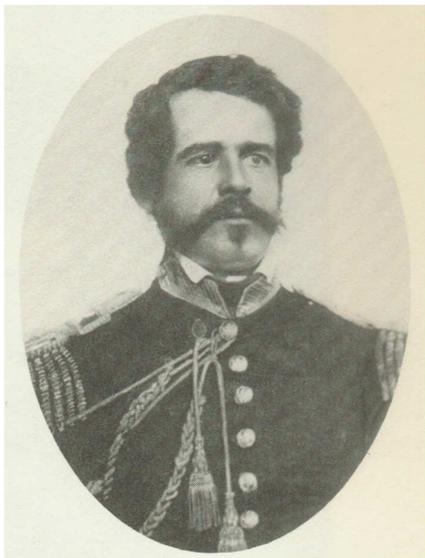
Saving the Ranch

- Seven generations, now held by four families
- Land rich and cash poor
- 48,000 acres – Now 12,000 acres
- Debts and taxes are eating the ranch; a legacy is in danger of being lost
- Valuation is a big part of the problem, and valuation is the solution

Saving the Ranch



Saving the Ranch



Saving the Ranch



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Saving the Ranch

- Subject 20% interest in 4,200 acre ranch
- Hilly coastal terrain, some water
- Grazing, hunting, mining, mushroom gathering, past farming, equip storage, beekeeping, cell tower
- H&B Use is single family w/grazing
- Real estate value \$4,500,000

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Saving the Ranch

- Cash flows \$54,000/year
- Balance sheets de minimis
- New LLC (2001), was tenants-in-common
- Managers represent four families, ages 48-64
- 70% supermajority + manager agreement required

Saving the Ranch

Mission statement – The purpose of forming the LLC is to affirm the status of the Rancho as:

“...a family heritage, whose true worth, both tangible and intangible, can best be realized if it is retained intact by successive generations of the family. In this way, the members believe that it can be a satisfying and unifying common interest as well as a financially profitable business enterprise.”

Saving the Ranch

The intent at formation is explicitly stated:

“...to encourage retention of the Rancho substantially intact, and stimulate an interest in it among descendants which will cause them to choose to retain ownership...”

Managers are adamant: agitate to sell ranch, become disinherited. Happened twice (interest converted to life estate).

Saving the Ranch

- Remaining lives at least 33 years, conclude holding period 20 years for analysis
- Low risk real estate
- Very low economic return
- Intra-family conflicts
- Intangible benefits

Saving the Ranch

- Distribution rate 1.2%, land value growth 4%
- Control discount 51% first 10 years + 18% = 69%
- Marketability discount 46%
- Concluded discount 83%
- Pro rata NAV = \$900,000 FMV = \$153,000
- Good lawyering + valuation saved the ranch

Saving the Ranch - Conclusions

Lack of collaboration between appraisers in different disciplines, lawyers and property owners has consequences:

- Appraisal firms very often find themselves and their work in court and their client's plans undermined
- The tax authorities pour resources down the rat hole of enforcing compliance
- The courts throw out testimony because it doesn't make sense

Saving the Ranch – Conclusions

Professional capability for *integrated valuation*, collaboration between valuers, lawyers and clients, is sorely needed

- The Webb Discount Chart is an example of how easily this professional capacity can be adopted
- Valuers in any country have a resource they can call upon to literally “save the ranch”

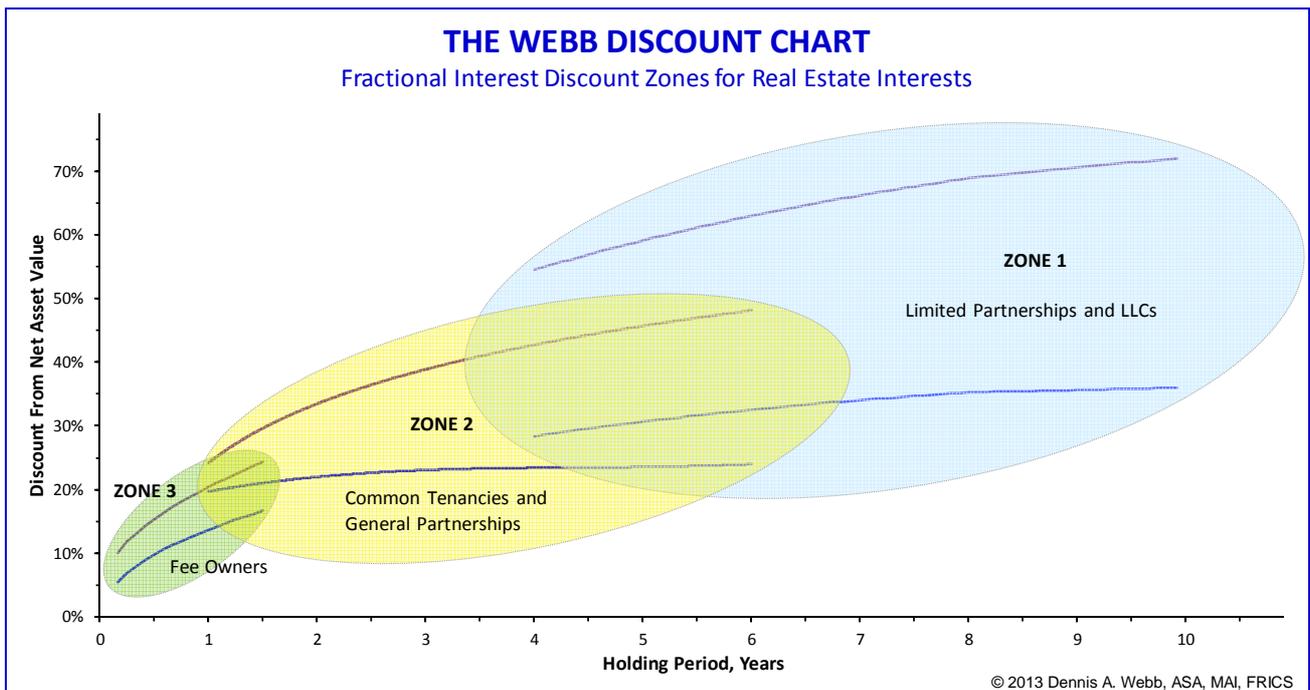
Tools for Saving the Ranch

Current tools for interdisciplinary valuation practice:
Highly complex; facts easily lost; land mines unseen

The Webb Discount Chart tool is for valuing partnership interests; it works directly with the facts and the story

It's easy to learn, reduces risk (helps avoid land mines)

Valuers in any country have resources they can call upon to literally “save the ranch”



WD Chart Functions

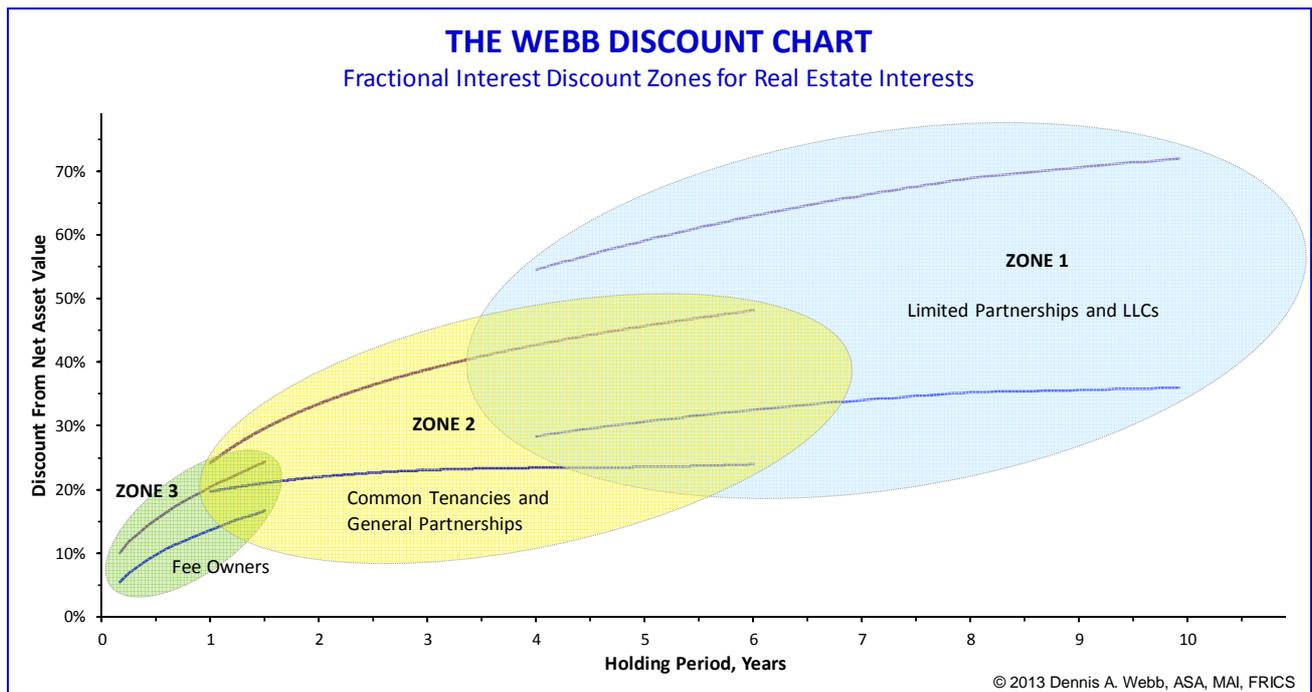
- Defines boundaries based on stories
 - Most facts & circumstances are inside, some outliers
- Shows structural relationships
 - Difference between common tenancy / limited partnership
- Focus on facts – otherwise gone missing
- Fosters collaboration

WD Chart Models

- Regression: Partnership Profiles Data
- Quantitative Marketability Discount Model
- Black-Scholes option pricing model
- Partition time and cost model
- Regression: Short-term liquidating partnerships data

WD Chart Experience/Judgment

- Yield rate buildup
- Risk, value and CF growth ranges
- Model application and weighting
- B/S volatility interpolation
- Variable significance (informed by data)
- Fact & circumstance ranges
- Typical organization structures, attributes



Valuation Zones

- **Zone 1:** LLCs, LPs etc. long life
 - Little or no control, no exit
 - Shorter life, more control \Rightarrow Zone 2
- **Zone 2:** General partnerships, common tenancies
 - Control affects risk, ability to exit
 - Locked in, low-value, other impairments \Rightarrow Zone 1
- **Zone 3:** Real estate impaired by facts/circumstance

Zone 1: Lower Limit Basics

- Asset: Moderate risk, say apartments
- Financial: Low/no leverage
 - Revenues grow m inflation
 - Pro rata distributions @ 6.5% on NAV
- Owners: Competent management, long history
- Hold period 4-10+ years
- You would like to be in this partnership

Zone 1: Upper Limit Basics

- Asset: Higher risk, say mobile home park
- Financial: Moderate to high, maybe refi risk
 - Revenue growth limited
 - Pro rata distributions @ 2.5% on NAV
- Owners: Management change, disputes
- Hold period 4-10+ years
- You would not be thrilled to be in this partnership

Zone 2: Lower Limit Basics

- Asset: Moderate risk, say apartments
- Financial: Low/no leverage
 - Revenues grow m inflation
 - Pro rata distributions @ 6.5% on NAV
- Owners: Competent management, long history
- Hold period 1-6 years w/put or partition right
- Some influence over management decisions

Zone 2: Upper Limit Basics

- Asset: Higher risk, say mobile home park
- Financial: Moderate to high, maybe refi risk
 - Revenue growth limited
 - Pro rata distributions @ 2.5% on NAV
- Owners: Management change, disputes
- Hold period 1-6 years w/put or partition right
- Onerous risks, impaired exit

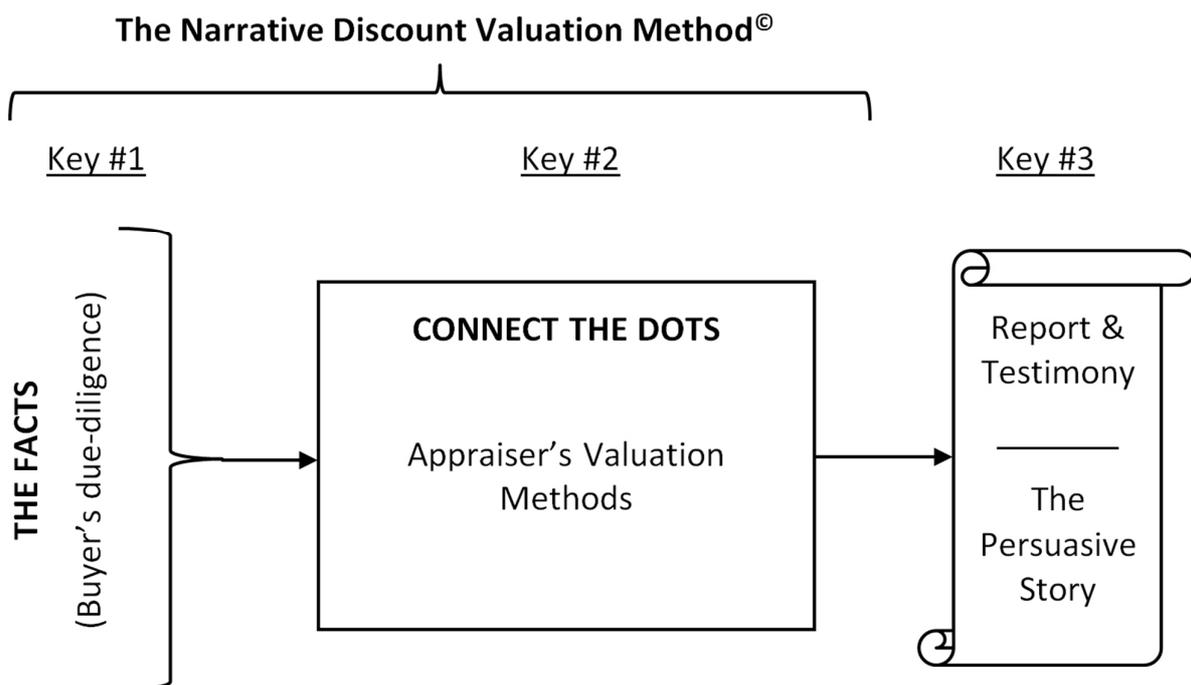
Zone 3: Property Impairments

- Change in highest & best use
- Changing market conditions
- No market data
- Impaired credit markets
- Permissions, external risk
- Discount a function of extra time, risk

Narrative Discount Valuation Method

Appraisal Approaches and Methods

- 3 Approaches × 3 levels of value = 9 possibilities
- Add multiple methods = totally not understood
- NDVM is an *overall* methodology
 - Does not replace approaches and methods
 - Does force appraiser to focus on facts, process and story
 - Keeps 'em from getting lost in the weeds



Narrative Discount Valuation Method

Organizes application of process into three parts:

1. Find the Facts (& circumstances)

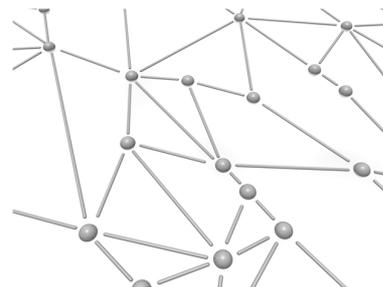
- Essential but M.I.A.
- The basis for collaboration
- The foundation of the story
- Case of Ludwick
- Another ranch story



Narrative Discount Valuation Method

2. Connect the Dots

- The appraiser's process
- Tie facts to market data
- Webb Discount Chart
- Vague assertions are not connections
- The WD Chart allows relationship between fact patterns to be seen – how do changed facts affect the result?



Narrative Discount Valuation Method

3. Tell the Story

- Value IS a story
- Analysis is NOT
- A collaboration check
- How do the facts integrate with your analysis of the data?
- *“Please tell me what your analysis has to do with the facts”*

This matches the lawyer’s process for developing a persuasive argument



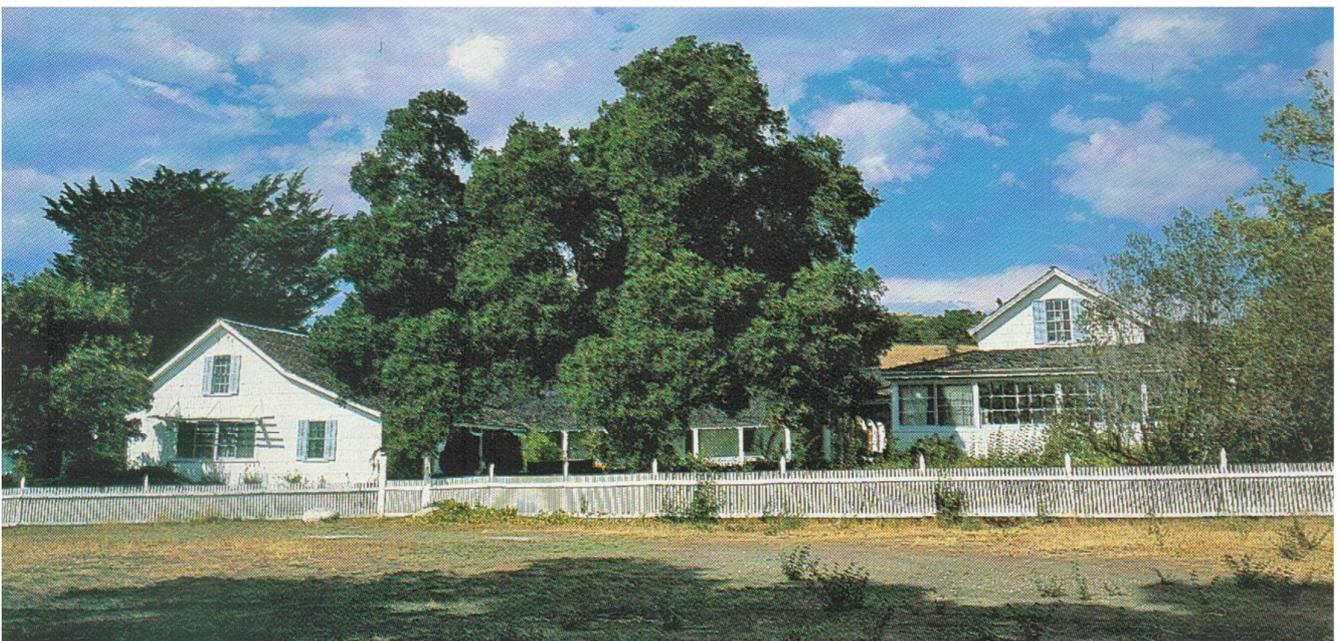
The Practitioner Landscape

- IRS went berserk because the interdisciplinary void is filled by not-so-good and casual valuers
- What passes for discount valuation?
 - “I heard IRS allows 35% discounts without question”
 - “Common tenancy discounts are 15%”
- It’s hardly about saving the ranch, is it?

Value is a Story

- Webb Discount Chart reveals fact-based discounts
- WD Chart Provides fact connections to market data, experience and judgment
- Story foundation is accessible and collaborative
- Counsel and clients are brought in, not kept out
- The facts make the story...
and the story saves the ranch

The End



Thank you for attending!

Dennis A. Webb

dwebb@primusval.com

