

ANZVGN 7 THE VALUATION OF PARTIAL INTERESTS IN PROPERTY HELD WITHIN CO-OWNERSHIP STRUCTURES

1.0 Introduction

1.1 Purpose

The purpose of this Guidance Note is to provide members with an awareness of some of the principal issues to be considered in the valuation of a partial interest in a property held within a co-ownership structure.

Status of Guidance Notes

Guidance Notes are intended to embody recognised 'good practice' and therefore may (although this should not be assumed) provide some professional support if properly applied. While they are not mandatory, it is likely that they will serve as a comparative measure of the level of performance of a Member. They are an integral part of the Valuation and Property Standards Manual.

1.2 Scope

This Guidance Note applies to partial (fractional) interests in property held (jointly) in co-ownership structures.

This Guidance Note does not apply to strata title, community title or other similar divisible title property or a part share in the common property thereof.

This Guidance Note does not apply to interests that are not partial interests in property held in co-ownership structures.

Accordingly, this Guidance Note does not apply to such interests as that of a single lessor and a single lessee under a lease. (Refer IVGN 2 Valuation of Lease Interests).

1.3 Definition

A partial interest may be described as a divided or undivided ownership right in property that represents less than the whole.

1.4 Freehold or Leasehold

There are many forms of co-ownership structure. Partial interests may be in a freehold or leasehold co-ownership structure

Leasehold co-ownership may be comprised under a ground lease, development lease or similar leasehold interest usually subjugating the interests of the freeholder for an extended period of time.

1.5 Sector

Partial interests may occur in a wide range of property sectors, including residential, small and large commercial and retail, leisure, rural and others.

Plant and Machinery Assets are also sometimes held in joint ownership.

1.6 Entity

The valuation of partial interests is becoming increasingly common, particularly amongst members who undertake valuations for listed property trusts, wholesale funds, family law and estate matters.

2.0 Instruction

2.1 Clarity of Instruction

In accordance with Rule of Conduct 1.20, members should ensure clarity of instructions concerning the interest that is to be valued.

2.2 Subject of Instruction

The subject of the potential instruction to value may comprise:

- all or part of the physical underlying asset unencumbered by the co-ownership structure;
- all or part of the physical underlying asset encumbered by the co-ownership structure;

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- the form of entity comprising the co-ownership structure; or
- a partial interest in the form of entity comprising the co-ownership structure.

2.3 Competence

In accordance with Rule of Conduct 1.6, members should not accept instructions beyond their competence.

2.4 ASIC Licence

In Australia, Members should not value securities unless they are licensed to do so by the relevant licensing authority (ASIC).

2.5 Exclusion

Unless holding a relevant licence (being an Australian Financial Services Licence in Australia), members should assure themselves that the partial interest in a property held in co-ownership to be valued does not comprise an interest for which such a license is required.

3.0 General

3.1 Distinction

For the purposes of valuation, the property (3.2, below) is distinguishable from the co-ownership structure (3.3 and 3.4, below), which are each distinguishable from the property held in a co-ownership structure.

3.2 Property

The property comprises the physical underlying asset, which may be valued subject to relevant Practice Standards and Guidance Notes (4.0, below)

3.3 Co – Ownership

The co-ownership structure comprises the form of entity in which the property is held. This may include a joint tenancy, tenancy in common (divided or undivided), companies, trusts, unincorporated joint ventures, partnerships or other form of entity (5.0, below).

3.4 Rights and Obligations Created

The co-ownership structure may create rights and obligations for consideration that impact upon the value of the co-ownership interest (6.0, below).

3.5 Property in Co–Ownership

The valuation of a partial interest in a property held in a co-ownership structure represents a combination of consideration of the issues impacting upon the value of the physical underlying asset and the issues impacting upon the value of the interest in the co-ownership structure.

3.6 Proportional Share

It is possible that the value of a partial interest in a co-ownership entity may be greater or less than the value of the proportional share of the physical asset held by the co-ownership entity (5.0 and 6.0 below).

3.7 Sum of Parts

It is possible that the sum of the partial interests in a co-ownership entity may be greater or less than the value of the physical asset held by the co-ownership entity (5.0 and 6.0 below).

3.8 Value and Worth

IVS 1 defines market value as:

Market Value is the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.

with IVS 2 explaining worth (or investment value) to be the value of a property to a particular investor, or class of investors, for identified investment objectives.

3.9 Value vs Worth

Having regard to 3.8 (above), in the valuation of a partial interest in a physical underlying asset held in a co-ownership structure, the value of an interest may be distinguishable from the worth of an interest.

In determining the worth of an interest and depending upon the nature of instruction received, debt finance taxation issues may require consideration.

4.0 Valuation of Physical Underlying Asset

4.1 Property Valuation Approach

In accordance with ANZVGN 1, the comparability of the property comprising the physical underlying asset (3.2, above) to sales evidence should be measured against established criteria of quality relative to a property's peer stock and the overall property market.

4.2 Suitability For Co-Ownership

The quality of the physical underlying asset should also be considered in the context of the form of co-ownership structure and the appropriateness of the assets ownership to such division.

4.3 Cash Flow

For investment property, the nature, quality, divisibility, liquidity and security of the underlying cash flow should be considered.

4.4 Value of Part

Whilst a valuation of a partial interest may include an assessment of the value of the physical asset underlying the partial interest, it should only address the value of the relevant partial interest in a property held in a co-ownership structure which may not, necessarily, be its pro-rata value (5.0 and 6.0 below).

4.5 Market Value

Where the value of the partial interest is more or less than the proportional ownership share, the valuation should note such variance and comment on any potential marriage value, which may be realised in the event of conversion to a single interest.

5.0 Co – Ownership Principles

5.1 Influences on Value

The form of entity comprising the co-ownership structure (3.3 above) may influence the value of a partial interest in a property held in such co-ownership structure through such aspects as:

- the ongoing conduct of the co-ownership relationship;
- the process for resolution of disputes amongst co-owners;

- the ongoing costs of supporting the co-ownership structure;
- the treatment of asset and property management costs;
- the mechanism and basis for treating commitments to capital expenditure;
- the ability to use an interest as security for debt;
- the timetable for unit pricing calculation, where relevant;
- the basis upon and timing of a termination of the co-ownership relationship;
- the ease (or otherwise) of disposing of the interest on the open market;
- the cost of disposing of an interest in the co-ownership structure;
- the cost of terminating the co-ownership structure and disposing of the underlying asset;
- the basis of and terms applying to any disposal of the underlying asset;
- the constraints and other terms of any disposal of the relevant interest including:
 - first and subsequent right of refusal provisions or other priorities of the co-owner;
 - any absolute restrictions on disposal;
- the implications of ongoing liabilities of a co-owner after disposal of the relevant interest; and
- taxation implications.

6.0 Co – Ownership Issues

6.1 Influences On Value

The principal rights and obligations for consideration (3.4 above) which impact upon the value of the co-ownership interest may include:

- control of the interest (being the extent to which the co-ownership interest confers the right to direct); and
- liquidity of the interest (being the ease with which the interest can be converted into cash).

6.2 Level of Control

Control relates to the right to direct the interests of the investment at the owner's absolute discretion. Where an ability to direct is diminished through co-ownership structure, the impact of that inability to direct should be considered and reflected in the valuation.

6.3 Control Issues

Control issues for consideration may include:

- number of parties in the co-ownership structure;
- voting rights where disproportional to the pro-rated interest;
- cost allocation where disproportional to the pro-rated interest;
- revenue allocation where disproportional to the pro-rated interest;
- complexity of process and time taken to direct;
- protection at law for minority rights;
- use of dispute resolution levels and mechanisms;
- pre-emptive rights; and
- existence of a controlling interest.

6.4 Liquidity Issues

Liquidity issues for consideration may include:

- the proportionality of the interest - where the interest being valued is considered in the context of the overall holding and the number of other co-owners;
- the right to divide an interest, unfettered, and deal with that interest - this includes the rights of co-owners and the obligations the co-owner of an interest to its fellow co-owners;
- effect of pre-emptive rights – where a co-owner has a right to acquisition of other co-owners interests on a basis that may be prescribed;
- non-structural impediments to liquidity - these may include disengagement from a co-owner or co-owners with incompatible investment philosophies and complexity of process and timing in connection with disposal of the interest and disposal of the underlying asset; and

- the reasonable selling period for the interest - both in the context of the ownership structure and any co-ownership agreement selling constraints.

7.0 Comparable Evidence

7.1 Comparability

Comparability of evidence of sales transactions should be considered in the valuation of both the physical underlying asset (3.2 above) and the co-ownership interest (3.4 above).

In both the valuation of the physical underlying asset and the co-ownership structure, the precise extent of comparability of evidence of sales transactions should be carefully considered.

7.2 Available Evidence

Some forms of co-ownership structure may be traded on the open market and directly comparable evidence is therefore available to the member for consideration.

In such cases of directly comparable evidence, the level of adjustment of that evidence for application to the subject interest to reflect the differences between each may be limited.

7.3 Relevance of Comparable Evidence

Members should assure themselves that such evidence is directly comparable in respect of control, liquidity and other relevant issues.

In the event of differences in respect of control, liquidity or other relevant issues, members should ensure that adjustment is made to appropriately reflect such differences.

7.4 No Available Evidence

Some forms of co-ownership structure may not be traded on the open market and directly comparable evidence is therefore not available to the member for consideration.

In the absence of directly comparable evidence, the level of adjustment of available evidence for application to the subject interest may be significant.

7.5 Appropriate Adjustment

In the absence of directly comparable evidence, the member should consider available, relevant comparable evidence from whole or other partial interests.

In the event of differences in respect of structure, control, liquidity and other relevant issues, members should ensure that adjustment is made to appropriately reflect such differences.

7.6 Relevant Information

In completing the valuation of a partial interest, a member should obtain relevant information from the instructing party concerning control, liquidity and other issues, for review.

7.7 Checklist

Such information may include:

- relevant documents supporting the ownership structure, including amendments to those documents, such as:
 - shareholders/unit holders agreement;
 - trust deed and trustee structural arrangements;
 - joint venture agreement;
 - articles of association;
 - partnership agreement; or
 - any other similar arrangement document;
- co-ownership agreement regulating the relationship between the co-owners; including fee or other co-owners remuneration arrangements;
- notice of any agreements between the co-owners which vary any of the terms of the agreements including board or management meeting minutes;
- any financing agreements relevant to the entity;
- financial statements, statements of compliance with accounting standards, auditors reports and tax returns;
- any option or other right of sale, acquisition agreements, first right of refusal or pre-emption agreements between the co-owners and pertinent to the relevant interest;
- details of any other agreement, arrangement or obligation likely to impact on the value of the relevant interest; and
- an extract of the valuation component of the compliance plan of the single responsible entity if the relevant interest is owned by a managed investment scheme.

7.8 Vigilance

The above list is not intended to be exhaustive and members should be vigilant to seek any documents relevant to a particular ownership structure being valued.