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Valuing Assets in Divorce Mediation

In a long-term marriage, any assets that the divorcing couple owned should be valued. The complexity arises from the need to understand whether the valuation is just to establish a value or to defend that value in litigation. The valuation technique can be, and often should be, dramatically different depending on its purpose. Where it seems helpful to do so, there's a discussion of how the techniques of valuation are different in mediation from what they would be in litigation. For convenience, I've grouped the various assets into logical categories, in descending order of liquidity.

CASH	1
SECURITIES	1
RETIREMENT PLANS	3
VEHICLES	4
HOUSEHOLD ITEMS.....	5
COLLECTIBLES.....	5
THE MARITAL HOME	6
NON-RESIDENTIAL REAL ESTATE.....	6
THE FAMILY BUSINESS.....	6
WHEN ALL ELSE FAILS	7

Cash

No issue. Don't we wish our clients had more of it? In your dreams. Cash can solve all manner of problems in divorce, but it's almost never available.

I actually did have a divorce mediation a few years ago after a long-term marriage where the parties had about 50% of their marital wealth in cash and cash equivalents. It was a simple, pleasant mathematical process; when it was over I wondered why they had needed me, and I think they may have had some of the same questions!

Securities

The actual market value for marketable securities is, by definition, easy to determine. The challenges arise from the date on which the valuation is determined, questions about vesting, and the tax impact of selling a given block of securities.

◆ *For Litigation*

Typically, gladiators end up preparing a summary of the values of the relevant securities for negotiation and then updating the values repeatedly. Their challenge is to organize the values in a way that makes it easy for them to tell the story quickly and effectively. Each party also will include or exclude assets depending on what narrative they are trying to emphasize.

◆ *For Mediation*

Constantly fluctuating values for marketable securities can be exhausting. I encourage my clients to set a date for the valuation of all securities. The spouse who ends up with a block of securities then carries the investment risk on those securities from that date. This helps, but it helps incompletely. If mediation fails and they end up in litigation, the date will get shifted again, because the securities will probably be valued anew as of the trial or as of the separation date.

One or both spouses in divorce frequently overlook the tax consequences attached to individual securities. Two blocks of securities can both be valued at \$100,000 and yet can have dramatically different real values, depending on the basis the taxpayers have in them. It is imprudent for spouses to negotiate a division of securities without knowing the basis of each asset.

Valuation of options to buy marketable securities is a particularly challenging task. Imagine a block of options to buy 1,000 shares of XYZ Corp. at \$25 per share. XYZ is now selling for \$18 per share. Do the options have any value? The options cannot be used today to buy shares of XYZ and sell them at a profit (the term for this fortunate condition is “in the money”). But the options do indeed have value, for exactly the reason that the employer gave them in the first place. If the shares of XYZ were to increase in value beyond \$25 per share, the options will then be “in the money” and their holder will become more wealthy.

So how does one assign a value to the options? Like many other calculations based on uncertainty, one way to do it is to reduce the uncertainty to a series of probabilities. Just for fun, let's try it with those XYZ options. Assume that we agree that we want to estimate the value of the options based on what they will be worth in 10 years. If so, what is the probability that XYZ Corp. stock (after splits of course) will be worth \$50-70 per share in 10 years? 5%? How about \$40-50? 20%? How about \$30-40? 50%? How about \$25-30? 10%? How about less than \$25? 15%? How about more than \$70? So low we choose to call it zero?

Armed with these assumptions, we can construct a probability table to estimate the total value of the options:

Value of XYZ Stock	Value of option	Probability	Weighted value of option
\$50-70	\$35	5%	1.75
\$40-50	\$20	20%	4.00
\$30-40	\$10	50%	5.00
\$25-30	\$2.50	10%	.25
Less than \$25	\$0	15%	0
Total Value		100%	\$11.00

So the value of an option, using the series of assumptions above, is \$11.00. 1,000 options, therefore, would be worth \$11,000. Does this mean that a couple in mediation dealing with options that are not in the money should engage in this process? Rarely. The mere awareness of that this kind of process is available, however, makes it “safe” to talk about the value of the options, and it also finesses the argument that the options are worth nothing because they’re not in the money.

Another technique for dealing with options is simply to provide that the value will be shared “as and when exercised.” This keeps the parties entangled in ways most of us would discourage, but it provides a simple solution that often keeps the options from becoming a sticking point.

Retirement Plans

The complexity of valuing a retirement plan interest will depend on the kind of plan. Retirement plans break down into two groups, defined contribution plans and defined benefit plans. Valuing an interest in a defined contribution plan is usually simple and straightforward. Valuing an interest in a defined benefit plan is usually complicated and subject to lots of interpretation.

◆ *Defined Contribution Plans*

Think of a defined contribution plan as a “bucket of money” with a person’s name on it. Most plan administrators want their participants to be proud of their retirement plan interest, so they work to make benefit statements easy to understand. They also send out regular updates of investment performance and new contributions made by the participant and the employer. The result of all this is that most participants in defined contribution plans know the approximate value of their interest at most any point in time.

One of the valuation challenges in the defined contribution plan context is the plan interest that is not yet vested. If a plan interest is 0% vested now but will become 100% vested if the participant remains employed with the employer for two more years, is the plan interest worthless? If not, is it the full amount for which the participant will be eligible after working for another two years? What happens if the participant were to leave or be fired in the meantime? Fortunately, this is not your divorce, so you don’t have to answer those questions. What you can do is offer a few options, then invite your clients to come up with their own solution.

I might say something like “sounds to me like you have several options. You could choose to assume that _____’s going to work until she’s fully vested and value her interest at 100%; you could choose to assume that she’s going to leave before she’s vested and consider her interest to be worthless; or you could assume that she may stay and she may leave, and discount her interest in some way to account for the uncertainty. And the two of you probably have several options of your own that might make sense.” Then I would stop and look at back and forth at both of them until one of them makes a suggestion.

The other valuation challenge on defined contribution plans is the after-tax value. For most plans, taking money out and spending it before age 59 ½ (other than in a series of payments designed to run for the life expectancy of the owner) will trigger a 10% penalty. In addition, whenever the owner of a deferred plan interest takes money out and spends it, he or she will most likely be required to pay tax on the withdrawal at his or her tax rate.

You should offer your clients flexibility about how to value these tax impacts on retirement plans, but most end up discounting retirement plan interests for the income tax effect but not for the penalty, on the assumption that the person who ends up with it will hold it long enough to avoid the penalty but will eventually have to pay income tax on it. The one exception to this, of course, is the Roth IRA, whose proceeds can be removed and spent without the payment of income tax.

◆ **Defined Benefit Plans**

Think of a defined benefit plan not as a bucket of money with anyone's name on it, but rather as a promise – a promise made to a participant by a company, a union, a governmental entity or other institution. The typical defined benefit plan formula might speak of “x% times final average earnings times years of service.” Because a defined benefit plan interest is merely a promise, valuing that interest is much more difficult than valuing the typical defined contribution plan interest. This is because the factors affecting the value are less certain and more subject to judgment. Valuation depends on the chance that the participant might die between now and the time he or she begins receiving the benefit. It depends on how long he or she lives after payout begins. It depends on what inflation does between now and then.

Far too many lawyers deal with this complexity by ignoring it; they simply don't pay attention to the defined benefit plan interest, and the participant retains it without any significant accounting for its value. You don't need to do that. Raise it. Mention the possibilities for valuing it. Then let your clients decide how they want to deal with it.

What are the possibilities? There are several firms that specialize in valuing pension plan benefits. One of them is Legal Economic Evaluations, Inc. in Palo Alto, CA 94303 (800-221-6826), http://www.legaleconomic.com/family_law_pension_valuations.html. You give them \$150, the SPD (Summary Plan Description) for the plan, and lots of information about the participant, and they give you back a valuation report within a couple of days. FinPlan sells software called “Divorce Math” to calculate a “quick and dirty” estimate of value, selling along with their excellent tax program for about \$300 per year (800-777-2108) - <http://www.finplan.com/>. I own Divorce Math and have found it to be simple to use, accurate, and helpful in mediation.

Defined contribution plans make up the bulk of plans offered today, and they're becoming more and more common in relation to defined benefit plans. That's good, because participants understand them much more easily, and so do their spouses.

Vehicles

For all but the really old or the really special car, this is simple. Use the Blue Book. It's available at most any bank or credit union, and you can check it online:

- **Kelly Blue Book:** (<http://www.kbb.com>)
- **NABA “CarPrices” Service:** (<http://www.carprices.com>)

If your clients can't get a price through the Blue Book, they can get a used car dealer to give them a price pretty easily. After they get two or three prices, they'll have a pretty good idea what they could get for the car if they had to sell it.

◆ **Leased cars**

If the car is leased, the value of the asset to the husband and wife is difficult to gauge. For the vast majority of leases, the contract purchase price they pay at the end of the lease term is designed to be close to the value of the car at that time. That means they are not building up any “equity” in the normal sense of the term.

For a while when leases were new, it was not incorrect to assume that if you showed the value of a leased automobile as zero, you wouldn't be too far off. Increasingly (and distressingly), however, people who lease cars are discovering big “gotchas” at the end of their lease term in the form of unrealistically low assumptions about mileage, strict inspections for nicks and dings, and transaction

fees. Consequently, most leases are net liabilities. You probably wouldn't be too far off base nowadays to assume that a typical leased car is "upside down" by \$2-4,000.

◆ **Other Vehicles**

For low-value items like utility trailers, it's simply a matter of as accurate a guess as possible. The parties probably have an idea what it's worth, and it's just not that critical. If it's a high-value item like a recreational vehicle or an airplane, they may decide it's worth getting an appraisal, or at least getting two or three dealers to give them a price for it.

Appraisers are notoriously willing to peg a price at the level where their client wants it. If the parties can agree on one appraiser whose neutrality they both trust and can instruct that appraiser to strive for accuracy and accuracy alone, they will save a great deal of time and energy. If they absolutely cannot agree on a common appraiser, perhaps they can agree on what I call a "greed/right" system. The way greed/right works, the appraisers for each party set a value. If they set the same value, great. If they do not, they seal their appraisals, and a third appraiser chosen independently sets the value. The value that will be set eventually is not the value set by this third appraiser. Rather, it is the value provided by one of the first two appraisers, the one closest to the third appraiser. This gives both the first appraisers an incentive to peg a price that will be accurate, because if they range too far from accuracy, their value will be disregarded.

Household Items

I encourage my clients to avoid getting lawyers, judges, or me involved in dividing their household items, for two reasons. First, the value of the items is usually not enough to make it worthwhile. Second, the husband and the wife are usually the ones who really know what their household items are worth and how best to divide everything in a way that makes sense to both of them.

When the parties value their household items, they often make the following mistakes:

1. They undervalue tools.
2. They undervalue china, crystal, and particularly silver.
3. They overvalue furniture.
4. They overvalue electronics, particularly computers.

If the parties are unable to agree on how to divide their household items, I operate from a working assumption that one of them is reluctant for the relationship to end and is holding on to it by fighting over the candlesticks. Most of my clients don't. Most of yours won't either.

Collectibles

This one is a wild card. Some collectibles, like coins, stamps, and beanie babies, are popular enough that there are experts available who can speak with some authority about value. Others, like all the class t-shirts from Rockville elementary school for the last 13 years, are anybody's guess. Fortunately, again, this is not your responsibility. All you need to do is ask the question about value and let the husband and wife find a solution both can accept. To the extent that a collection has risen in value dramatically while a party has owned it, it's important that they know that it may be subject to tax on the capital gains. You don't need to know how much tax; you just need to point out the possibility of tax and let them decide whether to gather more information about it before they agree on division.

The Marital Home

◆ *For Litigation*

When preparing a case for trial where there's a dispute over the value of the house, lawyers almost always want a professional appraisal. The emphasis is not on accuracy but rather on telling the story as compellingly and persuasively as possible.

◆ *For Mediation*

A professional appraisal is rarely needed. I encourage my clients to work with a real estate salesperson active in the neighborhood where the house is located. Most real estate agents are happy to perform, free of charge, an informal valuation based on sales prices of comparable properties sold recently. I suggest that they drive through the neighborhood and look for the agents who have the most signs. The agents with lots of properties listed are likely to be

- (1) successful, so that they're more likely to state a price at which they think the house will sell easily and quickly, not a "highball" price to win the listing; and
- (2) knowledgeable of the properties in the neighborhood, which streets are sought-after and which are "turkeys," and which traffic patterns are relevant.

Should the value be reduced by anticipated real estate commission? Fortunately, you don't need to answer that question. All you need to do is ask it. I always calculate what the commission might run and let it sit there, but I offer my clients the option to disregard it. A surprising number of them do.

Non-residential Real Estate

◆ *Rural Land*

Establishing the value of rural land is much trickier than the same process houses in residential subdivisions. Unfortunately, appraisals are no more likely to be useful. The challenge the divorcing couple faces is to locate a real estate agent, or a county extension agent, or for that matter a storekeeper, who can speak with some authority and experience about what the property is worth.

◆ *Commercial Property*

If the property is of high value, and most commercial property is, there's probably no substitute for getting an appraisal. To ensure that the parties don't end up with "dueling appraisals," they can apply some of the same techniques described above under "Other Vehicles."

The Family Business

People can and do spend devote their entire lives learning how to value a closely held business. Valuing a family business is a discipline in itself, and it's beyond the scope of this quick summary. There's lots of information about valuing a family business on my web site at <http://www.divorceinfo.com/familybusiness.htm>.

When All Else Fails . . .

When valuation is both illusive and controversial, I sometimes suggest what my Daddy used to call (my apologies to our brothers and sisters from the Netherlands) a “Dutch auction.” Both sides cooperate with each other to allow each other to gather all the relevant information they wish about the value of the property. On or before an appointed date, they each submit a sealed bid for a cash price to a trusted third party. The high bidder becomes the “buyer” at the price the high bidder submitted, and the low bidder becomes the “seller.”

What this means in mediation or negotiations, of course, is that the “buyer” will be deemed to have been “awarded” the property. The inference (which is itself negotiable) is that the “buyer” will end up compensating the “seller” for the value of the disputed property by means of an adjustment in the division of other property.

I rarely use or have my clients use the Dutch Auction. However, I talk about it fairly regularly. When the parties are stuck on the value of an asset, suggesting a Dutch Auction as one of the options available to them is a great tool for “crap-cutting.”