



Australian Property Institute and
Property Institute of New Zealand

TECHNICAL INFORMATION PAPER - THE VALUATION OF PARTIAL INTERESTS IN PROPERTY HELD WITHIN CO-OWNERSHIP STRUCTURES

Reference ANZVTIP 6 – The Valuation of Partial Interests in Property Held Within Co-Ownership Structures
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Owner National Manager – Professional Standards

Australian Property Institute
6 Campion Street
Deakin ACT 2600

Telephone: 02 6282 2411
Email: national@api.org.au
Website: www.api.org.au

Property Institute of New Zealand
Level 3, Gleneagles House
69 The Terrace
Wellington

Telephone: 0800 698 258
Email: national@property.org.nz
Website: www.property.org.nz

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Technical Information Papers

The principal objective of a Technical Information Paper (TIP) is to reduce diversity of practice by identifying commonly accepted processes and procedures and discussing their use. A TIP is designed to be of assistance to property professionals and informed users alike.

A TIP will do one or more of the following:

- provide information on the characteristics of different types of asset that are relevant to the advice,
- provide information on appropriate practices and their application, provide information that is helpful to property professionals in exercising the judgements they are required to make in specific situations.

A TIP does not:

- provide training or instruction,
- direct that a particular approach or method should or should not be used in any specific situation.

The contents of a TIP are not intended to be mandatory. Responsibility for choosing the most appropriate approach is the responsibility of the property professional based on the facts of each task.

Whilst TIPs are not mandatory, it is likely they will serve as a comparative measure of the level of performance of a Member. They are an integral part of “Professional Practice”.

The reader should understand that legislation may change and whilst this TIP is accurate and relevant at the time it was completed, relevant referred reading and legislation should be investigated at the time of relying on this TIP.

The Valuation of Partial Interests in Property Held within Co-Ownership Structures

1.0 Introduction

1.1 Purpose

The purpose of this Technical Information Paper (TIP) is to detail commonly accepted processes and procedures for the Valuation of Partial Interests in Property Held within Co-Ownership Structures and to discuss the use of these processes and procedures.

1.2 Status of Technical Information Papers

The contents of a TIP are not mandatory. Responsibility for choosing the most appropriate approach is the responsibility of the property professional based on the facts of each task.

Nevertheless, it is likely they will serve as a comparative measure of the level of performance of a Member and therefore they are an integral part of “Professional Practice”.

1.3 Scope of this Technical Information Paper

This TIP applies to Members who undertake the Valuation of Partial Interests in Property Held within Co-Ownership Structures on behalf of known clients with whom those Members or their employers have entered into the appropriate Valuation Services Agreement. This TIP should be read in conjunction with other TIPs and/or API/PINZ Practice Standards, which are either over-arching or directly applicable to the issues raised in this TIP.

TIPs are intended to embody for API Members recognised ‘competent professional practice’, and for PINZ Members, recognised ‘best practice’. Therefore a TIP may (although this should not be assumed) assist an API Member to act in a competent professional manner, or a PINZ Member to practice to a level that meets best practice, if properly applied. While TIPs are not mandatory, it is likely that Members who have regard to and apply the guidance provided by TIPs will be able to evidence that they have acted in a competent professional (API) or to a level that meets best practice (PINZ). The API and PINZ do not warrant that anything contained in this or any TIP is the definitive and/or final statement on any issue raised in the TIP. Members must perform their own work pursuant to their own professional expertise and experience.

Where recommendations are made in this TIP for Members to undertake a specific professional task, these are intended to represent ‘competent practice’ for API Members and ‘best practice’ for PINZ Members, i.e. recommendations that in the opinion of the API and PINZ, as the case may be, would meet practice accepted by peer professional opinion. Although Members are not required to follow the recommendations contained in the TIP, they should take into account the following points.

When an allegation of professional negligence and/or breach of a statutory duty is made against a Member, a court or tribunal will almost always take account of the contents of any relevant TIP published by the API and PINZ in deciding whether or not the Member acted to a standard as required by law.

In the opinion of the API and the PINZ, a Member conforming to the practices recommended in this TIP should have at the very least a partial defence to an allegation of negligence and/or other alleged breach, if they have followed those practices. However, Members have the responsibility of deciding when it is inappropriate to follow a TIP.

It is for each Member to decide on the appropriate procedure to follow in any professional task.

However, where Members do not comply with the practice recommended in this TIP, they should do

so only for a good professional reason and it is recommended that Members record for their own purposes why they did not comply with something contained within a TIP. Members may wish to seek legal and/or other advice before embarking on a path of non compliance with practice recommended in a TIP. In the event of a legal dispute, a court or tribunal may require them to explain why they decided not to adopt the recommended practice.

1.4 Definition

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

1.5 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.

A partial interest may also comprise, although relatively rare, tenancies defined by a future event- e.g. A life interest.

1.6 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.

1.7 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;
- 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 tenure or 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

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

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.

IVS 2 explains 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 require 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.

4.6 Marriage Value

This refers to the difference between the unencumbered freehold value and the total of the values of the partial interests.

As a guide, it is common for some marriage value to occur in a partial interest's scenario, but it would be very rare for the partial interests to be worth more than the unencumbered freehold.

5.0 Co-Ownership Principles

5.1 Influences on Value

The form of entity tenure 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 factors as:

- the ongoing conduct of the co-ownership relationship e.g. co-operative vs. fractious;
- the available 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 (often a difficulty);
- the timetable for unit pricing calculation, where relevant;
- the basis of and timing of a termination of the co-ownership relationship e.g. risks and unknowns, such as life interests;
- the ease (or otherwise) of disposing of the interest on the open market e.g. in-built restrictions on sale;
- 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;
- taxation implications; and
- the extent to which the co-ownership structure / framework prevents the underlying asset being used for its highest and best use e.g. a long-term ground leasehold for 'industrial purposes' in a location now supporting high-rise residential development.

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-rata interest;
- cost allocation where disproportional to the pro-rata interest;
- revenue allocation where disproportional to the pro-rata 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 need to be extensive given the infrequency of these sales.

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.

In these cases a check method of valuation is recommended. Such a check method would seek to examine the property rights conferred by the partial interest and assess their (summed) value by applying market based income and financial criteria e.g. the present value of the rental streams and reversionary interests.

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.

7.7 Special Comment

The structure and documentation of partial interests is often complex and has evolved more complexity over many years. Members should ensure all aspects of the respective interests are clear to them before proceeding and, if they are not, they should request expert legal advice.

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.

8.0 Effective Date

This TIP is effective from:

Australian Adoption Date: 15 November 2016

New Zealand Adoption Date: 1 July 2019 (Earlier adoption is permitted)

The above TIP, ANZVTIP 6, replaces the superseded Guidance Note “ANZVGN 7 The Valuation of Partial Interests in Property Held Within Co-ownership Structures” which operated from January 2012 to 14 November 2016.