

Valuation Issues In the COVID-19 Economic Crisis

Those contemplating a divorce, or in the middle of one, no doubt have many questions about how the COVID-19 economic crisis will impact property division and valuation of assets in a divorce.

In general, New York courts recognize two different classes of assets — *passive* and *active* — and value each class differently. *Active* assets, such as businesses, that change in value because of the owner's efforts, are valued as of when you file for divorce. *Passive* assets, such as mutual funds, that change in value due to market forces, are valued at the date of trial or division of the asset. Judges have discretion to value assets at a different date, if they deem appropriate, such as where the value of a business changed due to circumstances outside of the parties' control.

The coronavirus crisis, and the economic damage it has inflicted and will likely still inflict, is most certainly beyond anyone's control. And so, in the coming months, and more likely years, divorce will no doubt include much litigation over when and how assets should be valued. We cannot predict what judges will do, but we share here some thoughts about valuing different kinds of assets and what approaches might be best to take at this time.

Investment Portfolios and Retirement Assets

Investment portfolios and retirement accounts are fluctuating in value wildly from day to day and week to week. Some investments may actually be doing better, with some companies thriving as they meet the needs created by the COVID-19 crisis. But in general, the stock market is down significantly since the start of 2020. The only way to ensure that such assets are divided fairly is to divide them in kind, rather than offsetting one such assets against another, so that both parties share in the risk of such fluctuations. As discussed below, this may not be possible for other types of assets, such as a business or a family home, where one party wishes to retain the asset or where dividing it is no simple feat.

Real Estate

Where one party in a divorce wishes to keep the family home, trading its value for other assets to be retained by his or her spouse, we look to licensed real estate appraisers to tell us the value of the home. Typically, that value is based on a review of comparable sales in the neighborhood. With the current economic downturn, the true value of a home may be difficult to appraise as it may take many months to see whether there has been a significant impact on the value of similar homes. Looking at general market trends might give us some insight

into the impact on the value of the home. However, we may find that the market varies significantly depending on price point or location. For divorces that are already in process, we may be considering a re-appraisal, but we might not have valid data available to us before trial or finalizing an agreement. A further complication may be that the spouse who plans to keep the home may not be able to refinance an existing mortgage if he or she has suffered a temporary decline in income.

One option here is to fix a future date on which the parties will reappraise the home, adjusting any buyout at that time. The parties may agree to continue as co-owners, giving the "purchasing" party more time to refinance. Ultimately, as we know, the only way to know what real property is worth is to sell it on the open market and more parties may find themselves going down that path, either now or at some agreed-upon date, when the state of the market is more clear.

Business Interests

Perhaps the greatest area of uncertainty is in valuing business interests. The impact of the global shut-down is widespread, with nearly every industry impacted in some way. If you are an owner whose business was already valued for divorce purposes, you may be considering having the business reappraised. You might also be contemplating a divorce, and looking to time a divorce filing to take advantage of an apparently depressed value.

As with real estate, there is no way to be certain that a valuation analysis, typically prepared by a forensic accountant, captures the true worth of a business. This is particularly true now, as the future of the economy as a whole is uncertain, as is the future of each individual business. Restaurants, salons, and many stores are closed; commercial real estate owners are not consistently collecting rents. Professional service providers such as lawyers, dentists, and non-essential medical providers are working at a fraction of the capacity they once were. No one has a crystal ball to predict the impact of this current financial crisis, nor whether it will have short-term or long-term effects on the valuation of any particular asset or industry. It may take a year or more for the economy to evolve to a "new-normal" that can be reliable for valuation purposes.

Business valuations are generally based in part on the business's anticipated future income, as predicted by an analysis of the business's past income and an analysis of future risk. With that in mind, the valuation cannot reasonably be based primarily on the business's performance during the second quarter of 2020, a time that is an aberration for virtually every industry. Should a forensic accounting discount all the economic results of 2020 or give a

different weight to that year? And how should risk factors be adjusted in light of the current economic circumstances?

Further complicating the aberration of 2020 are the resources available to business owners during this economic crisis, including the Federal Reserve Main Street Lending Program and the Paycheck Protection Program. Some business owners may be able to stay afloat thanks to these programs, but others may choose not to avail themselves of such relief and then find their businesses suffering. Non-titled spouses may later argue that the business owner should have taken advantage of those programs and urge that the business should be valued as if it had received such support. Additionally, valuation experts will have to consider whether the relief loans are likely to be forgiven or should stay on the business's books as a liability.

Yet another complication is the uncertainty about long-term prospects for businesses given the COVID-19 crisis. For example, a business that is struggling now, such as a bankruptcy law firm or a retailer, may be thriving in a year. Still, other businesses, such as restaurants, may be forced to close, leaving no value for that asset in a divorce. But what happens if that spouse opens a similar business in six months or a year? Does the non-titled spouse benefit at all from that new venture or the future increase in value?

These are just some of the questions that lawyers and valuation experts will be asking themselves, and asking judges, for months and maybe years to come. One thing that is clear is that these are uncertain times that require thoughtful legal analysis and creative solutions.