



Fair Market Value of a Restricted Asset



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When an asset is restricted and its value depends on the probability of the future exercise of an option, what is its fair market value?

Background – The Griffing Group provided valuation services in a recent estate tax matter in which the decedent’s trust (the “Trust”) owned 27,338 shares of Chicago Board of Trade (“CBOT”) common stock, the equivalent of one membership seat. The Trust was a member of an LLC that was a CBOT “merchant”, but the Trust’s seat was held outside of the LLC. The two other LLC members had each contributed 27,338 CBOT common shares to the LLC to meet the CBOT requirement that a merchant control two seats. One of the other two LLC members had a put option to withdraw his CBOT shares from the LLC at any time after the decedent’s death. If that member exercised his option to withdraw his shares, the Trust was required to put its shares into the LLC to replace the outgoing shares and maintain the two seat requirement for merchant status. Therefore, the Trust could not sell its shares: it was required to hold them for as long as the LLC continued to operate as a CBOT merchant and the other member might withdraw his shares. This restriction on the Trust’s shares presented a unique challenge for valuation.

The Griffing Group Solution – In determining the fair market value of the restricted shares, we considered that the Trust could lease its CBOT seat. However, the amount of potential lease income was small compared to the shares’ trading price. We concluded that the fair market value of the shares depended primarily upon the likelihood of the LLC ceasing operations and liquidating (which would free the shares from restriction and allow the Trust to sell them).

We created a decision tree to model the probability of the LLC’s liquidation. Using the CBOT stock’s beta and standard deviation of returns, we modeled a number of potential scenarios for changes in the stock’s price. We determined a probability of liquidation for each scenario, assuming that a decrease in the CBOT stock price would signal a poor outlook for CBOT merchants (and thus a higher probability of liquidation for the LLC) and, conversely, that an increase in the CBOT stock price would signal an optimistic outlook for CBOT merchants (and thus a lower probability of liquidation for the LLC).

We concluded that the probability that the LLC would be liquidated within ten years was low. This uncertainty of liquidation [ability to sell the shares] indicated that the fair market value of the shares was significantly less than the value implied by their trading price. Also, we applied a discount for lack of marketability. The restricted nature of the shares would cause a buyer to require an incentive (discount from market price) to buy the restricted shares when unrestricted shares were available in the open market.

The Griffing Group Advantage – The Griffing Group quantified the impact of the restriction on the Trust’s CBOT shares using a logical, reasonable, and supportable valuation method. We successfully demonstrated that the fair market value of the shares was significantly less than their trading price. Through an inventive solution, we provided key support to the Trust in its effort to determine its estate tax burden.

The Griffing Group is consistently chosen to solve complex matters of estate valuation because of our ingenuity and experience. We look forward to an opportunity to be considered as a resource for your next complex valuation matter.

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