



Rates

In this issue, we switch gears from rates of return (discount and capitalization rates) to rates that affect the value arrived from using a rate of return. These rates are referred to as control and minority rates and can be either discounts (rates that reduce value) or premiums. The first rates we will discuss are the Discount for Lack of Control (DLOC) and the Premium for Control.

Control

Discount for Lack of Control

It is best to start by labeling each method as to whether it generates a controlling or a minority interest.

Income Approach

Single Period Capitalization Method Controlling Interest or Minority Interest

Multiple Period Discount Method Controlling Interest or Minority Interest

Market Approach

Guideline Public Company Method Minority Interest

Direct Market Data Method Controlling Interest

Asset Approach

Net Asset Value Controlling Interest

Excess Earnings Method Controlling Interest

The income methods can be either controlling or minority interest depending on the adjustments that were made to arrive at the normalized financial statements. If your subject business interest is a minority interest and the method used generates a controlling interest, a DLOC would be required. Why? A minority interest can not initiate transactions that would affect the business. Examples would be to sell assets, payout dividends, etc.

Premium for Control

The Premium for Control is the exact opposite of the DLOC. If you have a controlling interest as the subject and the method generates a minority interest value, then a premium for control is required.

When the purpose (standard of value) is fair market value, a DLOC or a premium for control may be required depending on the interest being appraised. When valuing fair value, this is not always the case. Typically, a DLOC is not applied when fair value is the standard of value. The deciding factors are the function (use) of the appraisal, the courts, and how they define fair value. Fair value is a legal term, not an appraisal term.

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