Rural Valuation Topic #RVT 20: Fractional or Partial Interests

Partial Interests are defined as, "divided or undivided rights in real estate that represents less than the whole, i.e., a fractional interest such as tenancy in common, easement, or life interest"[1]. Simply, this is a shared right of occupancy and liability of ownership. A hypothetical example is "if someone owns an undivided 40% ownership in 100 acres, they do not own 40 acres --- they own 40% of EVERY acre"[2].

> "Fractional interest sales are scarce and rarely sell to 'disinterest third parties' in the private sector. Thus, valuation of undivided partial interests in real property presents a difficult problem for valuers. Traditional data sources do not provide information on partial sales. Also, there is limited education from traditional providers directed toward this ownership situation; however, those available are limited in scope. Many appraisers approach the problem by merely applying discounts to proportional ownership percentages that may be shown by applicable case law. These procedures are not based on or derived from the market. Thus, the validity of those mathematical exercises is not recommended, if reporting ***'market value'*** is the objective"[3].

Surface Fractional Interests:

> "If any co-owner of an undivided interest in real property becomes dissatisfied with the status of ownership, there are several options to realize the value of the asset:
>
> - sell the fractional interest,
> - seek voluntary partition, or
> - demand court partition.
>
> Under the sale option, fractional interests are difficult to sell on the open market. First, the transaction will likely require "cash" or "seller financing" because conventional financing is difficult to obtain. Thus, this factor limits the number of qualified buyers. Second, the owner of a fractional interest may have little to say in the way the property is operated. Third, a fractional interest does not meet the requirements of a good investment i.e., marketability, liquidity, and value as collateral." (Valuing Rural America, ASFMRA, 2019 Edition, p. 526).

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[1] Appraisal Institute, *The Dictionary of Real Estate Appraisal*, 6th Ed., (Chicago: AI 2015, p. 167)

[2] American Society of Farm Managers and Rural Appraisers: *Valuing Rural America*, 2019 Edition, (Denver, ASFMRA, p. 525).

[3] Ibid

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Sales of fractional interests to other co-owners of the same property are not considered arm's-length, i.e., they have a vested interest in acquiring the remaining interests to improve their ownership percentage. The only sales that meet the test of market value are to "disinterested third parties".

ASFMRA Recommendation:

The valuation of fractional interests as a "partial" interest departs from the traditional "before" versus "after" procedure typically used when something less than the whole in acquired or taken. Simply, there is no "whole before" because the only interest which could be transferred existed as a "partial" interest.

From the rural perspective, a valuation procedure would "include a 33% ownership in 1,000 acres of crop or pasture sold somewhere in the U.S. for $800/acre, which would indicate the 100% price should have been $2,400/acre [by simple division]. Three other sales with 100% of the rights sold within the same market for $5,500/acre. The difference of $3,100/acre equates to a 56.4% discount. Several of these rural sales should be collected and analyzed" (Valuing Rural America, ASFMRA, 2019 Edition, p. 527) to provide market support for any conclusion of value.

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