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**AUSTRALIA AND NEW ZEALAND**

# **VALUATION AND PROPERTY STANDARDS**

Your guide to being a member of an industry  
leading professional, property institute



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# FOREWORD

It is with great pleasure that we introduce the latest publication of the Australia and New Zealand Valuation and Property Standards (formerly Professional Practice). This represents the third joint publication of the Standards by the Australian Property Institute (API) and the Property Institute of New Zealand (PINZ).

For property professionals in both Australia and New Zealand there has been an increasing shift towards International Valuation Standards (IVS). International Financial Reporting Standards are now formulated in full consultation with representatives of the International Valuation Standards Committee and there is now the practical requirement to be aware of IVS. Both the API and PINZ are strong supporters of and have played an active role in the work of the International Valuation Standards Committee (IVSC).

This edition of the Australia and New Zealand Valuation and Property Standards represents a further stage toward the harmonisation of valuation and real property standards within Australia and New Zealand and reflects the continued move towards IVS. This edition includes all IVSC Applications, Standards and Guidance Notes, which have been drawn from IVS 2007. Interposed within the IVSC material is additional information to assist members in meeting local valuation and real property reporting requirements.

There are several important changes in this edition, including new and revised documents. The new documents being :-

IVA3	Valuation of Public Sector Assets for Financial Reporting
IVGN15	Valuation of Historic Property
ANZVGN8	Valuation For Use in Offer Documents
ANZVGN9	Assessing Rental Value
ANZVGN10	Valuation of Agricultural Property

The IVSC extensively revised the following:-

IVS2	Bases Other Than Market Value
IVA2	Valuation for Secured Lending Purposes

and updated throughout the document to ensure consistency with the new and rewritten components.

In presenting this edition of the Australia and New Zealand Valuation and Property Standards we acknowledge the substantial work and effort of the following:

- Australian and New Zealand Valuation and Property Standards Boards (AV&PSB)(NZV&PSB).
- The National Professional Board representatives of the API and PINZ.
- Many individual members from both the API & PINZ who responded to requests for assistance and comment.

The end product is a team effort and is presented to all members as best practice, having regard to current law and accounting concepts.

It is the intention that the Australia and New Zealand Valuation and Property Standards will be available electronically on the respective web sites. Updates will also be made available upon release, both on the web and in hard copy for those who have purchased a copy of this edition of the Standards.

Yours faithfully,

**James Pledge**  
National President  
Australian Property Institute

**Chris Stanley**  
President  
Property Institute  
of New Zealand

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# CONTENTS

Foreword .....	iii	IVGN 8 The Cost Approach for Financial Reporting - (DRC) .....	6.8.1
Introduction to Valuation and Property Standards .....	1.1	IVGN 9 Discounted Cash Flow Analysis for Market Valuations and Investment Analyses .....	6.9.1
<b>Code of Ethics and Rules of Conduct</b> .....	<b>2</b>	IVGN 10 Valuation of Agricultural Properties .....	6.10.1
API Code of Ethics .....	2.1.1	IVGN 11 Reviewing Valuations .....	6.11.1
API Rules of Conduct .....	2.2.1	IVGN 12 Valuation of Trade Related Property.....	6.12.1
PINZ Code of Ethics.....	2.3.1	IVGN 13 Mass Appraisal for Property Taxation .....	6.13.1
PINZ Rules of Conduct .....	2.4.1	IVGN 14 Valuation of Properties in the Extractive Industries .....	6.14.1
<b>IVSC Valuation Standards 2007</b> .....	<b>3</b>	IVGN 15 The Valuation of Historic Property .....	6.15.1
The International Valuation Standards Committee .....	3.1.1	<b>API &amp; PINZ Practice Standards</b> .....	<b>7</b>
The International Valuation Standards .....	3.2.1	ANZPS 1 Valuations for Compulsory Acquisitions .....	7.1.1
IVSC Code of Conduct.....	3.3.1	<b>API &amp; PINZ Valuation Guidance Notes</b> .....	<b>8</b>
General Valuation Concepts and Principles.....	3.4.1	ANZVGN 1 Valuation Procedures – Real Property.....	8.1.1
Property Types.....	3.5.1	ANZVGN 2 Valuations for Mortgage and Loan Security Purposes .....	8.2.1
<b>International Valuation Standards</b> .....	<b>4</b>	ANZVGN 3 Valuations for Mortgage and Loan Security Purposes (Forced Sale) .....	8.3.1
Introduction to IVS 1,2 & 3 .....	4.1.1	ANZVGN 4 Valuations for Rating and Taxing .....	8.4.1
IVS 1 Market Value Basis of Valuation .....	4.2.1	ANZVGN 5 Valuations for Compulsory Acquisitions... ..	8.5.1
IVS 2 Bases Other Than Market Value.....	4.3.1	ANZVGN 6 Valuations of Accommodation Hotels.....	8.6.1
IVS 3 Valuation Reporting .....	4.4.1	ANZVGN 7 The Valuation of Partial Interests in Property held within Co-Ownership Structures .....	8.7.1
<b>International Valuation Applications</b> .....	<b>5</b>	ANZVGN 8 Valuations for use in Offer Documents ....	8.8.1
IVA 1 Valuation for Financial Reporting .....	5.1.1	ANZVGN 9 Assessing Rental value.....	8.9.1
IVA 2 Valuation for Secured Lending Purposes.....	5.2.1	ANZVGN 10 Valuation of Agricultural Properties .....	8.10.1
IVA 3 Valuation of Public Sector Assets for Financial Reporting .....	5.3.1	<b>API Valuation Guidance Notes</b> .....	<b>9</b>
<b>International Valuation Guidance Notes</b> .....	<b>6</b>	AVGN 1 Valuations for use in Australian Financial Reports .....	9.1.1
IVGN 1 Real Property Valuation .....	6.1.1	AVGN 2 Valuations for Insurance Purposes.....	9.2.1
IVGN 2 Valuation of Lease Interests.....	6.2.1	<b>PINZ Valuation Guidance Notes</b> .....	<b>10</b>
IVGN 3 Valuation of Plant and Equipment.....	6.3.1	NZVGN 1 Valuations for use in New Zealand Financial Reports .....	10.1.1
IVGN 4 Valuation of Intangible Assets .....	6.4.1	NZVGN 2 Insurance Valuation Reports.....	10.2.1
IVGN 5 Valuation of Personal Property .....	6.5.1		
IVGN 6 Business Valuations .....	6.6.1		
IVGN 7 Consideration of Hazardous and Toxic Substances in Valuation .....	6.7.1		

## CONTENTS

NZVGN 3 Valuation of Houses Under Construction and Houses to be Built or Previously Unoccupied New Houses .....	10.3.1	<b>Valuation Proforma</b>	<b>16</b>
<b>API &amp; PINZ Real Property Guidance Notes</b>	<b>11</b>	<i>PropertyPRO</i> Residential Valuation and Security Assessment Pro-Forma Supporting Memorandum .....	16.1.1
ANZRPGN 1 Disclaimer Clauses and Qualification Statements .....	11.1.1	Restricted Valuation Proforma .....	16.2.1
ANZRPGN 2 Acting as an Expert Witness, Advocate or Arbitrator .....	11.2.1	Restricted Valuation Supporting Memorandum .....	16.3.1
ANZRPGN 3 Leasing Incentives .....	11.3.1	<b>API Annual CPD Record</b> .....	16.4.1
ANZRPGN 4 Methods of Measurement .....	11.4.1	<b>API and PINZ Offices – Contact Details</b> .....	16.5.1
ANZRPGN 5 Feasibility Studies .....	11.5.1	<b>Index</b>	<b>17</b>
ANZRPGN 6 Due Diligence .....	11.6.1		
ANZRPGN 7 Property Insurance Management .....	11.7.1		
ANZRPGN 8 Preparing Property for Sale .....	11.8.1		
ANZRPGN 9 Property Development Management and ‘Terms of Appointment’ .....	11.9.1		
ANZRPGN 10 Leasing Agent Services .....	11.10.1		
<b>API Real Property Guidance Notes</b>	<b>12</b>		
ARPGN 1 Land Contamination Issues .....	12.1.1		
ARPGN 2 Native Title Issues .....	12.2.1		
<b>PINZ Real Property Guidance Notes</b>	<b>13</b>		
NZRPGN 1 Valuation of Contaminated Land .....	13.1.1		
NZRPGN 2 Counter-signing of Valuation Reports Prepared by Unregistered Valuers .....	13.2.1		
<b>Business Focus</b>	<b>14</b>		
Business Focus .....	14.1.1		
Professional Activities .....	14.2.1		
Reports, Content and Compilation .....	14.3.1		
Property Action Plans .....	14.4.1		
CPD Requirements, Activity Planner and Recorder .....	14.5.1		
<b>Client Focus</b>	<b>15</b>		
Client Focus .....	15.1.1		
Types of Services Provided by API and PINZ Members .....	15.2.1		
Instructing Valuers .....	15.3.1		
Residential Desktop Assessment - Advisory Note .....	15.4.1		
Feedback to API and PINZ Members and/or the API/PINZ .....	15.5.1		

# INTRODUCTION TO VALUATION AND PROPERTY STANDARDS

## 1.0 The Australian Property Institute & The Property Institute of New Zealand

The Australian Property Institute and the Property Institute of New Zealand have both enjoyed a long and proud history representing property professionals in Australia and New Zealand.

The Australian Property Institute is the successor to the Commonwealth Institute of Valuers formed in 1926. The Property Institute of New Zealand was formerly the New Zealand Institute of Valuers established in 1942.

The two Institutes today represent the interests of more than 11,000 property specialists throughout Australia and New Zealand.

The primary role of the two organisations is to set and maintain high standards of professional practice, education, ethics and discipline.

Members include experts in property such as valuers, property advisors, property managers, property analysts and facilitators. Membership of either organisation has become synonymous with qualities of integrity, experience, professionalism and specialist expertise.

The two Institutes are committed to maintaining a strong professional base to ensure the future of the property professions through education and broadening of the expertise and knowledge of the Membership.

The clients of members are also considered to be clients of the Institute. Both Institutes are interested in assisting their members to provide high quality professional services that are relevant to the current and changing needs of clients and the community at large.

Both Institutes recognise their roles as guardians of the status and standing of the property profession and of their duty to protect and further the public interest.

The Australian Property Institute and the Property Institute of New Zealand acknowledge that the privileges accorded to professional persons by the community are accompanied by responsibilities to client and community, which cannot be waived.

For more information about the Australian Property Institute (API) and Property Institute of New Zealand (PINZ)

please visit their websites: [www.api.org.au](http://www.api.org.au) or [www.property.org.nz](http://www.property.org.nz)

## 2.0 Valuation and Property Standards Manual

This Manual sets out the duties, responsibilities and professional standards of members of the Australian Property Institute and of the Property Institute of New Zealand.

### 2.1 Scope

This edition adopts the International Standards and Guidance Notes of the International Valuation Standards Committee (IVSC) in their entirety. Where there are departures or differences in application in either Australia or New Zealand, an appropriate note has been included in the IVSC documents in this Manual.

Areas of practice not covered by the IVSC standards and guidance notes are covered by Australian and New Zealand standards and guidance notes.

Australia and New Zealand have both been closely involved with the development of IVSC standards and guidance notes. These documents represent world best practice and very few departures are included in this edition of the Valuation and Property Standards Manual.

This edition also retains the Business Focus papers, which were in the previous professional practice publications.

### 2.2 Copyright

The following sections (excluding material interposed by the Australian Property Institute and the Property Institute of New Zealand) are copyright by the International Valuation Standards Committee:

The International Valuation Standards Committee,

- IVSC Code of Conduct,
- IVSC Valuation Standards 2007,
- International Valuation Standards,
- International Valuation Applications, and
- International Valuation Guidance Notes.

## INTRODUCTION

All rights are reserved, subject to permission having been granted to the Australian Property Institute and Property Institute of New Zealand to reproduce the 8th Edition of International Valuation Standards in their Valuation and Property Standards Manual.

No responsibility is accepted by the IVSC for the accuracy of the information contained in the Manual text as republished by the API & PINZ.

The full text of the official version may be obtained from the IVSC International Headquarters, 12 Great George Street, London SW1P 3AD, UK. [www.ivsc.org](http://www.ivsc.org)

### 2.3 Amendments and Updates

Amendments and updates to this edition of the Valuation and Property Standards Manual will be published by the API and PINZ on their websites.

### 2.4 Date of Application

This edition of the Valuation and Property Standards Manual becomes operative from 1 August 2008.

## 3.0 Development of Practice Standards & Guidance Notes

### 3.1 Process before Release

The two most important elements in the Manual are practice standards and guidance notes. From the initial identification of the need for a particular issue to be addressed, these elements go through an extensive development process.

Potential practice standards and guidance notes may be proposed by a number of sources but require the consent of the National Professional Board (NPB) prior to development. Initial development will often be through a particular state, branch, professional board or ad-hoc committee before being examined by the NPB. The NPB will establish the requirement for a practice standard or guidance note and if satisfied that such a document is required, will formulate any policy and professional aspects, which must be addressed in the practice standard or guidance note.

The initial brief requesting development of a practice standard or guidance note along with the policy requirements are then forwarded to the Australian Valuation & Property Standards Board (AV&PSB), which is responsible for managing the development and review process of practice standards and guidance notes.

Once the draft document reaches a standard that satisfies the AV&PSB it is then forwarded to the NPB, which must satisfy itself that the draft document adequately addresses all of the requirements established by the Board.

At least 50% of the AV&PSB is made up of API Members, the balance comprising representatives of invited organisations such as:

- The Australian Accounting Standards Board
- The Property Institute of New Zealand
- The Australian Bankers Association
- The Law Council of Australia (Property Law Group)
- The Financial Services Institute of Australasia
- The International Valuation Standards Committee
- Mortgage Industry Association
- State Valuers General
- Commonwealth Government

If satisfied, the AV&PSB will then issue the draft document as an Exposure Draft within the API and PINZ and to appropriate organisations inside and outside of the profession. Comments are then forwarded to the authors and assimilated where appropriate.

After consideration of the comments received, a final draft will be presented by the AV&PSB to the NPB, and if no further amendments are required, it will be released for issue. This representation and external exposure process is designed to ensure that practice standards and guidance notes are consistent with the requirements of the Corporations Law, Australian and New Zealand Accounting Standards, Statements of Accounting Concepts and, where applicable, circulars from the Insurance and Superannuation Commission. It is also intended that all standards are to be consistent with the concepts and definitions contained in the International Valuation Standards, except where Australian or New Zealand law and practice requires otherwise.

The National Secretariat administers the process of the production of practice standards and guidance notes.



## 2.1

# API CODE OF ETHICS

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This Code is a public statement of the principles, values and behaviour expected of Members of the Institute.

### 1. Compliance with Standards

Members shall at all times observe the requirements of the Code of Ethics, the Rules of Conduct and the Practice Standards of the Institute.

### 2. Professional Duty

It is the duty of Members to render service to their clients and employers with fidelity, to practise their vocation with integrity, honour and professionalism, to act impartially and objectively when providing independent advice, and to respect the public interest.

### 3. Competence

A Member shall not accept instructions in a matter where, based on a reasonable objective standard, the Member does not have the competence, skill and/or experience to complete the assignment to the acceptable professional standard in accordance with this Code of Ethics, the Rules of Conduct and the Practice Standards of the Institute, unless the assignment is completed in conjunction with a qualified and suitably experienced practitioner.

### 4. Conflict of Interest

Members shall consider and identify any actual or potential conflict of interest when carrying out their professional duties, and shall not act in a matter where such conflict or potential conflict has been identified by the Member or any other interested party unless all interested parties have been made aware of the situation and have consented to the Member continuing in the task.

### 5. Confidentiality

Members must observe the requirements of confidentiality in their dealings with clients and the public.

### 6. The Profession

Members shall at all times conduct business in a manner befitting their profession and the Rules of Conduct of the Institute and in accordance with reasonable public expectations of professional persons.

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## API RULES OF CONDUCT

The Rules of Conduct are an interpretation and expansion of the Code of Ethics of the Institute. These Rules are mandatory for all Members.

### Rule 1: Professional and Personal Conduct

- 1.1 Members shall conduct their professional duties and activities in a manner that reflects credit upon themselves and their profession. High standards of competence, honesty, loyalty, integrity and fairness shall be observed at all times.
- 1.2 Members are bound by and agree to abide by all Fundamental Rules which include the Code of Ethics, Rules of Conduct, Constitution, By-Laws, Practice Standards and compliance with CPD as adopted by the Institute.
- 1.3 Members shall not accept an assignment that is contingent upon or influenced by any condition or requirement for a predetermined result where the exercise of objective judgment is required. Members shall maintain the strictest independence and impartiality in undertaking their professional duties. To this end, no Member shall:
- (a) adopt the role of advocate in a case where their duty is to exercise independence and impartiality;
  - (b) (i) act as an advocate and as an expert in the same matter;
  - (ii) act as an advocate in a matter where another member of the same firm has acted as an expert in the same matter
  - (iii) act as an expert in a matter where another member of the same firm has acted as an advocate in the same matter.
  - (c) allow the performance of their professional duties to be improperly influenced by the needs or preferences of a client or other party;
  - (d) rely upon critical information supplied by a client without appropriate qualification or confirmation from other sources;
  - (e) act in any other way inconsistent with the duties of independence and impartiality.
- Same Matter is defined as being; A matter in which it may reasonably be construed that the member, or another representative from the member's firm, has acted or is acting as either an expert or advocate in a related context concerning the subject property.
- 1.4 Members shall not provide any advice or make any statement without reasonable foundation unless it is appropriately qualified or limited.
- 1.5 Members shall not claim or present professional qualifications which may be subject to erroneous interpretations or which they do not possess.
- 1.6 Members shall not accept instructions beyond their competence; however, assignments may be undertaken in conjunction with a person having the required competence after disclosure to the client.
- 1.7 Fees may be negotiated with a client on any agreed basis that does not:
- a) infringe any statute, rule of conduct or regulation;
  - b) depend on a client-nominated particular outcome of any valuation or other independent objective advice.
- 1.8 No Member shall pay by commission, allowance or other benefit any person who may introduce clients to them without appropriate disclosure.
- 1.9 Members shall not accept payment or favours from another party which may affect their relationship with a client.
- 1.10 A valuation shall not be performed by a Certified Practising Valuer without an inspection of the property concerned. The inspection shall be sufficiently comprehensive to enable the Member to complete the valuation in accordance with the Practice Standards of the Institute. Where, however, a client's instructions expressly exclude the requirements for a comprehensive inspection and these instructions are accepted by the member then the limitations to the valuation must be clearly acknowledged by the member and client.
- 1.11 Members shall not reproduce any work or reference prepared and presented by any other Member, person, body or authority which creates the impression that it is their own.
- 1.12 Members shall be fair and honest in any public criticism of the Institute or fellow Members.

## API RULES OF CONDUCT

- 1.13 Members shall include in reports, references to any relevant assumptions, conditions, requirements and limitations arising from their instructions or inquiries, or imposed from any other source.
- 1.14 Members shall retain for as long as legally required, adequate file notes which substantiate their opinions by way of inquiry, objective comparison, deduction and calculation.
- 1.15 Where information critical to the assignment being undertaken is relied upon by a Member, the source of that information should either be disclosed in the relevant report or contained in the working papers supporting the relevant report and be appropriately attributed in either case, unless the information is protected by confidentiality, or the member is prevented by privacy or other like laws from disclosing or referring to the source.
- 1.16 Members shall accept full responsibility for the content of their reports. Where the report relies on professional opinion from outside experts, the degree of reliance must be indicated.
- 1.17 Co-signatories to reports shall indicate the extent of their involvement or the capacity in which they are signing.
- 1.18 Members will fully cooperate with any request for information or directive from the Institute where a complaint has been lodged or where there is deemed to be a prima facie breach of the Rules of Conduct.
- 1.19 Members shall not maliciously or carelessly do anything to injure, directly or indirectly, the reputation, prospects or business of other Members.
- 1.20 Instructions accepted by Members should preferably be in writing and/or be confirmed in writing by the Member in sufficient detail to avoid any misinterpretation. Any variations or extensions of the original instructions should similarly be confirmed in writing.
- 1.21 A Student Member admitted to the Australian Property Institute on or after 1 October 2007 shall not undertake valuations in their own right but may assist a Certified Practising Valuer, who is an Associate, Fellow or Life Fellow of the Institute in undertaking a valuation and may assist in the preparation of the valuation report.
- 1.22 A Member who is convicted of an offence involving dishonesty is in breach of these Rules of Conduct.

## Rule 2: Conflict of Interest

Members shall not accept or carry out any instruction where there may be, or may reasonably be, construed to be a conflict of interest. Members shall withdraw from any instruction if a conflict of interest arises or becomes known after an instruction has been accepted. An exception to this rule is where the conflict of interest is disclosed to and accepted by the party or parties.

- 2.1 Where a conflict of interest arises or could arise a Member shall promptly disclose the relevant facts to the client and where appropriate:
  - a) advise the client to obtain independent professional advice;
  - b) inform the client that neither the Member nor the firm can act or continue to act for the client unless the appointment or instruction is confirmed in writing acknowledging the actual or potential conflict of interest; and
  - c) disclose the matter in any relevant document or report.
- 2.2 Where a conflict arises or could arise between the interests of different clients of a Member or a firm or company of which a Member is a partner, director or employee, a Member shall promptly disclose the relevant facts to the instructing client and where appropriate:
  - a) advise the client to obtain independent professional advice;
  - b) inform the client that neither the Member nor the firm can act or continue to act for the client unless the appointment or instruction is confirmed in writing acknowledging the actual or potential conflict of interest, and disclose the matter in any relevant document or report.

## Rule 3: Client Relationships

- 3.1 Members shall not disclose to any other person or party any confidential information provided directly or indirectly by a client or to a client without the permission of the client except where there is a legal requirement for disclosure or the information is of public or common knowledge.
- 3.2 Members shall conduct themselves in a manner and demeanour which is neither detrimental to their profession nor likely to lessen the confidence of clients or the public in the Institute or the profession.

- 3.3 Members shall act promptly and efficiently in the servicing of the client's instructions.
- 3.4 Members shall, in the case of unavoidable delay, communicate to the client the progress being made in respect of the instructions issued to the Member.
- 3.5 Consistent with the duty of a Member to preserve the confidentiality of a client's affairs, a Member shall not accept a retainer to act for another person in any action or proceedings against, or in conflict with, the interests of the client.

### **Rule 4: Advertising**

- 4.1 Any advertisement by a Member must not reflect adversely on the professional integrity of the Institute or its Members.
- 4.2 Members shall not include exaggerated or false claims in any advertisement.

### **Rule 5: Reference to the Institute**

- 5.1 No Member or Members shall:
  - a) purport to represent the views of the Institute unless expressly authorised to do so
  - b) publicise the Institute or its Members generally in terminology which has not either already appeared in an advertisement published by the Institute or received the approval of the Institute.

### **Rule 6: Inducements for the Introduction of Clients**

- 6.1 No Member shall invite instructions for work except in accordance with these Rules.
- 6.2 No Member shall directly or indirectly exert undue pressure or influence on any persons, whether by the offer or provision of any payment, gift or favour or otherwise, for the purpose of securing instructions for work, or accept instructions from any person where there is reason to believe that undue pressure or influence may have been exerted by a third party in expectation of receiving a reward for the introduction.

### **Rule 7: Departure Provisions**

- 7.1 Where a Member considers circumstances exist that warrant departure from or non-compliance with any rule herein, the Member's report shall include a statement that outlines the reasons for the departure or non-compliance and any impact on the content of the report.

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## 2.3

# PINZ CODE OF ETHICS AND RULES OF CONDUCT NZIV CODE OF ETHICS (as provided in Rule 133)

The Joint Code of Ethics as approved at the 2004 annual general meeting is the legal document for all PINZ members. This document refers to NZIV and other matters relating to NZIV because it was intended to be a joint code of ethics. However; this was not passed by the Minister of NZrV so the 1996 code of ethics for NZIV is still in force.

The Code of Ethics comprises two parts:-

### **A: Public Statement of the principles, values and behaviour expected of Members of the Institute:**

#### **1. Compliance with Standards**

Members shall, at all times, observe the requirements of the Code of Ethics and Rules of Conduct, and (where applicable) the Constitution, Bylaws or Rules of the Institute, the Practice Standards of the Institute and compliance with Continuing Professional Development (CPO) requirements.

#### **2. Professional Duty**

It is the duty of Members to render service to their clients and employers with fidelity, to practise their vocation with integrity, honour and professionalism, to act impartially and objectively when providing independent advice, and to respect the public interest.

#### **3. Competence**

A Member shall not accept instructions in a matter where, based on a reasonable objective standard, the Member does not have the competence, skill and/or experience to complete the assignment to the acceptable professional standard in accordance with this Code of Ethics, and the Practice Standards of the Institute, unless the assignment

is completed in conjunction with a qualified and suitably experienced practitioner.

#### **4. Conflict of Interest**

Members shall consider and identify any actual or potential conflict of interest when carrying out their professional duties, and shall not act in a matter where such conflict or potential conflict has been identified by the Member or any other interested party unless all interested parties have been made aware of the situation and have consented to the Member continuing in the task.

#### **5. Confidentiality**

Members must observe the requirements of confidentiality in their dealings with clients and the public.

#### **6. The Profession**

Members shall at all times conduct business in a manner befitting their profession in accordance with reasonable public expectations of professional persons.

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## 2.4

# PINZ RULES OF CONDUCT

The following clauses are an expansion of the preceding public statement.

### 1.0 Professional and Personal Conduct

- 1.1 Members shall conduct their professional duties and activities in a manner that reflects credit upon themselves and their profession. High standards of competence, honesty, loyalty, integrity and fairness shall be observed at all times.
- 1.2 Members are bound by and agree to abide by the Code of Ethics and Rules of Conduct, and (where applicable) the Constitution, Bylaws or Rules of the Institute, Practice Standards and compliance with Continuing Professional Development (CPD) as adopted by the Institute.
- 1.3 Members shall not accept an assignment that is contingent upon or influenced by any condition or requirement for predetermined results where the exercise of objective judgement is required. Members shall maintain the strictest independence and impartiality in undertaking their professional duties. To this end, no Member shall:
  - a. adopt the role of advocate in a case where their duty is to exercise independence and impartiality;
  - b. allow the performance of their professional duties to be improperly influenced by the needs or preferences of a client or other party;
  - c. rely upon critical information supplied by a client without appropriate qualification or confirmation from other sources;
  - d. act in any other way inconsistent with the duties of independence and impartiality.
- 1.4 Members in providing a valuation of real property or an opinion on a real estate matter must give a considered and reasoned answer. A member's counsel constitutes professional advice which must be prepared to the highest standards of competency and rendered only after having properly ascertained and weighed the facts.
- 1.5 Members shall not claim or present professional qualifications which may be subject to erroneous interpretations or which they do not possess.

- 1.6 Members shall be fair and honest in any public criticism of the Institute or fellow Members.
- 1.7 Members shall not maliciously or carelessly do anything to injure, directly or indirectly; the reputation, prospects or business of other Members.

### 2.0 Instructions, Inspections and Reports

- 2.1 Instructions accepted by Members should preferably be in writing and/or be confirmed in writing by the Member in sufficient detail to avoid any misinterpretation. Any variations or extensions of the original instructions should similarly be confirmed in writing.
- 2.2 Members shall not accept instructions beyond their competence; however, assignments may be undertaken in conjunction with a person having the required competence after disclosure to the client.
- 2.3 A valuation shall not be performed by a Member without an inspection of the property concerned. The inspection shall in all cases be sufficiently comprehensive to enable the Member to complete the valuation in accordance with the Practice Standards of the Institute. Where, however, a client's instructions expressly exclude the requirements for a comprehensive inspection and these instructions are accepted by the member then the limitations to the valuation must be clearly acknowledged by the member and client.
- 2.4 Members shall not reproduce any work or reference prepared and presented by any other Member, person, body or authority which creates the impression that it is their own.
- 2.5 Members shall include in reports reference to any relevant assumptions, conditions, requirements and limitations arising from their instructions or enquires, or imposed from any other source.
- 2.6 Members shall retain for as long as legally required, adequate file notes which substantiate their opinions by way of inquiry, objective comparison, deduction and calculation.
- 2.7 Where information critical to the assignment being undertaken is relied upon by a Member, the source of that information should either be disclosed in

## PINZ RULES OF CONDUCT

the relevant report or contained in the working papers supporting the relevant report, and be appropriately attributed in either case, unless the information is protected by confidentiality, or the Member is prevented by privacy or other like laws from disclosing or referring to the source.

- 2.8 Members shall accept full responsibility for the content of their reports. Where the report relies on professional opinion from outside experts, the degree of reliance must be indicated.
- 2.9 Co-signatories to reports shall indicate the extent of their involvement or the capacity in which they are signing.

### 3.0 Fees and Payments

- 3.1 Fees may be negotiated with a client on any agreed basis that does not:
- (a) infringe the Code of Ethics or any Statute or Regulation;
  - (b) depend on the outcome of any valuation or other independent objective advice.
- 3.2 No Member shall pay by commission, allowance or other benefit to any person who may introduce clients to them.
- 3.3 Members shall not accept payment or favours from another party, which may affect their relationship with a client.

### 4.0 Use of Member's Name and Designation

- 4.1 A Member should avoid the use of the Member's name by, or personal association with, any enterprise or activity which may bring the Member, the Institute, or the profession into disrepute.
- 4.2 Where applicable
- (a) The initials FNZIV and ANZIV denoting Members' status, and statutory designations "Registered Valuer" and "Public Valuer", as appropriate, are personal to individual Members and shall be used only following or immediately in connection with the Member's name.
  - (b) A Member's name and signature must appear on every valuation or report undertaken, together with the approved initials indicating their status and where appropriate the designation of "Public Valuer", "Registered Valuer" or such other designation as the Institute may from time to time approve.

- 4.3 For Members of the Property Institute of New Zealand, the use of post nominals indicating the status of Members and "Registered" designations may only be used as permitted by the Property Institute of New Zealand Bylaws.

### 5.0 Conflict of Interest

- 5.1 Members shall not accept or carry out any instruction where there may be, or may reasonably be construed to be a conflict of interest. Members shall withdraw from any instruction if a conflict of interest arises or becomes known after an instruction has been accepted. An exception to this clause is where the conflict of interest is disclosed to and accepted by the party or parties.
- 5.2 Where a conflict of interest arises or could arise a Member shall promptly disclose the relevant facts to the client and where appropriate:
- (a) advise the client to obtain independent professional advice;
  - (b) inform the client that neither the Member nor the firm can act or continue to act for the client unless the appointment or instruction is confirmed in writing acknowledging the actual or potential conflict of interest; and
  - (c) disclose the matter in any relevant document or report.
- 5.3 Where a conflict arises or could arise between the interests of different clients of a Member or a firm or company of which a Member is a partner director or employee, a Member shall promptly disclose the relevant facts to the instructing client and where appropriate:
- (a) advise the client to obtain independent professional advice;
  - (b) inform the client that neither the Member nor the firm can act or continue to act for the client unless the appointment or instruction is confirmed in writing acknowledging the actual or potential conflict of interest; and
  - (c) disclose the matter in any relevant document or report.

### 6.0 Client Relationships

- 6.1 Members shall not disclose to any other person or party any confidential information provided directly or indirectly by a client or to a client without the permission of the client except where there is a legal requirement for disclosure or the information is of public or common knowledge.

- 6.2 Members shall conduct themselves in a manner and demeanour which is neither detrimental to their profession nor likely to lessen the confidence of clients or the public in the Institute or the profession.
- 6.3 Members shall act promptly and efficiently in the servicing of their client's instructions.
- 6.4 Members shall, in the case of unavoidable delay, communicate to the client the progress being made in respect of the instructions issued to the Member.
- 6.5 Consistent with the duty of a Member to preserve the confidentiality of client's affairs, a Member shall not accept a retainer to act for another person in any action or proceedings against, or in conflict with, the interests of the client.

## **7.0 Advertising**

- 7.1 Any advertising by a Member must not reflect adversely on the professional integrity of the Institute or its Members.
- 7.2 Members shall not include exaggerated or false claims in any advertisement.

## **8.0 Reference to the Institute**

- 8.1 No Member shall:
  - (a) purport to represent the views of the Institute unless expressly authorised to do so;
  - (b) publicise the Institute or its Members generally in terminology which has not either already appeared in an advertisement published by the Institute or received the approval of the Institute.

## **9.0 Inducements for the Introduction of Clients**

- 9.1 No Members shall invite instructions for work except in accordance with the Code of Ethics.
- 9.2 No Member shall directly or indirectly exert undue pressure or influence on any persons, whether by the offer or provision of any payment, gift or favour or otherwise, for the purpose of securing instructions for work, or accept instructions from any person where there is reason to believe that undue pressure or influence may have been exerted by a third party in expectation of receiving a reward for the introduction.

## **10.0 General**

- 10.1 Members shall fully co-operate with any request for information or directive from the Institute where a complaint has been lodged or where there is deemed to be a prima facie breach of the Code of Ethics.
- 10.2 A Member who is convicted of any offence involving dishonesty is in breach of the Code of Ethics.
- 10.3 A Member (NZIV Members) shall at all times faithfully observe and perform all the Member's obligations under the Valuers Act .1948, with its Amendments and the Regulations thereunder; and the Rules of the Institute.

# NEW ZEALAND INSTITUTE OF VALUERS CODE OF ETHICS

(As provided in Rule 133)

*Note: If you are a member of both NZIV and PINZ the NZIV Code of Ethics takes precedence.*

Approved by members at the Annual General Meeting of the Institute held on 12 April 1996, and approved by the Minister in Charge of the Valuation Department in accordance with Section 16(3) of the Valuers Act 1948, on 9 May 1996.

The following is the Code of Ethics of the Institute, and every person referred to in Rule 8 of the Rules of the Institute is bound by this Code. A breach of any of the provisions of this Code may render the person concerned liable to disciplinary action.

## I. Professional Responsibility

- 1.1 The first duty of each and every member is to render service to the member's client or the member's employer with absolute fidelity, and to practise their profession with devotion to high ideals of integrity, honour and courtesy, loyalty to the Institute, and in a spirit of fairness and goodwill to fellow members, employees and subordinates.
- 1.2 A members conduct shall at all times uphold the reputation of the Institute and the dignity of the profession and abide by all laws, statutes, regulations and rules relevant to their professional practice.
- 1.3 Each and every member shall maintain the high standards of their profession and should refer to the Institute, any act or omission of a fellow member they are aware of and which may appear to bring discredit on the Institute or its members.
- 1.4 No member shall prepare or certify any statement which is known to be or ought to be known to be false, incorrect, misleading, deceptive or open to misconstruction by reason of a misstatement, omission or suppression of a material fact, any deceptive act, or otherwise.
- 1.5 A member shall exercise the utmost care and good faith to ensure the maintenance of the highest standards in the preparation of statements, reports and certificates, as these constitute one of the most valuable assets of the profession, being relied upon by clients, employers, shareholders, investors, creditors and the public.

1.6 When asked for a valuation of real property, or an opinion on a real estate matter, no member shall give an unconsidered answer. A member's counsel constitutes professional advice which must be prepared to the highest standards of competency and rendered only after having properly ascertained and weighed the facts.

1.7 A member must maintain the strictest independence and impartiality in the performance of the member's professional duties. To this end no member shall

- a) adopt the role of advocate to the exclusion of that independence and impartiality
- b) allow the performance of that member's professional duties to be improperly influenced by the preferences of clients or others as to the result of their professional work
- c) rely improperly upon information supplied by clients or others in the performance of their professional duties; or,
- d) act in any other way inconsistent with the duties of independence and impartiality.

## 2. Responsibility to Clients

2.1 Every member shall act towards that member's clients in all professional matters strictly in a fiduciary manner. Any information of a confidential nature given to the member by a client shall be kept confidential and not disclosed to any other party without the consent of the client. A member shall not be deemed to commit a breach of this requirement by reason of a member answering any question which the member is legally compellable to answer in any judicial proceedings in which the member is called as a witness.

2.2 A member must not accept or carry out any instruction where there is, or may reasonably be construed to be, a conflict of interest and must withdraw from any instruction if such a conflict of interest arises or becomes known after the instruction has been accepted, unless such conflict of interest is fully disclosed in writing to all relevant parties and all such parties agree that the

instruction may be accepted or continued by the member.

- 2.3 A member must inform the member's client or clients of the nature of any business connections, interests or other affiliations the member may have in connection with the service to the client or clients.
- 2.4 A member should not undertake any work for which the member is not qualified or where the member is in any doubt or ought to be in any doubt as to the adequacy of the member's professional competency and or experience to undertake the work unless such work is completed under the supervision of a person of adequate competence.

### 3. Professional Fees

- 3.1 No member shall in respect of the member's professional work levy a fee to the member's client that is other than reasonable in all the circumstances. A member shall make known the basis of the member's fee if requested by the client.
- 3.3 Fees may be negotiated on any mutually agreeable basis. However, no fee shall be contingent upon the reporting of a predetermined value or direction of value that favours the cause of the client, the amount of the value estimate, the attainment of a stipulated result, or the occurrence of a subsequent event.
- 3.4 A member shall not pay by commission or otherwise any person who may introduce clients to the member.
- 3.5 A member's charge to the member's client or clients shall constitute their only remuneration in connection with their professional advice.

### 4. Professional Work by Members in Employment

- 4.1 A member in employment shall not accept professional work on the member's own account unless with the knowledge and consent of the member's employer or unless the member's employment contract expressly provides such authority.

### 5. Professional Competency

- 5.1 As part of maintaining the standards of professional competency referred to under Clause

1.6 and 2.4 hereof every member shall, unless exempted by Council, participate in an ongoing annual programme of Continuing Professional Development in accordance with guidelines published to members from time-to-time by the Institute.

### 6. Use of Member's Name and Designation

- 6.1 A member should avoid the use of the member's name by, or personal association with, any enterprise or activity which may bring the member, the Institute, or the profession into disrepute.
- 6.2 The initials F.N.Z.I.V. and A.N.Z.I.V. denoting members' status, and statutory designations "Registered Valuer" and "Public Valuer", as appropriate, are personal to individual members and shall be used only following or immediately in connection with the member's name.
- 6.3 A member's name and signature must appear on every valuation or report undertaken, together with the approved initials as set out in the Rules of the New Zealand Institute of Valuers indicating their status as a Fellow or Associate and where appropriate the designation of "Public Valuer", "Registered Valuer" or such other designation as the Institute may from time to time approve.
- 6.4 A member acknowledges that when signing reports as the primary professional the member accepts full responsibility for the content of those reports including content that may be the result of inquiries or development by others.

### 7. Advertising and Promotion

- 7.1 A member may advertise or promote the member's professional services, either individually or collectively, provided that such advertising or promotion complies with the following:
  - 7.1.1 It must not contravene, or be inconsistent with, the other provisions of the Code of Ethics.
  - 7.1.2 It must not contain any reference to a client without that client's consent having first been obtained.
  - 7.1.3 The content does not carry the implication of any ability to influence any court, tribunal, regulatory agency, or similar body or official.

## **PINZ RULES OF CONDUCT**

- 7.2 A member when advertising or presenting practice stationery shall not do so in a manner that may be construed as misleading.
- 7.3 A member is responsible for any advertising or promotion which the member has expressly or impliedly authorised or which is for the member's benefit.
- 7.4 Neither the Institute's crest or logo may be used without first obtaining approval of the Council.

### **8. General**

- 8.1 A member shall at all times faithfully observe and perform all the member's obligations under the Valuers Act 1948, with its amendments and the Regulations thereunder, and the Rules of the Institute.
- 8.2 A member shall at all times abide by every lawful decision of the Council or of the Committee of the Branch of which they are a member or of any general meeting of the Institute or of that Branch.

## 3.1

# THE INTERNATIONAL VALUATION STANDARDS COMMITTEE

## Introduction

Rapid economic changes taking place in the 1970s served to enhance the recognition given by market participants to the importance of professional property valuations. The quickening pace in the globalisation of investment markets further underscored the need for internationally accepted standards for reporting the value of property. It became obvious that without international valuation standards there was considerable potential for confusion. Differences of viewpoints among national professional valuation bodies might lead to unintentional misunderstandings. In response to this situation, members of a technical committee of the Royal Institution of Chartered Surveyors (RICS) and representatives of the U.S. appraisal profession began a dialogue in the late 1970s, which led to the founding of The International Assets Valuation Standards Committee (TIAVSC) in 1981. The Committee changed its name in 1994 to the International Valuation Standards Committee (IVSC). The objectives of the Committee are twofold:

- To formulate and publish, in the public interest, valuation Standards for property valuation and to promote their worldwide acceptance; and
- To harmonise Standards among the world's States<sup>1</sup> and to identify and make disclosure of differences in statements and/or applications of Standards as they occur.

The IVSC has long recognised the diversity of purposes for which property valuations are required, including use in financial statements, decisions on loans and mortgages secured by property, transactions involving transfers of ownership, and litigation and tax settlements. Beyond Standards, the IVSC began publishing Applications dealing with valuation for financial reporting and secured lending purposes, as well as Guidance Notes regarding specific valuation issues and the application of Standards in more specific business and service-providing situations. In particular, the IVSC has sought that the International Valuation Standards (IVSs) be recognised in accounting and

other reporting standards, and that Valuers recognise what is needed from them under standards of other disciplines.

In 2003, the IVSC became an incorporated association, comprising professional valuation associations from around the world, and bound by Articles of Incorporation.

The IVSC has undertaken eight revisions of the International Valuation Standards, which were published in 1985, 1994/97, 2000, 2001, 2003, 2005 and 2007. The evolution of these Standards attests to the recognition by IVSC that change is inevitable and continuous even when gradual and not easily discernable. The ongoing development of Standards reflects the commitment of the IVSC to ensure that fundamental valuation definitions and guidance stay current in a dynamic world.

## Membership and Organisation

The International Valuation Standards Committee has become a truly international body in terms of both its membership and mission. The Committee, which was founded with a membership of twenty national associations, has grown by the year 2007 to include associations, with member or observer status, representing 52 countries. Member associations in these states subscribe to IVSC objectives concerning valuation and must have a sufficient number of their members capable of conducting valuations that comply with Standards. Member associations support the Standards and Guidance Notes published by IVSC and endeavor to secure recognition of the Standards where appropriate in their respective States.

Member associations are enjoined to disclose to the IVSC any significant differences between domestic and international Standards so that such differences can be reported to the international community. The IVSC recognises that Valuers must act legally and comply with the laws and regulations of the States in which they practise. Member associations work with controlling and regulatory authorities, both statutory and voluntary, and other professional societies to ensure that valuations comply with the IVSC Standards and Guidance Notes. They also play an educative and consultative role in the area of valuation standards within their respective States.

<sup>1</sup> Throughout this document, the word 'State' conveys the same meaning as it is used by the United Nations, which recognises and refers to its members as States, i.e., politically organised communities having their own apparatus of government and occupying sovereign territory.



## Achievements of IVSC

The International Valuation Standards Committee is a Non-Government Organisation (NGO) member of the United Nations, having been granted Roster status with the United Nations Economic and Social Council in May 1985. The IVSC works cooperatively with Member States and maintains liaison with international agencies, such as the Organisation for Economic Cooperation and Development (OECD), the World Bank, the International Monetary Fund (IMF), the World Trade Organisation (WTO), the Commission of the European Union, the Bank for International Settlements (BIS), and the International Organisation of Security Commissions (IOSCO). The IVSC also maintains a close relationship with the International Accounting Standards Board (IASB), and the independent standards setting boards of the International Federation of Accountants (IFAC)--the International Public Sector Accounting Standards Board and the International Auditing and Assurance Standards Board.

IVSC provides the accounting profession with advice and counsel relating to valuation, seeks to coordinate its Standards and work programs with those of related professional disciplines in the public interest, and cooperates with international bodies in determining and promulgating new Standards. In order to ensure that the international standards governing valuation practice are consistent with the requirements of Valuers under international financial reporting standards, the IVSC annually reviews each new edition of the International Financial Reporting Standards (IFRSs), promulgated by the International Accounting Standards Board (IASB), and the International Public Sector Accounting Standards (IPSASs), promulgated by the International Public Sector Accounting Standards Board. The IVSCs make reference to these accounting standards wherever they apply to the work of Valuers. The IVSC publishes White Papers and Technical Papers at its website. At the time this edition was released, the following papers were available: two White Papers, Valuation in Emerging Markets and The Valuation of Real Estate Serving as Collateral for Securitised Instruments; and one Technical Paper, Mass Appraisal for Property Taxation.

## Headquarters

The IVSC's international headquarters are in London.

**12 Great George Street  
London  
United Kingdom SW1P 3AD  
Telephone: 44 1442 879306  
Facsimile: 44 1442 879306**

Financial matters and orders are handled at the Committee's international financial bureau in Chicago, IL, USA. Information about the Committee and ongoing development of the Standards can be obtained through the IVSC web site at <http://www.ivsc.org/>.

IVSC officers, who are appointed representatives of their respective national association(s), are chosen through a peer election of all national representatives. A new chairman is elected every two years. The IVSC is directed by a Management Board, which includes Full and Elected Board Members as well as the Chairman and the two Vice Chairmen. The Management Board delegates responsibility for reviewing current standards and guidance, and producing new drafts, where appropriate, to the IVSC Standards Board. Members of the Standards Board are drawn from a wider constituency than IVSC member institutes. In determining the membership of the Standards Board, the IVSC Management Board seeks to draw together a group of people with the best available combination of technical skills and background experience in relevant international business and property markets, who can contribute to the development of high quality, international valuation standards. The IVSC By-Laws and Articles of Incorporation set forth detailed provisions for the membership, management, and operations of the organisation, and are available to view on the IVSC web site.



## 3.2

# THE INTERNATIONAL VALUATION STANDARDS

### Objectives and Scope

The development of the International Valuation Standards (IVSs) has been guided by three principal objectives

- To facilitate cross-border transactions and contribute to the viability of international property markets by promoting transparency in financial reporting as well as the reliability of valuations performed to secure loans and mortgages, for transactions involving transfers of ownership, and for settlements in litigation or tax matters;
- To serve as a professional benchmark, or beacon, for Valuers around the world, thereby enabling them to respond to the demands of international property markets for reliable valuations and to meet the financial reporting requirements of the global business community; and
- To provide Standards of valuation and financial reporting that meet the needs of emerging and newly industrialised countries.

Users of valuations under IVSs should be able to rely on such valuations as having been carried out by competent professionals who subscribe to high standards of ethical conduct. As the scope of valuation practice becomes broader, the term property valuation has gained currency over the more restrictive term asset valuation, a term referring to valuations performed primarily for use in financial reporting. A Professional Property Valuer is a person who possesses necessary qualifications, ability, and experience to estimate property value for a diversity of purposes including transactions involving transfers of property ownership, property considered as collateral to secure loans and mortgages, property subject to litigation or pending settlement on taxes, and property treated as fixed assets in financial reporting. A Professional Property Valuer may also possess the specific expertise to perform valuations of other categories of property, i.e., personal property, businesses, and financial interests.

The International Valuation Standards represent accepted, or best, practice in the Valuation profession, also known as Generally Accepted Valuation Principles (GAVP). Valuer compliance with the IVSs may be voluntary, mandated by law or regulation, or at the instruction of clients, intended users, and/or national societies or organisations. Having no enforcement power of its own, the IVSC looks to national

institutes and financial professionals and authorities to enforce standards. It is intended that the International Valuation Standards and the national standards of respective Member States shall be complementary and mutually supportive. The IVSC advocates that differences between statements and/or applications of national and International Valuation Standards be disclosed.

Detailed examination of methodology and its application to specific property types or markets is the province of specialist education and literature. For this reason, the IVSC encourages all professional Valuers to avail themselves of continuing education programs throughout their careers. The International Valuation Standards prescribe what Valuers do rather than explain how specific procedures or methodologies are applied. The IVSs recognise that every application is tied to a specific valuation problem, the solution of which depends on the Valuer's ability to select relevant techniques and exercise appropriate judgment.

Where the standards of other disciplines, such as accounting, may apply to Valuations, the IVSC advises Valuers to understand the accounting use to which their valuations are put.

### Organisation of the International Standards

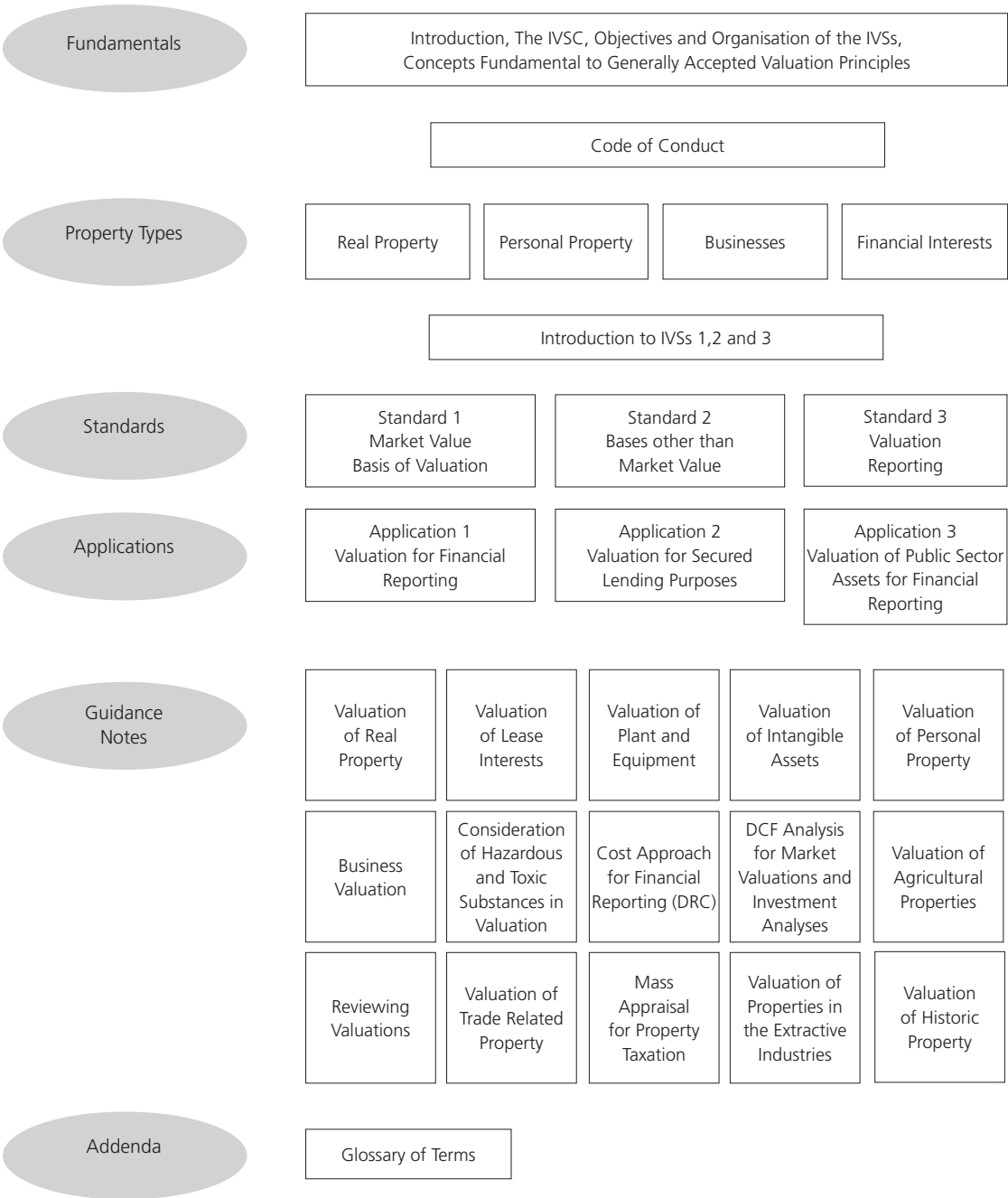
Various valuation principles and techniques are understood within the valuation profession and are well established throughout the global business community. The abbreviated discussions of such principles and techniques included in the Standards, Applications, and Guidance Notes should not be considered exhaustive. Therefore, it is important to the understanding and use of these Standards that, although the individual Standards, Applications, or Guidance Notes may be published as separate sections, each is a component part of the entirety. **Thus, definitions, preface statements, valuation concepts and principles, and other common elements are to be understood as pertaining to each component.** Although an attempt has been made to develop each part of the Standards document as a self-contained item, the requirements of the IVSC Code of Conduct and IVS 3, Valuation Reporting, apply to all elements. Thus, the reader will benefit most from reading the entire document. Extensive cross-referencing facilitates

# THE INTERNATIONAL VALUATION STANDARDS

the task of tracing related areas throughout the text. **The Standards, Applications, and Guidance Notes include paragraphs in both plain type and bold type, which have equal authority. Paragraphs in bold type indicate the main principles.** Technical Papers published on the IVSC website supplement the Standards, Applications and Guidance Notes but are not considered as integral to the Standards document.

The International Valuation Standards Committee (IVSC) recognises the complexity of professional valuation procedures, the diversity of property situations, the difficulty other professional disciplines may have in interpreting valuation activities, problems in the usage and translation of terminology, and the paramount need of the public for well-founded professional valuations developed in accordance with generally accepted

## Structure of Standards, Applications, Guidance Notes and Commentary



## THE INTERNATIONAL VALUATION STANDARDS

standards. Accordingly, the content and format of these Standards have been designed with these issues in mind and an understanding of the structure of the Standards is, therefore, important to their application. The organisation of the Standards follows.

1. **Introduction** – The introduction offers an overview of the origins of the International Valuation Standards, the work of the International Valuation Standards Committee, and the general context of the Standards. The organisation of the Standards is explained and their intended applicability is discussed.
2. **Concepts Fundamental to Generally Accepted Valuation Principles** – A full discussion of the body of knowledge constituting valuation methods and practices is beyond the scope of these Standards. To foster understanding among professional disciplines and to alleviate difficulties arising from language barriers, this section aims at providing commentary on basic legal, economic, and conceptual frameworks upon which the valuation discipline and its Standards are based. Comprehension of these concepts and principles is crucial to understanding valuation and to the application of these Standards.
3. **Code of Conduct** – A code of conduct addresses the ethical and competency requirements of Valuers in professional practice. Ethical conduct serves the public interest, sustains the trust financial institutions necessarily place in the services of Valuers, and works to the benefit of the valuation profession itself. It ensures that the results of valuations are reliable, consistent, and unbiased.
4. **Property Types** – Real property is distinguished from personal property, businesses, and financial interests. These four property types and the distinctions between them are discussed.
5. **Introduction to the Standards** – This introductory section discusses differences between the Market Value Basis and Bases Other Than Market Value and the importance of clearly and informatively communicating the valuation. After the valuation is completed, the Valuer has to clearly explain the results and to communicate how those results were obtained.
6. **Standards** – Within the organisation of Standards, Applications, and Guidance Notes, the Standards are considered as most fundamental and permanent. IVSC Standards 1 and 2 deal respectively with Market Value and Bases Other Than Market Value. Standard 3 sets forth the requirements for Valuation Reporting. The Standards also serve as a foundation for the International Valuation Applications (IVAs), which

deal with the application of valuation for financial reporting and lending.

7. **Applications** – The application of both private and public sector asset valuation to financial statements or related accounts, and to decisions involving loan or mortgage security is described.
8. **Guidance Notes** – Issues that relate to the application of the Standards frequently arise in valuation practice and from those who use valuation services. The Guidance Notes provide guidance on specific valuation issues and how Standards are to be applied in more specific business and service-providing situations. The Guidance Notes complement and expand on the Standards and Applications, with which they have equal importance. Compliance with the Guidance Notes as with the Standards and Applications is, therefore, mandatory for all Valuers preparing assignments under the International Valuation Standards.
9. **Glossary** – The glossary provides a summary of all terms defined in the Standards, Applications and Guidance Notes.

### AUSNZ

**In Australia and New Zealand, Guidance Notes are not mandatory.**

**The three principal elements of the International Valuation Standards, i.e., the Standards, Applications and Guidance Notes, have equal weight, and all valuations prepared in compliance with the IVSs must conform to the principles and procedures elaborated throughout the entire document.**

# THE INTERNATIONAL VALUATION STANDARDS

## Format of the Standards, Applications and Guidance Notes

Each of the three Standards is written to address a broadly related area of valuation practice. As appropriate, each Standard contains the following nine sections.

1. Introduction
2. Scope
3. Definitions
4. Relationship to Accounting Standards
5. Statement of Standard
6. Discussion
7. Disclosure Requirements
8. Departure Provisions
9. Effective Date

The International Valuation Applications have the following nine sections:

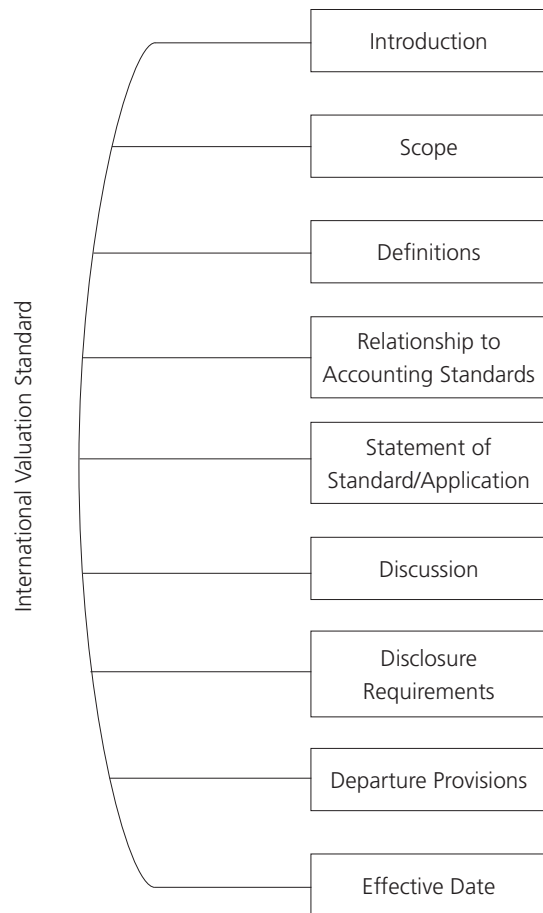
1. Introduction
2. Scope
3. Definitions
4. Relationship to Accounting Standards
5. Statement of Application
6. Discussion
7. Disclosure Requirements
8. Departure Provisions
9. Effective Date

Each of the Guidance Notes deal with issues relating to the application of the Standards that arise in valuation practice or from those who use valuation services. As appropriate, each Guidance Note contains the following six sections:

1. Introduction
2. Scope
3. Definitions
4. Relationship to Accounting Standards
5. Guidance
6. Effective Date

The Guidance Notes (GNs) may be divided into three groups. Four of the GNs address considerations specific to the valuation of different property categories, including Real Property, Lease Interests, Plant and Equipment, and Personal Property. Three of the GNs deal with property or assets that are valued on a cash flow basis, including Intangible Assets, Businesses, and Trade Related Property. Two of the GNs provide guidance in the application of valuation methodologies (The Cost Approach for Financial

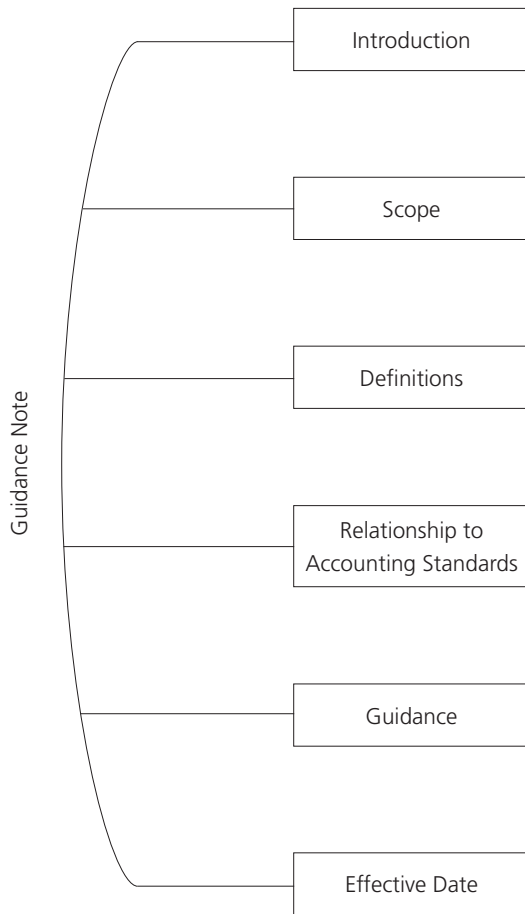
## Format of the Standards and Applications



Reporting-[DRC] and Discounted Cash Flow Analysis for Market Valuations and Investment Analyses). The reader may find it helpful to read these groups of GNs together because of such common basic elements.

Of the remaining six GNs, one addresses environmental issues (Consideration of Hazardous and Toxic Substances), three deal with the valuation of specialised property (agricultural properties, properties in the extractive industries, and historic properties), one provides guidance in an area of professional practice (Reviewing Valuations), and one discusses a cognate area of valuation practice (Mass Appraisal for Property Taxation).

**Format of the Guidance Notes**



The Guidance Notes on Real Property Valuation (GN 1), Valuation of Lease Interests (GN 2), Valuation of Intangible Assets (GN 4) and Business Valuation (GN 6) were adopted 1 July 2000 and the GN on the Valuation of Personal Property (GN 5), 30 April 2003. These 5 GNs have all been revised, and the current versions became effective 31 July 2007. The Guidance Notes on Discounted Cash Flow (DCF) Analysis for Market Valuations and Investment Analyses (GN 9), Valuation of Agricultural Properties (GN 10), and Reviewing Valuations (GN 11) were adopted on 30 April 2003. In their current form, GN 9, GN 10 and GN 11 became effective 31 July 2007. The Guidance Note on the Cost Approach for Financial Reporting-DRC (GN 8) was originally adopted 1 July 2000. It has undergone subsequent revision, achieving near current form in the seventh edition. The eighth edition version of GN 8 became effective 31 July 2007. The Guidance Note on the Valuation of Specialised Trading Property (GN 12) was adopted 31 January 2005. It was renamed Valuation of Trade Related Property and further edited in this edition. In its current form, GN 12 became effective 31 July 2007.

The Guidance Notes on Mass Appraisal for Property Taxation (GN 13) and the Valuation of Properties in the Extractive Industries (GN 14) were adopted 31 January 2005. GN 13 underwent no revision since the last edition. GN 14, in its current form, became effective 31 July 2007. New Guidance Note 15, Valuation of Historic Property, was also adopted 31 July 2007.

The Committee will continue to develop Standards, Applications and Guidance Notes as the users of valuations and the market require.

**Adoption Dates for Standards Documents**

The IVSC Market Value definition and the first two International Valuation Standards were adopted 24 March 1994. Two other Standards adopted at that time (IVS 3 and IVS 4) were revised and became Applications (IVA 1 and IVA 2) 1 July 2000. The third International Valuation Standard, Valuation Reporting, was adopted 30 April 2003, and the third International Valuation Application, Valuation of Public Sector Assets for Financial Reporting, was adopted 31 July 2007. Current IVS 1 and IVA 1; and revised versions of IVS 2, IVS 3 and IVA 2, became effective 31 July 2007.

The Guidance Note on the Consideration of Hazardous and Toxic Substances in Valuation (GN 7) was originally adopted 19 April 1996. In its current form, GN 7 became effective 31 January 2005. The Guidance Note on the Valuation of Plant and Equipment (GN 3) was originally adopted 1 July 1997. An extensive revision of GN 3 was approved 30 November 2005. In its current form, GN 3 became effective 31 July 2007.

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# 3.3

## IVSC CODE OF CONDUCT

### 1.0 Introduction

It is fundamental to the operation of International Valuation Standards that valuations performed in compliance therewith should be provided by honest and competent Professional Valuers, free of bias or self-interest, whose reports are clear, will not mislead, and will disclose all matters essential to the proper understanding of the valuation. Valuers should always promote and preserve public trust in the valuation profession.

### 2.0 Scope

- 2.1 Valuers comply with these Standards either by choice or by requirement placed upon them by law or regulation or at the instructions of clients, intended users, and/or national societies or organisations. A valuation claiming to be prepared under International Valuation Standards binds the Valuer to follow this Code of Conduct.
- 2.2 This Code does not have any formal authority in law, neither is it intended to be other than complementary to the rules, by-laws and regulations of national societies or organisations controlling or monitoring the activities of Valuers.
- 2.3 Valuations prepared under these Standards would only normally be acceptable to end users when prepared by a trained professional member of a recognised national professional body that itself enforces standards of qualification, competence, experience, ethics, and disclosure in valuation. In those countries where the infrastructure does not yet exist for a trained and regulated profession of valuation, primary responsibility lies with the client users to satisfy themselves as to the suitability of Valuers to undertake the task.

### 3.0 Definitions

- 3.1 *Assumptions* are suppositions taken to be true. Assumptions involve facts, conditions, or situations affecting the subject of, or approach to, a valuation but which may not be capable or worthy of verification. They are matters that, once declared, are to be accepted in understanding the valuation. All assumptions underlying a valuation should be reasonable.

All valuations are dependent to some degree on the adoption of assumptions. In particular,

the definition of *Market Value* incorporates assumptions to ensure consistency of approach and

the Valuer may need to make further assumptions in respect of facts which cannot be known or facts which could be determined.

- 3.2 *Limiting Conditions* are constraints imposed on valuations.

Limiting conditions may be imposed:

by clients ( e.g., where the Valuer is not permitted to investigate fully one or more of the significant factors likely to affect valuation);

by the Valuer ( e.g., where the client may not publish the whole or any part of the Valuation Report or Valuation Certificate without the Valuer's prior written approval of the form and context in which it may appear); or

by local statutory law.

- 3.3 A *Valuer* is a person who possesses the necessary qualifications, ability, and experience to execute a valuation. In some States, licensing is required before a person can act as a Valuer.

The Valuer shall be a person of good repute who:

- has obtained an appropriate degree at a recognised centre of learning, or an equivalent academic qualification;
- has suitable experience and is competent in valuing in the market and category of the asset;
- is aware of, understands, and can correctly employ those recognised methods and techniques that are necessary to produce a credible valuation;
- is a member of a recognised national professional valuation body;
- pursues a programme of professional learning throughout his or her career; and
- follows all the requirements of this Code of Conduct.

If, in any State, there are no appropriate academic qualifications, as stated above, the Valuer should

# IVSC CODE OF CONDUCT

have a sufficient level of training and experience in the valuation and be either:

a member of a recognised national professional valuation body, or licenced by government or appointed by the Courts or an Authority of an equivalent status.

In some States, to practice as a Valuer a licence or certification by an independent body is required by law.

- 3.4 An *Internal Valuer* is a Valuer who is in the employ of either the entity that owns the assets or the accounting firm responsible for preparing the entity's financial records and/or reports. An Internal Valuer is generally capable of meeting all the requirements of independence and professional objectivity required under this Code of Conduct, but for reasons of public presentation and regulation may not always be acceptable to fill the role of independent Valuer in certain types of assignments.
- 3.5 An *External Valuer* is a Valuer who, together with any associates, has no material links with the client, an agent acting on behalf of the client, or the subject of the assignment.
- 3.6 Since all Valuers undertaking assignments under International Valuation Standards must meet the requirements of impartiality, professional objectivity and disclosure required under this Code of Conduct, such Valuers should meet the requirements for independence which may attach to many assignments. With some clients, and in certain States, additional restraints on who may undertake valuation for a specific purpose may be applied by regulation or law. It is not the purpose of this Code to define different degrees of independence beyond the standard of independence already required under this Code.

## 4.0 Ethics

Valuers should at all times maintain a high standard of honesty and integrity and conduct their activities in a manner not detrimental to their clients, the public, their profession, or their respective national professional valuation body.

### 4.1 Integrity

- 4.1.1 A Valuer must not act in a manner that is misleading or fraudulent.
- 4.1.2 A Valuer must not knowingly develop and communicate a report that contains false, inaccurate, or biased opinions and analysis.

- 4.1.3 A Valuer must not contribute to, or participate in, a valuation service that other reasonable Valuers would not regard to be justified.
- 4.1.4 A Valuer must act legally and comply with the laws and regulations of the State in which he or she practices or where an assignment is undertaken.
- 4.1.5 A Valuer must not claim, or knowingly let pass, erroneous interpretation of professional qualifications that he or she does not possess.
- 4.1.6 A Valuer should not knowingly use false, misleading or exaggerated claims or advertising in an effort to secure assignments.
- 4.1.7 A Valuer shall ensure that any staff person or subordinate assisting with the assignment adhere to this Code of Conduct.

### 4.2 Conflicts of Interest

- 4.2.1 A Valuer must not act for two or more parties in the same matter, except with the written consent of those concerned.
- 4.2.2 A Valuer must take all reasonable precautions to ensure that no conflicts of duty arise between the interests of his or her clients and those of other clients, the Valuer, his or her firm, relatives, friends, or associates. Potential conflicts should be disclosed in writing before accepting instructions. Any such conflicts of which the Valuer subsequently becomes aware must be disclosed immediately. If such conflicts come to the attention of the Valuer after completion of the valuation, disclosure must be made within a reasonable time.

### 4.3 Confidentiality

- 4.3.1 A Valuer must at all times deal with client's affairs with proper discretion and confidentiality.
- 4.3.2 A Valuer must not disclose sensitive factual data obtained from a client, or the results of an assignment prepared for a client, to anyone other than those specifically authorised by the client except when legally required to do so as in situations where a Valuer must comply with certain quasi-judicial proceedings within the recognised national professional valuation body of which the Valuer is a member.

### 4.4 Impartiality

- 4.4.1 A Valuer must perform an assignment with the strictest independence, objectivity, and impartiality, and without accommodation of personal interests.
- 4.4.2 A Valuer must not accept an assignment that



includes the reporting of predetermined opinions and conclusions.

- 4.4.3 Fees connected with an assignment must not depend on the predetermined outcome of any valuation or other independent, objective advice contained in the valuation report.
- 4.4.4 Whether the Valuer's fee is or is not contingent upon any aspect of the report must be disclosed.
- 4.4.5 A Valuer must not rely upon critical information supplied by a client, or any other party, without appropriate qualification or confirmation from an independent source unless the nature and extent of such reliance is specified as a limiting condition.
- 4.4.6 A Valuer should not accept an assignment to report on assumed hypothetical conditions that are unlikely to be realised in any reasonable timescale.
- 4.4.7 Hypothetical conditions that are a reasonable possibility may be reported on provided they are accompanied by some discussion both of the prospects of realising the hypothesis and a consideration of value that reflects the true situation prevailing, e.g., a situation where a client wants to know what the value of land will be pending detoxification.
- 4.4.8 A Valuer should not use or rely on unsupported conclusions based on prejudice of any kind or report conclusions reflecting an opinion that such prejudice is necessary to maintain or maximise value.
- 4.4.9 In reviewing another Valuer's report, a Valuer shall exhibit impartial judgment and justify his or her reasons for agreeing or disagreeing with the conclusions of the report.

## 5.0 Competence

A Valuer must have the knowledge, skill, and experience to complete the assignment efficiently in relation to an acceptable professional standard. Only those Valuers able to conform to the definition of the Valuer set out in Definitions (para. 3.3 above) should undertake work in connection with these Standards.

### 5.1 Acceptance of Instructions

- 5.1.1 Prior to accepting an assignment or entering into an agreement to perform any assignment, a Valuer must properly identify the problem to be addressed and be certain he or she has the experience and knowledge, or in the event of an assignment overseas, will be able to associate

with a professional possessing the experience and knowledge of the market forces, language, and law to complete the assignment competently.

## 5.2 Outside Assistance

- 5.2.1 When engaging the services of outside assistance necessary to complement a Valuer's own skills, a Valuer should first establish that those assisting have the requisite skills and ethical principles.
- 5.2.2 The client's consent should be obtained when outside assistance is required, and the identity of the assistants and extent of their role should be disclosed in the Valuer's report.

## 5.3 Efficiency and Diligence

- 5.3.1 Valuer should act promptly and efficiently in carrying out the client's instructions and should keep the client informed of the Valuer's progress.
- 5.3.2 Instructions should be declined where circumstances preclude sufficient diligent enquiry, quality of work, and completion within a reasonable time.
- 5.3.3 Before the valuation is reported, written instructions should be received from the client and/or confirmed in writing by a Valuer in sufficient detail to avoid any misinterpretation.
- 5.3.4 A Valuer should make diligent enquiries and investigations to ensure that the data for analysis in the valuation are correct and can be relied upon.
- 5.3.5 A Valuer should prepare a work file for each assignment which, upon completion, should contain a true copy, in paper or electronic form (suitably backed up), of all written reports, correspondence, and memoranda plus adequate file notes which substantiate the Valuer's opinions by way of enquiry, objective comparison, deduction, and calculation.
- 5.3.6 The work file for each assignment should be retained for a period of at least five years after completion of the assignment.

## 6.0 Disclosure

It is essential that Valuers develop and communicate their analyses, opinions, and conclusions to users of their services through reports that are meaningful and not misleading and that disclose anything that might be taken to affect objectivity.

- 6.1 The valuation report should set out a clear and accurate description of the scope of the

## IVSC CODE OF CONDUCT

assignment and its purpose and intended use, disclosing any assumptions, hypothetical scenarios, or limiting conditions that directly affect the valuations and, where appropriate, indicating their effect on the value.

- 6.2 The valuation report must provide sufficient information to describe the work performed, the conclusions reached, and the context in which they were shaped.
- 6.3 A Valuer must disclose any direct or indirect personal or corporate relationship with the property or company that is the subject of any assignment and that might lead to a potential conflict of interest.
- 6.4 Where a Valuer is acting as an Internal Valuer, the relationship with the entity controlling the asset should be disclosed in the valuation report.
- 6.5 Where a Valuer is acting as an External Valuer but also has worked in a fee-earning capacity for the client, such relationship must be disclosed lest a third party, having to rely on the valuation, deem the Valuer's objectivity compromised.
- 6.6 Any limitations to quality of the service that a Valuer is able to offer must be disclosed whether this is due to externally imposed constraints or peculiar to the Valuer or the assignment. Where outside assistance has been sought the Valuer must disclose the identity of the assistants, the extent of reliance on, and the nature of, such assistance.
- 6.7 A Valuer must place a restriction against the publication of a valuation or its conclusions without consent so that the Valuer can keep a measure of control over the form and context in which his or her valuations are publicly disclosed.
- 6.8 A Valuer should disclose any departures from the International Valuation Standards.
- 6.8.1 Standards are devised for the generality of situations and cannot cater to every eventuality. There will be occasions where departure from Standards is inescapable. When such situations arise, departure would be unlikely to constitute a breach of these Standards, provided such departure is reasonable, complies with the principles of ethics and measures of competence, and a rationale for such departure is provided in the valuation report.

## 7.0 Reporting of Values

Valuation assignments may deal with one or more properties. The style of the valuation report must be tailored to the nature of the assignment and the needs of the client while meeting certain minimum requirements as to content.

- 7.1 This paragraph sets out the minimum contents of any report or certificate. The following items must be included. (Also see para, 5.1 of IVS 3, Valuation Reporting.)
- the identity of the Valuer and the date of the report;
  - the identity of the client;
  - the instructions, date of the value estimate, purpose and intended use of the valuation;
  - the basis of the valuation, including type and definition of value;
  - the identity, tenure, and location(s) of the interest(s) to be valued;
  - the date and extent of inspections;
  - the scope and extent of the work used to develop the valuation;
  - any assumptions and limiting conditions; and any special, unusual, or extraordinary assumptions;
  - a compliance statement that the valuation has been performed in accordance with these Standards and any required disclosures;
  - the professional qualification and signature of the Valuer; and

As required in some States, specific certification by the Valuer in the prescribed form.

- 7.2 The use of the valuation and the complexity of the property determine the level of detail appropriate to the report. Where a single or complex property is being reported, it may be appropriate for the report to go into greater detail on the data upon which the valuation is based and the reasoning behind the conclusions. Where a report is being prepared for a portfolio of properties for use in an audit function, the level of detailed data required for each of the properties within the portfolio may be less extensive.
- 7.3 This section is not to be taken to represent the enquiries, research and analysis needed to perform a proper valuation, merely the minimum that must be presented in the report.

## 3.4

# CONCEPTS FUNDAMENTAL TO GENERALLY ACCEPTED VALUATION PRINCIPLES (GAVP)

## 1.0 Introduction

1.1 The experience of Valuers and dialogue among nations through the International Valuation Standards Committee (IVSC) have demonstrated that, with few exceptions, there is common worldwide agreement regarding fundamentals that underpin the valuation discipline. Local laws and economic circumstances may, on occasion, require special (and sometimes limited) applications, but fundamentals of valuation methods and techniques are generally similar throughout the world. It is an objective of the International Valuation Standards Committee to avow and promote these fundamentals.

1.2 IVSC's Standards, Applications and Guidance Notes (GNs) are based on these fundamentals, but it is the position of the Committee that it is inappropriate to attempt to articulate all appropriate fundamentals within the body of each Standard. Instead, this section supplements each Standard and provides an overview of fundamentals that are particularly important to understanding the valuation profession and to applying the Standards.

## 2.0 Land and Property Concepts

2.1 *Land* is essential to our lives and our existence. Its importance brings land into focus for consideration by lawyers, geographers, sociologists, and economists. As each of these disciplines relates to land and to uses of land, the societies and nations of our world are affected.

2.2 Valuation of land as if vacant or of land and improvements to or on the land, is an economic concept. Whether vacant or improved, land is also referred to as *real estate*. Value is created by real estate's utility, or capacity to satisfy the needs and wants of human societies. Contributing to value are real estate's general uniqueness, durability, fixity of location, relatively limited supply, and the specific utility of a given site.

2.3 *Property* is a legal concept encompassing all the interests, rights and benefits related to ownership. Property consists of the rights of ownership, which entitle the owner to a specific interest or interests in what is owned. To distinguish between real estate, which is a physical entity, and its ownership, which is a legal concept, the ownership of real estate is called *real property*. The combination of rights associated with the ownership of real property is, in some States, referred to as the *bundle of rights*. The bundle-of-rights concept likens property ownership to a bundle of sticks with each stick representing a distinct and separate right of the property owner, e.g., the right to use, to sell, to lease, to give away, or to choose to exercise all or none of these rights.

2.4 Ownership of an interest in items other than real estate is referred to as *personal property*. The word *property*, used without further qualification or identification, may refer to real property, personal property, or other types of property such as businesses and financial interests, or a combination thereof. (See Section 3 below and Property Types).

2.5 Property Valuers, Asset Valuers, and Appraisers are those who deal with the special discipline of economics associated with preparing and reporting valuations. As professionals, Valuers must meet rigorous tests of education, training, competence, and demonstrated skills. They must also exhibit and maintain a Code of Conduct (ethics and competency) and Standards of professional practice and follow *Generally Accepted Valuation Principles (GAVP)*.

2.6 Price changes over time result from specific and general effects of economic and social forces. General forces may cause changes in price levels and in the relative purchasing power of money. Operating on their own momentum, specific forces such as technological change may generate shifts in supply and demand, and can create significant price changes.

## CONCEPTS FUNDAMENTAL TO GAVP

- 2.7 Many recognised principles are applied in valuing real estate. They include the principles of supply and demand; competition; substitution; anticipation, or expectation; change; and others. Common to all these principles is their direct or indirect effect on the degree of utility and productivity of a property. Consequently, it may be stated that the utility of real estate reflects the combined influence of all market forces that come to bear upon the value of property.

### 3.0 Real Estate, Property, and Asset Concepts

- 3.1 *Real estate* is defined as the physical land and those human-made items, which attach to the land. It is the physical, tangible “thing” which can be seen and touched, together with all additions on, above, or below the ground. Local laws within each State prescribe the basis for distinguishing real estate from personal property. Although these legal concepts may not be recognised in all States, they are adopted here to distinguish important terms and concepts.
- 3.2 *Real property* includes all the rights, interests, and benefits related to the ownership of real estate. An interest or interests in real property is normally demonstrated by some evidence of ownership (e.g., a title deed) separate from the physical real estate. Real property is a non-physical concept.
- 3.3 *Personal property* includes interests in tangible and intangible items which are not real estate. Items of tangible personal property are not permanently affixed to real estate and are generally characterised by their moveability.
- 3.4 In accounting terminology, *assets* are resources controlled by an entity as a result of past events and from which some future economic benefits are expected to flow to the entity. Ownership of an asset is itself an intangible. However, the asset owned may be either tangible or intangible.
- 3.4.1 The future economic benefits embodied in an asset may flow to the entity in a number of ways. For example, an asset may be: (a) used singly or in combination with other assets in the production of goods or services to be sold by the entity; (b) exchanged for other assets; (c) used to settle a liability; or (d) distributed to the owners of the entity. (International Financial Reporting Standards [IFRSs], Framework, 55)
- 3.4.2 An asset is recognised in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably. (IFRSs, Framework, 89)
- 3.5 International Financial Reporting Standards distinguish among tangible and intangible assets. Of particular importance are the following terms and concepts:
- 3.5.1 *Current assets*. Assets not intended for use on a continuing basis in the activities of an entity. Examples include stocks, obligations owed to the entity, short-term investments, and cash in bank and in hand. In certain circumstances real estate, normally treated as a fixed asset, may be treated as a current asset. Examples include land or improved real estate held in inventory for sale.
- 3.5.2 *Non-current assets (fixed, or long-term, assets)*. These are tangible and intangible assets which fall into the following two broad categories:
- 3.5.2.1 *Property, plant and equipment*. Assets intended for use on a continuing basis in the activities of an entity including land and buildings; plant and equipment; and other categories of assets, suitably identified; less accumulated depreciation. Property, plant and equipment are tangible, or physical assets.
- 3.5.2.2 *Other non-current assets*. Assets not intended for use on a continuing basis in the activities of an entity, but expected to be held in long-term ownership including long-term investments; long-term receivables; goodwill; expenditures carried forward; and patents, trademarks, and similar assets. This asset category includes both tangible, or physical assets and intangible, or non-physical assets. *Intangible assets* are considered items of intangible personal property, and may include management and marketing skill, credit rating, goodwill, and various legal rights or instruments (patents, trademarks, copyrights, franchises, and contracts).
- 3.5.3 Where either historic or current cost accounting conventions are upheld, a distinction is drawn between operational and investment assets. Operational assets are considered requisite to the operations of the going concern or corporation. Investment assets that are owned by a corporation are considered extraneous to the operational requirements of the corporate owner.

- 3.6 Accounting terminology differs somewhat from terms more common to Valuers. Within the classifications discussed in para. 3, Valuers of real property are principally involved with fixed assets. Technically it is the ownership of the asset, or the right of ownership, that is valued rather than the tangible or intangible asset itself. This concept distinguishes the economic concept of valuing an asset objectively based upon its ability to be purchased and sold in a marketplace from some subjective concept such as assuming an intrinsic or other than *Market Value* basis. The objective market concept does, however, have special applications for limited or non-market property valuation as discussed in International Valuation Standard 2.
- 3.7 The term *depreciation* is used in different contexts in valuation and in financial reporting. In the context of asset valuation, *depreciation*, refers to the adjustments made to the cost of reproducing or replacing the asset to reflect physical deterioration and functional (technical) and external (economic) obsolescence in order to estimate the value of the asset in a hypothetical exchange in the market when there is no direct sales evidence available (see para. 9.2.1.3, Concepts Fundamental to Generally Accepted Valuation Principles). In financial reporting *depreciation* refers to the charge made against income to reflect the systematic allocation of the depreciable amount of an asset over its useful life to the entity. It is specific to the particular entity and its utilisation of the asset, and is not necessarily affected by the market.

#### 4.0 Price, Cost, Market, and Value

- 4.1 Imprecision of language, particularly in an international community, can and does lead to misinterpretations and misunderstandings. This is particularly a problem where words commonly used in a language also have specific meanings within a given discipline. That is the case with the terms *price*, *cost*, *market*, and *value* as they are used in the valuation discipline.
- 4.2 *Price* is a term used for the amount asked, offered, or paid for a good or service. Sale price is an historical fact, whether it is publicly disclosed or kept confidential. Because of the financial capabilities, motivations, or special interests of a given buyer and/or seller, the price paid for goods or services may or may not have any relation to the value which might be ascribed to the goods or services by others. Price is, however, generally an indication of a relative value placed upon the goods or services by the particular buyer and/or seller under particular circumstances.
- 4.3 *Cost* is the price paid for goods or services or the amount required to create or produce the good or service. When that good or service has been completed, its cost is an historical fact. The price paid for a good or service becomes its cost to the buyer.
- 4.4 A *market* is the environment in which goods and services trade between buyers and sellers through a price mechanism. The concept of a market implies that goods and/or services may be traded among buyers and sellers without undue restriction on their activities. Each party will respond to supply-demand relationships and other price-setting factors as well as to the party's own capacities and knowledge, understanding of the relative utility of the goods and/or services, and individual needs and desires. A market can be local, regional, national, or international.
- 4.5 *Value* is an economic concept referring to the price most likely to be concluded by the buyers and sellers of a good or service that is available for purchase. Value is not a fact, but an estimate of the likely price to be paid for goods and services at a given time in accordance with a particular definition of value. The economic concept of value reflects a market's view of the benefits that accrue to one who owns the goods or receives the services as of the effective date of valuation.
- 4.6 Value is therefore a hypothetical price, and the hypothesis on which the value is estimated is determined by the valuation basis adopted. A *Basis of Value* is defined in IVS 2 as a statement of the fundamental measurement principles of a valuation on a specified date. A *Basis of Value* defines the nature of the hypothetical transaction, e.g., whether or not there is exposure to a market, and the assumed motivation and behaviour of the parties. A *Basis of Value* is not a description of the method or approach used to produce the estimate, and neither does it describe the state or condition in which the asset is assumed to be transferred. It is of paramount importance to the use and understanding of valuations that the *Basis of Value* be clearly disclosed, and that it is a basis that is appropriate to the particular valuation assignment. A change in the *Basis of Value* can have a material effect on the valuation.

## CONCEPTS FUNDAMENTAL TO GAVP

- 4.7 Professional Valuers, who possess intimate knowledge of a property market; understand the interaction of participants in the market; and are, thereby, able to judge the most likely prices to be concluded between buyers and sellers of property in that market avoid the unqualified term value by preceding the term with some adjective describing the particular type of value involved. *Market Value* is the most common type of value associated with property valuations and is discussed in International Valuation Standard 1.
- 4.8 The value concept contemplates a monetary sum associated with a transaction. However, sale of the property valued is not a condition requisite to estimating the price for which property should sell if it were sold on the date of valuation under conditions prescribed in the definition of *Market Value*.
- 4.9 The *Market Value* of real estate is a representation of its market-recognised utility rather than its purely physical status. The utility of assets to a given entity or individual may differ from that which would be recognised by the market or by a particular industry.
- 4.9.1 Considerations similar to those expressed above are applied to the valuation of property other than real estate. Financial reporting will require application of *Market Value* methods and a clear distinction between such methods and methods used to estimate values other than *Market Value*.
- 4.10 The total cost of a property includes all direct and indirect costs of its production. If supplemental capital costs are incurred by a purchaser subsequent to acquisition, they will be added to the historical acquisition cost for cost accounting purposes. Depending upon how the utility of such costs is perceived by the market, they may or may not be fully reflected in the property's *Market Value*.
- 4.11 A cost estimate for a property may be based on either an estimate of reproduction cost or replacement cost. *Reproduction* cost is the cost to create a virtual replica of a property using identical or, if identical materials are not available, similar materials. A *replacement* cost estimate envisions a modern equivalent of comparable utility, employing the design, technology and materials that are currently used in the market.

## 5.0 Market Value

- 5.1 The concept of *Market Value* reflects the collective perceptions and actions of a market and is the basis for valuing most resources in market-based economies. Although precise definitions may vary, the *Market Value* concept is commonly understood and applied.
- 5.2 *Market Value* is defined as:  
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.
- 5.3 It is important to stress that the professionally derived *Market Value* estimate is an objective valuation of identified ownership rights to specific property as of a given date. Implicit within this definition is the concept of a general market comprising the activity and motivation of many participants rather than the preconceived view or vested interest of a particular individual. *Market Value* is a market-supported estimate developed in accordance with these Standards.
- 5.4 Real property is distinguished from most goods and services because of the relatively longer period required to market what is a relatively illiquid commodity in order to achieve a price that represents its *Market Value*. This characteristically longer exposure time, the absence of a 'spot market' (a market in which commodities are available for immediate sale), and the nature and diversity of properties and property markets give rise to the need for Professional Valuers and Valuation Standards.
- 5.5 In some States, the legal term *Fair Market Value* is used synonymously with the term *Market Value*. *Fair Market Value* should not be confused with the accounting term, *Fair Value*. (See para. 8.1 below.) The IVSC position is that the term *Market Value* never requires further qualification and that all States should move toward compliance with this usage.

## 6.0 Highest and Best Use

- 6.1 Land is regarded as a permanent asset, but improvements upon or to the land have a finite life. Because of the immobility of land, each real estate parcel possesses a unique location. Land's permanence also means that it will normally be



expected to outlast uses and improvements, which have a finite life.

- 6.1.1 The unique characteristics of land determine its optimal utility. When improved land is valued separately from improvements to or upon the land, economic principles require that improvements to or on the land be valued as they contribute to or detract from the total value of the property. Thus, the *Market Value* of land based upon the "highest and best use" concept reflects the utility and the permanence of land in the context of a market, with improvements constituting the difference between land value alone and total *Market Value* as improved.
- 6.2 Most properties are valued as a combination of land and improvements. In such cases, the Valuer will normally estimate *Market Value* by considering the highest and best use of the property as improved.
- 6.3 *Highest and best use* is defined as:  
The most probable use of a property which is physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value of the property being valued.
- 6.4 A use that is not legally permissible or physically possible cannot be considered a highest and best use. A use that is both legally permissible and physically possible may nevertheless require an explanation by the Valuer justifying why that use is reasonably probable. Once analysis establishes that one or more uses are reasonably probable uses, they are then tested for financial feasibility. The use that results in the highest value, in keeping with the other tests, is the highest and best use.
- 6.5 Application of this definition permits Valuers to assess the effects of deterioration and obsolescence in buildings, the most appropriate improvements for land, the feasibility of rehabilitation and renovation projects, and many other valuation situations.
- 6.6 In markets characterised by extreme volatility or severe disequilibrium between supply and demand, the highest and best use of a property may be a holding for future use. In other situations, where several types of potential highest and best use are identifiable, the Valuer should discuss such alternative uses and anticipated future income and expense levels. Where land use and zoning are in a state of change, the immediate highest and best use of a property may be an interim use.

- 6.7 The concept of highest and best use is a fundamental and integral part of *Market Value* estimates.

## 7.0 Utility

- 7.1 The key criterion in the valuation of any real or personal property is its utility. Procedures employed in the valuation process have the common objective of defining and quantifying the degree of utility or usefulness of the property valued. This process calls for interpretation of the utility concept.
- 7.2 *Utility* is a relative, or comparative term, rather than an absolute condition. For example, the utility of agricultural land is ordinarily measured by its productive capacity. Its value is a function of the quantity and quality of produce, which the land will yield in an agricultural sense, or of the quantity and quality of buildings essential to the agricultural operation. If the land has development potential, however, its productivity is measured by how productively it will support a residential, commercial, industrial, or mixed use. Consequently, land value is established by evaluating its utility in terms of the legal, physical, functional, economic, and environmental factors that govern its productive capacity.
- 7.3 Fundamentally, property valuation is governed by the way specific property is used and/or how it would ordinarily be traded in the market. For some property, optimum utility is achieved if the property in question is operated on an individual basis. Other property has greater utility if operated as part of a group of properties, e.g., properties owned and managed by a business entity such as a chain of multiple retail outlets, fast food restaurants, or hotels. Therefore, a distinction must be made between a property's utility viewed individually and when considered as a part of a group. A Valuer will regard the property as the market views it, whether as a discrete entity or as part of an aggregate or portfolio. Typically, the Valuer estimates and reports the value of the property as an individual entity. If the value of the property, taken as part of an aggregate or portfolio, is other than its individual value, such value should be considered and reported.
- 7.4 An individual property may possess an additional, or special, value above its value as a separate entity by reason of its physical or functional association with an adjoining property owned by others or its attractiveness to a purchaser with other special

## CONCEPTS FUNDAMENTAL TO GAVP

interests. The extent or amount of such additional, or special, value is generally reported separately from *Market Value*.

### 8.0 Other Important Concepts

8.1 The expression *Market Value* and the term *Fair Value* as it commonly appears in accounting standards are generally compatible, if not in every instance exactly equivalent concepts. *Fair Value*, an accounting concept, is defined in International Financial Reporting Standards and other accounting standards as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. *Fair Value* is generally used for reporting both *Market* and *Non-Market Values* in financial statements. Where the *Market Value* of an asset can be established, this value will equate to *Fair Value*.

#### AUSNZ 8.1.1

**The IVSC has updated this segment in IVA1. Fair Value is not necessarily synonymous with Market Value (para, 5.3.3 IVA1).**

8.2 *Specialised property* is property that is rarely, if ever, sold in the market except by way of a sale of the business or entity of which it is part, due to uniqueness arising from its specialised nature and design, its configuration, size, location, or otherwise. Where there is limited or no directly comparable market information for Valuers to consider, the valuation process may become more complex. However, it is the Valuer's responsibility to develop data and reasoning from the market to support and/or explain the value conclusion. Each of the valuation methods may be applied, and all applicable methods should be considered. Where possible, the Valuer develops land value, cost, and accumulated depreciation estimates from market information, and explains the basis for the value estimate.

8.3 Where normal market conditions are disrupted or suspended, or where supply and demand imbalances lead to market prices that do not meet the *Market Value* definition, the Valuer may face a difficult valuation problem. By using the *Market Value* concept and definition, and by applying market data and reasoning to the valuation process, Valuers ensure the relevance and usefulness of asset values reported in financial

statements. As availability and/or applicability of market data decrease, the valuation assignment may require a higher degree of professional Valuer vigilance, experience, and judgement.

8.4 A Valuer may be required to apply a particular definition of *Market Value* to meet legal or statutory requirements. If so required, the Valuer must make specific disclosure of the fact and describe the impact of any differences upon the value estimated. Where an assignment is undertaken in accordance with International Valuation Standards, the term *Market Value* will always conform to the IVS definition.

8.5 All valuation reports should make clear the purpose and intended use of the valuation. In addition to other reporting requirements, where financial reporting is involved the report should specifically identify the asset class into which each asset is placed and the basis for such placement. Each asset class should be explicitly explained.

8.6 The estimation and reporting of property and asset values, and related guidance, are the scope of these International Valuation Standards, Applications, and related Guidance Notes. How the results of valuations are to be compiled, conveyed, and incorporated with the findings of other professionals is of crucial importance to Valuers. Proper understanding of terminology is essential for Valuers and those who read their reports. The sound use of experience and expertise and correct application of methodology are also essential. These Standards are intended to serve the common objectives of those who prepare property and asset valuations and those who must rely on their results.

### 9.0 Valuation Approaches

9.1 In order to estimate the price implied by the appropriate *Basis of Value*, the Valuer will need to apply one or more valuation approaches. A *valuation approach* or *method* refers to generally accepted analytical methodologies that are in common use.

9.2 Market based valuations normally employ one or more of the *valuation approaches* by applying the economic *principle of substitution*, using market-derived data. This principle holds that a prudent person would not pay more for a good or service than the cost of acquiring an equally satisfactory substitute good or service, in the absence of the complicating factors of time, greater risk, or inconvenience. The lowest cost of the best



alternative, whether a substitute or the original, tends to establish *Market Value*.

9.2.1 Market based *valuation approaches* include:

9.2.1.1 *Sales Comparison Approach*. This comparative approach considers the sales of similar or substitute properties and related market data, and establishes a value estimate by processes involving comparison. In general, a property being valued (a subject property) is compared with sales of similar properties that have been transacted in the market. Listings and offerings may also be considered.

9.2.1.2 *Income Capitalisation Approach*. This comparative approach considers income and expense data relating to the property being valued and estimates value through a capitalisation process. Capitalisation relates income (usually a net income figure) and a defined value type by converting an income amount into a value estimate. This process may consider direct relationships (known as *capitalisation rates*), *yield* or *discount rates* (reflecting measures of return on investment), or both. In general, the principle of substitution holds that the income stream which produces the highest return commensurate with a given level of risk leads to the most probable value figure.

9.2.1.3 *Cost Approach*. This comparative approach considers the possibility that, as an alternative to the purchase of a given property, one could acquire a modern equivalent asset that would provide equal utility. In a real estate context, this would involve the cost of acquiring equivalent land and constructing an equivalent new structure. Unless undue time, inconvenience, and risk are involved, the price that a buyer would pay for the asset being valued would not be more than the cost of the modern equivalent. Often the asset being valued will be less attractive than the cost of the modern equivalent because of age or obsolescence. A depreciation adjustment is required to the replacement cost to reflect this. (See GN 8, The Cost Approach for Financial Reporting-(DRC).)

9.3 Valuations developed for purposes other than establishing *Market Value* may apply similar approaches. For example:

9.3.1 An entity may apply a cost approach to compare the cost of other buildings with the cost of a proposed building to the entity, thereby ascertaining the bargain or premium accruing a particular property at variance with the market at large. This application focuses on a particular property and what may be a non-market cost.

9.3.2 An owner of land may pay a premium price for adjacent property. In applying a sales comparison approach to determine a maximum price that owner is willing to pay for adjacent land, a Valuer arrives at a figure that may well exceed its *Market Value*. Such an estimate is called *Special Value*.

9.3.3 An investor may apply a rate of return that is non-market and particular only to that investor. In applying an income capitalisation approach to determine the price that investor is willing to pay for a particular investment based on the investor's anticipated rate of return, a Valuer arrives at an estimate of *Investment Value* or *Worth* rather than *Market Value*.

9.4 Each valuation approach has alternative methods of application. The Valuer's expertise and training, local standards, market requirements, and available data combine to determine which method or methods are applied. The reason for having alternative approaches and methods is to provide the Valuer with a series of analytical procedures which will ultimately be weighed and reconciled into a final value estimate, depending upon the particular type of value involved.

9.5 Valuation approaches and methods are generally common to virtually all types of valuation, including real property, personal property, businesses, and financial interests. However, valuation of different types of property involves different sources of data that appropriately reflect the market in which the property (and/or service or business) is to be valued. For example, individual buildings are commonly sold and valued in the relevant real estate market whereas the values of the shares of stock in a property company that owns a number of buildings are reflected by pricing in the relevant shares market.

### 10.0 Summary

- 10.1 The International Valuation Standards are intended to facilitate cross-border transactions involving property and contribute to the viability of global markets by promoting transparency in financial reporting. Emphasis is placed on the use of factual market information from which informed professional judgements regarding property valuations can be drawn.

## 3.5

# PROPERTY TYPES

## 1.0 Introduction

Real property represents a considerable portion of the world's wealth, and its valuation is fundamental to the viability of global property and financial markets. Real property has to be distinguished from other categories of property, namely personal property, businesses, and financial interests. Without further qualification or identification, the word *property* may refer to all or any of these categories. Because Valuers often encounter assignments involving property types other than real property or properties whose value includes several property categories, an understanding of each property type and its distinguishing characteristics is essential. While the customary division of property into four discrete categories has long been recognised, new entities and instruments have proliferated over recent decades. The accepted frame of reference has readily accommodated these new classes of property and familiarity with specialised property types and interests is becoming ever more integral to valuation practice. The International Valuation Standards Committee recognises the following four property types: real property, personal property, businesses, and financial interests.

## 2.0 Real Property

- 2.1 *Real property* is an interest in real estate. This interest is normally recorded in a formal document, such as a title deed or lease. Therefore, property is a legal concept distinct from real estate, which represents a physical asset. Real property encompasses all the rights, interests, and benefits related to the ownership of real estate. In contrast, real estate encompasses the land itself, all things naturally occurring on the land, and all things attached to the land, such as buildings and site improvements.
- 2.1.1 The term *realty* is sometimes used to distinguish either real property or real estate from items of personal property, which in certain States are legally referred to as *personalty*.
- 2.2 The combination of all the rights associated with the ownership of real property is sometimes referred to as the *bundle of rights*. These can include the right to use, to occupy, to enter, to sell, to lease, to bequeath, to give away, or to choose to exercise any or none of the above-mentioned. In many situations, specific rights may be separated

from the bundle and transferred, leased, or alienated by the State.

- 2.2.1 Rights or interests in real property derive from *legal estates*. Legal estates are defined by the laws of the State in which they exist. Legal estates are usually subject to outside limitations imposed by the State, such as taxation (assessments/ ratings), compulsory acquisition (eminent domain/ compulsory purchase/condemnation), regulation (police power/planning/zoning), or appropriation by government in cases of intestacy (escheat/ bona vacantia).
- 2.2.2 Absolute ownership subject only to limitations imposed by the State is known as a *fee simple estate*, or *freehold*.
- 2.2.3 Leases are contractual arrangements, which create other estates in real property. Under a lease, the landlord, or lessor, maintains the ownership interest, known in some States as the leased fee estate, with the right of use and occupancy being conveyed or granted to a tenant. The interest which the tenant, or lessee, acquires under the lease, known in some States as the *leasehold estate*, is the right of use and occupancy for a stated term under certain conditions.
- 2.2.3.1 **Subleaseholds** are created when the tenant or lessee in a prior lease conveys to a third party, a sublessee, the interest that the tenant, or lessee, enjoys, i.e., the right to use and occupy the property.
- 2.2.3.2 A Valuer analyses whether any terms or conditions in a lease may affect property value.
- 2.2.4 Besides restrictions by the State, other lawful limitations may be imposed upon the rights inherent in the ownership of real property.
- 2.2.4.1 *Deed restrictions* and *restrictive covenants*, which run with the land, may affect the use, development, and conveyance of ownership.
- 2.2.4.2 *Easements* are nonpossessory (incorporeal) interests in landed property conveying use, but not ownership, of a portion of that property. Rights-of-way are rights or privileges, acquired through use or contract, to pass over a portion

## PROPERTY TYPES

- or strip of landed property owned by another.
- 2.2.5 Other important ownership and financial interests may be associated with real property.
- 2.2.5.1 *Partial or fractional interests* in real property rights are created by legal divisions of the ownership interest. For example, real property is not only owned in sole proprietorships. It may also be held by corporations (shareholders), partnerships, joint tenancies, and tenancies in common.
- 2.2.5.2 Trusts create another type of interest in real property rights. The interest of a beneficiary under a trust is known as the *equitable or equity interest* as opposed to the legal interest of the trustee(s). (A beneficiary is said to hold equitable title while legal title is held by the trustee[s].)
- 2.2.5.3 *Security or financial interests* are created by mortgage pledges where the property is used as collateral to secure finance or a charge is taken over the property. An owners' equity position in the property is considered a separate financial interest.
- 2.3 Real property, in the terminology of accounting, usually falls into the category of fixed, or long-term, assets. Sometimes, real property may be considered a current asset, e.g., where land or improved real estate is held in inventory for sale.
- 2.3.1 The asset is the interest held in the real estate, i.e., the asset is the real property.
- 2.3.2 It is the ownership of the asset that is valued rather than the real estate as a physical entity.
- 2.3.3 Where the ownership of an asset is purchased and sold in a marketplace, market participants ascribe specific values to ownership of particular interests in real estate. These values ascribed by market participants form the objective basis for estimating the *Market Value* of real property.
- 2.4 Valuation of real property is undertaken for a variety of reasons, which include the following categories: financial reporting, transactions involving transfers of ownership, loans and mortgages to be secured by property, litigation, tax matters, and counseling or investment decision making. With the exception of the last category, *Market Value* is the value basis in all the following groupings:
- 2.4.1 Valuations of fixed assets prepared for financial statements and related accounts to reflect the effect of changing prices or current values;
- 2.4.2 Valuations to assist a prospective buyer in setting an offering, to assist a prospective seller in establishing an acceptable asking price, or to help both parties in determining the sale price for a proposed transaction; valuations to establish the basis for reorganising or merging the ownership of multiple properties;
- 2.4.3 Valuations required to estimate the value of collateral property offered for a proposed mortgage loan or to establish a basis for insuring or underwriting a loan on the property;
- 2.4.4 Valuations performed in compulsory acquisition (eminent domain/ condemnation proceedings), in litigation or arbitration involving disputes over contracts and partial interests, and settlements of damages caused by environmental accidents or violations;
- 2.4.5 Valuations required to estimate assessed value/ rating; to separate assets into depreciable and non-depreciable items and, thereby estimate applicable depreciation; or to determine gift or inheritance taxes;
- 2.4.6 Valuations and ancillary assignments performed for a broad spectrum of clients, e.g., investors, insurers, claims adjusters, auctioneers or liquidators, and zoning boards (on the probable effects of planning proposals) as well as for a diversity of purposes, e.g., market or feasibility analyses, cost/benefit analyses, determination of book value for new stock issues (or revisions thereof), and the setting of prospective rent schedules and lease provisions.
- 2.5 In any valuation of real property, the relevant characteristics of the property must be identified. Property characteristics include:
- 2.5.1 the location, the physical and legal description, and the economic or income-producing attributes;
- 2.5.2 the real property interest (fee simple/freehold, leased fee, leasehold, subleasehold) to be valued;
- 2.5.3 any personal property, trade fixtures, or intangible items that are not real property but that are included in the valuation (see Para. 3.2 below);
- 2.5.4 any known easements, restrictions, encumbrances, leases, covenants, or special assessments/ratings on the property or other items of similar nature; and

- 2.5.5 whether the subject property is a partial or fractional interest or a physical segment of a larger land parcel.

**AUSNZ 2.5.6**

**Refer ANZVGN 7, The Valuation of Partial Interests in Property Held Within Co-Ownership Structures.**

- 2.6 The valuation of real property may be influenced by special considerations, such as:
  - 2.6.1 A requirement to analyse the merger of estates (*Synergistic Value*) or the separation of property interests (*Component Value*);
  - 2.6.2 The effects of likely zoning changes and infrastructure development, e.g., the extension of public utility systems or access corridors;
  - 2.6.3 Depressed markets characterised by weak demand, oversupply, and few sale transactions, where estimates of *Market Value* may be difficult to support on the basis of current or historical evidence. In such circumstances, the focus of market participants may shift to other indicators of property value or performance.

**3.0 Personal Property**

- 3.1 *Personal property* refers to ownership of an interest in items other than real estate. These items can be tangible, such as a chattel, or intangible, such as a debt or patent. Tangible personal property represents interests in items that are not permanently attached or affixed to real estate and are generally characterised by their moveability. In some States, items of personal property are legally recognised as *personalty* in distinction to *realty* (see Property Types, para. 2.1.1).
- 3.2 Examples of personal property includes interests in:
  - 3.2.1 Identifiable, portable, and tangible objects considered by the general public to be personal, e.g., furnishings, collectibles, and appliances. Ownership of the current assets of a business, trade inventories, and supplies is considered to be personal property.
    - 3.2.1.2 In some States, the above are referred to as *goods and chattels personal*.
  - 3.2.2 Non-realty fixtures, also called *trade fixtures* or *tenant's fixtures* (*fixtures and fittings*), are attached to the property by the tenant and used in conducting the trade or business. *Leasehold improvements*, or *tenant's improvements*, are

fixed improvements or additions to the land or buildings, installed and paid for by the tenant to meet the tenant's needs. Trade or tenant's fixtures are removable by the tenant upon expiration of the lease. Their removal causes no serious damage to the real estate. Leasehold or tenant's improvements are finishings or fittings, such as partitions and outlets constructed on site. The useful life of tenant's improvements may be shorter or longer than the term of the lease. If longer than the lease term, the tenant may be entitled to compensation reflecting the extent to which the leasehold improvements have increased the value of the rented premises.

- 3.2.2.1 By extension, the above category may include specialised, non-permanent buildings, machinery and equipment..
- 3.2.2.2 In some States, the term *Furniture, Fixtures, and Equipment* (FF&Es) comprises both of the categories described in para. 3.2.1 and 3.2.2.

- 3.2.3 Net working capital and securities, or net current assets, are the sum of liquid assets less short-term liabilities. Net working capital may include cash, marketable securities, and liquid supplies less current liabilities such as accounts payable and short-term loans.
- 3.2.4 *Intangible assets* are interests held in intangible entities. Examples of intangible property interests include the right to recover a debt and the right to profit from an idea. It is the right, i.e., to recover or to profit, as distinct from the intangible entity itself, i.e., the debt or the idea, which is the property and to which value is ascribed.
- 3.3 A valuation that includes both personal property and real property must identify the personal property and consider its effects on the value estimate given.
  - 3.3.1 Valuations of personal property may be an element of a larger assignment. The definition of value by which the personal property is valued must be consistent with the purpose of the property valuation, whether that purpose is to sell, to renovate, or to demolish the property. Personal property may be valued according to its *Market Value* under various assumptions, e.g., that the personal property is included among the assets of a hotel that was sold as a going concern, or that the personal property was among the assets of a hotel, which went out of business, and consequently were to be liquidated or sold for salvage. (See IVS 2, para. 6.9.)

## PROPERTY TYPES

- 3.3.2 A Valuer must be able to distinguish personal property from real property and on occasion may be required to exclude it, e.g., in assignments undertaken for government-related functions such as taxation or compulsory acquisition.
- 3.3.3 In a valuation of business assets, the Valuer must consider whether such assets are to be valued as part of a going concern or as separate assets.
- 3.4 A Valuer should be familiar with local custom regarding whether an item is considered personal property or real property. In certain circumstances, a securely affixed item, nominally treated as personal property, may revert to real property upon termination of occupancy, especially if its removal and relocation would result in costly damage to the item itself or the building in which it is located.
- 3.5 The techniques used in the three valuation approaches may be applied to the valuation of personal property. (See GN 5, Valuation of Personal Property.)
  - 3.5.1 If a Valuer finds that personal property included in the property subject to valuation is either superior or inferior to that typically found in comparable properties, the Valuer should make allowance for the differing contributory value of the personal property.
  - 3.5.2 In certain assignments, a Valuer may have to determine the degree of physical deterioration, functional obsolescence, and external obsolescence afflicting items of personal property. Such a determination will also consider the remaining economic life of the building(s) with which the related personal property is associated.

## 4.0 Businesses

- 4.1 A *business* is any commercial, industrial, service or investment entity pursuing an economic activity. Businesses are generally profit-making entities operating to provide consumers with products or services. Closely related to the concept of business entity are the terms *operating company*, which is a business that performs an economic activity by making, selling, or trading a product or service, and *going concern*, which is an entity normally viewed as continuing in operation in the foreseeable future with neither the intention nor necessity of liquidation or of curtailing materially the scale of its operations.
- 4.2 Business entities are constituted as legal entities. A business may be unincorporated or incorporated.
  - 4.2.1 Examples of unincorporated entities include sole proprietorships, joint ventures, and general and limited partnerships.
  - 4.2.2 Examples of incorporated entities include closely-held corporations, or close companies, and publicly-held corporations, or public companies whose stock is available to and held by the public.
  - 4.2.3 Other legal forms of business entities include *trust arrangements* whereby control is vested in either individual trustees or corporate trustees, and *multiple entities* combining parent and associate or subsidiary corporations, partnership interests, and trusteeships.
  - 4.3 Business entities cut across an extremely broad range of economic activities, encompassing both private and public sectors. Business activities include *manufacturing, wholesaling, retailing, lodging, health care, and financial, legal, educational and social services*, among others. Business entities established to provide infrastructure services to the public, i.e., public utilities, are in many States set up as corporations controlled but not owned by the government.
    - 4.3.1 *Investment businesses or holding companies*, which maintain the controlling interest in subsidiary companies by virtue of ownership of stock in those companies, include property and agricultural businesses, among others.
    - 4.3.2 Properties such as hotels; fuel stations; restaurants; and movie theatres, or cinemas, variously called *properties associated with a business entity, properties with trading potential, trade related properties or operational entities*, are valued at *Market Value*, but their *Market Value* includes value components constituting land, buildings, personal property, intangible assets, and the business itself. Because these properties are commonly sold in the market as an operating package, separate identification of land, building, and other values may be difficult, so additional care should be taken to identify the property components included in the valuation. (See GN 12, Valuation of Trade Related Property.)
  - 4.4 Under the terminology of accounting, both tangible and intangible assets are included among the assets of a business entity:
    - 4.4.1 Tangible assets include current assets, and long-term assets such as realty, fixtures, equipment, and tangible personal property.
    - 4.4.2 Intangible assets, which are considered intangible personal property, include management skill,



marketing know-how, credit rating, an assembled work force, an operational plant, goodwill, and ownership of various legal rights and instruments (e.g., patents, copyrights, franchises, and contracts).

- 4.4.2.1 Goodwill may include two distinct components: goodwill that is property-specific, or inherent within the property and transferable to a new owner on sale of the property, and personal goodwill that is associated with the proprietor or manager.
- 4.5 The valuation of businesses (see the Guidance Note on Business Valuation, GN 6, para. 5.0) is undertaken for a variety of purposes including:
  - 4.5.1 the acquisition and disposition of an individual business, a business merger, or the estimation of the value of the capital stock owned by the shareholders in the business.
  - 4.5.2 Business valuations are often used as a basis for allocating and reflecting the *Value in Use* of the various assets of a business. Business valuations may also provide the basis for estimating the extent of obsolescence of specified fixed assets of a business.
- 4.6 Business valuations may be based on the *Market Value* of the business entity. The *Market Value* of a business is not necessarily equivalent to the *Value in Use* of the business. Valuations done for financial reporting are generally required to report *Fair Value*, which may or may not be equivalent to *Market Value*. In such situations, a Valuer should indicate whether the value satisfies or does not satisfy both *Market Value* and *Fair Value* definitions (see Concepts Fundamental to Generally Accepted Valuation Principles, para. 8.1). Valuations of going concerns (defined in Property Types, para. 4.1) are generally based on *Value in Use*. For financial reporting purposes, *Value in Use* has a specific meaning under International Accounting Standard 36, Impairment of Assets, which distinguishes the term from its common usage in valuation practice.
- 4.7 A Valuer must clearly define the business (e.g., operating company, holding company, trading company), business ownership interest, or security (e.g., closely held or publicly held company stock, and investment trust shares) being valued.
- 4.7.1 An ownership interest may be undivided, divided among shareholders, and/or involve a majority interest and minority interest.

- 4.7.2 A Valuer must consider the rights, privileges and conditions that attach to the ownership interest, whether held in corporate form, partnership form, or as a proprietorship.
- 4.8 Business valuations employ three approaches to value. Valuers commonly reconcile the indications derived from two or more of these approaches and associated methods. (See the Guidance Note on Business Valuation, GN 6, para. 5.14.)

## 5.0 Financial Interests

- 5.1 Financial interests in property result from the legal division of ownership interests in businesses and real property (e.g., partnerships, syndications, corporations, cotenancies, joint ventures), from the contractual grant of an optional right to buy or sell property (e.g., realty, stocks, or other financial instruments) at a stated price within a specified period, or from the creation of investment instruments secured by pooled real estate assets.
  - 5.1.1 Ownership interests may be legally divided to create partnerships, in which two or more persons jointly own a business or property and share in its profits and losses.
    - 5.1.1.1 A *general partnership* is an ownership arrangement in which all partners share in investment gains and losses and each is fully responsible for all liabilities.
    - 5.1.1.2 A *limited partnership* is an ownership arrangement consisting of general and limited partners; the general partners manage the business and assume full liability for partnership debt while the limited partners are passive and liable only to the extent of their own capital contributions.
  - 5.1.2 Other legal entities related to partnerships are syndications and joint ventures.
    - 5.1.2.1 A *syndication* is often organised by a general partner. Investors in the syndication become limited partners. A syndication pools funds for the acquisition and development of real estate projects or other business ventures.
    - 5.1.2.2 A *joint venture* is a combination of two or more entities that join to undertake a specific project. A joint venture differs from a partnership in that it is limited in duration and project-specific.

## PROPERTY TYPES

- 5.1.3 An *option* is an agreement to keep open an offer to buy, sell, or lease real property for a specified period and at a stated price. An option creates a contractual right, the exercise of which is generally contingent upon the fulfillment of specified conditions. The holder may or may not ultimately choose to exercise the option. In this respect, an option differs from a contract to buy or sell a property. Purchase options may also be written into leases. *Purchase options* often contain the provision that certain parts of all rents paid may be applied to the purchase price.
- 5.1.4 Real estate investment through the ownership of *securities*, or instruments securing both debt and equity positions, represents an alternative to the direct ownership of property. Investors are able to own and trade shares of an interest in a property or pool of properties in the same way they would buy and sell shares of corporate stock.
- 5.1.4.1 The market for such securities includes both a private, or institutional, sector (partnerships, corporations, pension/ superannuation funds, and insurance companies) and a public sector (individual investors who trade in a securities market).
- 5.1.4.2 Securitised investment instruments include real estate investment trusts (REITs) (property investment or unit trusts), collateralised mortgage obligations (CMOs), commercial mortgage-backed securities (CMBSs), real estate operating companies (REOCs), and separate and commingled accounts. (Such instruments are discussed in the IVSC White Paper, Valuation of Real Estate Serving as Collateral for Securitised Instruments.)
- 5.2 Financial interests are intangible assets and can include:
- 5.2.1 the rights inherent in the ownership of a business or property, i.e., to use, to occupy, to sell, to lease, or to manage;
- 5.2.2 the rights inherent within a contract granting an option to buy, or a lease containing a purchase option, i.e., to exercise or not to exercise; or
- 5.2.3 the rights inherent in ownership of a security issue (i.e., to hold or to dispose thereof).
- 5.3 Financial interests require valuation for a wide variety of reasons.
- 5.3.1 A financial interest may be included among the assets of a partner. To establish the total value of assets owned by the partner, the value of the financial interest must be determined. Or a partner may wish to sell his or her interest, or the interest may have passed into an estate subject to inheritance taxes and probate proceedings. A general partner may also purchase interests for the purpose of transferring them to a limited partnership.
- 5.3.2 Options to buy, which are often obtainable for a small amount of money, create considerable leverage, or gearing, the impact of which must be considered in the final transaction price. Lease purchase options restrict the marketability of the leased property, and may limit the *Market Value* of the leased property and/or leasehold interest.
- 5.3.3 Valuations of securitised investment instruments are done for purposes of underwriting and rating the securities prior to initial public offerings.
- 5.4 International Accounting Standard, IAS 32, Financial Instruments: Disclosures and Presentation, para. 11, defines *financial asset*, *financial liability*, *financial instrument*, and *equity instrument*; IAS 32, para. 28, defines *compound (financial) instrument*. Under IAS 32, para. 86, an entity shall disclose information about *Fair Value* for each class of financial assets and financial liabilities, in a way that permits comparison with the corresponding carrying amount in the balance sheet. IAS 32, para. 92, summarises the items an entity is required to disclose.
- 5.4.1 A *financial asset* is any asset that is a) cash; b) an equity instrument of another entity; c) a contractual right: (i) to receive cash or another financial asset from another entity; or (ii) to exchange financial instruments with another entity under conditions that are potentially favorable; or d) a contract that will or may be settled in the entity's own equity instruments and is: (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.
- 5.4.1.1 Common examples of financial assets representing a contractual right to receive cash in the future are a) trade accounts receivable and payable; b)



notes receivable and payable; c) loans receivable and payable; and d) bonds receivable and payable.

5.4.2 A *financial liability* is any liability that is: (a) a contractual obligation (i) to deliver cash or another financial asset to another entity; or (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or (b) a contract that will or may be settled in the entity's own equity instruments and is: (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments. (An entity may have a contractual obligation that it can settle by delivery of cash or another financial asset, exchange of financial assets and liabilities, or by payment in the form of its own equity instruments, either non-derivative or derivative.)

5.4.2.1 Common examples of financial liabilities representing a contractual obligation to deliver cash in the future are a) trade accounts receivable and payable; b) notes receivable and payable; c) loans receivable and payable; and d) bonds receivable and payable.

5.4.3 A *financial instrument* is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. Financial instruments range from traditional primary instruments such as bonds to various forms of derivative financial instruments:

5.4.3.1 Derivative financial instruments give one party a contractual right to exchange financial assets with another party under conditions that are potentially favorable, or a contractual obligation to exchange financial assets with another party under conditions that are potentially unfavorable. However, they generally do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a transfer necessarily take place on maturity of the contract. (IAS 32, AG 16)

5.4.3.2 Derivative financial instruments create rights and obligations, effectively transferring between the parties to the instrument one or more of the financial risks inherent in an underlying financial instrument. (IAS 32, AG 16)

5.4.3.3 Many other types of derivative financial instruments embody a right or obligation to make a future exchange, including interest rate and currency swaps, interest rate caps, collars and floors, loan commitments, note issuance facilities, and letters of credit. (IAS 32, AG 19)

5.4.3.4 A *finance lease* is regarded as a financial instrument but an operating lease is not regarded as a financial instrument (IAS 32, AG 9).

5.4.4 An *equity instrument* is any contract that evidences a residual interest in the assets of an entity after deducting all its liabilities.

5.4.4.1 Examples of equity instruments include non-puttable ordinary shares, some types of preference shares, and warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary shares in the issuing entity in exchange for a fixed amount of cash or another financial asset (IAS 32, AG 13).

5.4.4.2 A purchased call option or other similar contract acquired by an entity that gives it the right to reacquire a fixed number of its own equity instruments in exchange for delivering a fixed amount of cash or another financial asset is not a financial asset of the entity (IAS 32, AG 14).

5.4.5 A *compound (financial) instrument* is a financial instrument that, from the issuer's perspective, contains both a liability and an equity element.

5.5 The value of the assemblage of all the various financial interests in a property may be larger or smaller than simply the sum of the individual interests in that property.

5.5.1 The value of the 100% ownership interest (inclusive of all shareholders or partners) in income-generating properties held by partnerships or syndications will likely exceed the aggregate value of minority interests in the properties. Similarly, the value of a REIT portfolio, representing

## PROPERTY TYPES

an assemblage of various properties, is likely to differ from simply the sum of the values of all the properties that make up the portfolio, a consequence attributable to the specific assemblage of properties in the portfolio and/or the management of the portfolio.

- 5.5.2 A Valuer estimates the value of the entirety or whole interest in the property before dealing with the disaggregated or fragmented ownership interests.
- 5.5.3 In assignments involving financial interests, a Valuer must clearly identify the exact ownership interest being valued, whether it be a majority or minority ownership interest in a business or property, a contractual right, or a majority or minority ownership interest in securitised real estate investment. The Valuer must examine the contractual arrangements between parties or articles of association (articles of incorporation or articles of partnership) to verify the percentage share or stake that the financial interest in the property represents.
- 5.6 The valuation of financial interests involves highly specialised considerations. Therefore, a Valuer must adapt the valuation approach or approaches to the nature of the financial interest subject to valuation.
  - 5.6.1 All three approaches may be appropriate to the valuation of property held by general partnerships.
    - 5.6.1.1 When comparable sales are analysed in the *sales comparison approach*, the Valuer determines whether non-realty items were included in the purchase price. If non-realty items were included, they should be identified and their effect on value considered and estimated.
  - 5.6.2 In situations where a general partner has acquired interests in partnership or syndications for sale as limited partnership interests, the Valuer considers the effect of non-realty items on the transaction price. These items may include special financing, guarantees of occupancy or income, and management services.
  - 5.6.3 Options to buy are considered at the cost to the buyer when the option is exercised. Thus, the cost of an option to buy that has been exercised is to be added to the sale price of the realty. A Valuer considers the effect of leverage, or gearing, produced by a purchase option on the final transaction price for a property. When a purchase

option in a lease is exercised and past rent payments are credited to the purchase price, such payments are treated as installment payments.

- 5.6.4 Units or shares in securitised real estate investment are priced in markets where such securities are traded. Valuations of real estate assets held as part of a package of investment instruments may be required for underwriting or rating purposes prior to an initial public offering. In such situations, a Valuer applies those approaches and methods consistent with the income-generating characteristics of the real estate.

# 4.1

## INTERNATIONAL VALUATION STANDARDS 1, 2, AND 3

### INTRODUCTION

#### Developing and Communicating the Valuation

Valuations are developed on the basis of the *Market Value* of an asset or on bases other than *Market Value*. Central to all valuations are the concepts of market, price, cost and value. These concepts are relevant both to valuations based on *Market Value* and those based on non-market criteria. Of equal importance to the work of Valuers is clear communication of the results of the valuation and an understanding of how those results have been obtained. A well prepared Valuation Report fulfills these functions. It is only appropriate, therefore, that the International Valuation Standards should address each of these three fundamental aspects of valuation: IVS 1, Market Value Basis of Valuation; IVS 2, Bases Other Than Market Value; and IVS 3, Valuation Reporting.

#### Bases of Value

##### 1.0 Introduction

At the most fundamental level, value is created and sustained by the interrelationship of four factors that are associated with any product, service, or commodity. These are *utility*, *scarcity*, *desire*, and *purchasing power*.

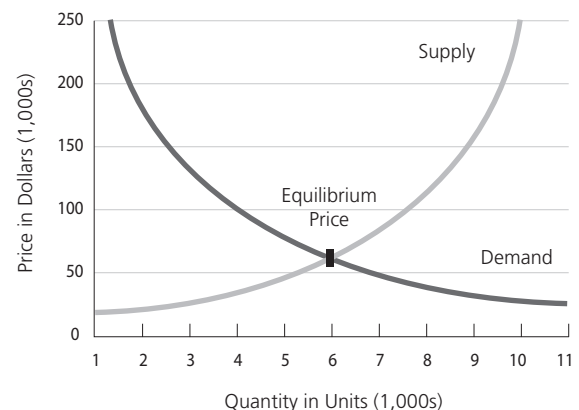
- 1.1 The working of the economic principle of supply and demand reflects the complex interaction of the four factors of value. The supply of a good or service is affected by its utility and desirability. The availability of the good or service is limited by its scarcity and effective checks on the purchasing power of likely consumers. The demand for a good or service is, likewise, created by its utility, influenced by its scarcity and desirability and restrained by limits on purchasing power.
- 1.2 The utility for which a good or service is produced and the scarcity, or limited availability, of the good or service are generally considered *supply-related* factors. Consumer preferences and purchasing power, which reflect desire for the good or service and define the affordability of the item, are generally considered *demand-related* factors.

#### 2.0 Markets

A *market* is an environment in which goods, services, and commodities are traded between buyers and sellers through a price mechanism. The concept of a market implies the ability of buyers and sellers to carry on their activities without restriction.

- 2.1 The *principle of supply and demand* states that the price of a good, service, or commodity varies inversely with the supply of the item and directly with the demand for the item.
- 2.2 In property markets, *supply* represents the quantity of property interests that are available for sale or lease at various prices in a given market within a given period of time, assuming labour and production costs remain constant.
- 2.3 *Demand* constitutes the number of possible buyers or renters seeking specific types of property interests at various prices in a given market within a given period of time, assuming other factors such as population, income, future prices, and consumer preferences remain constant.

#### Supply and Demand Curve



#### 3.0 Price, Cost, and Value

The distinctions between price, cost, and value have previously been discussed. (See section 4.0 of Concepts Fundamental to Generally Accepted Valuation Principles.)

## INTERNATIONAL VALUATION STANDARDS 1, 2, & 3

These terminological distinctions are important to the operation of markets because of the specific functional relationship each describes, i.e., price pertains to the actual exchange of the good or service; cost reflects the expense of producing the good or service; value represents the price most likely to be concluded by the buyers and sellers of a good or service that is available for purchase.

- 3.1 *Price* is a concept that relates to the exchange of a commodity, good, or service. Price is the amount that has been asked, offered, or paid for the item. Once the exchange has been transacted, the price, whether disclosed or undisclosed, becomes an historic fact. The price paid represents the intersection of supply and demand.
- 3.2 *Cost* is a production-related concept, distinct from exchange, which is defined as the amount of money required to create or produce a commodity, good, or service. Once the good is completed or the service is rendered, its cost becomes an historic fact.
- 3.3 The concept of *Value* addresses the price most likely to be concluded by the buyers and sellers of a good or service available for purchase. Value establishes the hypothetical, or notional, price that typically motivated buyers and sellers are most likely to conclude for the good or service. Thus, value is not a fact, but an estimate of the most likely price that will be paid for a good or service available for purchase at a given time.
- 3.4 A *Basis of Value* describes the nature of this hypothetical transaction, for example, whether or not it takes place in a public market and what accounts for the motivation and behaviour of the parties. It does not describe the status of the good or service involved in the transaction, for example, whether it is operational or non-operational, or whether or not it is aggregated with other assets. A *Basis of Valuation* will, therefore, usually need to be accompanied by additional assumptions in order to adequately define the valuation hypothesis adopted. Different accompanying assumptions may result in different values for the same asset, and therefore, it is vital that these be clearly understood and expressed.

### 4.0 Bases of Value

The concept of *Market Value* is tied to the collective perceptions and behaviour of market participants. It recognises diverse factors that may influence transactions in a market, and distinguishes these from other intrinsic or non-market considerations affecting value. *Market*

*Value* is market-based and therefore, all inputs should be developed from market data.

- 4.1 Market-based valuations of property assume the operation of a market in which transactions occur without restriction by non-market forces.
  - 4.1.1 Market-based valuations must determine the *highest and best use*, or most probable use, of the property asset, which is a significant determinant of its value.
  - 4.1.2 Market-based valuations are developed from data specific to the appropriate market(s) and through methods and procedures that try to reflect the deductive processes of participants in those markets.
  - 4.1.3 Market-based valuations may be performed by application of the *sales comparison*, *income capitalisation*, and *cost approaches* to value. The data and criteria employed in each of these approaches must be derived from the market.
- 4.2 Besides the hypothetical exchange value concluded by two typically motivated market participants, valuations of property may also use measurement principles that consider alternative economic utility or function(s) of an asset, value attributable to unusual or atypical motivation on the part of the parties to a transaction, or value specified by statutory or contractual law.
  - 4.2.1 Examples of bases of value other than *Market Value* are Fair Value, Investment Value, Special Value, and Synergistic Value. The additional assumptions required in applying these bases are often more specific than those required for establishing *Market Value* as they may relate to the circumstances of a particular party. For this reason, a valuation reported on one of these bases should ensure that it cannot be construed as *Market Value*.
  - 4.2.2 Valuations performed on bases other than *Market Value* must employ appropriate procedures and analyse sufficient data to produce a reasonable estimate of value.

### 5.0 Communicating the Results of the Valuation

- 5.1 The content and presentation of the Valuation Report are of critical importance to
  - 5.1.1 communicating the value conclusion to the client and user(s) of the valuation, and

## INTERNATIONAL VALUATION STANDARDS 1, 2, & 3

- 5.1.2 confirming the basis of the valuation, the purpose of the valuation, and any assumptions or limiting conditions underlying the valuation.
- 5.2 To help guide the reader through the procedures and evidence used by the Valuer in developing the valuation, the Valuation Report may also provide the analytical processes and empirical data used to arrive at the value conclusion.
- 5.3 Other essential information contained in the Valuation Report includes
  - 5.3.1 the name of the Valuer and the date as of which the value estimate applies,
  - 5.3.2 the property and property rights or interests subject to the valuation,
  - 5.3.3 the dates of the valuation and the valuation report,
  - 5.3.4 the extent of the inspection,
  - 5.3.5 the applicability of these Standards and any required disclosures.

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# MARKET VALUE BASIS OF VALUATION

*This Standard should be read in the context of the background material and implementation guidance contained in General Valuation Concepts and Principles.*

## 1.0 Introduction

- 1.1 The objective of this Standard is to provide a common definition of *Market Value*. This Standard also explains the general criteria relating to this definition and to its application in the valuation of property when the purpose and intended use of the valuation calls for estimation of *Market Value*.
- 1.2 *Market Value* is a representation of value in exchange, or the amount a property would bring if offered for sale in the (open) market at the date of valuation under circumstances that meet the requirements of the *Market Value* definition. To estimate *Market Value*, a Valuer must first determine highest and best use, or most probable use. (See International Valuation Standards [IVSs], Concepts Fundamental to Generally Accepted Valuation Principles, paras. 6.3, 6.4, 6.5.) That use may be for continuation of a property's existing use or for some alternative use. These determinations are made from market evidence.
- 1.3 *Market Value* is estimated through application of valuation methods and procedures that reflect the nature of property and the circumstances under which given property would most likely trade in the market. The most common methods used to estimate *Market Value* include the sales comparison approach, the income capitalisation approach, including discounted cash flow analysis, and the cost approach.
- 1.4 All *Market Value* measurement methods, techniques, and procedures will, if applicable and if appropriately and correctly applied, lead to a common expression of *Market Value* when based on market-derived criteria. Sales comparisons or other market comparisons should evolve from market observations. The income capitalisation approach, including discounted cash flow analysis, should be based on market-determined cash flows and market-derived rates of return. Construction costs and depreciation should be determined by

reference to an analysis of market-based estimates of costs and accumulated depreciation. Although data availability and circumstances relating to the market or the property itself will determine which valuation methods are most relevant and appropriate, the outcome of using any of the foregoing procedures must be *Market Value* if each method is based on market-derived data.

- 1.5 The manner in which property would ordinarily trade in the market distinguishes the applicability of the various methods or procedures of estimating *Market Value*. When based on market information, each method is a comparative method. In each valuation situation one or more methods are generally most representative of (open) market activities. The Valuer will consider each method in every *Market Value* engagement and will determine which methods are most appropriate.

## 2.0 Scope

- 2.1 IVS 1 applies to the *Market Value* of property, normally real estate and related elements. It requires that the property under consideration be viewed as if for sale on the market, in contrast to being evaluated for some other purpose.

## 3.0 Definitions

- 3.1 *Market Value* is defined for the purpose of these Standards as follows:

*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.*

- 3.2 The term *property* is used because the focus of these Standards is the valuation of property. Because these Standards encompass financial reporting, the term asset may be substituted for general application of the definition. Each element of the definition has its own conceptual framework:

## INTERNATIONAL VALUATION STANDARDS 1

- 3.2.1 “The estimated amount...” refers to a price expressed in terms of money (normally in the local currency), payable for the property in an arm’s-length market transaction. Market Value is measured as the most probable price reasonably obtainable in the market on the date of valuation in keeping with the Market Value definition. It is the best price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer. This estimate specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, special considerations or concessions granted by anyone associated with the sale, or any element of Special Value (defined in IVSC Standard 2, para. 3.5).
- 3.2.2 “...a property should exchange...” refers to the fact that the value of a property is an estimated amount rather than a predetermined amount or actual sale price. It is the price at which the market expects a transaction that meets all other elements of the Market Value definition should be completed on the date of valuation.
- 3.2.3 “...on the date of valuation...” requires that the estimated Market Value is time-specific as of a given date. Because markets and market conditions may change, the estimated value may be incorrect or inappropriate at another time. The valuation amount will reflect the actual market state and circumstances as of the effective valuation date, not as of either a past or future date. The definition also assumes simultaneous exchange and completion of the contract for sale without any variation in price that might otherwise be made.
- 3.2.4 “...between a willing buyer...” refers to one who is motivated, but not compelled to buy. This buyer is neither over-eager nor determined to buy at any price. This buyer is also one who purchases in accordance with the realities of the current market and with current market expectations, rather than in relation to an imaginary or hypothetical market that cannot be demonstrated or anticipated to exist. The assumed buyer would not pay a higher price than the market requires. The present property owner is included among those who constitute “the market.” A Valuer must not make unrealistic assumptions about market conditions nor assume a level of market value above that which is reasonably obtainable.
- 3.2.5 “...a willing seller...” is neither an over-eager nor a forced seller, prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in the current market. The willing seller is motivated to sell the property at market terms for the best price attainable in the (open) market after proper marketing, whatever that price may be. The factual circumstances of the actual property owner are not a part of this consideration because the ‘willing seller’ is a hypothetical owner.
- 3.2.6 “...in an arm’s-length transaction...” is one between parties who do not have a particular or special relationship (for example, parent and subsidiary companies or landlord and tenant) that may make the price level uncharacteristic of the market or inflated because of an element of *Special Value*. (See IVS 2, para. 3.8.) The *Market Value* transaction is presumed to be between unrelated parties, each acting independently.
- 3.2.7 “...after proper marketing...” means that the property would be exposed to the market in the most appropriate manner to effect its disposal at the best price reasonably obtainable in accordance with the *Market Value* definition. The length of exposure time may vary with market conditions, but must be sufficient to allow the property to be brought to the attention of an adequate number of potential purchasers. The exposure period occurs prior to the valuation date.
- 3.2.8 “...wherein the parties had each acted knowledgeably and prudently...” presumes that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the property, its actual and potential uses, and the state of the market as of the date of valuation. Each is further presumed to act for self-interest with that knowledge, and prudently to seek the best price for their respective positions in the transaction. Prudence is assessed by referring to the state of the market at the date of valuation, not with benefit of hindsight at some later date. It is not necessarily imprudent for a seller to sell property in a market with falling prices at a price that is lower than previous market levels. In such cases, as is true for other purchase and sale situations in markets with changing prices, the prudent buyer or seller will act in accordance with the best market information available at the time.
- 3.2.9 “...and without compulsion...” establishes that each party is motivated to undertake the transaction, but neither is forced or unduly coerced to complete it.



- 3.3 *Market Value* is understood as the value of an asset estimated without regard to costs of sale or purchase and without offset for any associated taxes.
- 3.4 *Highest and Best Use* (HABU). The most probable use of a property, which is physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value of the property being valued.

## 4.0 Relationship to Accounting Standards

- 4.1 Valuation for financial reporting, which is the focus of International Valuation Application 1 (IVA 1), should be read in conjunction with this standard.
  - 4.1.1 IVA 1, Valuation for Financial Reporting, provides guidance to Valuers, Accountants, and the Public regarding valuation standards affecting accountancy. The *Fair Value* of fixed assets is usually their *Market Value*. (See Concepts Fundamental to Generally Accepted valuation Principles, para. 8.1.)
- 4.2 There are numerous examples of terms used interchangeably by Valuers and Accountants. Some lead to misunderstandings and possible Standards abuses. IVS 1 defines *Market Value* and discusses criteria for establishing *Market Value*. Other important terms are defined in IVSs 1 and 2 and contribute to the more specific requirements discussed in IVA 1, Valuation for Financial Reporting.

## 5.0 Statement of Standard

To perform valuations that comply with these Standards and Generally Accepted Valuation Principles (GAVP), it is mandatory that Valuers adhere to all sections of the Code of Conduct pertaining to Ethics, Competence, Disclosure, and Reporting (sections 4, 5, 6, and 7).

- 5.1 In performing and reporting a *Market Value* estimate, the Valuer shall
  - 5.1.1 completely and understandably set forth the valuation in a manner that will not be misleading;
  - 5.1.2 ensure that the estimate of *Market Value* is based on market-derived data;
  - 5.1.3 ensure that the estimate of *Market Value* is undertaken using appropriate methods and techniques;

- 5.1.4 provide sufficient information to permit those who read and rely on the report to fully understand its data, reasoning, analyses, and conclusions; and
- 5.1.5 comply with the requirements of IVS 3 in reporting the valuation. Accordingly, the Valuer shall
  - 5.1.5.1 define the value being estimated and state the purpose and intended use of the valuation, the effective date of valuation, and the date of the report;
  - 5.1.5.2 clearly identify and describe the property and property rights or interests being valued;
  - 5.1.5.3 describe the scope/extent of the work undertaken and the extent to which the property was inspected;
  - 5.1.5.4 state any assumptions and limiting conditions upon which the valuation is based;
  - 5.1.5.5 fully and completely explain the valuation bases/approaches applied and the reasons for their applications and conclusions; and
  - 5.1.5.6 include a signed Compliance Statement attesting to the Valuer's objectivity, professional contributions, non-bias, non-contingency of professional fees or other compensation, as well as Standards' applicability, and other disclosures.

## 6.0 Discussion

- 6.1 The *Market Value* concept and definition are fundamental to all valuation practice. A brief summary of essential economic and procedural foundations is presented in Concepts Fundamental to Generally Accepted Valuation Principles and Code of Conduct, the documents upon which these Standards are predicated.
- 6.2 The concept of *Market Value* is not dependent on an actual transaction taking place on the date of valuation. Rather, *Market Value* is an estimate of the price that should be realised in a sale at the valuation date under conditions of the *Market Value* definition. *Market Value* is a representation of the price to which a buyer and seller would agree at that time under the *Market Value*

## INTERNATIONAL VALUATION STANDARDS 1

definition, each previously having had time for investigation of other market opportunities and alternatives, and notwithstanding the fact that it may take some time to prepare formal contracts and related closing documentation.

- 6.3 The concept of *Market Value* presumes a price negotiated in an open and competitive market, a circumstance that occasionally gives rise to the use of the adjective *open* before the words *Market Value*. The words *open* and *competitive* have no absolute meaning. The market for one property could be an international market or a local market. The market could consist of numerous buyers and sellers, or could be one characterised by a limited number of participants. The market in which the property is exposed for sale is not a definitionally restrictive or constricted market. Stated conversely, the omission of the word *open* does not indicate that a transaction would be private or closed.
- 6.4 Market valuations are generally based on information regarding comparable properties. The Valuation Process requires a Valuer to conduct adequate and relevant research, to perform competent analyses, and to draw informed and supportable judgements. In this process, Valuers do not accept data without question but should consider all pertinent market evidence, trends, comparable transactions, and other information. Where market data are limited, or essentially non-existent (as for example with certain specialised properties), the Valuer must make proper disclosure of the situation and must state whether the estimate is in any way limited by the inadequacy of data. All valuations require exercise of a Valuer's judgment, but reports should disclose whether the Valuer bases the *Market Value* estimate on market evidence, or whether the estimate is more heavily based upon the Valuer's judgement because of the nature of the property and lack of comparable market data.
- 6.5 Because changing conditions are characteristic of markets, Valuers must consider whether available data reflect and meet the criteria for *Market Value*.
- 6.5.1 Periods of rapid changes in market condition are typified by rapidly changing prices, a condition commonly referred to as disequilibrium. A period of *disequilibrium* may continue over a period of years and can constitute the current and expected future market condition. In other circumstances, rapid economic change may give rise to erratic market data. If some sales are out of line with the market, the Valuer will generally give them less weight. It may still be possible for the Valuer to judge from available data where the realistic level of the market is. Individual transaction prices may not be evidence of *Market Value*, but analysis of such market data should be taken into consideration in the Valuation Process.
- 6.5.2 In poor or falling markets there may or may not be a large number of "willing sellers." Some, but not necessarily all, transactions may involve elements of financial (or other) duress or conditions that reduce or eliminate the practical willingness of certain owners to sell. Valuers must take into account all pertinent factors in such market conditions and attach such weight to individual transactions that they believe proper to reflect the market. Liquidators and receivers are normally under a duty to obtain the best price in asset disposals. Sales, however, may take place without proper marketing or a reasonable marketing period. The Valuer must judge such transactions to determine the degree to which they meet the requirements of the *Market Value* definition and the weight that such data should be given.
- 6.5.3 During periods of market transition characterised by rapidly rising or falling prices, there is a risk of over- or under-valuation if undue weight is given to historic information or if unwarranted assumptions are made regarding future markets. In these circumstances Valuers must carefully analyse and reflect the actions and attitudes of the market and take care that they fully disclose the results of their investigations and findings in their reports.
- 6.6 The concept of *Market Value* also presumes that in a market value transaction a property will be freely and adequately exposed on the (open) market for a reasonable period of time and with reasonable publicity. This exposure is presumed to occur prior to the effective date of value. Markets for fixed assets typically differ from those available for stocks/shares, bonds, and other current assets. Fixed assets tend to be unique. They are usually sold less frequently and in markets which are less formal and more inefficient than, for example, markets for listed securities. Further, fixed assets are less liquid. For these reasons, and because fixed assets do not commonly trade on a public exchange, the application of the concept of *Market Value* requires the use of assumptions such as adequate market exposure over a reasonable time period to allow for proper marketing, and completion of negotiations.
- 6.7 Revenue producing properties held as long-term investments by a property company, pension (or superannuation fund), property trust, or similar

type of owner are typically valued on the basis of individual asset disposal pursuant to an orderly plan. The aggregate value of such assets viewed or treated as a portfolio or as an assembled group of properties could exceed or could be less than the sum of the *Market Value* of each asset individually.

- 6.8 All valuations should refer to the purpose and intended use of the valuation. In addition to other reporting requirements, the Valuer should make it abundantly clear into which class each asset has been placed if the function of the valuation is related to the preparation of financial statements.
- 6.9 In exceptional circumstances *Market Value* may be expressed as a negative amount. Situations include certain leasehold properties, some specialised properties, obsolete properties with demolition costs exceeding land value, some properties affected by environmental contamination, and others.

## 7.0 Disclosure Requirements

- 7.1 Valuation Reports must not be misleading. Valuations conducted for the purpose of estimating and reporting *Market Value* shall meet the requirements of section 5 above. Reports shall contain a specific reference to the definition of *Market Value* as set forth in this Standard, together with specific reference as to how the property has been viewed in terms of its utility or its *highest and best use* (or most probable use) and a statement of all substantive assumptions.
- 7.2 In making *Market Value* estimates the Valuer shall clearly identify the effective date of valuation (the date at which the value estimate applies), the purpose and intended use of the valuation, and such other criteria as are relevant and appropriate to ensure adequate and reasonable interpretation of the Valuer's findings, opinions, and conclusions.
- 7.3 Although the concept, use, and application of alternative expressions of value may be appropriate in certain circumstances, the Valuer shall ensure that if such alternative values are estimated and reported, they should not be construed as representing *Market Value*.
- 7.4 When valuations are made by an Internal Valuer, i.e., one who is in the employ of either the entity that owns the assets or the

accounting firm responsible for preparing the entity's financial records and/or reports, there shall be a specific disclosure in the Valuation Report or Certificate of the existence and nature of any such relationships.

## 8.0 Departure Provisions

- 8.1 In following this Standard any departures must be in accordance with directions provided in IVS 3, Valuation Reporting.

## 9.0 Effective Date

- 9.1 This International Valuation Standard became effective 31 July 2007.

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# BASES OTHER THAN MARKET VALUE

## REVISED 2007

*This Standard should be read in the context of the background material and implementation guidance contained in General Accepted Valuation Principles.*

### 1.0 Introduction

- 1.1 The objectives of International Valuation Standard 2 (IVS 2) are to identify, explain and distinguish bases of value other than *Market Value* and to establish standards for their application.
- 1.2 *Market Value* is the most appropriate basis of value for a wide range of applications. However, alternative valuation bases may be appropriate in specific circumstances. It is essential that both the Valuer and users of valuations clearly understand the distinction between *Market Value* and these other bases of valuation and the effects (if any) that differences between bases may have on the applicability of the valuation.
- 1.3 The concept of *Market Value* is based on specific, identified assumptions that are set out in IVS 1. Other bases of valuation require the application of different assumptions, which if not clearly identified, may result in misinterpretation of the valuation.

### 2.0 Scope

- 2.1 This Standard defines and discusses the application of valuation bases other than *Market Value* for purposes other than financial reporting.

### 3.0 Definitions

#### International Valuation Standards Definitions

- 3.1 *Basis of Value*. A statement of the fundamental measurement principles of a valuation on a specified date.
- 3.2 *Fair Value*. The amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's-length transaction.
- 3.3 *Investment Value, or Worth*. The value of property to a particular investor, or a class of investors, for

identified investment or operational objectives. This subjective concept relates specific property to a specific investor, group of investors, or entity with identifiable investment objectives and/or criteria.

- 3.4 *Special Purchaser*. A purchaser to whom a particular asset has *Special Value* because of advantages arising from its ownership that would not be available to general purchasers in the market.
- 3.5 *Special Value*. An amount above the *Market Value* that reflects particular attributes of an asset that are only of value to a *Special Purchaser*.
- 3.6 *Synergistic Value*.<sup>1</sup> An additional element of value created by the combination of two or more interests where the value of the combined interest is worth more than the sum of the original interests.

### 4.0 Relationship to Accounting Standards

- 4.1 For most purposes, valuations under International Financial Reporting Standards require the use of fair value. This is a specific application of *Fair Value* that may require more restrictive assumptions than are required in general use. International Valuation Application 1, Valuation for Financial Reporting, discusses the specific valuation requirements under accounting standards.

### 5.0 Statement of Standard

To perform valuations that comply with these Standards and Generally Accepted Valuation Principles (GAVP), it is mandatory that Valuers adhere to all sections of the Code of Conduct pertaining to Ethics, Competence, Disclosure and Reporting (sections 4, 5, 6, and 7).

- 5.1 When carrying out a valuation under this standard the Valuer shall ensure that:

<sup>1</sup> Synergistic Value may also be known as Marriage Value.

## INTERNATIONAL VALUATION STANDARDS 2

- 5.1.1 the estimate of value is based on data and circumstances appropriate to the valuation;
- 5.1.2 the estimate of value is undertaken using appropriate methods and techniques;
- 5.1.3 the valuation is developed on the basis of sufficient information to support the analyses and conclusions therein.
- 5.2 In reporting an estimate of value under this standard the Valuer shall
  - 5.2.1 comply with all the requirements of International Valuation Standard 3, Valuation Reporting. In particular, the Valuer shall report the valuation in a manner that will not be misleading (IVS 3, 5.1.1)
  - 5.2.2 define the basis or bases of value used and state the purpose and intended use of the valuation, the effective date of valuation, and the date of the report (IVS 3, 5.1.2 and 5.1.3);
  - 5.2.3 clearly identify and describe the property and property rights and interests valued and the scope of work undertaken to develop the valuation conclusion (IVS 3, 5.1.4 and 5.1.5);
  - 5.2.4 specify all assumptions and limiting conditions upon which the valuation is based (IVS 3, 5.1.6 and 5.1.7);
  - 5.2.5 clearly distinguish the assumptions that are different from or additional to those underlying an estimate of *Market Value*;
  - 5.2.6 fully explain the valuation approaches and procedures that have been applied and the reasoning that supports the analyses, opinions and conclusions in the report (IVS 3, 5.1.8);
  - 5.2.7 include a statement that the valuation has been performed in accordance with IVSs, disclose any departure from the specific requirements of the IVSs and provide an explanation for such departure. (IVS 3, 5.1.10)

### 6.0 Discussion

- 6.1 *A Basis of Valuation* describes the fundamental measurement principles of a valuation. These principles may vary depending on the purpose of the valuation. *A Basis of Valuation* is not a statement of the method used, nor a description of the state of an asset or assets when exchanged. *Market Value* is the most commonly required basis and is defined and discussed in IVS 1. This Standard defines and discusses other valuation bases. These fall into three principal categories:

- 6.1.1 The first category reflects the benefits that an entity enjoys from ownership of an asset. The value is specific to that entity. Although under some circumstances, it may be the same as the amount that could be realised from sale of the asset, this value essentially reflects the benefits received by holding the asset, and therefore does not necessarily involve a hypothetical exchange. *Investment Value*, or *Worth*, fall into this category. Differences between the value of an asset to a particular entity and the *Market Value* provide the motivation for buyers or sellers to enter the market place.
- 6.1.2 The second category represents the price that would be reasonably agreed between two specific parties for the exchange of an asset. Although the parties may be unconnected and negotiating at arm's length, the asset is not necessarily exposed in the wider market and the price agreed may be one that reflects the specific advantages (or disadvantages) of ownership to the parties involved rather than the market at large. This category includes *Fair Value*, *Special Value* and *Synergistic Value*.
- 6.1.3 The third category is value determined in accordance with a definition set out in a statute or a contract.
- 6.2 The application of *Fair Value* under accounting standards is discussed in IVA 1. In accounting standards, *Fair Value* is normally equated to *Market Value*.
- 6.3 For other purposes, *Fair Value* can be distinguished from *Market Value*. *Fair Value* requires the assessment of the price that is fair between two specific parties taking into account the respective advantages or disadvantages that each will gain from the transaction.
- 6.4 *Fair Value* is a broader concept than *Market Value*. Although in many cases the price that is fair between two parties will equate to that obtainable in the general market, there will be cases where the assessment of *Fair Value* will involve taking into account matters that have to be disregarded in the assessment of *Market Value*.
- 6.5 A common application of *Fair Value* is for assessing the price that is fair for the shareholding in a business, where particular synergies between two specific parties may mean that the price that is fair between them is different from the price that might be obtainable in the wider market. In contrast, *Market Value* requires any element

- of *Special Value*, of which *Synergistic Value* is an example, to be disregarded.
- 6.6 *Special Value* can arise where an asset has attributes that make it more attractive to a particular buyer, or to a limited category of buyers, than to the general body of buyers in a market. These attributes can include the physical, geographic, economic or legal characteristics of an asset. *Market Value* requires the disregard of any element of *Special Value* because at any given date it is only assumed that there is a willing buyer, not a particular willing buyer.
- 6.7 *Synergistic Value* can be a type of *Special Value* that specifically arises from the combination of two or more assets to create a new asset that has a higher value than the sum of the individual assets.
- 6.8 When *Special Value* is reported, it should always be clearly distinguished from *Market Value*.
- 6.9 A *Basis of Valuation* should not be confused with assumptions that may also be required to clarify the application of the basis to a specific situation. Some terms that are often used to describe a valuation are not distinct bases of value as they describe the state of the asset or the circumstances under which it is assumed to be exchanged, rather than the underlying measurement objective. The value may be measured on one of the bases defined in section 3, or on the basis of *Market Value*, see IVS 1. Examples of such terms that are in common use include:
- 6.9.1 *Going Concern Value*: This describes a situation where an entire business is transferred as an operational entity. Alternative valuation scenarios to a going concern could include a transfer of all the assets as a whole but following the closure of the business, or a transfer of specific assets currently used in the business as individual items.
- 6.9.2 *Liquidation Value*: This describes a situation where a group of assets employed together in a business are offered for sale separately, usually following a closure of the business. Although often associated with a forced sale (see 6.11 below), these terms have distinct meanings. There is no reason why assets cannot be liquidated by an orderly sale following proper marketing.
- 6.9.3 *Salvage Value*: This describes the value of an asset that has reached the end of its economic life for the purpose it was made. The asset may still have value for an alternative use or for recycling.
- 6.10 Terms such as those in 6.9 should not be used without further qualification. Used alone, they are insufficient as a reporting basis. By way of illustration, a business that is a going concern may have one value to a specific party (*Investment Value*), another value between two specific parties reflecting business synergies (*Fair Value*), and yet another value in the market (*Market Value*). It is therefore necessary to state the underlying valuation basis by the use of expressions such as "*Market Value* as a going concern", "*Market Value* for the liquidation of the assets" or "*Fair Value* as a going concern."
- 6.11 The term "forced sale" is often used in circumstances where a seller is under compulsion to sell and/or a proper marketing period is not available. The price obtainable in these circumstances will not meet the definition of *Market Value*. The price that could be obtained in these circumstances will depend upon the nature of the pressure on the seller or the reasons why proper marketing cannot be undertaken. It may also reflect the consequences for the seller of failing to sell within a specified period. Unless the nature of, and reason for, the constraints on the vendor are known, the price obtainable in a forced sale cannot realistically be predicted. The price that a seller will accept in a forced sale will reflect its particular circumstances rather than those of the hypothetical willing seller in the *Market Value* definition. The price obtainable in a forced sale will bear only a coincidental relationship to *Market Value*, or any of the other bases defined in this standard. It is not a *Basis of Valuation* as the forced sale is a description of the situation under which the transfer takes place, not a distinct measurement objective.
- 6.12 The third category of valuation bases comprises those set by statute, regulation or contract. Statutory bases are often prescribed for taxation purposes. Examples of private contracts, prescribing valuation definitions and assumptions, include criteria for setting the price payable under an option or for reviewing the payments made under a lease. The detailed interpretation of both statutory and contract provisions are often subject to precedent, established by court decisions. Although many of the bases defined by statute and contract may appear similar to bases defined in these standards, unless unequivocal reference is made to these standards, their detailed application may require an approach different from that required by these Standards. Further discussion of statutory or contractual valuation bases is outside the scope of International Standards.



## **INTERNATIONAL VALUATION STANDARDS 2**

- 6.13 All valuations will involve different assumptions, which must be clearly identified by the Valuer and reported with the valuation. In some situations, it may be appropriate to provide alternative valuations based on alternative assumptions to illustrate the effect of these assumptions.

### **7.0 Disclosure Requirements**

- 7.1 Valuation Reports must not be misleading. All valuations shall meet the requirements of section 5 above. The Code of Conduct requires that the purpose and intended use of any valuation be clearly reported, and that full disclosure be made of the basis for the valuation estimate, its applicability, and its limitations.
- 7.2 If a valuation by an Internal Valuer is made, there shall be a specific disclosure in the Valuation Report of the existence and nature of any such relationship. (IVS 3, 7.1).
- 7.3 If a Valuer is involved in a valuation assignment in a capacity other than as a Valuer, for example, as an independent or impartial agent, as a consultant or advisor to a business entity, or as a mediator, the Valuer should disclose the specific role taken in each assignment. (IVS 3, 7.2)
- 7.4 The Valuer shall disclose the regulatory framework and any departure required from these Standards to comply with local legislation, regulation (including accounting rules), or custom. (IVS 3, 7.3)

### **8.0 Departure Provisions**

- 8.1 In following this Standard any departures must be in accordance with directions provided in IVS 3, Valuation Reporting.

### **9.0 Effective Date**

- 9.1 This International Valuation Standard became effective 31 July 2007.



# VALUATION REPORTING

## REVISED 2007

### 1.0 Introduction

- 1.1 The critical importance of a Valuation Report, the final step in the valuation process, lies in communicating the value conclusion and confirming the basis of the valuation, the purpose of the valuation, and any assumptions or limiting conditions underlying the valuation. The analytical processes and empirical data used to arrive at the value conclusion may also be included in the Valuation Report to guide the reader through the procedures and evidence that the Valuer used to develop the valuation.
- 1.2 The Valuation Report indicates the value conclusion. It contains the name of the Valuer and the date of the valuation. It identifies the property and property rights subject to the valuation, the basis of the valuation, and the intended use of the valuation. It discloses all underlying assumptions and limiting conditions, specifies the dates of valuation and reporting, describes the extent of the inspection, refers to the applicability of these Standards and any required disclosures, and includes the Valuer's signature.
- 1.3 Because of the key role of the Valuation Report in communicating the conclusion of a valuation to users and third-party readers, this Standard sets forth the following as its principal objectives:
  - 1.3.1 To discuss reporting requirements consistent with professional best practice
  - 1.3.2 To identify essential elements to be included in Valuation Reports

### 2.0 Scope

- 2.1 The reporting requirements addressed in this Standard apply to all types of Valuation Reports.
- 2.2 Compliance with these reporting requirements is incumbent upon both Internal and External Valuers.
- 2.3 Some instructions involving valuations undertaken for specific purposes and property types, e.g., financial reporting, and lending, may differ from those given for other assignments. The

reader is advised to consult those sections of the International Valuation Standards (IVSs) that address these situations, i.e., International Valuation Applications 1 and 2 (IVA 1 and IVA 2).

### 3.0 Definitions

- 3.1 *Compliance Statement.* An affirmative statement attesting to the fact that the Valuer has followed the ethical and professional requirements of the IVSC Code of Conduct in performing the assignment.
- 3.2 *Oral Report.* The results of a valuation, verbally communicated to a client or presented before a court either as expert testimony or by means of deposition. A report communicated orally to a client must be supported by a work file and at a minimum followed up by a written summary of the valuation.
- 3.3 *Special, unusual, or extraordinary assumptions.* Before completing the acquisition of a property, a prudent purchaser in the market typically exercises due diligence by making customary enquiries about the property. It is normal for a Valuer to make *assumptions* as to the most likely outcome of this due diligence process and to rely on actual information regarding such matters as provided by the client. *Special, unusual, or extraordinary assumptions* may be any additional assumptions relating to matters covered in the due diligence process, or may relate to other issues, such as the identity of the purchaser, the physical state of the property, the presence of environmental pollutants (e.g., ground water contamination), or the ability to redevelop the property. (See para. 5.1.7 below.)
- 3.4 *Specifications for the Valuation Assignment.* The first step in the Valuation Process, which establishes the context and scope/extent of the assignment and resolves any ambiguity involving the valuation issue or problem. A Valuer ensures that the analyses, information and conclusions presented in the report fit the specifications for the assignment. The *specifications for the value assignment* include the following seven elements:

## INTERNATIONAL VALUATION STANDARDS 3

- 3.4.1 An identification of the real, personal (plant and machinery; furniture, fixtures, and equipment), business or other property subject to the valuation and other classes of property included in the valuation besides the primary property category;
- 3.4.2 An identification of the property rights (sole proprietorship, partnership, or partial interest) to be valued;
- 3.4.3 The intended use of the valuation and any related limitation; and the identification of any subcontractors or agents and their contribution;
- 3.4.4 A definition of the basis or type of value sought;
- 3.4.5 The date as of which the value estimate applies and the date of the intended report;
- 3.4.6 An identification of the scope/extent of the valuation and of the report. and
- 3.4.7 An identification of any contingent and limiting conditions upon which the valuation is based
- 3.5 *Valuation Report.* A document that records the instructions for the assignment, the basis and purpose of the valuation, and the results of the analysis that led to the opinion of value. A Valuation Report may also explain the analytical processes undertaken in carrying out the valuation, and present meaningful information used in the analysis. Valuation Reports can be either oral or written. The type, content and length of a report vary according to the intended user, legal requirements, the property type, and the nature and complexity of the assignment.
- 3.6 *Written Report.* The results of a valuation communicated to a client in writing, which includes electronic communication. Written reports may be detailed narrative documents containing all pertinent materials examined and analyses performed to arrive at a value conclusion or abbreviated pertinent narrative documents, including periodic updates of value, forms used by governmental and other agencies, or letters to clients.

### AUSNZ 3.6.1

**Refer to Business Focus 2, Reports, Content and Compilation.**

## 4.0 Relationship to Accounting Standards

- 4.1 Where applicable, the Valuation Report shall meet or exceed the requirements of the International Financial Reporting Standards (IFRSs)/International Accounting Standards (IASs) and International Public Sector Accounting Standards (IPSASs).
- 4.2 Valuation for Financial Reporting, which is the focus of IVA 1, should be read in conjunction with this Standard.

## 5.0 Statement of Standard

To perform valuations that comply with these Standards and Generally Accepted Valuation Principles (GAAP), it is mandatory that Valuers adhere to all sections of the IVSC Code of Conduct pertaining to Ethics, Competence, Disclosure, and Reporting (sections 4, 5, 6, and 7).

- 5.1 Each Valuation Report shall
  - 5.1.1 clearly and accurately set forth the conclusions of the valuation in a manner that is not misleading;
  - 5.1.2 identify the client, the intended use of the valuation, and relevant dates:
    - 5.1.2.1 the date as of which the value estimate applies,
    - 5.1.2.2 the date of the report, and
    - 5.1.2.3 the date of the inspection;

**AUSNZ 5.1.2.4 Date of Valuation**

All valuations undertaken by Members must be assessed as at the date of inspection of the property except where the valuation instructions are to assess the value at a retrospective date.

When a retrospective valuation is reported, the date of the valuation must be recorded next to or immediately above or below the valuation figure in the report.

In all other cases the valuation date must be clearly linked to the valuation figure in the report.

A Member must not provide an assessment of Market Value at a future date. This does not preclude members from making residual value forecasts for plant & equipment leasing transactions.

When a valuation is required for financial reporting purposes at a future date, the valuation shall be recorded as at the date of inspection and the valuer may make comment on the use of that valuation as at that future date subject to the relevant factors influencing the value and the property being unchanged as at that future date.

In these circumstances, a Member shall include an appropriate qualification to the valuation.

- 5.1.3 specify the basis of the valuation, including type and definition of value;
  - 5.1.3.1 When any component of the valuation is valued on more than one basis of value, a clear distinction must be made between the bases.
- 5.1.4 identify and describe the
  - 5.1.4.1 property rights or interests to be valued,
  - 5.1.4.2 physical and legal characteristics of the property, and
  - 5.1.4.3 classes of property included in the valuation other than the primary property category;
- 5.1.5 describe the scope/extent of the work used to develop the valuation;
- 5.1.6 specify all assumptions and limiting conditions upon which the value conclusion is contingent;
- 5.1.7 identify special, unusual, or extraordinary assumptions and address the probability that such conditions will occur;
- 5.1.8 include a description of the information and data examined, the market analysis performed, the valuation approaches and procedures followed, and the reasoning that supports the analyses, opinions, and conclusions in the report;
- 5.1.9 contain a clause specifically prohibiting the publication of the report in whole or in part, or any reference thereto, or to the valuation figures contained therein, or to the names and professional affiliation of the Valuers, without the written approval of the Valuer;
- 5.1.10 include a Compliance Statement that the valuation has been performed in accordance with IVSs, disclose any departure from the specific requirements of the IVSs and provide an explanation for such departure in accordance with the IVSs Code of Conduct;
- 5.1.11 include the name, professional qualifications, and signature of the Valuer.
- 5.2 When Valuation Reports are transmitted electronically, a Valuer shall take reasonable steps to protect the integrity of the data/text in the report and to ensure that no errors occur in transmission. Software should provide for security of transmission.
  - 5.2.1 The origin, date and time of the sending as well as the destination, date and time of receipt should be identified. Software should allow confirmation that the quantity of data/text transmitted corresponds to that received and should render the report as 'read-only' to all except the author.
  - 5.2.2 The Valuer should ensure that the digital signature(s) is/are protected and fully under the Valuer's control by means of passwords (PIN numbers), hardware devices (secure cards), or other means. A signature affixed to a report electronically is considered as authentic and carries the same level of responsibility as a written signature on a paper copy report.
  - 5.2.3 A true electronic and/or paper copy of an electronically transmitted report must be retained by the Valuer for the period required by law in his or her jurisdiction, in any event not less than five years. Files of the records of electronically transmitted reports may be kept on electronic, magnetic, or other media.
- 5.3 The presentation of a Valuation Report is decided by the Valuer and the client based

## INTERNATIONAL VALUATION STANDARDS 3

on the instructions or specifications for the assignment.

- 5.4 The type, content, and length of a report depend on the intended user of the report, legal requirements, property type, and the nature and complexity of the valuation issue or problem.
- 5.5 For all Valuation Reports, sufficient documentation must be retained in the work file to support the results and conclusions of the valuation and must be held for a period of at least five years after completion.

### AUSNZ 5.6 Value as if Complete

#### 5.6.1 Proposed Improvements

Where a Member undertakes a valuation of a proposed building or other improvement the valuation must be expressed as “Value As If Complete” and appropriate cautions, including the requirement for a final inspection by the valuer on completion to confirm or vary the valuation figure, shall be included.

The “Value As If Complete” valuation must be the market value at the date of inspection.

#### 5.6.2 Documentation

A Member shall not undertake a valuation on an “As If Complete” basis without appropriate and sufficient documentation.

#### 5.6.3 Proposed Lease(s)

Where a Member undertakes a valuation of a property on the assumption of a proposed lease (or multiple leases), the valuation must be subject to appropriate cautions, including the requirement for finalisation and execution of the lease(s)

in accordance with the original proposed lease(s).

### AUSNZ 5.7 Sale in One Line or Single Transaction

Where a valuation is undertaken of multiple properties in one development the sum of the individual values must not be reported as the value of the development, but if aggregated must be reported as the total gross realisation.

A Sale In One Line valuation must be based on the assumption of a single transaction for the total holding or a sale in one line to one buyer.

### AUSNZ 5.8 Goods and Services Tax

In Australia a valuation shall be expressed as being GST inclusive, GST exclusive or GST free.

In New Zealand non-residential valuations shall be stated as plus GST (if any) and residential valuations shall be stated as including GST (if any). Any exceptions to the standard treatment of GST shall be clearly stated.

## 6.0 Discussion

- 6.1 The context in which a valuation figure is reported is as important as the basis and accuracy of the figure itself. The value conclusion should make reference to the market evidence, and procedures and reasoning that support that conclusion.
- 6.2 Communicating the answer to the valuation question in a consistent and logical manner demands a methodical approach that enables the user to understand the processes followed and their relevance to the conclusion.
- 6.3 The report should convey to the reader a clear understanding of the opinions being expressed by the Valuer and also be readable and intelligible to someone with no prior knowledge of the property.
- 6.4 The report should demonstrate clarity, transparency, and consistency of approach.
- 6.5 The Valuer should exercise caution before permitting the valuation to be used other than for the originally agreed purpose.

## 7.0 Disclosure Requirements

- 7.1 When valuations are made by an Internal Valuer, specific disclosure shall be made in the Valuation Report of the existence and nature of the relationship between the Valuer and entity controlling the asset.
- 7.2 If a Valuer is involved in a valuation assignment in a capacity other than as a Valuer, for example, as an independent or impartial agent, as a consultant or advisor to a business entity, or as a mediator, the Valuer should disclose the specific role taken in each assignment.
- 7.3 The Valuer shall disclose the regulatory framework and any departure required from these Standards to comply with local legislation, regulation (including accounting rules), or custom.

## 8.0 Departure Provisions

- 8.1 No departure is permissible from the requirements that each Valuation Report clearly and accurately set forth the conclusions of the valuation, and clearly disclose any assumptions and limiting conditions, which affect the valuation and value conclusion.
- 8.2 If a Valuer is asked to perform an assignment that departs from these requirements or calls for something less than, or different from, the work normally performed in compliance with the IVSs and the IVSC Code of Conduct, the Valuer should accept and perform such services only when the following conditions can be met:
  - 8.2.1 The Valuer determines that the instructions will not tend to mislead the intended users.
  - 8.2.2 The Valuer determines that the valuation is not so limited that the results are no longer reliable and credible for the intended purpose and use of the valuation.
  - 8.2.3 The Valuer advises the client that the instructions for the assignment involve a departure from the Standards that must be disclosed in full in the Valuation Report.
- 8.3 In any circumstances involving a departure from the reporting of *Market Value*, the Valuer should clearly identify that the valuation reported is other than *Market Value*.

## 9.0 Effective Date

- 9.1 This International Valuation Standard became effective 31 July 2007.

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# VALUATION FOR FINANCIAL REPORTING

Material for this Application is drawn from International Financial Reporting Standards (IFRSs) published by the International Accounting Standards Board (IASB). IFRSs comprise individually numbered standards. Those originally published before 2004 are denoted IASs (International Accounting Standards) 1-41. Those published subsequently are prefixed as IFRSs. Extracts from IFRSs are reproduced in this publication of the International Valuation Standards (IVSs) with the permission of IASB.

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## 1.0 Introduction

- 1.1 The objective of this Application is to explain the principles that apply to valuations prepared for use in financial statements and related accounts of business entities. Valuers undertaking work of this nature should have an understanding of the accounting concepts and principles underlying the relevant International Accounting Standards.
- 1.2 The Valuer's adherence to market-based definitions, objectivity, and full disclosure of relevant matters within a pertinent and user-friendly format are fundamental to the requirements of valuation for financial reporting.

## 2.0 Scope

- 2.1 This Application applies to all valuations of asset classes included in any financial statement, which fall within the skills and expertise of Valuers.
- 2.2 IVSs facilitate cross-border transactions and the viability of global markets through harmonisation and transparency in financial reporting. As such this Application is developed in the context of

International Financial Reporting Standards (IFRSs) as at 31 March 2004.

- 2.3 IFRSs adopt two models for the recognition of property assets in the balance sheet: a cost model, and a fair value model. Where the fair value model is applied, a current revaluation of the asset is required, and this Application focuses on these particular circumstances where Market Values are to be reported.
- 2.4 Legislative, regulatory, accounting, or jurisprudence requirements may oblige modification of this Application in some countries or under certain conditions. Any departure due to such circumstances must be referred to and clearly explained in the Valuation Report.

## 3.0 Definitions

### International Valuation Standards Definitions

- 3.1 *Depreciated Replacement Cost.* The current cost of replacing an asset with its modern equivalent asset less deductions for physical deterioration and all relevant forms of obsolescence and optimisation.
- 3.2 *Improvements.* Buildings, structures or modifications to land, of a permanent nature, involving expenditures of labour and capital, and intended to enhance the value or utility of the property. Improvements have differing patterns of use and economic lives.
- 3.3 *Market Value.* The estimated amount for which a property should exchange on the date of valuation between a willing buyer and willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion (IVS 1, para. 3.1).
- 3.4 *Specialised Property.* A property that is rarely if ever sold in the market, except by way of sale of the business or entity of which it is part, due to uniqueness arising from its specialised nature and design, its configuration, size, location, or otherwise.



# INTERNATIONAL VALUATION APPLICATION 1

## International Financial Reporting Standards Definitions

- 3.5 *Carrying Amount.* The amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon (IAS 36, para. 6).
- 3.6 *Cash-Generating Unit.* The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets (IAS 36, para. 6)
- 3.7 *Depreciable Amount.* The cost of an asset, or other amount substituted for cost (in the financial statements), less its residual value (IAS 16, para. 6).
- 3.8 *Depreciation.* The systematic allocation of the depreciable amount of an asset over its useful life (IAS 16, para. 6; IAS 36, para. 6)
- 3.9 *Economic Life.* Either
- the period over which an asset is expected to be economically usable by one or more users; or
  - the number of production or similar units expected to be obtained from the asset by one or more users (IAS 17, para. 4).
- 3.10 *Fair Value.* The amount for which an asset could be exchanged or a liability settled between knowledgeable willing parties in an arm's length transaction (IAS 16, para. 6).
- 3.11 *Fair Value Less Costs to Sell.* The amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal (IAS 36, para. 6).
- 3.12 *Impairment Loss.* The amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount (IAS 36, para. 6).
- 3.13 *Investment Property.* Property (land or building, or part of a building, or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation, or both, rather than for:
- use in the production or supply of goods or services or for administrative purposes, or
  - sale in the ordinary course of business (IAS 40, para. 5).
- 3.14 *Net Realisable Value.* The estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale (IAS 2, para. 6). Net realisable value refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business. Fair value reflects the amount for which the same inventory could be exchanged between knowledgeable and willing buyers and sellers in the market place. The former is an entity-specific value; the latter is not. Net realisable value for inventories may not equal fair value less costs to sell (IAS 2, para. 7).
- 3.15 *Owner-Occupied Property.* Property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes (IAS 40, para. 5).
- 3.16 *Property, Plant and Equipment.* Tangible items that
- are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
  - are expected to be used during more than one period. (IAS 16, para 6)
- 3.17 *Recoverable Amount.* The recoverable amount of an asset or cash-generating unit is the higher of its fair value less costs to sell and its value in use. (IAS 36, para 6)
- 3.18 *Residual Value.* The estimated amount that an entity would currently obtain from disposal of an asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life (IAS 16, para. 6)
- 3.19 *Revalued amount.* The fair value of an asset at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses (IAS 16, para. 31).
- 3.20 *Useful Life.* Either
- the period over which an asset is expected to be available for use by an entity; or
  - the number of production or similar units expected to be obtained from the asset by an entity (IAS 16, para. 6; IAS 36, para. 6; IAS 38, para. 8).

In regard to leases, useful life is defined as:

The estimated remaining period, from the commencement of the lease term, without limitation by the lease term, over which the economic benefits embodied in the asset are expected to be consumed by the entity (IAS 17, para. 4).



- 3.21 *Value in Use*. The present value of the future cash flows expected to be derived from an asset or cash-generating unit (IAS 36, para. 6).

## NZ 3.22

### NZ IAS16 Public Benefit Entities

**These are reporting entities whose primary objective is to provide goods and services for community or social benefit and where any equity has been provided with a view of supporting that primary objective rather than for a financial return (NZ-IAS16, NZ6.1).**

## 4.0 Relationship to Accounting Standards

- 4.1 This Application applies the principles developed in IVS 1, IVS 2, and IVS 3 to the requirements of IASs/IFRSs.
- 4.2 This Application focuses on valuation requirements under IAS 16, *Property Plant and Equipment*; IAS 17, *Leases*; and IAS 40, *Investment Property*. Reference is also made to valuation requirements under IAS 36, *Impairment of Assets*; IAS 2, *Inventories*; and IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*.
- 4.3 IASB is currently undertaking fundamental reviews of both the measurement of assets and liabilities in financial statements and of lease accounting. Although this Application has been updated to reflect the revisions made to various standards in 2003 as part of the IASB "Improvements Project", further changes may be necessary as a result of these continuing review projects.

### AUSNZ 4.4 Application of Australian and New Zealand Accounting Standards.

**A Member, when undertaking a valuation for financial reporting purposes must have regard to the provisions of the relevant Australian and New Zealand accounting standards.**

These include in Australia:-

**AASB 116 – Property Plant and Equipment;**

**AASB 117 – Leases;**

**AASB 136 – Impairment of Assets;**

**AASB 140 – Investment Property;**

**AASB 141 – Agriculture;**

**AASB 3 – Business Combinations; and**

**AASB 5 – Non Current Assets Held For Sale and Discontinued Operations;**

and in New Zealand:-

**FRS 3 – Accounting for Property, Plant and Equipment (applicable to 2007);**

**NZ IAS 16 – Property Plant and Equipment. Operative/mandatory for accounting periods on or after 1 January 2007, but optional until then. This Standard is based on IAS 16 with 3 major points of difference affecting valuers, the qualification to the assessment of Land Value, how that impacts on DRC, and the inclusion of Public Sector Public Benefit Entities (There is significant further guidance that has been incorporated into NZ IAS 16 for Public Benefit Entities).**

**ICANZ SSAP-17 – Accounting for Investment Property and Properties Intended for Sale; (applicable to 2007)**

**ICANZ NZIAS-40 – Investment Property Operative/mandatory for accounting periods on or after 1 January 2007, but optional until then**

**NZ IFRS 5 – Non-Current Assets Held for Sale and Discontinued Operations. Operative/mandatory for accounting periods on or after 1 January 2007, but optional until then.**

# INTERNATIONAL VALUATION APPLICATION 1

## 5.0 Application

To perform valuations that comply with this Application and Generally Accepted Valuation Principles (GAVP), it is essential that Valuers adhere to all sections of the IVS Code of Conduct pertaining to Ethics, Competence, Disclosure, and Reporting (sections 4, 5, 6, and 7)

- 5.1 *Classification of Assets.* Valuers shall obtain from the directors of the owning entity a list of assets to be valued, designating them as operational assets, i.e., assets requisite to the operations of the entity, or non-operational assets, being properties held for future development, investment, or assets surplus to the operations of the entity.
- 5.2 *Applicable Standards.* The classification of assets determines which IAS or IFRS applies. IAS 16 requires non-current property and plant assets held for the production or supply of goods or services to be recognised initially in the balance sheet at cost and thereafter carried in accordance with either the cost model or fair value model described in 5.3. Other accounting standards that require or permit the valuation of tangible assets include:
- Investment Property – IAS 40
  - Leases – IAS 17
  - Impairment of Assets – IAS 36
  - Inventories – IAS 2
  - Business Combinations – IFRS 3
  - Non current Assets Held for Sale and Discontinued Operations – IFRS 5

### AUSNZ 5.2.1

**For application in Australia International Equivalents to the International Accounting Standards (IFRSs) apply. However, in New Zealand local accounting standards apply until 2007.**

**Where they vary from the International practice in assessment requirements for fair value, the difference shall be identified and explained.**

### 5.3 IAS 16, Cost and Fair Value

- 5.3.1 IAS 16 deals with the cost model in paragraph 30 as follows:

“After recognition as an asset, an item of property, plant and equipment shall be carried

at its cost less any accumulated depreciation and any accumulated impairment losses.”

### NZ 5.3.1.1

**IAS 15.1 “In respect of Public Benefit Entities, notwithstanding ...where an asset is acquired at no cost, or for a nominal cost, the cost is its fair value as at the date of acquisition....”**

- 5.3.2 The fair value model, which requires regular revaluations, is explained in paragraph 31 as follows:

“After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.”

- 5.3.3 Fair value is not necessarily synonymous with *Market Value*. It is used throughout IFRSs in differing contexts.
- 5.3.4 Financial statements are produced on the assumption that the entity is a going concern unless management either intends to liquidate the entity or cease trading, or has no realistic alternative but to do so. (IAS 1, para 23). This assumption therefore underlies the application of fair value to property plant and equipment, except in cases where it is clear that there is either an intention to dispose of a particular asset or that option of disposal has to be considered, e.g. when undertaking an impairment review.

### 5.4 Valuations under IAS 16.

Where an entity adopts the fair value revaluation option under IAS 16, the assets are included in the balance sheet at their fair value as follows:

- a) “The fair value of land and buildings is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers. The fair value of items of plant and equipment is usually their market

value determined by appraisal" (IAS 16, para. 32).

- b) "If there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment and the item is rarely sold, except as a part of a continuing business, an entity may need to estimate fair value using an income or a depreciated replacement cost approach" (IAS 16, para. 33).

## NZ IAS 33.1

**"For Public Benefit Entities, depreciated replacement cost is a method of valuation based on an estimate of:**

- a) in the case of property:
- i) the fair value of land; plus
  - ii) the gross current replacement costs of improvements less allowances for physical deterioration, and optimisation for obsolescence and relevant surplus capacity; and;
- b) in the case of plant and equipment, the current gross replacement cost less allowances for physical deterioration, and optimisation for obsolescence and relevant surplus capacity."

- 5.4.1 IVSC considers that a professional Valuer undertaking an appraisal for this purpose should report the *Market Value* of the asset. Any assumptions or qualifications made in applying *Market Value* should be discussed with the entity and disclosed in the report.
- 5.4.2 The valuation conclusion shall be reported in accordance with IVS 3, Valuation Reporting. Valuers shall ensure that reports include sufficient information for the entity to meet the requirements of IAS 16, para. 77, when preparing financial statements:
- a) the effective date of the revaluation;
  - b) whether an Independent Valuer was involved (Note, IVSC interprets this as an *External Valuer*);
  - c) the methods and significant assumptions applied;
  - d) the extent to which the values were determined directly by reference to

observable prices in an active market or recent market transactions on arm's length terms, or were estimated using other valuation techniques

## 5.5 *Valuations under IAS 40 - Investment Property.*

Where an entity opts to account for investment property using the fair value model, IVSC considers that the requirements of this model are met by the Valuer adopting *Market Value*. Further guidance on Investment Property is provided at para. 6.7.

- 5.5.1 IAS 40, para. 75, requires amongst others the following disclosures, which the Valuer should include in the Report in addition to the requirements of IVS 3

- a) the methods and significant assumptions applied in determining the fair value of investment property, including a statement whether the determination of fair value was supported by market evidence or was more heavily based on other factors (which the entity should disclose) because of the nature of the property and lack of comparable market data; and
- b) the extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an Independent Valuer (IVSC interprets this as an *External Valuer*), who holds a recognised and relevant professional qualification and who has recent experience in the location and category of the investment property being valued.

## 5.6 *Valuation Requirements for Leased Assets – IAS 17*

- 5.6.1 Leased assets are classified under IAS 17 as either finance leases or operating leases (see para. 6.6.1 below and Addendum A). If a lease is classified as a finance lease, the fair value of the asset is required to establish the amount of the asset and liability recorded by the entity on its balance sheet, IAS 17, para 20.
- 5.6.2 For leases of land and buildings special rules apply, which are described in para. 6.6.3. For all property, other than investment property,

## INTERNATIONAL VALUATION APPLICATION 1

land and buildings have to be considered separately for classification as either a finance lease or an operating lease.

5.6.3 IAS 40 allows Investment Property held by a lessee to be accounted for as a finance lease under IAS 17, subject to further special rules. Firstly, no allocation is made between the land and buildings. Secondly, the fair value is recognized as the value subject to the lessee's future liabilities under the lease.

5.6.4 IVSC considers that in each case the requirement to establish the fair value of the leased asset under IAS 17, para 20, is met by the Valuer reporting the *Market Value*. For leases of real estate, this is the *Market Value* of the lease interest held by the lessee. For leases of other assets, it is normally the *Market Value* of the asset unencumbered by the lease, as the liability is recorded separately.

### 5.7 *Valuation of Impaired Assets – IAS 36*

5.7.1 Impairment arises where there is a permanent decrease in the value of an asset below its carrying amount. The entity is required to write down the carrying amount of an impaired asset to the higher of its *value in use* or *fair value less costs to sell*. The requirements are discussed further at para. 6.8.2.

### 5.8 *Valuations after Business Combinations – IFRS 3*

5.8.1 Where a business acquires or is merged with another, the acquirer has to account for the assets and liabilities of the acquiree at their fair value as of the acquisition date. For identifiable assets and liabilities, IVSC considers that the Valuer should report the *Market Value* as they existed at the date of acquisition.

### 5.9 *Surplus Assets – IFRS 5*

5.9.1 Under IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations*, surplus assets are to be separately identified. Such assets may be accounted for individually or as a "disposal group", i.e., a group of assets to be disposed of together, by sale or otherwise, and the liabilities directly associated with those assets that will also be transferred in the transaction. Surplus assets are to be initially accounted for at the lower of the carrying

amount and the fair value less costs to sell, and subsequently at fair value less cost to sell. Valuers should therefore ascertain whether surplus assets are to be valued as individual items, or as a group or portfolio of assets that will be disposed of in a single transaction, and report the *Market Value* with the appropriate assumptions.

### 5.10 *Properties Held for Sale in the Ordinary Course of Business – IAS 2*

5.10.1 Valuations of properties held for sale in the ordinary course of business should comply with the requirements of IAS 2, *Inventories*. These properties are measured at the lower of cost and *net realisable value*. Net realisable value is the *Market Value* less the costs of sale.

### 5.11 *Selling Costs*

5.11.1 When instructed to value impaired or surplus assets, or assets that are held for sale in the course of business, the Valuer must report their *Market Value* without deducting selling costs. If the client requests the Valuer to advise on the costs to sell the assets, such costs are to be reported separately.

### 5.12 *Biological Assets – IAS 41*

5.12.1 These include Agricultural and Forestry assets. The Valuer should value these assets in accordance with the guidance in GN 10.

5.13 *Co-operation with Auditors*. Subject to first obtaining the consent of their client, Valuers shall discuss and explain their valuations openly with the entity's auditors.

## 6.0 Discussion

### 6.1 Identification of Asset Class

Separate disclosures are required for each class of property, plant and equipment. IAS 16, para. 73, requires that financial statements shall disclose for each class the measurement basis used for determining the gross carrying amount, the depreciation method used, and the useful lives or the depreciation rates used. A class of property, plant or equipment is a grouping of assets of a similar nature and use. The following are examples of separate classes (IAS 16, para. 37):

- a) land;
- b) land and buildings;

- c) machinery;
- d) ships;
- e) aircraft;
- f) motor vehicles;
- g) furniture and fixtures;
- h) office equipment

When an item is revalued, the entire class to which it belongs should be revalued in order to avoid both selective revaluations and the reporting of a mix of costs and fair values as at different dates. An asset class for this purpose is a grouping of assets of a similar nature and use in an entity's operation

#### AUS 6.1.1

**AASB 116 (para 36) requires that the entire class of Property Plant & Equipment to which an asset belongs shall be revalued.**

## 6.2 Depreciation – IAS 16

- 6.2.1 IAS 16, paras. 43–62, sets out the requirements for an entity to account for the depreciation of property, plant and machinery assets. Valuers may be requested to allocate value between different elements of an asset, to advise on the residual value or to advise on the future life of an asset.
- 6.2.2 *Elements of cost.* Any part of an item, which has a cost that is significant in relation to the total cost of the item, has to be depreciated separately. Where parts have a similar useful life and will depreciate at a similar rate, they may be grouped in determining the depreciation charge. Valuers may be consequently requested to allocate a valuation they have provided to the different component parts of an asset in order to enable the entity to depreciate them separately.
- 6.2.3 *Residual Value.* The residual value is deducted from the carrying amount of the asset to determine the amount the entity has to depreciate. If the management policy of the entity involves disposal after a specific time, the useful life of an asset may be less than its economic life. IAS 16, para. 58, recognises that land normally has an unlimited useful life and therefore should be accounted for separately. It also provides that an increase in the value of land should not affect the determination of the depreciable amount of the building.

#### AUS 6.2.3.1

**AASB 116 This is a direction to the entity and not to the valuer, however, the valuer may be able to assist the entity in this process.**

- 6.2.4 *Future life.* A Valuer can advise on the remaining economic life of the asset. When reporting the economic life of buildings, improvements, plant and equipment, it should be stated that this is not necessarily the same as the useful life to the entity, which is subject to any policy of the entity on future disposal or renewal.
- 6.2.5 *Reporting requirements.* When providing allocations, or estimating the residual value of an element of an asset based on an apportionment of the value of the complete asset, the Valuer should state that the figures provided are hypothetical allocations of the value of the whole item prepared solely for calculating the appropriate rate of depreciation in the entity's financial statements, and that these figures should not be relied upon for any other purpose.

## 6.3 Alternative Use Value

If an owner-occupied property has potential for an alternative use, which would result in its *value* in isolation from the business being higher than its value as part of the *cash-generating unit* to which it belongs, the Valuer shall report the *Market Value* for that alternative use. A statement should also be made that the *value* for the alternative use takes no account of issues such as business closure or disruption and the associated costs that would be incurred in achieving the alternative use, and that these should be considered by the entity when deciding the appropriate amount to adopt as fair value.

#### AUSNZ 6.3.1 Owner- Occupied Property

**Where the income approach to value is used for financial reporting purposes in relation to owner-occupied property, a deduction is not made for vacancy or letting-up factors if the going concern presumption applies. This direction does not apply to unoccupied areas or areas intended to be vacated by the entity.**

## 6.4 Specialised Property

Both IVSs and IAS 16 recognize that there are categories of assets for which market-based evidence may be unavailable because of their

# INTERNATIONAL VALUATION APPLICATION 1

specialised nature. It endorses the application of either an income or depreciated replacement cost approach to the valuation of these assets. The choice of approach is not dictated by the type of asset but by the presence or absence of market evidence. For further discussion and guidance on the use of these approaches see paras. 5.12 and 5.13 of GN 1 and section 5 of GN 8.

**NZ IAS 16-33.1 to 13, provides further guidance. Refer NZVGN 1**

## **NZ 6.4.1 Depreciated Replacement Cost**

**NZ IAS 16-33.11 directs valuers to assess the depreciated replacement cost of the assets applying the process of optimization to the improvements but not to the land.**

## **NZ 6.4.2 Land Value**

**NZ IAS 16-33.12 & 13 directs valuers to assess the land value at the Market Value highest and best use.**

## **NZ 6.4.3 Borrowing Costs**

**NZ IAS 16-33.14 directs entities who adopt the alternative treatment under IAS 23 to embody borrowing costs as a component within the DRC.**

## **6.5 Frequency of Revaluation**

Paragraph 31 of IAS 16 states:

“Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date”

## **6.6 IAS 17 – Leased Property, Plant and Equipment**

6.6.1 IAS 17 deals with the accounting for assets that are held under a lease. All leases require classification as either operating leases or finance leases (see para. 5.6.1 above and Addendum A). Different accounting treatments apply to each type of lease. A finance lease is recorded in a lessee's balance sheet as both an asset and a liability at amounts equal to the fair value of the asset or,

if lower, the present value of the minimum lease payments, each determined as at the inception of the lease. Any initial direct costs incurred by the lessee are added to the amount recognized as an asset.

6.6.2 Valuers may be required to advise on the fair value of the asset at the inception of the lease to enable a lessee to account for the asset correctly in accordance with IAS 17.

6.6.3 Special provisions apply to leases of land and buildings. IAS 17, para. 14, states that “because a characteristic of land is that it normally has an indefinite economic life ... a lease of land will be an operating lease”. Where a lease is of land and buildings, these elements have to be considered separately for the purposes of lease classification (IAS 17, para. 15). Most leases of real property will grant the lessee rights to occupy both the land and buildings, following which the interest in both elements reverts to the lessor. If the lessee also has to maintain the building and hand it back to the lessor in good repair, it is probable that both elements will correctly be classified as operating leases (see Addendum A). If both elements are not considered to share the same classification, the minimum lease payments (including any initial capital payment) are allocated between the land and buildings elements in proportion to the relative fair values of the leasehold interests in the two elements at the inception of the lease. If the lease payments cannot be reliably allocated the entire lease is treated as a finance lease, unless it is clear that both elements are operating leases (IAS 17, para. 16). This allocation is not required in the case of a lessee's interest accounted for as investment property (IAS 17, para. 18).

6.6.4 For further guidance on Leasehold interests, see Addendum A.

## **6.7 IAS 40 – Investment Property**

6.7.1 IAS 40 defines an investment property as a property (land or a building--or part of a building--or both) held by the owner, or by a lessee under a finance lease, to earn rentals, or for capital appreciation or both. It excludes owner-occupied property used for the production or supply of goods or services, or for administrative purposes, and also property held for sale in the ordinary course of business.

6.7.1.1 If part of a property is held as an investment property and part is owner-occupied, or if the parts could



be sold or leased separately, the parts are accounted for separately. If the parts could not be sold separately, the property is an investment property only if an insignificant proportion is held for the production or supply of goods or services or for administrative purposes (IAS 40, para. 10).

- 6.7.1.2 Property leased to a subsidiary or parent under an inter-company leasing arrangement does not qualify as investment property in the consolidated financial statements of the group, but may be treated as such in the individual financial statements of the lessor entity (IAS 40, para. 15).
- 6.7.2 Investment property is measured initially at cost. After initial recognition an entity may choose to adopt either:
- a) *The Fair Value Model.* Investment property should be measured at fair value and changes recognised in the profit and loss statement; or
  - b) *The Cost Model.* The “historic” cost model is in accordance with the model described in IAS 16. An entity that chooses the (historic) cost model should nonetheless disclose the fair value of its investment property.
- 6.7.2.1 The fair value model is described in detail in IAS 40, paras. 33 - 55. *The Market Value* of the entity's interest in the investment property derived in accordance with IVS 1 accords with these detailed requirements. The *Market Value* will reflect any current leases, current cash flows and any reasonable assumptions about future rental income or outgoings.
- 6.7.3 *Leasehold investment property.* A property held under a lease, rather than owned outright, and that otherwise meets the definition of an investment property, may be accounted for using the fair value model. If this option is taken for one such property held under a lease, all property classified as investment property shall be accounted for using the fair value model (IAS 40, para. 6).
- 6.7.3.1 IAS 40, para. 50(d), recognizes that the fair value of an investment property held under a lease will reflect the net income after deduction of future lease liabilities.

Although the entity is required to add to the reported fair value any recognised lease liability to arrive at the carrying amount for accounting purposes, this does not affect the requirement for the Valuer to report *Market Value*.

- 6.7.3.2 At initial recognition an investment property held under a lease shall be accounted for as though it were a finance lease under IAS 17, para. 20, i.e., at the fair value of the property, or if lower, at the present value of the minimum lease payments. Any capital sum paid to acquire the property interest is treated as part of the minimum lease payments and is therefore included in the cost of the asset (IAS 40, para. 25).
- 6.7.3.3 Subsequent measurement of an investment property held under an operating lease requires the fair value model to be adopted (see para. 6.6.3.1 above).
- 6.7.4 *External Valuations.* Entities are encouraged, but not required, to determine the fair value of investment property on the basis of a valuation by an Independent (External) Valuer who holds a recognised and relevant professional qualification and who has recent experience in the location and category of the investment property being valued (IAS 40, para. 26).

## 6.8 Other Requirements under IASs

- 6.8.1 *Portfolios:* A collection or aggregation of properties held by a single ownership and jointly managed is referred to as a *portfolio*. The *Market Value* of such assets viewed or treated as a portfolio or as an assembled group of properties could exceed or could be less than the sum of the *Market Value* of each asset individually. Where this is the case, it should be reported separately to the directors or trustees.

### AUS 6.8.1.1

**It should be noted that the valuer is only required to report the possible existence of a premium or discount, and is not required to quantify the actual premium or discount, unless specifically requested.**

- 6.8.2 *Impairment:* An entity is required, under IAS 36, *Impairment of Assets*, to review, at each balance sheet date, whether there is any indication that

## INTERNATIONAL VALUATION APPLICATION 1

a tangible asset may be impaired. Impairment might be indicated by, for example, a reduction in the value of the asset because of market or technological changes, obsolescence of the asset, asset underperformance in comparison to the expected return, or an intention to discontinue or restructure operations. If impairment is considered to have arisen, the *carrying amount* of the asset, derived from either its historic cost or an earlier valuation should be written down to the *recoverable amount*, which is the higher of the asset's *value in use* or its *fair value less costs to sell*. *Value in use* reflects the value that the entity will obtain from the asset throughout its remaining useful life to the business and its eventual disposal. Although entity-specific, the valuation inputs for the *value in use* of an asset should be market determined wherever possible. However, if the value an entity can obtain from the continued use of an asset is less than the net proceeds that could be obtained from its immediate retirement and disposal, the *carrying amount* should reflect this latter figure. The *fair value less costs to sell* of an asset is its Market Value less the reasonably anticipated selling costs.

- 6.8.3 *Disrupted Markets*. When markets are disrupted or suspended, Valuers must be vigilant in their analyses as explained in IVS 1, paragraph 6.5. Under IAS 29, *Financial Reporting in Hyperinflationary Economies*, Valuers may be required to assess balance sheet value.

### 7.0 Disclosure Requirements

- 7.1 The Valuer shall make all disclosures required under IVS 3, Valuation Reporting.
- 7.2 For disclosures required under IFRSs/IASs, see paragraphs 5.4.2, 5.5.1 and 6.1 above.
- 7.3 The Valuer shall disclose the regulatory framework and any departure required from these Standards to comply with local legislation, regulation (including accounting rules), or custom.

### 8.0 Departure Provisions

- 8.1 In following this Application any departures must be in accordance with directions made in IVS 3, Valuation Reporting.

#### AUS. 8.1.1

**To the extent that government Treasury Corporation guidelines are in any conflict with this Application, the valuer shall specify and note in the report any departures from this Application.**

### 9.0 Effective Date

- 9.1 This International Valuation Application became effective 31 July 2007.



## Addendum A

### Further Guidance on Lease Accounting

#### Lease Classification

Under IAS 17, leases have to be classified for inclusion in financial statements as either operating leases or finance leases:

A *finance lease* is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not be eventually transferred.

An *operating lease* is a lease other than a finance lease.

The following examples are listed in IAS 17, paras 10-11, as situations that could be indicative of a finance lease, either individually or in combination. These are not absolute tests but illustrations, i.e., one or more of these circumstances may arise, but the lease would still not be classified as a finance lease if it is clear from the overall context that substantially all the risks and rewards of ownership have not been transferred from the lessor to the lessee.

- (a) the lease transfers ownership of the asset to the lessee by the end of the lease term;
- (b) the lessee has the option to purchase the asset on advantageous terms;
- (c) the lease term is for the major part of the economic life of the asset even if title is not transferred;
- (d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset;
- (e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications;
- (f) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
- (g) gains or losses from the fluctuation in the fair value of the residual accrue to the lessee;
- (h) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

If it is concluded that substantially all the risks and rewards of ownership are not transferred to the lessee, then the lease is an operating lease.

As classification does involve an assessment of the degree to which economic benefits are transferred by a lease, Valuers are likely to be requested to provide advice to assist classification by lessor and lessees. IVSC considers that in the majority of cases, a qualitative assessment of the lease terms will quickly indicate the correct classification without the need for detailed calculation of the value of the different lease interests. The relative values of the lessor's and lessee's interests are not a key factor in classification; the key test is whether the lessor has transferred substantially all the risks and rewards of ownership.

#### Land and Building Allocation

Where a lease is of land and buildings together, IAS 17, para. 15, requires that the two elements be considered separately for the purposes of classification. If it appears that the buildings element could be a finance lease, it will be necessary to make an allocation of the initial rent based on the relative fair values of the leasehold interests in each element at the inception of the lease (IAS 17, para. 16).

In most leases of real property, the interest in the land and buildings is not distinguishable, and in any event the interest in both normally reverts to the lessor at the end of the lease. There are often provisions for the rent to be reviewed periodically to reflect changes in the *Market Value* of the property and also an obligation on the lessee to hand the buildings back to the lessor in good repair. These are all clear indicators that the lessor has not transferred substantially all the risks and rewards of ownership of either the buildings or the land to the lessee.

Consequently, finance leases of real property will generally arise only where the lease is clearly designed as a way of funding the eventual purchase of the land, buildings, or both by the lessee, often by means of an option to acquire the lessor's interest for a nominal sum after the rental payments have been made. Occasionally leases that are not clearly structured as finance agreements may meet some of the criteria of a finance lease, for example, where the rental payments do not reflect the underlying value of the property. In those cases a more detailed analysis of the value of the risks and benefits transferred may be required in order to confirm or rebut their classification.

Under IAS 17, para. 17, allocation between the land and buildings elements of an investment property held under a lease is not required. Under IAS 40, even though the investor may hold the investment property under an operating lease, the whole is accounted for as though it were a finance lease.

Where a lease is of a self-contained plot of land and the building upon it, allocating the rent to each element is a task that could be undertaken reliably where there is

## INTERNATIONAL VALUATION APPLICATION 1

an active market for land for similar development in the locality. In other situations, for example where the lease is of part of a multi-let building with no identifiable land attributable to any particular lease, reliable allocation may be impossible. IAS 17, para. 16, recognises that such cases can arise and makes the proviso that where a reliable allocation cannot be made, the whole lease should be treated as a finance lease, unless it is clear that both elements are operating leases. If it were clear that both elements were operating leases from the outset, the allocation exercise would not be necessary.

In practice, leases of part of a multi-let building will normally be operating leases and the whole property will be classified as investment property by the lessor. In such cases allocation will be unnecessary. In cases where the buildings element is clearly a finance lease, the land element is likely to be identifiable. It will be comparatively rare for the buildings element to meet the criteria for classification as a finance lease and for the land element not to be clearly identifiable. In such cases, the Valuer should not attempt an allocation based on unreliable criteria, but should advise that the allocation cannot be reliably made. The entity will then have to treat the whole as a finance lease.

# VALUATION FOR SECURED LENDING PURPOSES

## REVISED 2007

### 1.0 Introduction

- 1.1 The objective of International Valuation Application 2 (IVA 2) is to provide a framework for valuations of assets that are to be offered or taken as loan security.
- 1.2 It is important that Valuers consistently apply accepted valuation principles within the scope of these standards, providing clear, independent and objective opinions that are relevant to the needs of valuation users.

### 2.0 Scope

- 2.1 This Application applies in all circumstances where valuations are required of assets that are, or are proposed to be, held as security for lending. The lending may be done by different means, including *mortgage* or other forms of fixed or floating charge.

### 3.0 Definitions

#### International Valuation Standards Definitions

- 3.1 *Market Value*. The estimated amount for which a property should exchange on the date of valuation between a willing buyer and willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion (IVS 1, para. 3.1).
- 3.2 *Mortgage*. A pledge of an interest in property as security or collateral for repayment of a loan with provision for redemption on repayment. In the event the borrower (mortgagor) defaults, the lender (mortgagee) has the power to recover the property pledged.
- 3.3 *Specialised Property*. A property that is rarely if ever sold in the market, except by way of sale of the business or entity of which it is part, due to uniqueness arising from its specialised nature and design, its configuration, size, location, or otherwise.

- 3.4 *Trade Related Property*. Certain classes of real property, which are designed for a specific type of business and that are normally bought and sold in the market, having regard to their trading potential.

#### European Union Legislation Definition

- 3.5 *Mortgage Lending Value*. The value of the property as determined by a prudent assessment of the future marketability of the property taking into account long term sustainable aspects of the property, the normal and local market conditions, and the current use and alternative appropriate uses of the property. Speculative elements shall not be taken into account in the assessment of the mortgage lending value. The mortgage lending value shall be documented in a clear and transparent manner. (This definition is from Directive 2006/48/EC of the European Parliament.)

### 4.0 Relationship to Accounting Standards

- 4.1 A valuation prepared for lending purposes will not necessarily be the same as one made for accounting purposes, particularly one made for financial reporting purposes. Although a similar base such as *Market Value* may be applicable, the assumptions on which the valuation is based may be different.
- 4.2 By way of example, the underlying principle of many valuations for financial reporting is the presumption that the entity will continue as a going concern. However, this would not usually be appropriate for valuations undertaken for lending purposes. Such a presumption has particular implications for specialised assets where the value and marketability of the secured property, separate from the business of which it forms part, may be limited.

## INTERNATIONAL VALUATION APPLICATION 2

### 5.0 Application

To perform valuations that comply with this Application and Generally Accepted Valuation Principles (GAVP), Valuers shall adhere to all sections of the IVS Code of Conduct pertaining to Ethics, Competence, Disclosure, and Reporting (sections 4, 5, 6, and 7).

- 5.1 In performing valuations of property for lending purposes, Valuers will normally provide the *Market Value* of such property in accordance with these International Valuation Standards.
- 5.2 If the circumstances are such that a departure from the *Market Value* basis is justified, the departure shall be clearly set out and explained in the Valuation Report along with the identification and definition of the alternative basis used and an explanation of the reasons for the departure. If there is a material difference between the *Market Value* of the property and the alternative value, this should be reported.
- 5.3 The valuation opinion shall be reported in accordance with IVS 3, Valuation Reporting.
- 5.4 In addition to fulfilling the requirements of IVS 3, Valuation Reports for secured lending of real property will normally include comment, where relevant, on the following items:
  - 5.4.1 current activity and trends in the relevant market;
  - 5.4.2 historic, current and anticipated future demand for the category of property in the locality;
  - 5.4.3 the potential and likely demand for alternative uses;
  - 5.4.4 both the current marketability of the property and if requested, the likelihood of its sustainability;
  - 5.4.5 any impact of foreseeable events (at the date of valuation) on the value of the security;
  - 5.4.6 the valuation approach adopted, and the extent of market-based evidence in support of the valuation.
- 5.5 Valuations for lending purposes may be required on an assumption there has been a change in the state or condition of the property, for example, the assumed development of a new building, or upgrade of a building. Such a valuation will normally be provided on the assumption that the change

has occurred at the valuation date. It is not a projection of the value at the date in the future when the change will have actually occurred. The report must make it clear that the valuation is based on the assumption that the change specified had already been made at the valuation date. Use of the term *Market Value* without a modifier in these circumstances can be misleading. The term "*Market Value as if complete*" is an example of a suitable modification of *Market Value* that may be used in these circumstances.

- 5.6 A valuation of a property may also be required on the assumption that an estimated occupancy level had been achieved. This should also reflect the realistic expectations and perceptions of market participants as at the date of the report.
- 5.7 Corporate and individual loans from banks and other financial institutions are often secured by specific property assets. Valuers need to have a general understanding of the requirements of such institutions, and possibly the structure of loan terms and agreements. Lenders will usually require that the terms of a loan be kept confidential, but this does not relieve the Valuer of the obligation to have a general understanding of the lending process.

#### AUSNZ 5.7.1 Application

The extent of general understanding of requirements of financial institutions for valuers in Australia and New Zealand would normally be limited to:

- the requirements of professional indemnity insurance policies including prudent lender clauses
- the distinction between first and second mortgages
- loan to value ratios
- basic loan terms

General knowledge of requirements of financial institutions in Australia and New Zealand does not extend to knowledge of loan terms and conditions for a particular loan or loan application, which valuers are typically not privy to.

Ultimately loan terms and conditions are the commercial prerogative of a mortgagee or financier, and will have no impact on the assessment of market value by a valuer.

## 6.0 Discussion

- 6.1 At the outset of an assignment, the Valuer needs to clearly identify the property that is to serve as the security. Particular care is required to distinguish between property types where real property and personal property are combined.
- 6.2 The manner in which property would ordinarily trade in the market will determine the applicability of the various approaches to assessing *Market Value*. Based upon market information, each approach is a comparative method, and the use of more than one method may be required.
- 6.3 Each relevant valuation method will, if appropriately and correctly applied, lead to a similar result. All valuation methods should be based on market observations. Construction costs and depreciation, where they apply, should be determined by reference to an analysis of market-based estimates of costs and accumulated depreciation. The use of an income method, particularly discounted cash flow techniques, will also be based on market-determined cash flows and market-derived rates of return.
- 6.4 Occasionally a lender may request a valuation on a basis other than *Market Value*. IVS 2 addresses the types, use and reporting of some common alternative bases of valuation. The Valuer should ensure that an alternative basis is not confused with *Market Value*. Although there may be circumstances where an alternative basis is appropriate for secured lending, users of such valuations should be made aware that such value may not be realisable if the alternative assumptions made are no longer applicable.

### 6.5 Investment Properties

- 6.5.1 Income-producing properties are usually valued as individual properties. Lending institutions may also wish to have a property assessed as part of a portfolio of properties. In such instances, the distinction between the value of the individual property, assuming it is sold individually, and its value as part of the portfolio should be clearly expressed.
- 6.5.2 Although the Valuer should comment on the expected demand and marketability of the property over the life of the loan (see para. 5.4 above), it is normally outside the scope of the valuation exercise to advise on the ability of a tenant to meet future lease obligations beyond comment on the market's current perception of the tenant's quality.

### 6.6 Owner-Occupied Properties

#### 6.6.1

**Owner-occupied properties valued for lending purposes will normally be valued on the assumption that the property is transferred unencumbered by the owner's occupancy i.e. that the buyer is entitled to full legal control and possession commensurate with the concept of vacant possession. This does not preclude consideration of the existing owner as part of the market, but it does require that any special advantage attributable to the owner's occupancy, which may be reflected in a valuation of the business, be excluded from the valuation.**

### 6.7 Leases Between Related or Connected Parties

- 6.7.1 Caution is required where property offered as security is subject to a lease to a party connected to the borrower. If the valuer considers that the lease creates a more favourable income stream than would be obtainable on a letting to an unconnected third party in an arm's-length transaction, the lender should be alerted and it may be appropriate to disregard the existence of the lease in a valuation of the property as security.

#### AUSNZ 6.7.2 Leases Between Related or Connected Parties

**In Australia and New Zealand if the valuer considers that the lease creates a more favourable income stream than would be obtainable on a letting to an unconnected third party in an arm's-length transaction, the lender should be alerted and it is appropriate to disregard the existence of the lease in a valuation of the property as security.**

### 6.8 Sales Incentives

- 6.8.1 It is not uncommon for a seller of property, especially developers of real property, to offer incentives to buyers. Examples of such incentives include rental income guarantees, contributions to the buyer's removal or fitting out costs, or the supply of personal property such as furnishings or equipment. *Market Value* ignores any price inflated by special considerations or concessions (IVS 1, para 3.2.1). It may also be appropriate to alert the lender as to the effect that any incentives being offered have on the actual selling prices achieved.

### 6.9 Specialised Properties

- 6.9.1 Specialised properties by definition may have limited marketability and significant value only

## INTERNATIONAL VALUATION APPLICATION 2

as part of a business (see Concepts Fundamental to Generally Accepted Valuation Principles, para. 8.2). For loan security purposes, such properties will normally be valued on a vacant possession basis (see para. 6.6.1 above) and a valuation based on the highest and best alternative use is usually applicable. This will involve consideration of the costs and risks that would be involved in achieving that use. Lenders may not consider specialised property to be suitable as a security for lending purposes.

- 6.9.2 A valuation may be required of a specialised property where the property is part of a going-concern business. The lender should be alerted to the valuation being dependent on the continuing profitability (or otherwise) of the going concern. If the value on a vacant possession basis is potentially lower, this should be drawn to the attention of the lender.

### 6.10 Trade Related Properties

- 6.10.1 Certain classes of property, including but not limited to hotels and other trading businesses, where the property is approved and purpose-designed for only that use, are usually valued based on profitability but excluding *Personal Goodwill* (see GN 12, para. 3.3.2). In such cases, the lender should be made aware of the significant difference in value that may exist between an operating concern and a non-operating concern where the business is closed, the inventory is removed, licences (and other intangible assets such as certificates, franchise agreements, or permits) are removed or are in jeopardy, and any other circumstances exist that may impair future profitability and value.
- 6.10.2 If the income from a property is critically dependent on a tenant or tenants from a single sector or industry or some other factor, which could cause future income instability, the Valuer should address these factors in the Valuation Report. In certain cases, an assessment of the value of the property based on an alternative use, assuming vacant possession, may be appropriate.

### 6.11 Development Properties

- 6.11.1 Properties held for redevelopment or sites intended for development of buildings should be valued taking into account existing and potential development entitlements and controls. Any assumptions as to planning issues and other material factors must be reasonable, validated

by market behaviour and explicitly stated in the Valuation Report.

- 6.11.2 The approach to the valuation of development properties will depend on the state of development of the property at the date of valuation and may take into account the degree to which the development is pre-sold or pre-leased. The valuation approach may need to be discussed with the lender prior to undertaking the valuation. Care should be taken by the Valuer to:

- 6.11.2.1 make a reasoned estimate of the development period from the date of valuation. The effect of additional development requirements on costs and revenues, using present value discounting where appropriate, will be reflected in this analysis;
- 6.11.2.2 evaluate as far as is possible at the date of valuation, market behaviour during the period of the development;
- 6.11.2.3 consider and outline the risks associated with the development; and
- 6.11.2.4 consider and disclose any known special relationships between the parties involved in the development.

### 6.12 Wasting Assets

- 6.12.1 Specific lending issues arise in relation to the valuation of wasting assets such as mines or quarries. The lender's attention needs to be drawn to the risk associated with this type of a wasting asset and the planned program for its extraction or use.
- 6.12.2 Property rental that exceeds the current market or economic rent may constitute a wasting asset because any value attributable to this factor diminishes as the term of the lease decreases.

### 6.13 The Valuer

- 6.13.1 The nature and scope of the Valuer's engagement should be clear to the Valuer and the user of the valuation. Valuers should be aware of the risk associated with valuations for lending purposes where miscommunication, misunderstanding or error may lead to a dispute or litigation between the lender and the Valuer.
- 6.13.2 In some jurisdictions financial services legislation requires licensing or registration of advisers when advice is related not only to the value of property, but also to securities issues such as equity, participatory interests, collective investment



schemes, or syndicated loans. Valuers may be restricted in the advice they can provide in these jurisdictions.

- 6.13.3 In undertaking valuations for lending purposes, it is particularly important that the Valuer be independent of the borrower.
- 6.13.4 It is important that the Valuer possess appropriate experience in relation to the particular property type and locale for the property involved, or if not, seek expert assistance.

### 6.14 Forced Sales and Limited Marketing or Disposal Periods

- 6.14.1 Lending institutions may request valuations on a forced, or liquidation, sale basis or impose a time limit for disposal of the security. Because the impact of a constraint on the price obtainable will depend upon the specific circumstances under which the sale takes place, it is not realistic for the Valuer to speculate on a price that could be obtained without either knowledge of the reasons for the constraint, or the circumstances under which the property might be offered for sale. An alternative valuation may be provided based on defined assumptions, but the Valuer should draw the lender's attention to the fact that this opinion is valid only at the valuation date, and may not be relied upon in the event of a future default, when both market conditions and the sale circumstances may be different.

### 6.15 Lenders' Solvency Ratios

- 6.15.1 Major banks and other lenders are normally subject to regulations that limit the total amount they can lend as a proportion of the lenders' assets, known as the *solvency ratio*. In the international context, the Basle II Accord sets out rules for the minimum solvency ratios to be maintained by lending institutions and how those ratios are to be calculated. The value of assets over which the lender holds security is used in calculating the solvency ratio.
- 6.15.2 In exceptional circumstances for well-developed and long-established markets, the Basle II Accord requires the estimation of the *Market Value* and *Mortgage Lending Value* of a security backed by commercial real estate. A preferential risk weight of 50% is assigned to the tranche of a secured loan that does not exceed the lower of 50% of the *Market Value* or 60% of the *Mortgage Lending Value*.

- 6.15.3 *Mortgage Lending Value* is a long-term, risk assessment technique. As such, it is not a basis of value. MLV is a technique that is primarily used by banks in a number of European countries. Further information on *Mortgage Lending Value* is available on the IVSC website.

#### NZ 6.16 Security Recommendation

**In New Zealand where a Member is requested to complete a valuation for the purposes of the Trustee Act 1956 and amendments, the Solicitors Nominee Company Rules 1996, or the Securities Act (Contributory Mortgage) Regulations 1988, or for any lender whom the Member is aware is acting in the capacity as a trustee, a recommendation shall be provided as to the maximum amount which the member considers it would be prudent to lend on the security of the property.**

**In all other cases in New Zealand a mortgage recommendation should be provided.**

## 7.0 Disclosure Requirements

- 7.1 In reporting *Market Value* for lending security purposes, the Valuer shall make all disclosures required under IVS 3, *Valuation Reporting*.
- 7.2 The basis of the Valuer's engagement is to be clearly set out in any reports to be used by third parties. All reports should be presented in a way that would not be considered by a reasonable person to be misleading.
- 7.3 The Valuer shall disclose the regulatory framework and any departure required from these Standards to comply with local legislation, regulation, or custom.

## 8.0 Departure Provisions

- 8.1 In following this Application any departures must be in accordance with directions provided in IVS 3, *Valuation Reporting*.

## 9.0 Effective Date

- 9.1 This International Valuation Application became effective 31 July 2007.

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# VALUATION OF PUBLIC SECTOR ASSETS FOR FINANCIAL REPORTING

## ADOPTED 2007

### 1.0 Introduction

- 1.1 Public sector assets are those assets owned and/or controlled by governmental or quasi-governmental entities to provide goods or services to the general public. The principles that apply to the valuation of public sector assets are essentially the same as for any other assets.
- 1.2 The valuation of public sector assets may be undertaken for a range of purposes including financial reporting, privatisation planning, loan origination, bond issuance, and cost-benefit or economic analyses performed by governments and quasi-government entities either to determine whether a public sector asset is being used and managed efficiently or to set pricing for monopoly services.
- 1.3 The International Federation of Accountants' International Public Sector Accounting Standards Board (IPSASB) develops accounting standards for public sector entities, referred to as International Public Sector Accounting Standards (IPSASs). IPSASs, which apply to accrual accounting, are based on the International Financial Reporting Standards (IFRSs), issued by the International Accounting Standards Board (IASB). IPSASs cover public sector specific financial reporting issues, some of which are not addressed by IFRSs.
- 1.4 IVA 1 generally addresses the application of valuation bases to accounting principles in the context of IFRSs. Because of parallels between IPSASs and IFRSs, this Application necessarily repeats some of the content of IVA 1 while also addressing the specific requirements for the valuation of public sector assets and their treatment in financial reporting.
- 1.5 Property in the public sector comprises conventional cash-generating and non-cash-generating property assets as well as specialised property assets, including *heritage and conservation assets, infrastructure assets, public buildings, public utility plants, and recreational assets*. As with private sector assets, public sector assets fall into *operational* and *non-operational*

categories. Non-operational assets include investment and surplus assets

### 2.0 Scope

- 2.1 This Application applies to all valuations of public sector asset classes, included in any financial statement, which fall within the skills and expertise of Valuers (with the exception of valuations of Government Business Enterprises or GBEs that are performed according to IVA 1).
- 2.2 IVSs facilitate cross-border transactions and the viability of global markets through harmonisation and transparency in financial reporting. As such, this Application is developed in the context of International Public Sector Accounting Standards (IPSASs). In September 2005, the IPSAS Board issued an Exposure Draft of eleven IPSASs that had been updated to converge with the amended International Accounting Standards issued by IASB in December 2003 as part of its General Improvements Project. This Application is developed in the context of the proposed revisions to IPSASs contained within this Exposure Draft.
- 2.3 IPSASs and IFRSs adopt two models for the recognition of property assets in the balance sheet: a cost model, and a fair value model. Where the fair value model is applied, a current revaluation of the asset is required, and this Application focuses on these particular circumstances where Market Values are to be reported.
- 2.4 Legislative, regulatory, accounting, or jurisprudence requirements may require the modification of this Application in some countries or under certain conditions. Any departure due to such circumstances must be referred to and clearly explained in the Valuation Report.

### 3.0 Definitions

#### International Valuation Standards Definitions

- 3.1 *Depreciated Replacement Cost*. The current cost of replacing an asset with its modern equivalent asset

## INTERNATIONAL VALUATION APPLICATION 3

less deductions for physical deterioration and all relevant forms of obsolescence and optimisation.

- 3.2 *Market Value*. The estimated amount for which a property should exchange on the date of valuation between a willing buyer and willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion (IVS 1, para. 3.1).
- 3.3 *Obsolescence*. A loss in value due to a decrease in the usefulness of property caused by decay, changes in technology, people's behavioural patterns and tastes, or environmental changes. Obsolescence is sometimes classified according to items of outmoded design and functionality, items with structural design unable to meet current code requirements, and factors arising outside the asset, such as changes in user demand.
- 3.4 *Optimisation*. The process by which a least cost replacement option is determined for the remaining service potential of an asset. It is a process of adjusting the replacement cost to reflect that an asset may be technically obsolete or over-engineered, or the asset may have a greater capacity than that required. Hence optimisation minimises, rather than maximises, a resulting valuation where alternative lower cost replacement options are available.
- 3.5 *Public building*. A building that serves some community or social function and is held in public ownership. Examples include courthouses, municipal centres, schools, prisons, police stations, military facilities, libraries, hospitals, clinics, and social or public housing.
- 3.6 *Public sector asset*. An asset, owned and/or controlled by a governmental or quasi-governmental entity, for the provision of some public service or good. Public sector assets comprise different asset types, including conventional assets as well as heritage and conservation assets, infrastructure assets, public utility plants, recreational assets, and public buildings (e.g., military facilities), each category of which constitutes property, plant and equipment within the meaning of IPSASs and IFRSs.
- Public sector assets typically include:
- assets, which have atypical tenure, are irreplaceable, are non-cash-generating, or provide goods or services in the absence of any market competition;
  - land with restrictions on its sale or leasing; and

- land, which is designated for a specialised use that is not necessarily its highest and best use.

See also *Heritage assets*, *Infrastructure assets*, *Public building*, *Public utility*, and *Recreational assets*.

- 3.7 *Public utility*. A property that:
- produces a service or good for general public consumption; and
  - is usually a monopoly or quasi-monopoly provider subject to some form of governmental control.
- 3.8 *Recreational assets*. Properties held in public ownership that:
- are managed by or on behalf of national, municipal, or local governmental authorities; and
  - provide for recreational use by the general public.
- Examples include parks; playgrounds; greenbelts; walks and trails; swimming pools; playing courts, fields and courses; and other properties equipped with recreational and athletic facilities.
- 3.9 *Service potential*. The capacity of an asset to continue to provide goods and services in accordance with the entity's objectives.
- 3.10 *Value of improvements*. The value added to the land by improvements such as buildings, structures or modifications to the land, of a permanent nature, involving expenditures of labour and capital, and intended to enhance the value or utility of the property. Improvements have differing patterns of use and economic lives.

### International Public Sector Accounting Standards Definitions

- 3.11 *Cash Generating Assets*. Assets held to generate a commercial return. (IPSAS 21.14)
- 3.12 *Depreciable Amount*. The cost of an asset, or other amount substituted for cost, less its residual value (IPSAS 17.13).
- 3.13 *Depreciation*. The systematic allocation of the depreciable amount of an asset over its useful life (IPSAS 17.13, IPSAS 21.14).
- 3.14 *Government business enterprise (GBE)*. An entity that has all of the following characteristics:
- is an entity with the power to contract in its own name;
  - has been assigned the financial and operational authority to carry on a business;

- c) sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;
  - d) is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and
  - e) is controlled by a public service entity. (IPSAS 21.14)
- 3.15 *Heritage assets.* Assets having some cultural, environmental or historical significance. Heritage assets may include historical buildings and monuments, archaeological sites, conservation areas and nature reserves, and works of art. Heritage assets often display the following characteristics (although these characteristics are not necessarily limited to heritage assets):
- a) their economic benefit in cultural, environmental, educational and historic terms is unlikely to be fully reflected in a financial value based purely on market price;
  - b) legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;
  - c) they are often irreplaceable and their economic benefit may increase over time even if their physical condition deteriorates; and
  - d) it may be difficult to estimate their useful lives, which in some cases could be hundreds of years.

The above definition is consistent with the description of heritage assets in IPSAS 17.9

- 3.16 *Impairment.* A loss in the future economic benefits, or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation (IPSAS 21.14).
- 3.17 *Infrastructure assets.* Assets that usually display some or all of the following general characteristics:
- a) they are part of a system or network;
  - b) they are specialised in nature and do not have alternative uses;
  - c) they are immovable; and
  - d) they may be subject to constraints on disposal.

The above definition is consistent with the description of infrastructure assets in IPSAS 17.21

- 3.18 *Non-cash-generating assets.* Assets other than cash-generating assets (IPSAS 21.14).
- 3.19 *Recoverable service amount.* The higher of a non-cash-generating asset's fair value less costs to sell and its value in use (IPSAS 21.14).
- 3.20 *Useful life (of property, plant and equipment).*  
Either
- a) the period over which an asset is expected to be available for use by an entity; or
  - b) the number of production or similar units expected to be obtained from the asset by an entity. (IPSAS 17.13, IPSAS 21.14)
- 3.21 *Value in use of a non-cash-generating asset.* The present value of the asset's remaining service potential. (IPSAS 21.14)

### 4.0 Relationship To Accounting Standards

- 4.1 This Application applies the principles developed in IVS 1, IVS 2, IVS 3 and IVA 1 to the requirements of IPSASs. tandards
- 4.2 This Application focuses on valuation requirements under IPSAS 17 (Exposure Draft, September 2005), Property, Plant and Equipment; and IPSAS 21, Impairment of Non-Cash-Generating Assets. Further requirements may become mandatory, pending publication of revised IPSAS 17.

### 5.0 Application

To perform valuations that comply with this Application and Generally Accepted Valuation Principles (GAVP), it is essential that Valuers adhere to all sections of the IVS Code of Conduct pertaining to Ethics, Competence, Disclosure, and Reporting (sections 4, 5, 6, and 7)

- 5.1 *Classification of Assets.* Valuers shall obtain from the directors of the owning entity a list of assets to be valued, designating them as operational assets, i.e., assets requisite to the operations of the entity, or non-operational assets, being properties held for future development, investment, or assets surplus to the operations of the entity.
- 5.2 *Applicable Standards.* The classification of assets determines which IPSAS applies. IPSAS 17, paras. 26 and 27, requires non-current property, plant and equipment assets held for the production or supply of goods or services to be measured upon recognition at

## INTERNATIONAL VALUATION APPLICATION 3

cost, or where an item is acquired through a non-exchange transaction, its cost shall be measured at its fair value at the date of acquisition. IPSAS 17, para. 42 requires that after recognition, such assets be carried in accordance with either the cost model or revaluation (fair value) model described in 5.3. Other accounting standards that require or permit the valuation of tangible assets include:

- Leases – IPSAS 13
- Investment Property – IPSAS 16
- Impairment of Non-Cash Generating Assets – IPSAS 21

### 5.3 IPSAS 17, *Cost and Fair Value*

5.3.1 IPSAS 17 deals with the cost model in paragraph 43 as follows:

“After recognition as an asset, an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.”

5.3.2 The fair value model, which requires regular revaluations, is explained in paragraph 44 as follows:

“After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the reporting date.”

5.3.3 Fair value is not necessarily synonymous with *Market Value*. It is used throughout IPSASs in differing contexts.

5.3.4 Financial statements are produced on the assumption that the entity is a going concern unless management either intends to liquidate the entity or cease operation, or has no realistic alternative but to do so. This assumption therefore underlies the application of fair value to property plant and equipment, except in cases where it is clear that there is either an intention to dispose of a particular asset or that option of disposal

has to be considered, e.g. when undertaking an impairment review.

### 5.4 *Valuations under IPSAS 17*

Where an entity adopts the fair value revaluation option under IPSAS 17, the assets are included in the balance sheet at their fair value as follows:

- a) “The fair value of items of property is usually determined from market-based evidence by appraisal. The fair value of items of plant and equipment is usually their market value determined by appraisal” (IPSAS 17, para. 45).
- b) “If no market evidence is available to determine the market value in an active and liquid market of an item of property, the fair value of the item may be established by reference to other items with similar characteristics, in similar circumstances and location...” (IPSAS 17, para. 47).
- c) “If there is no market-based evidence of fair value because of the specialized nature of the item of plant and equipment, an entity may need to estimate fair value using ... depreciated replacement cost, or the restoration cost or service units approaches...” (IPSAS 17, para. 48). (See paras. 6.5, 6.6 and 6.7 below.)

5.4.1 IVSC considers that a professional Valuer undertaking an appraisal under 5.4 (a) to (c) above should report the *Market Value* of the asset. Any assumptions or qualifications made in applying *Market Value* should be discussed with the entity and disclosed in the report.

Where a reliable assessment of *Market Value* is not possible, the Valuer must disclose the basis for this conclusion to the reporting entity.

5.4.2 The valuation conclusion shall be reported in accordance with IVS 3, Valuation Reporting. Valuers shall ensure that reports include sufficient information for the entity to meet the requirements of IPSAS 17, para. 92, when preparing financial statements:

- a) the effective date of the revaluation;
- b) whether an Independent Valuer was involved (Note, IVSC interprets this as an *External Valuer*);

- c) the methods applied and significant assumptions made ...; and
  - d) the extent to which the asset's fair values were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms, or were estimated using other valuation techniques.
- 5.5 Valuations under IPSAS 16 - Investment Property**
- All public sector investment property is valued in accordance with IVA 1.
- 5.6 Valuation Requirements for Leased Assets – IPSAS 13**
- 5.6.1 Leased assets are classified under IPSAS 13 as either finance leases or operating leases. (For further explanation, see IVA 1, para. 6.6.1 and Addendum A.) If a lease is classified as a finance lease, the fair value of the asset is required to establish the amount of the asset and liability recorded by the entity on its balance sheet (IPSAS 13, para 20).
- 5.6.2 For leases of land and buildings special rules apply. (See IVA 1, para. 6.6.3.) For all property, other than investment property, land and buildings have to be considered separately for classification as either a finance lease or an operating lease.
- 5.6.3 IVSC considers that in each case the requirement to establish the fair value of the leased asset under IPSAS 13, para. 28, is met by the Valuer reporting the *Market Value*. For leases of real estate, this is the *Market Value* of the lease interest held by the lessee. For leases of other assets, it is normally the *Market Value* of the asset unencumbered by the lease, as the liability is recorded separately.
- 5.7 Valuation of Impaired Non-Cash Generating Assets – IPSAS 21**
- 5.7.1 Impairment arises where there is a permanent decrease in the recoverable service amount of an asset below its carrying amount. IPSAS 21, para. 48, requires that if, and only if, the recoverable service amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable service amount. That reduction is an impairment loss. IPSAS 21, para. 51, further states that when the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an entity shall recognise a liability if, and only if, that is required by another IPSAS.
- 5.7.2 The entity is required to write down the carrying amount of impaired cash-generating assets to the higher of their *value in use* or *fair value less costs to sell*. The requirements for cash-generating assets are discussed further in IVA 1, para. 6.8.2.
- 5.8 Valuations after Business Combinations**
- 5.8.1 Where a governmental or quasi-governmental entity acquires or is merged with another, the acquirer has to account for the assets and liabilities of the acquiree at their fair value as of the acquisition date. For identifiable assets and liabilities, IVSC considers that the Valuer should report their Market Value as they existed at the date of acquisition.
- 5.9 Surplus Assets**
- 5.9.1 Surplus assets are to be separately identified. Such assets may be accounted for individually or as a "disposal group", i.e., a group of assets to be disposed of together, by sale or otherwise, and the liabilities directly associated with those assets that will also be transferred in the transaction. Surplus assets are to be initially accounted for at the lower of the carrying amount and the fair value less costs to sell, and subsequently at fair value less cost to sell. Valuers should therefore ascertain whether surplus assets are to be valued as individual items, or as a group or portfolio of assets that will be disposed of in a single transaction, and report the *Market Value* with the appropriate assumptions.
- 5.10 Properties Held for Sale in the Ordinary Course of Business – IPSAS 12 Inventories**
- 5.10.1 Valuations of properties held for sale in the ordinary course of business should comply with the requirements of IPSAS 12, *Inventories*. These properties are measured at the lower of cost and *net realisable value*. Net realisable value is the estimated selling price in the ordinary course of operations less the estimated costs of completion and the estimated costs necessary to make the sale, exchange or distribution.



## INTERNATIONAL VALUATION APPLICATION 3

### 5.11 Selling Costs

5.11.1 When instructed to value impaired or surplus assets, or assets that are held for sale in the ordinary course of business, the Valuer must report their *Market Value* without deducting selling costs. If the client requests the Valuer to advise on the costs to sell the assets, such costs are to be reported separately.

### 5.12 Non-Agricultural Biological Assets

5.12.1 These include naturally occurring flora and fauna. The Valuer should value these assets in accordance with the guidance in GN 10.

5.13 *Co-operation with Auditors.* Subject to first obtaining the consent of their client, Valuers shall discuss and explain their valuations openly with the entity's auditors.

## 6.0 Discussion

IPSAS 17 and 21 provide the following clarification, which is useful in understanding the correct application for public sector accounting.

### 6.1 *Absence of Market Evidence - IPSAS 17*

"For some public sector assets, it may be difficult to establish their market value because of the absence of market transactions for these assets. Some public sector entities may have significant holdings of these assets". (IPSAS 17, para. 46)

6.1.1 "If no market evidence is available to determine the market value in an active and liquid market of an item of property, the fair value of the item may be established by reference to other items with similar characteristics, in similar circumstances and location. For example, the fair value of vacant government land that has been held for a long period during which time there have been few transactions may be estimated by reference to the market value of land with similar features and topography in a similar location for which market evidence is available. In the case of specialized buildings and other man-made structures, fair value may be estimated by using depreciated replacement cost, or the restoration cost or the service units approach (see IPSAS 21). In many cases, the depreciated replacement cost of an asset can be established by reference to the buying price of a similar asset with similar remaining service potential in an active and liquid market. In some cases, an asset's reproduction cost will be the best indicator of its replacement cost. For example, in

the event of loss, a parliament building may be reproduced rather than replaced with alternative accommodation because of its significance to the community". (IPSAS 17, para. 47)

6.1.2 "If there is no market-based evidence of fair value because of the specialized nature of the item of plant and equipment, an entity may need to estimate fair value using depreciated replacement cost, or the restoration cost or service units approaches (see IPSAS 21). The depreciated replacement cost of an item of plant or equipment may be established by reference to the market buying price of components used to produce the assets or indexed price for the same or similar asset based on a price for a previous period. When an indexed price method is used, judgement is required to determine whether technology has changed significantly over the period, and whether the capacity of the reference asset is the same as the asset being valued". (IPSAS 17, para. 48)

### 6.2 *Government Business Enterprises (GBEs) – IPSAS 21*

"GBEs include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge". (IPSAS 21, para. 15)

### 6.3 *Cash-Generating Assets – IPSAS 21*

"Cash-generating assets are those that are held to generate a commercial return. An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit-oriented entity. Holding an asset to generate a 'commercial return' indicates that an entity intends to generate positive cash inflows from the asset (or of the unit of which the asset is a part) and earn a return that reflects the risk involved in holding the asset". (IPSAS 21, para. 16)

"Assets held by GBEs are cash-generating assets. Public sector entities other than GBEs may hold assets to generate a commercial return. For the purposes of this Standard [IPSAS 21], an asset held by a non-GBE public sector entity is classified as a cash-generating asset if the asset (or unit of which the asset is a part) is operated with the objective

of generating a commercial return through the provision of goods and or services to external parties". (IPSAS 21, para. 17)

### 6.4 *Value in Use – IPSAS 21*

"The value in use of a non-cash-generating asset is the present value of the asset's remaining service potential. 'Value in use' in this Standard [IPSAS 21] refers to 'value in use of a non-cash-generating asset' unless otherwise specified. The present value of the remaining service potential of the asset is determined using any one of the approaches identified in paragraphs 41 to 45, as appropriate". (IPSAS 21, para. 40)

### 6.5 *Depreciated Replacement Cost Approach – IPSAS 21*

"Under this approach, the present value of the remaining service potential of an asset is determined as the depreciated replacement cost of the asset. The replacement cost of an asset is the cost to replace the asset's gross service potential. This cost is depreciated to reflect the asset in its used condition. An asset may be replaced either through reproduction (replication) of the existing asset or through replacement of its gross service potential. The depreciated replacement cost is measured as the reproduction or replacement cost of the asset, whichever is lower, less accumulated depreciation calculated on the basis of such cost, to reflect the already consumed or expired service potential of the asset". (IPSAS 21, para. 41)

"The replacement cost and reproduction cost of an asset are determined on an 'optimized' basis. The rationale is that the entity would not replace or reproduce the asset with a like asset if the asset to be replaced or reproduced is an oversized or overcapacity asset. Oversized assets contain features which are unnecessary for the goods or services the asset provides. Overcapacity assets are assets that have a greater capacity than is necessary to meet the demand for goods or services the asset provides. The determination of the replacement cost or reproduction cost of an asset on an optimized basis thus reflects the service potential required of the asset". (IPSAS 21, para. 42).

"In certain cases, standby or surplus capacity is held for safety or other reasons. This arises from the need to ensure that adequate service capacity is available in the particular circumstances of the entity. For example, the fire department needs to have fire engines on standby to deliver services in

emergencies. Such surplus or standby capacity is part of the required service potential of the asset". (IPSAS 21, para. 43)

### 6.6 *Restoration Cost Approach – IPSAS 21*

"Restoration cost is the cost of restoring the service potential of an asset to its pre-impaired level. Under this approach, the present value of the remaining service potential of the asset is determined by subtracting the estimated restoration cost of the asset from the current cost of replacing the remaining service potential of the asset before impairment. The latter cost is usually determined as the depreciated reproduction or replacement cost of the asset whichever is lower". (IPSAS 21, para. 44)

### 6.7 *Service Units Approach – IPSAS 21*

"Under this approach, the present value of the remaining service potential of the asset is determined by reducing the current cost of the remaining service potential of the asset before impairment to conform with the reduced number of service units expected from the asset in its impaired state. As in the restoration cost approach, the current cost of replacing the remaining service potential of the asset before impairment is usually determined as the depreciated reproduction or replacement cost of the asset before impairment, whichever is lower". (IPSAS 21, para. 45)

### 6.8 *Other Considerations*

- 6.8.1 *Heritage Assets.* "Some heritage assets have service potential other than their heritage value, for example, an historic building being used for office accommodation. In these cases, they may be recognized and measured on the same basis as other items of property plant and equipment. For other heritage assets, their service potential is limited to their heritage characteristics, for example, monuments and ruins. The existence of alternative service potential can affect the choice of measurement base". (IPSAS 17, para. 10)
- 6.8.2 *Non-Agricultural Biological Assets.* Naturally occurring flora and fauna include special conservation assets, which may or may not be protected. Some are so significant that they have international recognition while others may reflect the environment in its natural state.
- 6.8.3 *Absence of Free Cash Flows to Monopolies.* Some public sector entities can be classed as monopolies. While monopoly service providers often generate

## INTERNATIONAL VALUATION APPLICATION 3

cash flows, these cash flows cannot be considered reflective of market levels since there is no market evidence against which to check the characteristic circularity of cash flow, yield, and value. Thus, a critical feature that differentiates certain classes of public sector assets from private sector assets is the absence of "free" cash flows to such public sector entities. In some cases it may be appropriate to use the cost approach either as the primary valuation method or as a cross check to establish that the rate of return being earned from the assets being valued is reasonable. This application does not apply to government business enterprises (GBEs), which are valued according to IVA 1.

- 6.8.4 *Test of Adequate Service Potential.* As non-cash generating assets have no free cash flows to test the adequate profitability of a public sector asset, the concept of *service potential* becomes the test of an asset's performance. Service Potential is a measure of the suitability of the asset to continue meeting the objectives of the entity. This suitability may be assessed by reference to financial, social or political considerations. The measurement may be tangible, for example the number of visitors to a museum or users of a public library, or intangible, e.g. the social benefits of maintaining an otherwise uneconomic facility in a particular location.

Where a non-cash-generating asset is measured by reference to depreciated replacement cost, it is subject to the test of adequate service potential in order to determine whether the asset is impaired. (Also see GN 8, para. 5.11.)

- 6.8.5 *Frequency of Revaluations.* "Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the reporting date...." (IPSAS 17, para. 44)

In volatile markets the entity may be required to revalue annually whereas in more stable markets revaluations may be required every three to five years.

## 7.0 Disclosure

- 7.1 The Valuer shall make all disclosures required under IVS 3, Valuation Reporting.
- 7.2 For disclosures required under International Public Sector Accounting Standards (IPSASs), see paragraph 5.4.2 above.
- 7.3 The Valuer shall disclose the regulatory framework, and any departure required from these Standards to comply with local legislation, regulation (including accounting rules), or custom.
- 7.4 When no reliable measurement is possible, disclosure must be made to the reporting entity. (See para. 5.4.1 above)

## 8.0 Departure

- 8.1 In following this Application any departures must be in accordance with directions given in IVS 3, Valuation Reporting.

## 9.0 Effective Date

- 9.1 This International Valuation Application became effective 31 July 2007.



# REAL PROPERTY VALUATION

## REVISED 2007

### 1.0 Introduction

- 1.1 The International Valuation Standards Committee's (IVSC) Concepts Fundamental to Generally Accepted Valuation Principles set forth terms and concepts that are fundamental to all valuations. The purpose of Guidance Note No.1 (GN 1) is to amplify those fundamentals so they may be better understood in valuations of real property.
- 1.2 *Real property* constitutes a substantial portion of the world's wealth. If the operations of property markets are to be established on dependable valuations, there must be generally agreed upon Standards by which *Market Value* and other value types are determined and reported by Valuers. Correct understanding and proper application of these Standards will inevitably promote the viability of international and domestic transactions in real property, improve the relative position of real property among other investment alternatives, and reduce the instances of fraud and abuse.
- 1.3 The term *property* in a legal sense may be defined as ownership rather than the physical entity of land, buildings, and tangible personal items. In this context, the IVSC identifies four general property types:
- 1.3.1 Real Property (GN 1)
  - 1.3.2 Personal Property (GNs 3, 4, and 5)
  - 1.3.3 Businesses (GN 6)
  - 1.3.4 Financial Interests
- 1.4 As with other property types, there are commonly agreed upon and generally accepted methods for valuing real property. It is important to the Valuer and the users of valuation services that proper methods be thoroughly understood, competently applied, and satisfactorily explained. By meeting this objective, Valuers contribute to the soundness and reliability of *Market Value* estimates and, thereby, the well-being of the markets in which they practice.
- 1.5 Promotion of understanding and avoidance of abuses in the market require that the Valuer and user of valuation services carefully distinguish between the types of property. Failure to do so can result in improper or ill-advised market decisions and misrepresentations of reported values. Over- or under-reporting of value is a common result where property types are confused or mixed. The same is true when terminology is indistinct or inadequate.
- 1.6 Real Property Valuers recognise the complexities of markets and the real estate bought and sold therein. Differences in real estate markets and between individual properties are reflected accurately and reliably where Generally Accepted Valuation Principles (GAVP) are followed.
- 1.7 In all IVSC Member States, it is recognised that the valuation of real property requires special education, training, and experience. Just as the emergence of professional valuation societies at the national level attests to a market need for competent and highly ethical Valuers within each country, the globalisation of property markets and the establishment of IVSC reflect the market need for Valuers to adopt consistent methods throughout the world. GN 1, Real Property, provides an international framework for the application of generally accepted methods used for real property valuation.
- 1.8 The relationship between GNs 6 and 12, pertaining to business and trade related property (TRP) valuation, and GN 1, pertaining to real property valuation, must be clearly understood. Real property is valued as a distinct "entity," i.e., as physical assets to which particular ownership rights apply. For example, an office building, a residence, a factory, or other property types generally incorporate an underlying land component. Business or TRP valuation, however, values a business entity or TRP asset of which real property may be a component. The *Market Value* of real property is always valued in accordance with International Valuation Standard 1 (IVS 1). When a real property value estimate is incorporated as an element of a business valuation, it is a *Market Value* estimate of the real property. As discussed in GN 1, this convention is distinct from the unacceptable practice of purportedly developing a *Market Value* estimate for real property as an allocation of the value of a going concern.
- 1.9 It is not the objective of GN 1 to provide specific Guidance as to how a given valuation should

# INTERNATIONAL VALUATION GUIDANCE NOTE NO. 1

be performed or to supercede the qualifications for and procedures applied by Valuers. These are addressed within the training programs of each State. It is the IVSC's intent to establish a framework and requirements for real property valuation that will serve to harmonise worldwide valuation practices.

## 2.0 Scope

- 2.1 This GN is provided to assist in the course of rendering or using real property valuations.
- 2.2 Principal elements of GN 1 include
  - 2.2.1 an identification of key terms and definitions;
  - 2.2.2 a summary of the Valuation Process and its rationale;
  - 2.2.3 an elaboration on the importance of principles and concepts;
  - 2.2.4 a discussion of proper disclosure and reporting requirements;
  - 2.2.5 examples of abuses and misunderstandings; and
  - 2.2.6 a presentation of real property Guidance.
- 2.3 The specific application of quantitative and qualitative valuation procedures is beyond the scope of GN 1. It is important to stress, however, that Valuers are trained in such procedures, and that the procedures are included in generally accepted practices. In application, Valuers commonly apply several procedures in each valuation and then reconcile the results into a final indication of *Market Value* or other specified value.

## 3.0 Definitions

- 3.1 Concepts Fundamental to Generally Accepted Valuation Principles defines the concepts of *land* and *property*; *real estate*, *property*, and *asset*; *price*, *cost*, and *value*; *Market Value*, *highest and best use*, and *utility*. The Glossary of Terms further defines many of the concepts and technical terms used throughout the Standards and Guidance Notes. The following definitions are specific to GN 1 and are included here for reader convenience.
- 3.2 *Comparable Data*. Data generally used in a valuation analysis to develop value estimates. *Comparable Data* relate to properties that have characteristics similar to those of the property being valued (the subject property). Such data include sale prices, rents, income and expenses, and market-derived capitalisation and yield/discount rates.

- 3.3 *Elements of Comparison*. Specific characteristics of properties and transactions that cause the prices paid for real estate to vary. *Elements of comparison* include, but are not limited to, the following: property rights conveyed, financing terms, conditions of sale, market conditions, location, and physical and economic characteristics. (See para. 5.22 of this document for a full presentation of *Elements of Comparison*.)
- 3.4 *Highest and Best Use*. The most probable use of a property which is physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value of the property being valued. (See Concepts Fundamental to Generally Accepted Valuation Principles, section 6.)
- 3.5 *A Market*. The environment in which goods, services and commodities trade between buyers and sellers through a price mechanism.
- 3.6 *Market Value*. Definitions are included in Concepts Fundamental to Generally Accepted Valuation Principles and International Valuation Standard 1, section 3.
- 3.7 *Property Rights*. The rights that are related to the ownership of real estate. These include the right to develop or not develop the land, to lease it to others, to sell it, to give it away, to farm it, to mine it, to alter its topography, to subdivide it, to assemble it, to use it for waste disposal, or to choose to exercise none of these rights. The combination of these property rights is sometimes referred to as the *bundle of rights* inherent in the ownership of real estate. *Property rights* are typically subject to public or private restrictions such as easements, rights-of-ways, specified development density, zoning, and other restrictions that may encumber the property.
- 3.8 *Real Estate*. Land and all things that are a natural part of the land, e.g., trees and minerals, as well as all things that are attached by people, e.g., buildings and site improvements. All permanent building attachments such as plumbing, heating and cooling systems; electrical wiring; and built-in items like elevators, or lifts, are also part of the *real estate*. *Real estate* includes all attachments, both below and above the ground. (See also Concepts Fundamental to Generally Accepted Valuation Principles as well as in the Glossary of Terms.)
- 3.9 *Real Property*. All the rights, interests, and benefits related to the ownership of *real estate*. *Real property* is a legal concept distinct from *real estate*, which is a physical asset. There may also

be potential limitations upon ownership rights to real property. (See Property Types, para. 2.2.1 and 2.2.4.)

3.10 *Units of Comparison.* Typically a factor produced by two components, which reflects precise differences between properties and facilitates analysis in the three approaches to value, e.g., price per square metre or square foot, or the ratio of a property's sale price to its net income (net income multiplier/years' purchase).

3.11 The *Cost Approach.* One of the approaches to value commonly applied in *Market Value* estimates and many other valuation situations.

*Depreciated replacement cost* is an application of the cost approach used in assessing the value of specialised assets for financial reporting purposes, where direct market evidence is limited. (See GN 8, The Cost Approach for Financial Reporting-(DRC).)

## 4.0 Relationship to Accounting Standard

4.1 For a general discussion of the accounting requirements for real property valuations, and the utility of *Market Value* in promoting the objectivity and comparability of real property valuations, see International Valuation Application 1.

## 5.0 Guidance

5.1 Value, in its broadest sense, is defined as the relationship between something owned and an individual or individuals who wish(es) to own it. To distinguish between the broad subjective relationships that may occur among people, Valuers must identify a particular type of value as the basis of any valuation. ***Market Value is the most common value type, but valuation bases other than Market Value also exist.*** (See Introduction to Standards 1, 2 and 3; and IVS 1 and 2.)

5.1.1 *Market Value* has evolved in concept and definition under the influence of market forces and in response to various principles of real estate economics. **By applying a definition of value such as Market Value in valuations, Valuers and the users of their services are afforded an objective plan of analysis.**

5.1.2 When *Market Value* is the purpose of a valuation, the Valuer shall apply definitions, processes, and methods consistent with IVS 1.

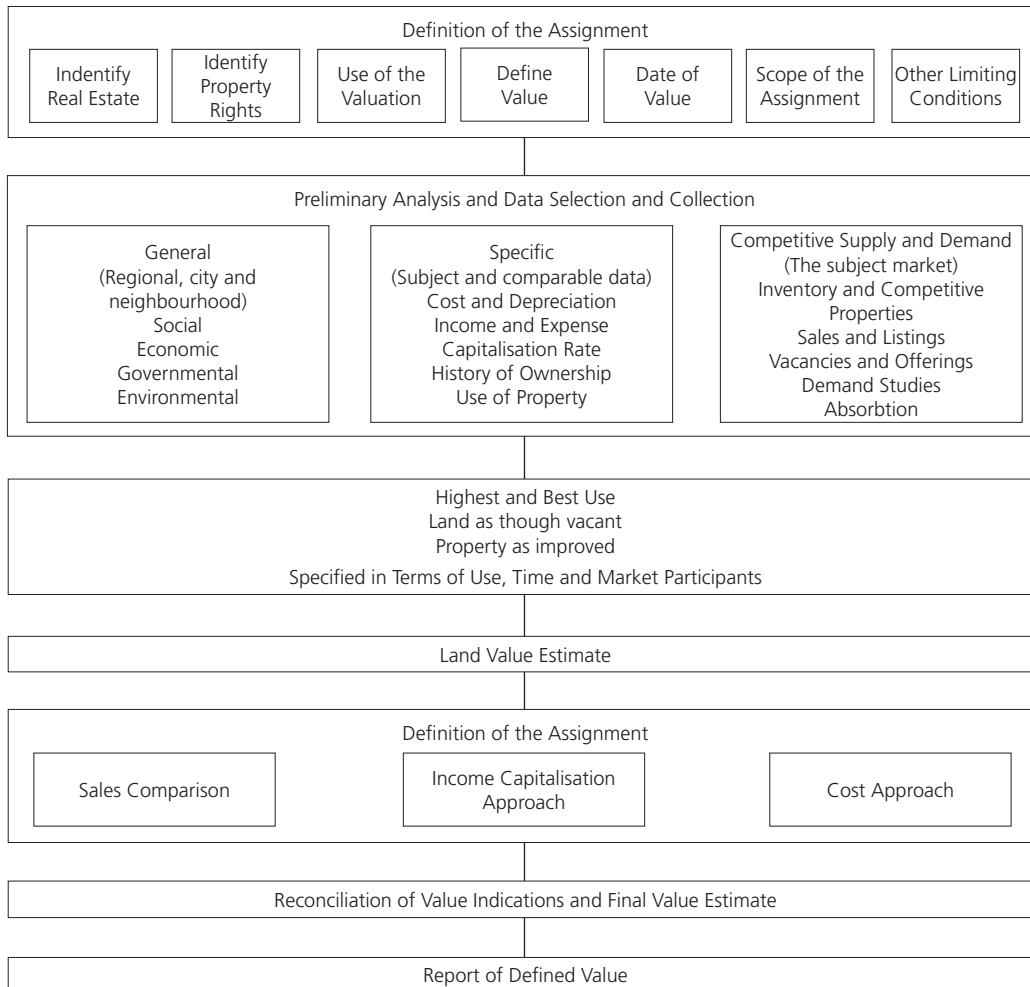
5.2 Where a type of value other than *Market Value* is the purpose of a valuation, the Valuer shall apply the appropriate definition of value and shall follow IVS 2 and applicable GNs. It is the responsibility of the Valuer to avoid potential misunderstandings or misapplications of the valuation estimate in situations where a value other than *Market Value* is the purpose of the assignment. Proper disclosures, identification and definition of terms, and stated limitations on the applicability of the valuation and the Valuation Report normally ensure compliance.

5.3 GN Figure 1-1 illustrates the Valuation Process as it is applied in many States. The process reflects Generally Accepted Valuation Principles (GAVP) and is approximated in virtually all States, whether or not the particular steps are explicitly followed. The principles from which this process derives are common to all States. Although the process may be used for either *Market Value* or applications founded on other bases of value, *Market Value* applications require the development of valuations solely on the basis of market data.

5.4 A valuation must be distinguished from a Valuation Report. Valuation includes all of the research, data, reasoning, analysis, and conclusions necessary to arrive at a value estimate. A Valuation Report communicates those processes and conclusions. Although requirements differ among States, it is a requisite under these Standards that adequate records be kept to demonstrate that a Valuation Process was followed and that the conclusions are credible and reliable. These records must be available in case reasonable enquiry is subsequently made. (See IVS Code of Conduct, para. 5.3.5 and 5.3.6.) In practice, some forms of reporting may incompletely represent the entire basis for the valuation. If the report is in any way limited, the Valuer will generally identify and distinguish between the scope of the valuation and that of the Valuation Report.

# INTERNATIONAL VALUATION GUIDANCE NOTE NO. 1

Guidance Note Figure 1-1: The Valuation Process



5.5 It is appropriate and customary that a *client's instruction* (para. 5.6 below) be stated in writing in a *letter or contract for services*. In *Market Value* situations it is also common for the independence, or external status, of the Valuer to be established in an affirmative statement. The agreement also sets forth the business relationship between the Valuer and the client, fee and payment terms, special directives and limitations, an identification of the Standards to be applied, and other pertinent matters.

5.6 As GN Figure 1-1 indicates, a Valuer and the valuation client must agree on the context and scope of the valuation. The *definition of the assignment* includes

- 5.6.1 an identification of the real estate involved in the valuation;
- 5.6.2 an identification of the property rights to be valued;

5.6.3 the intended use of the valuation, and any related limitations;

5.6.4 the identification of any subcontractors or agents and their contribution;

5.6.5 a definition of or the basis of the value sought;

5.6.6 the date as of which the value estimate will apply; and the date of the intended report;

5.6.7 an identification of the scope/extent of the valuation and of the report; and

5.6.8 an identification of any contingent and limiting conditions upon which the valuation is based.

5.7 In performing the steps of a *preliminary analysis*, and *data selection and collection*, suggested in the Valuation Process, the Valuer becomes familiar with the general market and subject property, thereby proceeding to a

- position from which more specific analyses can be made.
- 5.7.1 **General economic data** are collected at the neighbourhood, city, regional, and even national and international levels, depending on the property involved. Social, economic, governmental, and environmental factors that may have bearing on *Market Value* (or other defined value type) are examined to better understand the particular property. Any other specific forces that must be considered are investigated in detail.
- 5.7.2 **Property-specific data**, or data more directly relevant to the property being valued and to comparable properties are also gathered and examined. These include site and improvement data, cost and depreciation data, income and expense data, capitalisation and yield rate data, ownership and utilisation histories, and other information determined to be significant and generally considered by buyers and sellers in their negotiations and transactions.
- 5.7.3 **Supply and demand data** characteristic of the most probable market for the property are analysed to develop an inventory of properties that compete with the subject property for market share as well as an inventory of existing properties to be adapted or new properties to be built, which will increase the competitive supply. Markets are analysed to determine market trends, relationships between supply and demand, absorption rates, and other market-specific information.
- 5.8 Once the above data are gathered and analysed, the Valuer will be able to determine possible land uses for the subject property. Because different real estate parcels may have different use potentials, **the first requisite step toward selecting sales and other comparable data is to determine the highest and best use (HABU) of the subject property. The Valuer considers both the highest and best use of the land as though vacant and the highest and best use of the property as improved.** (See the discussion of HABU in Concepts Fundamental to Generally Accepted Valuation Principles, para. 6.0 et seq.)
- 5.8.1 **The concept of HABU** is based on the notion that although two or more parcels of real estate may have physical similarities and closely resemble one another, there may be significant differences in how they can be used. How a property can be optimally utilised is a foundation for determining its *Market Value*.
- 5.8.2 **Basic determinants of HABU** include the answers to the following questions:
- Is the suggested use a reasonable and likely one?
  - Is the use legal, or is there a reasonable likelihood that a legal entitlement for the use can be obtained?
  - Is the property physically suited to the use or can it be adapted to the use?
  - Is the suggested use financially feasible? and
  - Of those uses that meet the first four tests, is the selected HABU the most productive use of the land?
- 5.9 **Several methods are used for land valuation.** Their applicability differs according to the type of value estimated and availability of data. **For Market Value estimates, any method chosen must be supported by market data.** (See para. 5.25 et seq.)
- 5.10 In many, but not all, States **three valuation approaches are recognised in the Valuation Process: sales comparison, income capitalisation, and cost.** While a well-evidenced market may make the *cost approach* less relevant, a lack of comparable data may cause the *cost approach* to be predominant. The laws of some States preclude or limit the application of one or more of the three approaches. Unless there are such restrictions, or unless there are other compelling reasons for a particular omission, **it is reasonable for the Valuer to consider each approach.** In some States, the use of each approach is mandated unless the Valuer can demonstrate a lack of supporting data or other valid reason for omission of a particular approach. **Each approach is based, in part, on the Principle of Substitution**, which holds that when several similar or commensurate commodities, goods, or services are available, the one with the lowest price attracts the greatest demand and widest distribution. In simple terms, the price of a property established by a given market is limited by the prices commonly paid for properties that compete with it for market share, the financial alternatives of investing money elsewhere, and the cost of building a new property or adapting an old property to a use similar to that of the subject property (property being valued).
- 5.11 **The sales comparison approach** recognizes that property prices are determined by the market. **Market Value can, therefore, be calculated**

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 1

from a study of market prices for properties that compete with one another for market share. The comparative processes applied are fundamental to the Valuation Process.

5.11.1 When data are available, the *sales comparison approach* is the most direct and systematic approach to estimating value.

5.11.2 When data are insufficient, the applicability of the *sales comparison approach* may be limited. Insufficient research by the Valuer, however, is not an excuse for omission of this approach where data are available or could reasonably be developed. (See section 5.23 et seq. for discussion of market research, data verification, adjustment procedure, and reconciliation of indications.)

5.11.3 After sales data are gathered and verified, one or more *units of comparison* are selected and analysed. Units of comparison use two components to produce a factor (e.g., the price per measurement unit or a ratio such as that produced by dividing a property's sale price by its net income, i.e., net income multiplier, or years' purchase) that reflects precise differences between properties. The units of comparison that buyers and sellers in a given market use in making their purchase and sale decisions take on special relevance and may be afforded greater weight.

5.11.4 *Elements of comparison* are the specific characteristics of properties and transactions that cause the prices paid for real estate to vary. They are crucial considerations in the *sales comparison approach*.

5.11.5 To make direct comparisons between a comparable sale property and the subject property, a Valuer shall consider possible adjustments based on differences in the elements of comparison. Adjustments can narrow the differences between each comparable and the subject. Valuers apply quantitative and/or qualitative methods to analyse differences and estimate adjustments.

5.12 The *income capitalisation approach* can be applied in both *Market Value* assignments and other types of valuations. However, for *Market Value* applications, it is necessary to develop and analyse relevant market information. This focus differs distinctly from the development of subjective information for a specific owner or the reflection or viewpoint of a particular analyst or investor.

5.12.1 The *income capitalisation approach* is based on the same principles that apply to other valuation approaches. In particular, it perceives value as created by the expectation of future benefits (income streams). *Income capitalisation* employs processes that consider the present value of anticipated future income benefits.

5.12.2 As with other approaches, the *income capitalisation approach* can be used reliably only when relevant comparative data are available. When such information is not available, the approach may be used for general analysis but not for the purpose of direct market comparison. The *income capitalisation approach* is particularly important for properties that are purchased and sold on the basis of their earnings capabilities and characteristics and in situations where there is market evidence to support the various elements incorporated into the analysis. Nonetheless, the mathematical precision of the procedures used in the approach must not be mistaken as an indication of the precise accuracy of the results.

5.12.3 Market research is important to the *income capitalisation approach* in a number of ways. In addition to providing specific data that will be processed, market research also furnishes qualitative information to determine comparability and to assist in weighing the applicability of the results of the analysis. Thus, the approach is not merely quantitative, or mathematical, but requires qualitative assessments as well.

5.12.4 Once appropriate market research is completed and comparable data are collected and verified, Valuers analyse the income and expense statement provided for the subject property. This step involves a study of the historical incomes and expenses of the property under consideration and of other competing properties for which data are available. Subsequently, a cash flow (based upon a *reconstructed operating statement*) is developed that reflects market expectations, eliminates the special experiences of a particular owner, and provides a format that assists further analysis. The purpose of this step is to estimate the income that can be earned by the property, which will be capitalised into an indication of value. This estimate may reflect income and expenses for only a single year or a series of years.



- 5.12.5 Following the development of a cash flow (based on a *reconstructed operating statement*), the Valuer must choose a means of capitalisation. *Direct capitalisation* applies an *overall rate*, or *all risks yield*, which produces a value indication. *Direct capitalisation* is used in particularly well-evidenced markets. *Yield capitalisation* considers the time value of money, and is applied to a series of net operating incomes for a period of years. A method called *discounted cash flow analysis* (DCF) is a prominent example of *yield capitalisation*. (See Guidance Note 9). Either *direct capitalisation* or *yield capitalisation* (or both) can be applied to estimate *Market Value* if the capitalisation and yield rates are appropriately supported by the market. If applied correctly, both procedures should result in the same value estimate.
- 5.12.6 Reconstructed operating statements specify that the income projection is subject to the assumption that the property is run by a reasonably efficient operator or average competent management.

#### AUSNZ 5.12.7

**When adopting the income approach to value for owner-occupied property, the valuer must adopt notional market lease terms and conditions including a market rental. These terms and conditions should be stipulated in the report and if applicable, any vacancy and/or letting-up allowances included.**

#### AUSNZ 5.12.8

**Where the income approach to value is used for financial reporting purposes in relation to owner-occupied property, a deduction is not made for vacancy or letting-up factors if the going concern presumption applies. Areas intended to be vacated should not be valued on this basis.**

- 5.13 The *cost approach*, also known as the contractor's method, is recognised in most States. In any application, the *cost approach* establishes value by estimating the costs of acquiring land and building a new property with equal utility or adapting an old property to the same use with no undue expense resulting from delay. The cost of land is added to the total cost of construction. (Where applicable, an estimate of entrepreneurial incentive, or developer's profit/loss, is commonly added to

construction costs.) The cost approach establishes the upper limit of what the market would normally pay for a given property when it is new. For an older property, some allowance for various forms of accrued depreciation (physical deterioration; functional, or technical, obsolescence; and economic, or external obsolescence) is deducted to estimate a price that approximates *Market Value*. Depending upon the extent of market data available for the calculations, the cost approach may produce a direct indication of *Market Value*. The *cost approach* is very useful in estimating the *Market Value* of proposed construction, special-purpose properties, and other properties that are not frequently exchanged in the market. (See also GN 8, The Cost Approach for Financial Reporting- (DRC).)

- 5.14 The three approaches to value are independent of one another even though each approach is based on the same economic principles. All three approaches are intended to develop an indication of value, but the final value conclusion depends on consideration of all data and processes employed and the reconciliation of the value indications derived from different approaches into a final estimate of value. As shown in GN Figure 1-1, the reconciliation process is followed by a report of defined value.
- 5.15 The requirements for valuation reports are addressed in the IVSC Code of Conduct, and IVS 3, Valuation Reporting.
- 5.16 Where there is sufficient market data to support the valuation, *Market Value* is derived. In other circumstances, where there is insufficient market data or special instructions have been given, the result will be a *Value* other than *Market Value*.
- 5.17 The existence of different types of value must not confuse Valuers or the users of valuation services. *Market Value*, the value type most commonly sought in the market, is distinct from all other value types. Each of the other value types has its own rationale and application and shall be investigated only in an appropriate context. By proper reporting, adequate disclosure and discussion, and the assurance that the value type identified in the valuation report suits the intended purpose and use of the valuation, the Valuer assists the market in its reliance on valuations.
- 5.18 The terms *market* and *markets* imply properties, buyers, sellers, and some degree of



# INTERNATIONAL VALUATION GUIDANCE NOTE NO. 1

- competition.** If a property chosen for comparison does not, or cannot, compete in the same market as the property being valued, it is likely that the comparison property belongs to a different market.
- 5.19 The totality of private ownership rights associated with a particular property is referred to as a *freehold interest*, a *fee simple interest*, or by other appropriate terms depending on the State.
- 5.20 **In any analysis of comparable data, it is essential that the properties from which the comparable data are collected have characteristics similar to the property being valued.** These include legal, physical, locational, and use characteristics that are consistent with those of the subject property and reflect conditions in the market where the subject property competes. Differences shall be noted and analysed to develop adjustments in all three valuation approaches.
- 5.20.1 **In the sales comparison approach, comparable sales data** are adjusted to reflect the differences between each comparable property and the subject property. **Elements of comparison** include real property rights conveyed, financing terms, conditions of sale, expenditures made immediately after purchase, market conditions, location, physical characteristics, economic characteristics, use, and non-realty components of a sale.
- 5.20.2 **In the income capitalisation approach, comparable data** include rental, income, expense, and capitalisation and yield rate data. **The categories of comparable income and expense data** used in projections of future income and expenses and in the development of capitalisation and yield rates **must be identical.**
- 5.20.3 **In the cost approach, comparable data** refer to the costs of building or development, and adjustments are made to account for differences in quantities, qualities, and utility. In addition, analysis of comparable land data and comparable depreciation estimates is undertaken.
- 5.21 **Suitable units of comparison** are selected to conduct proper analyses. Different units of comparison may be used, depending on the property type and focus of the analyses. Office buildings and warehouse properties can be compared using price per square metre or square foot of leaseable or lettable area. In some markets, comparison of warehouse properties may use price per cubic metre or cubic foot; apartments can be compared using price per apartment unit or flat; and agricultural properties can be compared, using crop yield per hectare or per acre or supportable Animal Units (AU) per hectare or per acre. **Units of comparison are only useful when they are consistently selected and applied to the subject property and the comparable properties in each analysis and most closely reflect the units of comparison used by buyers and sellers in a particular market.**
- 5.22 **Elements of comparison** identify specific characteristics of properties and transactions that may explain price variations. Market analysis identifies which elements are especially sensitive. **The following elements of comparison are considered as basic in comparable sales analysis.**
- 5.22.1 **Real property rights conveyed.** A precise identification of the real property rights conveyed in each comparable transaction, selected for analysis, is essential because the transaction price is always predicated on the property interest conveyed.
- 5.22.2 **Financing terms.** Where different financing arrangements can cause the price paid for one property to differ from that of another identical property, the types and conditions of financing arrangements in the transaction shall be fully understood, analysed, and accounted for.
- 5.22.3 **Conditions of sale.** The special motivations of the parties to the transaction in many situations can affect the prices paid and even render some transactions as non-market. Examples of special conditions of sale include a higher price paid by a buyer because the parcel had synergistic, or marriage, value; a lower price paid because a seller was in a hurry to conclude the sale; a financial, business, or family relationship between the parties involved in the transaction; unusual tax considerations; lack of exposure of the property in the (open) market; or the prospect of lengthy litigation proceedings.
- 5.22.4 **Expenditures made immediately after the purchase** are expenditures that would have to be made upon purchase of the property and that a knowledgeable buyer may negotiate into the purchase price. Examples include the cost to repair or replace structures or parts of structures, the cost to remediate environmental contamination, or the costs associated with zoning changes to permit development.
- 5.22.5 **Market conditions.** Market conditions at the time of the sales transaction of a comparable property may differ from those on the valuation date of

- the property being valued. Factors that impact market conditions include rapidly appreciating or depreciating property values, changes in tax laws, building restrictions or moratoriums, fluctuations in supply and demand, or any combination of forces working in concert to alter market conditions from one date to another.
- 5.22.6 **Location.** The locations of the comparable sale properties and the subject property are compared to ascertain whether location and the immediate environs are influencing the prices paid. Extreme locational differences may indicate that a transaction is not truly comparable and should be disqualified.
- 5.22.7 **Physical characteristics.** Attributes such as the size, construction quality, and physical condition of the subject property and the comparable properties are described and analysed by the Valuer. If the physical characteristics of a comparable property vary from those of the subject property, each of the differences is considered, and the Valuer shall adjust for the impact of each of these differences on value.
- 5.22.8 **Economic characteristics.** Qualities such as income, operating expenses, lease provisions, management, and tenant mix are used to analyse income-producing properties.
- 5.22.9 **Use.** Zoning and other restrictions or limitations affect the use of a property. If there is a difference in the current use or *highest and best use* of a comparable property and that of the subject property, its impact on value shall be carefully considered. Generally, only properties with the same or similar *highest and best uses* are used in comparable analysis.
- 5.22.10 **Non-realty components of sale.** Personal property, business interests, or other items that do not constitute real property may be included in either the transaction price or the ownership interest in the property being valued. These components shall be analysed separately from the real property. Typical examples of personal property are furniture, fixtures, and equipment (FF&E) in a hotel or restaurant.
- 5.23 **In applying the sales comparison approach, a Valuer follows a systematic procedure. The Valuer will:**
- 5.23.1 **Research the market** to develop appropriate market information for similar properties that compete with the subject for market share; this information will vary among different property types but will commonly include the property type, date of sale, size, location, zoning, and other relevant information.
- 5.23.2 **Verify the information** by confirming that it is accurate and that the terms and conditions of sale are consistent with *Market Value* requirements; where differences occur, the Valuer will determine whether the data warrant only general consideration.
- 5.23.3 **Select relevant units of comparison** (e.g., price per metre or per square square foot; price per room; income multiplier, or years' purchase; or others) and develop a comparative analysis for each unit.
- 5.23.4 **Compare the sale properties with the subject property** using the elements of comparison and adjusting the sale price of each comparable property when data are available to support such adjustments. As an alternative, the Valuer may use the sales data to bracket or determine a probable range of values for the property. If the data are found not to be sufficiently comparable, the sale property shall be eliminated as a comparable.
- 5.23.5 **Reconcile the results into a value indication.** Where market conditions are indefinite, or when an array of the sales data shows varying degrees of comparability, it may be advisable to develop a range of value indications.
- 5.24 **Highest and best use underlies the analysis for all Market Value assignments.** An understanding of real estate market behaviour and dynamics is essential to the determination of a property's *highest and best use*. Since market forces create *Market Value*, the interaction between market forces and *highest and best use* is of fundamental importance. **Highest and best use identifies the most profitable use among potential uses to which the property can be put, and is, therefore, market-driven.**
- 5.24.1 It is possible that the *highest and best use* (HABU) of land as though it were vacant and the HABU of an improved parcel of land are different. In many States, it may be illegal to demolish buildings even if a more productive use is possible. Where demolition and site clearance are legal and possible, the costs associated with them might make new construction economically unfeasible. Thus, it is possible that there is a difference between the HABU of land as though vacant and that of the property as improved. The Valuer must analyse and report these considerations, and

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 1

clearly distinguish which HABU was selected. The Valuer must also provide support for the HABU selection.

5.24.2 In many States, it is necessary to make a land value estimate based on the HABU as though there were no improvements on the land. This HABU determination is, of course, necessary if the land is vacant, but it also provides an economic basis for judging the productivity of the improvements when they are present. The practice also involves analysing market information to determine the extent of accrued depreciation that may be present in the improvements. In other States, or in situations where there is little, if any, market information on vacant land sales, it is possible that land value may not be estimated. Local standards within each State prescribe practice in these situations, but in any event such restrictions shall be fully and clearly understood.

5.25 The primary methods of valuing land are:

5.25.1 A **sales comparison technique** for land valuation involves direct comparison of the subject property with similar land parcels for which actual data on recent market transactions are available. Although sales are the most important, analysis of listings and prices offered for similar parcels that compete with the subject may contribute to greater understanding of the market.

5.25.2 A **subdivision development technique** may also be applied to land valuation. This process entails projecting the subdivision of a particular property into a series of lots, developing incomes and expenses associated with the process, and discounting the resulting net incomes into an indication of value. This technique may be supportable in some situations, but is subject to a number of assumptions that may be exceedingly difficult to associate with the *Market Value* definition. Caution is advised in the development of supportable assumptions, of which the Valuer is advised to make full disclosure.

**Where direct land comparisons are not available, the following methods can be applied with caution.**

5.25.3 **Allocation** is an indirect comparison technique that develops a ratio between land value and improvement value or some other relationship between property components. The result is a measure that allocates a total market price between the land and improvements for comparative purposes.

5.25.4 **Extraction** is another indirect comparison technique (sometimes called *abstraction*). It provides a value estimate of improvements by applying a cost less depreciation analysis and extracting the result from the total price of otherwise comparable properties. The residual is an indication of possible land value.

5.25.5 The **land residual technique** for land valuation also applies income and expense data as elements in its analysis. A financial analysis is made of the net income that can be obtained by an income-producing use and a deduction from the net income is made for the financial return required by the improvements. The remaining income is considered residual to the land and is capitalised into a value indication. The method is limited to income-producing properties and is most applicable to newer properties for which fewer assumptions are required.

5.25.6 Land can also be valued by **ground rent capitalisation**. If the land is capable of independently producing a ground rental, that rent may be capitalised into a *Market Value* indication where sufficient market data are available. Care must be taken, however, not to be misled by special terms and conditions in a ground-rent lease that may not necessarily be representative of the particular market. In addition, since ground leases may have been drawn up many years before the valuation date, the rents quoted therein may be outdated, and current income capitalisation rates may be hard to obtain.

5.26 A **real estate market** may be defined as the interaction of individuals or entities that exchange real property rights for other assets, typically money. **Specific real estate markets** are defined by the property type, location, income-producing potential, typical tenant characteristics, attitudes and motivations of typical investors, or other attributes recognised by those individuals or entities participating in the exchange of real property. In turn, **real estate markets** are subject to a broad variety of social, economic, governmental, and environmental influences.

5.26.1 In comparison to markets in goods, securities, or commodities, **real estate markets are still considered inefficient**. This feature is attributable to a variety of factors including the relatively inelastic supply and the fixed location of real estate. Consequently, the supply of real estate does not adjust quickly in response to changes in market demand.

- 5.26.2 **Investment in real estate**, which is relatively illiquid, involves large sums of money for which appropriate financing might not be readily available. Valuers shall recognize these inefficiencies, and their understanding of the particular characteristics of a real estate market and/or sub-market shall produce a credible and objective analysis for the clients they serve.
- 5.27 **The use of the *cost approach*** can be appropriate when properties are new or of relatively new construction, provided estimates of items such as land value and depreciation are validated by market evidence. In depressed markets, economic or external obsolescence must be factored into the indication of value derived from the *cost approach*.

## 6.0 Effective Date

- 6.1 This International Valuation Guidance Note became effective 31 January 2005.

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# VALUATION OF LEASE INTERESTS

## REVISED 2007

### 1.0 Introduction

- 1.1 International Valuation Standards (IVSs) Concepts Fundamental to Generally Accepted Valuation Principles distinguish between *real estate*, the physical tangible “thing” (see Concepts Fundamental to GAVP 3.0), and *real property* which pertains to the rights, interests, and benefits related to the ownership of real estate. *Lease interests* are a form of real property, arising from the contractual relationship (the terms of which are conveyed by a *lease*) between a *lessor*, one who owns the property leased to another, and a *lessee*, or tenant, one who typically receives a non-permanent right to use the leased property in return for rental payments or other valuable economic consideration.
- 1.2 To avoid misunderstandings or misrepresentations, Valuers and users of valuation services should recognise the important distinction between the physical and the legal issues involved in considering the value of lease interests.
- 1.3 This class of ownership is, as for the fee simple or freehold interest, common to all types of property assets valued. A piece of real estate may comprise one or more property interests, each of which will have a *Market Value* providing it is capable of being freely exchanged.
- 1.4 In no circumstances is it considered proper to value different property interests in the same piece of *real estate* separately and then to aggregate their values as an indication of the *real estate's* total value. Lease contracts establish unique legal estates that are different from fee simple, or freehold, ownership.
- 1.5 International Financial Reporting Standards (IFRSs) (including International Accounting Standards (IASs)) contain specific accounting requirements for property that is either held under a lease, or subject to a lease.
- 1.6 The relationships between different legal interests in the same property can be complex and can be made more confusing by the different terminology used to describe the various interests. This Guidance Note (GN) seeks to address and clarify

these issues. The diagram on the following page illustrates the relationship between lease interests.

### 2.0 Scope

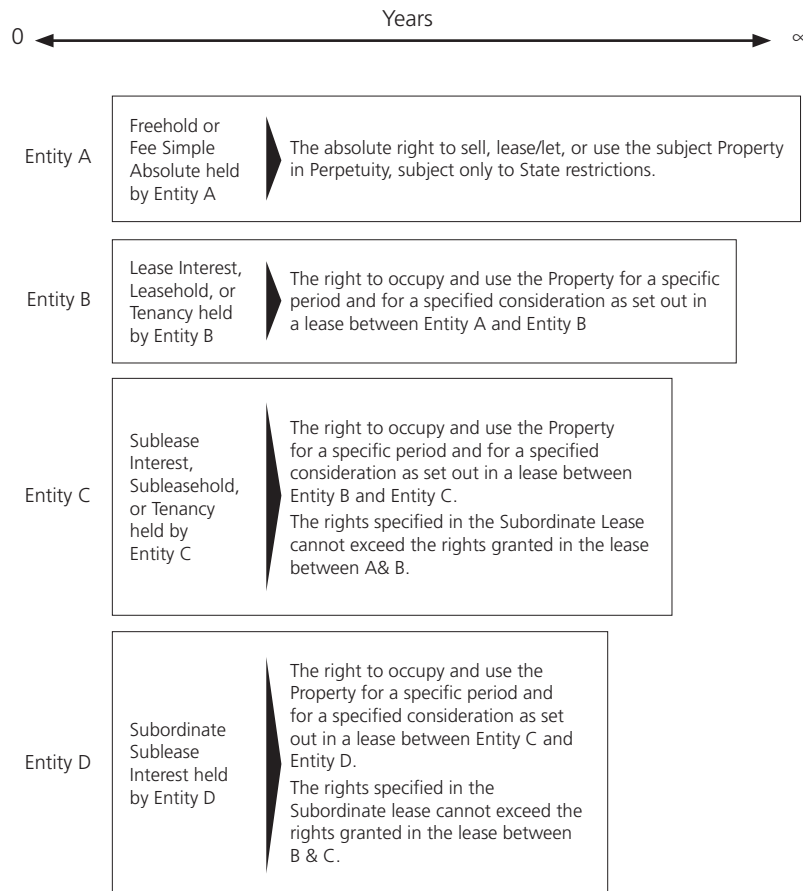
- 2.1 This GN sets out definitions, principles, and important considerations in the valuation of and related reporting for lease interests.
- 2.2 This GN is to be applied with particular reference to IVSs Concepts Fundamental to Generally Accepted Principles and to IVSs 1 and 2, and IVAs 1, 2 and 3.
- 2.3 This GN applies in States where a lessee holds an interest in land and/or buildings, which is regarded as a separate legal estate. A lease interest is subordinate to a superior interest, which itself may be either another lease interest for a longer term or the ultimate fee simple, or freehold, interest.

### 3.0 Definitions

- 3.1 Terms basic to the definition and valuation of legal interests include the following:
- 3.1.1 *Freehold Interest*. A *fee simple* estate, representing the perpetual ownership in land.
- 3.1.2 *Freehold subject to Lease Interest/s*, has the same meaning as Leased Fee Interest, representing the ownership interest of a lessor owning real estate that is subject to (a) lease(s) to others.
- 3.1.3 *Ground Lease*. Usually a long-term lease of land with the lessee permitted to improve or build on the land and to enjoy those benefits for the term of the lease.
- 3.1.4 *Headlease, or Master Lease*. A lease to a single entity that is intended to be the holder of subsequent leases to sublessees that will be the tenants in possession of the leased premises.
- 3.1.5 *Headleasehold Interest* has the same meaning as *Sandwich Lessor Interest*. The holder of a headlease or master lease.

# INTERNATIONAL VALUATION GUIDANCE NOTE NO. 2

## Hierarchy of Property Rights



The Valuer must identify the property interest to be valued along with the pertinent rights and restrictions.

- 3.1.6 *Lease.* A contract arrangement in which rights of use and possession are conveyed from a property's title owner (called the landlord, or lessor) in return for a promise by another (called a tenant, or lessee) to pay rents as prescribed by the lease. In practice the rights and the duties of the parties can be complex, and are dependent on the specified terms of their contract.
- 3.1.7 *Lease Interest*, also known as *Lessee Interest*, *Tenant's Interest*, or *Leasehold Estate*. The ownership interest that is created by the terms of a lease rather than the underlying rights of real estate ownership. The lease interest is subject to the terms of a specific lease arrangement, expires within a specified time, and may be capable of subdivision, or subleasing to other parties.
- 3.1.8 *Lessor Interest.* The interest held by the lessor in any of the circumstances set out in paras. 3.1.2, 3.1.4, or 3.1.5 above.

- 3.1.9 *Marriage Value*, or *Merged Interests Value*. The excess value, if any, produced by a merging of two or more interests in a property, over-and-above the sum of the values of those individual interests.

### 3.1.10 Rent Types

- 3.1.10.1 *Market Rent.* The estimated amount for which a property, or space within a property, should lease on the date of valuation between a willing lessor and a willing lessee on appropriate lease terms in an arm's-length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.

Whenever *Market Rent* is provided, the "appropriate lease terms" which it reflects should also be stated.

- 3.1.10.2 *Contract Rent*, or *Passing Rent.* The rent



specified by a given lease arrangement; although a given contract rent may equate to the *Market Rent*, in practice they may differ substantially, particularly for older leases with fixed rental terms.

### 3.1.10.3 *Turnover Rent, or Participation Rent.*

Any form of lease rental arrangement in which the lessor receives a form of rental that is based on the earnings of the lessee. Percentage rent is an example of a turnover rent.

- 3.1.11 *Sale and Leaseback.* A simultaneous sale of real estate and lease of the same property to the seller. The buyer becomes the lessor, or landlord, and the seller becomes the lessee, or tenant. Because there may be unique circumstances or relationships between the parties, sale and leaseback transactions may or may not involve typical market terms.

## 4.0 Relationship to Accounting Standards

- 4.1 Leased property is accounted for differently from freehold property, plant and equipment under IFRSs/IASs. The valuation requirements are summarized in IVA 1 and Addendum A to IVA 1.

## 5.0 Guidance

- 5.1 Lease interests are valued on the same general principles as freeholds, but with recognition of the differences created by the lease contract encumbering the freehold interest, which may cause the interest to be unmarketable or restricted.
- 5.2 Lease interests, in particular, are often subject to restrictive covenants or alienation provisions.
- 5.3 Freeholds subject to an *operating lease* are for accounting purposes generally considered *investment property*, and as such are valued on the basis of *Market Value*. Headleasehold interests are also commonly valued on the basis of *Market Value*.
- 5.4 In some States a lessee may have a statutory right to purchase the lessor's interest, usually the freehold, or may have an absolute or conditional right to a renewal of the lease for a term of years. The Valuer should draw attention to the existence of statutory rights

and indicate in the Valuation Report whether or not regard has been paid to them.

- 5.5 The importance of the distinction between the physical matter and the legal interest in it is critical to valuation. For example, a lease might specify that the lessee has no right to sell or transfer the leasehold interest, causing it to be unmarketable during the term of the lease. Its value to the lessee, therefore, lies solely in the rights of use and occupancy. The leasehold value may be expressed in monetary terms but is not a *Market Value* as the interest cannot be sold in the market. However, the lessor's interest (leased fee value) does have a *Market Value*, based on the value of the rental income during the lease together with any residual value remaining at the end of the lease.

- 5.6 Each legal interest in a property shall be valued as a separate entity and not treated as though merged with another interest. Any calculation of *merged interests value* or *marriage value* should be referred to in supplementary advice only and may be undertaken as a valuation based on specific assumptions only and where the Valuer's Report is appropriately qualified.

- 5.7 Onerous lease covenants may adversely affect the *Market Value* of a lease interest. The Valuer must draw attention in the Valuation Report to the existence of such circumstances. The most common situation where this adverse effect arises involves restrictions on assignment, or on the right to sublet.

### 5.8 Inter-Company Leases

- 5.8.1 Where a property is subject to a lease or tenancy agreement between two companies in the same group, it is acceptable to take account of the existence of that agreement, providing the relationship between the parties is disclosed in the report, and that the agreement is on arm's-length terms in accordance with normal commercial practice. When the valuation is being undertaken for inclusion in a financial statement, it is acceptable to reflect any inter-company leases, providing the interests of one of the parties to the lease are being valued. However, if the interest of the group is being valued for inclusion in its consolidated accounts, the existence of any inter-company leases should be disregarded. (International Accounting Standard 40, para B21)

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 2

### 5.9 Leasehold Alterations

5.9.1 When valuing any property interest that is subject to a lease, it is important that Valuers establish whether any alterations or adaptations have been made to the property by the lessee. If so the following questions need to be addressed:

- a) has the lessee complied with any lease conditions or restrictions relating to the alterations?
- b) what is the impact of any state laws on the rights of the parties in relation to the alterations?
- c) are the alterations obligatory or voluntary? (see below)
- d) is there any obligation on the lessor to compensate the lessee for the cost or value of the work, or on the lessee to remove the alterations at the lease end?

5.9.2 Leasehold alterations fall into two main categories:

- a) *Obligatory alterations*: These usually arise where a property is leased in a basic state or constructed to a "shell" specification that is not suitable for occupation without the lessee undertaking further building or fitting-out work. The lease will often impose a condition that such work be carried out by the lessee within a certain timescale
- b) *Voluntary alterations*: Typically these arise where a property is leased in a completed state ready for immediate occupation, but where the lessee elects to undertake work to improve or adapt the accommodation to suit the lessee's own particular requirements. Although the tenant may regard these as alterations, the general market may not.

5.9.3 Obligatory alterations will usually have a beneficial impact on the *Market Rent*. Voluntary alterations may have a beneficial, neutral or detrimental effect on the *Market Rent*, depending upon their nature and degree of specialisation. The degree to which the impact on the *Market Rent* is reflected in the value of either the lessor's or the lessee's interest will depend upon the answers to the questions in 5.9.1.

### 5.10 Negative *Market Values*

5.10.1 Where lease interests are liabilities to an undertaking, they may have a negative *Market Value*.

### 5.11 General

Due to the relative complexity of lease interest valuations, it is essential that the client or the client's legal advisor provide the Valuer with either copies of all the leases or, for multitenanted property, typical sample leases together with a summary of lease terms on the other leases.

## 6.0 Effective Date

6.1 This International Valuation Guidance Note became effective 31 July 2007.

# VALUATION OF PLANT AND EQUIPMENT

## REVISED 2007

### 1.0 Introduction

- 1.1 Plant and equipment collectively constitute a general class of tangible property assets. International Valuation Application 1 (IVA 1) deals with valuation requirements for financial reporting purposes. This Guidance Note provides additional information to assist in the application of the International Valuation Standards to plant and equipment assets.
- 1.2 Plant and equipment assets have particular characteristics that distinguish them from most types of real property and that influence both the approach to and reporting of their value. Plant and equipment are normally capable of being moved or relocated and often will depreciate at a significantly faster rate than real property. Frequently, the value will differ notably depending on whether an item of plant or equipment is valued in combination with other assets within an operational unit or whether it is valued as an individual item for exchange, and where it may be considered as either in-situ (in place) or for removal.

### 2.0 Scope

- 2.1 This Guidance Note focuses on the application of the approaches, principles and bases described in the Standards to the valuation of plant and equipment. The following Guidance Notes may also be relevant to the valuation of plant and equipment:
- GN 4, Valuation of Intangible Assets
  - GN 5, Valuation of Personal Property
  - GN 6, Business Valuation
  - GN 7, Consideration of Hazardous and Toxic Substances in Valuation
  - GN 8, Cost Approach for Financial Reporting—(DRC)
- 2.2 This Guidance Note applies to the valuation of the plant and equipment assets of both private-sector and public-sector entities.

### 3.0 Definitions

#### International Valuation Standards Definitions

- 3.1 *Fair Value*. The amount for which an asset could be exchanged between knowledgeable willing parties in an arm's length transaction.
- 3.2 *Market Value*. 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.
- 3.3 *Plant and Equipment*. Tangible assets, other than *realty*, that:
- (a) are held by an entity for use in the production or supply of goods or services, for rental by others, or for administrative purposes; and
  - (b) are expected to be used over a period of time.

The categories of plant and equipment are:

*Plant*. Assets that are inextricably combined with others and that may include specialised buildings, machinery, and equipment.

*Machinery*. Individual machines or a collection of machines. A machine is an apparatus used for a specific process in connection with the operation of the entity.

*Equipment*. Other assets that are used to assist the operation of the enterprise or entity.

#### International Financial Reporting Standards Definitions

- 3.3 *Finance Lease*. A lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not be eventually transferred. (IAS 17, para. 4)
- 3.4 *Operating Lease*. A lease other than a finance lease. (IAS 17, para. 4)

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 3

- 3.5 *Property, Plant and Equipment*. Tangible items that:
- are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
  - are expected to be used during more than one (accounting) period. (IAS 16, para. 6)

### 4.0 Relationship to Accounting Standards

- 4.1 Under International Financial Reporting Standards (IFRSs), *Property Plant and Equipment* may be included on an entity's balance sheet at either cost less depreciation less impairment or at fair value at the date of revaluation less depreciation less impairment. (IAS 16, paras. 29, 30 and 31). The fair value of items of plant and equipment is usually their market value determined by appraisal (IAS 16, para. 32). Plant and equipment, together with other fixed assets, may be subject to other IFRSs, including IAS 2, Inventories; IAS 17, Leases; IAS 36, Impairment of Assets; IFRS 3, Business Combinations; and IFRS 5, Non-Current Assets Held for Sale and Discontinued Operations.
- 4.2 International Valuation Application (IVA) 1, Valuation for Financial Reporting, sets out the valuation and valuation reporting requirements under the various IFRSs referred to above.
- 4.3 International Public Sector Accounting Standards (IPSASs) require that after recognition, items of *Property, Plant and Equipment* be carried at either cost less any accumulated depreciation and any accumulated impairment losses, or at a revalued amount being the fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses (IPSAS 17, paras. 43 and 44). IPSAS 21, Impairment of Non-Cash-Generating Assets, may also apply to plant and equipment, together with other fixed assets. International Valuation Application 3, Valuation of Public Sector Assets for Financial Reporting, sets out the valuation and valuation reporting requirements under IPSASs.
- 4.4 The valuation approach and assumptions applicable to a valuation of plant and equipment for inclusion in a financial statement may be very different from those appropriate for another purpose. A clear distinction should be made if values for different purposes are reported in the same document. Different valuation assumptions

may be appropriate under different IFRSs and IPSASs and therefore it is important for the Valuer to be familiar with the basic requirements of the relevant standard, and to discuss the appropriate assumptions with the client before proceeding.

### 5.0 Guidance

- 5.1 Valuations of plant and equipment can be carried out using any of the following approaches:
- sales comparison approach*.
  - cost approach (depreciated replacement cost)* (See GN 8); and
  - income capitalisation approach*.

#### AUSNZ 5.1.4 Income Streams

**It is recognised that it is rarely possible to identify an income stream and allocate it to individual assets. As a result, it is generally very difficult, if not impossible, to assess values for individual assets by reference to the income approach. It is also arguable that any cash flow based valuation will, by default, include more than just the plant & equipment assets.**

- 5.2 For many purposes, including compliance with IFRSs, the most appropriate basis of value is *Market Value*. However, *Market Value* simply stipulates that an exchange is assumed to take place on an arm's-length basis between knowledgeable and willing parties; it is silent as to how the particular asset is to be presented for sale or any of the other specific circumstances that could have a fundamental effect on the valuation. When undertaking a valuation of plant and equipment, the Valuer must therefore establish and state the additional assumptions that are appropriate, having regard to the nature of the asset and the purpose of the valuation. These assumptions may include the state of the business in which the plant and equipment are currently utilized, or the extent to which individual items are aggregated with other assets. Examples of assumptions that may be appropriate in different circumstances, or for different valuation purposes include:
- that the plant and equipment are valued as a whole, in-situ (in place) and as part of the business considered as a going concern;

- 5.2.2 that the plant and equipment are valued in-situ but on the assumption that the business is closed; or
- 5.2.3 that the plant and equipment are valued as individual items for removal from their current location.

For assets in the public sector, the assumption equivalent to a business continuing as a going concern is that the public sector assets will continue to be used for the provision of the relevant public good or service.

### AUS 5.2.4

**There is no distinction in Australian Accounting Standards between public and private sector assets. However there is a distinction between for-profit and not-for-profit sector assets. Valuations determined using the DRC approach should be reported subject to the test of adequate profitability in the case of a for-profit enterprise and to the test of service potential in the case of a not-for-profit enterprise. Along the same lines, for assets in the not-for-profit sector, the assumption equivalent to a business continuing as a going concern is that the not-for-profit sector assets will continue to be used for the provision of the relevant good or service.**

- 5.3 The list of assumptions above is not comprehensive. Because of the diverse nature and transportability of much plant and equipment, *Market Value* will need appropriate qualifying assumptions to describe the state and circumstances in which the asset is offered to the market. These assumptions should be discussed with the client and must be included in the report. Frequently, it may be appropriate to report on more than one set of assumptions, e.g., in order to illustrate the effect of business closure or cessation of operations on the *Market Value* of plant and equipment assets, where closure or cessation is not yet definite.
- 5.4 Other factors that can affect the *Market Value* of plant and equipment include:
  - 5.4.1 the costs of installation and commissioning where plant and equipment are valued in situ;
  - 5.4.2 where they are valued for removal, any allowance made for the costs of decommissioning, removal, and possible reinstatement following removal, and which party is to bear those costs. In some cases,

these costs can be substantial and therefore the Valuer should reach an agreement with the client as to how they should be reflected and which specific assumption(s) are to be made.

- 5.5 Factors such as finite sources of raw materials, the limited life of the buildings or limited tenure of the land and buildings housing the plant, and statutory restrictions or environmental legislation can also have a significant impact on the value of plant and equipment. These factors will need to be taken into account by the Valuer and any necessary assumptions will have to be made.
- 5.6 Some plant and equipment connected with the supply or provision of services to a building will normally be included in any exchange of the real estate interest. Examples include plant for the supply of electricity, gas, heating, cooling or ventilation and equipment such as elevators. Although the value of these items would normally be reflected in the value of the real estate interest, for certain purposes, such as depreciation accounting, it may be necessary to value these items separately. Where this is the case, the Valuer should make it clear that the separate valuation and treatment of these items will affect the value of the real estate interest. When different Valuers are employed to carry out valuations of real estate assets and plant and equipment assets at the same location, careful liaison is necessary to avoid either omissions or double counting.
- 5.7 Intangible assets fall outside the definition of plant and equipment. However, intangible assets may have an impact on the value of plant and equipment; for example, the value of patterns and dies is often inextricably linked to associated intellectual property rights. In such cases the Valuer should establish what assumptions are appropriate as to the availability of those intangible assets before reporting a valuation. Operating software, technical data, production records and patents are examples of intangible assets that can have an impact on the value of plant and equipment, depending on whether or not they are included in the transfer.
- 5.8 An item of plant and equipment may be subject to a financing arrangement, such as a finance lease. Accordingly, the asset cannot be sold without the lender or lessor being paid any balance outstanding under

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 3

the arrangement. This payment may or may not exceed the unencumbered value of the item. Items of plant and equipment subject to such arrangements should be separately identified from assets that are unencumbered, and their value separately reported. Items, which are subject to operating leases or are otherwise the property of third parties, are normally excluded as the benefits of ownership are not transferred to the lessee. Guidance on Finance and Operating Leases is included in Addendum 1 to IVA 1.

- 5.9 *Market Value* does not imply any particular method of sale, as for example, by private treaty, tender, auction, etc. The conceptual framework in IVS 1 makes it clear that *Market Value* assumes a sale after proper marketing in the most appropriate manner. It is implicit in this definition that the method of sale will be the one that will achieve the highest price for the asset or the defined group of assets in a given set of circumstances. A willing and knowledgeable seller would not voluntarily choose a method of sale that did not maximize the price. However, if the exchange is to take place under circumstances that prevented the seller from choosing the optimal method of disposal, the anticipated realisation will not be the *Market Value* unless the constraint on the seller was one common to all sales in that particular market at that time. A constraint specific to a particular seller or asset, coupled with a requirement to sell subject to that constraint, will result in a forced sale.
- 5.10 Plant and equipment assets are more likely to be subject to forced sale circumstances than real estate interests. For example, assets sometimes have to be disposed of in a time frame that precludes proper marketing because the current owner of the assets has to vacate or surrender the land and buildings where they are located. If such a scenario has actually arisen, or is reasonably foreseeable, it may be appropriate for the Valuer to provide advice on the price that could be anticipated or that should be accepted, although before doing so the Valuer will need to establish the exact nature of the constraint on the vendor and understand the consequences for the vendor of failing to dispose of the assets within the stipulated time limit. For example, the assets may be subject to forfeit or the owner may be subject to a specific financial penalty. It may also be necessary to consider any alternatives

to sale, for example, the practicality and cost of removing the items to another location for disposal. Without knowledge of the actual or anticipated circumstances, the Valuer cannot give meaningful advice since the exchange may fall outside the definition of *Market Value*. Assumptions regarding realisation of a transfer under forced sale circumstances must be carefully considered and clearly stipulated.

### AUSNZ 5.11 Materiality

**In order to establish what represents a 'sufficiently comprehensive' inspection of plant & equipment it is necessary to have regard to materiality. For the purpose of defining materiality the API and PINZ refers to the principles of materiality as identified in Australian and New Zealand Accounting Standards, which define materiality as follows:**

*"Materiality means, in relation to information, that information which if omitted, misstated or not disclosed has the potential to adversely affect decisions about the allocation of scarce resources made by users of the financial report or the discharge of accountability by the management or governing body of the entity".*

## 6.0 Effective Date

- 6.1 This Guidance Note became effective 31 July 2007.



# VALUATION OF INTANGIBLE ASSETS

## REVISED 2007

### 1.0 Introduction

- 1.1 The International Valuation Standards Committee (IVSC) adopted this Guidance Note (GN) to improve the consistency and quality of intangible asset valuations among the international community for the benefit of users of financial statements and users of intangible asset valuations.
- 1.2 Intangible asset valuations are commonly sought and performed on the *Market Value* basis of valuation applying the provisions of International Valuation Standard 1 (IVS 1). Where other bases of valuation are used with proper explanation and disclosure, the provisions of IVS 2 are applied.
- 1.3 In general, the concepts, processes, and methods applied in the valuation of intangible assets are the same as those for other types of valuations. Certain terms may have different meanings or uses. Those differences become important disclosures wherever they are used. This GN sets forth important definitions used in valuations of intangible assets.
- 1.4 Care should be taken by Valuers and users of valuation services to distinguish between the value of individual, identifiable intangible assets and going concern considerations, including those encountered in the valuation of real property interests. An example of the latter is valuations of trade related property.

### 2.0 Scope

- 2.1 This GN is provided to assist in the course of rendering or using valuations of intangible assets.
- 2.2 In addition to the elements that are common to other GNs to the International Valuation Standards, this GN contains a more expansive discussion of the intangible asset valuation process. This is included to typify what is commonly involved in valuations of intangible assets and to provide a basis of comparison with other types of valuations, but the discussion should not be considered as either mandatory or limiting except as provided in this GN or otherwise in the IVSs.
- 2.3 Because other basic valuation principles, the

International Valuation Standards, and Guidance Notes are also applicable to valuations of intangible assets, this GN should be understood to incorporate all other applicable portions of the IVSs.

### 3.0 Definitions

#### 3.1 Book Value

- 3.1.1 With respect to assets, the capitalised cost of an asset less accumulated depreciation, depletion, or amortisation as it appears on the account books of the business.
- 3.1.2 With respect to a business entity, the difference between total assets (net of depreciation, depletion, and amortisation) and total liabilities of a business as they appear on the balance sheet. In this case, book value is synonymous with net book value, net worth, and shareholder's equity.
- 3.2 *Business Entity*. A commercial, industrial, or service organisation pursuing an economic activity.

#### 3.3 Capitalisation

- 3.3.1 At a given date, the conversion into the equivalent capital value of net income or a series of net receipts, actual or estimated, over a period.
- 3.3.2 In business valuation, the term refers to the capital structure of a business of a business entity.
- 3.3.3 In business valuation, this term also refers to the recognition of an expenditure as a capital asset rather than a periodic expense.
- 3.4 *Capitalisation Factor*. Any multiple or divisor used to convert income into capital value.
- 3.5 *Capitalisation Rate*. Any divisor (usually expressed as a percentage) that is used to convert income into capital value.

#### 3.6 Cash Flow

- 3.6.1 *Gross Cash Flow*: Net income after taxes, plus non-cash items such as depreciation and amortisation.
- 3.6.2 *Net Cash Flow*: During an operating period, that amount of cash that remains after all cash needs of the business have been satisfied. *Net cash flow*



## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 4

is typically defined as being cash available to equity or invested capital.

- 3.6.3 *Equity Net Cash Flow*: Net income after taxes, plus depreciation and other non-cash charges, less increases in working capital, less capital expenditures, less decreases in invested capital debt principal, plus increases in invested capital debt principal.
- 3.6.4 *Invested Capital Net Cash Flow*: *Equity net cash flow*, plus interest payments net of tax adjustment, less net increases in debt principal.
- 3.7 *Discount Rate*. A rate of return used to convert a monetary sum, payable or receivable in the future, into present value. A weighted average of the discount rate applied to intangibles and the discount rate applied to tangibles should correlate with the weighted average cost of capital for the business.
- 3.8 *Economic Life*. The period over which property may be profitably used. Economic life may vary by State depending on the level of industrial development and regulatory atmosphere in each State.
- 3.9 *Effective Date*. The date as of which the Valuer's opinion of value applies. (Also referred to as *Valuation Date*, and/or *As Of Date*.)
- 3.10 *Enterprise*. See Business Entity.
- 3.11 *Going Concern*. An operating business.  
The entity is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the entity has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operations. (IAS 1, 23-24, Framework, 23)

### 3.12 Goodwill.

- 3.12.1 Future economic benefits arising from assets that are not capable of being individually identified and separately recognised. (IFRS 3, Appendix A)
- 3.12.2 *Personal Goodwill*. The value of profit over and above market expectations, which would be extinguished upon sale of the trade related property, together with those financial factors related specifically to the current operator of the business, such as taxation, depreciation policy, borrowing costs and the capital invested in the business.
- 3.12.3 *Transferable Goodwill*. That intangible asset that arises as a result of property-specific name and reputation, customer patronage, location, products, and similar factors, which generate economic benefits. It is inherent to the trade related property, and will transfer to a new owner on sale.
- 3.13 *Income Capitalisation Approach*. A general way of estimating a value indication of an intangible asset using one or more methods wherein a value is estimated by converting anticipated benefits into capital value.
- 3.14 *Intangible Assets*. Assets that manifest themselves by their economic properties. They do not have physical substance; they grant rights and privileges to their owner and usually generate income for their owner. Intangible Assets can be categorised as arising from *Rights*, *Relationships*, *Grouped Intangibles*, or *Intellectual Property*.
- 3.14.1 *Rights* exist according to the terms of a contract, written or unwritten, that is of economic benefit to the parties. Examples are supply contracts, distribution contracts, providing contracts, and licensing permits, among others.
- 3.14.2 *Relationships* between parties are normally non-contractual, can be short-lived, and can have great value to the parties. Examples are assembled workforce, customer relationships, supplier relationships, distributor relationships, and structural relationships between parties, among others.
- 3.14.3 *Grouped Intangibles* are the residual *intangible asset* value left after all identifiable *intangible assets* have been valued and deducted from total intangible asset value. Alternative concepts include patronage, excess earnings, and residual value. *Grouped intangibles* are often called *goodwill*. *Goodwill* has, at various times, been said to be the tendency for customers to return to a place of business, the extra income generated by a business over and above a fair return to the identified assets, and/or the extra value of the entity as a whole over and above the aggregate value of its constituent identifiable assets.
- 3.14.4 *Intellectual Property* is a special classification of *intangible assets* because it is usually protected by law from unauthorised use by others. Examples are brand names, or tradenames; copyrights; patents; trademarks; trade secrets, or know-how; among others.
- 3.14.5 In general, the accounting profession limits the recognition of individual *intangible assets* to those that are commonly recognisable, have a statutory or contractual remaining life, and/or must be individually transferable and separable from the

business.

- 3.15 *Intangible Property*. The rights and privileges granted to the owner of intangible assets.
- 3.16 *Legal Life*. The life of the *intangible assets* allowed by law.
- 3.17 *Market Approach*. A general way of estimating a value indication for an intangible asset using one or more methods that compare the subject to similar assets that have been sold.
- 3.18 *Market Value*. See IVS 1, para. 3.1.
- 3.19 *Rate of Return*. An amount of income (loss) and/or change in value realised or anticipated on an investment, expressed as a percentage of that investment.
- 3.20 *Replacement Cost New*. The current cost of a similar new item having the nearest equivalent utility as the item being appraised.
- 3.21 *Report Date*. The date of the Valuation Report. May be the same as or different from the valuation date.
- 3.22 *Reproduction Cost New*. The current cost of an identical new item.
- 3.23 *Valuation Approach*. In general, a way of estimating value using one or more specific valuation methods. (See *Asset Based Approach*, *Market Approach*, and *Income Capitalisation Approach* definitions).
- 3.24 *Valuation Method*. Within valuation approaches, a specific way to estimate a value.
- 3.25 *Valuation Procedure*. The act, manner, and technique of performing the steps of a valuation method.
- 3.26 *Valuation Ratio*. A factor wherein a value or price serves as the numerator and financial, operating, or physical data serve as the denominator.
- 3.27 *Value in Use*. This value type focuses on the value that specific property contributes to the entity of which it is a part without regard to the property's *highest and best use* or the monetary amount that might be realised upon its sale. Value in use is the value a specific property has for a specific use to a specific user and is, therefore, non-market related.

## 4.0 Relationship to Accounting Standards

- 4.1 Intangible asset valuations are commonly used as a basis for making allocations of value for various assets to aid in the establishment or restatement

of financial statements. In this context, Intangible Asset Valuers reflect the *Market Value* of all components of a business's balance sheet in order to meet accounting Standards, having regard to the convention that reflects the effect of changing prices.

- 4.2 International Accounting Standard 38 (IAS 38) prescribes the accounting treatment for intangible assets, discusses the criteria an intangible asset must meet for recognition, specifies the carrying amount of intangible assets, and sets forth requirements for disclosures about intangible assets.

## 5.0 Guidance

- 5.1 **Valuations of intangible assets may be required for a number of possible uses including acquisitions and dispositions of businesses or parts of businesses, mergers, sale of an intangible asset, financial reporting and the like.**
  - 5.1.1 **Where the purpose of the valuation requires a *Market Value* estimate, the Valuer shall apply definitions, processes, and methodologies consistent with their provision in IVS 1.**
  - 5.1.2 **When an engagement calls for a value basis other than *Market Value*, the Valuer shall clearly identify the type of value involved, define such value, and take steps necessary to distinguish the value estimate from a *Market Value* estimate.**
- 5.2 If, in the opinion of the Valuer, certain aspects of an engagement indicate that a departure from any provision of the International Valuation Standards or of this GN is necessary and appropriate, such departure should be considered for disclosure along with the reason for invoking the departure.
- 5.3 **The Valuer shall take steps to assure that all data sources relied on are reliable and appropriate to the valuation undertaking.** In many instances it will be beyond the scope of the Valuer's services to perform a complete verification of secondary or tertiary data sources. Accordingly, the Valuer shall verify the accuracy and reasonableness of data sources as are customary in the markets and locale of the valuation.
- 5.4 **Valuers of intangible assets must frequently rely on information received from a client or from a client's representatives. The source of any such data relied upon must be cited by the Valuer in oral or written reports, and the data**

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 4

- shall be reasonably verified wherever possible. The requirements for Valuation Reports are addressed in the IVSC Code of Conduct (section 7), and IVS 3, Valuation Reporting.
- 5.5 Although many of the principles, methods, and techniques of intangible asset valuation are similar to those used in other fields of valuation, valuations of intangible assets require special education, training, skills, and experience.
- 5.6 A description of the valuation assignment must include
- 5.6.1 identification of the intangible asset(s), or the ownership interest in the intangible asset(s), to be valued;
- 5.6.2 the effective date of the valuation;
- 5.6.3 the definition of value;
- 5.6.4 the owner of the interest; and
- 5.6.5 the purpose and use of the valuation.
- 5.7 Factors to be considered by the Intangible Asset Valuer include:
- 5.7.1 The rights, privileges, or conditions that attach to the ownership interest
- 5.7.1.1 Ownership rights are set forth in various legal documents. In various States, or in some legal jurisdictions, these documents may be called patents, trademarks, brands, know-how, databases, and copyrights, to name a few.
- 5.7.1.2 Whoever owns the interest is bound by the documents that record such interest in the intangible assets. There may be rights and conditions contained in an agreement or exchange of correspondence, and these rights may or may not be transferable to a new owner of the interest.
- 5.7.2 Remaining economic life and/or legal life of the intangible asset
- 5.7.3 The earnings capacity of the intangible assets
- 5.7.4 The nature and history of the intangible assets. Since value resides in the benefits of future ownership, history is valuable in that it may give a guide to the expectations of the intangible assets for the future.
- 5.7.5 The economic outlook that may affect the subject intangible assets, including political outlook and government policy. Matters such as the exchange rate and inflation and interest rates may affect intangible assets that operate in different sectors of the economy quite differently.
- 5.7.6 The condition and outlook of the specific industry, which may affect the subject intangible assets
- 5.7.7 Intangible value may also be contained in undifferentiated assets, often called *goodwill*. Note that goodwill value in this context is similar to goodwill in the accounting sense in that both are the residual value (historical cost in accounting terms) after all other assets have been taken into account.
- 5.7.8 Prior transactions in ownership interests of the subject intangible assets
- 5.7.9 Other market data, e.g., rates of return on alternative investments, etc.
- 5.7.10 The market prices for acquisition of similar intangible assets interests or intangible assets
- 5.7.10.1 Often, particularly in the use of acquisition transactions, adequate information is difficult or impossible to obtain. While the actual transaction price may be known, the Valuer may not know what warranties and indemnities were given by the seller, what terms were given or received, or what impact taxation planning had on the transaction.
- 5.7.10.2 Comparable data should always be used with care, and numerous adjustments may need to be made.
- 5.7.11 Adjustment of historical financial statements to estimate the economic abilities of and prospects for the intangible assets
- 5.7.12 Any other information the Valuer believes to be relevant
- 5.8 Intangible asset valuation approaches
- 5.8.1 *Market (sales comparison) approach* to intangible asset valuation
- 5.8.1.1 The *market approach* compares the subject to similar intangible assets or intangible asset ownership interests and securities that have been sold in the open market.
- 5.8.1.2 The two most common sources of

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 4

- data used in the *market approach* are markets in which ownership interests of similar intangible assets are traded and prior transactions in the ownership of the subject intangible assets.
- 5.8.1.2.1 There must be a reasonable basis for comparison with and reliance upon the similar intangible assets in the *market approach*. These similar intangible assets should be in the same industry as the subject or in an industry that responds to the same economic variables. The comparison must be made in a meaningful manner and must not be misleading.
- 5.8.1.3 Through analysis of acquisitions of intangible assets, the Valuer often computes valuation ratios, which are usually price divided by some measure of income or net assets. Care must be used in calculating and selecting these ratios.
- 5.8.1.3.1 The ratio(s) selected must provide meaningful information about the value of the intangible assets.
- 5.8.1.3.2 The data on the similar intangible assets used to compute the ratio must be accurate.
- 5.8.1.3.3 The calculation of ratios must be accurate.
- 5.8.1.3.4 If the data are averaged, the time period considered and the averaging method must be appropriate.
- 5.8.1.3.5 All calculations must be done in the same way for both the similar intangible assets and the subject intangible assets.
- 5.8.1.3.6 The price data used in the ratio(s) must be valid as of the valuation date and representative of the market at that time.
- 5.8.1.3.7 Where appropriate, adjustments may need to be made to render the similar intangible assets and the subject intangible assets more comparable.
- 5.8.1.3.8 Adjustments may need to be made for unusual, non-recurring, and non-operating items.
- 5.8.1.3.9 The selected ratios must be appropriate given the differences in risk and expectations of the similar intangible assets and the subject intangible assets.
- 5.8.1.3.10 Several value indications may be calculated since several valuation multiples may be selected and applied to the subject intangible assets.
- 5.8.1.4 When prior transactions in the subject intangible assets are used to provide valuation guidance, adjustments may need to be made for the passage of time and for changed circumstances in the economy, the industry, and the intangible assets.
- 5.8.2 *Income capitalisation approach* to intangible asset valuation
- 5.8.2.1 The *income approach* estimates the value of an intangible asset or of intangible asset ownership interests by calculating the present value of anticipated benefits. The two most common *income approach* methods are (*direct*) *capitalisation* of income and *discounted cash flow analysis* (DCF).
- 5.8.2.1.1 In (*direct*) *capitalisation* of income, a representative income level is divided by a capitalisation rate or multiplied by an income multiple (capitalisation factor) to convert the income into value.
- 5.8.2.1.2 Income is typically allocated to the various intangible assets by the Valuer. Care must be taken so that the income allocated to all of the individual assets does not exceed the income available to all assets.
- 5.8.2.1.3 In theory, income can consist of a variety of types of income and cash flow. In practice, the income measure is usually pre-tax income or post-tax income. If capitalisation methods are used, the economic life of the assets must be infinite, or very long.
- 5.8.2.1.4 In DCF *analysis* and/or *dividend method*, cash receipts are

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 4

estimated for each of several future periods. These receipts are converted to value by the application of a discount rate, using present value techniques. Many definitions of *cash flow* could be used. Discounting methods are most commonly used for intangible assets with finite economic lives. The time period covered by the discounting methods is normally the shorter of the economic life or the legal life (the definable period over which the asset or interest therein is legally protected).

- 5.8.2.1.4.1 **Economic life** is measured as the period when the intangible assets can be expected to give the owner an economic return on the assets. An example is computer software that may have an expected life of 36 months before it is necessary to replace it with an updated version.
- 5.8.2.1.4.2 **Legal life** is measured as the period when the intangible asset can be protected by law. An example is a patent that has a definable life at its inception and that slowly, over time, goes to zero.
- 5.8.2.1.5 **Capitalisation rates and discount rates are derived from the market and are expressed as price multiples (derived from data on publicly traded businesses or transactions) or an interest rate (derived from data on alternative investments).**
- 5.8.2.2 Anticipated income or benefits are converted to value using calculations that consider the expected growth and timing of the benefits, the risk associated with the benefit stream, and the time value of money.
- 5.8.3 The **cost approach**, often called the cost to recreate, is also known as the *adjusted asset approach*.
  - 5.8.3.1 A cost-based approach is founded on the Principle of Substitution, i.e., an asset is worth no more than it would cost to replace all of its constituent parts.

- 5.8.3.2 In the execution of the cost approach, the cost of each item in the creation of the assets, including developer's profit, must be estimated using the knowledge possessed as of the valuation date.

### 5.9 Reconciliation processes

- 5.9.1 The value conclusion shall be based upon
  - 5.9.1.1 the definition of value, and
  - 5.9.1.2 all relevant information as of the valuation date necessary in view of the scope of the assignment.
- 5.9.2 The value conclusion shall also be based on value indications from the valuation methods performed.
  - 5.9.2.1 The selection of and reliance on the appropriate approaches, methods, and procedures depend on the judgment of the Valuer.
  - 5.9.2.2 The Valuer must use judgment when determining the relative weight to be given to each of the value indications derived during application of the Valuation Process. The Valuer should provide the rationale and justification for the valuation methods used and for the weighting of the methods relied on in reaching the reconciled value conclusion.

## 6.0 Effective Date

- 6.1 This International Valuation Guidance Note became effective 31 July 2007.

# VALUATION OF PERSONAL PROPERTY

## REVISED 2007

### 1.0 Introduction

- 1.1 The objective of this Guidance Note (GN) is to improve the consistency and quality of personal property valuations for the benefit of users of personal property valuation services.
- 1.2 Personal property valuations are commonly sought and performed on the *Market Value* basis of valuation, applying the provisions of International Valuation Standard 1 (IVS 1). Where other bases of valuation are used, the provisions of IVS 2 are applied, subject to proper disclosure and explanation.
- 1.3 While certain terms may have alternative definitions, and the applicability of specific methods may diverge, the theory, concepts, and processes applied in the valuation of personal property are fundamentally the same as those for other types of valuations. Whenever terms that have different meanings are used, it is important that those differences be disclosed. This GN sets forth important definitions used in personal property valuations.
- 1.4 Care should be taken by Valuers and users of valuation services to distinguish among the market components and corresponding *Market Values* of personal properties. One example of such differentiation is the *Market Value* of properties sold at auction vs that of properties sold by or acquired from private dealers where the negotiated price is not publicly disclosed. Another example would be the *Market Value* of personal property sold wholesale vs the market value of the same item(s) sold retail.

### 2.0 Scope

- 2.1 This GN is provided to assist in the course of rendering or using personal property valuations.
- 2.2 In addition to the elements that are common to other Applications and Guidance Notes in the International Valuation Standards, this GN contains an expanded discussion of the Valuation Process

for personal properties. This is included to typify what is commonly involved in personal property valuations and to provide a basis of comparison with other types of valuations.

- 2.3 Plant and equipment (P&E) is a category of personal property, but P&E valuation is dealt with under GN 3.

### 3.0 Definitions

- 3.1 *Auction Price*. The price that is the final accepted bid at a public auction; may or may not include any fees or commissions. See also Hammer Price, Private Treaty Sale.
- 3.2 *Collectibles*. Broad descriptive term for objects collected because of the interest they arouse owing to their rarity, novelty, or uniqueness. In some States, the term may be applied to fine art, antiques, gems and jewelry, musical instruments, numismatic and philatelic collections, rare books, and archival materials, among others. Elsewhere the term is normally used for these and a wide variety of other items not found in any other category.
- 3.3 *Cost Approach*. A comparative approach to the value of property or another asset that considers as a substitute for the purchase of a given property, the possibility of constructing another property that is equivalent to the original or one that could furnish equal utility with no undue cost resulting from delay. The Valuer's estimate is based on the reproduction or replacement cost of the subject property or asset, less total (accrued) depreciation.
- 3.4 *Cost Approach for Valuing Fine Art*. A comparative approach to the value of fine art that considers as a substitute for the purchase of a given work of fine art the possibility of creating another work of fine art that replaces the original. The Valuer's estimate is based on the reproduction or replacement cost of the subject work of fine art, and the nature of the replacement, i.e., whether it be *new for old*, *indemnity basis*, a *replica*, or a *facsimile*.



## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 5

*New for old* refers to the cost of purchasing the same item or, if unavailable, an item similar in nature and condition in the retail market for new works of fine art.

*Indemnity basis* refers to the cost of replacing an item with a similar item in similar condition in the second-hand retail market for art and antiques.

A *replica* is a copy of the original item, as near as possible to the original in terms of nature, quality, and age of materials but created by means of modern construction methods.

A *facsimile* is an exact copy of the original item, created with materials of a closely similar nature, quality, and age and using construction methods of the original period.

- 3.5 *Fixtures and Fittings*. The totality of improvements integral to a property, valued collectively. See Trade Fixtures or Tenant's Fixtures.
- 3.6 *Furniture, Fixtures and Equipment*. (FF&E) A term used in North America to refer to tangible personal property plus trade fixtures and leasehold improvements. See also Personal Property.
- 3.7 *Goods and Chattels Personal*. In certain States, a term used for identifiable, portable, and tangible objects considered by the public to be personal property. See also Personal Property.
- 3.8 *Hammer Price*. The accepted and announced bid, exclusive of any fees or commissions and, therefore, not necessarily the purchase price. See also Auction Price, Private Treaty Sale.
- 3.9 *Income Capitalisation Approach*. A comparative approach to value that considers income and expense data relating to the property being valued and estimates value through a capitalisation process.
- 3.10 *Intrinsic Value*. The amount considered, on the basis of an evaluation of available facts, to be the "true" or "real" worth of an item. A long-term, *Non-Market Value* concept that smoothes short-term price fluctuations.
- 3.11 *Leasehold Improvements or Tenant's Improvements*. Fixed improvements or additions to land or buildings, installed by and paid for by the tenant to meet the tenant's needs; typically removable by the tenant upon expiration of the lease; removal causes no material damage to the real estate. See also Personal Property, Trade Fixtures or Tenant's Fixtures.
- 3.12 *Market Value*. See IVS 1, para. 3.1.
- 3.13 *Personal Property*. A legal concept referring to all

rights, interests, and benefits related to ownership of items other than real estate. In certain States, items of personal property are legally designated as personalty in distinction to realty, which may either refer to real property or real estate. Items of personal property can be tangible, such as a chattel, or intangible, such as a debt or patent. Items of tangible personal property typically are not permanently affixed to real estate and are generally characterized by their movability. See also Collectibles; Fixtures and Fittings; Furniture, Fixtures and Equipment (FF&E); Goods and Chattels Personal; Leasehold Improvements or Tenant's Improvements; Plant and Equipment; Trade Fixtures or Tenant's Fixtures.

- 3.14 *Personalty*. A legal term used in certain States to designate items of personal property in distinction to realty, which may either refer to real property or real estate. Personalty includes tangible and intangible items that are not real estate. See also Personal Property.

- 3.15 *Plant and Equipment*. Tangible assets, other than realty, that:

- (a) are held by an entity for use in the production or supply of goods or services, for rental by others, or for administrative purposes; and
- (b) are expected to be used over a period of time.

The categories of plant and equipment are:

*Plant*. Assets that are inextricably combined with others and that may include specialised buildings, machinery, and equipment.

*Machinery*. Individual machines or a collection of machines. A machine is an apparatus used for a specific process in connection with the operation of the entity.

*Equipment*. Other assets that are used to assist the operation of the enterprise or entity.

- 3.16 *Private Treaty Sale*. A sale negotiated and transacted between persons rather than by public auction or another method. The sale price paid in a private treaty sale is generally not known except by the parties to the transaction. See also Auction Price, Hammer Price.
- 3.17 *Professional Property Valuer*. A person who possesses necessary qualifications, ability, and experience to estimate property value for a diversity of purposes including transactions involving transfers of property ownership, property considered as collateral to secure loans and mortgages, property subject to litigation or



- pending settlement on taxes, and property treated as fixed assets in financial reporting.
- 3.18 *Sales Comparison Approach.* A general way of estimating a value indication for personal property or an ownership interest in personal property, using one or more methods that compare the subject to similar properties or to ownership interests in similar properties. This approach to the valuation of personal property is dependent upon the Valuer's market knowledge and experience as well as recorded data on comparable items.
- 3.19 *Trade Fixtures or Tenant's Fixtures.* Non-realty fixtures attached to property by the tenant and used in conducting the trade or business. See also Leasehold Improvements or Tenant's Improvements, Personal Property.
- 3.20 *Valuation Approach.* In general, a way of estimating value that employs one or more specific valuation methods. Depending on the nature and purpose of the property, three valuation approaches may be applied. These are the *sales comparison, income capitalisation, and cost approaches*. Their application will enable the Valuer to determine *Market Value* or a value other than *Market Value*.
- 3.21 *Valuation Method.* Within the valuation approaches, a specific way to estimate value.
- 3.22 *Valuation Procedure.* The act, manner, and technique of performing the steps of a valuation method.

## 4.0 Relationship to Accounting Standards

- 4.1 In some instances the valuation of personal property undertaken in conjunction with the valuation of real property and/or a business provides a basis for determining the extent of depreciation or obsolescence of certain fixed assets. In this application, the personal property valuation *per se* may or may not be the principal reason for the valuation, but the combination of services by a Personal Property Valuer, a Business Valuer and/or a Real Property Valuer, is necessary to properly allocate and reflect the *Market Value* of assets to be included in a financial statement.

## 5.0 Guidance

- 5.1 **Personal property valuations may be required for a number of possible uses including financial reporting, acquisitions and disposals/**

**dispositions, insurance, and taxation.**

- 5.1.1 Where the purpose of the valuation requires a **Market Value** estimate, the Valuer shall apply definitions, processes, and methodologies consistent with their provision in IVS 1.
- 5.1.2 When an engagement calls for a value basis **other than Market Value**, e.g., insurable value, the Valuer shall clearly identify the type of value involved, define such value, and take steps necessary to distinguish the value estimate from a *Market Value* estimate as consistent with IVS 2.
- 5.2 **Steps shall be taken by the Valuer to assure that all data sources relied upon are reliable and appropriate to the valuation undertaking.** In many instances, it will be beyond the scope of the Valuer's services to perform a complete verification of secondary or tertiary data sources. Accordingly, the Valuer shall take reasonable steps to verify the accuracy and reasonableness of data sources as is customary in the market(s) and locale of the valuation.
- 5.3 It is not uncommon for personal property valuations to require that the Personal Property Valuer call for and rely upon the services of other Professional Property Valuers and/or other professionals. Thus, **the parameters of responsibility relating to the classification of property items must be established between Valuers of different disciplines to ensure that nothing has been omitted or double entered.** A common example is reliance upon a Real Property Valuer to value the real estate components of a property. **Where the services of other experts are relied upon, the Personal Property Valuer shall:**
- 5.3.1 **take verification steps as are reasonably necessary to ensure that such services are competently performed and that the conclusions relied upon are reasonable and credible, or**
- 5.3.2 **disclose the fact that no such verification steps were taken.**
- 5.4 **Personal Property Valuers must frequently rely upon information received from a client or from a client's representatives. The source of any such data relied upon shall be cited by the Valuer in oral or written reports, and the data shall be reasonably verified wherever possible.**
- 5.5 Although many of the principles, methods, and techniques of personal property valuation are similar to those in other fields of valuation,

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 5

- personal property valuations require special education, training, skill, and experience.
- 5.6 Requirements for Valuation Reports are addressed in the IVSC Code of Conduct, and IVS 3, Valuation Reporting. For personal property the Valuation Report must include:
- 5.6.1 Identification of the property and owner or ownership interest to be valued (location of the object of personal property and address of the owner);
- 5.6.2 The effective date of the valuation;
- 5.6.3 The basis or definition of value;
- 5.6.4 Identification of the owner of interest or instructing party (n.b., in some States, the identity of the owner of interest may not be made known for reason of confidentiality);
- 5.6.5 The purpose and use of the valuation;
- 5.6.6 The conditions of the valuation;
- 5.6.7 Liens and encumbrances on the property; and
- 5.6.8 A Compliance Statement (signed and dated).
- 5.7 Factors to be considered (but not necessarily reported) by the Personal Property Valuer include:
- 5.7.1 Rights, privileges, or conditions that attach to the ownership of the subject property
- 5.7.1.1 Ownership rights are set forth in various legal documents
- 5.7.1.2 Rights and conditions contained in an owner's agreement or exchange of correspondence; these rights may or may not be transferable to a new owner of the subject property.
- 5.7.1.3 The documents may contain restrictions on the transfer of the property and may contain provisions governing the basis of valuation that has to be adopted in the event of transfer of the property.
- 5.7.2 The nature of the property and history of its ownership (provenance)
- 5.7.2.1 Previous sales or transfers of the property
- 5.7.3 The economic outlook that may affect the subject property, including political outlook and government policy
- 5.7.4 The condition and outlook of a market specific to the trade of personal properties that may affect the subject property
- 5.7.5 Whether or not the subject property has intangible value
- 5.7.5.1 If intangible value is inherent in the personal property, the Valuer must ensure that the intangible value is fully reflected, whether the identifiable intangible has been valued separately or not.
- 5.7.5.1.1 Intangible value, insofar as can be reasoned, should be distinguished from the value of the tangible property.
- 5.7.5.2 It is essential that the Valuer be aware of the legal restrictions and conditions that arise through the laws of the State in which the property exists.
- 5.7.5.3 Often, particularly in the use of acquisition transactions, adequate information is difficult to obtain. While the actual transaction price may be known, the Valuer may not know what warranties and indemnities were given by the seller, whether cash or other assets were taken from the seller prior to acquisition, how value should be allocated among the assets acquired, or what impact taxation planning had on the transaction.
- 5.7.5.4 For the reasons explained in para. 5.7.5.3, comparable data should always be used with care, and adjustments may need to be made. When using published auction results, it must be borne in mind that those results may represent transactions for a small market sector. Adjustments may be needed for differences due to differing market levels.
- 5.7.6 Any other information the Valuer believes is relevant.
- 5.8 Personal property valuations performed by means of the *sales comparison approach*
- 5.8.1 The *sales comparison approach* compares the subject property to similar properties and/or property ownership interests that have been sold in open markets.
- 5.8.2 The two most common sources of data used in the *sales comparison approach* are published auction results and transactions reported by firms regularly engaged in the trade of similar properties.

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 5

- 5.8.3 There must be a reasonable basis for comparison with and reliance upon the similar properties in the *sales comparison approach*. These similar properties should be regularly traded in the same market as the subject or in a market that responds to the same economic variables. The comparison must be made in a meaningful manner and must not be misleading. Factors to be considered in whether a reasonable basis for comparison exists include:
- 5.8.3.1 Similarity to the subject property in terms of qualitative and quantitative descriptive characteristics
  - 5.8.3.2 Amount and verifiability of data on the similar property
  - 5.8.3.3 Whether the price of the similar property represents an arm's-length transaction
  - 5.8.3.4 A thorough, unbiased search for similar properties is necessary to establish the independence and reliability of the valuation. The search should include simple, objective criteria for selecting similar properties
  - 5.8.3.5 A comparative analysis of qualitative and quantitative similarities and differences between similar properties and the subject property must be made
  - 5.8.3.6 Where appropriate, adjustments may need to be made to render the value of the similar properties more comparable to the subject property. Adjustments may need to be made for unusual, non-recurring and unique items.
  - 5.8.3.7 Appropriate adjustments for differences in the subject property's ownership and the ownership of similar properties with regard to the character and influence of such provenance or marketability/saleability or lack thereof, must be made, if applicable.
- 5.8.4 When prior transactions of the subject property are used to provide valuation guidance, adjustments may need to be made for the passage of time, for changes in the subject property, and for changed circumstances in the economy, industry, scholarly appreciation, and the business in which such properties are traded.
- 5.8.5 Anecdotal valuation rules, or rules of thumb, may be useful in the valuation of a property or ownership interest in an item of personal property.
- However, value indications derived from the use of such rules should not be given substantial weight unless it can be shown that buyers and sellers place substantial reliance on them.
- 5.9 **Personal property valuations performed by means of the *income capitalisation approach***
- 5.9.1 The Income Capitalisation Approach to value considers income and expense data relating to the property being valued and estimates value through a capitalisation process.
- 5.9.2 The application of *the income capitalisation approach* may be appropriate in the valuation of furniture, fixtures, and equipment (FF&E) essential to the operation of properties such as hotels, furnished apartments, and care facilities.
- 5.9.2.1 FF&E may be subject to heavy use and, therefore, require periodic replacement to maintain the attractiveness and utility of the facility.
  - 5.9.2.2 The useful lives of items of FF&E are estimated on the basis of their quality, durability, and the amount of use they receive. A weighted average for the useful lives of items of FF&E may then be calculated.
  - 5.9.2.3 An estimate of the future replacement cost of the items of FF&E is divided by this figure to arrive at an annual replacement allowance/renewal fund. The replacement allowance/renewal fund is included among the entity's operating expenses/outgoings.
- 5.10 **Personal property valuations performed by means of the *cost approach***
- 5.10.1 The *cost approach* considers as a substitute for the purchase of a given item of personal property, the possibility of creating another item equivalent to the original or one that could furnish equal utility with no undue cost resulting from delay.
- 5.10.2 The Valuer's estimate is based on the reproduction or replacement cost of the subject property or asset.
- 5.10.2.1 Replacement cost refers to what one might expect to pay for an object of similar age, size, color, and condition. Generally, it seeks to establish the cost of an alternative example or of a *replica*, or copy, of the original item, as near as possible to the original in terms of nature, quality, and age of materials

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 5

but created by means of modern construction methods.

- 5.10.2.1.1 In the case of assets such as valuable antiques or paintings, replacement may be impractical regardless of the cost.
- 5.10.2.1.2 Reproduction cost refers to what one might expect to pay for a *facsimile*, or exact copy, of the original item, created with materials of a closely similar nature, quality, and age and using construction methods of the original period.
- 5.10.2.1.3 Over time some items of personal property that do not suffer physical depreciation may appreciate since current cost to replace or reproduce such items typically outpaces increases in their current price.

5.10.3 The application of the *cost approach* is especially appropriate in valuations of personal property such as manufactured products or items for which multiple copies exist, e.g., prints, porcelain figurines, or products turned out by a mint.

### 5.11 Reconciliation processes

- 5.11.1 The value conclusion shall be based upon
  - 5.11.1.1 the definition of value;
  - 5.11.1.2 the purpose and intended use of the valuation; and
  - 5.11.1.3 all relevant information as of the valuation date necessary in view of the scope of the assignment.
- 5.11.2 The value conclusion shall also be based on value estimates from the valuation methods performed.
  - 5.11.2.1 The selection of and reliance on the appropriate approaches, methods, and procedures depend on the judgment of the Valuer.
  - 5.11.2.2 The Valuer must use judgment when determining the relative weight to be given to each of the value estimates during the Valuation Process. The Valuer should provide the rationale and justification for the valuation methods used and for the weighting of the methods relied on in reaching the value reconciliation when requested.

## 6.0 Effective Date

- 6.1 This International Valuation Guidance Note became effective 31 July 2007.

# BUSINESS VALUATIONS

## REVISED 2007

### 1.0 Introduction

- 1.1 The International Valuation Standards Committee (IVSC) adopted this Guidance Note (GN) to improve the consistency and quality of business valuations among the international community for the benefit of users of financial statements and users of business valuations.
- 1.2 Business valuations are commonly sought and performed on the *Market Value* basis of valuation applying the provisions of International Valuation Standard 1 (IVS 1). Where other bases of valuation are used, with proper explanation and disclosure, the provisions of IVS 2 are applied.
- 1.3 In general the concepts, processes, and methods applied in the valuation of businesses are the same as those for other types of valuations. Certain terms may have different meanings or uses. Those differences become important disclosures wherever they are used. This GN sets forth important definitions used in business valuations.
- 1.4 Care should be taken by Valuers and users of valuation services to distinguish between the value of a business entity or trade related property, the valuation of assets owned by such an entity, and various possible applications of business or going concern considerations encountered in the valuation of real property interests. An example of the latter is valuations of trade related property. (See Property Types, para. 4.3.2.)

### 2.0 Scope

- 2.1 This GN is provided to assist in the course of rendering or using business valuations.
- 2.2 In addition to the elements that are common to other GNs to the International Valuation Standards, this GN contains a more expansive discussion of the business valuation process. This is included to typify what is commonly involved in business valuations and to provide a basis of comparison with other types of valuations, but the discussion should not be considered as either mandatory or limiting except as provided in this GN or otherwise in the International Valuation Standards.

- 2.3 Because other basic valuation principles, International Valuation Standards, and Guidance Notes are also applicable to business valuations, this GN should be understood to incorporate all other applicable portions of the IVSs.

### 3.0 Definitions

- 3.1 *Adjusted Book Value*. The book value that results when one or more asset or liability amounts are added, deleted or changed from the reported book amounts.
- 3.2 *Asset-based Approach*. A means of estimating the value of a business and/or equity interest using methods based on the *Market Value* of individual business assets less liabilities.
- 3.3 *Book Value*
  - 3.3.1 With respect to assets, the capitalised cost of an asset less accumulated depreciation, depletion, or amortisation as it appears on the account books of the business.
  - 3.3.2 With respect to a business entity, the difference between total assets (net of depreciation, depletion, and amortisation) and total liabilities of a business as they appear on the balance sheet. In this case, *book value* is synonymous with *net book value*, *net worth*, and *shareholder's equity*.
- 3.4 *Business Entity*. A commercial, industrial, service, or investment entity pursuing an economic activity.
- 3.5 *Business Valuation*. The act or process of arriving at an opinion or estimation of the value of a business or entity or an interest therein.
- 3.6 *Business Valuer*. A person who, by education, training, and experience is qualified to perform a valuation of a business, business ownership interest, security and/or intangible assets.
- 3.7 *Capitalisation*
  - 3.7.1 At a given date, the conversion into the equivalent capital value of net income or a series of net receipts, actual or estimated, over a period.
  - 3.7.2 In business valuation, the term refers to the capital structure of a business entity.

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 5

- 3.7.3 In business valuation, this term also refers to the recognition of an expenditure as a capital asset rather than a periodic expense.
- 3.8 *Capitalisation Factor*. Any multiple used to convert income into value.
- 3.9 *Capitalisation Rate*. Any divisor (usually expressed as a percentage) that is used to convert income into value.
- 3.10 *Capital Structure*. The composition of the invested capital.
- 3.11 *Cash Flow*
- 3.11.1 *Gross Cash Flow*: Net income after taxes, plus non-cash items such as depreciation and amortisation.
- 3.11.2 *Net Cash Flow*: During an operating period, that amount of cash that remains after all cash needs of the business have been satisfied. *Net cash flow* is typically defined as being cash available to equity or invested capital.
- 3.11.3 *Equity Net Cash Flow*: Net income after taxes, plus depreciation and other non-cash charges, less increases in working capital, less capital expenditures, less decreases in invested capital debt principal, plus increases in invested capital debt principal.
- 3.11.4 *Invested Capital Net Cash Flow*: *Equity net cash flow*, plus interest payments net of tax adjustment, less net increases in debt principal.
- 3.12 *Control*. The power to direct the management and policies of a business.
- 3.13 *Control Premium*. The additional value inherent in the control interest that reflects its power of control, as contrasted to a minority interest.
- 3.14 *Discount for Lack of Control*. An amount or percentage deducted from a pro rata share of the value of 100 % of an equity interest in a business to reflect the absence of some or all of the powers of control.
- 3.15 *Discount Rate*. A rate of return used to convert a monetary sum, payable or receivable in the future, into present value.
- 3.16 *Economic Life*. The period over which property may be profitably used.
- 3.17 *Effective Date*. The date as of which the Valuer's opinion of value applies (Also referred to as *Valuation Date*, and/or *As Of Date*).
- 3.18 *Enterprise*. See Business Entity.
- 3.19 *Going Concern*
- 3.19.1 An operating business.
- 3.19.2 A premise of valuation, under which Valuers and accountants consider a business as an established entity that will continue in operation indefinitely. The premise of a going concern serves as an alternative to the premise of liquidation.
- Adoption of a going concern premise allows the business to be valued above liquidation value and is essential to the development of *Market Value* for the business.
- 3.19.3 The entity is normally viewed as a going concern, that is, as continuing in operation in the foreseeable future. It is assumed that the entity has neither the intention nor the necessity of liquidation or of curtailing materially the scope of its operations. (IAS 1, 23-24, Framework, 23)
- 3.20 *Goodwill*
- 3.20.1 Future economic benefits arising from assets that are not capable of being individually identified and separately recognised. (IFRS 3, Appendix A)
- 3.20.2 *Personal Goodwill*. The value of profit over and above market expectations, which could be extinguished upon sale of the trade related property, together with those financial factors related specifically to the current operator of the business, such as taxation, depreciation policy, borrowing costs and the capital invested in the business.
- 3.20.3 *Transferable Goodwill*. That intangible asset that arises as a result of property-specific name and reputation, customer patronage, location, products, and similar factors, which generate economic benefits. It is inherent to the trade related property, and will transfer to a new owner on sale.
- 3.21 *Holding Company*. A business that receives returns on its assets.
- 3.22 *Income Capitalisation Approach*. A general way of estimating a value indication of a business, business ownership interest, or security using one or more methods wherein a value is estimated by converting anticipated benefits into capital value.
- 3.23 *Invested Capital*. The sum of the debt and equity in a business on a long-term basis.
- 3.24 *Majority Control*. The degree of control provided by a majority position.
- 3.25 *Majority Interest*. Ownership position greater than 50% of the voting interest in a business
- 3.26 *Market Approach*. A general way of estimating a value indication of a business, business ownership



interest, or security using one or more methods that compare the subject to similar businesses, business ownership interests, or securities that have been sold.

- 3.27 *Market Value*. See IVS 1, para. 3.1.
- 3.28 *Marketability Discount*. An amount or percentage deducted from an equity interest to reflect lack of marketability.
- 3.29 *Minority Discount*. A Discount for lack of control applicable to a minority interest.
- 3.30 *Minority Interest*. Ownership position less than 50% of the voting interest in a business.
- 3.31 *Net Assets*. Total assets less total liabilities.
- 3.32 *Net Income*. Revenue less expenses, including taxes.
- 3.33 *Operating Company*. A business that performs an economic activity by making, selling, or trading a product or service.
- 3.34 *Rate of Return*. An amount of income (loss) and/or change in value realised or anticipated on an investment, expressed as a percentage of that investment.
- 3.35 *Replacement Cost New*. The current cost of a similar new item having the nearest equivalent utility as the item being appraised.
- 3.36 *Report Date*. The date of the Valuation Report. May be the same as or different from the Valuation date.
- 3.37 *Reproduction Cost New*. The current cost of an identical new item.
- 3.38 *Valuation Approach*. In general, a way of estimating value using one or more specific valuation methods. (See *Market Approach*, *Income Capitalisation Approach*, and *Asset Based Approach* definitions.)
- 3.39 *Valuation Method*. Within approaches, a specific way to estimate value.
- 3.40 *Valuation Procedure*. The act, manner, and technique of performing the steps of a valuation method.
- 3.41 *Valuation Ratio*. A factor wherein a value or price serves as the numerator and financial, operating, or physical data serve as the denominator.
- 3.42 *Working Capital*. The amount by which current assets exceed current liabilities.

## 4.0 Relationship to Accounting Standards

- 4.1 Business valuations are commonly used as a basis for making allocations of various assets to aid in the establishment or restatement of financial statements. In this context, business Valuers reflect the *Market Value* of all components of a business's balance sheet in order to meet Accounting Standards, having regard to the convention that reflects the effect of changing prices.
- 4.2 In some instances the business valuation provides a basis for estimating the extent of obsolescence of certain fixed assets. In this application the business valuation may or may not be the principal reason for the valuation, but the combination of services by the Business Valuer and, for example, a Real Property Valuer, is necessary to properly allocate and reflect the *Market Value* of assets to appear in a financial statement.
- 4.3 Other considerations relative to the relationship of business valuations and Accounting Standards are similar to the provisions discussed in International Valuation Application 1 (IVA 1).

## 5.0 Guidance

- 5.1 Business valuations may be required for a number of possible uses, including acquisitions and dispositions of individual businesses, mergers, valuation of shareholder ownings, and the like.
  - 5.1.1 Where the purpose of the valuation requires a *Market Value* estimate, the Valuer shall apply definitions, processes, and methodologies consistent with their provision in IVS 1.
  - 5.1.2 When an engagement calls for a value basis other than *Market Value*, the Valuer shall clearly identify the type of value involved, define such value, and take steps necessary to distinguish the value estimate from a *Market Value* estimate.
- 5.2 If, in the opinion of the Valuer, certain aspects of an engagement indicate that a departure from any provision of IVSs or of this Guidance, is necessary and appropriate, such departure shall be disclosed and the reason for invoking the departure clearly set forth in all Valuation Reports (oral or written) issued by the Valuer. The requirements for Valuation Reports are addressed in the IVSC Code of Conduct and IVS 3, Valuation Reporting.



## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 6

- 5.3 The Valuer shall take steps to assure that all data sources relied upon are reliable and appropriate to the valuation undertaking. In many instances it will be beyond the scope of the Valuer's services to perform a complete verification of secondary or tertiary data sources. Accordingly, the Valuer shall verify the accuracy and reasonableness of data sources as is customary in the markets and locale of the valuation.
- 5.4 Business Valuers must often rely upon the services of Professional Property Valuers and/or other experts. A common example is reliance upon a Real Property Valuer to value the real estate components owned by a business. Where the services of other experts are relied upon, the Business Valuer shall
- 5.4.1 take such verification steps as are necessary to assure that such services are competently performed and that the conclusions relied upon are reasonable and credible, or
- 5.4.2 disclose the fact that no such steps were taken.
- 5.5 Business Valuers must frequently rely upon information received from a client or from a client's representatives. The source of any such data relied upon shall be cited by the Valuer in oral or written Valuation Reports, and the data shall be reasonably verified wherever possible.
- 5.6 Although many of the principles, methods, and techniques of business valuation are similar to other fields of valuation, business valuations require special education, training, skills, and experience.
- 5.7 Going concern has several meanings in accounting and valuation. In some contexts, going concern serves as a premise under which Valuers and accountants consider a business as an established entity that will continue in operation indefinitely.
- 5.7.1 The premise of a going concern serves as an alternative to the premise of liquidation. Adoption of a going concern premise allows the business to be valued above liquidation value and is essential to the development of the *Market Value* of the business.
- 5.7.1.1 In liquidations, the value of most intangible assets (e.g., goodwill) tends toward zero, and the value of all tangible assets reflects the circumstance of liquidation. Expenses associated with liquidation (sales fee, commissions, taxes, other closing costs, administrative costs during close-out, and loss of value in inventory) are also calculated and deducted from the estimate of business value.
- 5.8 Awareness of current market activity, and knowledge about relevant economic developments and trends are essential for competent business valuations. In order to estimate the *Market Value* of a business, Business Valuers identify and assess the impact of such considerations in their valuations and Valuation Reports.
- 5.9 A description of the business valuation assignment must include
- 5.9.1 Identification of the business, business ownership interest, or security to be valued;
- 5.9.2 the effective date of the valuation;
- 5.9.3 the definition of value;
- 5.9.4 the owner of the interest; and
- 5.9.5 the purpose and use of the valuation.
- 5.10 Factors to be considered by the Valuer in the valuation of a business include:
- 5.10.1 The rights, privileges, or conditions that attach to the ownership interest, whether held in corporate form, partnership form, or proprietorship
- 5.10.1.1 Ownership rights are set forth in various legal documents. In various States these documents may be called articles of association and/or the capital clause in the memorandum of the business, articles of incorporation, bylaws, partnership agreements, and shareholder agreements, to name a few.
- 5.10.1.2 Whoever owns the interest is bound by the business's documents. There may be rights and conditions contained in an owner's agreement or exchange of correspondence, and these rights may or may not be transferable to a new owner of the interest.
- 5.10.1.3 The documents may contain restrictions on the transfer of the interest and may contain provisions governing the basis of valuation that has to be adopted in the event of transfer of the interest. For example, the documents may stipulate

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 6

that the interest to be transferred should be valued as a pro rata fraction of the value of the entire issued share capital even though the interest to be transferred represents a minority interest. In each case the rights of the interest being valued and the rights attaching to any other class of interest must be considered at the outset.

- 5.10.2 **The nature of the business and history of the business.** Since value resides in the benefit of future ownership, history is valuable in that it may give guidance as to the expectations of the business for the future.
- 5.10.3 **The economic outlook that may affect the subject business,** including political outlook and government policy. Matters such as exchange rates, inflation and interest rates may affect businesses that operate in different sectors of the economy quite differently.
- 5.10.4 **The condition and outlook of the specific industry that may affect the subject business**
- 5.10.5 **The assets, liabilities, and equity and financial condition of the business**
- 5.10.6 **The earnings and dividend paying capacity of the business**
- 5.10.7 **Whether or not the business has intangible value**
- 5.10.7.1 Intangible value may be embodied in identifiable intangible assets such as patents, trademarks, copyrights, brands, know-how, databases, etc.
- 5.10.7.2 Intangible value may also be contained in undifferentiated assets, often called "*goodwill*." Note that goodwill value in this context is similar to goodwill in the accounting sense in that both are the residual value (historical cost in accounting terms) after all other assets have been taken into account.
- 5.10.7.3 If the business has intangible assets, the Valuer must ensure that the value of the intangibles is fully reflected, whether the identifiable intangible assets have been valued separately or not.
- 5.10.8 **Prior transactions in ownership interests of the subject business**
- 5.10.9 **The relative size of the ownership interest to be valued**
- 5.10.9.1 **There are different levels of control or lack of control resulting from differences in the size of ownership interests.** In some instances effective control may be obtained with less than 50% of the voting rights. Even if one person owns more than 50% of the voting rights and has operational control, there may be certain actions, such as winding the business up (i.e., putting everything in order before the business may be dissolved), that may require more than 50% affirmative vote, and may require an affirmative vote of all owners.
- 5.10.9.2 It is essential that the Valuer be aware of the legal restrictions and conditions that arise through the laws of the State in which the business exists.
- 5.10.10 **Other market data,** e.g., rates of return on alternative investments, advantages of control, disadvantages of lack of liquidity, etc.
- 5.10.11 **The market prices of publicly traded stocks or partnership interests, acquisition prices for business interests, or businesses engaged in the same or similar lines of business.**
- 5.10.11.1 Often, particularly in the use of acquisition transactions, adequate information is difficult or impossible to obtain. While the actual transaction price may be known, the Valuer may not know what warranties and indemnities were given by the seller, what terms were given or received, whether cash or other assets were taken from the business prior to acquisition, or what impact taxation planning had on the transaction.
- 5.10.11.2 Comparable data should always be used with care, and inevitably numerous adjustments need to be made. When using market prices that reflect public trading, the Valuer must bear in mind that the market prices are from transactions for small minority holdings. The price for the acquisition of an entire business

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 6

represents 100% of the business. Adjustments must be made for differences arising due to different levels of control.

5.10.12 Any other information the Valuer believes to be relevant.

### 5.11 Use of financial statements

5.11.1 There are three goals of financial analysis and adjustment:

5.11.1.1 Understanding of the relationships existing in the profit and loss statement and the balance sheet, including trends over time, to assess the risk inherent in the business operations and the prospects for future performance

5.11.1.2 Comparison with similar businesses to assess risk and value parameters

5.11.1.3 Adjustment of historical financial statements to estimate the economic abilities of and prospects for the business

5.12 To aid in understanding the economics of and risk in a business interest, financial statements should be analysed in terms of 1) money, 2) percentages (percentage of sales for items in the income statement and percentage of total assets for items in the balance sheet), and 3) financial ratios.

5.12.1 **Analysis in terms of money** as stated in the financial statements is used to establish trends and relationships between income and expense accounts in a business interest over time. These trends and relationships are used to assess the expected income flow in the future, along with the capital needed to allow the business to provide that income flow.

5.12.2 **Analysis in terms of percentages** compares accounts in the profit and loss statement to revenues, and accounts in the balance sheets to total assets. Percentage analysis is used to compare the trends in relationships, i.e., between revenue and expense items, or between balance sheet amounts, for the subject business over time and among similar businesses.

5.12.3 **Analysis in terms of financial ratios** is used to compare the relative risk of the subject business over time and among similar businesses.

5.13 For estimates of the *Market Value* of a business, common adjustments to the financial record of the business are made to more closely approximate economic reality of both the income stream and the balance sheet.

5.13.1 Financial statement adjustments should be made to reported financial information for items that are relevant and significant to the valuation process. Adjustments may be appropriate for the following reasons:

5.13.1.1 To adjust revenues and expenses to levels that are reasonably representative of expected continuing operations

5.13.1.2 To present financial data of the subject and guideline comparison businesses on a consistent basis

5.13.1.3 To adjust from reported values to *Market Values*

5.13.1.4 To adjust for non-operating assets and liabilities and the related revenue and expenses

5.13.1.5 To adjust for non-economic revenue or expense

5.13.2 Whether an adjustment is appropriate, or not, may depend on the degree of control held by the ownership interest under valuation. For controlling interests, including an ownership interest of 100%, most adjustments may be appropriate if the owner could make the changes implied by the adjustment. For valuation of minority interests, whose owners do not have the ability to change most items, the Valuer should be careful to reflect reality when considering potential adjustments. **Common adjustments include:**

5.13.2.1 **Elimination of the impact of non-recurring events from the income statement and balance sheet, if any.** Since these events are not likely to recur, a buyer of the interest would not expect to incur them, and would not include them in the income stream. Adjustments may be required in taxes. These types of adjustments are typically appropriate for both majority and minority interest valuations. Examples of non-recurring items include:

5.13.2.1.1 Strikes, if unusual

5.13.2.1.2 New plant startup

- 5.13.2.1.3 Weather phenomena such as floods, cyclones, etc.
- 5.13.2.2 **The Valuer should be wary of adjusting for non-recurring items whenever non-recurring items arise in most years, but in each year they appear to be the result of different events.** Many businesses have non-recurring items every year, and the Valuer should make contingency provisions for these expenses.
- 5.13.2.3 **Elimination of the impact of non-operating items from the balance sheet and the income statement** in the context of valuation of a controlling shareholder's interest. In the context of valuation of a minority shareholder's interest, these adjustments may not be appropriate. If non-operating items are on the balance sheet, they should be removed and valued separately from the operating business. Non-operating items should be valued at *Market Value*. Tax adjustments may be required. Costs of sale should be taken into account. Adjustments to the income statement should include removal of both income and expense arising from the non-operating assets, including tax impacts. **Examples of non-operating items and the appropriate adjustments include:**
- 5.13.2.3.1 **Non-essential personnel.** Eliminate compensation expense and taxes related to compensation expense and adjust income taxes. The Valuer should be wary of adjusting for items such as non-essential personnel in arriving at a maintainable profits figure. Unless the Valuer knows that the acquirer, or whoever the Valuer is acting for, actually has the controlling power to make the change and intends to get rid of non-essential personnel, there is a danger of overvaluing the business if the expenses are added back to profit.
- 5.13.2.3.2 **Non-essential assets** (e.g., an airplane). Eliminate the value of the non-essential asset(s) and any associated assets and liabilities from the balance sheet. (After the business has been valued, the value of the non-essential asset(s) is added to reconciled business value net of costs of disposal, including taxes if any.). Eliminate income statement impact of owning the non-essential asset(s), including support expenses (in the case of an airplane, the fuel, crew, hanger, taxes, maintenance, etc.) and revenue (charter or rental income).
- 5.13.2.3.3 **Redundant assets** (surplus or not necessary to the requirements of the business) should be discussed in the Valuation Report similarly with non-operating items. Such redundant assets may principally include: unemployed licences, franchises, copyrights and patents; investments in land, rental buildings and excess equipment; investments in other businesses; a marketable securities portfolio; and, excess cash or term deposits. The net realisable value of redundant assets (net of income tax and selling costs) must be added as inflow to operating net cash flow, especially in the first year of the specified forecast period.
- 5.13.2.4 **Depreciation** may need to be adjusted from the tax or accounting depreciation shown in the reported financial statements to an estimate that compares more accurately to depreciation used in similar businesses. Tax adjustments may subsequently need to be made.
- 5.13.2.5 **Inventory accounting** may need to be adjusted to more accurately compare to similar businesses, whose accounts may be kept on a different basis from the subject business, or to more accurately reflect economic reality. **Inventory adjustments** may be different when considering the income statement and when considering the balance sheet. For example, first-in-first-out (a method of costing inventory that assumes the first acquired stock will be the first sold) may most accurately represent the value of the inventory when constructing a *Market Value* balance sheet. But, when examining the income statement, last-in-first-out (a method of costing inventory that assumes the most recently acquired stock will be the first sold) may more

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 6

accurately represent the income level in times of inflation or deflation. Tax adjustments may subsequently need to be made.

- 5.13.2.6 **Compensation of the owner(s)** may need to be adjusted to reflect the market cost of replacing the labor of the owner(s). **Severance pay** for non-essential personnel may need to be considered. **Tax adjustments** may need to be made. **Service contracts** may need to be looked at carefully to adjust for the value (rather than the face amount of the cost) of terminating contracts with senior personnel.
- 5.13.2.7 **Cost of items leased, rented or otherwise contracted from related parties** may need to be adjusted to reflect *Market Value* payments. Tax adjustments may subsequently need to be made.
- 5.13.3 **Some adjustments that would be made in the context of valuation of the entire business might not be made in the context of valuation of a non-controlling interest** in that entity since the non-controlling interest would not have the ability to exert an influence that would warrant adjustment.
- 5.13.4 **Financial statement adjustments are made for the purpose of assisting the Valuer in reaching a valuation conclusion.** If the Valuer is acting as a consultant to either the buyer or seller in a proposed transaction, the adjustments should be understood by the client. For example, the proposing purchaser should understand that the value derived after adjustments may represent the maximum that should be paid. If the purchaser does not believe the financial or operational improvements can be made, a lesser price may be appropriate.
- 5.13.5 **Adjustments made should be fully described and supported.** The Valuer should be very careful in making adjustments to the historical record. Such adjustments should be discussed fully with the client. The Valuer should make adjustments only after sufficient access to the business to support their validity.

### 5.14 Business valuation approaches

#### 5.14.1 *Market approach* to business valuation

5.14.1.1 The *market approach* compares the

subject to similar businesses, business ownership interests, and securities that have been sold in the market.

5.14.1.2 The three most common sources of data used in the *market approach* are public stock markets in which ownership interests of similar businesses are traded, the acquisition market in which entire businesses are bought and sold, and prior transactions in the ownership of the subject business.

5.14.1.3 There must be a reasonable basis for comparison with and reliance upon the similar businesses in the *market approach*. These similar businesses should be in the same industry as the subject or in an industry that responds to the same economic variables. The comparison must be made in a meaningful manner and must not be misleading. Factors to be considered in whether a reasonable basis for comparison exists include:

5.14.1.3.1 Similarity to the subject business in terms of qualitative and quantitative business characteristics

5.14.1.3.2 Amount and verifiability of data on the similar business

5.14.1.3.3 Whether the price of the similar business represents an arm's-length transaction

5.14.1.3.3.1 A thorough, unbiased search for similar businesses is necessary to establish the independence and reliability of the valuation. The search should include simple, objective criteria for selecting similar businesses.

5.14.1.3.3.2 A comparative analysis of qualitative and quantitative similarities and differences between similar businesses and the subject business must be made.

5.14.1.4 Through analysis of the publicly traded businesses or acquisitions, the Valuer often computes valuation ratios, which are usually price divided by some measure of income or net assets. Care must be used in calculating and selecting these ratios.

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 6

- 5.14.1.4.1 The ratio must provide meaningful information about the value of the business.
- 5.14.1.4.2 The data from the similar businesses used to compute the ratio must be accurate.
- 5.14.1.4.3 The calculation of ratios must be accurate.
- 5.14.1.4.4 If the data are averaged, the time period considered and averaging method must be appropriate.
- 5.14.1.4.5 All calculations must be done in the same way for both the similar businesses and the subject business.
- 5.14.1.4.6 The price data used in the ratio must be valid as of the valuation date.
- 5.14.1.4.7 Where appropriate, adjustments may need to be made to render the similar businesses and the subject business more comparable.
- 5.14.1.4.8 Adjustments may need to be made for unusual, non-recurring, and non-operating items.
- 5.14.1.4.9 The selected ratios must be appropriate given the differences in risk and expectations of the similar businesses and the subject business.
- 5.14.1.4.10 Several value indications may be derived since several valuation multiples may be selected and applied to the subject business.
- 5.14.1.4.11 Appropriate adjustments for differences in the subject ownership interest and interests in the similar businesses with regard to control or lack of control, or marketability or lack of marketability, must be made, if applicable.
- 5.14.1.5 **When prior transactions in the subject business are used to provide valuation guidance, adjustments may need to be made for the passage of time and for changed circumstances in the economy, the industry, and the business.**
- 5.14.1.6 Anecdotal valuation rules, or rules of thumb, may be useful in the valuation of a business, business ownership interest, or security. However, value indications derived from the use of such rules should not be given substantial weight unless it can be shown that buyers and sellers place significant reliance on them.
- 5.14.2 ***Income capitalisation approach to business valuation***
- 5.14.2.1 **The *income capitalisation approach* estimates the value of a business, business ownership interest or security by calculating the present value of anticipated benefits. The two most common income approach methods are capitalisation of income and *discounted cash flow analysis* or *dividends method*.**
- 5.14.2.1.1 **In (direct) capitalisation of income, a representative income level is divided by a capitalisation rate or multiplied by an income multiple to convert the income into value. In theory, income can be a variety of definitions of income and cash flow. In practice, the income measured is usually either pre-tax income or post-tax income. The capitalisation rate must be appropriate for the definition of income used.**
- 5.14.2.1.2 **In *discounted cash flow analysis* and/or *dividends method*, cash receipts are estimated for each of several future periods. These receipts are converted to value by the application of a discount rate using present value techniques. Many definitions of cash flow could be used. In practice, net cash flow (cash flow that could be distributed to shareholders), or actual dividends (particularly in the case of minority shareholders) are normally used. The discount rate must be appropriate for the definition of cash flow used.**
- 5.14.2.1.3 **Capitalisation rates and discount rates are derived from the market and are expressed as a price multiple (derived from data on publicly traded businesses or transactions) or an interest rate (derived from data on alternative investments).**
- 5.14.2.2 **Anticipated income or benefits are converted to value using calculations**



## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 6

that consider the expected growth and timing of the benefits, the risk associated with the benefits stream, and the time value of money.

- 5.14.2.2.1 Anticipated income or benefits should be estimated considering the capital structure and historical performance of the business, expected outlook for the business, and industry and economic factors.
- 5.14.2.2.2 The *income approach* requires the estimation of a capitalisation rate, when capitalising income to arrive at value, or a discount rate, when discounting cash flow. In estimating the appropriate rate, the Valuer should consider such factors as the level of interest rates, rates of return expected by investors on similar investments, and the risk inherent in the anticipated benefit stream.
- 5.14.2.2.3 In capitalisation methods that employ discounting, expected growth is explicitly considered in the estimate of the future benefit stream.
- 5.14.2.2.4 In capitalisation methods that do not employ discounting, expected growth is included in the capitalisation rate. The relationship, stated as a formula, is discount rate minus long-term growth rate equals capitalisation rate ( $R=Y-\Delta a$  where R is the capitalisation rate; Y is the discount, or yield, rate; and  $\Delta a$  is the annualised change in value).
- 5.14.2.2.5 The capitalisation rate or discount rate should be consistent with the type of anticipated benefits used. For example, pre-tax rates should be used with pre-tax benefits; net after-income-tax rates should be used with net after-income-tax benefit streams; and net cash flow rates should be used with net cash flow benefits.
- 5.14.2.2.6 When the forecast income is expressed in nominal terms (current prices), nominal rates must be used, and when the forecast income is expressed in real terms (level prices), real rates

must be used. Similarly, the expected long-term growth rate of income should be documented and clearly expressed in nominal or real terms.

- 5.14.3 *Asset-based business valuation approach*
  - 5.14.3.1 In business valuation the *asset-based approach* may be similar to the cost approach used by Valuers of different types of assets.
  - 5.14.3.2 The *asset-based approach* is founded on the principle of substitution, i.e., an asset is worth no more than it would cost to replace all of its constituent parts.
  - 5.14.3.3 In the execution of the *asset-based approach*, the cost basis balance sheet is replaced with a **balance sheet that reports all assets, tangible and intangible, and all liabilities at Market Value or some other appropriate current value**. Taxes may need to be considered. If market or liquidation values apply, costs of sale and other expenses may need to be considered.
  - 5.14.3.4 The *asset-based approach* should be considered in valuations of controlling interests in business entities that involve one or more of the following:
    - 5.14.3.4.1 An investment or holding business, such as a property business or a farming business
    - 5.14.3.4.2 A business valued on a basis other than as a going concern
  - 5.14.3.5 The *asset-based approach* should not be the sole valuation approach used in assignments relating to operating businesses appraised as going concerns unless it is customarily used by sellers and buyers. In such cases, the Valuer must support the selection of this approach.
  - 5.14.3.6 If the valuation of an operating business is not on a going concern basis, the assets should be valued on a *Market Value* basis or on a basis that assumes a shortened time period for exposure in the market, if that is appropriate. All costs related



to the sale of the assets or the closing of the business need to be taken into account in this type of valuation. Intangible assets such as goodwill may not have value under these circumstances, although other intangible assets such as patents, trademarks, or brands may retain their value.

- 5.14.3.7 If the holding business simply holds property and receives investment income from the property, *Market Values* should be obtained for each property.
- 5.14.3.8 If an investment holding business is to be valued, the securities (both quoted and unquoted), the liquidity of the interest, and the size of the interest may be relevant and may lead to a deviation from the quoted price.

### 5.15 Reconciliation processes

#### 5.15.1 The value conclusion shall be based upon

- 5.15.1.1 the definition of value;
- 5.15.1.2 the purpose and intended use of the valuation; and
- 5.15.1.3 all relevant information as of the valuation date necessary in view of the scope of the assignment.

#### 5.15.2 The value conclusion shall also be based on value estimates from the valuation methods performed.

- 5.15.2.1 The selection of and reliance on the appropriate approaches, methods and procedures depends on the judgment of the Valuer.
- 5.15.2.2 The Valuer must use judgment when estimating the relative weight to be given to each of the value estimates reached during the Valuation Process. The Valuer should provide the rationale and justification for the valuation methods used and for the weighting of the methods relied on in reaching the reconciled value.

## 6.0 Effective Date

- 6.1 This International Valuation Guidance Note became effective 31 July 2007.

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# CONSIDERATION OF HAZARDOUS AND TOXIC SUBSTANCES IN VALUATION

## 1.0 Introduction

- 1.1 The objective of this Guidance Note (GN) is to assist Valuers in preparing valuations when specific hazardous or toxic substances may influence property values.
- 1.2 Hazardous and toxic substances are included among a number of possible environmental factors that, when appropriate, are specifically considered by Valuers. This GN is limited to consideration of hazardous and toxic substances because other environmental factors that may be encountered in valuations typically have less involvement with scientific and associated technical issues, including related law.
- 1.3 This GN addresses general concepts, principles, and considerations that guide Valuers in preparing valuations when hazardous or toxic materials that may influence property values are present. It also discusses concepts that must be understood by accountants, regulatory authorities, and other users of valuation services.
- 1.4 Valuers rarely have special qualifications in legal, scientific, or other technical areas that involve evaluating risks associated with hazardous or toxic substances. When considering the market effects of such risks in property valuations, Valuers commonly rely upon other experts' advice. As specified in the IVSC Code of Conduct, paras. 5.2 and 6.6, significant reliance upon other experts' advice must be disclosed and explained in the context of the property addressed in the Valuation Report.
- 1.5 Fundamental to the application of this GN are the Valuer's adherence to market-based valuations, objectivity, and full disclosure of relevant matters. Similarly, Valuers are obliged to write Valuation Reports that may be reasonably understood by clients and others. The obligation for clarity and full disclosure is particularly important when scientific, technical, and legal issues are involved.

- 1.6 This GN also provides for proper treatment and disclosure of hazardous and toxic substance issues when valuing specialised properties and in other situations, which preclude the application of *Market Value* concepts.

## 2.0 Scope

- 2.1 This GN applies to all valuations of property including plant and equipment. Special provisions of the GN should be observed when hazardous or toxic substances that may influence the property's *Market Value* or other defined value are known or reasonably believed to be present.

## 3.0 Definitions

- 3.1 *Hazardous or toxic substances* within the context of this GN involve specific materials that, by their presence or proximity, may have adverse effect on property value because of their potential to cause harm to life forms. Such materials may be incorporated into improvements to or on the site, or they may be found in or on the land. They may also be offsite, but nearby. In some instances they may be airborne.
  - 3.1.1 In a more general use beyond this GN, environmental factors may be characterized as influences external to the property being valued which may have positive effect, negative effect, or no effect at all on the property's value. Hazardous or toxic substances may be found either on or off the site of the property valued.
  - 3.2 Hazardous substance within the context of a valuation is any material within, around, or near the property being valued that has sufficient form, quantity, and bio-availability to create a negative impact on the property's Market Value.
  - 3.3 Toxic describes the status of a material, whether gas, liquid, or solid, that in its form, quantity, and location at the date of valuation has capacity to cause harm to life-forms. Toxicity refers to the degree or extent of such capacity.

## 4.0 Relationship to Accounting Standards

- 4.1 While the expressions Market Value and Fair Value may not always be synonymous (see International Valuation Standards 1 and 2 [IVS 1 and 2] and International Valuation Application 1 [IVA 1]), each type of value reflects market behaviour under conditions contained within the respective definitions. To the extent that property values reported under either type of value may be affected by hazardous or toxic substances, proper disclosure and the application of proper valuation procedures to the circumstances are necessary in making and reporting valuations.
- 4.2 This GN is applicable to all circumstances involving public disclosure of property values, whether reported individually or in the aggregate, when hazardous or toxic substances may have adverse effect on such values. In addition to the possible effect of such considerations on the properties valued, it is possible that there are other accompanying issues such as curative or restoration costs, maintenance or monitoring costs, third-party or regulatory liabilities, and the like. Thus, proper disclosure and handling are essential in valuations used for preparation of financial statements and related accounts.
- 4.3 In the ordinary course of conducting an asset valuation, the Valuer will be instructed by the Directors of the entity as provided in IVA 1. Any special instructions to the Valuer concerning the handling of hazardous or toxic substance issues that may have negative impact upon property value are, under IVA 1, important disclosures to be discussed by the Valuer in the Valuation Report. Such disclosures shall be accompanied by the Valuer's explanation of how the issues are handled in the Valuation Process; any assumptions that are made; and the effect, if any, such considerations have upon the value reported.
- 4.4 Although the value effects of hazardous or toxic substances are derived from the market in a Market Value assignment, such effects may not be as readily discerned when valuing property for which a Depreciated Replacement Cost method is appropriate. To comply with IVA 1 when applying the DRC method, Valuers should apply the principles of this GN to the extent possible and should fully disclose the extent of their analysis and the basis for their conclusions.

- 4.5 The accounting definition of impairment loss is the amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount (IAS 36, para. 6). The negative impact of hazardous or toxic materials that are present in a property may contribute to its impairment. The impairment loss incurred by a property where such substances are present may include the adverse effect of those substances upon property value. (See para.5.4 below.)

## 5.0 Guidance

- 5.1 In dealing with a client or prospective client in matters pertaining to the valuation of property when known or reasonably discoverable environmental conditions that may have adverse influence on property values are present, the Valuer should disclose to the client the extent of his or her knowledge, experience, and competency to deal with the situation.
- 5.1.1 If the environmental factors are known or are suspected to exist at the time the Valuer and prospective client are discussing the potential engagement, the Valuer should satisfy himself or herself that the client understands the Valuer's competency and disclosure obligations and that undertaking the engagement will in no way compromise these obligations.
- 5.1.2 If the environmental factors are discovered after commencing the engagement, the Valuer should make known to the client the knowledge, experience, and competency disclosures specified by this Guidance, and should then comply with all other IVS disclosure requirements.
- 5.2 Recognising that many environmental situations will require advice on physical, legal, scientific, and other technical issues, if the engagement is otherwise acceptable to both the client and the Valuer, the Valuer should take the necessary steps to complete the assignment competently. These steps may include appropriate personal study; association with another Valuer who has the requisite knowledge, experience, and competency; or obtaining the professional assistance of others who possess the requisite knowledge, experience, and competency.
- 5.3 Disclosure of the existence of any hazardous or toxic substance that may have adverse effect upon a property's value is included among the general reporting requirements of IVS 1, 2, and 3. Also required is the Valuer's disclosure regarding

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 7

- how that factor has been dealt with in the engagement. If the engagement calls for valuation of the property as though no such environmental factor existed, full disclosure must be made of the limiting assumption, and reporting must comply with the statements above. (See para. 5.1 and 5.2.) The requirements for valuation reports are addressed in the Code of Conduct and IVS 3, Valuation Reporting.
- 5.4 Where impairment is present in a property, the Valuer should estimate the value of the property as if the impairment had been removed. Where possible, the Valuer should identify the cost of remediation; but if this is not possible, the Valuer should disclose the fact that the property is impaired.
- 5.5 If a property is valued as if unaffected by hazardous substances, and such substances are known or suspected to exist, the Valuation Report should contain a qualification that clearly limits the scope of the valuation, an appropriate statement of purpose, properly qualified conclusions, and a restriction against use of the valuation conclusion without accompanying disclosure of the qualification and its explanation.
- 5.6 The names and nature of expert assistance of others who contributed specific information concerning effects of environmental factors on the property valued should be acknowledged in the Valuation Report.
- 5.7 When there are no known environmental factors that may have adverse effect on property value, the Valuer should, as a matter of routine practice, include within the Valuation Report a contingent and limiting condition or other disclaimer affirming that the valuation was made on the assumption that no such factors were known to exist at the date of valuation, but if such factors did exist they could well have an adverse effect on value.
- 5.8 There is growing worldwide concern about the effects of hazardous and toxic substances upon lives and property. Many potential hazards have been recently identified, and others are likely to be added over time as new and additional discoveries are made and subsequent controls are invoked by governments or are required by the market.
- 5.9 Some hazardous or toxic substances can have material effect on property values. However, as Valuers normally deal with Market Values, it is the market's reaction to these substances that is at issue in Market Value engagements. Over time, substances once believed to have no adverse effect on property value may be determined to have such an effect. Conversely, materials once believed to have substantial effect may be found to have little or no property value effect, or to have such effect only under certain market conditions.
- 5.10 The handling of physical, legal, scientific, and technical issues involved with hazardous or toxic substances is frequently beyond the skill of the Valuer. However, the Valuer's role in consideration of such factors will be facilitated if
- 5.10.1 situations involving environmentally sensitive substances are recognised and dealt with in accordance with this Guidance, whether they are encountered prior to undertaking an engagement or subsequent to its commencement;
- 5.10.2 proper reliance is placed upon the professional advice and assistance of others when special skills, knowledge, training, and experience are required, and any such assistance is acknowledged and explained in the Valuation Report;
- 5.10.3 proper treatment is given to the influence of hazardous or toxic substances in the Valuation Process, or alternatively, if the Valuation Process is to exclude consideration of such matters, proper disclosure is made of any assumptions made, the purpose of the analysis, and the likely effect of the assumptions on the defined value;
- 5.10.4 reasonable effort is made to ensure that reports and the value estimates they contain are not misleading and can be reasonably used only for the purpose for which they are intended.
- 5.11 Valuers are expected to correctly apply those recognised methods and techniques that are necessary to comply with this Guidance. When valuing property subject to some hazardous or toxic substance that adversely influences property value, the Valuer should apply those processes necessary to adequately reflect any such value losses, taking care to neither over- or understate the value effects. In a Market Value engagement, it is the Valuer's responsibility to reflect the market effect of the particular condition or circumstance.
- 5.12 Valuers are cautioned that there can be considerable controversy among legal, scientific, and other technical experts upon whose advice the Valuer may need to rely. Particular differences may be found in the methods experts use to determine the extent of clean-up, maintenance, or monitoring that may be associated with hazardous or toxic substances and the costs required to accomplish such clean-up, maintenance, or

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 7

monitoring.

- 5.12.1 Engagements may require valuation of the affected property under an assumption that any value effect of the hazardous or toxic substances is excluded from the reported value. Such engagements are acceptable, provided that the resulting valuation is not misleading, that the client is informed of and agrees to this limiting assumption, and that the Valuation Report clearly sets forth the limitation and the reasons therefore.
- 5.12.2 Because of technical issues frequently involved in environmental matters, it is common for Valuers, directly or through the client, to seek the counsel of and rely upon the opinions of those who hold appropriate qualifications to evaluate problems involving hazardous or toxic substances. Valuers should disclose the level and nature of reliance placed upon such opinions.
- 5.13 Valuers and users of valuation services should recognise that the effect of a particular hazardous or toxic substance may vary widely with differences in properties, locations, and markets. Adverse value effects may range from none to those that are more than costs of cure and remediation. The latter may occur, for example, where highest and best use of the property affected is changed by the condition and where marketability or other usefulness of the property is altered. In any case, it is the role of the Valuer to research and reflect the effects of the environmental factor on a particular property in its market.
- 5.14 In the typical valuation engagement, the Valuer will not have the skills to make legal, scientific, or technical findings regarding hazardous or toxic substances, or other environmental factors that may have adverse effect on value. It is important to the credibility and usefulness of the reported value that if any such conditions exist, they be properly considered and reported.
- 5.14.1 When the Valuer knows that a hazardous or toxic substance is present in the property specified in a valuation engagement, the Valuer should follow all requirements of this Guidance. Normally, any technical experts upon whose advice the Valuer may rely will be engaged by the client or by others.
- 5.14.2 When the Valuer has some reason to believe that a potentially adverse hazardous or toxic substance may be present, the Valuer should immediately make the client aware of the concern and request that the client take steps to resolve pertinent questions. By handling this concern on a private, confidential basis, the Valuer keeps information confidential that in itself could affect the property involved.
- 5.15 Guidelines for Valuers' responsibilities to observe, locate, and identify hazardous or toxic substances or circumstances may vary from time to time within and among jurisdictions. In general, determination of the nature, extent, and physical effects of environmental conditions is beyond the scope of service of Valuers.
- 5.16 In dealing with hazardous or toxic substances, the Valuer should research all related issues in a confidential manner so as not to raise undue speculation concerning the property.
- 5.17 It is not uncommon for individuals unfamiliar with hazardous or toxic substances issues to assume that if there is a physical effect of such substances, there must be an adverse economic reaction. Market experience shows there can be, and frequently are, important differences between general public perceptions and actual market effects of the presence of such substances. The Valuer's role is to avoid such generally held but possibly erroneous assumptions and to carefully consider all significant factors, perform competent market research, and reflect relevant market attitudes towards the situation in Valuation Reports.

### AUSNZ 5.18 Qualification if No Obvious Matters

If there are no obvious matters of contamination evident on inspection of a site and no environmental expert's report is made available to the Member, then the Member's report should be suitably qualified to reflect the limited extent of the Member's expertise in relation to environmental factors and to place the onus upon parties relying upon the report to make their own enquiries. Although any qualification used should be specifically worded to suit the particular circumstances of the valuation or report, the following clause provides an example of the type of qualification that should be made:

'A visual site inspection and (detail other enquiries, eg. enquiries of local government authorities) has not revealed any obvious pollution or contamination. Nevertheless, we are not experts in the detection or quantification of environmental problems and, accordingly, have not carried out a detailed environmental investigation. Therefore, the valuation (or report as applicable) is made on the assumption that there are no actual or potential contamination issues affecting:

- The value or marketability of the property; (or...)
- The site (... as applicable).
- Verification that the property is free from contamination and has not been affected by pollutants of any kind may be obtained from a suitably qualified environmental expert. Should subsequent investigation show that the site is contaminated this valuation (or report) may require revision.'

### AUSNZ 5.19 Four Main Approaches

Once a Member becomes aware of contamination or suspects a property has contamination, there are four main approaches to choose from:

- Unaffected Valuation Basis;
- Affected Valuation Approach;
- Environmental Balance Sheet Approach;
- Comparative Approach.

### AUSNZ 5.20 Unaffected Valuation Basis

Provide an assessment on an unaffected basis, together with an outline of the preliminary indication of actual or possible contamination and the inclusion of a qualification in the report indicating that the valuation assumes that the land is not contaminated and recommending that expert advice be obtained before reliance is placed upon the valuation.

### AUSNZ 5.21 Affected Valuation Approach

Assuming the client's approval is first obtained, have the extent of contamination assessed by appropriate environmental consultants with inclusion of costing for various remedy options and then calculate the property's discounted value. This process would include consideration of the liability for cleaning up adjoining properties that may be affected, plus the influence of any residual market 'stigma' after the anticipated contamination remedy.

### AUSNZ 5.22 Detail on How Valuation Reached

Where a discount for environmental factors is applied by a Member, it is always preferable to give the client information as detailed as possible as to how the final assessment is reached. Therefore, the use of the Environmental Balance Sheet Approach described below is generally to be preferred. Nevertheless, in some circumstances it may not be possible to adopt that method. In such circumstances the Member should state clearly in the report that the discount applied was arrived at based upon information obtained from an environmental expert and that the Member has not formed an opinion as to the veracity of that information. A copy of the environmental expert's report should be annexed to the Member's report



## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 7

### AUSNZ 5.23 Environmental Balance Sheet Approach

This is a method to build-up a profile of the property's attributes in terms of positive and negative factors affecting the property's current market value, and is complimentary to the Affected Valuation Approach detailed above. For instance, the asset entry would be the value of the property as if it had no environmental impairments whilst the liability entries would be environmental offsets to value including:

- the cost of determining if a problem is likely to be present, ie. a full or partial environmental investigation before purchase;
- costs associated with quantifying the magnitude of the problems from an environmental consultancy viewpoint and developing alternative courses of action, from which an owner can choose to thoroughly identify and remedy a problem situation;
- the estimated cost of putting an appropriate management plan and remediation strategy into place;
- the actual cost of pumping-out or of locating pollutants and so on;
- the cost of liabilities imposed on the owner as a result of prior actions, such as licensing breaches, etc;
- the calculated present value of future remediation, management, and related costs affecting future cash flows to be derived from the property;
- an estimate of offset to value resulting from perceptive effects, ie. the stigma or negative intangible offset which can prove difficult to quantify.

The net worth under this method is represented by the owner's impaired position. As some of the above negative effects will have a time deferment factor, it is suggested that Members consider a discounted cash flow approach where appropriate. An example of an Impaired Value Opinion Balance Sheet is shown in Appendix 4, while Appendix 5 provides A Method of Assessing Stigma.

### AUSNZ 5.24 Obtain Expert's Environmental Cost Estimates

Members should not provide their own estimates of environmental costs. These figures should be obtained from a suitable environmental specialist and a copy of that expert's report should be clearly annexed to the valuation. The Member should make it clear in the report that these figures have been obtained from an environmental expert and that the Member has not formed an opinion as to the accuracy of those figures. A failure to include a qualification to this effect could result in the Member being held to have adopted these figures. A qualification in the following form or to a similar effect may be appropriate where this method is adopted:

'The Impaired Valuation Opinion contained herein has been calculated by subtracting the Total Environmental Liabilities of the property from the Unimpaired Valuation Opinion. It has been provided in this form for convenience only. The figures which comprise the Total Environmental Liabilities, have been obtained from (stage name of the environmental expert) on instructions from you. A copy of (the environmental expert's) report is annexed to this valuation as Annexure 'X'. (The Member) has not formed an opinion as to the accuracy of these figures and accepts no responsibility for them. Any enquiries in relation to these figures should be directed to (the environmental expert) directly.'

### AUSNZ 5.25 Comparative Approach

A Comparative Approach may be possible in limited circumstances where this type of sales data is available.

### AUSNZ 5.26 Where Sales are Available

Assessment of the 'unaffected value' indicated above would, where sales are available, involve the comparative approach. It is also advisable to use the comparative approach in the assessment of environmentally contaminated property. There are only limited instances where direct comparison of contaminated property sales can be made, but efforts should be made to establish whether this sales data is available just in case the comparative approach can be applied. Members should, however, use great caution to ensure that the properties being compared are truly comparable. Members should not make judgements as to the comparability of contaminated sites without access to the reports of suitable environmental experts in relation to both the subject property and any properties sought to be used as comparables.

### AUSNZ 5.27 Valuation Qualification

Where a member has relied upon contamination reports and costings provided by other experts, the Member should advise the client of such reliance and that the assessed value is qualified to the extent of the veracity of that information. The Member should also advise the client that should the information relied upon vary, then the valuation should be referred back to the Member for further comment as there is the potential for the valuation figure to alter.

### AUSNZ 5.28 Negative Land Value

There have been instances where the cost of remediation exceeds the market value (unaffected) of the land and this infers a negative land value. The established practice is to adopt a figure no less than zero value. However, in these instances, the member should advise that the cost of remediation or liability for clean up costs required for the land results in a negative figure.

### AUSNZ 5.29 Future Liability

Members should consider potential and value impacts future liability, particularly in terms of highest and best use, when completing these valuations or reports.

### AUSNZ 5.30 Client Considerations

Client considerations are also important. For, example mortgagees and purchasers (where advising for acquisition purposes), can be particularly worried by the prospect of contamination and should be informed about the suspicion of contaminants on any property.

## 6.0 Effective Date

- 6.1 This International Valuation Guidance Note became effective 31 January 2005.

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# THE COST APPROACH FOR FINANCIAL REPORTING-(DRC)

## REVISED 2007

### 1.0 Introduction

1.1 The purpose of this Guidance Note (GN) is to assist users and preparers of Valuation Reports in the interpretation of the meaning and application of *depreciated replacement cost* for financial reporting purposes.

1.2 *Depreciated replacement cost* is an application of the cost approach that may be used in arriving at the value of specialised assets for financial reporting purposes. *Depreciated replacement cost* may be the more applicable approach when comparable sales data is insufficient but sufficient market data exists concerning costs and accrued depreciation. As an application of the cost approach, it is based on the principle of substitution.

### 2.0 Scope

2.1 This GN provides background to the use of *depreciated replacement cost* in connection with International Valuation Application 1 (IVA 1), Valuation for Financial Reporting.

2.2 The *depreciated replacement cost* approach is also discussed in GN3 (Valuation of Plant and Equipment) and IVA 3 (Valuation of Public Sector Assets for Financial Reporting).

### 3.0 Definitions

3.1 *Depreciated Replacement Cost*. The current cost of replacing an asset with its modern equivalent asset less deductions for physical deterioration and all relevant forms of obsolescence and optimisation.

3.2 *Improvements*. Buildings, structures, or some modifications to land, of a permanent nature, involving expenditures of labour and capital, and intended to enhance the value or utility of the property. Improvements may have differing patterns of use and economic lives

3.3 *Modern Equivalent Asset*. An asset which has a similar function and equivalent productive capacity

to the asset being valued, but of a current design and constructed or made using current materials and techniques.

3.4 *Optimisation*. The process by which a least cost replacement option is determined for the remaining service potential of an asset. It is a process of adjusting the replacement cost to reflect that an asset may be technically obsolete or over-engineered, or the asset may have a greater capacity than that required. Hence optimisation minimises, rather than maximises, a resulting valuation where alternative lower cost replacement options are available.

3.5 *Plant and Equipment*. Tangible assets, other than *realty*, that:

- (a) are held by an entity for use in the production or supply of goods or services, for rental by others, or for administrative purposes; and
- (b) are expected to be used over a period of time

The categories of plant and equipment are:

*Plant*. Assets that are inextricably combined with others and that may include specialised buildings, machinery, and equipment.

*Machinery*. Individual machines or a collection of machines. A machine is an apparatus used for a specific process in connection with the operation of the entity.

*Equipment*. Other assets that are used to assist the operation of the enterprise or entity.

3.6 *Service Potential*. The capacity of an asset to continue to provide goods and services in accordance with the entity's objectives.

3.7 *Specialised Property*. A *property* that is rarely, if ever, sold in the market, except by way of a sale of the business or entity of which it is part, due to uniqueness arising from its specialised nature and design, its configuration, size, location, or otherwise.

## 4.0 Relationship to Accounting Standards

- 4.1 *Depreciated replacement cost* is used where there is insufficient market data to arrive at Market Value by means of market-based evidence.
- 4.1.1 International Accounting Standard (IAS) 16, Property, Plant and Equipment, paragraph 33, provides that in the absence of market-based evidence an entity may need to estimate the fair value of a specialised asset using an income or a depreciated replacement cost approach.
- 4.1.2 International Public Sector Accounting Standard (IPSAS) 17, Property, Plant and Equipment, paragraphs 42 and 43, prescribe the use of *depreciated replacement cost* for valuing *specialised buildings and other man-made structures* as well as *items of plant and equipment of a specialised nature*.
- 4.2 The application of *Fair Value* under accounting standards is discussed in IVA 1. In accounting standards, *Fair Value* is normally equated to *Market Value*.

## 5.0 Guidance

- 5.1 The classification of an asset as specialised should not automatically lead to the conclusion that a *depreciated replacement cost* valuation must be adopted. **Even though an asset may be specialised, it may be possible if sufficient direct market evidence exists to undertake a valuation of the specialised property using the sales comparison approach and/or the income capitalisation approach.**
- 5.2 In the absence of sufficient direct market evidence, *depreciated replacement cost* is regarded as an acceptable method of arriving at the value of specialised assets but must incorporate market observations by the Valuer with regard to current costs and depreciation rates. The method is based on the same theoretical transaction between rational informed parties as the Market Value concept.
- 5.3 The Valuer estimates the cost of a *modern equivalent asset* at the relevant valuation date. This may involve estimating the cost of having a suitable asset commissioned to order. The replacement cost needs to reflect all incidental costs that would be incurred, for example for design, delivery, installation and commissioning.

In the case of *specialised property*, the cost of acquiring land suitable for the development of an equivalent specialised facility in the market should be included, together with the cost of all *improvements* that would be required to the land.

- 5.4 The Valuer then estimates depreciation by comparing the *modern equivalent asset* with the asset being valued. Depreciation rates may be all-encompassing or analysed separately for:
- Physical deterioration
  - Functional obsolescence
  - External obsolescence
- 5.4.1 In estimating the physical deterioration of the actual asset resulting from wear and tear over time, including any lack of maintenance, different valuation methods may be used for estimating the amount required to rectify the physical condition of the improvements. Estimates of specific elements of depreciation and contractors' charges can be used or direct unit value comparisons between properties in similar condition.
- 5.4.2 Functional obsolescence can be caused by advances in technology that result in new assets being capable of a more efficient delivery of goods and services. Modern production methods may render previously existing assets fully or partially obsolete in terms of current cost equivalency. The application of the optimisation process will account for many elements of functional obsolescence.
- 5.4.3 Obsolescence resulting from external influences may affect the value of the asset. External factors include changed economic conditions, which affect the supply of and demand for goods and services produced by the asset or the costs of its operation. External factors also include the cost and reasonable availability of raw materials, utilities, and labour.
- 5.4.4 When valuing *specialised property* it is not appropriate to depreciate the cost of replacing the land element.
- 5.5 In the application of depreciated replacement cost, the Valuer shall ensure that the key elements of a market transaction have been considered. These include:
- 5.5.1 an understanding of the asset, its function, and its environment;

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 8

- 5.5.2 research and analysis to determine the remaining physical life (to estimate physical deterioration) and economic life of the asset;
- 5.5.3 knowledge of changes in preferences, technical innovations, and/or market standards that may affect the asset (to estimate functional obsolescence);
- 5.5.4 an analysis of potential external changes that may affect the asset (to estimate external obsolescence);
- 5.5.5 familiarity with the class of property through access to available market data;
- 5.5.6 knowledge of construction techniques and materials (to estimate the cost of a *modern equivalent asset*); and
- 5.5.7 sufficient knowledge to determine the impact of external obsolescence on the value of the improvements.
- 5.6 Depreciation rates and estimates of future economic life are influenced by market trends and/or the entity's intentions. Valuers should identify these trends and intentions and be capable of using them to support the depreciation rates applied. The application of depreciated replacement cost should replicate the deductive process of a potential buyer with a limited market for reference.
- 5.7 In the final stage of the process Valuers should consider if the actual asset has any additional features not reflected in the cost of the *modern equivalent asset* and make any appropriate further adjustments. An example would be a *specialised property* where there is the possibility of a more valuable use in future when the *improvements* have reached the end of their economic life.
- 5.8 If it is clear that the result based on the depreciated replacement cost method is materially lower than a readily identifiable alternative use that is both financially and legally feasible at the date of valuation, the *Market Value* based on that alternative use shall be reported. This should include a statement that the value for the alternative use takes no account of matters such as business closure or disruption and any associated costs that would be incurred. The alternative use value will be evident from sales comparison and its valuation is not part of the depreciated replacement cost application but a separate valuation.
- 5.9 If the Valuer considers that the value of the asset would be materially different if it ceases to be part of the going concern, a statement to this effect should be included in the report.
- 5.10 Where the value of a specialised asset is estimated by the *depreciated replacement cost* method, a statement should be made that it is subject to a test of adequate profitability in relation to the whole of the assets held by a for-profit entity or the cash generating unit. The reasons why this statement is necessary are explained in Addendum A.
- 5.11 For not-for-profit public sector entities, the reference to a test of adequate profitability is replaced by a test of adequate *service potential*, which should be justifiable by the entity. Governments place particular emphasis on the test of adequate service potential in asset reporting as many agencies utilise public sector assets in the context of a service obligation to the general public. (The application of *depreciated replacement cost* to the valuation of public sector assets and the test of adequate service potential are discussed at greater length in IVA 3, Valuation of Public Sector Assets for Financial Reporting in paragraphs 5.4, 6.1, 6.5 and 6.8.4.)
- 5.12 The valuation conclusion shall be reported in accordance with IVS 3, Valuation Reporting.
- 5.12.1 The Valuer reports the result as Market Value subject to the test of adequate profitability or justified service potential, a test which is the responsibility of the entity.
- 5.12.2 In reporting the value the Valuer shall identify the valuation method as depreciated replacement cost noting that the value can only be adopted in the accounts of the entity if the relevant test of either adequate profitability or service potential is applied and met.

### 6.0 Effective Date

- 6.1 This International Valuation Guidance Note became effective 31 July 2007.

### ADDENDUM A: Profitability Test When Reporting DRC

- 1 Accounting standards require entities to periodically review their assets for "impairment", which is a permanent loss in the value of the asset to the entity. The appropriate figure to be included in the balance sheet for an asset following an "impairment review" is the higher of either its "Value in Use" or its "Fair Value" less costs to sell. In simple terms this means that the amount in the balance sheet should be written down to the higher of either the current value of the future benefits that will be derived by the entity from the continued use of the asset or the proceeds it would derive from the asset's immediate retirement and disposal.
- 2 The Market Value of an asset derived by reference to the sales of similar assets will usually approximate to the sum that the entity could obtain from the retirement and sale of the asset. If the Value in Use of the asset is lower than a Market Value based on sales comparisons, the latter figure can safely be relied upon as the base figure for inclusion in the accounts; it is an amount recoverable by the entity regardless of whether it continues to use or retire the asset.
- 3 In contrast, DRC is used to value assets, which are rarely, if ever, sold except as part of a sale of the entire operation of which they form part. The assumption that there will be demand for the use for which the asset is currently employed is an inherent feature of the approach. As a consequence, a Market Value derived using this approach will often not equate to the figure that would be obtained if the asset were retired and sold. If the Value in Use is lower than a Market Value arrived at using a DRC approach, the latter figure cannot be relied upon as the base figure, as it may not bear any relation to the amount that would be received following a cessation of operations.
- 4 Although the possibility that a valuation derived using a DRC approach would be materially affected by a cessation of operations is covered by the disclosure requirement in 5.9, the requirement in 5.12.1 to indicate additionally that the valuation is subject to "adequate profitability" emphasises to the entity that even if the Value in Use of the asset is lower than the reported Market Value, it may still be higher than the Net Realisable Value on cessation. It may therefore be necessary to write the reported Market Value down to the Value in Use in an impairment review.
- 5 The need to consider impairment is also a requirement of public sector accounting. However, in the public sector, assets are held for service delivery rather than profit. A valuation of a public sector asset using the cost approach has to be reported to be subject to a continuing requirement to use the asset for the provision of the service in question, i.e. that it has adequate service potential. This requirement may arise from political or social considerations rather than purely economic criteria. Combined with any appropriate disclosure under 5.9, this emphasises to users that the valuation cannot be relied upon as an indication of the amount that could be recovered if the service was discontinued and the asset retired.



# DISCOUNTED CASH FLOW ANALYSIS FOR MARKET VALUATIONS AND INVESTMENT ANALYSES

REVISED 2007

## 1.0 Introduction

- 1.1 *Discounted cash flow (DCF)* analysis is a financial modelling technique based on explicit assumptions regarding the prospective income and expenses of a property or business. Such assumptions pertain to the quantity, quality, variability, timing, and duration of inflows and outflows that are discounted to present value. DCF analysis, with appropriate and supportable data and discount rates, is one of the accepted methodologies within the *income capitalization approach* to valuation. DCF analysis has gained widespread application due in part to the advancement of computer technology. DCF analysis is applied in valuations of real property, businesses and intangible assets; in investment analyses; and as an accounting procedure to estimate value in use. The use of DCF analysis has increased substantially in institutional, investment property and business valuation sectors and is frequently required by clients, underwriters, financial advisers and administrators, and portfolio managers.
- 1.2 DCF valuations, as with other income-based valuations, are established on analysis of historical data and assumptions about future market conditions affecting supply, demand, income, expenses, and the potential for risk. These assumptions determine the earning capability of a property or business upon which the pattern of its income and expenditures/outgoings is projected.
- 1.3 The objective of this Guidance Note (GN) is to prescribe Generally Accepted Valuation Principles (GAVP), best practice, and due diligence measures for Valuers to follow in performing DCF analysis for market and non-market based valuations and to distinguish between applications of DCF analysis in these two different types of valuation assignments.

## 2.0 Scope

- 2.1 This GN applies to market and non-market valuations developed by means of DCF analysis. It discusses the structure and components of DCF models and the reporting requirements for valuations based on DCF analysis.
- 2.2 The scope of this GN extends to the reasonableness and supportability of the assumptions upon which the DCF analyses are based. Assumptions made in any valuation directly affect the value conclusion. In accordance with the IVSC Code of Conduct, all assumptions underlying a valuation should be likely, reasonable, and supportable.

## 3.0 Definitions

- 3.1 *Discount Rate.* A rate of return used to convert a monetary sum, payable or receivable in the future, into present value. Theoretically it should reflect the opportunity cost of capital, i.e., the rate of return the capital can earn if put to other uses having similar risk.
- 3.2 *Discounted Cash Flow Analysis (DCF).* A financial modelling technique based on explicit assumptions regarding the prospective cash flow to a property or business. As an accepted methodology within the *income approach* to valuation, DCF analysis involves the projection of a series of periodic cash flows either to an operating property, a development property, or a business. To this projected cash flow series, an appropriate, market-derived discount rate is applied to establish an indication of the present value of the income stream associated with the property or business. In the case of operating real properties, periodic cash flow is typically estimated as gross income less vacancy and collection losses and less operating

expenses/outgoings. The series of periodic net operating incomes, along with an estimate of the reversion/terminal value/exit value, anticipated at the end of the projection period, is then discounted. In the case of development properties, estimates of capital outlays, development costs, and anticipated sales income are estimated to arrive at a series of net cash flows that are then discounted over the projected development and marketing periods. In the case of a business, estimates of periodic cash flows and the value of the business at the end of the projection period are discounted. The most widely used applications of DCF analysis are the Present Value (PV), or Net Present Value (NPR) and the Internal Rate of Return (IRR) of cash flows.

- 3.3 *Financial Modelling.* The projection of a business' or property's periodic income or cash flow pattern from which measures of financial return can be calculated. Income or cash flow projections are generated through the use of a financial model that takes into account historical relationships between income, expense, and capital amounts as well as projections of those variables. Financial modelling may also be used as a management tool to test expectations for property performance, to gauge the integrity and stability of the DCF model or as a method to replicate the steps taken by investors in making decisions involving the purchase, sale, or holding of a property or business.
- 3.4 *Internal Rate of Return (IRR).* The discount rate that equates the present value of the net cash flows of a project with the present value of the capital investment. It is the rate at which the Net Present Value (NPV) equals zero. The IRR reflects both the return on the invested capital and the return of the original investment, which are basic considerations of potential investors. Therefore, deriving the IRR from analysis of market transactions of similar properties having comparable income patterns is a proper method for developing market discount rates for use in valuations to arrive at *Market Value*.
- 3.5 *Investment Analysis.* A study undertaken for the purposes of development and investment, the evaluation of investment performance, or the analysis of a transaction involving investment properties. Investment analyses are variously called (economic) feasibility studies, market or marketability analyses, or financial projection studies.

- 3.6 *Net Present Value (NPV).* The measure of the difference between the discounted revenues, or inflows, and the costs, or outflows, in a discounted cash flow analysis.

There is little real distinction between NPV and Present Value (PV). NPV is normally used to describe the difference between all discounted inflows and outflows while PV is often used where the initial outlay or price is not included in the cash flow. In a valuation that is done to arrive at *Market Value*, where discounted cash flows and the discount rate are market derived, the resulting NPV should be indicative of the *Market Value* and is often termed PV rather than NPV.

### 4.0 Relationship to Accounting Standards

- 4.1 Discounting is a standard procedure employed by accountants in considering the time value of money.
- 4.2 The International Financial Reporting Standards (IFRSs) prescribe a discounting procedure to estimate the value in use of an asset. An estimate of the value in use involves a) estimating the future cash inflows and outflows to be derived from the continuing use of the asset and from its ultimate disposal and b) applying the appropriate discount rate to these future cash flows. (IAS 36, para. 31)
- 4.3 IAS 36, para.55 states that "the discount rate (rates) shall be a pre-tax rate (rates) that reflect(s) current market assessments of: (a) the time value of money; and (b) the risks specific to the asset for which the future cash flow estimates have not been adjusted". It is also true that other measures of income or cash flow may be used so long as the discount rate(s) are appropriately matched with the income flow(s).

### 5.0 Guidance

- 5.1 Discounted cash flow methods are structured upon a specified term, or duration. In real property analysis, although events such as rent reviews, lease renewal/reletting, redevelopment, or refurbishment can affect the analysis term, this term is typically driven by market behaviour that is characteristic of the class of property and its market sector. For example, the analysis term for investment properties typically runs between five and ten years. The Valuer, however, should be fully aware of the implications of different holding

periods, e.g., a short holding period makes the appraisal conclusion more dependent upon the estimate of the terminal value at the expense of the periodic cash flow.

The frequency of inflows and outflows (monthly, quarterly, annually) should also be market derived. As with other accepted methodologies, inflows and outflows should be appropriate and reasonably supported. The correct discount rate needs to be applied to the cash flow. If the frequency of the time points selected for the cash flow are, for example, quarterly, the discount rate must be the effective quarterly rate and not a nominal rate. As each time period within a cash flow is in fact set off by time points, the Valuer must seek to place the various cash flows at the correct point in time within the cash flow. Often the frequency of the cash flow is decided by the time points at which rent is collected. If other events take place at more frequent times, the Valuer must decide whether to include them at the time point before or after they actually occur. Expenses/outgoings may be placed at the accounting point in time rather than the point of time at which they are carried out. The obvious best solution is to have a cash flow frequency that matches the timing of the most frequent aspect of the periodic cash flow.

The initial period (time interval) of a real property cash flow study is described as period 0 and this period is not discounted. Any inflows or outflows that are expected to occur within this time period should be included in period 0. Net income or expenses can be placed in period 0 and should be incorporated in this period if the cash receipts or payments take place during this period. For example, many investment properties receive net income monthly. Therefore, if annual intervals are used, the net income receivable in the initial year must be placed in period 0, regardless of whether a beginning or end period calculation is adopted.

Selection of the method for calculating the reversion/terminal value/exit value depends upon practices in the subject market as normally, it represents an estimate of the *Market Value* of the property at the termination date. Valuers should mirror those market practices and fully disclose the chosen method(s) and its(their) application. *Market*

*Value* is understood as the present value of the future benefits of ownership. Thus, for an investment property, this normally means that cash flows/values at the time point of the terminal valuation (or depending on the method adopted, beyond the terminal valuation date) should be used rather than those in the period up to that date. A reversion/terminal value/exit value can be based on a projection of the net income for the year following the last year of the DCF analysis.

As with all other components of DCF analysis, the discount rate should also reflect market data, i.e., other market derived discount rates. Discount rates should be selected from comparable properties or businesses in the market. In order for these properties to be comparable, the revenue, expenses, risk, inflation, real rates of return, and income projections for the properties must be similar to those of the subject property.

- 5.1.1 Present value calculations of cash flows are most often calculated using appropriate discount rates for each class of cash flows. When non-annual time interval studies, such as monthly or daily intervals, are used, the annual discount rate must be adjusted to an effective and equivalent discount rate for the selected time interval. A reversion/terminal value/exit value is capitalised at a terminal capitalisation rate, or reversion yield, and discounted to present value at an appropriate discount rate. In many instances, a single discount rate is used for all cash flows.
- 5.1.2 The cash flows and sale prices of comparable properties may be analysed to derive market discount rates or internal rates of return (IRR).
- 5.1.3 DCF model cash flow can be developed both gross or net of tax and gross or net of debt financing, and in real (inflation or cost-index deflated) or nominal terms. The discount rate will therefore be based on the assumptions of the cash flow, gross or net of tax and gross or net of debt financing, and in real or nominal terms. Analyses of the market evidence to determine discount rate or cash flows must be based on the same assumptions.
- 5.2 In keeping with the IVSC Code of Conduct, it is incumbent on the Valuer to identify the components of DCF analysis, including the following:

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 9

- 5.2.1 a projection period wherein the commencement date of cash flow and the number and term of periods are specified;
- 5.2.2 the components of cash inflow and cash outflow grouped by category and the reason behind their selection;
- 5.2.2.1 For real property valuation, cash inflow includes income from rents and tenant services adjusted for collection, incentives and vacancy loss in the case of completed or built properties, and for income from sales, adjusted for cost of sales, in the case of development properties.
- 5.2.2.2 For real property valuation, cash outflow includes fixed and variable expenses, replacement allowance/renewal fund, and capital expenditures, where applicable; for development properties, the hard and soft costs should be identified.
- 5.2.2.3 For business valuation, the cash flow most often includes all cash inflows and outflows, of both an operating nature and a capital nature. The discounted cash flow then represents the money that an investor could remove from the business while leaving adequate cash to fund its operation and growth.
- 5.2.3 debt finance or debt service (payment of interest and principal) per period and the annual effective rate at which periodic interest is calculated, if applicable;
- 5.2.4 net cash flows per period (the sum of inflows less the sum of outflows);
- 5.2.5 the discount rate or rates that are applied to the net cash flows and the reasoning behind and support for their selection;
- 5.2.6 the terminal capitalisation rate/reversion yield that is applied to calculate the reversion/terminal value/exit value and the reasoning behind its selection; and
- 5.2.7 a list of all assumptions underlying the analysis.
- 5.3 DCF analysis makes use of available market evidence and typically reflects the thought processes, expectations, and perceptions of investors and other market participants. As a forecasting technique, DCF analysis should not be judged on the basis of whether or not the specific DCF forecast was ultimately realised but rather on the degree of market support for the DCF forecast at that time it was made.
- 5.3.1 When DCF is used to develop a *Market Value* estimate, the valuation should meet all criteria for *Market Value* estimates as set forth in IVS 1.
- 5.4 Where a client provides the Valuer with specific requirements that do not correspond to those for *Market Value* estimates as to holding period, financing terms, taxation, or discount rate, the resultant value estimate is to be considered *Non-Market Value*. The result is an estimate of investment value/worth specific to the assumptions provided rather than an estimate of *Market Value*.
- 5.5 DCF analysis may also be used to test the validity of conventional views by analysis of varying assumptions. The result of this type of sensitivity analysis is investment value/worth. If DCF is used in this way, the results should be identified as a *Value* other than *Market Value*, and the valuation should meet all criteria for non-market based valuations as set forth in IVS 2.
- 5.6 A Valuer should carry out sufficient research to ensure that cash flow projections and the assumptions that are the basis for the DCF model are appropriate and reasonable for the subject market.
- 5.6.1 As an example, the lease-by-lease analysis to support the cash flow projection for a multitenanted property should address contract/passing rent and market rent, lease expiration and lease review dates, rent escalations/stepped rents, operating expenses/outgoings, expense pass-throughs/recoverable costs, lease incentives, leasing costs, vacancy allowances, capital expenditures, and any other specific provisions that apply.
- 5.6.2 Assumptions of growth or decline in income must be premised on analysis of economic and market conditions. Changes in operating expenses/outgoings should reflect all expense trends and specific trends for significant expense items.
- 5.6.3 The results of a DCF analysis should be tested and checked for errors and reasonableness.
- 5.7 To derive discount and terminal capitalisation

- rates, a Valuer makes use of various sources of data and information on real estate and capital markets. In addition to data on the income streams and resale prices of comparable properties or businesses, surveys of investor opinion and rates of return are useful in selecting discount rates provided that the market for the subject property is consistent with the market for the property acquired by the investors consulted in the survey.
- 5.8 It is the responsibility of the Valuer to ensure that the controlling input is consistent with market evidence and the prevailing market outlook. Further, the Valuer who supervises the construction of the DCF model or selection of a proprietary model is responsible for the integrity of that model in terms of theoretical and mathematical correctness, the magnitude of the cash flows, and the appropriateness of all inputs. A Valuer must have suitable experience and market knowledge to structure cash flow and provide other inputs to the model.
- 5.9 In reporting the results of a DCF analysis, a Valuer shall follow the requirements of the IVSC Code of Conduct and IVS 3, Valuation Reporting.
- 5.9.1 Disclosure must be made under those circumstances described in IVS 3, paragraphs 5.1.10, 7.0, and 8.2.3.
- 5.9.2 Inherent in DCF analysis are the explicit assumptions that are used as inputs for the analysis. To provide users of valuation services the ability to replicate the results, the Valuer must disclose the assumptions and support for their use in developing the DCF model. Using real property examples, these include but are not limited to:
- 5.9.2.1 the commencement date, term, and frequency employed in the model;
  - 5.9.2.2 the projected rent and other income and the rate at which income is projected to change;
  - 5.9.2.3 the projected operating expenses and the rate at which expenses are projected to change;
  - 5.9.2.4 the treatment of lease expirations/ break costs, vacancies, and collection losses; and
  - 5.9.2.5 the discount rate and terminal capitalization rate or reversion yield.
- 5.9.3 The Valuer must:
- 5.9.3.1 indicate the annual effective rate at which periodic interest is calculated, where finance debt or debt service (payment of interest and principal) is a component of the projected periodic cash flow;
  - 5.9.3.2 specify the rate(s) of taxation used, where applicable;
  - 5.9.3.3 explain the reasoning behind any provision for lease incentives, where applicable;
  - 5.9.3.4 explain the treatment of any capital expenditures incurred in the acquisition or improvement of property or business assets;
  - 5.9.3.5 explain the basis for the adopted terminal capitalisation rate/reversion yield and the adopted discount rate or the effective, equivalent rate (if appropriate); and
  - 5.9.3.6 identify the cash flow model by name of the developer or, if proprietary software, by product name and version; describe the methods and assumptions inherent in the model; and specify the dates on which the model was developed and employed.

## 6.0 Effective Date

- 6.1 This International Valuation Guidance Note became effective 31 July 2007.

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# VALUATION OF AGRICULTURAL PROPERTIES

## REVISED 2007

### 1.0 Introduction

- 1.1 In many regions of the world, lands devoted to the production of agricultural commodities are the major economic asset and, frequently, the sole economic base of a region.
- 1.2 Lands devoted to agricultural use are thus a principal subject of valuation services for a multitude of reasons including private and public transfer of ownership, taxation, determination of collateral for financing, and economic, land-use, and investment studies. Reliable valuations of agricultural lands are essential to ensure the availability of capital necessary to support the continuity of the economic base, to promote the productive use of the land, to maintain the confidence of capital markets, and to meet the needs for general financial reporting.
- 1.3 Providing reliable and accurate valuation service for agricultural properties requires that the Valuer have a sound knowledge and understanding of the physical and economic elements that affect the productive capacity of agricultural lands and the value of the commodities produced thereon.
- 1.4 The physical and economic characteristics of agricultural lands differ from those of non-agricultural or urban environments in degree of importance.
- 1.4.1 Soils in an urban environment must be suitable for bearing the improvements that stand upon them. In agricultural properties, the soil is the principal agent in production, varying in its capacity to support a given amount of a particular commodity or class of commodities.
- 1.4.2 In urban environments, the economic use of a property and/or the amenities it provides may remain unchanged over a period of years and may even be guaranteed by contractual arrangements. While for some agricultural properties, the same use may extend over a long duration (e.g., forests harvested after 25 years), for others, the economic benefits can vary from year to year, depending

on the commodities the property is capable of producing.

- 1.4.3 The income stream associated with agricultural property will vary from year to year, depending on the type of agriculture for which it is used, the commodities produced, and the cyclical nature of the commodity markets.

#### AUSNZ 1.4.4

**Agricultural and pastoral productivity relies on a critical relationship between soils, climate, water, management and commodity options. The valuation of agricultural and pastoral lands demands an understanding of the interrelationships between these critical factors.**

### 2.0 Scope

- 2.1 This GN encompasses:
- 2.1.1 Those characteristics of value associated with agricultural properties, and
- 2.1.2 The basic requirements of the Valuation Standards and Applications as they apply to the valuation of agricultural properties.

### 3.0 Definitions

The agricultural uses of properties may be classified in several broad groups, definitions of which follow.

- 3.1 *Crop(ping) Farms.* Agricultural properties used for growing commodities that are typically planted and harvested within a twelve-month cycle. Properties used for annual crop production may grow more than one type of annual crop over the same period and may or may not make use of irrigation to produce the crops. Some commodities are annual crops that may be left in the ground beyond a twelve-month cycle, per contract provisions or in circumstances where market conditions are unfavorable. These crops will last for more than one year after harvest but are considered less than permanent. Also see *irrigated land, perennial plantings.*



## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 10

- 3.2 *Dairy Farms.* Agricultural properties used for the production of milk from cows or for other dairy products. These properties usually have extensive structural improvements (barns, milking parlours, silos) and equipment (feed bins, milking machines). Feed may be produced on the property, imported, or supplied by both sources.
- 3.3 *Forestry/Timberland.* Agricultural property used for the growing of non-orchard trees that are periodically harvested over extended growing periods (10 to 20 or more years). Considered to be agricultural properties because they produce a *crop*, i.e., wood, even though that crop requires a long-term growing period. Also see perennial plantings.
- 3.4 *Irrigated Land.* Lands used to produce crops or forage for livestock and which require the application of water other than that from natural rainfall, are called *irrigated crop(ping) farms* or *irrigated grazing land*. Properties that lack a water source other than natural rainfall are referred to as *dry land agricultural properties*.
- 3.5 *Livestock Ranches/Stations.* Agricultural properties used to raise and feed animals such as cattle, sheep, pigs, goats, horses, or combinations thereof. The actual use of these properties can take many forms. The animals may be bred, raised, and sold within the operation of the property. Young animals may be acquired from outside the property and then raised within the property. The animals may be raised for consumptive use or for breeding stock. Feed for the animals may be produced on the property, imported, or supplied by both sources. Properties used for the production and feeding of livestock have significant capital investment in the structural improvements (pens, livestock shelters, sheds, division fencing) and the livestock, which may or may not be depreciable depending on the laws and regulations of the local jurisdiction.
- 3.6 *Perennial Plantings.* Crops grown from plantings that have a life extending beyond one year or one-crop cycle. Examples are vineyards and orchards. These types of properties can have significant capital investment in the plantings, which represent a depreciable asset. Also see *forestry/timberland*.
- 3.7 *Specialised Livestock Facilities.* See *dairy farms, livestock ranches/stations*.
- 3.8 *Specialised, or Special Purpose Properties.* Agricultural properties that do not typically produce a crop but are used for the handling,

processing, or storage of crops following harvest. These properties frequently have a small land base that is extensively developed with structural improvements (grain elevators) and equipment (lifting machinery). Properties may also be classified as *special purpose* by the nature of the commodity produced. Examples are truck farms, poultry farms, farms that produce certified crop seeds or fresh cut flowers, and racehorse breeding or training stables.

### Other definitions

- 3.9 *Agricultural Activity.* Management by an entity of the biological transformation of biological assets for sale, into agricultural produce, or into additional biological assets. (See International Accounting Standard 41 [IAS 41], Agriculture., para. 5)
- 3.10 *Biological Asset.* A living animal or plant. (IAS 41, para. 5)
- 3.11 *Integrated Unit.* An agricultural entity that has common ownership of all or part of the processes involving the production and marketing of its products and/or commodities.

## 4.0 Relationship to Accounting Standards

- 4.1 International Accounting Standards 16 (Property, Plant and Equipment), 40 (Investment Property), and 41(Agriculture) apply to the valuation of agricultural property. An entity follows IAS 16 or IAS 40, depending on which standard is appropriate in the circumstances. IAS 16 requires that land be measured either at its cost less any accumulated depreciation and accumulated impairment losses or at a revalued amount. IAS 40 requires land that is investment property to be measured at its fair value, or cost less any accumulated depreciation and accumulated impairment losses. IAS 41, which establishes no new principles for land related to agricultural activity, requires that biological assets physically attached to land (e.g., trees in a plantation forest) be measured at their fair value less estimated point-of-sale costs, separately from the land.
- 4.2 IAS 41 acknowledges that there may be no separate market for biological assets attached to the land but that an active market may exist for the combined assets, i.e., the biological assets, raw land, and land improvements, as a package. An entity may, therefore, use information regarding the combined assets to determine fair value for

the biological assets. The fair value of raw land and land improvements may be deducted from the fair value of the combined assets to arrive at the fair value of the biological assets. (See IAS 41, para. 25.) IAS 41 also gives guidance on how to determine fair value for a biological asset or agricultural produce where an active market exists as well as in the absence of an active market.

4.3 Agricultural property assets can be classified as:

- Land
- Structural improvements
- Plant and machinery (attached to the land)
- Plant and machinery (not attached to the land)
- Biological assets (attached to the land)
- Biological assets (not attached to the land)

The *Fair Value/Market Value* of biological assets is the contributory, or added, value they give to the land. IAS 41 requires that biological assets be measured upon initial recognition and at each balance sheet date.

4.4 IAS 16 recommends frequent revaluations, stating that every three to five years may be sufficient. IAS 40 requires revaluation on an annual basis.

## 5.0 Guidance

5.1 **Diverse forms of commodity production and methods of operation are characteristic of agricultural properties. These properties may also represent various combinations of land, buildings, equipment, and crop plantings. Generally accepted valuation principles (GAVP) are as applicable to agricultural properties as they are to the valuation of other forms of real property.**

5.1.1 The Valuer must have competence in valuing the various assets that comprise the property. (See IVSC Code of Conduct, section 5, Competence.)

5.2 ***Market Value* must be recognised as the fundamental basis of valuation (IVS 1).**

5.2.1 The Valuer shall arrive at the *Market Value* for the agricultural property, ensuring that the valuation is market-derived.

5.2.2 For financial reporting, the Valuer shall apportion the *Market Value* in accordance with the requirements of the IAS. For guidance, the reader is referred to IVA 1.

5.3 **Where other bases of valuation are used, they must be distinguished from the *Market Value* basis.**

5.3.1 When estimating values other than *Market Value* as required for financial reporting, depreciation schedules, or tax purposes, the Valuer must ensure that the distinction is clearly defined and noted.

## 5.4 Non-Realty Elements

5.4.1 When the valuation is made of an agricultural property that may include *non-realty elements* such as livestock, stored crops, and equipment, the Valuer needs to understand when a crop or other commodity is real property and when it may become personal property. Timber for example, is part of the real property while growing but becomes personal property when it is removed from the land.

5.5 **The Valuer must understand the unique nature of agricultural productive factors, commodity markets, production practices, and cycles in the market region.**

5.5.1 In the valuation of agricultural properties, the physical and environmental aspects of the property assume special importance. These include features such as climate, soil types and their productive capability, the availability or absence of water for irrigation, and the feeding/carrying capacity for livestock. External factors to be considered include the availability and adequacy of support facilities required for storage, processing, and transportation. The relative importance of these factors will vary depending upon the type of agriculture for which the property is suited or used. The Valuer needs to consider both internal and external factors in making a determination of which class of agricultural use the property is best suited for.

5.5.2 In keeping with the definition of *Market Value*, a *highest and best use* analysis of the property should always be conducted in order 1) to warrant that an agricultural use is to be continued, especially when it appears that another land use, e.g., subdivision development occasioned by encroaching urban/suburban expansion, might be more appropriate, and 2) to determine whether the specific agricultural use is to be continued.

5.5.3 Where the Valuer is specifically instructed to ignore uses other than the current agricultural use, the resulting valuation will not necessarily indicate the *Market Value* of the property, and this should be fully disclosed.

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 10

5.6 **The estimate of stabilised income to the agricultural property must be based on the crop patterns and cycles in the market area.**

5.6.1 The cash flow to agricultural properties is a function of both the production cycle followed on the property and cyclical forces such as commodity markets. The Valuer should understand the impact of these cycles on cash flows. The valuation of the property must be based on the stabilised pattern of income that is consistent with the production cycles commonly practiced in the region in which the property is located.

5.7 **The Valuer of agricultural property that has more than one physical component or class of agricultural use must clearly state whether the value of each component or use is its value contribution as part of the whole property or its value as a separate, free-standing component.**

5.7.1 The various components of a whole property may have value as separate parts which is greater or lesser than their value as part of the whole. The Valuer must determine whether each component is to be valued individually or as part of the whole property.

5.7.2 Agricultural properties may be managed to simultaneously produce more than one class of commodity based on different physical conditions within the property or on management decisions. In the valuation of agricultural properties on which crops of more than one agricultural classification are cultivated and harvested at different times, the value of each agricultural classification must be based on its contribution to total property value and not its stand-alone value.

5.7.3 The agricultural use of the property may require extensive building improvements, e.g., barns, silos, dairy machinery. Such improvements, while requisite to the proper operation of the property, are frequently secondary to the principal land asset. Their value must be based on their contribution to the total value of the property regardless of their cost or other measure.

Typically, such improvements have a value-in-use, i.e., their contributory value to the enterprise/ entity. On those occasions where an allocation of value between the assets may be required, such an allocation is not to be taken as an indication of the individual value of the improvements as separate assets.

5.8 The requirements for valuation reports are addressed in the IVSC Code of Conduct and IVS 3, Valuation Reporting.

### 6.0 Date of Issue

6.1 This International Valuation Guidance note became effective 31 July 2007.

# REVIEWING VALUATIONS

## REVISED 2007

### 1.0 Introduction

- 1.1 A valuation review is a review of a Valuer's work undertaken by another Valuer exercising impartial judgment.
- 1.2 Because of the need to ensure the accuracy, appropriateness, and quality of Valuation Reports, valuation reviews have become an integral part of professional practice. In a valuation review, the correctness, consistency, reasonableness, and completeness of the valuation are considered.
- 1.2.1 A valuation review may call for input from experts with specialist knowledge of construction costs, property income, legal and tax matters, or environmental problems.
- 1.2.2 A valuation review provides a credibility check on the valuation under review, and tests its strength by focusing upon
- 1.2.2.1 the apparent adequacy and relevance of the data used and enquiries made;
  - 1.2.2.2 the appropriateness of the methods and techniques employed;
  - 1.2.2.3 whether the analysis, opinions, and conclusions are appropriate and reasonable; and
  - 1.2.2.4 whether the overall product presented meets or exceeds Generally Accepted Valuation Principles (GAVP).
- 1.3 Valuations reviews are performed for a variety of reasons, including:
- 1.3.1 Due diligence required of financial reporting and asset management;
  - 1.3.2 Expert testimony in legal proceedings and circumstances;
  - 1.3.3 A basis for business decisions; and
  - 1.3.4 Determination of whether a report complies with regulatory requirements, where
    - 1.3.4.1 Valuations are used as part of the mortgage lending process, especially mortgages insured or regulated by the government, and

- 1.3.4.2 It is necessary to test whether Valuers have met regulatory standards and requirements within their jurisdiction.

### 2.0 Scope

- 2.1 The requirements in this GN apply to the development and reporting of valuation reviews.
- 2.2 Compliance with this GN is incumbent upon any Valuer who, in a supervisory or managerial capacity, signs a valuation review, thereby accepting responsibility for the contents of that review.

### 3.0 Definitions

- 3.1 *Administrative (Compliance) Review.* A valuation review performed by a client or user of valuation services as an exercise in due diligence when the valuation is to be used for purposes of decision-making such as underwriting, purchasing, or selling the property. A Valuer may, on occasion, perform an administrative review to assist a client with these functions. An administrative review is also undertaken to ensure that a valuation meets or exceeds the compliance requirements or guidelines of the specific market and, at a minimum, conforms to Generally Accepted Valuation Principles (GAVP).
- 3.2 *Desk Review.* A valuation review that is limited to the data presented in the report, which may or may not be independently confirmed. Generally performed using a checklist of items. The reviewer checks for the accuracy of calculations, the reasonableness of data, the appropriateness of methodology, and compliance with client guidelines, regulatory requirements, and professional standards. Also see *field review*.
- 3.3 *Field Review.* A valuation review that includes inspection of the exterior and sometimes the interior of the subject property and possibly inspection of the comparable properties to confirm the data provided in the report. Generally performed using a checklist that covers the items examined in a desk review and may also include confirmation of market data, research to gather

# INTERNATIONAL VALUATION GUIDANCE NOTE NO. 11

additional data, and verification of the software used in preparing the report. Also see *desk review*.

- 3.4 *Technical Review*. A valuation review performed by a Valuer to form an opinion as to whether the analyses, opinions, and conclusions in the report under review are appropriate, reasonable, and supportable.
- 3.5 *Valuation Review*. A valuation assignment that covers a range of types and purposes. The principal characteristic all valuation reviews have in common is that one Valuer exercises impartial judgment in considering the work of another Valuer. A valuation review may support the same value conclusion in the valuation under review or it may result in disagreement with that value conclusion. Valuation reviews provide a credibility check on the valuation as well as a check on the strength of the work of the Valuer who developed it, as regards the Valuer's knowledge, experience, and independence.

In some States a valuation review may also be an update done by a Valuer of the same valuation firm that carried out the original valuation.

Valuation organisations around the world distinguish between various types of reviews, e.g., *administrative (compliance) reviews, technical reviews, desk reviews, field reviews, reviews to ensure that a valuation has been carried out in accordance with professional standards (where the bases of valuation used in the valuation under review are accepted), reviews that muster general market information to support or contest the value conclusion, and reviews that examine the specific data in the valuation under review with comparable data from a sample group.*

## 4.0 Relationship to Accounting Standards

- 4.1 The relationship between accounting standards and valuation practice is discussed in IVA 1.

## 5.0 Guidance

- 5.1 In developing a valuation review, the Review Valuer shall:
- 5.1.1 identify the client and intended users of the Valuation Review, the intended use of the Review Valuer's opinions and conclusions, and the purpose of the assignment;
- 5.1.2 identify the subject property, the date of the valuation review, the property and ownership

interest valued in the report under review, the date of the report under review, the effective date of the opinion in the report under review, and the Valuer(s) who completed the report under review;

- 5.1.3 identify the scope of the review process to be performed;
- 5.1.4 identify all assumptions and limiting conditions in the valuation review;
- 5.1.5 develop an opinion as to the completeness of the report under review within the scope of work applicable to the assignment;
- 5.1.6 develop an opinion as to the apparent adequacy and relevance of the data and any adjustments;
- 5.1.7 develop an opinion as to the appropriateness of the methods and techniques used and develop the reasons for agreement or any disagreement with the report under review; and
- 5.1.8 develop an opinion as to whether the analyses, opinions, and conclusions in the work under review are appropriate, reasonable, and supportable.
- 5.2 In reporting the results of a valuation review, the Review Valuer shall:
- 5.2.1 state the identity of the client and intended users, the intended use of the assignment results, and the purpose of the assignment;
- 5.2.2 state the information that must be identified in accordance with paragraphs 5.1.1-5.1.4 above;
- 5.2.3 state the nature, extent, and detail of the review process undertaken;
- 5.2.4 state the opinions, reasons, and conclusions required in paragraphs 5.1.5-5.1.8 above;
- 5.2.5 indicate whether all known pertinent information is included; and
- 5.2.6 include a signed Compliance Statement in the review report.
- 5.3 The Review Valuer shall not consider events affecting the property or market that occurred subsequent to a valuation, but only information that was readily available in the market at the time of the valuation.
- 5.4 Reasons for agreement or disagreement with the conclusions of a valuation report should be fully explained by the Review Valuer.

- 5.4.1 Where the Review Valuer agrees with the conclusions of a valuation report, reasons for such agreement should be fully explained and disclosed.
- 5.4.2 Where the Review Valuer does not agree with the conclusions of a valuation report, the reasons for such disagreement should be fully explained and disclosed.
- 5.4.3 Where the Review Valuer is not in possession of all the facts and information on which the Valuer relied, the Review Valuer must disclose the limitations of his or her conclusions.
- 5.5 Where the scope of the work undertaken is sufficient to constitute a new valuation, such valuation must conform to the requirements of the International Valuation Standards and IVS Code of Conduct.

### **6.0 Effective Date**

- 6.1 This International Valuation Guidance Note became effective 31 July 2007.

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# VALUATION OF TRADE RELATED PROPERTY

## REVISED 2007

### 1.0 Introduction

- 1.1 Trade Related Properties (TRPs) are individual properties, such as hotels, fuel stations, and restaurants that usually change hands in the marketplace while remaining operational. These assets include not only land and buildings, but also fixtures and fittings (furniture, fixtures and equipment) and a business component made up of intangible assets, including transferable goodwill.
- 1.2 This Guidance Note provides direction on the valuation of TRPs as operating assets as well as the allocation of TRP value into its main components. Component values are usually required for depreciation and tax purposes. This Guidance Note should also be read in conjunction with the Guidance Notes cited in para. 2.1 below.
- 1.3 Some concepts involved in the valuation of a business not classed as a TRP (see GN 6, Business Valuation) must be distinguished from those involved in the valuation of *Trade Related Property*. (Also see paras. 5.6 and 5.7.2 below.)

### 2.0 Scope

- 2.1 This Guidance Note focuses on TRP valuation. For further insight into the application of valuation principles, the following IVSs Guidance Notes should be consulted:
- 2.1.1 GN 1, Real Property Valuation,
- 2.1.2 GN 3, Valuation of Plant and Equipment,
- 2.1.3 GN 4, Valuation of Intangible Assets,
- 2.1.4 GN 5, Valuation of Personal Property,
- 2.1.5 GN 6, Business Valuation,
- 2.1.6 GN 10, Discounted Cash Flow Analysis for Market Valuations and Investment Analyses.

### 3.0 Definitions

- 3.1 *Capitalisation*. At a given date the conversion into the equivalent capital value of net income or a

series of net receipts, actual or estimated, over a period.

- 3.2 *Discounted Cash Flow*. A financial modeling technique based on explicit assumptions regarding the prospective cash flow to a property or business. The most widely used applications of DCF analysis are the Internal Rate of Return (IRR) and Net Present Value (NPV).

#### 3.3 Goodwill.

- 3.3.1 Future economic benefits arising from assets that are not capable of being individually identified and separately recognised. (IFRS 3, Appendix A)

- 3.3.2 *Personal Goodwill*. The value of profit generated over and above market expectations, which would be extinguished upon sale of the trade related property, together with those financial factors related specifically to the current operator of the business, such as taxation, depreciation policy, borrowing costs and the capital invested in the business.

- 3.3.3 *Transferable Goodwill*. That *intangible asset* that arises as a result of property-specific name and reputation, customer patronage, location, products and similar factors, which generate economic benefits. It is inherent to the trade related property, and will transfer to a new owner on sale.

- 3.4 *Reasonably Efficient Operator, or Average Competent Management*. A market based concept whereby a potential purchaser, and thus the Valuer, estimates the maintainable level of trade and future profitability that can be achieved by a competent operator of a business conducted on the premises, acting in an efficient manner. The concept involves the trading potential rather than the actual level of trade under the existing ownership so it excludes personal goodwill.

- 3.5 *Trade Related Property*. *Certain classes of real property, which are designed for a specific type of business and that are normally bought and sold in the market, having regard to their trading potential.*

## **4.0 Relationship to Accounting Standards**

4.1 Under International Financial Reporting Standards (IFRSs), like other types of real property, a TRP may be carried on an entity's balance sheet at either cost or at fair value (see IVA 1). It may be necessary to allocate the value of a TRP between its different components for depreciation purposes.

## **5.0 Guidance**

5.1 This Guidance Note describes that category of property referred to as TRPs and explains how TRPs are valued in accordance with International Valuation Standard 1, Market Value Basis of Valuation.

5.2 When performing a TRP valuation, the Valuer may also find relevant guidance in the six Guidance Notes cited in para. 2.1 above. If the valuation is for inclusion in a Financial Statement, the Valuer should refer to IVA 1, Valuation for Financial Reporting.

5.3 TRPs are considered as individual trading concerns and typically are valued on the basis of their potential Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA), as adjusted to reflect the trading of a reasonably efficient operator and often on the basis of either DCF methodology or by use of a capitalisation rate applied to the EBITDA.

5.4 Valuations of TRPs are usually based on assumptions that there will be a continuation of trading by a Reasonably Efficient Operator, with the benefit of existing licences, trade inventory, fixtures, fittings and equipment, and with adequate working capital. The value of the property including transferable goodwill is derived from an estimated maintainable level of trade. If the valuation is required on any other assumption, the Valuer should make such assumption explicit through disclosure. While the actual trading performance may be the starting point for the assessment of the fair maintainable level of trade, adjustments should be made for atypical revenues or costs so as to reflect the trade of a reasonably efficient operator.

5.5 Profit generated, in excess of market expectations that may be attributed to the manager is not included. The manager's particular tax position, depreciation policy,

borrowing costs and capital invested in the business are not considered for the purpose of establishing a common basis to compare different properties under different managers.

5.6 Although the concepts and techniques are similar to those often used in the valuation of a large-scale business, to the extent that the valuation of a TRP does not usually consider tax, depreciation, borrowing costs and capital invested in the business, the valuation is based on different inputs from those of a valuation of a sizable business.

5.7 The valuation conclusion may need to be broken down between the different asset components for the purposes of financial reporting, for property taxation or, when required, for property lending purposes.

5.7.1 The components of TRP entity value are typically:

5.7.1.1 land;

5.7.1.2 building(s);

5.7.1.3 fixtures and fittings (furniture, fixtures and equipment), including software;

5.7.1.4 inventory, which may or may not be included (this should be disclosed);

5.7.1.5 intangible assets, including transferable goodwill; and

5.7.1.6 any licences and permits required to trade.

5.7.2 Items such as working capital and debt are considered in valuing equity for businesses, but equity is not valued for TRPs. TRPs may, however, comprise part of a business.

5.7.3 An estimation of the individual values of the components can only represent an apportionment, unless direct market evidence is available for one or more of these components to isolate component value from the overall TRP value.

5.8 TRPs are by their nature, specialist assets that are usually designed for a specific use. Changes in market circumstances, whether structural to the industry or due to the local competition or another reason, can have a material impact on value.

5.9 It is necessary to distinguish between the asset value of a Trade Related Property and the ownership value of the business. In order

to undertake a valuation of a TRP, a Valuer will require sufficient knowledge of the specific market sector so as to be able to judge the trading potential achievable by a Reasonably Efficient Operator, as well as knowledge of the value of the individual component elements.

### **6.0 Effective Date**

- 6.1 This International Valuation Guidance Note became effective 31 July 2007.

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# MASS APPRAISAL FOR PROPERTY TAXATION

## 1.0 Introduction

- 1.1 The objective of this Guidance Note is to provide a framework for the performance of *Mass Appraisal* assignments for *Ad Valorem Property Taxation* throughout IVSC Member States. The Guidance Note provides assistance in understanding recognised Mass Appraisal methods, the design and implementation of property taxation systems and the relationship of Mass Appraisal to International Valuation Standards.
- 1.2 The *Mass Appraisal Process* may be utilised as a methodology for *Ad Valorem Property Taxation*, or statistical and economic studies under government administrative programs. The appraisal outputs facilitate revenue raising, revenue equalisation, and the distribution of financial benefits or grants to government authorities. In this Guidance Note, reference to Mass Appraisal implies Mass Appraisal for the above purposes.
- 1.3 For a property taxation system to be effective, the following elements must be in place:
- (a) a legal system and legal infrastructure that define, support and protect property rights;
  - (b) a recording and inventory system for all parcels of land, which represents the basis of taxation;
  - (c) sufficient market data from which valuations may be determined;
  - (d) sufficient resources and trained personnel to implement the system;
  - (e) continued maintenance of the inventory and databases to ensure more refined data, more accurate valuations, and more equitable taxation; and
  - (f) a process for sampling and testing developed models to ensure consistency in methodology and application.
- 1.4 The Mass Appraisal process includes:
- (a) identifying properties to be appraised;
  - (b) defining the market area in terms of consistent behaviour on the part of property owners and would-be purchasers;
  - (c) identifying characteristics of supply and demand that affect the creation of value in the defined market area;
  - (d) developing a model structure that reflects the relationship among the characteristics affecting value in the market area;
  - (e) calibrating the model structure to determine, among other attributes, the contribution of the individual property features affecting value;
  - (f) applying the conclusions reflected in the model to the characteristics of the property(ies) being appraised;
  - (g) validating the adopted mass appraisal process, model, measurements or other readings including the performance measures, on an ongoing basis and/or at discrete stages throughout the process;
  - (h) reviewing and reconciling the Mass Appraisal results.
- 1.5 The valuation basis for Mass Appraisal is *Market Value* as defined in *IVS 1, Section 3*, subject to any modification of the concept as specified under relevant instructions or legislation. If such instructions or legislation stipulate a valuation basis other than Market Value as defined above, Valuers should apply appropriate valuation methods to accomplish the objectives of IVSC Standards under these circumstances. See *IVS 2, Section 5*, and also para. 5.5.1 (e) below under Disclosure in Mass Appraisal Valuation Reports.
- 1.6 Mass Appraisals can be prepared with or without computer assistance. While computerised methodology has made the Mass Appraisal process more efficient and more widespread, it has not altered that process. Data banks and computerised applications are used in data storage, mapping, data analysis, and testing of the results.
- 1.7 The development of Mass Appraisal systems for Property Taxation should follow recognised scientific standards in statistical applications.
- 1.8 While local legal requirements will take precedence, observance of the *IVSs Code of*

*Conduct* is, nonetheless, incumbent upon assessment personnel, who carry out Mass Appraisals. The concept of Market Value is recognised as the assessment basis in most jurisdictions. The requirements of the *IVSs Code of Conduct* necessarily supplement those of local law. Requirements under the *Code of Conduct* apply to:

- (a) the mass valuation process itself; and
- (b) the use of computers and computer-generated models in the mass appraisal process.

## AUSNZ 1.9

Members should also review ANZVGN 4 Valuations For Rating & Taxes.

## 2.0 Scope

- 2.1 The professional responsibility of Valuers is, in most instances, prescribed by statute or regulations affecting Mass Appraisal assignments. It is the professional duty of the Valuer to be familiar with, adhere to, and administer the provisions of the law established in the Ad Valorem property taxing jurisdiction.
- 2.2 The various outputs from Mass Appraisal programs have financial implications in government administration. For purposes of revenue raising, revenue equalisation, or the distribution of benefits or grants, any departure from an accurate basis of assessment will result in inequities. Local statutes prescribe the basis and definitions of values to be returned (i.e., the assessments and/or indices developed in Mass Appraisal assignments), the administrative procedures for the collection and delivery of valuation data, the time-frames between undertaking Mass Appraisals, and the processes for appeal of assessments or indices.
- 2.3 The scope of the completed assignment shall be consistent with:
  - (a) the expectations of participants in the market for the same or similar valuation services; and
  - (b) the requirements of IVSC Standards, Guidance Notes and Applications for the same or a similar assignment.

## 3.0 Definitions

- 3.1 *Ad Valorem Property Taxation*. A revenue-raising procedure, based on the assessed value of property related to a scale of charges defined by statute within a specified time-frame.

- 3.2 *Calibration*. The process of analysing sets of property and market data to determine the specific parameters operating upon a model.
- 3.3 *Mass Appraisal*. The practice of appraising multiple properties as of a given date by a systematic and uniform application of appraisal methods and techniques that allow for statistical review and analysis of results.
- 3.4 *Mass Appraisal Process*. The procedures applied in mass appraisal assignments for arriving at assessments and/or indices. This process includes the eight steps, identified in para. 1.4 above.

## 4.0 Relationship to Accounting Standards

- 4.1 Mass Appraisal does not fall under the governance of national or international accounting standards.
- 4.2 Valuers should be aware that revaluation procedures for financial reporting purposes are unrelated to Mass Appraisal procedures for Ad Valorem Property Taxation.
- 4.3 Legislative requirements and standards of appraisal level and uniformity in valuations for Ad Valorem Property Taxation are likely to produce variations in property values from those determined for financial reporting purposes.

## 5.0 Guidance

### 5.1 Data Collection and System Recording

- 5.1.1 A robust data collection system must be available to the Valuer. The recording of data has evolved from the use of manual methods to the creation of sophisticated data banks that facilitate computer-assisted appraisal, often incorporating geographic information systems (GIS). Property data may be quantitative (e.g., land areas, dimensions, building specifications) and/or qualitative (assessment of the physical condition, character, or market desirability of the improvements).
  - 5.1.1.1 Appraisal data banks are built around land tenure records, e.g., title deeds, transfer documents, and sales information, in national, federal, state or local government jurisdictions that define property ownership or interests in land.
- 5.1.2 Characteristics of the market that are relevant to the purpose and intended use of the Mass

Appraisal shall be recorded in the system including:

- (a) location of the defined market area;
- (b) physical, legal, and economic attributes of the properties;
- (c) time-frame of market activity; and
- (d) property interests reflected in the market.

## 5.2 The Development and Maintenance of Assessment Lists

- 5.2.1 Assessment Lists will contain information on property ownership, value definitions, details of the assessment, date of the assessment, and date on which the assessment comes into force.
- 5.2.2 Assessment Lists must allow for periodic adjustments or alterations to ensure the currency and consistency of assessed values.

## 5.3 Mass Appraisal Value Definitions

- 5.3.1 Where mass appraisal is undertaken for the purpose of Ad Valorem Property Taxation, value definitions are generally mandated by local statute. Specific valuation methodologies may be required under different value definitions.

## 5.4 Standards of Appraisal Level and Uniformity

- 5.4.1 In the interests of assessment equity, standards of appraisal level (the proximity between assessments and actual prices) and uniformity (the statistical measure of valuation consistency) must be observed in the application of mass appraisal systems.

## 5.5 Disclosure in Mass Appraisal Assignment Reports

- 5.5.1 Valuers undertaking Mass Appraisal assignments are subject to the provisions of *IVS 3, Valuation Reporting*. The Valuer shall disclose the following essential data that is specific to Mass Appraisal reporting:
  - (a) the client and other intended users;
  - (b) the purpose and intended use of the appraisal;
  - (c) the scope of work necessary to complete the assignment, including any special limiting conditions;
  - (d) any extraordinary assumptions and hypothetical conditions needed to carry out the assignment, provided these are reasonable and result in a credible analysis;

- (e) the relevant basis of valuation if, under reasonable terms and conditions, the value opinion to be developed is other than Market Value;
- (f) the characteristics of the properties that are relevant to the purpose and intended use of the Mass Appraisal;
- (g) a reference to each individual property in the Assessment List or grouping, indicating where information is stored in the property record relating to its identity;
- (h) the characteristics of the market that are relevant to the purpose and intended use of the Mass Appraisal (see para. 5.1.2).

## 5.6 Departure

- 5.6.1 Departure from the instructions in this Guidance Note should only result from required compliance with statutory provisions, administrative instructions, or the agreed or amended terms of appraisal contracts.
- 5.6.2 Further discussion on Departure provisions is set out in section 6.8 of the *IVSs Code of Conduct* and section 8.2 of *International Valuation Standard 3*.

## 6.0 Effective Date

- 6.1 This International Valuation Guidance Note became effective on 1 January 2005.



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# VALUATION OF PROPERTIES IN THE EXTRACTIVE INDUSTRIES

## 1.0 Introduction

- 1.1 The purpose of this Guidance Note (GN) is to provide clarification and guidance on the valuation of assets or property interests (rights) held by entities involved in the Extractive Industries. It distinguishes among the various property interests that must be recognised, and discusses concepts that should be understood by financial reporting and regulatory authorities, courts, financiers, investors, participants in natural resource transactions, and other users of valuation services for property involved in the Extractive Industries.
- 1.2 Reliable valuations of Extractive Industries assets, including interests (rights) in natural resource properties, are essential to ensure the availability of capital necessary to support the continuity of the Extractive Industries component of the world's economic base, to promote the productive use of Mineral and Petroleum natural resources, and to maintain the confidence of capital markets.
- 1.3 Extractive Industries comprise the Minerals Industry and the Petroleum Industry, but do not include activities focused on the extraction of water from the earth.
- 1.4 The Minerals and Petroleum Industries are characterised by the extraction from the earth of natural resources, which may pass through a series of ownership, processing and measurement stages. It is important to Valuers and the users of valuation services that distinctions are made among real property, personal property, and business interests involved in these stages. Financial reporting requires the recognition of various asset classifications into which these interests may fall. Additionally, clear and precise understanding of these distinctions is necessary for valuations to be performed and used in the public interest, regardless of the application.
- 1.5 Valuations in the Extractive Industries often must rely heavily on information provided by (a) Technical Expert(s) or other accredited specialist(s) specific to the industry.
- 1.6 A typical characteristic of the Extractive Industries that sets them apart from other industries or economic sectors is the depletion or wasting of natural resources, that can be replaced in their original state by natural actions following extraction only in special cases. Special cases of natural replacement may occur for water transported minerals and geothermal fluid. The means of production is extraction from the earth of natural resources that form part of the Real Estate.
- 1.6.1 The ultimate quantity and quality of material of economic interest that might be extracted from an Extractive Industry natural resource property is often not known at the Effective Date of Valuation.
- 1.7 Examples of depleting or wasting natural resources include, but are not limited to:
- 1.7.1 metallic Mineral deposits containing metals such as copper, aluminium, gold, iron, manganese, nickel, cobalt, zinc, lead, silver, tin, tungsten, uranium, and platinum group metals;
- 1.7.2 non-metallic Mineral deposits such as coal, potash, phosphates, sulphur, magnesium, limestone, salt, mineral sands, diamonds and other gemstones;
- 1.7.3 construction materials such as sand, gravel, crushed stone, and dimension stone;
- 1.7.4 Petroleum deposits including oil, natural gas, natural gas liquids, other gases, heavy oil, and oil sands.
- 1.8 There are contrasts between the production and transportation phases of the Minerals and Petroleum Industries that must be understood:
- 1.8.1 Items 1.7.1, 1.7.2 and 1.7.3 above include products of the Minerals Industry, which extracts valuable mineralization, generally by mining in a surface mine (open pit, open-cast, open-cut, or strip mine; a quarry used to produce construction material is also considered a surface mine), or an underground mine. Some extraction is undertaken through wells, for example, sulphur extraction, and in situ leaching (solution mining) of various salts and uranium minerals. Some extraction is also done by dredging the floors of bodies of water, such as for gravel, mineral sands, diamonds, and alluvial gold. Extraction of mineral products

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 14

- from water, such as halite (common salt) and magnesium, is also part of the Minerals Industry.
- 1.8.2 The Minerals Industry generally has a planned extraction phase, though this phase is often extended through Mineral Reserve additions. Once extraction is completed, no more known economically recoverable asset remains in place at that time.
- 1.8.3 The raw materials cited in para.1.7.4 above are produced by the Petroleum Industry, which extracts valuable product generally through wells drilled into the earth's crust. Some extraction is also undertaken using mining methods, for example, open pit mining of oil sand and oil shale. The extraction of a solid asset is more labour intensive than the extraction of a fluid asset. A single person may operate oil and gas extraction by pumps or valves, with the occasional need for well maintenance or well work-over crews.
- 1.8.4 The Petroleum Industry frequently has more than one economical extraction phase for crude oil. At the conclusion of the initial (primary) extraction phase, much of the initial Petroleum Reserve of crude oil may remain. Secondary and/or enhanced recovery methods are often applied to recover more oil and natural gas. Generally, a large percent of the initial oil in place remains in place at the conclusion of production operations.
- 1.8.5 Another significant difference between the Minerals and Petroleum Industries relates to land surface requirements for processing plant and infrastructure. Relatively little surface area is required for oil or gas well operations. A mining operation often requires a larger land area for stockpiles and disposal of waste material, as well as an open pit if applicable.
- 1.8.6 Crude oil, natural gas, and refined Petroleum products are more often than not transported to market or port by pipeline. In contrast, a mined product is generally transported to market or port by rail or truck, resulting in differing start-up costs and environmental impacts.
- 1.9 The Minerals and Petroleum Industries are both major industries throughout the world. Their products are essential in all modern economies by provision of raw and refined materials for other downstream industries, such as energy generation, construction, manufacturing, transport and communications.
- 1.10 Exploration of Minerals and Petroleum properties is a high-risk activity. Considerable work and study must be undertaken to determine the technical and economic viability of production. The large majority of Mineral and Petroleum properties do not reach the production stage.
- 1.11 The projected net earnings derived or potentially derived from an Extractive Industry natural resource property is its main source of value. The net earnings may vary from year to year, depending on the type of natural resource commodity, the cyclical nature of the commodity markets and prices, and variations in production rate and costs.
- 1.12 Mineral and Petroleum natural resource properties are valued primarily based on the presence of Mineral or Petroleum Reserves, and Mineral or Petroleum Resources, or the potential for discovery of Resources. The quantity and quality of such Reserves/Resources may vary over time due to changing economic and technical advances, as well as exploration success. Nevertheless, they are ultimately finite and will deplete over time.
- 1.13 The fixed assets and specialised plant and equipment (see Glossary for definitions) used in the extraction and processing of raw products of the Extractive Industries, may retain relatively little or no value when separated from production at the site.
- 1.14 Exploration Properties have asset value derived from their potential for the existence and discovery of economically viable Mineral or Petroleum deposits contained within. Exploration Property interests are bought and sold in the market. Many of these transactions involve partial interest arrangements, such as farm-in, option or joint venture arrangements.
- 1.14.1 The value of an Exploration Property is largely dependent upon surface and subsurface geological and related information, and its interpretation. Little may be known about the characteristics of a deposit that may be contained within the property until the deposit is discovered and explored.
- 1.14.2 Extractive Industries deposits are often located in remote areas and are generally substantially or completely buried below the land surface, and sometimes below the floor of bodies of water or under the sea.
- 1.15 The residual value of the real property interest, plant and equipment as well as environmental reclamation requirements (as liabilities and property improvements), are pertinent factors in the valuation process for Extractive Industries properties.

## 2.0 Scope

- 2.1 This Guidance Note provides specific guidance for valuation of assets and interests of the Extractive Industries. It provides supplemental guidance for application of the International Valuation Standards (IVSs 1, 2, and 3), International Valuation Applications (IVAs 1, 2, and 3) and Guidance Notes (GNs). In doing so, it specifically supplements the following GNs for their application to the Extractive Industries;
- GN1 Real Property Valuation;
  - GN2 Valuation of Lease Interests;
  - GN3 Valuation of Plant and Equipment;
  - GN4 Valuation of Intangible Assets;
  - GN6 Business Valuation;
  - GN8 The Cost Approach for Financial Reporting-(DRC); and
  - GN9 Discounted Cash Flow Analysis for Market Valuations and Investment Analyses.
- 2.2 The ownership of, or rights to, an industrial water supply and water storage system, can form an important component in the valuation of Properties in the Extractive Industries. Water rights may attach to land or may be obtained elsewhere. Adequate rights and facilities for transportation and storage of off-site water may be required for a reliable water supply. Valuation of the contribution of such rights poses special problems that must be addressed by the Valuer. However, this GN does not provide specific guidance for valuation of water ownership, rights, transportation and storage.
- 2.3 Where mark-to-market financial reporting procedures apply or are contemplated, Valuers should observe the provisions of IVA 1, *Valuation for Financial Reporting*, in conjunction with this GN. In some States, securities exchanges and administrations may have specific reporting requirements for the Minerals and Petroleum Industries that override IVSs provisions.
- 2.4 While providing supplemental guidance for the conduct and reporting of valuations of Extractive Industries property and interests in accordance with para. 2.1 above, the provisions of this GN do not replace provisions elsewhere in the current edition of the International Valuation Standards.

## 3.0 Definitions

- 3.1 *Extractive Industries.* Those industries involved in the finding, extracting and associated processing of natural resources located on, in or near the earth's crust. They are composed of the Minerals Industry and the Petroleum Industry. They do not include the industry sector focused on extraction of water from the earth, but they do include extraction of geothermal fluid for its energy content.
- 3.2 *Exploration Property or Area.* A Mineral or Petroleum real property interest that is being actively explored for Mineral deposits or Petroleum accumulations, but for which economic viability has not been demonstrated.
- 3.3 *Feasibility Study in the Extractive Industries.* A comprehensive study of a Mineral deposit or Petroleum accumulation, in which all geological, engineering, operating, economic, marketing, environmental, regulatory and other relevant factors are considered in sufficient detail. The study could reasonably serve as the basis for a final decision by a proponent or financial institution to proceed with, or finance, the development of the prospective property for Mineral or Petroleum production. See also *Prefeasibility Study*.
- 3.4 *Mineral.* Any naturally occurring material useful to, and/or having a value placed on it by humankind, and found in or on the earth's crust. For the purposes of this GN, Minerals include metallic minerals, industrial minerals, aggregates, precious stones and fuel minerals; but Minerals do not include Petroleum, which is defined separately.
- 3.5 *Mineral Reserve.* As defined by the Combined [Mineral] Reserves International Reporting Standard Committee (CRIRSCO): "the economically mineable part of a Measured and/or Indicated Mineral Resource. It includes diluting materials and allowances for losses, which may occur when the material is mined. Appropriate assessments that may include Feasibility Studies, have been carried out, and include consideration of, and modification by, realistically assumed mining, metallurgical, economic, marketing, legal, environmental, social and governmental factors. These assessments demonstrate at the time of reporting that extraction is justified. Mineral Reserves are subdivided in order of increasing confidence into Probable Mineral Reserves and Proved Mineral Reserves."
- The United Nations Framework Classification (UNFC) similarly defines a Mineral Reserve and its

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 14

- subdivisions, applying the UNFC coding system. Entities electing to adopt the UNFC or other definitions of Mineral Reserve for public financial reporting purposes must reconcile the Mineral Reserves to the CRIRSCO Proved and Probable Mineral Reserve categories for valuation purposes.
- 3.6 *Mineral Resource*. As defined by CRIRSCO: “a concentration or occurrence of material of intrinsic economic interest in or on the earth’s crust (a deposit) in such form and quantity that there are reasonable prospects for eventual economic extraction. The location, quantity, grade, geological characteristics and continuity of a Mineral Resource are known, estimated or interpreted from specific geological evidence and knowledge. Mineral Resources are subdivided, in order of increasing geological confidence, into Inferred, Indicated and Measured categories. Portions of a deposit that do not have reasonable prospects for eventual economic extraction must not be included in a Mineral Resource.”
- The United Nations Framework Classification (UNFC) similarly defines a Mineral Resource and its subdivisions, applying the UNFC coding system. For the purposes of this GN, mineralisation classified into the UNFC’s G4 (“Reconnaissance Study”) category, is excluded from a Mineral Resource. Entities electing to adopt the UNFC or other definitions of Mineral Resources for public financial reporting purposes must reconcile the Mineral Resources to the CRIRSCO Inferred, Indicated and Measured Mineral Resource categories for valuation purposes.
- 3.7 *Minerals Industry*. Entities involved in exploration for Minerals, and the mining, processing and marketing of Minerals. This GN is not designed to cover assets downstream from the metals refineries or minerals processing plants, such as assets involved in the distribution of refined metals to metals fabricators, or mineral products to retailers or the final market.
- 3.8 *Petroleum*. Any naturally occurring hydrocarbon, whether in a gaseous, liquid or solid state. Raw Petroleum products are primarily crude oil and natural gas.
- 3.9 *Petroleum Industry*. Entities involved in exploration for Petroleum, and the extraction, processing, refining and marketing of crude Petroleum and associated gases. This GN is not designed to cover assets downstream from the petroleum refineries and natural gas processing plants, such as assets involved in the distribution of refined petroleum products to retailers.
- 3.10 *Petroleum Reserves*. As defined by the Society of Petroleum Engineers (SPE) and the World Petroleum Congress (WPC): “those quantities of Petroleum, which are anticipated to be commercially recovered from known accumulations from a given date forward. All (Petroleum) Reserve estimates involve some degree of uncertainty. The uncertainty depends chiefly on the amount of reliable geologic and engineering data available at the time of the estimate and the interpretation of these data. The relative degree of uncertainty may be conveyed by placing reserves into one of two principal classifications, either Proved or Unproved. Unproved Reserves are less certain to be recovered than Proved Reserves and may be further sub-classified as Probable and Possible Reserves to denote progressively increasing uncertainty in their recoverability.” Proved Reserves can be categorised as Developed or Undeveloped.
- The United Nations Framework Classification (UNFC) similarly defines Petroleum Reserves and their subdivisions, applying the UNFC coding system.
- 3.11 *Petroleum Resources*. For the purpose of this GN, petroleum resources comprise only Petroleum Reserves and Contingent Resources. Contingent Resources as defined by the Society of Petroleum Engineers (SPE)/World Petroleum Congress (WPC), in conjunction with the American Association of Petroleum Geologists (AAPG), are “those quantities of petroleum, which are estimated, on a given date, to be potentially recoverable from known accumulations, but which are not currently considered to be commercially recoverable.”
- The United Nations Framework Classification (UNFC) similarly defines Petroleum Resources and subdivisions, applying the UNFC coding system. For the purpose of this GN, petroleum accumulations classified into the UNFC’s G4 (“Potential Geological Conditions”) category are excluded from Petroleum Resources.
- 3.12 *Prefeasibility Study in the Extractive Industries*. A study of a Mineral or Petroleum deposit, in which all geological, engineering, operating, economic, environmental and other relevant factors, are considered in sufficient detail to serve as the reasonable basis for a decision to proceed to a Feasibility Study.
- 3.13 *Royalty or “Royalty Interest” in the Extractive Industries*. The landowner’s or lessor’s share of production, in money or product, free of charge for expenses of production. An “Overriding

*Royalty*” is a share of mineral or petroleum produced, free of the expense of production, paid to someone other than the lessor, over and above any lessor’s *Royalty*.

- 3.14 *Technical Expert in the Extractive Industries* (called *Technical Expert* elsewhere in this GN). A person, who is responsible for all or part of the *Technical Assessment* that supports an Extractive Industry Valuation. A Technical Expert must have appropriate experience relevant to the subject matter, and in States where required by statute or regulation, must be a member or license-holder in good standing of a professional organisation that has the authority to sanction members or licensees. An accredited specialist may not take responsibility for all or part of a Technical Assessment without also being a Technical Expert.
- 3.15 *Technical Assessment in the Extractive Industries*. A technical document, prepared by (a) Technical Expert(s) that supports the Extractive Industry Valuation and is appended to, or forms part of, a Valuation Report.

## 4.0 Relationship to Accounting Standards

- 4.1 Amongst national GAAPs there are currently several approaches to the measurement of “Upstream Activities” that include exploration for, discovery of, and acquisition or development of, Mineral or Petroleum Resources up to when the Reserves are first capable of being sold or used. The extreme high-risk element in expenditure on these activities has led to two main approaches to Historical Cost accounting for the Extractive Industries, those being:
- (a) all “exploration and evaluation costs” to be written off unless such costs are expected to be recouped, or the activities have not yet established whether the costs are economically recoverable (i.e., adaptations of a “successful efforts” approach). In applications of this approach, there are variations as to which types of cost are permitted to be capitalised and the treatment of costs prior to the determination of “success”, or otherwise, of the exploration and evaluation activities; and
- (b) all expenditures incurred in finding and developing Mineral and Petroleum Reserves to be capitalised and treated as a part of the cost of whatever Reserves may have been found (i.e., a “full cost” approach).

4.2 In December 2004, the International Accounting Standards Board (IASB) released IFRS 6 *Exploration for and Evaluation of Mineral Resources*. Under the provisions of the Standard, entities are permitted to recognise their exploration and evaluation expenditures as “exploration and evaluation assets”. The Standard requires such assets to be measured at cost at initial recognition. After initial recognition, an entity may choose to apply a cost or revaluation model (as outlined in either IAS 16 *Property, Plant and Equipment*, or IAS 38 *Intangible Assets*) to measure their exploration and evaluation assets.

4.2.1 The concept of exploration and evaluation assets, and the costs that make up those assets, apply equally to the cost and revaluation models described above.

4.3. IFRS 6 states at paragraph 9 that: “An entity shall determine a policy for which expenditures are recognised as *exploration and evaluation assets* and apply the policy consistently. In making this determination, an entity considers the degree to which the expenditure can be associated with finding specific mineral resources. The following are examples of expenditures that might be included in the initial measurement of *exploration and evaluation assets* (the list is not exhaustive):

- acquisition of rights to explore;
- topographical, geological, geochemical and geophysical studies;
- exploratory drilling;
- trenching;
- sampling; and
- activities in relation to evaluating technical feasibility and commercial viability of extracting a mineral resource.”

4.3.1 IFRS 6, paragraph 5(a), excludes “activities that precede the exploration for and evaluation of mineral resources” from the scope of the Standard.

4.3.2 IFRS 6, paragraph 10, additionally states that: “Once the technical feasibility and commercial viability of extracting a mineral resource are demonstrable, expenditures related to the development of that mineral resource shall not be recognised as *exploration and evaluation assets*. The *Framework* and IAS 38 *Intangible Assets* provide guidance on the recognition of assets arising from development (or the development phase of an internal project).”

4.3.3 When facts and circumstances stated in paragraph 20 of the Standard suggest that the carrying



## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 14

amount of exploration and evaluation assets may exceed their recoverable amount, entities are required to measure and disclose any resulting impairment loss. The level at which such assets are assessed for impairment may comprise one or more cash-generating units, which is a higher level of aggregation than that otherwise allowed under IAS 36.

- 4.3.4 In the context of the IFRS 6, a minerals resource includes minerals, oil, natural gas and similar non-regenerative resources (see the Defined Terms in Appendix A to IFRS 6) and also in paragraphs 3.6 and 3.11 above.
- 4.4 IASB Standards that require value determinations to be provided under the provisions of this GN include:
- IAS 36 *Impairment of Assets* – for determining the recoverable amount of an asset (including assets that incorporate reserves and resources) in order to ascertain whether the asset is impaired. This process requires determination of “fair value less costs to sell” and/or “value in use” as defined in the Standard.
  - IFRS 3 *Business Combinations* – for determining the carrying amount of assets that were acquired in the acquisition of a business (including assets that incorporate reserves and resources); and
  - IAS 16 *Property, Plant and Equipment* – for the revaluation (if chosen) of property, plant and equipment that relates to extractive operations.
- 4.5 This Guidance Note recognises that the Historical Cost of finding and developing Mineral and Petroleum Reserves is usually not indicative of the realisable value of such Reserves once they have become established.

### 5.0 Guidance

#### 5.1 Valuation Concepts

- 5.1.1 The provisions of this GN are designed to assure application of Generally Accepted Valuation Principles (GAVP) to Extractive Industries Valuations, in accordance with the valuation fundamentals expressed in the IVSs *Concepts Fundamental to Generally Accepted Valuation Principles*.
- 5.1.2 The standard of value is Market Value defined in IVS 1, *Market Value Basis of Valuation*. If some other type of value is

to be determined in accordance with IVS 2, *Bases Other Than Market Value*, a clear definition of that value should be provided by the Valuer and highlighted in the Valuation Report as prescribed in IVS 3, and a clear and conspicuous explanation provided.

- 5.1.3 The property type(s) involved in valuation of Minerals and Petroleum Industry property must be correctly identified in order to correctly select the applicable IVSC Standards and GNs. Naturally occurring *in situ* Minerals and Petroleum are a part of physical land and Real Estate. The ownership of such *in situ* Minerals and Petroleum, an interest in such natural resources, and the right to explore and extract such natural resources, are Real Property, except where otherwise defined by statute. Minerals and Petroleum are Personal Property during transportation and processing. The operation of a mine, quarry or petroleum well is a business activity, as is the transportation and processing of Minerals and Petroleum. Such business activity is generally conducted by an Extractive Industries business enterprise that owns real property and personal property assets, and the activity contributes to the Going Concern Value of the enterprise.
- 5.1.4 A key aspect of the valuation of an Extractive Industry natural resource property is that the property interests and related rights being valued must be properly identified.
- 5.1.5 A Market Valuation of an Extractive Industry property as Real Property must be based on the Highest and Best Use (HABU) of the property. This requires consideration of non-Minerals or non-Petroleum uses for the property, if such uses are possible. Consideration must also be given to a change in exploration, development or operating strategy, or potential for leasing the property, in order to maximise its economic benefit.
- 5.1.6 In determining the HABU, the Valuer should determine the most probable use that is physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value of the property being valued.
- 5.1.7 In conducting a Market Valuation, the three Valuation Approaches are generally available for consideration:



- (a) Sales Comparison Approach (termed Market Approach for Business Valuations), generally by indirect means (see para. 5.3.1 below);
- (b) Income (Capitalisation) Approach, including market-related discounted cash flow;
- (c) Cost Approach (termed Asset-Based Approach for Business Valuations), including depreciated replacement cost and equivalent cost analysis.
- 5.1.8 Where one or more of the above Valuation Approaches has been applied in preference to others, the reason must be stated.
- 5.1.9 As applied to Mineral and Petroleum natural resource property interests, the appropriate Valuation Methods employed depend upon the stage of exploration or development of the property. For convenience, such Mineral and Petroleum properties can be categorised as four main types, though the categorisation is sometimes the subject of the opinion of a Valuer or Technical Expert.
- Exploration properties;
  - Resource properties;
  - Development properties;
  - Production properties.
- 5.1.10 Exploration Properties are defined at para. 3.2.
- 5.1.11 Resource properties contain a Mineral Resource or Petroleum Resource but have not been demonstrated by a Prefeasibility Study or a Feasibility Study to be economically viable.
- 5.1.12 Development properties, in general, have been demonstrated by a Feasibility Study to be economically viable but are not yet in production.
- 5.1.13 Production properties contain a Mineral or Petroleum producing operation active at the time of Valuation.
- 5.1.14 The different stages of exploration and development carry different levels of risk. The risk pertains to the likelihood of eventual or continued Mineral or Petroleum production. As an Exploration Property is advanced to a Resource property, to a Development property, and to a Production property, more technical information is collected, enabling technical analysis, including Prefeasibility and Feasibility Studies, to be carried out, and thereby reducing the risk factor, as the amount of capital investment at risk rapidly increases.
- 5.1.15 The results from the Valuation Approaches and Methods employed must be weighed and reconciled into a concluding opinion of value. The reasons for giving a higher weighting to one Approach or Method over another must be stated.
- ### 5.2 Competence and Impartiality
- 5.2.1 Valuations prepared under this Guidance Note shall comply with all provisions of the IVSC Code of Conduct.
- 5.2.2 To develop a Valuation of an Extractive Industry asset or interest, the Valuer must have competence relevant to the subject asset or interest, or retain the services of (an) appropriately skilled Technical Expert(s).
- 5.2.3 Providing a reliable and accurate valuation typically requires the Valuer to have specialised training, or assistance from (a) Technical Expert(s) or other accredited specialists(s), in geology, Resource and Reserve estimation, engineering, and economic and environmental aspects relevant to the subject natural resource type and geographic setting. The defined term Technical Expert includes “Competent Person”, “Independent Valuer”, and similar requirements that may apply in some States, if the intended use of the Valuation Report is related to public financial reporting or other regulatory purpose.
- 5.2.4 The Valuer is responsible for the decision to rely on a Technical Assessment, data, or opinion provided by other experts or specialists. This includes responsibility for conducting reasonable verification that those persons are appropriately qualified and competent and that their work is credible.
- ### 5.3 Special Considerations of Extractive Industries Valuations
- 5.3.1 Each Mineral deposit, Petroleum accumulation and Exploration Property is unique. Therefore, direct comparison of Mineral or Petroleum natural resource property transactions is often difficult or inappropriate. However, sales analysis is an important valuation tool. Sales adjustments or ratio analysis can frequently be applied for indirect sales comparison purposes. Sales analysis and other market analysis can often yield market factors such as a market discount rate, a risk factor or uncertainty factor that may be used in the Income Approach.

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 14

- 5.3.2 For a Valuation Report to provide an estimate of Market Value, the valuation analysis must be based on market evidence and current expectations and perceptions of market participants for the property valued, and such market evidence must be consistently applied in the Valuer's analysis.
- 5.3.3 The method most commonly used by businesses for investment decision-making within the Extractive Industries is net present value analysis/ discounted cash flow analysis (NPV analysis/ DCF analysis). The Valuer is cautioned that this and other methods, such as those based on option theory, will yield other than Market Value estimates of Investment Value or Value in Use, unless great care is taken to assure that a Market Value estimate is obtained. For the Valuer to report a Market Value estimate resulting from such an analysis, all inputs and assumptions must reflect available market-based evidence and current expectations and perceptions of market participants, in accordance with GN 9. Any departure from the requirements and analysis protocol of GN 9 must be specified.
- 5.3.4 The Market Value of Extractive Industries' natural resource properties and businesses are usually more or less than the value of the sum of their parts or component values. For example, the Market Value of a real estate tract owned in fee simple, that contains a Mineral deposit, is rarely the sum of the independent values of the Minerals, land surface, and plant and equipment. Similar situations may often occur in the Petroleum Industry.
- 5.3.5 For a producing Mineral or Petroleum Industry natural resource property, there may be separate ownership rights over component parts utilized by the enterprise, such as the Reserve, Royalties, and plant and equipment. It is important for a Valuer of the enterprise to correctly recognise these. There may also be a requirement to provide valuations of the separate ownership interests.
- 5.3.6 Material data relied on in developing the value estimate should be verified for accuracy whenever reasonable to do so. This may include selective review of drill hole information and samples and related analytical data for a subject natural resource property, and confirmation of published information pertaining to transactions of similar properties.
- 5.3.7 If there is more than one estimate of the quantity and quality of Resources and Reserves

for a subject natural resource property, the Valuer shall decide which estimates it is appropriate to disclose and discuss, and which estimate to use as the basis in the Valuation process, and shall state the reasons. A critique of alternative estimates may be submitted with the Valuation Report.

- 5.3.8 The Valuer shall take account of, and make reference to other matters that have a material impact on the Valuation. Dependent on the property type and rights being valued, these may include:
- the status of tenements, rights and other interests;
  - all Mineral or Petroleum deposits within the boundaries of the tenements or rights;
  - access to markets and the quality and quantity of product that can be sold;
  - services and infrastructure, and any toll arrangements, fees or liabilities related thereto;
  - environmental assessments and rehabilitation liabilities;
  - any Native Title aspects;
  - capital and operating costs;
  - timing and completion of capital projects;
  - residual value estimates;
  - material agreements and statutory/legal requirements;
  - taxation and Royalties;
  - liabilities and financial exposures;
  - site rehabilitation, reclamation and closure costs;
  - any other aspect that has a material bearing on the Valuation.

### 5.4 Disclosure in Extractive Industries Valuation Reports

- 5.4.1 The Valuation Report shall properly identify the property type(s), specific property interest(s) and related rights being valued as specified in IVS 3.
- 5.4.2 The Valuation Report shall disclose the name, professional qualifications and relevant industry experience of the Valuer, and other Technical Expert(s) whose Technical Assessment has been relied upon to support the Valuation.
- 5.4.3 The Valuation Report should be supported by disclosure of relevant Extractive Industries

Codes, Standards or Rules of Practice applicable to the Valuation and supporting Technical Assessment. All estimates of a Mineral or Petroleum Resource or Reserve disclosed in the valuation report or supporting Technical Assessment shall abide by the definitions provided in Section 3 above, and the classification systems referenced in those definitions, unless jurisdictional or other reasonable cause is disclosed.

- 5.4.4 Maps, geological sections, diagrams and photographs shall be included in the Valuation Report, if appropriate and possible, to aid the communication of information. Relevant technical information supporting the Valuation of a subject natural resource property(ies), including estimates of Resources and Reserves being valued, shall be disclosed and discussed in a Technical Assessment.
- 5.4.5 The Valuation Report shall disclose whether or not the entity employing/retaining the Valuer, or the owner of the subject asset or its operating management, has provided the Valuer with a statement that all available data and information requested by the Valuer or otherwise relevant to the Valuation have been supplied to the Valuer.

### 6.0 Effective Date

- 6.1 This International Valuation Guidance Note became effective on 31 July 2007.

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# THE VALUATION OF HISTORIC PROPERTY

## 1.0 Introduction

- 1.1 Historic properties are assets that embody a cultural, historic, and/or architectural heritage.
- 1.2 Historic properties may have legal or statutory protection because of their cultural and economic importance. Many governments have enacted measures to safeguard specific historic properties or to protect whole areas of special architectural or historic interest.
- 1.3 Private organisations play a significant role in promoting historic preservation and education about historic properties. In some cases, historic properties also bring economic benefits through increased tourism in the communities where they are located.
- 1.4 The valuation of historic properties requires consideration of a variety of factors that are associated with the importance of these properties, including the legal and statutory protections to which they are subject; the various restraints upon their use, alteration and disposal; and possible financial grants or rate/tax exemptions to the owners of such properties in some jurisdictions.
- 1.5 The costs to restore and maintain historic properties may be considerable and these costs, in turn, affect the value of the properties.
- 1.6 The assessment of the highest and best use of historic properties will depend on the specific restrictions that apply to them. In some situations, the use of historic properties is limited to restoration for non-commercial use whilst in others, adaptation to some other use, including commercial use, is permissible.

## 2.0 Scope

- 2.1 This Guidance Note covers real property that has cultural and historic significance, specifically focusing upon historic buildings and sites. It does not address either natural heritage assets or heritage assets that are personal property, e.g., works of art. (Guidance Note 5 offers direction on the valuation of personal property.)

- 2.2 This Guidance Note applies to the valuation of historic properties in both public and private sectors. Historic properties owned either by public sector or private sector entities are distinguished by similar cultural characteristics, and share common problems in regard to restoration and/or adaptation. But the specific legal and statutory protections that apply to private and public historic properties and other restraints upon their use, alteration and disposal may differ.
- 2.3 Historic property is a broad term, encompassing many property types. Some historic properties have been restored to their original condition; some have been partially restored (e.g., the building façade); and others have not been restored. Historic property also includes properties partially adapted to current standards (e.g., the interior space), and properties that have been extensively modernised. All historic properties (buildings and/or sites) have some degree of historic character. This Guidance Note addresses properties having historic character to some degree or other.

## 3.0 Definitions

### International Valuation Standards Definitions

- 3.1 *Historic House Owner Associations.* Not-for-profit membership associations that promote the preservation of historic properties and provide their owner-members with advice on matters such as the management, repair, maintenance, taxation and insurance of historic properties.
- 3.2 *Historic Property.* Real property publicly recognised or officially designated by a government-chartered body as having cultural or historic importance because of its association with an historic event or period, with an architectural style, or with the nation's heritage. Four characteristics are commonly associated with historic properties: 1) their historic, architectural and/or cultural importance; 2) the statutory or legal protection to which they may be subject; 3) restraints and limitations placed upon their use, alteration and disposal; and 4) the frequent obligation in some jurisdictions that they be accessible to the public.

## INTERNATIONAL VALUATION GUIDANCE NOTE NO. 15

The terms, historic property and heritage asset, often overlap but are not in all cases equivalent. See also *Heritage Asset, Publicly Designated Historic Properties*.

- 3.3 *Listing of (Heritage) Buildings or Historic Properties Register*. A recording of officially designated historic properties. Not all historic properties are necessarily listed in registers. Many properties publicly recognised as having cultural and historic importance also qualify as historic properties.
- 3.4 *Preservation Incentives*. Incentives to the owners of historic properties, primarily fiscal in nature, to promote the restoration and maintenance of such properties. Examples may include exemptions on inheritance taxes for conservation properties gifted to heritage trusts, government subsidies, exemptions in municipal rates/taxes, investment tax credits to owners of historic properties, transferable development rights and deductions taken on conservation easements donated to nonprofit organisations.
- 3.5 *Publicly Designated Historic Properties*. Those properties, the historic status of which is officially recognised by government-chartered bodies to identify historic properties and to promote historic preservation. Such bodies may be established by national/federal, state/provincial, or county/municipal governments. Local non-governmental historical societies may also designate historic properties and maintain *private historic property lists* or *registers* that confer many of the same benefits whilst remaining exempt from government restrictions. See also *Listing of (Heritage) Buildings or Historic Register*.

### International Public Sector Accounting Standards Definition

- 3.6 *Heritage Asset*. An asset having some cultural, environmental, or historical significance. Heritage assets may include historical buildings and monuments, archeological sites, conservation areas and nature reserves, and works of art. Heritage assets often display the following characteristics (although these characteristics are not necessarily limited to heritage assets):
- Their economic benefit in cultural, educational and historic terms is unlikely to be fully reflected in a financial value based purely on market price;
  - Legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;

- They are often irreplaceable and their economic benefit may increase over time even if their physical condition deteriorates; and
- It may be difficult to estimate their useful lives, which in some cases could be hundreds of years.

The above definition is consistent with the description of heritage and conservation assets in IPSAS 17.9 (n.b., IPSAS 17 does not currently contain a formal definition of heritage assets).

### Definitions from the UNESCO Glossary of World Heritage Terms

- 3.7 *Cultural Heritage*. Three groups of assets are recognised:
- Monuments: architectural works, works of monumental sculpture and painting, elements or structures of an archaeological nature, inscriptions, cave dwellings and combinations of features, which are of outstanding universal value from the point of view of history, art or science;
  - Groups of buildings: groups of separate or connected buildings which, because of their architecture, their homogeneity or their place in the landscape, are of outstanding universal value from the point of view of history, art or science; and
  - Sites: works of man or the combined works of nature and man, and areas including archaeological sites, which are of outstanding universal value from the historical, aesthetic, ethnological or anthropological point of view.

### World Heritage Convention, Article I, UNESCO, 1972.

- 3.8 *Cultural Property*. Property inscribed in the *World Heritage List* after having met at least one of the *cultural heritage criteria* and the *test of authenticity*. (World Heritage Convention, Article II, UNESCO, 1972)

## 4.0 Relationship to Accounting Standards

- 4.1 International Public Sector Accounting Standard 17 (Property, Plant and Equipment) does not require an entity to recognise heritage assets that would otherwise meet the definition of, and recognition criteria for, property, plant and equipment. If an entity does recognise heritage assets, it must apply

the disclosure requirements of IPSAS 17 and may, but is not required to, apply the measurement requirements of IPSAS 17 (paras. 2 and 8). The IPSAS Discussion Paper on Heritage Assets (January 2006) requires the valuation of heritage assets where this is practicable. However, where valuation is impracticable, an entity would be required to make relevant disclosures, including reasons why valuation is not practicable.

#### AUS 4.1.2

**“ In Australia, AASB116 requires that heritage assets be recognised unless their value cannot be reliably measured. In Australia therefore, where requested, valuers should seek to determine a value for heritage assets irrespective of the requirements of IPSAS 17.”**

- 4.2 This Guidance Note considers historic structures as a category of heritage and conservation assets.

## 5.0 Guidance

- 5.1 The valuation of historic properties involves special considerations dealing with the nature of older construction methods and materials, the current efficiency and performance of such properties in terms of modern equivalent assets, the appropriateness of methods used to repair, restore, refurbish, or rehabilitate the properties, and the character and extent of legal and statutory protections affecting the properties.
- 5.2 The sales comparison, cost and income capitalisation approaches may be employed in the valuation of historic properties. The selection of the approach or approaches to be used depends on the availability of data required to apply that or those approaches.
- 5.2.1 In applying the sales comparison approach, the historic nature of the property may change the order of priority normally given to attributes of comparable properties. It is especially important that the Valuer find comparable properties with historic features similar to those of the subject. Criteria for the selection of comparable properties include similarity in location (i.e., in zoning, permissible use, legal protection, and concentration of historic properties), architectural style, property size, and the specific cultural or historic associations of the subject property. A variety of adjustments may have to be made to the comparable sales. These involve differences in location, costs of restoration or rehabilitation, or specific encumbrances. Adjustments are made in the following situations:
- 5.2.1.1 when costs must be incurred to restore or rehabilitate the subject property, but not the comparable sales; and
- 5.2.1.2 where the specific encumbrances upon the subject, e.g., restrictive covenants or preservation easements, differ from those upon the comparable properties.
- 5.2.2 Historic properties having a commercial use are often valued by means of the income capitalisation approach. Where the distinctive architecture and ambiance of an historic property contribute to its drawing power under an income-producing use and that income-producing use is considered to be the highest and best use of the historic property, the valuation will address the following:
- 5.2.2.1 All work proposed to restore, adapt or rehabilitate the historic property must meet existing zoning requirements and covenant obligations.
- 5.2.2.2 Where listed building consents or a zoning variance and/or building code exemptions are required, the projected timeframe to obtain such authorisation needs to be taken into consideration.
- 5.2.2.3 The income capitalisation approach should consider the cost effectiveness of an income-producing historic property in terms of the rental and/or commercial income the property is able to generate. In particular, it should address the additional costs involved in maintaining the property, especially those costs incurred due to functional obsolescence or reserves set aside for any required sinking fund.
- 5.2.3 When applying the cost approach to historic property, the Valuer needs to consider whether the historic features of a building would be of intrinsic value in the market for that property. Some historic buildings will be of value simply because of their symbolic status, for example a famous art gallery where the building is as, or more, important than the function it fulfils. In other words, the service potential of such a building is inseparable from its historic features. The modern equivalent of



such properties would need to reflect either the cost of reproducing a replica, or if this is not possible because the original materials or techniques are no longer available, the cost of the modern building with a similarly distinctive and high specification.

In many cases the historic features will add no value, or be viewed as an encumbrance by a purchaser in the market, for example a hospital operating in an historic building. In such cases the modern equivalent would reflect the cost of a new building constructed to a conventional modern specification.

In all cases the adjustments for physical deterioration and functional obsolescence will need to reflect factors such as the higher cost of maintenance associated with historic property and the loss of flexibility for adapting the building to the changing needs of an occupier.

The land or site, upon which an historic property stands may be subject to constraints upon its use. In turn, any such constraints will affect land and overall property value.

- 5.3 Historic, or heritage assets, for which there is no reliable or relevant sales evidence, which have no potential for generating income, and which would or could not be replaced may be incapable of reliable valuation. An example could be a partially ruined building with no income generating potential. Where a reliable assessment of value is not possible, the Valuer must disclose the reasons for this conclusion in the report.
- 5.4 Legal measures to safeguard historic properties may limit or restrict the use, intensity of use, or alteration of an historic property. Examples include restrictive covenants that run with the land regardless of the owner; preservation easements that prohibit certain physical changes, usually based on the condition of the property at the time the easement was acquired or immediately after proposed restoration of the property; and conservation easements that limit the future use of a property so as to protect open space, natural features, or wildlife habitat.
- 5.4.1 Restrictive covenants and preservation easements, whether existing or proposed, may have a major influence on the highest and best use of an historic property, and thereby

have a significant effect on property value. Preservation easements can be donated, purchased, or obtained by compulsory acquisition/eminent domain.

- 5.5 The valuation conclusion shall be reported in accordance with IVS 3, Valuation Reporting.

### 6.0 Effective Date

- 6.1 This International Valuation Guidance Note became effective on 31 July 2007.

# ANZPS 1 VALUATIONS FOR COMPULSORY ACQUISITIONS

This Practice Standard relates to ANZ Valuation Guidance Note 5

## 1.0 Introduction

### 1.1 Underlying Principle

A Member undertaking a valuation as part of a compulsory acquisition process affecting an interest in land, shall observe the requirements of this Practice Standard and must conform with the Institute's Code of Ethics and Rules of Conduct and any relevant law, or regulation that may apply from time to time.

### 1.2 Status

**Practice Standards have mandatory status.**

### 1.3 Scope

This Practice Standard applies to a Member involved in an acquisition or the pre-acquisition process affecting an interest in land, whether acting for a Public Authority or a claimant.

## 2.0 THE MEMBERS ROLE

### 2.1 Advocate

A Member is entitled to act as a claimant's advocate during the acquisition process, however the advocacy role is subject to proper professional practice in conducting negotiations on a client's behalf and that role must be declared to all parties. A Member may conduct negotiations on a clients behalf based on valuation principles and practice but must not act as an advocate then as an expert in the same matter.

### 2.2 Ambit Claims

A Member shall not prepare a valuation, report or advice which cannot be supported by the application of market evidence and accepted valuation principles.

Members must support their clients claim by the preparation and submission of a valuation report.

### 2.3 Experts Report

A Member acting as an expert valuer shall prepare a valuation report as an independent expert in accordance with this Practice Standard having regard to relevant legislation and decisions of relevant Courts and which:

- addresses the elements or heads of compensation,
- explains the basis of the assessment,
- provides a description of the methodology, assumptions and calculations which have been utilised,
- rationalises the market evidence relied upon in assessing the value of the claimant's interest, and
- can be relied on as evidence of value at any stage of negotiations or as required under the settlement process by agreement, arbitration or court proceedings.

If required by the client a Member shall support the assessment (with relevant support from other professionals and experts) in any discussions with the other party or its representatives or consultants and if required, present evidence in a court or tribunal.

## 3.0 DEPARTURE PROVISIONS

Where a Member considers circumstances exist that warrant departure from or non-compliance with any rule herein, the Member's report shall include a statement that outlines the reasons for the departure or non-compliance and any impact on the content of the report.

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# ANZVGN 1

## VALUATION PROCEDURES – REAL PROPERTY

### 1.0 Introduction

#### 1.1 Purpose

The purpose of this Guidance Note is to provide information, commentary, opinion, advice and recommendations to Members undertaking valuations of any real property for any purpose.

#### 1.2 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'.

#### 1.3 Scope of this Guidance Note

This guidance note applies to Members providing valuations in respect of any real property for any purpose. It should be used, as far as applicable, in conjunction with other guidance notes and practice standards that are either over-arching or directly applicable to the type of real property, purpose or issues involved. As there are many types of properties and various levels of reporting, the member should decide which matters are applicable and the extent of detail required to ensure that the client is adequately and appropriately informed. This guidance note is not intended to outline methods of valuation of any particular type of property but may comment on matters that should be addressed in reports in respect of certain properties types or uses. Where appropriate, methods of valuation are covered in other guidance notes.

### 2.0 Instructions

#### 2.1 Confirmed in Writing

Instructions should be confirmed in writing, and include details regarding access arrangements, identification, ownership, agreed fee (or basis for its calculation) and, if applicable, the purchase price and the selling agent.

The instructions should also list the parties intended to rely on the valuation, the purpose of the valuation, and agreed time for completion of the report.

### 3.0 Scope of work

#### 3.1 Scope of Work

Before commencing any valuation it is important to clarify with the client what is to be included in the scope of work.

#### 3.2 Fixtures and Non-Fixtures/ Chattels

Often the distinction between fixtures (ie items that are included with real property) and not fixtures/chattels is contentious. An example of a fixture may include heating/ air conditioning installations including ventilation systems etc. An example of a non-fixture/chattel may include a moveable article of property such as household furniture. Borderline cases often arise and it is important that the Member clearly identifies what items have been included and what items have been excluded

#### 3.3 Examples of Fixtures

There are certain items that are generally regarded as fixtures (i.e. usually included with real property). These may include the following:

- electric wiring to light points and power sockets, lighting systems, etc.;
- fire and smoke detector, fire alarm and other hazard warning systems;

# ANZ VALUATION GUIDANCE NOTE 1

- heating/air conditioning installations including ventilation systems, etc.;
- goods and passenger lifts, escalators and power walkways;
- domestic water systems and domestic effluent waste disposal plants; and
- fire fighting installations including sprinkler systems, together with water tanks, pumping sets, etc., rising mains, fire hose reels and other fire extinguishing installations.

## 3.4 Examples of Non-Fixtures

As a guide items that are generally regarded as plant and equipment and therefore excluded from a real property valuation include the following:

- electric power distribution associated with the process or production of plant and equipment, including generators, transformers, switch panels and cabling;
- lifting equipment including overhead travelling cranes, swivel jib cranes, lifting beams and chain blocks;
- effluent treatment plants specifically installed for process and trade effluent;
- steam raising plants and boilers primarily used in connection with the manufacturing process including exhaust stacks and reticulation systems; and
- telephone installations and computer cabling.

## 3.5 Interpretation in Specific Cases

Where there is doubt regarding the classification of an item it should be clarified with the client.

## 4.0 Report Content

All valuation reports must include content as is relevant to the type of property and the style of report (unless using a pro-forma required by a client). The extent of detail under any heading will vary depending on the style of report and the nature of the property. Report content usually includes:

### 4.1 Instructing Party

Details of instructing party and/or client who is to rely on the valuation.

### 4.2 Purpose

A statement as to the purpose of the valuation.

### 4.3 Date of Valuation

The date of valuation is usually the date of inspection of the property.

## 4.4 Basis of Value

The basis or bases of value on which the valuation is conducted.

## 4.5 Methodology, Reconciliation and Value Range

Unless not required in a pro-forma report, the methodology should be appropriately outlined for each approach along with important calculations and rationale. A reconciliation of the approaches adopted should be included. A value range may be expressed before being reconciled to a single point figure.

## 4.6 Legal Description

The legal description of the property, noting any encumbrances on the available title documentation and the impact on value and marketability of the property. Members are encouraged to conduct their own title searches. A Member should indicate if a title search has not been undertaken.

## 4.7 Nature of Interest

The nature of the interest valued. This will usually be fee simple vacant possession, fee simple subject to tenancy or in some cases the value of the lessee's interest.

## 4.8 Lease or License Details

Where the property is the subject of a lease, licence or other occupancy agreement, then the Member should note all relevant details applicable to that lease/licence/agreement and its impact (if any) upon the value. If the Member is unable to obtain or sight the original lease documents/licence/agreements, or a proper copy thereof, then reference to that fact should be noted in the property report with an appropriate qualification that the detail is to be confirmed before relying on the valuation. A Member could recommend or request that a copy of the executed or registered documents be forwarded to the Member for confirmation.

## 4.9 Dimensions and Area

The land area should be included in a report and measurements may also be provided.

## 4.10 Location and Locality

The location requires a statement as to the position of the property relative to the CBD, nearest

main town or regional centre. Locality requires a description of the immediately surrounding neighbouring development, drawing attention to any positive and/or negative features which may affect value.

**4.11 Town Planning/Resource Management**

Provide town planning (NZ - Resource Management) details, noting the name of the Planning Instrument or Authority and comment on the present use of the property in relation to its zoning and any proposed alterations to the zoning. A Member should consider:

- the need to sight and review any development or other consent and the conditions thereto affecting the property.
- and make comment on the 'highest and best use' of the property, particularly when that use is different to the current use of the property.
- any public or private authority reservations, designations or proposals.

**4.12 Site, Services and Environmental Hazards**

A description of the nature of the site, its services and details of any significant observable/visual and/or known defects or hazards, eg. flooding, landslip, observable or known site contamination, inadequate drainage, etc. If Members are concerned as to the possibility of site contamination at inspection they should where possible make all appropriate enquiries, including enquiries of the relevant statutory authority (local or otherwise) as to the history and previous use of the site. An appropriate qualification as to the result of such investigation should where necessary, be incorporated within the property report.

A Member should indicate that they are not expert in contamination issues (unless that is the case) when comment is made on such matters.

**4.13 Structural Improvements**

A description of the structural improvements including, approximate age, area and accommodation of buildings and their general state of repair. Any integral plant included in the valuation should be identified. If the Member observes that the improvements are affected by any deleterious substances, (eg. asbestos), or items of obvious non-compliance in relation to relevant

regulatory codes, appropriate comments should be made. Comment should however be made on whether the building is functional for its current use and if there is significant obsolescence or over-capitalisation.

Members are not usually expert in structural matters and should recommend the use of other experts where appropriate.

**4.14 Lease(s)**

Where a property is subject to a lease(s), an appropriately detailed epitome should be included. A statement regarding the source of the documents should also be made and whether they have been sighted. In the event that the lease has not been sighted a qualification should be made in the report to this effect.

**4.15 Outgoings and Recoveries**

Where a property is subject to one or more leases which warrant the use of the income capitalisation approach, actual and/or estimated building outgoings and operating expenses should be noted along with any recoveries under the lease. Where appropriate, actual outgoings should be compared to historic actuals, current budget and those for comparable properties (explicit evidence should be noted where available).

**4.16 Marketability**

Comment on any inherent or external features favourably or adversely affecting the marketability of the property.

**4.17 Further Investigation Other Experts**

Any factors that the Member feels require further investigation and/or information should be noted including, for example, matters that other professionals may be required to provide because of the limit of a Member's qualifications, experience or knowledge.

**4.18 Condition of the Market**

Comment on the condition or state of the market for the class of property. In appropriate circumstances, a more detailed analysis of the market dynamics may be appropriate.

**4.19 Market Evidence**

The basis of valuation adequately detailed for the type of property, type of report, the condition of

## ANZ VALUATION GUIDANCE NOTE 1

the market and providing a reasoned approach to the valuation.

Comment on any sale of the subject property within the previous 3 years (or a longer period if the Member considers this relevant) and any known circumstances or conditions pertaining to that sale.

Comment on any known contract for sale including price and any circumstances or conditions relating to that sale contract, if these are known to the Member. A current or recent sale of the subject should be considered against other evidence as it has been a test of the market.

In the case of property this should include sales and rental data evidence and justification by reference to market evidence of any capitalisation rate adopted. As warranted, the application of this data should be shown or explained.

### 4.20 Single Valuation Figure

The Market Value should be expressed as a single valuation amount.

### 4.21 Sale in One Line or Single Transaction

Where a Member undertakes a valuation of multiple properties in one development, such as lots in a subdivision or units in a building, the sum of the individual values or gross realisation assessed on the basis of an orderly marketing and sale program should be clearly defined as the total gross realisation.

The valuation of multiple properties in one development should be completed on the basis of a single transaction or sale in one line to one buyer. This valuation approach should incorporate an appropriate discount to reflect the costs incurred in realising the proceeds from the sale of the individual properties. These costs normally include marketing and sale costs, holding costs and a profit and risk factor.

### 4.22 Proposed Developments

Where the subject of a report is a proposed development of the property the report should clearly state:

- the source of information upon which the report is based,
- the valuation on an 'As If Complete' basis, and

- any assumptions necessary to ensure the basis of the report is clear.

Further guidance is included below at 8.0

### 4.23 General Market Advice

It is acknowledged that Members may, in certain circumstances, be requested to provide general market advice to clients on a specific property. However Members should be aware that such market advice may still be interpreted in a legal sense as a valuation. The scope of work should be defined to protect the interests of all parties who may rely on the advice.

### 4.24 Going Concerns

Where the property being valued is operating as a 'Going Concern' and is to be valued on that basis, trading figures would normally be considered. The report should:

- state the source of the trading figures,
- have annexed to it, a copy of trading figures supplied, and
- show any adjustments made to those figures in the valuation process.

Further guidance is included below at 9.0

### 4.25 Disclaimers and Qualifications

Appropriate disclaimers and qualifications should be included in a valuation report. These are designed to inform the client of the level of reliance that can be placed on the report and whether further action is required. *ANZ Real Property Guidance Note 1* [ANZRPGN 1] 'Disclaimer Clauses and Qualification Statements' provides a range of clauses for consideration for inclusion in reports as appropriate as well as guidance in drafting them and incorporating them into a report.

#### *Due Consideration*

These disclaimers and qualifications should not be incorporated in valuation reports without due consideration. Each individual case will determine the qualifications that are appropriate. ANZRPGN 1 makes recommendations as to how they should be included.

#### *Third Party Disclaimers*

To the extent that such disclaimers are permitted by law, it may be appropriate, and indeed required by a Member's professional indemnity insurer to include a third party disclaimer in a valuation



report, although Members should recognise the fact that no one third party disclaimer will cover every possible situation. Examples of these clauses are also included in ANZRPGN 1.

**4.26 Signing the Report**

The report shall be signed by the person who conducts the valuation (who must be the person who inspects the property). Where the report is counter-signed, the capacity in which the counter-signatory is signing the report must be clearly stated (especially if the counter-signatory has not personally inspected the property and carried out the research and report). This is to avoid misunderstanding by anyone relying on the report who might otherwise be under the impression that a co-signatory signing as a ‘Member’, would have also inspected the property and had significant involvement in the valuation process. As an example, the following clause could be used:

*The counter signatory, who has read and signed this report, verifies that the report is genuine and is endorsed by [firm name]. The opinion of value expressed has been arrived at by the person who conducted the valuation.*

**5.0 Inspection and Enquiry Guidelines**

**5.1 Identification**

A Member should obtain sufficient information and carry out sufficient on-site observations to allow the property to be adequately identified. The source of the information should be noted. A member should exercise due caution and confirm where necessary before relying on information provided by other parties.

**5.2 Confirm Street Address by Plan Reference**

While identification of the subject property by street number and street name should be confirmed where the property has such, the street address is not the legal description of the property. A Member, where possible, should also sight a cadastral plan, deposited plan or other document enabling the actual identification of the property by lot and plan/section number and reference to physical features such as cross streets, public reserves, or other local features. These details may be found on a Certificate of Title. The availability

and use of digital mapping cadastres also provides for Geographic Positioning Systems (GPS) which can be a suitable aid in confirming the location of the property in an ‘on site’ situation.

**5.3 Sight Contract of Sale and Certificates**

It is desirable where possible for the Member to sight a contract of sale for the property and, where possible, obtain and/or sight any certificates attached to the contract of sale such as a survey certificate, sewer diagram, title plan, zoning and/or any other local government certificates. (NZ-Land Information Memorandum, Resource Consent)

**5.4 Within Fenced Boundaries**

When carrying out a valuation without the benefit of a current survey (cadastral) report or an accurate Geographic Positioning System (GPS) a Member is not qualified to advise lenders as to whether buildings or other improvements are within the title boundaries. A Member may indicate after observation that the buildings are within the fenced boundaries but should not generally comment in relation to the title boundaries without the benefit of a survey report (other than to indicate the need for a survey report). Any check measurement carried out to assist in this process should be appropriately qualified.

**5.5 Inspection of Buildings and Other Improvements**

Buildings and other significant improvements should be measured and inspected internally and notes taken recording the fixtures, fittings and the general state of repair and condition of the building (or buildings) and improvements at the time of inspection. A Member should also take appropriate photographs and comment upon the services available to the property at the time. Those notes and/or dictation recording should be clearly and accurately recorded in writing in the form of the Member’s ‘field notes’. Members should not discard their ‘field notes’ or any other documents relied upon in undertaking their valuation. A dictated recording made at the time of inspection is acceptable provided it is then converted to either hard copy format, or an electronic format enabling hard copy production upon request.

**5.6 Preferred Method of Inspection**

Subject to any specific instructions from the Client and as relevant to the property type, the preferred

method of inspection and notation of that inspection is as follows:

### *Sketch Plan of Main Building*

Sketch the external walls and record dimensions of the main building (preferably to scale) and record details of the internal layout (unless a copy of a building plan is obtained, checked and retained). While not imperative, noting on the plan positions of doors and windows, cupboards, special fixtures and services and prime cost (PC) items, could prove beneficial for subsequent reflection and reporting. Note also adjacent improvements and buildings. The Member may use suitable alternative methods of recording this information.

### *Items to Note*

During the course of inspection all relevant items should (as practical and as applicable to the type of property) be described and commented upon including:

- Services connected or available to the site;
- Flooring;
- Wall and Roof Framing;
- External wall coverings;
- Ventilation;
- Roof drainage;
- Internal linings to walls and floors;
- Ceilings;
- Ceiling heights;
- Roof coverings;
- Special design or architectural features;
- Building services, eg. sprinklers, hydrants, hose reels, ventilation/air conditioning, security systems, auxiliary power and lighting, escalators and elevators;
- Natural and artificial lighting;
- Prime Cost Items;
- Amenity and storage areas;
- Car parking facilities;
- Loading and unloading facilities;
- Courier access;
- Excavations;
- Landscaping;
- Vehicular access points and manoeuvring areas;

- Design features – spacing of columns or clear spans, internal height, minimum clearances to roof frame, door clearances (height and width);
- Ancillary structures and ground improvements;
- Hard-stand and storage areas; and
- Fencing.

The Member should also note:

- Any obvious significant external and/or internal defects, or items of non-compliance with Building and Fire Regulations which fall within the Member's area of expertise (noting any recommendations for obtaining advice from other professionals/experts in relation to those defects or items);
- Overall general condition, maintenance and/or state of repair of the building(s), building services and improvements as far as can be ascertained by ready visual inspection.
- Any current certificates on the land such as white ant certificates, Health orders, Council orders, Non-conforming uses

### *External Features*

Note any views, lines of sight and the nature of surrounding development.

### *Strata/Community Title Plan*

In the case of strata, unit and community title properties, obtain a copy of the relevant plan and any relevant documents.

### *Photographic Records*

A Member should take appropriate photographs as a record of the improvements and the other features of the property.

## 6.0 Market Evidence and Market Analysis

### 6.1 Research

Relevant market transactions should be researched and analysed along with other market indicators. The extent of the research and analysis should be appropriate to the type of property and the report.

#### *Sales Evidence*

Details of a number of comparable sales should be included in any valuation report, (though a much wider range of data may be considered and analysed).

***Local Transactions***

Sales researched should, as far as possible, be recent transactions. Where more than six months has elapsed since a sale (or if the market is changing rapidly, some lesser period), appropriate comments may need to be made about any change in the market since the sale occurred.

***Adjustment of Sales Evidence***

Where sales are not directly comparable as to date of sale or other factor, but in the same locality, the Member should provide an explanation.

***Company Title***

For company title units obtain details from the Company Secretary of any share transfers and review the articles and memorandum of association and any other relevant documents.

**6.2 Outside Evidence**

Where the property to be valued is within a new subdivision or development and is being purchased from the developer, re-sales or sales from other comparable developments should also be provided and considered where available as a cross reference.

**6.3 Consideration of Sale Price of Subject**

The selling price of the subject property should be researched and considered by the Member in relation to other sales evidence, the overall state of the market and the requirements set out in the definition of Market Value. If it appears inconsistent with the market, it may be appropriate to check with the agent or solicitor for any unusual circumstances surrounding the sale or special conditions in the contract. If it is confirmed as an inconsistent sale, this, and the reasons, should be specifically noted in the report.

**6.4 Written Down Values Of Plant**

The Written Down Value of plant and equipment for taxation purposes, when included with a property valued, should be commented upon in relation to any substantial departure from Market Value.

**7.0 Valuation**

**7.1 Methodologies**

Valuations should be based on the available market evidence and using one or more of the following methods as appropriate:

- Sales Comparison Approach, which includes direct comparison on a unit basis or the summation approach
- Income Capitalisation Approach; and
- Cost Approach (Depreciated Replacement Cost or DRC)

noting the relevance or limitations of any approach adopted and reconciling the various approaches.

**7.2 Owner-Occupied Property**

For owner-occupied properties the valuer should consider the purpose of the valuation (eg for financial reporting or mortgage and loan security purposes) to determine the correct valuation basis.

**7.3 Specialised Properties**

Where a property includes significant specialised improvements for which there could be limited demand, comment should be provided on alternative uses and how this might impact on value and marketability. It should also include comment on the strength of the market for the design use.

**7.4 Calculations**

Valuation calculations should be summarised in the report.

**7.5 Valuation**

A single amount should be recorded for the value in line with traditional valuation practice. A report may however address the value range or tolerance within which the valuation falls. The valuation will normally be arrived at after consideration of several valuation methodologies. The value assessed by the Member should relate to the market conditions existing at the date of valuation (which will normally be the date of inspection) and should reflect the appropriate definition of value.

**7.6 Marketing Period**

The assessment of Market Value does not envisage an indefinite marketing period, nor does it state a time period. It should reflect a typical marketing period for the class of property in the then current market conditions. Conceptually, this period is envisaged as having preceded the date of valuation. A Member should, if requested, provide an estimate of the likely marketing period necessary to achieve the assessed 'Market Value'. In such circumstances the Member should also

provide a statement of the dynamics of that market.

## 7.7 Specified Marketing Period

If a client requests a valuation reflecting a specified marketing period, careful consideration should be given as to whether it should be called 'market value'.

## 7.8 Forced Sale

Market Value does not reflect mortgagee-in-possession or other forced sale conditions, where the realisable price under certain market conditions is likely to be less than Market Value. Refer ANZVGN 3 Valuations for Mortgage and Loan Security Purposes (Forced Sale).

## 8.0 Value as If Complete

### 8.1 Valuation of Proposed Improvements

A Member may provide a valuation of a proposed building or project assuming completion at the date of valuation. This is a 'Value As If Complete' valuation. Members should refer to Guidance Note ANZVGN 2.

### 8.2 Proposed Lease(s)

Where a lease(s) is proposed over a property the valuation should be expressed as "Value As If Complete" and treated in a similar manner to a valuation of proposed improvements.

## 9.0 Valuation of Going Concerns

### 9.1 Basis

Valuations in relation to Going Concern properties should identify the interests valued as one of the following:

- Going Concern, walk-in, walk-out (plus Stock at Valuation (SAV))
- lessors interest (sometimes known as the freehold)
- lessees interest (sometimes known as the leasehold).

### 9.2 Trading Figures for Going Concerns

Trading figures for Going Concerns should be obtained, analysed and commented upon. Where possible audited or verified figures should be

used. Where figures are not sufficiently detailed or reliable or do not cover a sufficient period, comment should be made as to the impact this could have on the value and/or marketability of the property. If a Member is specifically instructed to carry out a valuation without adequate figures, the report should be appropriately qualified.

### 9.3 Chattels, Plant and Equipment

Where chattels, plant and equipment are part of the 'going concern', they should be noted in the report.

### 9.4 Management

The impact of management on the trading figures should be addressed.

### 9.5 Unusual Operations

Where the subject of the report is an property used for an unusual operation, the dynamics of the market for its product should be explained.

## 10.0 Licences, Rights and Permits

### 10.1 Preservation of Rights

Where a property has a licence, right or permit the Member should examine its terms and provide an epitome in the report. The Member should note any measures required to keep the element current or to preserve the licence, right, or permit in the event of the mortgagee having to enter into possession.

### 10.2 If Personal Property

Care should be exercised to ensure that the licence, right or permit attaches to the land (and/or improvements) and is not personal property, as a mortgage would not normally encompass personal property. A special charge may need to be taken over the element involved.

## 11.0 Transmission of Reports

Where a member proposes to provide a document to a client in an electronic format, the Member should:

- (a) obtain the client's prior consent to send the document electronically (as opposed to sending a traditional paper-based document) and
- (b) agree with the client on acceptable types of electronic signature to be used to sign the document.

Where Practice Standards require certain documents to be counter-signed, and where such documents are to be sent electronically, the Institute recommends that the member should obtain the clients consent in accordance with the section outlined above.

The Member should include a prominent disclaimer in the electronic transmission of the document (see *ANZ Real Property Guidance Note 1* for further information on Disclaimer Clauses and Qualification Statements). An example of such a disclaimer is as follows (*note: the Member should use their own skill and judgement when determining whether this example is appropriate for its circumstances*):

**"[COMPANY NAME] NOTICE**

The information in this electronic transmission (including any attached files) is intended only for the person or entity to which it is addressed and may contain confidential and/or sensitive material. Any review, retransmission, dissemination or other use of, or taking of any action in reliance upon, this information by persons or entities other than the intended recipient is prohibited. If you received this in error, please notify us immediately by reply e-mail [*or insert other contact details*] and delete the information from any computer."

## **12.0 Special Issues**

### **12.1 Adverse Impact**

A Member should be particularly alert to special issues which may impact adversely on the value and/or marketability of particular properties rather than properties in general. These could include but are not limited to:

- the potential for or the existence of a Native Title claim, a land claim or in New Zealand, Treaty of Waitangi claim
- actual or potential site contamination
- other environmental issues such as urban or rural salinity

## **13.0 Post Valuation Consultancy**

Where a Member has provided a valuation report and matters are raised with the Member by the instructing party, it is the Member's professional responsibility to respond to any such reasonable queries, even though no additional fee is offered. However, the Institute recognises that in the case of a variation from the original instructions, it may be appropriate for the Member to seek an additional fee.

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# ANZVGN 2 VALUATIONS FOR MORTGAGE AND LOAN SECURITY PURPOSES

## 1.0 INTRODUCTION

### 1.1 Purpose

The purpose of this Guidance Note is to provide information, commentary, opinion, advice and recommendations to Members undertaking valuations of property, plant and equipment for mortgage and loan security purposes.

### 1.2 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.

### 1.3 Scope

This Guidance Note applies to members producing valuation reports for mortgage and loan security purposes. As there are many types of assets and various levels of reporting, the member should decide which matters are applicable and the extent of detail required to ensure that the client is adequately and appropriately informed. This Guidance Note is not intended to outline methods of valuation of any particular type of asset but may comment on matters that should be addressed in reports in respect of certain property types or uses. Where appropriate, methods of valuation are covered in other guidance notes.

### 1.4 International Valuation Standards

This Guidance Note is intended to be consistent with the publication *International Valuation Standards 2007* as issued by the International Valuation Standards Committee. However, there may be departures from IVSC Standards to reflect Australian and New Zealand law and practice.

### 1.5 The Role

In addition to the responsibilities covered in IVS 3, IVA 2 and ANZVGN 1 the Member's role is to advise:

- the market value of the assets for mortgage and loan security purposes at the date of inspection. Market trends may also be advised.
- factors that can or could impact adversely on the property as a security. The Member may attempt to quantify the adverse impact or risk or draw the client's attention to the need for re-assessment should these risks eventuate.

## 2.0 INSTRUCTIONS

### 2.1 Instructions from Lender

It is desirable that all instructions to Members to undertake market valuations for mortgage and loan security purposes should be received from the lender and not from the borrower. It is important that the contract should be between the party relying on the valuation (the lender) and the member. Lenders should issue instructions direct to the firm/member.

### 2.2 Other Instructions

It is recognised that intending mortgagors (borrowers) may instruct members to provide a valuation for borrowing purposes. While receiving instructions directly from a lender is preferable, in New Zealand it is more usual for borrowers to issue instructions. Where instructions do originate directly from an intending borrower, members should be careful to confirm that their instructions are appropriate in the context of a potential lender's requirements and that the valuer member acts impartially.

## 3.0 REPORT CONTENT

### 3.1 Recommendation

In Australia, unless specifically requested by a lender, a recommendation should not be made as to the suitability of the asset as a security



as this is a commercial decision of the lender, which may involve other factors. It is however appropriate to comment on asset-specific and market factors impacting adversely on the asset (see Risk Analysis), as well as positive aspects. Unless required by State or Federal legislation it is not generally appropriate for the Member to recommend a maximum or minimum loan percentage or amount or recommend a loan period.

### 3.2 Risk Analysis

A Member should advise the lender of factors that could impact adversely on the property as a security. This may include those factors which, assessed on information that is common knowledge, readily ascertainable in the market and/or reasonably foreseeable, may have an adverse impact on the property's value and marketability.

### 3.3 Risk Rating

In the case of real property a rating method can be used as part of the risk analysis. The rating adopted for each aspect of any risk analysis needs a balanced overview. A property may have many counter balancing features.

### 3.4 Future Value

While forward-looking advice may be provided to the client the market value assessed should not attempt to predict future value levels. .

### 3.5 Pro-Forma Reports

To assist its Members to serve residential mortgage clients, the API has developed the PropertyPRO 'Residential Valuation and Security Assessment' pro-forma report and supporting memorandum for mortgage purposes.

### 3.6 Alternative Use Value

When the value of a property on a vacant possession basis is, or is likely to be, significantly different from the value of the property subject to an existing lease or, when the value of a property purpose-designed for the occupier has an alternative use value which is significantly different, then both values should be reported to ensure that a mortgagee/lender is fully informed. If leased, the valuer should draw attention to the potential for different values to be applied.

## 4.0 VALUATIONS ON AN 'AS IF COMPLETE' BASIS

### 4.1 Valuation of Proposed Improvements

A 'Value As If Complete' valuation assumes the proposed work is already complete at the date of inspection and reflects the market at that date. The Member assesses the value from plans and specifications having regard to the market at the date of inspection. In the original valuation, the member should reserve the right to review the valuation, and if necessary, vary the valuation if there are changes in the property itself or in property market conditions and prices.

### 4.2 Instructions

Instructions from clients to value proposed improvements to be erected should include:

- A copy of the builder's quotation, contract or tender or in the case of an owner-builder a schedule of costs on a trade by trade basis and including as relevant, the builder's licence number or the owner-builder's licence number
- A copy of plans and specifications, however council approved and stamped copies should be sighted prior to completion if not available at the time of instruction (in which case the valuation should be appropriately qualified);
- Engineer's details of the proposed building for concrete slab floors and other structural elements as applicable
- A copy of any accepted tender or builders quote
- Full Prime Cost and/or provisional cost allowance item list noting any works not being carried out by the builder
- A copy of any agreement to lease or other form of pre-commitment if applicable.

### 4.3 Information Not Available

If the above information is not made available to the Member, this should be drawn to the attention of the lender and further information requested.

### 4.4 Member's Building Qualifications

In undertaking a valuation of a property on which the dwelling or project is to be erected, a Member should not hold themselves out as having qualifications in a building/structural discipline unless they have such qualifications.

### 4.5 Cost Estimates and Inspections by Others

In the event that Members are not qualified in a building/structural discipline, they should recommend and advise the client that an assessment of costs or a report on any departures from acceptable standards of construction and/or relevant Australian and New Zealand Construction Standards, be provided by another suitably qualified person, e.g. Engineer, Architect or Quantity Surveyor.

### 4.6 Advise Significant Difference Between Costing and Tender

If a Member has appropriate costing expertise a check costing can be made and discrepancies noted.

### 4.7 'Value As If Complete' Qualifications

A Member in assessing the Market Value of a property based on plans and specifications and/or a proposed lease(s) on an "As If Complete" basis should be subject to qualifications such as:

- Satisfactory completion of the improvements in accordance with the plans, specifications and details as provided
- An inspection by the Member following practical completion of construction
- Confirmation or variation of the original valuation figure relevant to the original valuation date, following an inspection of the project and any leases after practical completion
- Issue of all relevant approvals including a satisfactory building completion certificate under the appropriate legislation
- Sighting of any reports from other experts who have provided advice in aspects of the construction of the buildings
- Such other matters/issues that the Member is of the opinion should be drawn to the attention of the client
- The right to review and, if necessary, vary the valuation if there are changes in the project itself or leasing

### 4.8 Confirmation at Original Valuation Date

Any confirmed or varied valuation will relate to the market conditions existing at the date of the original valuation. An updated figure may be provided at the specific request of the client and additional fees may be chargeable for this review.

### 4.9 Value under Construction

If construction is in progress and an 'as is' value is also required, consideration should be given as to whether or not the cost of the work to date is fully reflected in value. It should not be assumed that the added value of the work to date equals the cost of the work. Comment could also be made about the marketability of a partly completed project.

### 4.10 Significant Repairs and/or Renovations

Where significant repairs and/or renovations are involved, a valuation on an 'as if complete' basis may also be required. A Member should ensure that the current condition of the property is appropriately described in any description of improvements, and the existing and proposed improvements should be addressed separately.

## 5.0 CHATELS

### 5.1 State if Included

Chattels are not normally included in a valuation of real property if such items are included, this must be clear to the reader of the report. Chattels are regarded at law as personal property and are not included in a mortgage. In Australia the API supports the inclusion of the following items in residential mortgage valuations:

- fixed floor coverings,
- window coverings, and
- light fittings.

In New Zealand, the PINZ supports the exclusion of the above items in residential mortgage valuations.

Chattels not included are items such as furniture that is not built in, loose floor coverings, lamps and items not fixed with the intent that they should not remain in place and pass with a sale of the property.

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# ANZVGN 3 VALUATIONS FOR MORTGAGE AND LOAN SECURITY PURPOSES (FORCED SALE)

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to address the issue of providing a 'forced sale value' of property and its relation to the assessment of Market Value for mortgage purposes.

### 1.2 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.

### 1.3 Scope

This Guidance Note applies to Members valuing and providing various forms of reports over property for mortgage finance purposes. It should be used in conjunction with other guidance notes and practice standards which are either over-arching or directly applicable to the type of property, purpose or issues involved.

### 1.4 Market Value Policy [Def. Market Value]

It is the policy of this Institute that mortgage valuations must be provided by Members on a Market Value basis. A professional market valuation of a property will be consistent with the Market Value definition adopted by the Institute.

## 2.0 Forced Sale

### 2.1 Forced Sale Value inconsistent with Market Value

The expressions 'forced sale value' and 'distress sale value' are considered to be inconsistent with the concept of 'Market Value' and represent expressions of property prices achieved under different selling conditions.

### 2.2 May be Provided

Valuers may, when requested, provide an estimate of a realisable price when forced or distress sale circumstances exist. The reporting of a range of value can be appropriate in these circumstances.

### 2.3 Distress Sale

'Forced sale' and 'distress sale' are taken to have a similar meaning for the purposes of this statement. The term 'fire sale' has even less certainty of meaning than these terms and in relation to property its use should be avoided.

### 2.4 Essential Element(s) Missing

A sale of property under forced sale conditions does not meet all the criteria of a normal market transaction in that there is some element of undue compulsion or influence affecting the seller. One of the essential elements of a market valuation is therefore missing.

### 2.5 Circumstances

The circumstances surrounding a forced sale usually involve:

- An owner under some form of duress or pressure, financial or otherwise, to sell the property, or,
- A third party such as a receiver or mortgagee in possession of the property.

### 2.6 Marketing Conditions

A forced sale of property may involve:

- An inadequate exposure to the market.
- An unreasonably short period in which to achieve a sale.
- An inappropriate selling method.
- A vendor with a primary objective of recouping a loan or secured amount rather than obtaining the market price.
- Potential buyers being aware of the circumstances of sale and the seller's weakened bargaining position.
- Other unusual factors.

Any one or all of the above can have a negative impact on the realisable price.

### 2.7 Effect of Varying and Various Markets

In some market conditions and in certain selling situations there may be little or no difference between a forced sale price and the market value of a property. The state of the market, the supply factors and the strength of the demand will influence each result.

## 3.0 VALUATION ADVICE

### 3.1 Lender Requirements

The provision of a forced or distress sale 'value' in addition to a market value for a proposed mortgage is considered by this Institute to be a generally undesirable practice. However it is recognised that some lenders require valuers to provide forced or distress sale assessments.

### 3.2 Use of Term and Endorsement

In these circumstances it is considered prudent for the valuer to use the term current forced sale price and to include an endorsement along the following lines:

'This current forced sale assessment is based on a sale by the mortgagee (or receiver, etc, as appropriate) at public auction or within a reasonable period after such auction having regard to the nature of the subject property, after full and proper marketing and it reflects the valuer's view of the market conditions prevailing at the date of this report.'

### 3.3 Forced Sale Imminent

In circumstances when a forced sale is imminent such as when a mortgagee is in possession of a property, a valuer may provide an opinion of a forced sale expressed as a realisable price range and/or a most probable price based on the market conditions and the specified selling circumstances at the time.

### 3.4 Realisable Forced Sale Price Range

The realisable forced sale price range and/or most probable forced sale price is likely to vary in relation to actual selling circumstances at the time of sale.

### 3.5 Not Generally Indicative

Any forced realisation of a property will usually reflect the particular and special selling circumstances of that transaction and a sale price achieved in these circumstances is therefore not generally indicative of realisable prices for other similar properties under normal marketing conditions unless it can be viewed as consistent with most other transactions in the market.

### 3.6 GST Caution

Specific legal and/or accounting advice will need to be sought regarding the GST implications for this Guidance Note.

# ANZVGN 4 VALUATION FOR RATING AND TAXING

## 1.0 INTRODUCTION

### 1.1 Purpose

The purpose of this Guidance Note is to provide information to valuers employed or engaged by government or statutory authorities to assess valuations for use in the determination of Rates, Taxes and other statutory charges over land.

### 1.2 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.

### 1.3 Scope of this Guidance Note

This Guidance Note does not cover the administration of valuation lists or determine their use. That process is achieved by complementary legislation that prescribes the categories of properties to be valued and any exemptions or omissions from the valuation rolls of property in public ownership.

### 1.4 Compliance

Valuers engaged to assess valuations for rating and taxing, purposes should comply with statutes and precedents relevant to the type of valuations being made.

### 1.5 Statutory Responsibility

The professional responsibilities of valuers engaged to make rating and taxing valuations, are prescribed by regulatory jurisdiction in each State or Territory of Australia and New Zealand. Under the relevant legislative authority, the Valuer-General is responsible for maintenance of valuation standards.

### 1.6 Authorities

For the purpose of this Guidance Note, Rating and Taxing Authorities Include:

- The States and Territories of Australia,
- New Zealand,
- Local authorities,

Any statutory authority which is financed by revenue from a Rate or Tax.

## 2.0 BASES OF VALUATION

### 2.1 Form of Rating or Taxing Bases.

Each State and Territory of Australia and New Zealand has its own legislation defining the various bases of rating valuations. Practitioners should ensure that they are familiar with the legislative definitions and supporting case law in the jurisdiction in which they are practising. The bases comprise the types of valuation used to form the valuation roll, such as Improved Values, Unimproved Values, Site Values, Land Values, Gross Rental Values, Estimated Annual Value or Assessed Annual Values as defined in the various statutes. Such valuations shall be in accordance with market evidence at a common date, generally referred to as the *Date of Valuation*. Other information may be required to be included in the valuation lists such as the date of inspection of the relevant property and the prescribed date for effective use of the valuation for rating or taxing purposes. A qualification or reference to the legislation making such direction must be noted on the return of valuations.

### 2.2 Determining the Value of Land

In determining the value of land, including stratum, members may, amongst other valuation criteria, be required to take into account:

- The highest and best use to which the land might reasonably be expected to be put at the relevant date,

## ANZ VALUATION GUIDANCE NOTE 4

- The detrimental effect on value of any lease, mortgage, covenant or other charge over land,
- The actual use to which the land is being put at the relevant date and any potential use,
- The effect of any legislation, regulation, local law, planning scheme, including heritage provisions or any other such instrument which affects or may affect the use or development of such land,
- The shape, size, topography, soil quality, situation and aspect of the land,
- The situation of the land in respect to natural resources and to transport and other amenities, facilities and services,
- The extent, condition, and suitability of any improvements on or to the land,
- The actual and potential capacity of the land to yield a monetary return.

**CAUTION: WHERE THE REQUIREMENTS OF A STATUTE AND GENERALLY ACCEPTED VALUATION PRINCIPLES ARE IN CONFLICT, THE STATUTE IS THE OVERRIDING AUTHORITY.**

### 2.3 Land Values

Land Values are a widely used bases for the taxation of land. They are also provided to the Federal Government for the equitable distribution of Financial Grants to the States.

### 2.4 Determination

Land Values can be determined under 2.3 for most areas of the continent, islands and Territories of Australia and New Zealand. Measures of land value are usually readily available by reference to sales of comparable land or analysis of improved land transactions.

### 2.5 Vacant Land

Rating and taxing legislation generally refers to vacant land in two ways:

- Land in its raw undeveloped state is referred to as Unimproved Value. API members engaged to provide this type of valuation, must be familiar with the legislation applicable in the State within which they are operating, in order to know the type of land value to be applied.

- Land having merged improvements is referred to as Site Value, which is usually applied within urban areas or townsites where merged improvements may add value beyond the undeveloped land value and where the form of the land in its original state can no longer be determined. The categories and extent of the merged improvements are prescribed in the applicable legislation.

### 2.6 Continuing Land Use

In all instances, unless otherwise directed by local legislation, the valuer is to ignore the “existing use” in favour of the potential “highest and best use”, unless the former gives rise to a greater valuation than as a result of considering the latter. This includes land that is reserved for public purpose. The provisions of heritage or valuation legislation may bring about an exception to the highest and best use principle by prescription of existing use values for affected properties.

### 2.7 Rental Values.

Rental values are used in many States and Territories of Australia and in parts of New Zealand, generally for the assessment of Municipal and Water rating of improved properties. In some States, rental values are used by State Governments for the distribution of grants to Local Governments. Evidence of lettings is generally available for most classes of buildings. However, most legislation provides rules for the determination of rentals to be applied to properties of a type not normally rented. Rating and taxing legislation refers to rental value in Australia in several forms:

### 2.8 Gross Rental Value

*The Gross Rental Value* is the annual rent passing between landlord and tenant for the use of land or land and buildings on the assumption that the landlord is liable for all outgoings necessary to maintain the value of the land. Where a rent cannot be determined, legislation may provide a statutory formula for the calculation of the Gross Rental Value.

### 2.9 Assessed Annual Value

*Assessed Annual Value.* In some legislation, gross rental value or a percentage of gross rental value may be used to create what is known as “annual value”. This is usually accompanied by associated restrictions within the legislation as to its



application or modification. Annual Value should not be confused with “annual valuation” which refers to a periodic valuation on an annual basis.

**2.10 Net Annual Value or Estimated Annual Value**

*Net Annual Value or Estimated Annual Value.*

The net annual rental of a property is generally the amount that a property is likely to rent from year to year less an amount equal to the charges and costs required to maintain the property in a lettable state. These costs may vary with legislation and regulation, but usually include Rates, Taxes, insurance, and other expenses necessary to preserve the level of rent commanded.

**2.11 Capital Values/ Improved Value**

Capital Value is also referred to in rating and taxing legislation as Improved Value and applies to all parcels of land including vacant, improved or held in stratum. Such a value, unless specifically stated by the legislation, would not normally include any plant, machinery, tools, or other appliances, that are not fixed to the premises in a way that would justify inclusion in the real estate under the law of fixtures. In the case of a stratum the valuer will typically assume that if the stratum is wholly or partly in an excavation, that the excavation of the stratum had been made; has access, that access may be used or continue to be used; is capable of use, that it is used, may be used, or may continue to be used or could have been used at the date of valuation.

**3.0 VALUATION ACCURACY AND UNIFORMITY**

**3.1 Accuracy and Uniformity**

In accordance with the statutory responsibility of Valuers-General and other regulatory authorities, valuations for rating and taxing purposes must conform with standards of valuation accuracy and uniformity.

The terms of valuation contracts where they apply will specify the required standards.

**3.2 Measurement of Accuracy and Uniformity**

The parameters of valuation accuracy and uniformity expected of valuation contractors and professional practitioners will be dictated

by regulatory policy. These parameters are often expressed in the terms of valuation contracts by reference to statistical tests and other means of comparing subsequent sales with the valuation data presented in the valuation roll. Appendix 1 sets out accepted processes of statistical comparison to enable determination of valuation accuracy and uniformity.

**4.0 PROVISION OF REPORT**

**4.1 Revaluation Reports**

The regulations that form part of the respective State and Territorial Acts may contain the requirements for the provision of a Report with which practitioners should be familiar.

**4.2 Report Contents when Creating a Valuation List**

In the case of creating a roll for the Valuation Authority, the report must contain:

- Purpose of the roll including any other likely use of the valuations.
- Definitions of the type of valuation to be recorded in the roll and the enabling legislation under which it is created.
- The date of valuation (note use of multiple dates if required in some States).
- The date at which the valuations are to come into force.
- A schedule of evidence used to support the roll including market evidence and comments.
- A schedule of any evidence excluded and the associated qualification why this was necessary.
- A current cost schedule at the date of valuation should the type of roll require calculation or be supported by costs.

**4.3 Report Contents when Amending a Roll**

In the case of creating a supplementary valuation or amending a valuation list the report must contain:

- Type of valuation to be recorded in the roll and the enabling legislation under which it is created.
- The reason for amending the roll (eg. Addition or deletion of improvements, amended area etc.).

- The date the original valuation came into force.
- The date of valuation.
- The date at which the amended valuation is to come into force

### 5.0 CONFORMITY AND PROFESSIONAL RESPONSIBILITY

#### 5.1 Valuation Principles and Statutory Requirements

The valuer engaged or employed by a rating or taxing Authority should be cautious in carrying out valuations if the direction given by the Authority is contrary to established valuation principles or statutory requirements. If such a direction is given a qualification should be provided with the valuation.

#### 5.2 Professional Responsibility and Confidentiality

In the valuer's relationship to the Authority, there should be a declaration of any pecuniary or other interest that may arise in meeting the Authority's requirements. In many instances there will also be established a position of confidentiality, either by contract or by statute. It is the responsibility of the practitioner to honour any requirements contained in the vehicle of engagement or employment subject to 5.1 above.

#### 5.3 Conformity and Professional Responsibility

Additional information on this topic may be obtained from the Institute's *Valuation Principles and Practice: Second Edition*, Chapter 20: *Rating and Taxing*.

The performance of all valuation assignments should conform with generally accepted valuation principles and standards promulgated by the Australian Property Institute and the Property Institute of New Zealand.

### 6.0 SUPPLEMENTARY VALUATIONS

#### 6.1 Requirement

Supplementary or Interim valuations are required in most valuation rolls as a result of changes that are

advised or occur after the adoption of the general valuation roll.

#### 6.2 Occurrence

Supplementary valuations are new entries to the roll or substitute for land in the original roll. Changes may result from;

- zoning amendments.
- addition or removal of merged improvements.
- construction of, addition to, or removal of buildings.
- acquisition or resumption.
- physical changes to the land.
- errors and omissions.
- changes in value levels in relation to the balance of the properties recorded on the roll.
- movement of rating or authority boundaries by statute or prescription.

#### 6.3 Calculation

Supplementary values are calculated under definitions and in accordance with the methods described for general values listed on the roll. In nearly all instances the supplementary values are to be calculated at the valuation date of the original roll, taking into account all of the factors affecting value listed at 2.2 and provided to the Authority as shown in 4.0 above.

### 7.0 VALUATION CONTRACTS

#### 7.1 Outsourcing

There is an increasing trend in Australian municipal valuation practice towards valuation authorities engaging the services of professionally accredited contractors for the provision of municipal valuation services. The trend towards outsourcing has been driven by national competition policy and implemented in many cases by Government directive.

#### 7.2 Valuation Contracts

Typical valuation contracts will contain the following provisions:

- Description of municipal area.
- Requirements for inclusion in the valuation roll of property types and any exclusions.

## Confidentiality Agreement

Valuation definitions to be provided eg. Land Value, Site Value, Unimproved Value, Improved Value, Capital Value, Assessed Annual Value.

Required valuation methodologies eg. summation, residual valuation, capitalisation, deprival value for public sector entities and how these methodologies are to apply to various property types.

The names of nominated staff to undertake the duties of supervision, field inspections and any sub-contractors to be employed.

The level of inspection required for various property types.

Time frame for progressive and final submission of revaluation data.

Penalty provisions for non-compliance.

Termination provisions for non-compliance.

Standardised data sets for the return of data in digital format.

Requirements for ongoing maintenance of the valuation roll.

Submission of subsequent sales information and statistical tests required for standards of accuracy and uniformity.

Contract price and progressive or lump sum payment arrangements on submission of completed data for revaluation and maintenance of the valuation roll.

## Appendix 1

### Valuation Accuracy and Uniformity

It is important that valuations in a valuation roll are both accurate and uniform, in order to display equity and to be supportable before tribunals or courts of law. The following describes methods of measuring accuracy and uniformity. The methods shown here use evidence of sales and rentals to compare and make judgements about the accuracy and uniformity of entries included in the valuation roll. Differing methods may be adopted in each jurisdiction and the practitioner must ensure that the relevant requirement is met.

#### Accuracy

Measurement of accuracy must be subject to established standards of accuracy and be capable of independent audit.

Accuracy is measured against current market evidence to the date of valuation. Current practice in some States and Territories is to test the value against evidence two months before and two months after the date of valuation, as within this relatively short period, factors affecting the value of land are unlikely to change. However should API members be valuing in times of rapidly rising or falling markets, the period for the selecting of evidence should be adjusted accordingly. The degree of acceptable variation will reflect the volume and comparability of the market evidence.

Accuracy is easily understood as percentage error. For example it might be said that a *valuation* is within 10% of the *actual price* where *actual price* is the evidenced price in the base period (sale or rental, analysed and adjusted). Where the valuation is less than the actual price, the percentage error is computed from the formula  $100(\text{actual price} - \text{valuation})/(\text{actual price})$  If the valuation is greater than the actual price the percentage error is computed as  $(\text{valuation} - \text{actual price})/(\text{actual price})$ .

While the ideal is to produce a percentage error of zero, a value within 15% is generally regarded as acceptable.

The ratio  $100(\text{valuation} / \text{actual price})$  is an equivalent measure of accuracy which is equal to 100 minus the percentage error if the valuation is less than the actual price or 100 + percentage error if the valuation is greater than the actual price. Thus a percentage error of 10% is equal to a ratio of 90% if the valuation is less than the actual price or is 110% if the valuation is greater than the actual price.

Any measure of accuracy should be subject to the following considerations:

## ANZ VALUATION GUIDANCE NOTE 4

- The sales or rentals must be investigated and shown to be at arms-length. Sales or rentals discarded following investigation, should still be listed as part of the evidence, together with a qualification statement clearly indicating why they were excluded.
- The values must reflect the general level of sales or rentals occurring within the base period and for the sub-market of which they are typical or indicative.

### Measures of Accuracy and Uniformity

There is a need to combine the values for accuracy of individual valuations in aggregate samples to produce a combined measure of accuracy and uniformity. The term *accuracy* relates to the closeness of valuations to actual prices. The term *uniformity* is a measure of the consistency of the percentage errors or ratios. Thus a valuer who values three properties each at 80% of actual price is *uniform* in the valuation process but is not accurate.

Some useful measures of accuracy and uniformity are listed below together with conditions for their use and guidelines on interpretation of their values.

Any valuation methodology used for the roll must be subject to standards of consistency and be capable of audit.

Uniformity must be measured with reference to evidence, usually against the median percentage error or median ratio from all parcels in the aggregate sample. Accuracy is measured against the ideal percentage error of 0 or ideal ratio of 1.

The evidence for *accuracy* and *uniformity* should be based on an aggregate sample of current market evidence relevant to the date of valuation. Each jurisdiction should determine the appropriate base period for supporting the valuation roll. If no such determination is made by a jurisdiction, the practitioner should qualify the roll by stating the period within which the evidence sample supports the valuation. Present practice indicates that the use of evidence occurring two months before and two months after the date of valuation should be used to test the values in the roll effectively.

Listed below are some useful measures of valuation accuracy and uniformity. Each measure is described in words and interpretation of its values and conditions for its application are discussed. Mathematical formulae used to calculate the statistics are provided in the subsequent 'Formulae' section.

#### 1. Coefficient Of Dispersion (COD)

This is a widely used and accepted measure that is based on the differences between individual ratios of

valuations to actual prices and the median of all ratios in the aggregate sample. It is formed as the average of such differences (ignoring the signs of the differences) divided by the median ratio and expressed as a percentage. Values of COD less than 15% are expected.

The COD is firstly a measure of uniformity since it is formed from differences between individual ratios and the median ratio. Thus a collection of identical individual ratios of say 90% would yield a COD of 0 even though the valuations are not accurate. However, in practice, where not all ratios are identical, the use of the median ratio as a divisor does provide a form of adjustment for inaccuracy. Thus the COD is a combined measure of uniformity and accuracy.

The COD can be applied when there is a broad range of actual prices in the aggregate sample and provides a meaningful basis for comparison of accuracy across diverse collections.

#### 2. Median Percentage Error (MPE)

This is a simple and robust measure of accuracy. It is formed as the median percentage error. It will have a value of 0 when all valuations are identical with corresponding actual prices and increasing values of MPE imply decreasing accuracy. Values of MPE less than 10% are expected.

The MPE can be applied when there is a broad range of actual prices in the aggregate sample and provides a meaningful basis for comparison of accuracy across diverse collections

#### 3. Median Difference (MD)

Where there is interest in expressing the likely size of the difference (in \$ terms) between valuations and actual prices a simple calculation using the median percentage error is available. Multiply any chosen actual price by the MPE and divide by 100 to obtain the MD. For example, if the MPE is 5% and the chosen actual price is \$100,000 then MD is \$5,000.

Interpretation is simple: Based on a valuation system that produces an MPE of 5%, one half of the valuations on \$100,000 properties will lie within \$5,000 of the actual price.

Note that because the likely size of the difference is proportional to the actual price the size of the MD will double if the actual price doubles. Thus with an MPE of 5% for properties with an actual price of \$200,000 one half of the valuations will lie within \$10,000 of the actual price.

4. Percentage of High Valuations (PHV)

Interest in accuracy not only centres on how close valuations are to actual prices but also on possible bias in valuations. Valuers need to be aware if they are consistently undervaluing or overvaluing properties. Ideally the valuations should centre on the actual prices so that approximately equal numbers of valuations are on either side of the actual prices. A simple measure of bias is provided by counting the number of valuations in an aggregate sample that are above the corresponding actual prices, dividing this number by the total number of valuations that are either below or above the corresponding actual prices and multiplying by 100 to give the percentage of high valuations (PHV).

Valuations in the aggregate sample are without bias if the PHV is 50%. The further the PHV goes above 50% the more evidence that consistent overvaluation is occurring. The further the PHV goes below 50% the more evidence that consistent undervaluation is occurring. Values of PHV outside the range 35% to 65% are cause for concern, although these guidelines only apply if the sample size is at least 40. The use of PHV is not recommended for sample sizes that are less than 40.

The PHV can be applied when there is a broad range of actual prices in the aggregate sample and provides a meaningful basis for comparison of bias across diverse collections.

An additional role for the PHV is to check for internal consistency in an aggregate sample. If the actual prices are sorted by size, the PHV can be computed for two or more price subgroups and the values obtained provide a means of checking on consistency across subgroups.

Formulae

Valuations and actual prices are presumed to be available from n properties. The calculation of the measures defined below are based on the following table:

Property	1	2	...	n
Valuation	$v_1$	$v_2$	...	$v_n$
Actual price	$a_1$	$a_2$	...	$a_n$
Ratio	$r_1 = v_1/a_1$	$r_2 = v_2/a_2$	...	$r_n = v_n/a_n$
Percentage error	$p_1 =  (a_1 - v_1)/a_1 $	$p_2 =  (a_2 - v_2)/a_2 $	...	$p_n =  (a_n - v_n)/a_n $

Note that enclosing an expression between two bars, e.g.,  $|(a_1 - v_1)|$ , implies that the expression should be treated as a positive number. In mathematical terms it is called 'taking the absolute value' of the expression.

1. COEFFICIENT OF DISPERSION (COD)

Compute the median of the ratios,  $\tilde{r}$ . Then

$$COD = 100 [ |(r_1 - \tilde{r})| + |(r_2 - \tilde{r})| + \dots + |(r_n - \tilde{r})| ] / [n\tilde{r}]$$

2. MEDIAN PERCENTAGE ERROR (MPE)

$$MPE = \text{median of } \{p_1, p_2, \dots, p_n\}$$

3. MEDIAN DIFFERENCE (MD)

For an actual price of \$a,

$$MD = axMPE/100$$

4. PERCENTAGE OF HIGH VALUATIONS (PHV)

Let  $n_+$  be the number of valuations above the corresponding actual prices and  $n_-$  be the number of valuations below the corresponding actual prices, then

$$PHV = 100n_+ / (n_- + n_+)$$

Note that  $n_- + n_+$  is equal to the total number of properties minus the number of properties in which the valuation is equal to the actual price.

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# ANZVGN 5 VALUATIONS FOR COMPULSORY ACQUISITIONS

*This Guidance Note should be read in conjunction with and is subject to the provisions of ANZ Practice Standard 1*

## 1.0 INTRODUCTION

### 1.1 Purpose

The purpose of this Guidance Note is to provide information, commentary, opinion, advice and recommendations to Members involved in preparing valuations for compensation purposes including pre-acquisition advising and any subsequent discussions, negotiation or representation as part of a Public Authority acquisition process. This Guidance Note applies equally to valuers providing valuations to claimants (owners) and a Public Authority.

### 1.2 Status

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.

### 1.3 Scope

This Guidance Note applies to Members involved in preparing valuations for compulsory acquisition\* of interests of land. It should be used in conjunction with other guidance notes and practice standards as applicable to the type of property or issues involved.

*\* Whilst "resumption" is historically referred to in the context of compulsory acquisition proceedings, most recent statutes have adopted the word "acquisition" as standard terminology. For the purpose of this Guidance Note and its accompanying Standard these words are taken as referring to the same process. Acquisitions can be either by compulsory process or by negotiation.*

*Note: Whilst this Guidance Note and ANZPS 1 relate to acquisition by Public Authorities, The current trend of privatisation may result in acquisitions being undertaken by private enterprise organisations under statutory provisions. This Guidance Note and the Practice Standard apply equally to those acquisitions.*

### 1.4 Members Client

A Member may be involved in the process acting for either the Public Authority, or the claimant of an interest in land affected by the proposed or actual acquisition. In many cases when acting for a claimant, the Member's reasonable fees will be reimbursed by the Public Authority. This may be subject to certain conditions such as production of a copy of the report or production of a report meeting certain criteria. Where disputed claims are referred to a Court for determination, the Court will make an award as to costs. In such cases, both the claimant and the Public Authority are at risk in the recovery of costs. Where disputed claims are determined by agreement, the Public Authority will generally reimburse reasonable fees in respect to a valuation report carried out by the Member acting for the claimant. The party for whom the Member acts is the client regardless of who pays the fee.

### 1.5 Instructions

Members should accept instructions in writing in accordance with Rule 1.20 of the Rules of Conduct. As some dispossessed claimants may not fully understand the compulsory acquisition and related valuation processes, it may be appropriate for valuers to recommend that such claimants obtain expert advice from other appropriate specialists such as a suitably experienced solicitor or accountant (where there may be taxation issues). This process should ensure that the claimant is properly advised, that the Member is correctly instructed and is provided with a source of expert interpretation on points of law and taxation related aspects. It also assists in placing the Member at "arm's length" from the



dispossessed claimant to ensure that the Member's opinion is expressed as an independent expert. An acquiring authority may accept liability for a claimants reasonable professional expenses but confirmation of this should be obtained by the client in writing from the acquiring authority.

### 1.6 Valuers Entry into the Process

The Member's entry into the process may be at any time between notification from a Public Authority of an intention to acquire through to litigation. Early involvement by the Member will result in that member being in a better position to provide appropriate and timely advice. This Guidance Note applies equally in pre-acquisition stages.

### 1.7 Agreeing the Fee Basis and Payment

It is important that agreement is reached prior to commencement of the task on the basis of the Member's fees. This agreement should recognise that the Public Authority may offer to pay part or all of these fees. However, the agreement should also recognise that the client may be liable for additional fees.

### 1.8 Post Consultancy Report

Post Consultancy should be provided if required. As there is a reasonable probability of consultancy being required beyond the report phase, it is prudent to establish this position with the client at the time of taking instructions. In addition to agreeing the initial fee, it is recommended that from the outset Members agree in writing the following:

- basis of continuing consultancy fee
- basis of fee for any additional work or preparation required as a result of work by other experts on the team or as required by legal representative
- basis of fee for representation at any meetings, mediation or court hearing.

As the process can be protracted, it is recommended that agreement be made for rendering periodic accounts.

### 1.9 Other Professionals

In some matters, the Member may be the only professional engaged, in others the Member could be part of a team which includes various legal representatives, accountants, town planners, engineers, surveyors, etc.. Whilst strategic direction

may be provided by legal representation, the Member is responsible for ensuring their own professional integrity when acting as an expert. It is appropriate to include a note in a valuation report which identifies any outside professional advice relied upon.

## 2.0 BASIS of COMPENSATION ASSESSMENT

### 2.1 Legislation

Acquisitions and resumptions are effected under various legislation which affects many different types of property and many different interests in property (refer to "Property" in the Glossary of Property Terms).

#### 2.1.1 Enabling Legislation

Acquisitions and resumptions are effected under enabling legislation. This will normally contain provisions for compensation assessment or invoke the provisions of other over-arching legislation. An understanding of such legislation is fundamental to assessing compensation.

#### 2.1.2 Interest to be Assessed

The subject of the assessment is not simply the property but rather the claim of the claimant for compensation which could include the value to the claimant of the interest being acquired, plus claims under various other heads such as injurious affection, betterment, severance, disturbance and reinstatement. As an expert, the Member has a responsibility to consider all heads of claim identified in the relevant legislation.

#### 2.1.3 Market Value of Claimants Interest

The value of the owner's interest is usually required to be assessed in accordance with the provisions of the relevant act. The claimants interest will include the market value of the property together with other heads of compensation.

#### 2.1.4 Court Decisions

Many of the principles of compensation assessment have been laid down in Court decisions. A sound knowledge of the application of these legal precedents is fundamental to assessing compensation. Some decisions may be from other states or countries or have been given in terms of prior legislation and therefore their relevance may need to be considered.

**2.1.5 Examination of Issues**

Both the assessment of the claimants interest in the property, which includes various heads of claim are likely to involve the examination of a range of issues. Where these are complex and outside the valuers area of expertise, it may be prudent to instruct (with the client's written consent and appropriate understanding on fees) other experts. They should be briefed in writing and advised that they may be called to give evidence.

**2.1.6 Legal Representation**

Where a legal representative, experienced in compensation matters, is engaged as part of the team, it would be appropriate for that person to examine both the letter of instruction to the valuer and the report, or other specialist advice before it is issued. In such cases it may be preferable for the legal representative to issue instructions to other experts.

**2.1.7 Date of Assessment**

Any pre-acquisition assessment should relate to the current market. It is prudent, to advise the client that if the matter proceeds to formal acquisition, then the date at which compensation is assessed may change depending on the statutory requirements.

**2.1.8 Guidance on Methodology**

This Guidance Note is not intended to provide detailed assistance with methodology, and the valuer should refer to publications specialising in both the subject and court decisions. Most valuation publications will contain chapters dealing with the subject and the Institute's own professional journal has over many years reported court decisions and articles on compensation matters.

**3.0 INSPECTION & INQUIRY GUIDELINES****3.1 Other Standards & Guidance Notes**

Other standards and guidance notes provide direction and guidance for most elements of the property inspection, inquiry, research and analysis and these should be referred to. However due to the task requiring the assessment of the owner's interest and claims under other heads, special comment is warranted on certain aspects which the Member should address.

**3.1.1 Improvements Demolished before Settlement**

Members should be aware that instances may arise where they will be required to discuss or defend their assessment long after the improvements on the property have been demolished. It is important therefore that full and accurate inspection notes are maintained, and that these are supported by sketches and colour photographs (or video where appropriate). The property inspection must be completely objective and must record both the positive and negative aspects of the property. Significant features of surrounding properties which might also be acquired and which impact on the subject property should also be recorded.

**3.1.2 Interview the Owner**

It is important for the Member, whether acting for the claimant or the Public Authority, to discuss with the claimant(s), the details of the property being acquired and the acquisition process to ensure that all relevant particulars of the property and the owner's legal past and future use (if part only or an easement taken), but also so that the claimant feels that their position is well understood and that they will be adequately compensated. Note that this is likely to be a significant and unfamiliar event for the owner and occurring in an environment over which the owner has limited control. It is an opportunity to demonstrate professionalism and appropriate sensitivity, no matter which party is represented by the Member. An interview with the claimant should also be used to confirm other interests in the property, and how those interests affect those of the claimant for whom the report is prepared.

**3.1.3 Interviews and Discovery**

There could be unusual aspects requiring investigation and research both for the property and other heads of claim. These should be well documented and obtained where possible in writing from the source of the information. It is appropriate to explain circumstances sufficiently to your information source so they properly understand the nature of the information required (this could save embarrassment and damage to your case under cross examination for you or your information supplier). In particularly important or difficult cases it may be necessary to obtain copies of contracts of sale as appropriate confirmation if litigation is involved (you will also need to establish that the contracts contain no special clauses which would impact on their use to determine value). In order to obtain copies of contracts it

## ANZ VALUATION GUIDANCE NOTE 5

may be necessary to utilise the discovery powers of the court however valuers should explore other methods before turning to the court for assistance.

### 3.1.4 Public Authority

Where part of a property is required (including an easement), it is particularly important to interview staff from the Public Authority involved. While the acquisition notification will usually indicate the purpose of the acquisition, details of proposed works are important for establishing injurious affection, severance, betterment and reinstatement where applicable. The extent of works could impact significantly on the assessment. It is likely that the authority will have carried out studies of any impact. Members should obtain copies of plans and studies, examine and discuss them with the Authority and claimant who will possibly be able to indicate how these will impact on the use of the property.

### 3.1.5 Report Notes

Members should ensure that they keep full and accurate field notes of all inspections, meetings, sources of information, calculations and basis of their valuations. Photographs should also be obtained.

## 4.0 REPORT CONTENT

### 4.1 Other Standards & Guidance Notes

Other standards and guidance notes provide direction and guidance on contents of reports. In addition to considering those headings, the points to address and the annexures to provide in the report, the particular requirements of your client should be considered. Members should check if a preliminary report is required. The following should also be considered for inclusion.

#### 4.1.1 Acquisition or Resumption Date

Details of the acquisition or resumption should be noted and a copy of any notification annexed to the report. Most important are:

- date of the acquisition (if gazetted),
- date of Notice to Treat/Notice of intention to acquire/Notice of Acquisition,
- stated public purpose and scheme description,
- interest acquired,
- legal description of land resumed,
- name of the Public Authority.

- Legislation under which the interests have been acquired.

#### 4.1.2 Effect of the Acquisition or Resumption

Where part only of the property has been acquired, it is particularly important to note in some detail the impact of the acquisition on the residue of the property. Such issues as injurious affection, betterment, severance, disturbance and reinstatement may have to be considered and commented upon, as appropriate.

#### 4.1.3 Town Planning / Resource Management

Town planning or Resource Management details should always be included in a report, however additional detail is warranted where the current or proposed zoning may have been or is a step in the acquisition process (and as such may have to be ignored in the assessment of compensation). In such a case comment on the most likely alternative zoning should be included (supported if necessary by a planning consultants report).

#### 4.1.4 Reference Material

At appropriate points in the report, reference should be made to reports by other experts and publications or documents relied upon. Where appropriate, copies of these or extracts there-from should be annexed to the report.

#### 4.1.5 Heads of Claim

Heads of claim should be explained and their qualification/quantification adequately detailed.

#### 4.1.6 Summary of Claim

At some point in the report provide a summary of the amounts claimed for the value of the interest in the property taken and amounts under the heads of claim. This should be set out in such a way as to comply with any particular requirements of the relevant legislation and to enable any prescribed claim form to be completed. A total of the assessments or values of the claims should also be shown.

#### 4.1.7 Separate Valuation Statements

If the Member has prepared a number of valuations reflecting different interpretations of the law, planning or other matters, it is appropriate that separate valuation statements be made, **clearly setting out the basis of each valuation.**

#### 4.1.8 Degree of Detail

Members may be directed by the claimant's legal representatives as to the degree of detail to be

provided in their report. Where relevant, reports should be consistent with the Institutes practice standards.

market evidence, facts and reasoned argument in accordance with the relevant legislation and court procedures.

#### **4.1.9 Suitable for Exchange**

The Member should produce a report suitable for exchange prior to any discussions of value or negotiations (subject to direction from any legal representative). This will enable the parties to better understand the points of difference between them and will ultimately assist the Court. Exchange will normally be at the direction of the client or the team leader who may be a Property Professional, or legal representative.

#### **4.1.10 Expert Witness**

Members should be aware of any relevant court rules of practice directions or regulations relating to expert witnesses and should be conversant with and comply with their requirements.

## **5.0 POST ASSESSMENT CONSULTANCY**

### **5.1 After the Assessment**

A significant part of a Member's work can occur after the assessment has been carried out. This can take the form of discussions and negotiation, preparation and proof of evidence for appeal hearing, giving evidence and being cross-examined. If not prepared to carry through to these stages the Member acting as a valuer should notify the client and, if necessary, decline the instructions. It is desirable for the member's brief to extend beyond the assessment to include the negotiation of a settlement of the compensation claim. It is generally unacceptable for a Member acting as a valuer who has carried out an assessment to subsequently refuse to participate in the resolution process. The provisions of this clause apply equally to Members acting for acquiring authorities and claimants. Instances may occur where negotiations are undertaken by another professional who instructs a Member. In these cases this clause applies to the Member.

### **5.2 Negotiation with other Professionals**

Professionals assessing compensation claims following acquisition by a Public authority will often be called upon to negotiate with other property professionals. In any negotiation it is essential that both Members be prepared to substantiate their opinions by reference to

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# ANZVGN 6 VALUATIONS OF ACCOMMODATION HOTELS

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to set out matters to be addressed in addition to those required by IVA 2 Valuation for Secured Lending Purposes and ANZVGN 2 Mortgage Security Reports on Real Property.

### 1.2 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.

### 1.3 Scope of this Guidance Note

This Guidance Note should be applied to properties that are valued with regard to their trading potential, including Accommodation Hotels, Motels and Serviced Apartment complexes of 3 star standard and higher. This Guidance Note is not specifically intended to cover licensed hotels (pubs), whether free standing or part of, Accommodation Hotels.

### 1.4 International Valuation Standards

This Guidance Note recognises the International Valuation Standards 1 and 2, and International Valuation Application 2 by the International Valuation Standards Committee and it is intended to be consistent with the concepts and definitions contained in those standards, however, there may be departures from IVSC Standards to reflect Australian & New Zealand law and practice.

### 1.5 Role of the Valuer

The valuer needs to demonstrate in a report an understanding of the operation of the subject property, the operator and/or lessee, the Hotel's

market place, competition and any unique features it possesses.

### 1.6 Basis of Valuation

The valuation should clearly state whether it reflects the terms of an Operating or Management Agreement, or an occupational lease or whether the valuation is on a vacant possession basis. It should also state whether it has been undertaken as a 'going concern' on a 'Walk In Walk Out' basis inclusive of all plant, equipment, furniture and fittings but excluding stock.

### 1.7 Interests

The valuer should be aware of the different interests in a property, and should apply the same valuation principles to all interests based on the term of the management agreement or lease.

## 2.0 Compliance

### 2.1 Statement

A valuation of a property defined in 1.3: Scope of this Guidance Note should state that it complies with this Guidance Note.

### 2.2 Accepting an Instruction

Prior to accepting an instruction, a valuer must be confident of having the necessary expertise and sufficient information to undertake the valuation. For example, if the valuer does not have complete or appropriate access to comparable sales and trading data, then the valuation instruction should be declined, or undertaken in conjunction with a valuer who has the expertise and access to such information.

## 3.0 Review of Improvements

### 3.1 Key Factors

The improvements need to be considered in the context of their specialist use, with the following being examples of relevant factors:

- summary of room numbers by size/type/aspect
- location and adequacy of kitchen(s)
- appropriateness of food and beverage outlets
- size, location and appearance of entrance lobby and front desk
- layout and capacity of meeting rooms
- back of house facilities
- other facilities (eg Health Club, pool, etc)
- on-site car parking (numbers/adequacy)
- technological facilities (e.g. visual display units, communication/media access facilities)

### 3.2 Specialised Features

The valuer should consider the design characteristics and appeal of the property, including unique or specialised features that may impact upon the viability of operation, value and marketability. Factors to be considered include the efficiency of the layout in relation to guest servicing and labour costs, back of house servicing and adequacy of storage space (wet/dry/cold rooms).

## 4.0 Repair and Condition

### 4.1 State of Repair

Comment on the state of repair of the improvements of the property, including any outstanding works to be completed, and any modification or maintenance work required. Make comment upon the condition of Fixtures Fittings & Equipment, back of house equipment (e.g. kitchens), in the context of the Fixtures Fittings & Equipment Reserve.

### 4.2 Refurbishment

Comment on the feasibility and extent of possible refurbishment likely to be necessary over a normal investment period. Comment upon economic and functional obsolescence and the need or capability to upgrade improvements.

### 4.3 Capital Expenditure

The valuer should provide an estimate of likely required Capital expenditure, in respect to building works/services, refurbishment and Fixtures Fittings & Equipment Replacements.

### 4.4 Balance in FF&E Reserve

The valuer should establish whether there is an existing balance in the FF&E Reserve, and comment on its adequacy and appropriateness in relation to current and future Capital Expenditure requirements. Whether such balance has been reflected in the valuation figure should be clearly stated.

## 5.0 Approvals and Authorities

### 5.1 Building and Planning

Where necessary, issues relating to building compliance, heritage, environmental and planning classification should be reviewed and any consequent impact on value fully explained.

### 5.2 Non-Compliance

Whilst it is acknowledged that the valuer may not be qualified in these areas, based upon the inspection (noting limitations of such), comment should be made on any possible occupational health and safety requirements or requisitions recommending further inspection by qualified experts where appropriate.

In addition, the valuer should seek from the instructing party details of any notices of non-compliance of which the instructing party is aware.

### 5.3 Licences

The valuer should sight and comment on all licences required for the property's operation and note that these are included in the valuation.

### 5.4 Legislation

Comments are required as to whether the building is compliant with any current and pending legislation. Whilst it is recognised that the valuer is not an expert in this area, the report should highlight any potential risks in this regard through inspection and inquiry.

## 6.0 Trading Performance

### 6.1 Accounts

Where possible, accounts should be presented and analysed in accordance with the Uniform System of Accounts for Hotels. State whether the figures that have been relied upon have been audited.

The valuer should make a specific notation where relying upon information provided without being



able to verify it, and clearly state any consequent limitations to the advice as a result.

## 6.2 Summary of Detailed Figures

The valuer should provide a summary of detailed figures for the hotel, showing trading performance for the last 3 years on a departmentalised basis, together with year to date trading figures.

Appropriate periodic occupancy and average room rate statistics should be considered and commented upon.

## 6.3 Expenses/Outgoings

The valuer should itemise all expenses/outgoings in schedule form including management, all fixed costs, capital expenditure, and FF&E allowances, where possible in accordance with the Uniform System of Accounts for Hotels. Compare and contrast the current trading with the previous year's actuals, YTD figures versus budget, and comment upon any major variances. These figures should also be compared with appropriate industry benchmarks.

## 6.4 Trading Levels

The valuer should comment in detail on the current level of trading being achieved, the stability of the income and the projected maintainable trading performance of the property compared to the operator's projections.

## 6.5 Business Mix

The valuer should comment upon the business mix, typically analysed where available by geographical source, market segment and by guest type.

## 6.6 Operational Review

The valuer is not expected to carry out a detailed Operational Review, but would be expected to make appropriate comment upon:

- the marketing plan
- budget vs actual performances
- effectiveness of referrals within the operating group
- a fair market share analysis
- profile of operator

## 7.0 Trading Environment

### 7.1 Benchmarking

Benchmark the performance of the hotel in comparison to the Following:

- accepted market and industry indices,
- comparable and competing properties, to the extent that such data is available as well as identifying any items of revenue/expense which are outside acceptable market parameters.

### 7.2 Competition

The valuer should provide full details of current and proposed competition within the catchment area, incorporating demand and supply criteria.

### 7.3 Current State of Industry

The valuer should analyse the current state of the hotel and tourism industry and in particular the subject property's target market, and detail any changes (current or anticipated) which may impact on the long term income sustainability and growth potential of the asset. Statistics and research data should be used to highlight trends and as a basis for projections.

## 8.0 Management Agreement / Tenancy Details

### 8.1 Commentary

The valuer should:

- Sight a copy of the Management Agreement / Operating Lease. A summary of the Agreement / Lease should be incorporated together with commentary on the general market acceptability of its terms and conditions. If these terms are outside typical market practice this should be stated and some commentary on what is considered acceptable should be provided.
- Read and understand all factors in the agreement or lease which could affect value, such as quality and certainty of income, income guarantees and associated clawbacks, break clauses, owners involvement. The valuer should also comment on remedies of default, assignability, termination clauses, non-disturbance clauses and the quality of the lease covenants.

- Provide a brief profile on the hotel operator including details of its brands, number of hotels/rooms and geographical spread.
- Investigate and comment upon the existence of any agreements between the owner and manager/operator which may affect value. Similarly, comment upon any agreements between the operator and other properties in the vicinity that may affect the operation of the property, for example, non-compete clauses, shared costs and expenses.
- Where the hotel forms part of a mixed-use project, all leases relating to the property should be reviewed by the valuer. Tenancy information should be summarised in schedule form. Comment upon the relationship of the hotel with the other components of the property.

### 9.0 Earnings Potential

#### 9.1 Sustainable Net Return

Calculate the sustainable net return to the owner after reflecting appropriate outgoings. The treatment of Management Fees and FF&E Reserve varies, but as a general guide valuers should apply as they analyse and reflect the manner in which the market is capitalising. Although net return is typically expressed after Management Fees and FF&E Reserve, an owner operated property may be considered on a 'before fees' basis.

#### 9.2 Existing Agreement

Fees and FF&E provision should reflect any existing Management Agreement, or prevailing market rates. The net return should also be expressed before depreciation, amortisation, interest, tax and Capital Expenditure.

#### 9.3 Projections

Any projections should be in accordance with the 'Uniform System of accounts for Hotels', and preferably undertaken for a period of five years or beyond, reflecting the method adopted to analyse sales.

#### 9.4 Upgrades/Capital Expenditure

Have regard to any upgrading or capital expenditure which would impact on the trading performance of the hotel or its marketability.

#### 9.5 Cashflow

A detailed analysis of the cashflow is an essential requirement. The calculations should be completely self explanatory. Details of the discount rate, time period, etc, should be shown.

#### 9.6 Changes

Comment upon the anticipated changes to outgoings, timing of capital expenditure, particularly significant items (eg major contract renewals, rating changes, etc).

#### 9.7 Variation

Comment on variations between the operator's projections and those assumed by the valuer, with rationale supporting any variations.

#### 9.8 Analysis

A sensitivity analysis for key variables may be appropriate.

### 10.0 Market Commentary

#### 10.1 Purpose

This should address the following sectors, as relevant to the specific hotel – global, local (regional), comparison of design features with market demand and competitive supply.

#### 10.2 Market Conditions

This requires both a current and forward looking view (typically 3-5 years) rather than an historic view of market conditions. Typically this commentary should include:

- Investment activity including depth of market and identification of key 'players';
- Building activity including competition and likely additions to supply;
- A discussion of the major drivers of supply/ user demand over the period under review;
- A valuer should consider a model of future supply and demand to project average occupancies and room rates within the market and to form the basis of a fair market share assessment.

## 11.0 Sales Evidence

### 11.1 Sales Analysis

It is not always possible to obtain sufficient information to fully analyse every sale; however, the valuer still needs an appropriate level of sales that have been adequately analysed in order to arrive at an opinion of value. To simply quote a yield or a room rate from a sale, without first seeking the information to analyse the sale is unsatisfactory.

### 11.2 Trading Performance

The future trading performance of the adopted sale or sales being analysed should be explored for each sale, in combination with the sale's historic performance. This is required, in order to allow the formation of an acceptable level of consistency between the sale being analysed and the subject property, to allow informed comparison.

### 11.3 Relativity of Sale

The relativity of each sale should be commented on and explained.

### 11.4 Recent Sales History

The valuer should indicate recent sales history of the subject property. Where the property is being transacted, the contract for sale should be sighted and commented upon.

## 12.0 General Issues

### 12.1 Vacant Possession

Where owner occupied properties are valued on a vacant possession basis in existing condition, an indication of net income after management expenses and replacement reserve should also be provided for comparison purposes.

### 12.2 Leases, Plant and Equipment

The valuer should comment on leases of plant and equipment where the lease payments for plant and equipment are substantial so as to have a material effect on value if the costs are deducted from income. In such an instance the costs may be ignored if instead a payout figure can be ascertained and deducted from the value assessed.

### 12.3 Leasehold Title

In cases of hotels held upon leasehold title, the impact of the ground rent on returns/incomes

should be fully considered and reflected in the valuation. As with any other leasehold the valuer may need to consider the value of the hypothetical unencumbered freehold and then consider the value of the Lessors Interest, the Lessee's Interest, and potential Marriage Value of the interests concerned. See separate guidance note on Partial Interests.

### 12.4 Impact of Valuation

The impact on valuation of the separation of the various title components, related options, obligations and impediments, potential loss of tenure, etc should be identified and fully explored in relation to both sales and the subject property.

### 12.5 GST Caution

The Valuer should consider the manner in which similar properties are bought and sold from a GST perspective and adopt the most appropriate treatment of GST accordingly.

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# 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;

## ANZ VALUATION GUIDANCE NOTE 7

- 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.

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# ANZVGN 8 VALUATIONS FOR USE IN OFFER DOCUMENTS

## 1.0 INTRODUCTION

### 1.1 Purpose

The purpose of this Guidance Note is to provide advice to Members providing valuations for inclusion in offer documents. This Guidance Note does not purport to be a comprehensive description of the law and members should obtain independent legal advice.

### 1.2 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.

### 1.3 Scope of this Guidance Note

This Guidance Note applies to Members providing valuations of real property and related assets that are to be included in an offer document.

This Guidance Note addresses general concepts and principles to be followed by Members when preparing valuations for inclusion in offer documents.

Offer documents may include, but not be limited to, regulated offer documents (including prospectuses and product disclosure statements), unregulated offer documents (including information memorandums) and bidder's and target's statements.

### 1.4 Structure of This Guidance Note

The advice for Members provided in this Guidance Note includes:

- advice on process including:
  - responsibility of Member;
  - instructions;
  - obligations;

- style;
- statement of valuation;
- advice on transparency including:
  - conflicts of interest;
  - assumptions and qualifications;
  - forecasts;
  - value statement;
  - risk statement;
  - development properties; and
  - advice on regulatory observance.

### 1.5 International Valuation Standards

This Guidance Note is intended to be consistent with Standards and Guidance Notes published by the International Valuation Standards Committee, except as otherwise stated.

## 2.0 PROCESS

The following comprises advice to Members concerning issues of process in the provision of valuations for inclusion in offer documents

### 2.1 Responsibility of Member

#### 2.1.1 Requirement for Valuation

A Member may be instructed to provide a valuation for inclusion in an offer document at the request of a party such as the promoter, manager or trustee but for the benefit of potential or existing investors.

Such a valuation is likely to be an important consideration within a range of matters considered by a potential investor in determining whether or not to make an investment.

A Member should be aware that the valuation may be considered by other parties involved in the offer including lenders, accountants, auditors and lawyers.

A Member may be required to provide both a full report and a summary report for inclusion in the offer document.

## ANZ VALUATION GUIDANCE NOTE 8

### 2.1.2 Role of Member

A Member is fulfilling the role of an informed professional in providing an objective and impartial view and drawing the attention of a reader to key issues impacting on value.

A Member should, therefore, provide disclosure of relevant information (including assumptions and qualifications) to assist a reader understand the basis of the valuation (when included).

A Member should aim for maximum rather than minimum disclosure, seeking to exceed technical compliance in order to exceed public expectations, in their full report. A summary report should, therefore, seek to mirror the spirit of this approach within the confines of brevity and cross-referencing to other parts of the offer document where relevant.

The level of information provided should be such as potential investors and their advisers would reasonably require and reasonably expect to find in an offer document in relation to property value for the purpose of making an effective, fully informed decision.

A Member should not provide comment on the merit of the offer.

### 2.1.3 Relevant Skills and Expertise

In accordance with Rule of Conduct 1.6, a Member should not accept an instruction beyond their competence.

If a Member does not have the relevant skills and expertise to undertake the provision of a valuation, the Member should decline the instruction or retain an appropriate specialist to provide advice.

## 2.2 Instructions to Member

### 2.2.1 Written Instructions

In accordance with Rule of Conduct 1.20, a Member should accept instructions in writing.

Written instructions should be obtained prior to the valuation being undertaken.

### 2.2.2 Clarity of Instructions

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

### 2.2.3 Contents of Instructions

Such instructions should be clear and include all relevant details, which may be provided in a letter

of instruction, contract between the parties or other form of appointment.

A Member should note that the form of appointment may be regarded as a public document.

A Member should consider attaching a copy of the instructions to the valuation report.

### 2.2.4 Incomplete Instructions

In the event that any of the following are omitted from the instructions:

- a) identification of the instructing party;
- b) acknowledgment of respect for the Member's independence;
- c) provision to meet the cost of independent legal or other expert professional advice for the Member, if required;
- d) exact scope of the valuation, disclaiming responsibility for matters outside such scope;
- e) basis of valuation;
- f) date of valuation;
- g) purpose/reasons for valuation including a statement that it is for use in an offer document;
- h) the manner of distribution and likely recipients of the valuation including, if the valuation is to be used in an offer document;
- i) any requirements for a summary report for inclusion in an offer document;
- j) confirmation that, if a summary report is required, potential investors can have access to the full report;
- k) unfettered rights to inspect the property;
- l) the facts of the proposal;
- m) any data relevant to the proposal;
- n) any partial ownership arrangements or other restrictions on marketability;
- o) if the subject property is subject to current or previous acquisition, relevant details such as contract of sale, survey, due diligence reports and related documents;
- p) details of any consultants with whom the Member should liaise regarding the offer document, with costs arising there from to be borne by the instructing party;

- q) reference to statutory requirements and any additional requirements contained within the documents constituting the offer or entity;
- r) requirement for the instructing party to review and confirm the factual accuracy of the draft valuation report;
- s) whether any assumptions or qualifications have been prescribed by the instructing party, the reasonableness or achievability of such prescribed assumptions or qualifications and the sensitivity of the valuation to variations or non-compliance with such prescribed assumptions or qualifications;
- t) requirement for the Member to provide their consent to being named in the offer document and a description of any consents the Member may be required to sign in connection with the inclusion of their valuation in an offer document;
- u) specific requirements of the instructing party for the scope of continuous disclosure; or
- v) provision of draft offer documents together with adequate time for review and the right to control edited versions of the valuation contained therein a Member should consider requesting same from the instructing party.

### 2.3 Obligations of Members

#### 2.3.1 Duty to Prospective Investors

A Member should consider their responsibility to potential investors to whom the report is directed for their information and decision making.

If a Member is uncertain concerning their responsibility, they should seek independent legal or professional advice.

#### 2.3.2 Nature of Information to be Included

A Member should, if not provided by the instructing party with all information required for consideration or appropriate access to records, premises, etc as required, decline to provide a valuation.

#### 2.3.3 Significant Change in Information

A Member should be aware of the obligation on the issuer of any offer document to issue a supplementary offer document if a significant change occurs.

A Member should promptly inform the issuer of any offer document in which a Member's valuation

report is contained of any matter that could have a material impact on the valuation.

In the event that the valuation becomes impacted by a significant change during the offer period and the instructing party does not amend or withdraw the offer document accordingly, the Member should consider withdrawing their consent to being named in the offer document.

### 2.4 Style

#### 2.4.1 Goal

A Member should consider the test of a valuation to be measured as much by its clarity and utility to users as by the sophistication of its analysis and its information content.

#### 2.4.2 Written Style

A valuation should be worded and presented in a clear, concise and effective style using plain and direct language.

#### 2.4.3 Terminology

A Member should use terminology consistent with widely accepted industry guidelines, but without unnecessary technical jargon.

Where unavoidable, technical jargon should be used consistently and with an explanatory glossary provided in the full report, especially where, the definition or interpretation of specific or technical terms is central to the valuation.

### 2.5 Statement of Valuation

#### 2.5.1 Member's Consent

It is recommended that a Member's valuation not be published in part or full in an offer document without the Member consenting to the form and context in which it will appear.

Before consenting, a Member should confirm by sighting that the valuation has been accurately reproduced in the offer document and is being used for the purpose for which it is produced.

A Member should be vigilant to ensure misrepresentation or omission of factors, assumptions or qualifications that may be relevant to a party likely to rely on the offer document does not occur.

A Member should limit their responsibility for an offer document to solely their contribution to the offer document.

## ANZ VALUATION GUIDANCE NOTE 8

A Member may withdraw consent for the inclusion of a valuation in an offer document at any time.

A Member should withdraw consent for the inclusion of a valuation in an offer document if:

- the Member becomes aware of something occurring after the issue of the valuation which would cause the valuation, or a statement in the offer document to which a Member has consented, to be misleading or deceptive;
- the Member has informed the issuer of the occurrence; and
- the issuer has refused to issue a supplementary offer document or otherwise inform potential investors of the nature of the occurrence and its impact on the valuation.

### 2.5.2 Summary Valuation

If a Member provides a valuation and then also provides a summary valuation, it is recommended that each refer to the other.

The valuation, when read in full, should not contain any unexpected material issues for a reader who has previously read the summary valuation.

### 2.5.3 Currency of Valuation

A Member should make it clear that the valuation is applicable at the valuation date and that any change in circumstances or market condition after that date would require the valuation to be reviewed.

### 2.5.4 Assumptions and Qualifications

A Member should detail all assumptions and qualifications affecting the valuation (section 3.2 below).

The use of sensitivity analysis is encouraged to highlight those assumptions and qualifications that significantly impact the valuation.

### 2.5.5 Risk Statement

A Member should include a risk statement (section 3.5, below).

## 3.0 Transparency

The following comprises advice to Members concerning issues of transparency in the provision of a valuation for inclusion in offer documents.

### 3.1 Conflicts of Interest

#### 3.1.1 Independence

It is of paramount importance that a Member

is and is seen to be independent of the parties making the offer.

#### 3.1.2 Declaration of Interests

A Member should be independent of the parties making the offer, their advisers and associates for the duration of that period from first approach to publication of final report for its required purpose.

A Member should disclose any conflicts of interest (real, perceived or potential) including any interest by a Member's employer, family or associate or related parties.

A Member should disclose, clearly and prominently, any interest in the subject matter of the valuation even if it is considered that no conflict exists.

#### 3.1.3 Business Relationship

A Member should consider whether any previous, existing or intended future business relationship (within last two years or longer if sufficiently significant), with any relevant parties has the potential to affect or to be perceived to affect the independence of the Member.

#### 3.1.4 Performance Fees

In accordance with Rule of Conduct 1.7, a Member should not negotiate a fee contingent on the success of the offer.

#### 3.1.5 Client Interaction

A Member should not discuss the merits of an asset or the approach that may be adopted in the valuation until after the party making the offer has provided written instructions.

A Member must assess the merits of the asset independent of the party making the offer or anybody associated with that party.

A Member may supply the instructing party with a draft copy of a report for review and confirmation of factual accuracy only.

The party making the offer may seek to provide further information to, or clarification of matters for a Member, which a Member may then verify and consider.

Having regard to the correction of factual errors or following verification and consideration of further information or clarification, a Member may review their valuation.

Otherwise, it is inadvisable for a Member to change judgemental assessments in a draft report



(such as rental, growth, capitalisation or discount rates or opinion of value) following comment by the party making the offer.

A Member should keep accurate written records of such interaction with the party making the offer and of any changes that may be made by the Member to the draft in order to substantiate independence in the event of a claim otherwise.

## **3.2 Assumptions and Qualifications**

### **3.2.1 Statement of Assumptions and Qualifications**

It is recommended that a Member's valuation clearly discloses any assumptions or qualifications made or relied upon.

A valuation concerning a development property is often subject to assumptions and/or qualifications (section 3.6.2 below).

Accordingly, a Member should take as much care with the formation and publication of assumptions and qualifications as with the valuation itself.

The use of sensitivity analysis is encouraged to identify those assumptions and qualifications that significantly impact the valuation.

### **3.2.2 Prescribed Assumptions and Qualifications**

Where the instructing party has prescribed assumptions or qualifications, to be included in a valuation, the Member should restate these in the report and write explanatory comments where necessary.

A Member should critically evaluate information provided by an instructing party, taking note of any grounds for questioning the veracity, accuracy or completeness of such information and undertake whatever checks, inquiries, analyses and verification procedures as are considered necessary.

If assumptions or qualifications provided by an instructing party result in advice that differs from Market Value, a Member should report such difference and/or effect and the reasons why.

### **3.2.3 Reliance on Advice or Reports by Others**

If a Member relies on advice or a report by another expert, the material should preferably be reproduced in full or, if in part, the member should be aware of the risk of material omissions and, include a statement of the material on which a Member has relied and (if applicable) how this has impacted upon the valuation.

If a Member has relied on advice or a report by another party without conducting any independent investigation into the matters contained therein, the Member should clearly state this in the valuation.

## **3.3 Forecasts**

### **3.3.1 Basis of Forecasts**

A Member may be required to undertake forecasts in the preparation of a valuation.

Advice concerning development properties is often reliant on forecasts (section 3.6.3 below).

Members should have regard to International Valuation Guidance Note 9, concerning the use and basis of forecasts.

Forecasts should be supported by reasoned assumptions, recognising that past trends may not be a guide to future trends.

A Member should make sufficient inquiries to establish that forecasts are prepared on a reasonable basis. Appropriate documentation should be retained to prove such reasonable grounds.

A statement of assumptions relevant to the forecasts' is essential for the proper assessment of information contained in the forecast. A Member should clearly disclose any such assumptions in the valuation.

A Member should seek professional advice concerning the need for accreditation or licensing for the provision of information in an offer document and should ensure that the reliant party does not adopt any such forecasts as the basis for their own forecasts in the offer document without the Member's prior written consent.

### **3.3.2 Sensitivity Analysis**

Members are encouraged to include a sensitivity analysis within the valuation to ensure that readers are aware of the degree of uncertainty which such forecasts entail. Such analysis should address key risks which may impact upon the valuation outcome.

Members should, avoid potential confusion by clearly indicating which is their opinion of value.

## **3.4 Reporting The Value**

### **3.4.1 Value**

After considering all the issues affecting the property, including various approaches to

## ANZ VALUATION GUIDANCE NOTE 8

valuations and any sensitivity analysis, Members are encouraged to provide a single point value.

### 3.4.2 Market Volatility

Members are encouraged to discuss the implications of market volatility in relation to the value ascribed.

## 3.5 Risk Statement

### 3.5.1 Risk Statement

It is recommended that a Member's valuation include a risk statement comprising a balanced view of the negative and positive risks associated with the subject of the valuation.

### 3.5.2 Unusual Attributes

A Member's advice should draw the readers' attention to any atypical features or influences associated with the subject of the valuation.

Advice concerning development properties may be expected to include extensive analysis of risk (section 3.6.4 below).

### 3.5.3 Marketability

A Member should comment upon the marketability of the property.

## 3.6 Development Properties

### 3.6.1 Value As if Complete

If a Member provides a valuation of a property or asset to be subject to a material change of state, the Member is encouraged to report the value of the asset "as is" and the value of the asset in the "as if complete" state.

(For example, an offer document may contemplate the acquisition of a block of land upon which will be built an income producing multi-storey office property.)

### 3.6.2 Assumptions and Qualifications

If the "as if complete" value is dependent upon stated assumptions and qualifications, these should be fully addressed together with the implications should any fail to materialise.

(For example, an offer document may be based on development approval, a building contract and certain tenants to change a block of land into an occupied, income producing multi-storey office property.)

### 3.6.3 Forecasts

If the "as if complete" value is dependent upon forecasts, these should be fully addressed and

the Member should include a discussion of the reasonableness of such forecasts.

(For example, an offer document may contemplate certain time frames for the achievement of development approval, a building contract at a certain price and tenants at certain rentals to change a block of land into an occupied, income producing multi-storey office property.)

### 3.6.4 Risk Analysis

Advice concerning a material change of state may include extensive risk analysis.

A Member should comment on the risks involved and upon the vulnerability to multiple risks, both related and unrelated.

(For example, a valuation may include a detailed statement of the various risks involved in contemplating the acquisition of a block of land on which an income producing multi-storey office building will be built)

## 4.0 Regulatory Observance

### 4.1 Financial Services Licence

In Australia, the inclusion of a valuation report in an offer document may constitute the provision of financial product advice. Members that do not hold, or are not covered by an Australian Financial Services Licence, are advised to seek independent legal advice before providing a valuation report for inclusion in an offer document.

If it does constitute financial product advice, there may be an exemption from the requirement to hold a licence available if the following conditions are met:

- a) the valuation is included in a document issued in connection with an offer of a financial product;
- b) the advice is an opinion on matters other than financial products and does not include advice on a financial product;
- c) the document includes a statement that the person is not operating under an Australian Financial Services Licence when giving advice; and
- d) the person discloses in the document information about any remuneration or other benefits received or any interests, associations or relationships that might reasonably be

expected to be or to have been capable of influencing the person in providing the advice.

This exemption is narrow in operation and will not apply to the following documents where they do not possess a 'connection' with the 'offer of a financial product':

- a) an explanatory booklet for a scheme of arrangement;
- b) a compulsory acquisition notice under Chapter 6A of the Corporations Act; or
- c) an offer made in the circumstances where the shares to be acquired are held by shareholders dissenting from a scheme or contract approved by the majority.

### 4.2 Relevant Law

In Australia, relevant law may include but not be limited to:

- a) Common Law – including potential liability to a third party for loss suffered as a consequence of reliance upon negligent information or advice where it was not unreasonable for the third party to rely on the information or advice;
- b) Statute – including but not limited to:
  - Corporations Act – in particular;
    - s9 concerning the definition of an expert (being distinguished from a professional and/or an adviser);
    - s1041E relating to an offence of making false or misleading statements in relation to a financial product or service;
    - s1041H relating to a civil offence to engage in misleading or deceptive conduct in relation to a financial product or a financial service, and
    - ss 710 and 1013C(3) concerning information that should be included within prospectuses and product disclosure statements respectively;
  - Trade Practices Act – in particular, s52 concerning misleading or deceptive conduct or conduct that is likely to mislead or deceive;
  - ASIC Act – in particular s12DA concerning the prohibition against misleading or deceptive conduct in relation to financial services; and

- Fair Trading Acts, consumer protection legislation, trustee legislation, valuers registration legislation.

In New Zealand, relevant law may include but not be limited to:

- Common Law – including the potential liability to a third party for loss suffered as a consequence of reliance upon negligent information or advice where it was not unreasonable for the third party to rely on the information or advice;
- Statute – including but not limited to:
  - a) Securities Act 1978 and Amendments;
  - b) Securities Act (Real Property Proportionate Ownership Schemes) Exemption Notice 1996 – in particular the Second Schedule which outlines mandatory matters to be specified in Independent Registered Valuer's reports;
  - c) Securities Act (Contributory Mortgage) Regulations 1988 – in particular Schedule 3 (*Information and Other Matters to be Contained in Valuation Reports*). The inclusion of these specified details is mandatory; and
  - d) Fair Trading Acts, consumer protection legislation, trustee legislation, valuers registration legislation.

### 4.3 Relevant Guidance

In Australia, relevant guidance may include but not be limited to:

- ASIC
- Practice Note 42 – Independence of Expert's Reports;
- Practice Note 43 – Valuation Reports and Profit Forecasts;
- Practice Note 55 – Disclosure Documents and PDS: consent to quote;
- Policy Statement 56 – Prospectuses;
- Policy Statement 74 – Acquisitions Agreed to by Shareholders;
- Policy Statement 75 – Independent Expert Reports to Shareholders;
- Policy Statement 77 – Property Trusts and Property Syndicates;
- Policy Statement 146 – Licensing: Training of Financial Product Advisers;

## ANZ VALUATION GUIDANCE NOTE 8

- Policy Statement 170 – Prospective Financial Information;
- Policy Statement 175 – Licensing: Financial Product Advisers – Conduct and Disclosure; and
- Policy Statement 181 – Licensing: Managing Conflicts of Interest.

In New Zealand, relevant guidance may include but not be limited to:

- Securities Commission
- Inquiry into the 1 Parliament Street Car Park Limited Contributory Mortgage – 3rd May 2002
- Offers of Unlisted Interests in Commercial Properties – A Review – 30th March 2000

### 4.4 Texts

In Australia, relevant texts may include but not be limited to *The Legal Liability of Valuers* by Lindsay Joyce and Keith Norris (Southwood Press, Second Edition), particularly pages 48 to 53 and Chapter 2.

# ANZVGN 9

## ASSESSING RENTAL VALUE

### 1.0 Introduction

#### 1.1 Purpose

The purpose of this Guidance Note is to provide information, commentary and advice to Members assessing rental value.

#### 1.2 Status of Guidance Note

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.

#### 1.3 Scope of this Guidance Note

This Guidance Note applies to Members assessing the market rent of premises held under an actual or hypothetical lease and preparing a report thereon. Rental Value is a generic term including the term "rent".

#### 1.4 International Valuation Standards

This Guidance Note is intended to be consistent with the publication "International Valuation Standards 2007" as issued by the International Valuation Standards Committee. However, there may be departures from "International Valuation Standards 2007" to reflect Australian and New Zealand law and practice.

This Guidance Note should be read in association with the Practice Standards, Guidance Notes and related documents in Professional Practice, in particular IVGN 2 'Valuation of Lease Interests'

### 2.0 Instructions

#### 2.1 Prior Written Instructions

In accordance with the relevant Rules of Conduct (API or PINZ), a Member should confirm

acceptance of instructions in writing prior to the valuation being undertaken.

#### 2.2 Content of Instructions

Members should have regard to relevant provisions within Professional Practice concerning the content of instructions.

#### 2.3 Supporting Documentation

In assessing rental value, the following documentation should be considered:

- original lease documentation (including collateral agreements and executed documents) to be sighted where possible, otherwise the copy relied on should be executed;
- confirmation of current rent and other matters as may be appropriate;
- documents relating to financial implications such as outgoings;
- details of the floor areas, preferably surveyed in accordance with an industry accepted method such as ANZRPGN4 Methods of Measurement, PCNZ/PINZ Guide for the Measurement of Rentable Areas or the Property Council of Australia's 'Method of Measurement for Lettable Area';
- if applicable, a statement from the lessor and lessee as to the extent that information obtained from the parties may be detailed in the report;
- details of the fit-out or other incentives provided by the lessor, if applicable; and
- details of the lessor's and/or lessee's improvements.

#### 2.4 Relevant Skills and Expertise

In accordance with the relevant Rules of Conduct (API or PINZ), a Member should not accept an instruction beyond their competence.

If a Member does not have the relevant skills and expertise to assess rental value, the Member should decline the instruction or retain an appropriate specialist to provide advice.

### 2.5 Full Disclosure

Full disclosure of all relevant information by the parties is critical to the assessment of rental value. Where a Member suspects that information provided by a party, or the parties to a dispute is false, incomplete or misleading, the Member should advise the parties and, if not resolved, the Member may decide to decline the instructions.

### 2.6 Further Advice

It may be necessary for a Member to address legal or other issues where these are in dispute. The Member should obtain legal or other appropriate interpretation to ensure the correct course of action is taken. Where a Member is uncertain on the issues, the Member may:

- advise the parties to the dispute of the necessity to obtain such advice;
- provide to the parties a quote relating to obtaining such advice;
- obtain confirmation in writing from the appropriate party/parties accepting liability for the cost of that advice; and
- obtain confirmation from the parties that any time limitation that is imposed on the Member for completing the determination is appropriately extended.

## 3.0 Definitions

### 3.1 Primacy of Lease Definitions

In assessing or independently determining the rental value of premises held under the terms of an actual lease, the definition of terms contained within that lease have primacy, unless contrary to any legislation.

### 3.2 Common Terms

The following terms are in common use and are defined in the joint API, PCA & REIA publication, Glossary of Property Terms (2007):

- rent (including gross, net, face, effective, passing/contract and market);
- rent review;
- lease;
- leasing incentives;
- tenant;
- landlord;

- lessor;
- lessee;
- profit rent;
- rental shortfall; and
- permitted use.

The definitions adopted in the Glossary of Property Terms (2007) are provided in Appendix 1.

## 4.0 Assessing Rental Value

### 4.1 Impartiality

In assessing rental value the Member should maintain an independent, unbiased and balanced state of mind.

### 4.2 Purpose of Assessing Rental Value

Assessing rental value may comprise:

- assessing the rental value of premises held under the terms of an actual lease; or
- assessing the rental value of vacant or owner occupied premises, assumed to be held under the terms of a hypothetical lease; or
- independently determining the rental value of premises held under the terms of an actual lease.

### 4.3 Market Rent Reviews

Market rent reviews in a lease enable the rental to be varied to reflect changes in the market between the date on which the lease commenced or the rent was last reviewed and the relevant review date subject to the terms and conditions of that lease.

The fundamental starting point to any assessment of market rent, at rent review, is therefore the lease. A full understanding of the lease is required before the market rent can be assessed.

The agreed rental on review will reflect not only the market influences but also the terms and conditions in the actual lease document.

### 4.4 Issues for Consideration

When assessing rental value, a Member should have regard to:

- relevant legislation operating in Australia and New Zealand, including any retail and commercial tenancy legislation;

- directions to the valuer pursuant to the Lease; and
- Court decisions.

#### **4.5 Lease Directions**

When assessing the rental value of premises held under the terms of an actual lease or the independent determination thereof, members should follow the directions, if any, provided under the lease.

A Member should comply with any specific provisions contained in a lease unless:

- the parties have further agreed to vary that provision and have advised the member in writing of any agreed variations; or
- the provision is contrary to law.

#### **4.6 Unspecified or Assumed Lease Terms**

When undertaking an assessment of rental value under the terms of a lease and also when notional lease terms are to be assumed, the Member should address (where appropriate) the following elements:

- the name of the lessor (where applicable);
- the name of the lessee (where applicable);
- description of the premises;
- permitted use under the lease;
- date of commencement;
- term of lease;
- date of assessment;
- option(s) for renewal;
- commencing rental;
- current passing rent (if applicable);
- method and frequency of rent reviews;
- period to which the rental being assessed is applicable which may be:
  - a period equivalent to the term of the lease; or
  - a period equivalent to the unexpired term of the lease; or
  - a period equivalent to the interval between rent review; or

- another period;
- lessor's and lessee's liability for outgoings;
- assignment clause;
- sub-leasing rights;
- fitout and fitout costs;
- treatment of incentives; and
- make-good provisions.

#### **4.7 Sources of Comparable Evidence**

In assessing market rent the Member should consider the most appropriate evidence in the market place.

The best evidence is generally rentals which have been agreed in comparable tenancies, at the relevant date with vacant possession (i.e. new lettings between arms-length parties), and in particular, where the use is the same or a substantially similar use as the permitted use under the lease.

In the absence of new lettings evidence, the member may have to consider the following:

- rentals agreed between arms-length parties at lease renewal or at the exercise of an option to renew an existing lease;
- rentals agreed at market rent reviews; and
- the outcome of mediations or determinations.

#### **4.8 Application of Comparable Evidence**

The terms and conditions of a subject lease may vary from the terms and conditions for leases of comparable premises. These variations should be taken into account in the assessment of the market rent under the subject lease.

When a Member is required to assess a rental under an existing lease which relates to market rent or similar terminology, a distinction may need to be made between an assessment of market rent under the usual terms and conditions of similar leases/tenancies and the terms and conditions of the actual lease, with adjustments for differences.

### **5.0 Independent Determination**

#### **5.1 Purpose**

In the event of a dispute between a lessor and the lessee, a Member may be instructed or appointed to undertake



## ANZ VALUATION GUIDANCE NOTE 9

an independent determination of the rental value of the premises held under the terms of an actual lease.

### 5.2 Basis of Appointment

Depending on the requirements of the lease, a Member may be appointed to undertake an independent determination by acting as an Expert or as an Arbitrator.

The terms Expert and Arbitrator are defined in the Glossary of Property Terms (2007) and are provided in Appendix 1.

### 5.3 Conflict of Interest

When acting as an expert and the potential for a conflict of interest arises, Members are referred to ANZRPNG 2 'Acting as an Expert Witness, Advocate or Arbitrator' and the Institute's Rule of Conduct 1.3.

## 6.0 GST

Members should explicitly state the treatment of GST in their report.

## 7.0 References

Relevant texts may include, but are not limited to:

Hyam, A The Law Affecting Rent Review Determinations, The Federation Press, November 2005

Duncan, WD Commercial Leases in Australia, The Lawbook Company, 2005.

## 8.0 Appendix

Terms as defined in the Glossary of Property Terms (2007):

### Arbitrator

An independent person who is contracted by the parties to conduct an arbitration. It is usually a person with experience and/or qualification in a particular field and may be nominated by the parties.

### Advocate

A person who represents the cause or interest of another, even if that cause or interest does not necessarily coincide with one's own beliefs, opinions, conclusions, or recommendations.

### Expert

A person who is recognised as having special knowledge or skills.

### Rent

A payment made periodically by a lessee to a lessor for the use of premises.

The term "Rent" is often associated with a variety of other terms outlined below:

**Base:** The minimum acceptable rental provided in a lease. In retail leases the base rent generally refers to the commencing rent which is supplemented with a 'percentage rent' based on the tenants turnover.

**Break-Even:** The point at which a tenant's base rent is equal to an agreed level of sales above which percentage rent takes effect.

**Concessionary:** A discounted rent, usually during the initial lease term.

**Effective:** The actual liability for rent and outgoings after adjustments for any incentives to the face rent are taken into account.

**Equivalent:** Equivalent refers to the rent being adjusted for the effects of any market rent reviews that will occur in the period of consideration.

**Face:** The rent shown on a lease document which may or may not include incentives and may or may not include outgoings.

**Gross:** In a gross lease, all operating costs of the property (excluding direct tenancy expenses) are included in the rental.

**Market:** The estimated amount for which a property, or space within a property, should lease on the date of valuation between a willing lessor

and a willing lessee on appropriate terms in an arm’s-length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. Whenever Market Rent is provided, the “appropriate lease terms” which it reflects should also be stated.

**Net:** In a net lease the owner recovers outgoings from the tenant on a pro-rata basis (where applicable).

**Passing (or contract):** The rent specified by a given lease agreement; although a given contract rent may equate to the Market Rent, in practice they may differ substantially, particularly for older leases with fixed rental terms. The term, contract rent is North American usage; passing rent is Commonwealth usage. (IVSC)

**Peppercorn:** A term used where it is desired to reserve only a nominal rent for any period. A minimal rent which is below market value.

**Turnover / Percentage / Participation Rent:** Any form of lease rental arrangement in which the lessor receives a form of rental that is based upon the sales of the lessee. Percentage rent is an example of a turnover rent. (IVSC).

**Rent Review**

A periodic review of rental under a lease using a predetermined method.

For example, increase in line with Consumer Price Index (CPI), or in accordance with a market valuation.

**Lease**

(a) A contract arrangement in which rights of use and possession are conveyed from a property’s title owner (called the landlord, or lessor) in return for a promise by another (called a tenant or lessee) to pay rents as prescribed by the lease. In practice the rights and the duties of the parties can be complex, and are dependent upon the specified terms of their contract;

(b) An agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

**Leasing Incentives**

Inducements offered by landlords to attract tenants to lease space. Typically occurs when supply exceeds demand, but in order to maintain value by not lowering face rent or contract rent, tenants are given incentives such as rent free periods, cars and other gifts. Often such inducements are secret. The discount or contribution offered to a lessee at the commencement of a lease which

may be applied at the start, during, or at the end of the lease term and is outside the lease terms.

**Outgoings**

The expenses incurred in generating income. In real estate, these expenses include but are not necessarily limited to property rates, repairs, insurance, repairs and maintenance and management fees. Operating expenses when subtracted from gross income equal net operating income.

**Profit Rent**

The difference between the market rent and the current rent or ground rent resulting in a leasehold interest.

**Rental Shortfall**

The amount by which rent is less than the market rental.

**Tenant**

A person or entity paying rent in exchange for the occupancy of a building or dwelling. See also Lessee.

**Landlord**

The owner of leased property. The lessor.

**Lessor**

The owner of a property who transfers the right to occupy and use property to another by way of a lease agreement.

**Lessee**

A person / legal entity who receives the right to occupy and use a property under the terms of a lease.

**Permitted Use**

The allowable use within the premises specified in the lease contract (not to be confused with ‘permissible use’).

**Vacant Possession**

In real estate this refers to a right to possession of land or built-up property in respect of which there is no current occupant.

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# ANZVGN 10 VALUATION OF AGRICULTURAL PROPERTIES

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to provide advice to Members undertaking valuations of any agricultural property for any purpose.

### 1.2 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.

### 1.3 Scope of this Guidance Note

This guidance note applies to Members providing valuations in respect of any agricultural property for any purpose. It should be used, as far as applicable, in conjunction with other guidance notes and practice standards that are either overarching or directly applicable to the type of real property, purpose or issues involved.

This guidance note is not intended to outline methods of valuation of any particular type of property but may comment on matters that should be addressed in reports in respect of certain properties types or uses. Methods of valuation are covered in other guidance notes and authoritative texts.

### 1.4 International Valuation Standards

This Guidance Note is intended to be consistent with Standards and Guidance Notes published by the International Valuation Standards Committee, except where otherwise stated.

Members are specifically directed to read IVS Guidance Note 10 – Valuation of Agricultural Properties and ANZVGN 1 – Valuation Procedures – Real Property.

In addition to the above, this guidance note specifies any departures from IVS Standards or other particular circumstances which reflect Australian and New Zealand law and practice.

## 2.0 Valuation Considerations

In addition to the requirements of other relevant standards, members completing valuations of agricultural properties should consider the following factors, as applicable:

### 2.1 Land Tenure and Native Title Rights

Unlike most urban land, other forms of land tenure are common in relation to agricultural land. Valuations should have regard to the nature of tenure and interest held which can usually be established by title or lease search or other enquiries with the land holder.

Valuations of agricultural land which is not held by freehold title should be appropriately qualified eg Valuation of Leasehold Interest, Valuation of Crown Leasehold etc.

It should also be noted that some Crown tenures convey only a right of occupation to the land and infer no ownership or transferable right. An example of this is a license, which may be terminated at will by the relevant minister and is not transferable, and therefore may have no market value (albeit could have a value to the sitting licensee).

Agricultural land in many parts of Australia and New Zealand may be subject to Native Title or Treaty of Waitangi (NZ). Members should consider the possible impact of any known or potential claims for Native Title or the Treaty of Waitangi (NZ) and provide a statement within the valuation report as to how such issues have been treated.

### 2.2 Additional Rights

In addition to typical land rights, other rights can be conveyed to agricultural land which may have a material impact on the value of that land. Examples include water or irrigation rights, excavation or mineral rights etc.

Normally the value of any mineral rights are ignored in valuations, or are at least implicit within sales evidence, unless the existence of minerals is known or probable.

Additional rights may be separately transferable to the sale of land and accordingly valuations should make qualifying statements as to what rights are excluded or included with the valuation of the land.

### 2.3 Planning or Legal Constraints

Particular planning (resource management in NZ) or legal constraints may impact on the valuation of agricultural land. These may include (but not be limited to):

- prohibitions on subdivision
- prohibitions on construction of dwellings
- coastal and landscape protection policies
- forest or conservation reserves
- emissions
- water use
- effluent disposal and leeching
- possible need for planning approval of change in agricultural useage in some jurisdictions.

### 2.4 Land Use

The existing use of land may not necessarily represent the highest and best use of the land and the land could have a higher value for alternative agricultural uses. Examples may include:

- grazing land which has a higher value for forestry;
- dry grazing land which has access to water rights for irrigation purposes for cropping land;
- conversion of grazing land to intensive agriculture eg orchards

The highest and best use of land may change over time. In such cases members should consider changes in market cycles or trends and the potential costs incurred in changing the use of the land.

### 2.5 Accessibility and Locational Attributes

Accessibility to services including community facilities (eg schools, shops, medical services etc) and transport infrastructure (eg major roadways, ports, railway etc) could have an impact on the

value of agricultural land from the perspective of its appeal as a place to live, and farming operations and profitability. The locational attributes of agricultural land should therefore be considered by members and specific comments provided in valuation reports.

### 2.6 Climate

Australia and New Zealand are subject to varying climatic conditions, in particular rainfall, which can have a significant impact on the productivity and hence value of agricultural land.

In relation to extreme weather conditions the regularity of such conditions and the long term impact of such occurrences could be factors which prospective purchasers consider in assessing the value of agricultural land.

### 2.7 Topography

Australia and New Zealand have varying topographies ranging from exposed coastal lands, river flats, plains, arid dry lands, to mountainous highlands. These topographic features can have a significant impact on the productivity and hence value of agricultural land. Factors which have such an impact include (but are not be limited to):

- latitude
- altitude
- aspect
- access to natural or man-made water resources
- susceptibility to flooding
- landslip
- coastal or inland

Flooding can have an impact on productivity from the perspective of the potential for topsoil removal or erosion; or lost production, equipment or livestock. The impact of flooding may vary depending on the nature of the agricultural use of the land. For example a flood could cause significant damage to cropping land however the impact on grazing land may be less severe.

### 2.8 Soils, Salinity & Erosion

Australia and New Zealand have varying soil profiles ranging from rich alluvial soils, basalt soils, to more sandy soils. Soils can have a significant impact on the productivity and hence value of agricultural land. Accordingly members should consider the soil profile in assessing the value of agricultural land.

Soil salinity or the proneness to rising water tables and ground salts, as a consequence of land clearing or prolonged heavy irrigation, and soil erosion (including underground tunnel erosion) can have a dramatic detrimental impact on productivity and hence value of agricultural land. Accordingly members should consider the susceptibility of soil salinity or soil erosion in assessing the value of agricultural land, and make specific comment on any farming management practices which the farmer may have taken to minimise the risks of such issues.

**2.9 Classification**

The classification of the land is a primary consideration in the valuation of agricultural land.

Common land classes based on use include horticultural land, arable land, intensive grazing land, extensive grazing land, open run grazing, native bushland, conservation areas etc. Factors such as zoning, availability of water and easements are taken into account when determining the potential highest and best use of the land.

The classification land is obtained from various sources including title plans, past cropping areas, irrigated land by reference to available water resource agreements, topographical maps, aerial photos and geographical information systems.

Members should apply the land classification consistently to both the analysis of sales evidence and the valuation.

**2.10 Site Contamination**

Some agricultural uses may cause site contamination which could require either implementation of appropriate management practices or remediation. Examples of site contamination on agricultural properties include:

- sheep or cattle dips
- sources of effluent disposal (especially intensive livestock operations)
- chemicals used in fertilisers or sprays
- fuel storage tanks
- waste dump sites
- crop or livestock diseases

Members should consider the impact of any possible or known causes of site contamination on the value of the property, and report any assumptions and qualifications where required.

**2.11 Weeds and Pests**

Pests and weeds may impact on the productivity and hence value of agricultural land. In particular rabbits, foxes, blackberries, gorse bush or other introduced flora or fauna have had a devastating impact. Native fauna (for example possums, locust, or game) can also cause significant damage to pasture or crops, particularly when at plague proportions.

Farming management practices which have been implemented or which are required on an ongoing basis to control weeds or pests should be considered and detailed within valuation reports.

**2.12 Pasture or Crop Management**

Farming practices in terms of pasture or crop management can have an impact on the productivity of agricultural land. Issues such as pasture improvement, crop rotation or fertilising programs (and the sustainability of such practices) may need to be considered in the valuation of agricultural land.

**2.13 Water Resources**

Water and drainage (domestic/livestock/irrigation/effluent disposal) is becoming increasingly critical to agricultural or pastoral property. Water is a valued and scarce resource that is shared between potentially competing users eg rural industry, communities, and the environment.

The water resource which is held by a farming enterprise may be personal property. This should be considered in the valuation. It can comprise a significant element of value of an agricultural property. In some areas, if the water component is removed, the property may not be of a viable size for dry land production.

Licenses and/or consents are normally required to pump and/or store water from a river, stream or ground aquifer whilst alternative systems provide for the purchase of water (usually measured on a volumetric basis e.g. mega litres per annum) from either public or privately owned water reserves.

Water is an over allocated resource in many catchments and may be subject to reduced allocations during dry periods which can impact on productivity.

Members should have consideration of any legislation/regulation affecting water.

### 2.14 Improvements

The added value of improvements is an important consideration in the valuation of agricultural land. Generally the value of the main homestead is a critical consideration however the value of other improvements can also be significant. The value of farm improvements is limited by the degree of economic and functional obsolescence.

Members should carefully consider the treatment of integral farming improvements in the comparison of sales evidence and treatment in valuation calculations.

### 2.15 Past Carrying Capacity or Production History

The past carrying capacity or production history of agricultural land may be an important consideration in the valuation of agricultural land.

Whilst carrying capacity or production can vary significantly due to seasonal variations or farming management, such data may assist members in undertaking a valuation. Examples include:

- comparison of long term averages to recent productivity may indicate a decline or improvement in soil quality or farm management practices
- long term averages may be useful as a form of direct comparison with sales evidence on a productivity basis (eg rates per dry sheep equivalent)
- the life cycle of trees and yields from orchards or other intensive agricultural operations
- the sustainability of the current use of the property and potential to be used for alternative uses

### 2.16 Trading Performance

Generally most agricultural property is valued based on comparison with sales evidence however in some cases the past and/or current trading performance may be relevant in determining the market value of specialised agricultural enterprises. Examples include poultry and aquaculture farming operations.

Where the net profit is used to determine the market value, the valuation will represent the value of the enterprise as a going concern. In such cases members should acknowledge and report that the valuation includes the value of land, improvements, and the business including

fixed and non-fixed plant and equipment, business licenses and goodwill (as applicable).

Members are cautioned that some inclusions may be wasting assets and in such cases valuations for mortgage security purposes should advise the intending mortgagee to treat such assets differently from a mortgage lending perspective.

In order to adequately consider risk, valuations for mortgage security purposes which have been assessed on a going concern basis should also report the value of land and improvements on an alternative use basis if significantly different.

### 2.17 Inclusions

Other assets may be valued with agricultural properties. Examples include:

- Biological assets (including crops, timber, stock)
- Integral plant and equipment eg irrigation pipes, sprayers or pivot irrigators, dairy plant etc
- Non integral plant and equipment eg tractors or other farm equipment, portable fencing or stockyards etc
- Resource Consents (NZ). Resource consents are a right (asset) that is generally provided for a fixed term and often go through a renewal regime with the issuing authority having the ability to amend as it sees fit at renewal or during the consent process. These are not necessarily a wasting asset, but a right to the land that can have significant impact on value if discontinued or altered.

Typically such items are excluded from valuations unless a property is valued on a "walk in walk out" basis, in which case appropriate adjustments for the respective inclusions with comparable sales evidence may be required.

In order to prevent confusion as to the extent of inclusions, when providing valuations on a "walk in walk out" basis members should separately itemise valuations into the following categories:

- Land
- Improvements (including integral plant and equipment and other rights)
- Biological assets (including crops, timber, stock)
- Non-integral plant and equipment

Members may need to obtain separate expert advice in relation to the value of biological assets and non-integral plant and equipment.



## 2.18 Consideration of Sales Evidence

The existence of specific factors which may impact on the value of agricultural land as discussed within this guidance note, may or may not be reflected by the prices paid for comparable properties.

Sales of properties in proximity to a subject property may have a significantly different value due to particular characteristics. Examples include:

- different climatic conditions (eg susceptibility to frosts)
- different topographical features (eg northerly aspects in higher latitudes, rainfall shadows etc)
- different water or irrigation rights,
- different plant and equipment or stock,
- soil classification

Typically analysis of sales evidence for agricultural properties includes an analysis of land values per hectare, the added value of improvements, values on a rate per carrying capacity or production basis.

In the absence of sales of directly comparable properties, differences that exist between the sales evidence and the subject property may warrant appropriate adjustments to be made.

## 3.0 Terminology

Different terminology is adopted from country to country. This is particularly evident in the agricultural or rural sector. Members utilising the relevant standards and guidance notes should attempt to adopt relevant and accepted terminology appropriate in the specific location in which they are involved.

Common terms used within the valuation industry for agricultural land include:

- broad acre - a term used to describe large land holdings generally used for grazing purposes
- dry sheep equivalents (dse) - a measure of carrying capacity with reference to the potential number of wethers (dry sheep) that can be sustainably carried on the land;
- stock units - a measure of carrying capacity with reference to the potential number of stock that can be sustainably carried on the land;

## 4.0 Goods and Services Tax (GSTt)

**Members should explicitly state the treatment of GST in their report.**

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# AVGN 1 VALUATIONS FOR USE IN AUSTRALIAN FINANCIAL REPORTS

*This Guidance Note should be read in conjunction with International Valuation Application 1 (IVA 1) & International Valuation Guidance Note 8 (IVGN 8)*

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to provide information, commentary, opinion, advice and recommendations to Members producing valuations of property, plant & equipment assets (including heritage and infrastructure assets) for use in Australian financial reports and to assist users of those financial reports to understand the basis upon which property, plant and equipment valuations are undertaken.

### 1.2 Objectives

The objectives of this Guidance Note are to:

- Provide guidance to Members when preparing property, plant and equipment asset valuations for use in financial reports; and
- Assist users of financial reports to understand the basis upon which property, plant and equipment asset valuations are undertaken.
- Address general concepts and principles for use in the preparation of valuations for use in financial reports.

### 1.3 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.

### 1.4 Scope

This Guidance Note applies to Members valuing property, plant and equipment assets for use in Australian financial reports.

This Guidance Note does not apply where a valuation is undertaken for purposes other than for use in Australian financial reports.

### 1.5 Development of Accounting Standards

The development of accounting standards involves an extensive process, including the preparation and publication of discussion papers and exposure drafts, and extensive industry consultation, by the Australian Accounting Standards Board (AASB).

### 1.6 Relationship to Accounting Standards

Australian Standards issued by the AASB have the force of the Corporations Law.

### 1.7 Financial Statements

Financial statements report the assets, liabilities, equity, revenues, expenses (the "elements" of financial statements) and cash flows of the entity.

### 1.8 Materiality

Accounting Standards are subject to the concept of materiality which is defined to mean "in relation to information, that information which if omitted, misstated or not disclosed has the potential to adversely affect decisions about the allocation of scarce resources made by users of the financial report or the discharge of accountability by the management or governing body of the entity".

Members should reflect this concept when completing valuations for financial reporting purposes.

## 2.0 Accounting Framework

### 2.1 Introduction

The 2005 AASB accounting standards apply to annual reporting periods beginning on or after 1 January 2005. This Guidance Note has been developed to reflect with the adoption of the Australian equivalents to International Financial Reporting Standards.

## AUSTRALIAN VALUATION GUIDANCE NOTE 1

In the Australian context it is important to consider the relationship between Australian Standards and International Standards.

The International Accounting Standards Board (IASB) was charged with preparing a set of International Financial Reporting Standards in 2000. The intention was to develop a single set of Accounting Standards that would be accepted by capital markets worldwide.

The International Valuation Standards Committee (IVSC), has formulated and published, in the public interest, valuation standards and promotes those standards for worldwide acceptance and observance. IVSC valuation standards have been developed for the procedural guidance of the valuation of assets for a variety of purposes including for use in financial statements and to harmonise standards amongst the world states and bring uniformity.

The IVSC works closely with the IASB and other international bodies such as the International Federation of Accountants, International Organisation of Security Commissions and BASEL Committee on Banking supervision. The IVSC also provides advice and counsel relating to asset valuation to the accounting profession.

The IVSC has developed International Valuation Standards 7th Edition, 2005, the relevant sections of which comply with the International Financial Reporting Standards as at 1 January 2005. In its press release regarding the publication of its new standards dated 9 February 2005, the IVSC stated:

*"In 2004 the International Accounting Standards Board (IASB) made a number of significant changes to the Accounting Standards concerned with Real Estate and other fixed assets as part of its own improvements project. The IVSC revised its standards for the 2005 edition to reflect these changes.*

*The two standards most affected by the revised International Financial Reporting Standards are International Valuation Application 1 – Valuation for Financial Reporting; and International Valuation Guidance Note 8 – The Cost Approach for Financial Reporting – DRC.*

In Australia the Corporate Law Economic Reform Program Act of 1999 established the basis for new standard setting arrangements as a part of the Commonwealth Government's Corporate Law Economic Reform Program.

The Financial Reporting Council is responsible for the broad oversight of the process for setting accounting standards for use in for-profit and not-for-profit public and private sectors. The key function of the Financial Reporting Council is to advise the Commonwealth Government on the accounting standards setting process and development of International Financial Reporting Standards and to determine the broad strategic direction of the AASB.

The Financial Reporting Council is not able to influence the AASB's technical deliberations and hence the content of any particular accounting standards.

The International Financial Reporting Standards are adopted in Australia through the Australian equivalents to IFRSs made by the AASB.

The AASB accounting standards that affect the valuation of property, plant, and equipment are summarised as follows: -

- AASB 116 – Property Plant and Equipment;
- AASB 117 – Leases;
- AASB 136 – Impairment of Assets;
- AASB 140 – Investment Property;
- AASB 141 – Agriculture;
- AASB 3 – Business Combinations ; and
- AASB 5 – Non Current Assets Held For Sale and Discontinued Operation.

The table below shows the relationship between the previous and new standards:-

Previous Standards	Current Standards
AASB 1015 – Acquisition of Assets	AASB 3 – Business Combinations  AASB 116 – Property Plant and Equipment
AASB 1021 – Depreciation	AASB 116 – Property Plant and Equipment
AASB 1041 – Revaluation of Non Current Assets	AASB 116 – Property Plant and Equipment
AASB 1008 – Leases	AASB 117 – Leases
AASB 1010 – Recoverable Amount of Non Current Assets	AASB 136 – Impairment of Assets
No Previous Standard	AASB 140 – Investment Property
AASB 1037 – Self-Generating & Regenerating Assets	AASB 141 - Agriculture
AASB 1042 – Discontinuing Operations	AASB 5 – Non Current Assets Held For Sale and Discontinued Operations.

## 2.2 International Valuation Standards

The International Valuation Standards Committee (IVSC) publication *International Valuation Standards 2005*, discusses the term Fair Value at paragraph 8.1 (Pgg 31-33) of General Valuation Concepts and Principles by stating:

*“The expression market value and the term fair value as it commonly appears in accounting standards are generally compatible, if not in every instance exactly equivalent concepts. Fair value, an accounting concept, is defined in international financial reporting standards and other accounting standards as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms length transaction. Fair value is generally used for reporting both market and non-market values in financial statements. Where the market value of an asset can be established this value will equate to fair value.”*

### 2.3 AASB 116 – Property, Plant and Equipment

This standard prescribes requirements for the recognition, measurement at recognition and

measurement after recognition, and de-recognition of property, plant and equipment assets. After recognition as an asset, an item of property, plant & equipment is measured using the cost model or the revaluation model (at fair value).

The objective of AASB 116 is to prescribe the accounting treatment of property, plant and equipment so that the users of any Financial Report may discern information about the entity's investments in its property, plant and equipment and any changes in such investments.

The standard also prescribes requirements for depreciation of property, plant and equipment assets.

AASB 116 is equivalent to IAS 16 Property, Plant and Equipment issued by the IASB.

Current Australian standards require heritage assets to be recognised as they satisfy the definition of property, plant and equipment.

Therefore AASB 116 applies to heritage assets.

### 2.4 Relationship with Other Standards

AASB 116 is related to other standards which consider the Fair Value concept in certain specific areas. Depending on the classification of an asset it may be necessary to consider asset valuation requirements of the following:-

- **AASB 117 – Leases;**

It is noted that AASB 117 may apply to the disposal of an asset by way of sale and leaseback. This is important in considering the valuation of an asset by way of sale and leaseback where necessary (Refer definitions under Addendum “A” of IVA 1).

- **AASB 136 – Impairment of Assets;**

The main requirement of this standard is to ensure that assets are carried at amounts that are not in excess of their Recoverable Amount. The requirement to test for impairment is the responsibility of the directors of the reporting entity.

The Recoverable Amount of an asset or cash-generating unit is defined as the higher of its Fair Value less costs to sell and its Value In Use.

Value in Use is defined as the present value of future cash flows expected to be derived from the asset or cash-generating unit or, the depreciated replacement cost of the asset (when the future economic benefits of the asset of a not for profit entity are not primarily dependent on the assets

## AUSTRALIAN VALUATION GUIDANCE NOTE 1

ability to generate net cash inflows and where the entity would, if deprived of the asset, replace its remaining future economic benefit).

The standard also requires that where the Recoverable Amount of an asset is less than the assets Carrying Amount the Carrying Amount of the asset is reduced to its Recoverable Amount and the reduction is an Impairment Loss.

The standard also requires the immediate recognition of Impairment Loss as an expense in the Profit and Loss for assets carried at cost or in accordance with the revaluation accounting for assets carried out at the revalued amount.

### • AASB 140 – Investment Property;

This standard requires an entity to measure an investment property after recognition at Fair Value or using the Cost Model specified in AASB 116. The standard applies to reporting periods beginning on or after 1 January 2005.

Investment property is defined as “Land or a Building or a Part of a Building or Both” held by the owner (or by the Lessee under a Finance Lease) to earn rentals or for capital appreciation or both rather than for: -

- (a.) Use in the production or supply of Goods and Services or administrative purposes; or
- (b.) Sale in the ordinary course of business.

Owner occupied property is property held (by the owner or by the Lessee under a Finance Lease) for use in the production of supply of goods or services for administrative purposes.

### • AASB 3 – Business Combinations

This standard requires business combinations to be accounted for by applying the purchase method. It requires an acquirer to recognise separately, at the acquisition date, the acquiree’s identifiable assets that meet certain recognition criteria, regardless of whether they had been previously recognised by the acquiree.

The standard requires the identifiable assets that satisfy the stipulated recognition criteria to be measured initially by the acquirer at their fair values at the acquisition date, irrespective of the extent of any minority interest.

### • AASB 5 – Non Current Assets Held For Sale and Discontinued Operation.

This standard requires that assets that are classified as Held For Sale be measured at the lower of the Carrying Amount and Fair Value less costs to sell.

It also requires that assets that meet the criteria as being classified as Held For Sale be separately presented on the face of the balance sheet.

## 2.5 Fair Value

Fair Value is defined in AASB 116 as follows:-

“ . . . . . the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction.”

Fair value is considered further in non-mandatory “Australian Guidance” as an accompaniment to AASB 116 set out below.

### Fair Value

- G1 The fair value of an asset is the best estimate of the price reasonably obtainable in the market at the reporting date in keeping with the fair value definition. It is the most advantageous price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer. The estimate specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, or concessions granted by anyone associated with the sale.
- G2 Underlying the paragraph 6 definition of fair value is a presumption that the entity is a going concern without any intention or need to liquidate, to curtail materially the scale of its operations or to undertake a transaction on adverse terms. Similarly, to determine the fair value of an asset, it is assumed that the asset is exchanged after an adequate period of marketing to obtain its most advantageous price. The fair value of an asset is determined by reference to its highest and best use, that is, the use of the asset that is physically possible, legally permissible, financially feasible, and which results in the highest value. Opportunities that are not available to the entity are not taken into account. Where it is the market’s assessment that it is rational to continue to use the asset, the revalued amount shall include estimated entry costs. Where the asset is held for sale AASB 5 Non-current Assets Held for Sale and Discontinued Operations applies.
- G3 Where a quoted market price in an active and liquid market is available for an asset, that price represents the best evidence of the asset’s fair value. When a quoted market

price for the asset in an active and liquid market is not available, the fair value is estimated by reference to the best available market evidence of the price for which the asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. This evidence includes current market prices for assets that are similar in use, type and condition ('similar assets') and the price of the most recent transaction for the same or a similar asset (provided there has not been a significant change in economic circumstances between the transaction date and the reporting date). Current market prices for the same or similar assets can usually be observed for land, non-specialised buildings, used motor vehicles, and some forms of plant and equipment. For land and buildings, these prices can also be derived from observable market evidence (e.g. observable current market rentals) using discounted cash flow analysis.

- G4 In some circumstances the fair value of the asset is not able to be determined from market-based evidence as the market buying price and market selling price of an asset differ materially because the asset usually is bought separately in the new asset market, but if sold separately, could only be sold for its residual value. In other circumstances the fair value of the asset is not able to be determined from market-based evidence as there is no market evidence of the asset's market selling price. These circumstances will usually arise where the transaction price evidence arises in a monopoly context or the asset is specialised and rarely sold, except as part of a continuing business.
- G5 Where the fair value of an item of property, plant and equipment cannot be reliably determined using market-based evidence as outlined in paragraph 33 of AASB 116, the asset's fair value is measured at its market buying price and the best indicator of an asset's market buying price is depreciated replacement cost or an income approach. Depreciated replacement cost is the current replacement cost of an asset less, where applicable, accumulated depreciation calculated on the basis of such cost to reflect the already consumed or expired future economic benefits of the asset.

## 2.6 Depreciated Replacement Cost

### IVSC Definitions

**Depreciated Replacement Cost.** The current cost of reproduction or replacement of an asset less deductions for physical deterioration and all relevant forms of obsolescence and optimisation.

**Specialised Property.** Property that is rarely, if ever, sold in the market, except by way of a sale of the business or entity of which it is part, due to uniqueness arising from its specialised nature and design, its configuration, size, location, or otherwise.

**Improvements.** Buildings, structures, or modifications to land, or a permanent nature, involving expenditures of labour and capital, and intended to enhance the value or utility of the property. Improvements have differing patterns of use and economic lives.

**Adequate Profitability.** When an asset has been valued by reference to depreciated replacement cost, adequate profitability is the test that the entity should apply to ensure that it is able to support the depreciated replacement cost conclusion.

**Service Potential.** The capacity to provide goods and services in accordance with the entity's objectives, whether those objectives are the generation of a net cash inflows or the provision of goods and services of a particular volume and quantity to the beneficiaries thereof. In the public sector, the concept of *service potential* takes the place of the test of *adequate profitability* applied in the private sector.

**Modern Equivalent Asset (MEA).** An asset similar to an existing asset and having the equivalent productive capacity, which could be built using modern materials, techniques, and design. Replacement cost is the basis used to estimate the cost of constructing a modern equivalent asset.

**Impairment Loss.** The amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount. International Accounting Standard 36 (IAS 36), para. 6.

**Optimisation.** The process by which a least cost replacement option is determined for the remaining service potential of an asset. It is a process of adjustments reducing the replacement cost to reflect that an asset may be technically obsolescent or over-engineered, or the asset may have a greater capacity than that required. Hence



# AUSTRALIAN VALUATION GUIDANCE NOTE 1

optimisation minimises, rather than maximises, a resulting valuation where alternative lower cost replacement options are available. In determining the depreciated replacement cost, optimisation is applied for obsolescence and relevant surplus capacity.

## 2.7 IVSC Guidance

*Depreciated replacement cost* is used where there is insufficient market data to arrive at Market Value by means of market-based evidence.

AASB 116, Property, Plant and Equipment, paragraph 33, provides that in the absence of market-based evidence an entity may need to estimate the fair value of a specialised asset using an income or a depreciated replacement cost approach.

International Public Sector Accounting Standard (IPSAS) 17, Property, Plant and Equipment, paragraphs 42 and 43, prescribe the use of *depreciated replacement cost for valuing specialised buildings and other man-made structures as well as items of plant and equipment of a specialised nature*.

Property, plant and equipment that is commonly traded in the market should be distinguished from specialised assets.

The classification of an asset as specialised should not automatically lead to the conclusion that a *depreciated replacement cost* valuation must be adopted. Even though an asset may be specialised, it may be possible in some cases to undertake a valuation of a specialised property using the market comparison approach and/or the income capitalisation approach.

In the absence of direct market evidence, *depreciated replacement cost* is regarded as an acceptable method of assessing the value of specialised assets but the methodology must incorporate market observations by the Valuer with regard to land value (for property assets), current cost, and depreciation rates. The methodology is based on the same theoretical transaction between rational informed parties as the Market Value concept.

- In applying the *depreciated replacement cost* methodology, the Valuer should refer to IVGN 8

## 2.8 Specialised Properties

The conceptual approach to the valuation of specialised assets has not altered in relation

to assets which are not traded in the market place. In the absence of direct market transaction evidence for specialised assets, the use of depreciated replacement cost or income methodologies, is endorsed at paragraph 33 of AASB 116 as follows:-

“If there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment and the item is rarely sold, except as part of a continuing business, an entity may need to estimate fair value using an income or a depreciated replacement cost approach.”

The depreciated replacement cost approach for financial reporting is considered in GN8, IVSC Standards 2005.

The term *fair value less costs to sell* used in Australian accounting standards is not applicable unless the asset is held for disposal. Market value will still apply in this circumstance to property, plant and equipment, but not as part of a going concern.

## 2.9 Application

Points that valuers should note are:

- a) In the majority of instances in relation to property, fair value will be equivalent to market value.
- b) For specialised properties the application of the depreciated replacement cost approach or the income approach is an acceptable methodology for valuations for financial reporting purposes provided the value determined is consistent with the fair value definition.
- c) In the absence of direct (market) transaction evidence, when the depreciated replacement cost approach methodology is applied, valuers should consider the elements of depreciation and their application.
- d) Wherever possible, depreciation should be based on market evidence. (See IVSC GN8). Valuers constantly analyse market transactions which indicate a relationship between new cost, depreciation and value. These transactions can be indicative of depreciation for depreciated replacement cost purposes if care is taken to exclude influences such as economic depreciation affecting property sold for a use other than its original purpose-design use.

- e) Where the depreciated replacement cost approach is adopted and the value of the land for an alternative use is equal to or higher than the value of the (total) asset - after allowing for the cost of works to bring the land to a state in which the alternative use can be exploited (e.g. demolition and removal of plant and equipment and its cost of relocation) - then the land value, net of these costs, is the value of the asset.
- f) Consideration should also be given to the potential alternative use value of improvements on the land e.g. a building shell after removal of all plant and equipment. The alternative use value assessment does not necessarily mean that the improvements have no value for the alternative use.
- g) When an asset used in a for-profit enterprise has been valued by reference to the depreciated replacement cost, adequate potential profitability becomes the test (an "impairment" test) applied by the entity to the depreciated replacement cost estimate to determine whether the asset can be carried at that amount.
- h) The depreciated replacement cost approach methodology is expressed as subject to the test of the adequate profitability (or service potential in the case of assets employed in a not-for-profit enterprise) of the assets held by the entity.

## **2.10 Fair Value Responsibility**

The application of Australian Accounting Standards and International Accounting Standards is complex. Valuers of property, plant and equipment assets for financial reporting purposes should be aware of the inter-relationships and complexities.

The application of Market Value concepts by professional valuers will normally be the foundation of an independent assessment of value for financial reporting purposes.

However, ultimately the determination of Fair Value is the responsibility of the reporting entity.

## **3.0 Categorisation of Assets**

### **3.1 Operational Assets**

Operational Assets are categorised as follows:

- Non-Specialised, or
- Specialised

### **3.2 Degree of Specialisation**

Operational Assets may be Non-Specialised or Specialised in whole or part. The valuer assesses the degree of specialisation having regard to the following:

- the use to which the asset is put,
- the degree of special adaptation,
- the location,
- whether that category of asset has a readily definable market; and
- any guidance by the directors and/or technical staff of the entity.

### **3.3 Non-Specialised Assets**

Non-Specialised Assets are those normally traded in an open market where market-based price indicators are available to guide both market participants and market observers. These Non-Specialised Assets can be further categorised as those assets which are common and regularly traded in the marketplace and include offices, warehouses, shops, etc. and those that generate an income or profit by their operation and are traded in the open market and include trading hotels, hospitals and casinos.

### **3.4 Specialised Assets**

Specialised Assets are those not normally traded in any market, except as part of a total enterprise by reason of their specific design, size, location or other factor. These assets include, but are not limited to, oil refineries, power stations, communication towers, notable public buildings, roads and drains, parks and gardens, and can include standard buildings such as offices or warehouses in a market where there is little or no demand for the asset if it is no longer an operational asset.

### **3.5 Other Considerations**

The degree of specialisation will determine the valuation methodology adopted.

# AUSTRALIAN VALUATION GUIDANCE NOTE 1

Some assets may possess elements that fall into more than one category, for example multi-purpose or mixed use properties. Each element of the asset should be valued on the designated basis reflecting the degree of specialisation or non-specialisation.

A *Value in Use* determination is entirely the prerogative of the entity.

Where the *Fair Value* of specialised assets is calculated by the *depreciated replacement cost approach* and advised to the entity for inclusion in financial statements, the valuation will be subject to the impairment test. Both *Fair Value* and *Fair Value less costs to sell* are said to be asset specific whilst *Value in Use* is entity specific. In current Australian financial reporting practice, carrying amounts reported at Fair Value are tested for impairment by the Fair Value of the cash generating operation.

The *depreciated replacement cost* of specialised assets and their *Value in Use* are different approaches to value, which may not yield consistent figures. Valuers should be aware that depreciated replacement cost determinations will include items of functional and economic obsolescence as well as physical depreciation. These items are asset specific and will take into account current market conditions for the particular assets at the date of valuation.

consistency with the prior period. The auditor will consider these matters and the valuation itself in the light of the auditors overall knowledge of the entity's business.

The appropriateness and reasonableness of assumptions and methods used and their application are the responsibility of the valuer. The audit needs to determine that they are not unreasonable, based on the auditors knowledge of the entity's business.

Internal valuers will normally be under instruction to comply with any request from an auditor. While independent valuers may not be under a statutory or contractual obligation to comply with any reasonable request from an auditor, it is in the interests of the entity, its ownership group and the valuer that the valuer should comply as failure to do so may mean that the auditor will not be able to express an unqualified opinion. In such circumstances the approval of the client should be obtained.

The valuer, whether internal or independent, should co-operate reasonably and responsibly if approached by the auditor.

It is of particular importance that any special assumptions and/or limiting conditions be clearly and unequivocally disclosed by the valuer.

## 4.0 Other Issues

### 4.1 Liaison with Auditors

Auditors may request a valuer to provide information or explanations related to the valuations and may also seek assurance that valuers have experience in the location and category of the assets being valued.

Auditors may also communicate with valuers to:

- specify items the auditor expects the valuation report to cover
- clarify the valuers relationship with the client; and
- clarify the assumptions and methods to be used by the valuer.

Auditors require assurance that the valuers work constitutes appropriate audit evidence. Issues which are of particular relevance to auditors are the sources of data used, assumptions and methods used and their appropriateness and

# AVGN 2 VALUATIONS FOR INSURANCE PURPOSES

*This Guidance Note should be used in conjunction with IVS 1 & IVS 3 in particular.*

## 1.0 Introduction

### 1.1 Purpose

The purpose of this guidance note is to provide information, commentary, advice and recommendations to members undertaking valuations of property, plant and equipment for insurance purposes.

### 1.2 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.

### 1.3 Scope

This guidance note applies to API members undertaking valuations for insurance purposes. PINZ members are referred to a separate guidance note specific to New Zealand (NZVGN 2 – Insurance Valuation Reports). As there are many types of assets and various levels of reporting, the member should decide which matters are applicable and the extent of detail required to ensure that the client is adequately and appropriately informed. This Guidance Note is not intended to outline methods of valuation of any particular type of asset but may comment on matters that should be addressed in reports in respect of certain property types or uses. Where appropriate, methods of valuation are covered in other Guidance Notes.

### 1.4 International Valuation Standards

This guidance note is intended to be consistent with the publication "International Valuation

Standards 2007" as issued by the International Valuation Standards Committee. However, there may be departures from IVSC Standards to reflect Australian law and practice.

### 1.5 The Role

In addition to the responsibilities covered in IVS 1, IVS 3, IVA 2 and ANZVGN 1 the Members role (subject to the scope of work agreed with the client) is to advise:

- The replacement/reinstatement and/or indemnity value of the assets for insurance purposes at the date of valuation, in accordance with the requirements of policy wording.
- Factors that can or could impact adversely on the assets in respect of insurance issues. The Member may attempt to quantify the adverse impact or risk or draw the client's attention to the need for re-assessment should these risks eventuate.

## 2.0 Instructions

### 2.1 Instructions from Client

All instructions to members to undertake valuations for insurance purposes should be confirmed in writing by the client.

### 2.2 Policy Issues

Clear instructions need to be obtained from the client confirming the scope of the work, policy conditions under which the assets are insured, and the extent of inclusions under the policy.

## 3.0 Report Content

### 3.1 Buildings

In addition to those items covered under IVS 1, IVS 3 and ANZVGN 1, a replacement/reinstatement and/or indemnity insurance valuation report for building and site improvements should include:

## AUSTRALIAN VALUATION GUIDANCE NOTE 2

- A replacement/reinstatement with new value and/or indemnity value as at the date required
- The extra necessary costs, if any, to comply with current building and fire regulations.
- The cost of demolition and removal of building debris.
- Cost increases during policy period
- An allowance for cost increases during lead time, ie the period after a major loss when debris is removed, building plans are drafted, and necessary approvals are obtained.
- An allowance for cost increases during rebuild period.
- Estimated limit of liability.
- A statement as to the treatment of GST.
- A statement of specific valuation exclusions such as plant, equipment, tools, furniture and the like.
- A full description of assets.
- Extent of betterment, if any, should the replacement asset be better or more extensive than its condition when new.
- Any change impacting on land value caused by loss of the improvements should be noted.

The loss of rent may be required as a separate request to the insurance valuation

### 3.2 Plant & Equipment

For plant and equipment assets, report content should clearly state or explain the following.

- The reinstatement/replacement with new value and/or indemnity value as at the date required.
- The foreign exchange rates prevailing at the date of valuation for equipment manufactured overseas.
- The treatment of obsolete assets.
- The treatment of cost inflation.
- The treatment of the cost of money during the replacement process.
- Installation and commissioning costs.
- The treatment of debris removal costs.
- The treatment of GST.
- The extent of betterment, if any.

- Valuation exclusions such as landlord's fixtures and fittings, stocks and materials in trade, and the like.

## 4.0 Insurance Policies

### 4.1 Policy Types

There are different types of policies available. The most common are:

#### 1. *Common Householders Policy:*

There are two main types:

- (a) Common policies where the insurer may elect to replace, repair, or indemnify in the event of a loss.
- (b) Replacement with new policies, which sometimes can have age provisions or can be regardless of age.

#### 2. *Industrial Special Risk (ISR Policy)*

The most common policy for commercial/ industrial insurance. This policy addresses many areas in addition to asset insurance.

### 4.2 Policy Wording

When undertaking an insurance valuation of improvements or plant and equipment, the valuer should seek client instructions. Where instructions are not clear the valuer should seek clarification and in respect to policy wording, a copy of the insurance policy document may need to be obtained together with definitions. The wording thereof may need to be examined to establish the correct basis and methodology for the valuation. Some of the issues to consider when reading a policy document are described below and are taken from a typical policy.

### 4.3 Situation

The situation is the particular location of the insured assets. It should be defined in a precise way as to where the assets are located. An owner may have many situations covered by the same insurance policy.

### 4.4 Property Insured

The typical policy document insures all real and personal property of every kind and description, unless specifically excluded, belonging to the insured or for which the insured is responsible or has assumed responsibility to insure.

In addition to the buildings, plant and equipment other assets may include:

- External paving,
- Sheds, carports, etc,
- Lighting,
- Awnings,
- Flagpoles,
- Radio and television masts and antennae,
- Above and below ground tanks,
- Signage,
- Fire services,
- Water and electrical reticulation throughout site,
- Walls, fences and gates.

In some circumstances a property owner may self-insure some assets and these should be identified.

The property insured also extends to all such property in which the insured may acquire an insurable interest during the period of insurance. An insurable interest may result from the completion of an agreement to purchase an asset even though settlement may occur at a future time.

### 4.5 Typical Policy Indemnity

The typical policy provides that in the event of any physical loss, destruction or damage, which has not been specifically excluded under the policy, happening at the situation to the property insured, the insurer will indemnify the insured in accordance with the applicable basis of settlement.

The insurer will also typically indemnify the insured for the following, provided the liability of the insurer does not increase beyond the limit of liability (refer 4.13).

- Fees associated with the cost of rebuilding such as those applicable to architects, surveyors, consultant engineers, legal and the like.
- Government fees and charges.
- Costs and expenses incurred for the purpose of extinguishing a fire at or in the vicinity of the property insured and threatening to involve such property.
- Costs associated with making the property safe after a loss.

- Costs of replacing locks, keys or safe combinations in appropriate circumstances.
- Costs and expenses necessarily incurred in respect of removal of debris.
- Damage to tools and clothing belonging to Directors and employees of the Insured whilst on the Premises.
- Temporary protection of undamaged property.
- Temporary repairs.
- Property of others for which insured is legally liable.

Modern policy wording, such as the above, has moved away from the concept of providing “blanket” cover for multiple ownerships (many situations) and requires each situation to have adequate cover. That is, each building at each location is required to be insured fully and correctly. This implies that, for the determination of limit of liability proper allowances are made for the above fees and costs on an individual basis.

### 4.6 Basis of Settlement

The most common insurance policies provide for settlement on a Replacement / Reinstatement basis.

If the insured elects not to replace/reinstate or repair the asset then the insurer may make a payment on the basis of the indemnity value of the asset at the time of the happening of the damage, where indemnity value is, for example:

*the cost necessary to replace, repair and/or rebuild the asset insured to a condition and extent substantially equal to but not better or more extensive than its condition and extent at the time that the damage occurred, taking into consideration the age, condition and remaining useful life of the asset.*

The insured may elect to insure on an indemnity basis only.

### 4.7 Interest of Other Parties

Insurable interests of parties such as lessors, financiers, trustees, mortgagees, owners and the like which are specifically noted in the records of the insured may be included in the cover without notification or specification. The nature and extent of such interests should be disclosed by the insured in the event of damage.

The valuer should be aware of other party interests

## AUSTRALIAN VALUATION GUIDANCE NOTE 2

and should act in the knowledge that liability for the valuation may extend to those other parties.

### 4.8 Replacement / Reinstatement

Where this is a basis for settlement then typically, the amount payable is calculated as the cost of reinstatement of the damaged asset insured at the time of its reinstatement, subject to the following provisions and subject to the defined limit of liability in the policy.

Replacement/Reinstatement is typically defined as follows:

- Where property is lost or destroyed: in the case of a building, the rebuilding thereof or in the case of property other than a building, the replacement thereof by similar property in either case in a condition equal to, but not better or more extensive than, its condition where new.
- Where property is damaged: the repair of the damage and the restoration of the damaged portion of the property to a condition substantially the same as, but not better or more extensive, than its condition when new.

The valuer should ensure that the valuation does not give rise to betterment. That is, where the assessed value is based on a more substantial or superior property than that which exists. If betterment is unavoidable, then an offsetting allowance should be made against the assessed value.

### 4.9 Provisions

Typical provisions are:

- Rebuilding, replacing or repairing must commence as soon as possible after the loss and may be carried out upon any site and in any manner subject to the liability of the insurer not being thereby increased.
- In the case of a partial loss the cost of the damage cannot exceed the total sum insured.
- A claim for a loss may be subject to a co-insurance clause (refer 4.12).
- No payment will be made until a sum equal to the cost of reinstatement has been incurred.

Replacement/Reinstatement not only relates to assets at the situation, but also, for buildings and site improvements, requires the determination of limit of liability to be assessed at the time of

its reinstatement. That is, for the insured to be adequately covered, the valuer should determine all costs associated with reinstatement/replacement of assets assuming a worst case scenario that a loss may occur on the last day of the policy period.

### 4.10 Extra Cost of Reinstatement

Policies for buildings and site improvements may extend to include the extra cost of reinstatement of damaged property to comply with the requirements of any Act of Parliament or regulation made thereunder or any by-law or regulation of any municipal or other statutory authority.

These would include current building and fire regulations. This extension is typically subject to the following provision:

- The amount of the claim cannot include the cost of complying with a requirement which existed prior to the loss occurring and with which the insured was required to comply.

An insurance company will only insure the assets as they exist, not as they may be replaced. The reason for this is the incidence of a partial loss where repairs are made to the existing structure.

However it may not be possible to determine a reinstatement/replacement value for an existing structure because it no longer complies with current building and fire regulations or other statutory encumbrances.

Insurance companies therefore allow the insured to insure for the extra costs associated with complying with these regulations. Accordingly, the insured may wish to declare a sub-limit in respect to extra costs of reinstatement. The valuer may determine this amount on an elemental basis by aggregating the additional elemental costs required to comply with the regulations.

### 4.11 Reinstatement Rights

In the event of a total loss and where as a result of the exercise of statutory powers by a regulatory authority, the reinstatement of a building as it existed prior to the loss may be prohibited or restricted. Accordingly, the insurer may pay in addition to any other amount payable on reinstatement of the building the difference between:

- a. the actual cost of reinstatement. ; and,
- b. the cost of reinstatement if it is not prohibited or restricted.



Any payment made for the difference between (a) and (b) above would be made as soon as the difference is ascertained upon completion of the rebuilding works and certified by the architect acting on behalf of the insured in the reinstatement of the building.

### 4.12 Co-Insurance

A standard clause in a typical policy document relating to this matter may read as follows:

“In the event of damage to property insured hereunder at any Situation caused by any peril hereby insured against, the Insurer shall be liable for no greater proportion of such damage than the amount of the Insured’s declaration of value of such property on the day of the commencement of the Period of Insurance bears to the sum representing eighty five percent (85%) of the actual value of property insured at such Situation on the day of commencement of the Period of Insurance but not exceeding the Limit of Liability expressed in the Schedule.”

For this example, the insured and the insurer agree that they will share the liability of any claim according to the ratio of the declared amount and 85% of the actual value of the property insured. If the declared value is the lower amount then the clause comes into effect.

While 85% is the usual percentage applied to the calculation of the insurer’s liability, other percentages may be adopted.

### 4.13 Limit of Liability

When assessing sums insured for buildings and site improvements, the limit of liability is the amount representing the maximum liability of the insurer for any one loss or series of losses arising out of the one event at any one situation. That is, the determination by a valuer of the limit of liability should be all embracing including the following:

- The immediate replacement/reinstatement of value of the asset, including an allowance for preliminaries and contingencies.
- Extra cost of reinstatement to comply with current building and fire regulations.
- Cost of removal of debris.
- Professional fees.
- Statutory fees.
- Cost increases incurred in the policy period.

- Cost increases during lead-time during which demolition takes place, building plans are drafted and submitted to council for approval (assuming the loss occurs on the last day of the policy period).
- Cost increases during reconstruction period (assuming the loss occurs on the last day of the policy period).

### 4.14 Loss Situation

Insurance companies (insurers) employ skilled loss adjusters and forensic scientists when property destruction or damage occurs to adequately protect the insurers from both poorly calculated loss claims and inflated claims.

The insured may also employ its own assessor to make certain all aspects of a claim are considered by the insurer.

## 5.0 Replacement/Reinstatement Cost for Buildings

In completing a Replacement/Reinstatement cost valuations a valuer should consider the items below and have regard to section 4 above.

### 5.1 Elemental Costs

For buildings, the determination of the current reinstatement /replacement value may require establishing the elemental cost of construction of the various structural components. Building plans and specifications should be obtained whenever possible to assist in the accuracy of the determination.

Recent constructions of a similar nature assist the valuer to determine the appropriate cost for each part of the construction process. The valuer should consider the evidence available and assess the information in terms of comparability to the subject site and form an opinion as to the appropriate cost to adopt for each particular element of construction.

Alternatively or as a check method the valuer may refer to building cost guides for any variation against indicative ranges. If there were a variation then the valuer would be alerted to establishing reasons for the justification of the valuation adopted.

A further check can be made by having regard to the percentage of each element against total cost and comparing this to industry standards. Again,

## AUSTRALIAN VALUATION GUIDANCE NOTE 2

any marked variation would require reasoned, researched explanations.

In certain circumstances it may be appropriate for the valuer to forego this part of the valuation in lieu of establishing an average rate per square metre for the total construction.

Valuations undertaken in non-metropolitan and remote areas would usually reflect regional costs associated with labour and materials. The location factor can be assessed by investigating local construction costs and/or by examining a sample of costs and relating them to known cost centres.

Unless specifically excluded, all property assets are required to be included in the determination of insurable value. These may include:

- Building shells and services,
- Fixtures ,
- Walls,
- Gates,
- Fences,
- Paving,
- Awnings,
- External signs and lighting,
- Flagpoles,
- Radio and television masts and antennae,
- Other structural improvements including sheds, carports, etc,
- Underground tanks,
- Services and connections including supply mains and meters.

### 5.2 Building Rates

A valuer may provide a client an estimate of insurable value based on rates published in building cost guides, but care should be taken in their application. The estimate will provide a modern equivalent cost and not necessarily the cost to replace the existing structure

Such rates are intended to provide broad estimates. The Member should have regard to variations such as:

- Specific materials used in the building (eg mixture of stone, brick, plasterboard, etc).
- Location factors (i.e. non metropolitan sites).

- Design of building, including soil type, special footings, etc.
- Extra cost of reinstatement to comply with current building and fire regulations.
- Recovery of value for materials in a demolition.
- External dimensions of a building (rates per square metre published by some cost guides relate only to internal building measurements).
- All fees associated with reconstruction including architects, survey and engineering fees.

### 5.3 Fees and Contingencies

The valuer should assess in each case the extent of involvement of professionals such as architects, surveyors, consultant engineers and the like, and needs to continually research the prevailing level of fees relating thereto, as they can fluctuate considerably between high and low demand periods

### 5.4 Lead Time

This is the period of time after a loss occurs when remaining improvements are demolished, plans and specifications of the replacement building are drafted and agreed upon, appropriate approvals are sought and obtained from local government authorities and all matters are completed in preparation for rebuilding.

The valuer's assessment of this period should have regard to industry experience and continual research into the time required to complete each of these tasks including process and approval times for local government.

For buildings and site improvements, cost increases during this period need to be calculated and added to the determination of the total sum insured.

For plant and equipment the unpredictability of future cost inflation, especially that caused by foreign exchange fluctuations, generally precludes an allowance to be made under this heading.

### 5.5 Reconstruction Period

This is the period from the time building approvals have been obtained to completion and hand-over of the new facility.

Cost increases should to be added to the total sum insured but only to the extent that the building is completed in various stages.

The valuer should consider each element of construction to determine what allowance for cost increases should reasonably be made.

As noted above, for plant and equipment the unpredictability of future cost inflation, especially that caused by foreign exchange fluctuations, mostly precludes an allowance to be made under this heading.

### 5.6 Demolition & Removal of Debris

The amount determined under this heading is calculated by having regard to demolition and removal costs of similar construction in the locality of the situation. The valuer should allow for the amount able to be recovered by the demolition contractor for the building materials.

Further consideration should be given to the presence of known asbestos within a building, difficulty in gaining access to a site, the hazardous nature or otherwise of the debris after a major loss on the basis of total destruction of the site. The valuer should assume that all assets would be destroyed in a loss situation and would require removal prior to reinstatement.

### 5.7 Limit of Liability

As described in the policy, this is the amount representing the maximum liability of the insurer for any one loss or series of losses arising out of the one event at any one situation. It should therefore encompass the total cost of replacement/reinstatement from the time the policy commences up to the time replacement/reinstatement takes place after a loss.

In the worst case scenario a loss could occur on the last day of the policy period. If this was so, the insured would expect that there is sufficient cover to include all the likely costs not only associated with reconstruction but also in respect to making the property safe and secure, protecting undamaged property and the like.

## 6.0 INDEMNITY VALUE ASSESSMENT

### 6.1 Buildings

The indemnity value assessment should take into consideration the age, condition and remaining useful life of the asset. In the case of insurance, useful life is not synonymous with economic life, but rather, physical life. The insured is entitled to

insure the remaining physical life of an asset, even though the economic life may have expired.

Therefore, the determination of indemnity value requires in the first instance, the assessment of replacement/reinstatement value in accordance with the methodology stated above and then an assessment to be made of the likely physical life of the asset and the life expired. The expected physical life of an asset is assessed on the basis that reasonable maintenance is carried out to preserve the existing use.

The valuer should undertake research into the expected life of assets in the location of the valuation and elsewhere as appropriate.

It is common to apply a straight-line method of depreciation when determining indemnity value, which assumes that the remaining service potential of the asset is used up at a constant rate assuming reasonable maintenance. There are however other methods including reducing balance (diminishing value).

### 6.2 Plant and Equipment

The indemnity value of plant and equipment is an amount equal to the cost of replacing an existing asset with an identical or substantially similar asset of comparable age, in comparable condition and of similar but not better utility together with the cost of transport, installation, commissioning any other directly attributable costs

## 7.0 HERITAGE ASSETS

The principles of valuing buildings for insurance purposes either on a reinstatement/replacement or indemnity basis apply equally to determining an insurable value for a heritage building.

A building worthy of preservation as determined by relevant heritage authorities is usually because it is a good example of some aspect of heritage. Legislation in most jurisdictions may prevent renovations, modifications, additions and the like by imposing strict requirements and lengthy approval processes. However, in the case where part or the whole of the building has been destroyed along with the element of heritage to be preserved, then that heritage is lost and the owner can only ever replicate it.

The valuer should investigate the relevant legislation to confirm whether or not replication is a compulsory requirement after a loss.

The approach to the insurance valuation is the same as above. The valuer determines the elemental costs in

## AUSTRALIAN VALUATION GUIDANCE NOTE 2

rebuilding the structure as it exists allowing for all the “add-ons”, such as extra cost of reinstatement, fees and contingencies, and the like, to comply with policy wording. This method establishes the current cost for repairing or replacing every component of the building in a style and form of construction most closely resembling the original. The valuer should ensure that the engagement of suitable craftsmen, such as those skilled in stone masonry, iron tracery and stained glass, are accurately costed into the calculations.

# NZVGN 1 VALUATIONS FOR USE IN NEW ZEALAND FINANCIAL REPORTS

*This Guidance Note should be read in conjunction with IVA 1: Valuation for Financial Reporting.*

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to provide information, commentary, opinion, advice and recommendations to Members producing asset valuations for financial reporting purposes in New Zealand and to assist users of financial reports to understand the basis upon which asset valuations for financial reporting purposes are undertaken.

### 1.2 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 'Professional Practice'.

It should be noted that Financial Reporting Standards are mandatory. Accordingly, in effect, IVA 1 and this Guidance Note are mandatory.

### 1.3 New Financial Reporting Standards

New Zealand reporting entities will be required to apply New Zealand Equivalents of International Financial Reporting Standards (NZ IFRS) in the preparation of their external financial reports for periods commencing on or after 1 January 2007. Entities have had the option to adopt NZ IFRS early from 1 January 2005 but those electing to do so must make a complete shift to NZ IFRS, that is, they must adopt all of the standards.

The term 'IFRS' refers to the standards and Framework issued by the International Accounting Standards Board (IASB). The standards comprise:

1. International Accounting Standards (IASs) (the standards inherited by the IASB from

its predecessor body, the International Accounting Standards Committee (IASC) but in most cases revised by the IASB) and the interpretations of these standards (SICs) issued by the IASC's Standing Interpretations Committee;

2. International Financial Reporting Standards (the new standards developed and issued by the IASB), and the interpretations of these standards (IFRICs) issued by the IASB's International Financial Reporting Interpretations Committee.

NZ IFRS contain all the provisions of the corresponding IFRS, and may include additional disclosure requirements that apply to all entities, and also additional disclosure, recognition or measurement requirements that apply only to public benefit entities.

Profit oriented entities that comply with NZ IFRS simultaneously comply with IFRS. However, public benefit entities that comply with the additional recognition or measurement requirements in NZ IFRS will not simultaneously comply with IFRS. In this context, public benefit entities are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return.

### 1.4 New NZ IFRS Re: Property Valuations

Under NZ IFRS, property assets will normally fall into one of the following categories:

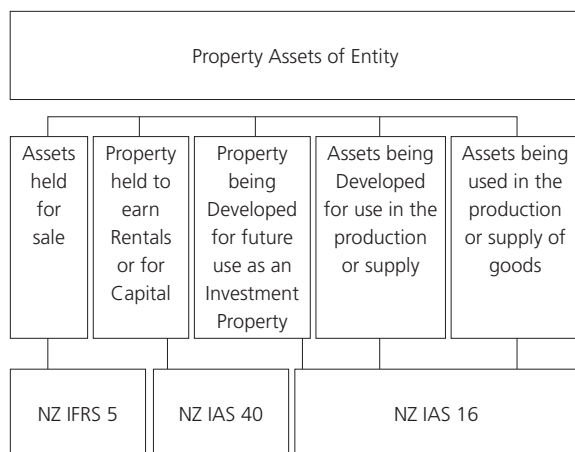
- Investment property – to be valued and accounted for in accordance with NZ IAS 40 Investment Property
- Non-current Assets Held for Sale - to be valued and accounted for in accordance with NZ IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

# NZ VALUATION GUIDANCE NOTE 1

- Property, plant and equipment - to be valued and accounted for in accordance with NZ IAS 16 Property, Plant and Equipment.

At the end of this Guidance Note is a summary of changes that have been made in adapting IFRS to NZ IFRS in respect of property assets.

NZ IAS 40 replaces SSAP-17 and NZ IFRS 5 and NZ IAS 16 replace FRS-3. Set out on the chart below is a summary of property asset classifications and the corresponding NZ IFRS:



As noted above, New Zealand reporting entities will be required to apply NZ IFRS for periods commencing on or after 1 January 2007. Up until then, the adoption of NZ IFRS is optional, but those entities electing to do so must make a complete shift to NZ IFRS, that is, they must adopt all of the NZ IFRS standards. Accordingly, up until 2007, valuations may be required to be completed in accordance with SSAP-17 or FRS-3, or their replacements – NZ IAS 40, NZ IFRS 5 and NZ IAS 16.

Members are referred to NZ IAS 40, NZ IFRS 5 and NZ IAS 16 for full details of the valuation requirements under each standard. There are no material changes to the way assets are to be valued (where revaluations are required) under the new NZ IFRS however, the following changes are highlighted:

- Under NZ IAS 16, the valuation guidance has been reduced in general terms, except as it relates to Public Benefit Entities where much of the content from FRS-3 has been repeated.
- Under NZ IAS 16, the requirement to revalue every five years as a minimum, has been deleted. Revaluations are however to be undertaken “with sufficient regularity to

ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.” (NZ IAS 16, paragraph 31)

- Under NZ IAS 16, the requirement for “recent” experience in the location and category of the asset being valued has been added in terms of the independent valuer. (NZ IAS 16, paragraph NZ 35.2)
- Under NZ IAS 16, specific disclosures as to the valuers, both internal and independent external, where inhouse valuations have been completed have been added (NZ IAS, paragraph 77.2).
- Under NZ IAS 40, the property is revalued to its fair value, and there is no longer a requirement to assess (and deduct) estimated disposal costs.
- Under NZ IAS 40, a revaluation is now able to be conducted internally, where the entity has in its employ a person sufficiently experienced to conduct a valuation, so long as the basis of valuation has been subject to review by an independent valuer (NZ IAS 40, paragraph NZ 33.1)
- Under NZ IAS 40, the requirement for “recent” experience in the location and category of the asset being valued has been added in terms of the independent valuer. (NZ IAS 40, paragraph NZ 33.2)

With the exception of the summary of changes that have been made in adapting IFRS to NZ IFRS in respect of property assets, the balance of this Guidance Note remains unchanged from that which became effective 15 February 2002 (with specific references to SSAP-17 and FRS-3 only). This Guidance Note will however be completely revised once NZ IFRS are required to be fully adopted by New Zealand reporting entities.

## 1.5 Scope of this Guidance Note

This Guidance Note applies to Members valuing assets for financial reporting purposes in New Zealand.

Compliance with this Guidance Note will ensure asset valuations are consistent and in accordance with the Institute of Chartered Accountants of New Zealand Financial Reporting Standard 3 - Accounting for Property, Plant and Equipment ('FRS-3') and Statement of Standard Accounting Practice 17 - Accounting for Investment Property and Properties Intended for Sale ('SSAP-17').

Where members are required to undertake revaluations in accordance with NZ IFRS, they should note in particular the preceding two sections.

FRS-3 provides extensive guidance on the principles relevant to the revaluation of 'Property, Plant and Equipment' assets for financial reporting purposes. A significant amount of guidance is provided on the application of depreciated replacement cost valuation methodology, and in particular, the process of optimisation.

Members should obtain and become familiar with the valuation requirements of both FRS-3 and SSAP-17.

This Guidance Note is to be read in the context of the background material and implementation guidance contained in the *International Valuation Standard 1 - Market Value Basis of Valuation, and International Valuation Standard 2 - Valuation Bases Other Than Market Value*. Where there is a conflict between this Guidance Note and -IVS 1 or 2, then the provisions of this Guidance Note shall prevail.

This Guidance Note applies to revaluations of assets undertaken for financial reporting purposes under the provisions of the New Zealand financial reporting standards FRS-3 and SSAP-17.

FRS-3 recognises asset revaluations as an alternative to historical cost, whereas SSAP-17, in respect of investment property, requires annual revaluations.

This Guidance Note does not apply where a valuation is undertaken for purposes other than for financial reporting e.g. pursuing a transaction, loan application etc.

This Guidance Note applies to asset revaluations undertaken for financial reporting purposes.

This Guidance Note addresses general concepts and principles to be complied with by Members when preparing asset valuations for financial reporting purposes.

If a valuation for financial reporting purposes under FRS-3 is carried out by a member other than a member of the PINZ, then the valuation is to be carried out in accordance with standards and guidance comparable to the valuation pronouncements issued, or officially endorsed, by the New Zealand Property Institute (FRS-3, paragraph 7.8).

## 1.6 Financial Statements

Financial statements must report the assets, liabilities, equity, revenues, expenses (the "elements" of financial statements) and cash flows of the entity.

## 2.0 Relationship to Financial Reporting Standards

The New Zealand financial reporting standards FRS-3 and SSAP-17 provide primary guidance on the basis upon which assets are to be revalued for financial reporting purposes.

Both FRS-3 and SSAP-17 require valuations to be prepared in accordance with the *API/PINZ Valuation Standards* (or in the case of FRS-3, standards and guidance comparable to the valuation pronouncements issued, or officially endorsed, by the PINZ - see FRS-3 paragraph 7.8 and SSAP-17 paragraph 4.13).

FRS-3's requirement for Fair (or Market) Value has brought about a fundamental change from the previous PINZ Valuation Standard 3, which required 'Market Value for the Existing Use' (i.e. a valuation assumption that the asset would continue to be used in its existing use).

## 3.0 Materiality

Most Accounting Standards are subject to the concept of materiality, which is defined to mean "*in relation to information, that information which if omitted, misstated or not disclosed has the potential to adversely affect decisions about the allocation of scarce resources made by users of the financial report or the discharge of accountability by the management or governing body of the entity*".

The concept of Fair Value has been embraced and encapsulated in accounting and financial reporting standards in Australia and New Zealand.

## 4.0 Definitions

### 4.1 FRS-3 Definitions

'Borrowing Costs' are interest and other costs incurred by an entity in connection with the borrowing of funds (FRS-3, paragraph 4.1).

Borrowing costs include:

- (a) interest on bank overdrafts, short and long term borrowings;
- (b) amortisation of discounts and premiums relating to borrowings;



## NZ VALUATION GUIDANCE NOTE 1

- (c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;
- (d) the cost of hedging contracts entered into, including the forward point differential at inception of the hedging arrangement (FRS-3, paragraph 4.2).

Borrowing costs do not include exchange differences arising on foreign currency borrowings except as provided in (d) above (FRS-3, paragraph 4.3).

'Carrying Amount' is the amount at which an asset or liability is included in the statement of financial position (FRS-3, paragraph 4.5).

'Depreciated Replacement Cost' is a method of valuation that is based on an estimate of:

- (a) in the case of property:
  - (i) the Fair Value of land; plus
  - (ii) the current gross replacement costs of improvements less allowances for physical deterioration, and optimisation for obsolescence and relevant surplus capacity;
- (b) in the case of plant and equipment, the current gross replacement cost less allowances for physical deterioration, and optimisation for obsolescence and relevant surplus capacity (FRS-3, paragraph 4.10).

'Depreciation' is the measure of the consumption of the economic benefits embodied in an asset whether arising from use, the passing of time or obsolescence (FRS-3, paragraph 4.22).

'Fair Value' is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction (FRS-3, paragraph 4.23).

Other terms commonly used to describe 'Fair Value' include 'Market Value', 'Open Market Value' and 'Current Market Value' (FRS-3, paragraph 4.24).

'Net Market Value' is the Fair Value at a particular date less the costs of disposal that could reasonably be anticipated at that date (FRS-3, paragraph 4.33).

'Optimisation' refers to the process by which a least cost replacement option is determined for the remaining service potential of an asset. This process recognises that an asset may be technically obsolescent or over-engineered, or the asset may have a greater capacity than that required. Hence

optimisation minimises, rather than maximises, a resulting valuation where alternative lower cost replacement options are available. In determining depreciated replacement cost, optimisation is applied for obsolescence and relevant surplus capacity (FRS-3, paragraph 4.13).

'Property, Plant and Equipment' are tangible assets that:

- a) are held by an entity for use in the production or supply of goods and services, for rental to others or for administrative purpose, and may include items held for the maintenance or repair of such assets; and
- b) have been acquired or constructed with the intention of being used on a continuing basis (FRS-3, paragraph 4.35).

'Recoverable Amount' is the greater of:

- a) net market value; and
- b) value-in-use (FRS-3, paragraph 4.40)

'Value-in-use' is the present value of the net future cash flows obtainable from an asset's continuing use and ultimate disposal (FRS-3, paragraph 4.54).

### 4.2 SSAP-17 Definitions

'Property' is, for the purposes of SSAP-17, an interest in land or buildings in which the reporting entity, or any of the members of a group, singly or in combination, does not occupy or intend to occupy more than 20 percent of the area of the land or buildings (SSAP-17, paragraph 3.1).

'Development Property' is either investment property or property intended for sale, depending on the intention of the reporting entity, which is both being developed and is identifiable as a separate project (SSAP-17, paragraph 3.4).

'Development Margin' on a development property is the difference between (i) expected net current value on completion and expected cost in the case of investment property, or (ii) net sale price and expected cost in the case of property intended for sale (SSAP-17, paragraph 3.5).

'Investment Property' is property held, or development property intended to be held, primarily for capital growth or rental or similar income (SSAP-17, paragraph 3.2).

'Net Current Value' is open market value, less the costs of disposal that could reasonably be anticipated. Open market value is the price for which a property might reasonably be expected to

be sold at the operative date (SSAP-17, paragraph 3.6). Thus, net current value is Fair Value net of disposal costs and therefore is the same as net market value as defined in FRS-3, paragraph 4.33.

'Net Realisable Value' is the same as net current value.

'Property Intended for Sale' is all property, other than investment property, held with the intention of realisation in the ordinary course of business (SSAP-17, paragraph 3.3).

## 4.3 IVSC Definitions

'Highest and Best Use' is the most probable use of a property which is physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value of the property being valued -(IVS General Valuation Concepts and Principles)

'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 arms length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion - -(IVS General Valuation Concepts and Principles)

'Obsolescence' is a loss in value due to a decrease in the usefulness of property caused by decay, changes in technology, people's behavioural patterns and tastes, or environmental changes (IVS -2003, Glossary of Terms).

'Service Potential' is the future economic benefits embodied in the asset in terms of its potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. Service potential is measured as the level of productive capacity that would have to be replaced if the entity were deprived of the asset (IVS -2003, Glossary of Terms).

## 5.0 Revaluation of Non-current Assets

### 5.1 Asset Classification under Financial Reporting Standards

In the ordinary course of an engagement, a Valuer will be provided with guidance from the entity from whom valuation instructions are received as to the classification of an asset between FRS-3 and SSAP-17 for financial reporting and valuation purposes.

The Valuer may be required to exercise professional judgement to determine the most appropriate classification. The following property will generally be accounted for in accordance with FRS-3:

- a) owner-occupied property;
- b) property held for short-term rental where the entity is actively managing that property;
- c) property whose rental is directly linked to the risks and rewards of the business being operated from that property.

Other property, including property held for rental and capital growth, is to be accounted for in accordance with SSAP-17. Thus owner-operated hotels are normally accounted for in accordance with FRS-3, whereas shopping centres and office blocks are normally accounted for in accordance with SSAP-17 (adapted from FRS-3, paragraph 4.36).

Diagram 1 provides additional guidance on the classification of property assets between FRS-3 and SSAP-17 for financial reporting and valuation purposes.

Where the Valuer is required to exercise professional judgement to determine the most appropriate classification, the determination and its basis must be fully disclosed in the valuation report by the Valuer.

Care should be taken to confirm the entity for whom the valuation is being prepared, particularly in the case of a group, as to whether the valuation is for the financial statements of a specific entity within the group or the group as a whole. The classification of the asset could be different under each which would mean a different valuation basis.

### 5.2 Basis of Valuation

The terms 'Fair Value', 'Current Value' and 'Open Market Value' used in financial reporting standards FRS-3 and SSAP-17 are synonymous with 'Market Value'.

Portfolios of investment properties or property, plant and equipment are usually valued on the basis of summing the individual asset values. The market value of such assets viewed or treated as a portfolio or as an assembled group of properties could exceed, or could be less than, the sum of the 'Market Value' of each asset individually. Where this is the case, the fact that this difference exists should be reported separately to the entity from whom valuation instructions are received.

# NZ VALUATION GUIDANCE NOTE 1

## 5.3 FRS-3

'Property, Plant and Equipment' is valued at Fair Value. Where an item of property, plant and equipment is able to be reliably determined using market based evidence, market value represents Fair Value.

Where the Fair Value of a property, plant and equipment asset is not able to be reliably determined using market-based evidence for the same or a similar asset, depreciated replacement cost is to be used to estimate Fair Value.

Disposal costs are not to be deducted from the assessed Fair Value of a property, plant and equipment asset for financial reporting purposes under the provisions of FRS-3, unless an asset has been withdrawn from use and there is an intention to dispose of the asset.

## 5.4 SSAP-17

'Investment Properties' are valued for financial reporting at net current value (market value less the costs of disposal). The valuer should report both market value and disposal costs.

## 5.5 Apportionments of Value/ Componentisation

For the purposes of FRS-3, valuers are to separately identify property asset values between land and buildings.

FRS-3 requires asset components that have different useful lives or which provide a different pattern of economic benefits to an entity to be recorded separately for financial reporting purposes. The valuer will be required to undertake further valuation apportionments of property, plant and equipment assets where requested by the instructing entity.

## 5.6 Disclosures

The valuer's written report should disclose the following information:

- The nature of instructions and purpose of the valuation;
- The date of valuation;
- The financial reporting standard governing the accounting treatment of the asset and whether the classification has been made by the instructing entity or the valuer;
- The basis of the valuation, including type and definition of value;

- Tenure of assets;
- Assumed lease details for owner-occupied property, where applicable;
- Identification of the assets and their locations including the date and extent of inspections;
- Values for each asset (and apportionments as appropriate);
- The assumptions underlying construction costs, construction period and borrowing costs, where appropriate;
- How any restoration, dismantling or removal obligations associated with an asset has been treated, where applicable;
- The names, qualifications and contributions of outside professional persons who have provided assistance, where used;
- Any key and/or special assumptions and/or limiting conditions;
- Sufficient detail to support the valuation conclusion as required in the API/PINZ Standards and Guidance Notes; and
- Such other matters that are pertinent to the valuation.

## 5.7 Liaison with Auditors

At the client's request, and subject to appropriate consent, valuers shall respond to the entity's auditor to discuss and explain the valuations openly. The client has the primary responsibility for the form and content of the financial statements. The auditor has the responsibility for forming and expressing an independent opinion on whether the financial statements, prepared by the client fairly present the financial position and performance of the entity, and comply with relevant financial reporting standards.

## 6.0 Discussion

### 6.1 FRS-3: Property, Plant and Equipment

When an entity chooses to revalue property, plant and equipment, FRS-3 requires that it be revalued to Fair Value. As mentioned -previously 'Fair Value' is synonymous with 'market value'.

The Fair Value of an asset is determined by reference to its highest and best use, that is, the most probable use of the asset that is physically possible, appropriately justified, legally permissible,

financially feasible, and which results in the highest value (FRS-3, paragraph 4.25).

Where the Fair Value of an asset is able to be determined by reference to the price in an active market for the same asset or a similar asset, the Fair Value of the asset is determined using this information. Where the Fair Value of an asset is not able to be determined in this manner, the Fair Value of the asset is determined using other market-based evidence, such as by a discounted cash flow calculation using market estimates of the cash flows able to be generated by the asset and a market-based discount rate. Where Fair Value of the asset is not able to be reliably determined using market-based evidence, depreciated replacement cost is considered to be the most appropriate basis for determination of Fair Value. This situation will usually only arise where an asset is specialised or the only transaction price evidence arises in a monopoly context (FRS-3, paragraph 4.26)

For property assets, market-based evidence may exist concerning either the land component or the property in aggregate. Depreciated replacement cost is used as an estimate of the Fair Value of property only where the Fair Value of the property in aggregate (that is, for land and improvements) cannot be reliably determined using market-based evidence (FRS-3, paragraph 4.11).

In the case of property, depreciated replacement cost methodology is based on the Fair Value of the land plus the current gross replacement cost of improvements less allowances for physical deterioration, and optimisation for obsolescence and relevant surplus capacity. Optimisation is not applied in determining the value of the land component of depreciated replacement cost. As discussed elsewhere, the value of the land in almost all cases will reflect the market value of the land.

The replacement cost of an item of property, plant and equipment comprises its purchase/construction price plus any other costs directly attributable to bringing the item to working condition for its intended use. Replacement cost includes, for example, the costs of obtaining resource consents, construction costs, architectural and engineering fees, freight, and charges for installation, commissioning and testing (adapted from FRS-3, paragraph 5.6).

FRS-3 requires capitalisation of borrowing costs that are directly attributable to the acquisition

or construction of an item of property, plant and equipment. However, entities may defer implementation of this requirement until reporting periods ending on or after 31 March 2004. Where an entity does capitalise borrowing costs, depreciated replacement cost must include allowance for borrowing costs. The estimate of borrowing costs for this purpose, should be based on the average debt to equity ratio and average cost of debt applicable to entities within the same industry as the entity reporting and should reflect only the costs of debt.

Where borrowing costs are included in depreciated replacement cost, the valuer shall provide a detailed statement of the borrowing cost, construction cost and construction period assumptions adopted in deriving the valuation conclusion.

In the case of plant and equipment, depreciated replacement cost methodology is based on the current gross replacement cost less allowances for physical deterioration, and optimisation for obsolescence and relevant surplus capacity.

Obsolescence may arise from factors such as outmoded design and functionality of an asset and changed code requirements preventing reconstruction of an asset in its current form. In determining depreciated replacement cost, optimisation for obsolescence is made by reducing the reproduction cost of the specific asset held to the cost of a modern equivalent asset that provides equivalent service potential to that of the specific asset held (FRS-3, paragraph 4.14).

Surplus capacity may arise from either over-design or from surplus components of an asset. In determining depreciated replacement cost, optimisation is applied only to surplus capacity that is not required currently and for which there is no reasonable prospect it will ever be required in utilising an asset in its current form (FRS-3, paragraph 4.15).

In determining depreciated replacement cost, the extent of any reduction in value for surplus capacity subject to optimisation depends on whether that surplus capacity has an alternative use to the current use of the asset. Where there is no alternative use, the optimised value of the surplus capacity is zero. Where there is an alternative use, the optimised value of the surplus capacity is the value of the highest and best alternative use of that surplus capacity (FRS-3, paragraph 4.16).

To illustrate the distinction described earlier between surplus capacity not having an alternative use to the current use of the asset and that which does, consider the following example. Assume depreciated replacement cost is to be determined for a network of water pipes where the pipe diameter is greater than that required or ever expected to be required (including that necessary for stand-by or for safety purposes). There is also a discrete segment of the piping network that is similarly not required for the current use of the asset but which can be closed off and used for other purposes, such as a liquid storage facility. In this case, the surplus diameter of the piping would be disregarded for valuation purposes but the surplus segment of the piping network would be valued at its highest and best alternative use (FRS-3, paragraph 4.17).

In most cases, surplus capacity subject to optimisation is expected to be disregarded in determining the depreciated replacement cost of an asset. Such surplus capacity is unlikely to have an alternative use unless it is physically and operationally separable from the required capacity (FRS-3 paragraph 4.18).

In determining depreciated replacement cost, optimisation for obsolescence and relevant surplus capacity is applied only to the extent that it reflects the most probable use of the asset that is physically possible, appropriately justified, legally permissible and financially feasible (FRS-3 paragraph 4.19).

Optimisation is applied only to the depreciated replacement cost of plant, and equipment and in determining an estimate of the value of improvements component of the depreciated replacement cost of property (adapted from FRS-3, paragraph 4.20)

Optimisation is not applied in determining the value of the land component of the depreciated replacement cost of property. The value of the land component will always reflect the market value of the actual land held, in terms of both its size and location, even if such factors are under-utilised (adapted from FRS-3, paragraph 4.20).

The Fair Value of land would normally be determined from market based evidence. However, in the rare instances where extensive works have been carried out in order to prepare land for use in the entity's business, available market evidence will normally relate to land of the same size and in the same general vicinity but which is priced for uses that are sub-optimal

relative to the use for which the works were carried out. In these rare instances the Fair Value of the land should be determined by having regard to the replacement cost of the land. For example, consider the case where an airport or port company acquires a section of seabed, fills it in and builds a seawall in order to produce flat land for use in the entity's business. The reclaimed land is in the precise location where the entity requires land. Market evidence may exist for other land of the same size and in the same general vicinity as the reclaimed land, but that other land is not suitable for the use intended by the entity. Thus, the market evidence on the Fair Value of that other land is not relevant to the reclaimed land, and the best indicator of the Fair Value of the reclaimed land would be the replacement cost of that land. Land resulting from extensive works by a local or central government body in constructing new roading provides a similar example. (FRS-3, paragraph 4.26A).

### 6.2 SSAP-17: Investment Properties

Investment properties by their nature are able to be valued using market based evidence. Applicable disposal costs (agency, legal etc.) are also able to be determined from the market.

Development properties intended to be held as investment properties which meet certain specified criteria are recognised in financial statements at cost plus accumulated development margins to date, determined on a percentage of completion basis. The development margin is the difference between expected net current value on completion and expected cost. Development properties intended to be held as investment properties which do not meet the specified criteria are carried at the lower of cost and net realisable value (see SSAP-17, paragraph 5.5).

The specified criteria referred to above are:

In the case of a development property intended to be held by the reporting entity, the following conditions should be met in order to provide the required degree of reliability for recognition of a development margin in the financial statements:

- i) the property should unconditionally be pre-let to at least 80 percent of the anticipated annual rental revenue to be received from entities external to the reporting group; and
- ii) all costs incurred and expected to be incurred by the entity can be reliably be estimated (SSAP-17, paragraph 4.14)

If a property, previously accounted for as an investment property, is now intended to be sold, it should be reclassified accordingly but continue to be recorded at the carrying amount at the date of change of intention except where carrying amount is greater than net realisable value, in which case, it should be written down to net realisable value (see SSAP-17, paragraph 5.8).

### **6.3 Apportionment of Value/ Componentisation**

Valuers will frequently be required to undertake an apportionment of reported property values, allocating value separately to the land element (non-depreciable) and the buildings (depreciable). Valuers should, as far as it is possible, continue to apply market concepts. While it is acknowledged that buildings cannot be separated from the land that they occupy, valuers should recognise that the purpose of carrying out the apportionment is to establish a basis for measuring the consumption in the financial statements. Typically, the land value should be established and deducted from the total value to arrive at the depreciable amount for the buildings (adapted from IVS -2003, IVA 1 -, paragraphs 5.4 and 6.2.5).

FRS-3 requires asset components that have different useful lives or which provide a different pattern of economic benefits to an entity to be recorded separately for financial reporting purposes. This requirement will necessitate the valuer to undertake further valuation apportionments where instructed by the reporting entity. For example, the value apportioned to buildings may need to be further split into the structure, building services and fitout (and in some cases, further sub-components within these components).

Paragraph 5.21 of FRS-3 states:

“Judgement will be required to decide which components of complex items of property, plant and equipment are accounted for separately. Components will not need to be accounted for separately if materially the same total depreciation expense, carrying amounts and revaluation movements will otherwise result. For entities with asset management plans, it is expected that items of property, plant and equipment will be accounted for at a higher aggregation level (i.e. at a lesser level of detail) than that recorded in the asset management plans.”

The implication of the above is that component apportionments should be limited to major

components which are clearly separately identifiable. In any event, valuers should liaise and discuss the required level of componentisation with the instructing entity.

For the purposes of componentisation, the costs attributed to the components should be based on an apportionment of the overall replacement costs (or value) i.e. ‘top down’ as opposed to ‘bottom up’. The reason for this is that the top down approach will more accurately reflect the market replacement cost/value since aggregating the replacement costs/values of individual parts from a ‘bottom up’ approach will usually produce a higher overall figure.

Valuers may be further requested to advise on appropriate useful lives over which asset components should be depreciated for accounting purposes.

In some circumstances where apportionment of values is appropriate this will require the valuer to seek the professional assistance of specialist valuers (e.g. plant & equipment valuers) or other experts such as engineers or quantity surveyors, where the valuer does not have the necessary expertise.

### **6.4 Revaluation Frequency**

Where an entity chooses to revalue its assets under the provisions of FRS-3, revaluations are to be undertaken on a systematic basis:

- (i) with sufficient regularity to ensure that no individual item of property, plant and equipment is recorded for financial reporting purposes at a valuation that is materially different from its Fair Value; and
- (ii) at a minimum, every five years (FRS-3, paragraph 7.1 (b)).

While the annual revaluation of items of property, plant and equipment is not required by FRS-3, the adoption of a system involving annual revaluation, especially for land and buildings assets, is encouraged in order to provide more relevant information to users of an entity’s financial report (FRS-3, paragraph 7.2). FRS-3 states that the principle for determination of the frequency of revaluations as being that revaluations must be carried out with sufficient regularity to ensure that the carrying amount of a revalued asset is not materially different from its Fair Value. Accordingly, under changing market conditions, revaluations may be required to take place more frequently. Examples of changing market conditions include:



## NZ VALUATION GUIDANCE NOTE 1

- Introduction of new technology;
- Demand changes resulting from, for example, centralisation or decentralisation;
- Movements in inflation and borrowing costs;
- Government policy and legislation.

Property assets classified as investment properties under the provisions of SSAP-17 are to be revalued annually.

### 6.5 Owner-Occupied Properties

Where the primary approach to valuation of owner-occupied properties for financial reporting purposes is capitalisation or discounting of future rental income, the valuer shall assume that a notional lease is in place on market terms and conditions reflecting the current use.

The valuer's report shall set out the basic terms of the assumed lease including the notional lease term, market rental, responsibility for outgoings, the basis and frequency of rental reviews and any other terms and conditions applicable to a typical lease of like nature in the market at the date of the valuation.

The capitalisation or discount rate utilised in the valuation shall reflect the notional lease terms and conditions.

Informal and unenforceable lease or occupancy arrangements between related entities or subsidiaries should not be taken into account or used as the basis of a valuation. The asset which is the subject of that agreement should be treated as owner-occupied.

The presence of a formal lease or occupancy agreement between related entities or subsidiaries which is legally enforceable consequently changes the interest in the properties being valued. Such properties should therefore be classified as investment properties. The reporting entity should declare these arrangements in the valuation instructions. In the context of a group, the classification of the properties is required to be reconsidered - and valued in accordance with the appropriate valuation basis applicable at the group level.

### 6.6 Assistance with Impairment Reviews

Where an item of property, plant or equipment is not revalued for financial reporting purposes, a review by the reporting entity is required at each reporting date to assess whether there is

any indication that the item may be impaired (see FRS-3, paragraph 9.3). Paragraph 9.4 of FRS-3 sets out the indications of possible impairment which must, as a minimum, be considered.

Where an item's future economic benefits are directly related to its ability to generate future cashflows, and there is indication that the carrying amount of the item exceeds the item's recoverable amount, the entity must estimate the item's recoverable amount (FRS-3, paragraph 9.3). If the recoverable amount is less than the carrying amount, the item must be written down to recoverable amount.

Where the future economic benefits of an item are not directly related to its ability to generate net cash in flows, the carrying amount of the item must not exceed net market value. However, where net market value cannot be determined because such items rarely, if ever, are sold in the open market except as part of the sale of a business in occupation, then the carrying amount must not exceed depreciated replacement cost.

It follows - that valuers may be requested to assist entities to estimate an item's recoverable amount. Valuers requested to assist entities in this way should have regard to the relevant requirements and guidance in FRS-3 and elsewhere in this Guidance Note.

### 6.7 Liabilities Associated with Assets

When an entity incurs an obligation to dismantle or remove an item of plant or equipment or restore a site, to the extent that a provision (liability) is recognised under FRS-15: Provisions, Contingent Liabilities and Contingent Assets, this is capitalised by the reporting entity as part of the cost of bringing the item of property, plant and equipment to working condition for its intended use.

The accounting treatment described - above applies in relation to both the initial recording of an item of property, plant and equipment (see paragraph 5.6 of FRS-3) and subsequent to initial recording (see paragraph 6.5 of FRS-3.)

When undertaking valuations of property, plant and equipment which have restoration, dismantling or removal obligations associated with them, the valuer must request guidance from the entity from whom valuation instructions are received about how such obligations are to be dealt with in the valuation. In all such circumstances, the valuation report is to disclose how such obligations have been treated.



**6.8 Appropriateness of Rating and Other Valuations**

Paragraph 7.10 of FRS-3 states that:

*“A valuation carried out for purposes other than financial reporting, for example a rating valuation, is not to be used as the basis for recording a revaluation unless the basis of valuation has been confirmed as appropriate, in accordance with the requirements of this Guidance Note, by an independent valuer.”*

A valuer requested to confirm the appropriateness of a rating or other valuation for financial reporting purposes must determine whether the valuation meets the requirements of FRS-3 and this Guidance Note. The valuer must comply with all the requirements of this Guidance Note.

For plant and equipment, where there is an active market or readily available price indices that establish the item’s Fair Value with reasonable reliability, the valuation need not be conducted by an independent valuer or experienced employee (FRS-3, paragraph 7.1(d)).

For the purposes of the above paragraph, a valuation may be undertaken without the need for an independent valuer or experienced employee only where there is sufficient objective market information available which enable two or more non-experts to determine materially the same Fair Values of the particular item of plant and equipment. The above paragraph is not applicable where depreciated replacement cost is the most appropriate basis for determination of the Fair Value of an item of property, plant and equipment (FRS-3, paragraph 7.9).

**6.9 Independent Review of Employee Valuations**

FRS-3 permits valuations to be conducted by employees who possess expert knowledge and experience in the location and category of property, plant and equipment being valued. The basis, methodology and assumptions underpinning valuations conducted by such experienced employees of the reporting entity are to be reviewed by an independent valuer to ensure the appropriateness of the valuation approach. (See paragraphs 7.1(c)(ii) and 7.7 of FRS-3.)

When a valuer is requested to undertake an independent review of a valuation undertaken by an employee of the reporting entity, the valuer must satisfy themselves that the basis and

methodology of valuation and the assumptions underpinning the valuation are appropriate for a valuation for financial reporting purposes as set out in this Guidance Note. The valuer must review the written report of the employee valuer and ensure that all matters have been properly dealt with. The valuer must be able to confirm that nothing has come to their attention to suggest that the valuation is not appropriate for financial reporting purposes.

**6.10 Public Sector and Infrastructure Asset Valuation**

Public sector assets comprise a number of different asset types, including conventional properties as well as heritage and conservation assets, infrastructure (e.g., public utility plants), recreational assets, and public buildings.

The valuation of public sector assets is to be undertaken following the same procedures and approaches as adopted in the valuation of private sector assets.

**6.11 Disclosure Requirements**

The valuation report shall contain a clause specifically prohibiting the publication of the report in whole or in part, or any reference thereto, or to the valuation figures contained therein, or to the names and professional affiliations of the valuers, without the written approval of the valuer as to the form and context in which it is to appear.

The valuation report shall also contain an affirmative statement that the valuation has been prepared in accordance with these or other recognised Standards, that the engagement was performed independently and without bias towards the client or others, and other disclosures required elsewhere in this Guidance Note.

The valuer shall require as a condition of the engagement that any special limitation, assumption, or departure be disclosed in any published document in which reference is made to the valuer’s opinion.

**6.12 Effective Date**

This Guidance Note was previously PINZ Valuation Standard 3 and became effective on 15 February 2002 and has been updated on 15 February 2006.

## ADDENDUM

IFRS to NZ IFRS – Summary of Changes in Respect to Property Assets.

The numbering in this addendum is not sequential as it corresponds to the applicable NZ IFRS reference.

### 1.0 Introduction

NZ IFRS refers to the New Zealand equivalent to (i) IFRS: International Financial Reporting Standards issued by the International Accounting Standards Board (IASB), (ii) IAS: International Accounting Standards adopted by the IASB and (iii) SIC: Interpretations issued by the International Financial Reporting Interpretations Committee of the IASB.

NZ IFRS contain all the provisions of the corresponding IFRS, (including IAS and SIC) and may include:

- (i) additional disclosure requirements that apply to all entities, and
- (ii) additional disclosure, recognition or measurement requirements that apply only to public benefit entities.

Profit oriented entities that comply with NZ IFRS simultaneously comply with IFRS. However, public benefit entities complying with additional recognition or measurement requirements in NZ IFRS will not simultaneously comply with IFRS.

Public Benefit Entities are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return.

In respect of property, plant and equipment assets, set out below are the changes that have been made in adapting IFRS to NZ IFRS. The changes listed should be read in the context of the standards from which they are drawn, the New Zealand *Preface* and the New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements*.

### NZ IFRS 1: First-Time Adoption of New Zealand Equivalents to International Financial Reporting Standards

#### **All Entities:**

Para 18(a) – deleted, as NZ IAS 40 does not permit the use of the cost model other than in the exceptional circumstances outlined in paragraph 53 of NZ IAS 40.

## NZ IFRS 4: Insurance Contracts

#### **All Entities**

#### **Appendix C**

(Life Insurance Entities):

- 10.3 Investment property that is within the scope of NZ IAS 40 *Investment Property* and that backs life insurance liabilities or life investment contract liabilities, shall be measured at fair value under NZ IAS 40.
- 10.4 Property, plant and equipment that is within the scope of NZ IAS 16 *Property, Plant and Equipment* and that backs life insurance liabilities or life investment contract liabilities shall be measured using the revaluation model under NZ IAS 16.
  - 10.4.1 An insurer applies NZ IAS 16 to its property, plant and equipment. Under NZ IAS 16 property includes owner-occupied property and property being constructed or developed for future use as investment property. Under NZ IAS 16, the cost model, for measurement subsequent to initial recognition, is to carry property, plant and equipment at cost. However, NZ IAS 16 has a revaluation model: an entity, subsequent to initial recognition, may carry its property, plant and equipment assets at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.
  - 10.4.2 Those property, plant and equipment assets that are within the scope of NZ IAS 16 and that the insurer considers back life insurance liabilities or life investment contract liabilities are measured using the revaluation model under NZ IAS 16, that is, they are measured at fair value with increases in fair value credited directly to equity and decreases recognised as an expense unless they reverse a previous increase.

#### **Appendix D**

(Financial Reporting of Insurance Activities):

- 15.3 Investment property within the scope of NZ IAS 40 and that backs general insurance liabilities shall be measured using the fair value model under NZ IAS 40.
- 15.4 Property, plant and equipment that is within the scope of NZ IAS 16 *Property, Plant and Equipment* and that backs general insurance liabilities, shall be measured using the revaluation model under NZ IAS 16.

- 15.4.1 An insurer applies NZ IAS 16 to its property, plant and equipment. Under NZ IAS 16 property includes owner-occupied property and property being constructed or developed for future use as investment property. Under NZ IAS 16, the cost model, for measurement subsequent to initial recognition, is to carry property, plant and equipment at cost. However, NZ IAS 16 also has a revaluation model: an entity, subsequent to initial recognition, may carry its property, plant and equipment assets at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.
- 15.4.2 Those property, plant and equipment assets that are within the scope of NZ IAS 16 and that the insurer considers back general insurance liabilities are measured using the revaluation model under NZ IAS 16.

### NZ IAS 2: Inventories

#### *Public Benefit Entities*

- NZ 8.1. Inventories held by public benefit entities may include:
- (a) ammunition;
  - (b) strategic stockpiles (for example, energy reserves);
  - (c) stocks of unissued currency; and
  - (d) postal service supplies held for sale (for example, stamps).
- NZ 9.1. In respect of public benefit entities, inventories held for distribution shall be measured at the lower of cost and current replacement cost.
- NZ 9.2. A public benefit entity may hold inventories whose future economic benefits or service potential are not directly related to their ability to generate net cash inflows. These types of inventories may arise when an entity has determined to distribute certain goods at no charge or for a nominal amount. In these cases, the future economic benefits or service potential of the inventory for financial reporting purposes is reflected by the amount of entity would need to pay to acquire the economic benefits or service potential if this was necessary to achieve the objectives of the entity. Where the economic benefits or service potential cannot be acquired in the market, an estimate of replacement cost will need to be made.
- NZ 9.3. If the purpose for which the inventory is held changes, then the inventory is valued using the provisions of paragraph 9 (that is, inventory is then measured at the lower of cost and net realisable value).
- NZ 10.1. In respect of public benefit entities, where inventories are acquired at no cost, or for nominal consideration, the cost shall be the current replacement cost as at the date of acquisition.

### NZ IAS 16: Property, Plant and Equipment

#### *All Entities*

- NZ 5.2. Under NZ IAS 40, paragraph 53, an entity is permitted to use the cost model for investment properties only where the fair value of the investment property is not reliably determinable on a continuing basis. This arises when, and only when, comparable market transactions are infrequent and alternative reliable estimates of fair value are not available.
- NZ 35.1. Subject to paragraph NZ 35.3 valuations shall be conducted either:
- (a) by an independent valuer; or
  - (b) where an entity employs a person sufficiently experienced to conduct a valuation, by that person, so long as the valuation has been subject to review by an independent valuer.
- NZ 35.2. The fair value of property, plant and equipment is determined or reviewed by an independent valuer who holds a recognised and relevant professional qualification and who has recent experience in the location and category of the property, plant and equipment being valued.
- NZ 35.3. For plant and equipment, where there is an active market or readily available price indices that establish the item's fair value with reasonable reliability, the valuation need not be conducted or reviewed by an independent valuer or experienced employee.
- NZ 77.2. An entity shall disclose in respect of each valuation conducted in accordance with paragraph NZ 35.1:
- (a) the name of each valuer;
  - (b) a statement in respect of each valuer as to whether they are an employee of the

## NZ VALUATION GUIDANCE NOTE 1

- entity or whether they are contracted as an independent valuer;
  - (c) the total fair value of property, plant and equipment valued by that valuer;
  - (d) where the valuation has been conducted by an employee of the entity the name of the independent valuer who reviewed the valuation; and
  - (e) the date(s) of such valuations.
- NZ 77.3. Where an entity has not used an independent valuer because there is an active market or readily available price indices that establish the fair value an item of plant or equipment with reasonable reliability in accordance with paragraph NZ 35.3, an entity shall disclose this fact.

### **Public Benefit Entities**

- NZ 15.1. In respect of public benefit entities, notwithstanding paragraph 15 (that is, an item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost), where an asset is acquired at no cost, or for a nominal cost, the cost is its fair value as at the date of acquisition. The fair value of the asset received must be recognised in the income statement.
- NZ 15.2. In most instances when property, plant and equipment is acquired, the cost of the item provides a measure of its value to the entity at the date of acquisition. When property, plant and equipment is donated, or the acquisition is subsidised, the cost of the item (if any) is not a reliable indication of its value to the entity. This standard therefore requires the fair value of such items to be determined as a substitute for the cost of purchase, and the amount of the donation or subsidy received to be recognised as revenue in the income statement.
- NZ 33.1. In the context of this Standard and in relation to public benefit entities, depreciated replacement cost is a method of valuation that is based on an estimate of:
- (a) in the case of property:
    - i. the fair value of land; plus
    - ii. the current gross replacement costs of improvements less allowances for physical deterioration, and optimisation for obsolescence and relevant surplus capacity; and
  - (b) in the case of plant and equipment, the current gross replacement cost less allowances for physical deterioration, and optimisation for obsolescence and relevant surplus capacity.
- NZ 33.2. Fair value is defined in paragraph 6 of this Standard (that is, the amount for which an asset could be exchanged between knowledgeable willing parties in an arms length transaction). Depreciated replacement cost is an acceptable estimate of the fair value of an asset only where the fair value of the asset is not able to be reliably determined using market-based evidence in accordance with paragraph 32 of this Standard.
- NZ 33.3. In the context of this Standard and in relation to public benefit entities, depreciated replacement cost is based on the reproduction cost of a specific asset. In principle, it reflects the service potential embodied in the asset. However, in some cases the reproduction cost of the specific asset is adjusted for optimisation in determining depreciated replacement cost.
- NZ 33.4. Optimisation refers to the process by which a least-cost replacement option is determined for the remaining service potential of an asset. This process recognises that an asset may be technically obsolescent or over-engineered, or the asset may have greater capacity than that required. Hence optimisation minimises, rather than maximises, a resulting valuation where alternative lower cost replacement options are available. In determining depreciated replacement cost, optimisation is applied for obsolescence and relevant surplus capacity.
- NZ 33.5. Obsolescence may arise from factors such as outmoded design and functionality of an asset and changed code requirements preventing reconstruction of an asset in its current form. In determining depreciated replacement cost, optimisation for obsolescence is made by reducing the reproduction cost of the specific asset held to the cost of a modern equivalent asset that provides equivalent service potential to that of the specific asset held.
- NZ 33.6. Surplus capacity may arise from either over-design or from surplus components of an asset. In determining depreciated replacement cost, optimisation is applied only to surplus capacity that is not required currently and for which there is no reasonable prospect it will ever be required in utilising an asset in its current form.

- Optimisation is not applied to surplus capacity that, while rarely or never used, is necessary for stand-by or for safety purposes.
- NZ 33.7. In determining depreciated replacement cost, the extent of any reduction in value for surplus capacity subject to optimisation depends on whether that surplus capacity subject to optimisation depends on whether that surplus capacity has an alternative use to the current use of the asset. Where there is no alternative use, the optimised value of the surplus capacity is zero. Where there is an alternative use, the optimised value of the surplus capacity is the value of the highest and best alternative use of that capacity.
- NZ 33.8. To illustrate the distinction described in paragraph NZ 33.7 between surplus capacity not having an alternative use to the current use of the asset and that which does, consider the following example. Assume depreciated replacement cost is to be determined for a network of water pipes where the pipe diameter is greater than currently required or ever expected to be required (including that necessary for stand-by or for safety purposes). There is also a discrete segment of the piping network that is similarly not required for the current use of the asset but which can be closed off and used for other purposes, such as a liquid storage facility. In this case, the surplus diameter of the piping would be disregarded for valuation purposes but the surplus segment of the piping network would be valued at its highest and best alternative use.
- NZ 33.9. In most cases, surplus capacity subject to optimisation is expected to be disregarded in determining the depreciated replacement cost of an asset. Such surplus capacity is unlikely to have an alternative use unless it is physically and operationally separable from the required capacity.
- NZ 33.10. In determining depreciated replacement cost, optimisation for obsolescence and relevant surplus capacity is applied only to the extent that it reflects the most probable use of the asset that is physically possible, appropriately justified, legally permissible and financially feasible.
- NZ 33.11. As evident from the definition of depreciated replacement cost, optimisation is applied only in determining the depreciated replacement cost of plant and equipment and in determining an estimate of the value of the improvements component of the depreciated replacement cost of property. Optimisation is not applied in determining the value of the land component of the depreciated replacement cost of property. The value of the land component will always reflect the fair value of the actual land held, in terms of both its size and location.
- NZ 33.12. In instances where the land is underutilised, the fair value of the land will be determined by reference to the highest and best use of such land. For example, in a case where specialised manufacturing facilities are located in a prime central business district site but the operation would be able to be run from a smaller sized and/or less valuable alternative site offering the same service potential, the fair value of the land would be the open market value of the entire central business district-located site.
- NZ 33.13. The fair value of land would normally be determined from market based-evidence. However, in the rare instances where extensive works have been carried out in order to prepare land for use in the entity's business, available market evidence will normally relate to land of the same size and in the same general vicinity but which is priced for uses that are sub-optimal relative to the use for which the works were carried out. In these rare instances the fair value of the land should be determined by having regard to the replacement cost of the land. For example, consider the case where an airport or port company acquires a section of seabed, fills it in and builds a seawall in order to produce flat land for use in the entity's business. The reclaimed land is in the precise location where the entity requires land. Market evidence may exist for other land of the same size and in the same general vicinity as the reclaimed land, but that other land is not suitable for the use intended by the entity. Thus, the market evidence on the fair value of that other land is not relevant to the reclaimed land, and the best indicator of the fair value of the reclaimed land would be the replacement cost of that land. Land resulting from extensive works by a local or central government body in constructing new roading provides a similar example.
- NZ 33.14. If an entity adopts the allowed alternative treatment in NZ IAS 23, an amount equal to the amount of borrowing costs that would be embodied in the fair value of the asset

## NZ VALUATION GUIDANCE NOTE 1

is included as a component of depreciated replacement cost. The inclusion of such an amount as a component of depreciated replacement cost is consistent with the principle underlying the inclusion in the initial cost of an asset of borrowing costs eligible for capitalisation as permitted by NZ IAS 23. The amount to be included as a component of depreciated replacement cost is determined on the basis of the average debt-to-equity ratio and average cost of debt applicable to entities undertaking the same activities as the entity reporting.

NZ 77.1. Public benefit entities are not required to disclose, for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model, as required by paragraph 77(e).

### NZ IAS 36: Impairment of Assets

#### *Public Benefit Entities*

NZ 2.1. This Standard shall be applied in accounting for the impairment of all assets of public benefit entities, other than:

- (a) [assets excluded by paragraph 2;] and
- (b) assets whose future economic benefits are not directly related to their ability to generate net cash inflows.

### NZ IAS 38: Intangible Assets

#### *Public Benefit Entities*

NZ 124.1. Public benefit entities are not required to comply with the requirement in paragraph 124(a)(iii) to disclose, in respect of intangible assets accounted for at revalued amounts, the carrying amount that would have been recognised had the revalued class of intangible assets been measured after recognition using the cost model in paragraph 74.

### NZ IAS 40: Investment Property

#### *All Entities*

30-32 [An entity is not permitted to use the cost model except in the circumstances outlined in paragraph 53.]

56 [An entity is not permitted to use the cost model except in the circumstances outlined in paragraph 53.]

53 There is a rebuttable presumption that an entity can reliably determine the fair value of an investment property on a continuing basis. However, in exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property following the completion of construction or development, or after a change in use) that the fair value of the investment property is not reliably determinable on a continuing basis. This arises when, and only when, comparable market transactions are infrequent and alternative reliable estimates of fair value (for example, based on discounted cash flow projections) are not available. In such cases, an entity shall measure that investment property using the cost model in NZ IAS 16. The residual value of the investment property shall be assumed to be zero. The entity shall apply NZ IAS 16 until disposal of the investment property.

NZ 33.1. Valuations shall be conducted either:

- (a) by an independent valuer; or
- (b) where an entity has in its employ a person sufficiently experienced to conduct a valuation, by that person, so long as the basis of valuation has been subject to review by an independent valuer.

NZ 33.2. The fair value of investment property is determined or reviewed by an independent valuer who holds a recognised and relevant professional qualification and who has recent experience in the location and category of the investment property being valued.

NZ 75.1. An entity shall disclose in respect of each valuer employed:

- (a) the name of the valuer;
- (b) the total fair value of property valued by that valuer; and
- (c) the date(s) of such valuations.

#### *Public Benefit Entities*

NZ 9.1. In respect of public benefit entities, property may be held to meet service delivery objectives rather than to earn rental or for capital appreciation. In such situations the property will not meet the definition of investment property and will be accounted for under NZ IAS 16, for example:

- (a) property held for strategic purposes; and

- (b) property held to provide a social service, including those which generate cash inflows where the rental revenue is incidental to the purpose for holding the property.

NZ 20.1. In respect of public benefit entities, notwithstanding paragraph 20, where an investment property is acquired at no cost or for nominal cost, its cost shall be deemed to be its fair value as at the date of acquisition.



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# NZVGN 2 INSURANCE VALUATION REPORTS

*The New Zealand Valuation & Property Standards Board issues the following guidance note to all members of the Property Institute of New Zealand and the New Zealand Institute of Valuers.*

## Insurance Valuation Reports

Following on from changes to the provisions for insurance under the Earthquake and War Damage Act 1951 the NZIV revised its "Certificate of Valuation for Insurance Purposes (Buildings)".

In November 1994 the NZIV published to members a revised insurance reporting format, together with a guidance note.

The revised insurance report "Valuation for Insurance Purposes" the "definitions of insurance valuation terms" and the "Guidance notes for use of Insurance Valuation Report" are now issued to members for their use and included in this "Technical Handbook" for members' information.

Stocks of the Insurance Reports and guidance notes are available from the National Office - NZIV.

Readers should note that the Format of this insurance report is Copyright to the NZIV and IPMV.

## Background

On the 1st September 1992 the New Zealand Institute of Valuers appointed a working group to review the Insurance Certificate which had been commonly used for a period of almost 20 years.

The working group was required to consider the need for a Certificate its wording and format.

Certification is no longer required but there is a need to provide a Valuation Report. The Valuation Report to which these guidance notes refer has been developed for use by members of the New Zealand Institute of Valuers and The Institute of Plant and Machinery Valuers.

The most significant changes to the former Certificate is the inclusion of Risk Management Information and the provision of market related value.

### 00.1 GENERAL

The most important feature of the Insurance Report is that it is a report and not a Certificate.

Valuers of both land and buildings and plant and machinery are able to use the report format.

The purpose of the report is to provide useful information for the client as well as the insurance industry and in an easily recognisable summary format.

Only those values or estimates required should be entered on the Valuation Report Form with a notation, "not required" or 'not provided" placed against the other headings, where appropriate. The intention is to allow for a range of information tailored to the needs of the insurance industry.

The opportunity exists for all valuers to liaise closely with clients so that useful and quality information will allow a decision to be made as to appropriate levels of insurance cover.

There may be instances where the information provided in standard form is insufficient to meet client requirements. In such cases a more detailed report should be provided. A report should be made available.

## General Information

### 0.1 NAME OF CLIENT:

While this is noted as normally "the insured", there will be occasions when it is not the insured as in the case of a "fund manager". The name of the client is the actual client of the valuer, broker and insurer.

### 0.2 ASSET DESCRIPTION:

This will include, in the case of the plant and machinery valuations any structure housing these items. It should be noted that when valuing residential property where the floor area is less than 100 square metres as in the case of smaller unit title units, the floor area should be provided in a covering letter or within the asset description, to enable appropriate coverage under the Earthquake Act.

### 0.3 UPGRADE REQUIREMENTS

Major items could include, but are not limited to:

## NZ VALUATION GUIDANCE NOTE 2

Sprinkler systems, lifts, major structural and/or machinery componentry, etc.

### 0.4 AGE

The estimated year of completion of the asset, not the commissioning date.

### 0.5 LAND CONTOUR

To ensure uniformity classification should correspond in general terms with those specified in the text, Urban Valuation in New Zealand, Volume I, 1991 by Rodney L Jefferies, published by NIIV, PO Box 27-146, Wellington, N.I.

### 0.6 SUB-SOIL TYPE (if known):

This information is required by Underwriters as a broad indicator of seismic stability. The perception gained from the definition can have a significant impact on insurance cost particularly in earthquake prone areas throughout New Zealand. It is important to discuss this aspect with your client and where potential penalties could arise, the insured should be encouraged to seek more detailed information from the Local and Regional Authority or engineering specialists. An entry should only be made in this portion of the report when the valuer has accurate knowledge as to the sub-soil type.

### 0.7 OTHER KNOWN CHARACTERISTICS:

These will include any items not otherwise covered within the report, which will be of assistance to the client and/or insurers and should only be detailed when information is known on the particular characteristics e.g. locational factors, surrounding property uses etc.

### 0.8 USE/OCCUPATION:

This should include a short description of the main site use, but where mixed use occurs e.g. commercial/residential, this should be recorded.

## 1.0 Reinstatement

### 1.1 REINSTATEMENT ESTIMATE:

The definition on the reverse of the report will apply but valuers should note that no specific identification is made in the Reinstatement Estimate of the cost of different materials and additional services. Should separate identification and calculation of costs be required, then this should be supplied on request as with details

on partial losses (refer reverse of report, and 0.3 of guidance notes). However any major items required as per 0.3. of the guidance notes must be shown under Upgrade Requirements.

### 1.2 INFLATIONARY PROVISION:

It should be noted that no allowance is to be made for any delay due to the need to comply with the provisions of the Resource Management Act including possibly the requirement to reinstate on an alternative site.

### 1.3 COST ESTIMATE:

In relation to the reinstatement, is as at a particular date (date of report) unless stated otherwise.

## 2.0 Indemnification

### 2.1 MARKET RELATED VALUE

If this value is required by the client, it is the value of the asset, excluding any land (Note b) on the front of the report, assuming that if appropriate, it is leased at a market rental. This would provide a similar value of the asset, as if it had been assessed in terms of the Valuation of Land Act 1951, being the added value which the asset gives to the land. As the property could be owner occupied, vacant or subject to rent review, it is considered appropriate to adopt this 'market related value' basis, and a market rental for the calculation of the value of the asset.

Should the insured wish to have Indemnity Value based on actual income then this must be stated by the valuer. This situation may arise in properties which are over or under rented, and when the client specifically requires rent recognition.

### 2.2 DEPRECIATED REPLACEMENT COST:

Note that this approach recognises physical depreciation only.

### 2.3 INFLATION PROVISION:

As detailed on the report, this would be calculated for the higher of "A" or "B" above. When only one of the two indemnification figures are being requested by the client, inflationary provision will apply to that only.

## 3.0 Functional Replacement

3.1 This would apply to assets unlikely to be reinstated to the same extent, or to the same

design or construction material as existing. This would be required when demand necessitates a smaller or different asset due to changes in technology, economics and other factors. Examples could be a freezing works through to a two storey retail/office building in a district where there is no demand for first floor space and would never be rebuilt. Any functional replacement assessment must be supported by a brief specification either provided by, or created in conjunction with, the client. A brief specification only is required, but if more detail is necessary this should be obtained from the client.

### **3.2 INFLATIONARY PROVISION:**

There is also the requirement to complete the Inflationary Provision during the reconstruction period on the same basis as the Reinstatement Estimate.

- 3.3 When this basis is used, then item 1.0 on the valuation form, REINSTATEMENT, must also be shown so the difference between the two methods is shown.

## **4.0 Demolition Estimate**

### **4.1 DEMOLITION ESTIMATE:**

This normally assumes that the total asset to be demolished has been damaged beyond repair. A Demolition Estimate covers the cost of demolition and removal as debris of the asset, excluding the cost of removal of any noxious materials or removal of debris on adjoining premises. If allowance is required to be made for the salvage or removal of fixtures, fittings and contents, then this should be specified and referred to in an attached letter. This could also apply to undamaged plant which must be removed from the property if considered necessary.

## **5.0 Other matters**

### **5.1 SITE IMPROVEMENTS:**

The Reinstatement Estimate. Indemnification and Functional Replacement figures if required should relate to the assets together with other assets within 8 metres of the external walls of the main structure or such other additional areas of the site likely to be damaged during reinstatement of the asset. If further infrastructural assets are required to be estimated they should be clearly identified.

### **5.2 VALUER'S SIGNATURE, QUALIFICATIONS & NAME:**

These are as stated. If the letterhead of the NZIV or IPMV is used, the name of the valuer's firm/organisation should also be incorporated at the bottom of the report. This would not be required if the company's letterhead is used.

### **5.3 VALUATION DATE:**

This is the date of the report. If the effective date of the valuation is different, or the valuation date is to cover a particular period other than a normal 12 months period of policy, then this information needs to be provided.

### **5.4 LESSEE'S IMPROVEMENTS:**

The valuation figures should exclude items installed and paid for by a lessee, unless requested by the client and detailed in the asset description. The asset description should also state whether the valuation report includes any plant or machinery.

## **Definitions of Insurance Valuation Terms**

The following definitions pertain to and form an integral part of the Valuation on the reverse hereof.

### **GENERAL**

#### *Name of Client*

Normally the insured.

#### *Address*

Physical location, including street address at which the assets are situated.

#### *Asset Description*

General description giving sufficient detail to identify the range of assets encompassed in the valuation including details of principal structure showing main construction materials. Any exclusions should be noted.

#### *Upgrade Requirements*

If the reinstatement estimate is based upon the use of different materials and/or additional services from those existing briefly describe the major item.

#### *Age*

Estimated year of completion and dates of any major additions and upgrades.

#### *Use/Occupation*

Nature of main activity carried out at location.

## NZ VALUATION GUIDANCE NOTE 2

### *Contour*

Valuer's classification of the land contour containing building and immediate yard areas:

- 1) Level
- 2) Gentle
- 3) Easy
- 4) Medium
- 5) Steep
- 6) Other - as specified

### *Subsoil Type*

General classification of land supporting building and immediate yard areas:

- 1) Bedrock
- 2) Finn natural ground
- 3) Filled ground
- 4) Other - as specified

As a geotechnical survey has not been undertaken the description is without prejudice.

## 1.0 Reinstatement

### *A. Reinstatement Estimate*

Is the estimated cost at date of valuation (including relevant fees) of reinstating the asset to an as new condition, including, where appropriate, the use of current equivalent technology, material and services. In the case of partial destruction no specific allowance has been made for any additional requirements that any Council, Government or other Authority may as additional expenditure to upgrade, alter or amend the undamaged portion of the asset.

### *B. Inflationary Provision*

This amount has been estimated on the basis of a loss occurring on the last day of a 12 month insurance period, if appropriate.

The inflation provision under 1.0 and 3.0 incorporates an allowance for the additional time required for damage inspections, demolition, preparation of new preliminary proposals and their approval by the Territorial Authority, preparation of working drawings and specifications, schedules of quantities, in addition to an estimated period of construction contract. No allowance is made for any delay due to the need to comply with the provisions of the Resource Management Act.

All inflationary provisions are given without prejudice.

## 2.0 Indemnification

### *A. Basis of Valuation*

#### (i) Market Related Value

Market Related Value is the estimated amount for which an asset leased at a market rent, if appropriate, should exchange on the date of valuation between a willing buyer and a willing seller in an arms length transaction after proper marketing, wherein the parties had each acted knowledgeably, prudently and without compulsion.

#### ii) Depreciated Replacement Cost

Is the Replacement Cost at the beginning of the insurance period, reduced by factors providing for age and physical depreciation.

## 3.0 Functional Replacement

Is the estimated cost required to reinstate all assets to perform similar tasks but under optimum current design and lay-out conditions with capacity requirements not greater than currently available. The value of any partial loss has been disregarded in this context.

## 4.0 Demolition Estimate

For the purpose of valuation, it is assumed that 100% of the assets have been damaged beyond repair and have no salvage value.

Unless otherwise noted in the valuation covering letter, Demolition Estimate covers the cost of demolition and removal as debris of the assets valued only excluding the cost of removal of any noxious materials, or removal of debris on adjoining premises.

VALUATION FOR INSURANCE PURPOSES

Name of Client: .....

Address of Assets: .....

.....

Asset Description: .....

Upgrade Requirements: .....

Age: ..... Use/Occupation: .....

Land Contour: ..... Subsoil Type: .....

Other Known Characteristics: .....

1.0 REINSTATEMENT

A. Reinstatement Estimate

B. Inflationary Provision

2.0 INDEMNIFICATION

A. Market Related Value

B. Depreciated Replacement Cost

C. Inflationary Provision (For the higher of 'A' or 'B' above during a 12 month insurance period if appropriate)

3.0 FUNCTIONAL REPLACEMENT

Refer to valuation report/letter for the specification of the functional design

A. Functional Replacement Cost

B. Inflationary Provision

4.0 DEMOLITION ESTIMATE

VALUER'S SIGNATURE: ..... QUALIFICATIONS: .....

NAME: .....

VALUATION DATE: .....

- (a) All figures quoted are exclusive of Goods & Service Tax, Finance costs and other indirect costs.
(b) All figures are exclusive of any allowance for land value.
(c) This form must be read in conjunction with the definitions of terms on the reverse hereof.
(d) The information in this report has been prepared to establish insurance values and may not be used for other purposes without the written consent of the Valuer.
(e) All figures assume compliance with building regulations and bylaws.

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Page 6 of 6
Issued 1 January 1995
GN5

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# NZVGN 3 VALUATION OF HOUSES UNDER CONSTRUCTION, AND HOUSES TO BE BUILT OR PREVIOUSLY UNOCCUPIED NEW HOUSES

*The New Zealand Valuation & Property Standards Board issues the following guidance note to all members of the Property Institute of New Zealand and the New Zealand Institute of Valuers.*

## 1.0 Introduction

- 1.1 This Guidance Note has been prepared for all members of the New Zealand Institute of Valuers involved in valuing houses under construction, houses to be built or previously unoccupied new houses.

## 2.0 Houses to be Built or Under Construction

- 2.1 When a valuation is being made assuming completion of the development, the valuer shall state in clear and concise language that the property has not yet been completed and that all values are based on the assumption that the property is or will be completed in accordance with the plans and specifications provided and the issuing upon completion of a Code Compliance Certificate by the territorial authority. The valuer should clearly establish the date to which the valuation applies. This would normally be the date of the report.
- 2.2 A valuation report prepared on a house partially completed, or on a proposed house prepared from plans and specifications, should describe in detail the nature of the building materials, accommodation, quality and nature of the fittings and finishes upon which the valuation is based.
- 2.3 Full details of any site works which are included in the valuation should be specified.
- 2.4 If it is anticipated that there will be any significant change in the value of the property between the

date of the valuation, and the expected date of completion of the building works, then this should be set out together with the reasons for the anticipated difference.

- 2.5 The effect, if any, on saleability and value of the property as at the valuation date due to such matters as partially developed site improvements, uncompleted building works and such like should be taken into account and commented upon in the valuation report.

- 2.6 It is recommended that a valuation report which assumes the completion of a house and/ or site development which is either under construction or is to be built or developed should include clauses on the following basis:

“As at the date of inspection the proposed improvements were approximately \_\_% complete. However, this report is based on the assumption that the house will be developed and completed according to the plans and specifications described herein and that the standard of construction is in accordance with that assumed within the report. It should be specifically noted that any significant deviation in respect of style, layout, design or construction standards would invalidate the value conclusions reached in this report.”

“The values reported herein are based on data collected and reviewed as at the date of this report. The valuer assumes no responsibility for unforeseeable events that alter market conditions prior to the completion of the development.”

## 3.0 Progress Payment Inspections

- 3.1 If a valuation is required of building works in progress it is incumbent on the valuer to verify that

## NZ VALUATION GUIDANCE NOTE 3

the work in progress conforms with the plans and specifications provided, including check measuring of the building(s).

- 3.2 The valuer should note in his/her valuation of "Work in Progress" not only the value of the work completed but also the estimated cost to complete the work in accordance with the plans and specifications.
- 3.3 Loose building materials, i.e. those not fixed in place, should not be included in the valuation of work completed. If the valuer considers it relevant, however, reference may be made to such loose building materials.

### 4.0 Final Payment Inspection

- 4.1 When requested to undertake a final inspection of the property the valuer should *refer* the client to the original valuation and date thereof, and *refer* to the client details of any work remaining to be done.
- 4.2 The valuer should inform the client as to whether the final balance of the monies outstanding may be released, or if a further retention should be made and the reasons why.
- 4.3 The valuer may wish to draw to the attention of the client prior to the final inspection being made of the importance of obtaining a Code Compliance Certificate.
- 4.4 The valuer should inform the client of the importance of obtaining a completed Code Compliance Certificate before releasing any final monies.

### 5.0 Valuation of Previously Unoccupied New Houses

- 5.1 Valuers should be aware that it is essential when valuing previously unoccupied new houses - either those completed or to be built - that consideration of comparable sales evidence should include not only similar new houses but also re-sales of similar properties.
- 5.2 Some new houses are offered for sale on finance terms favourable to the initial purchaser and this is often reflected in the initial purchase price. In addition the initial purchase price may reflect the building cost. The valuer should have regard to all such factors in determining *the* final value estimate.

5.3 The re-sale value of a house - particularly a previously unoccupied new property can be adversely affected by incomplete development of the property, whether the house itself or the site development.

5.4 Where the valuer considers that there is likely to be a significant difference between the value of a new house and its re-sale value in its same condition then this should be stated clearly in the valuation report, showing both value as a previously unoccupied new property and the re-sale value. The valuer should always comment on any differential between the purchase price new where known, and the assessed market value as a new house.

5.5 Where mortgage recommendations are provided the valuer should base such recommendation on the re-sale value of the property.

### 6.0 Duty of Care

Valuers are reminded of the duty of care and responsibility they owe to their client, mortgagees and third parties who may rely upon their valuations.

All enquiries should be addressed to:

Chief Executive Officer  
New Zealand Institute of Valuers  
P O Box 27-146  
WELLINGTON

# ANZRPGN 1 DISCLAIMER CLAUSES AND QUALIFICATION STATEMENTS

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to provide advice to members in the drafting and notifying disclaimer clauses and qualification statements when reporting to clients.

### 1.2 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.

### 1.3 Scope

This Guidance Note applies to members reporting to clients on any solution to a property problem. It relates specifically to the need for, and the drafting and notifying of, disclaimer clauses in those reports and should be used in conjunction with other guidance notes and practice standards which are either over-arching or directly applicable to the type of property, purpose or issues involved.

### 1.4 International Valuation Standards

This Guidance Note recognises the International Valuation Standards 1 and 2, and the International Valuation Application 2, effective from 2007 by the International Valuation Standards Committee and it is intended to be consistent with the concepts and definitions contained in those standards, however, there may be departures from IVSC Standards to reflect Australian & New Zealand law and practice.

### 1.5 Unlikely Instructions if Seek Exemption

Members are unlikely to be given instructions to value or give advice on property if they seek exemption from liability to their clients.

### 1.6 Protect from Unrelated Third Parties

They may, however, wish to protect themselves from unrelated third parties by attempting to limit the class of person to whom a duty of care may be owed. For that purpose members will often, and indeed, may be required by their professional indemnity insurer to, use a variety of third party disclaimers.

### 1.7 Qualification Statements

Similarly, a Member may wish to include qualification statements in a property report to bring to the attention of the reader assumptions and/or other issues concerning factors which might affect the property, and ultimately its value and any other conclusions in the report.

## 2.0 Third Party Disclaimer Clauses

### 2.1 Third Party Disclaimer Clauses

Third Party Disclaimer Clauses can take many forms, but would usually contain one or more of the following components:

- the purpose for which the valuation was prepared.
- the person for whom the report was prepared.
- a statement as to who can rely on the information contained in the report.
- a statement that the signatory/firm accepts no responsibility (other than to the client) for the document or its contents.

### 2.2 Not Able to Exclude Liability

A disclaimer will not, of itself, be able to exclude a member's liability in negligence where such a liability would otherwise exist. [Refer Barwick C.J in the Evatt's case and Allen J in Burke and Ors v Forbes Shire Council (1987), Supreme Court of New South Wales, Australian Torts Reports 80-122].

## NZ VALUATION GUIDANCE NOTE 1

### 2.3 Disclaimer Clause May be Effective

However, in spite of those rulings a disclaimer clause may be effective. The presence of such a clause is one factor which could be considered relevant in establishing whether there was a sufficiently close relationship between the parties, in particular whether it was reasonable, in the circumstances, for the third party to rely upon the information set out in the report.

### 2.4 Legislation

Similarly, under the various legislation e.g. Federal Trade Practices Act and the various State Fair Trading Acts in Australia, and the Fair Trading Act in New Zealand, it is not possible to avoid liability to third parties simply by stating that the member does not accept responsibility to that person.

### 2.5 May be Effective Where Limitation Reasonable

A disclaimer may be effective to avoid liability under these acts where the limitation upon liability to third parties sought to be created by the member is reasonable having regard to all the circumstances including the instructions provided, the purpose of the report, the intended circulation of the report (who is likely or intended to receive and rely upon it) and the clarity of the disclaimer.

### 2.6 Sufficient Warning to Third Parties

In such circumstances, the third party disclaimer will be effective because it provides a sufficient warning to third parties that it may not be safe to rely upon the report without further recourse to the author. A report containing such a third party disclaimer may be held not to be misleading or deceptive to a person of the class of third parties to which liability has been disclaimed.

### 2.7 Specifically Drafted

Accordingly, at both common law and under the Trade Practices Act and state Fair Trading Acts in Australia, and the Fair Trading Act in New Zealand, the most effective third party disclaimer will be one that is specifically drafted for the circumstances of the particular report and which, thereby reflects the instructions, purpose and intended recipients of the report.

### 2.8 Most Impact at the Beginning of Report

Generally, the clause is more likely to be effective if included at the beginning of the report.

### 2.9 Ambiguity

Where there is any ambiguity in the meaning of the clause, a Court is likely to interpret the disclaimer in a manner which is least helpful to the party relying on that clause. It is therefore necessary to consider carefully each set of instructions and to adopt clear, concise wording appropriate to the particular valuation or property report being undertaken.

### 2.10 Inappropriate Disclaimer

Members should also note that the use of a third party disclaimer, where the disclaimer is inappropriate to the instructions, purpose and intended recipients of the report, could itself constitute misleading or deceptive conduct in breach of the Federal Trade Practices Act or State Fair Trading Acts in Australia, and the Fair Trading Act in New Zealand.

### 2.11 Instruction Paragraph Details

Ideally, the instruction paragraph should set out the details of the party issuing the instruction, the date of their written instructions, the party to whom the report is addressed, the names of any other parties to whom liability is extended under the report and the purpose of the report. For example:

Acting on written instructions from ... dated ... on behalf of ..., we have inspected the property situated at ... for the purpose of assessing the current Market Value of that property for mortgage security purposes.

This valuation may only be relied upon by ...

The report has been prepared for the private and confidential use of the above parties and it should not be reproduced in whole or in part or relied upon for any other purpose or by any party other than ... without express written authority.

## 3.0 Qualification Statements

### 3.1 Highlight Factors Affecting Reliability

Qualification statements should be used whenever the quality of the information provided by the member can be improved by highlighting any factor which may affect the reliability of that information.

## 3.2 Clearly Inform the Reader

Qualification statements should clearly inform the reader of:

- any factors which might affect the reliability of information in the report;
- any additional steps which the reader should take to make the information more reliable;
- the potential effect on the value if the information is not correct.

## 3.3 Not a Substitute - Highlight Limitations

Qualification statements should not be used as a substitute for the member's own reasonable enquiries and verification of information. They do, however, have a legitimate role in highlighting particular aspects of the instructions, limitations upon the extent of enquiry, which the member is reasonably able or expected to carry out, and/or limitations in expertise.

## 3.4 Most Impact Adjacent Information Intended to Qualify

Qualification statements will have the most impact on the reader if they are included in the body of the report immediately adjacent to the information which they are intended to qualify. Where particular qualification statements (including assumptions) are of central importance to a particular property report, it may be good practice to repeat those qualification statements in a prominent place such as adjacent to the conclusion or statement of valuation opinion.

## 3.5 Mould to the Circumstances

While it is useful to have a standard set of commonly used qualification statements to act as a reminder or 'trigger', members should take care to mould the appropriate qualification statements to the circumstances of each particular report. A slavish adherence to standard qualification statements may undermine the effectiveness of those statements.

## 3.6 Appended Page Less Useful

Similarly, a page of qualification statements appended to a property report may not assist the reader of the report to focus on the issues and may be less useful in assisting the Member to resist allegations of negligence and/or misleading or deceptive conduct.

## 3.7 Must Inform the Reader

Qualification statements do not have any 'magic' effect. In order to be of assistance in minimising liability they must actually inform the reader in a way that allows the reader to assess the information provided by the property report in a balanced and informed manner. By doing so qualifications will assist the member to meet his or her duty of care and avoid information in the property report creating a misleading or deceptive impression.

## 3.8 Examples Relevant to Situations

Some examples of qualification statements which may be relevant to situations commonly encountered by members are set out below. The manner in which these examples are designed to address limitations in the member's role, instructions or expertise should be noted. They may assist to draft specific qualification statements to address particular circumstances or reports, however they should be used as a guide only. Disclaimer clauses should be specifically designed to suit particular instructions as appropriate.

## 3.9 Site Survey

### Member Generally not Qualified

The member is often asked to state that the improvements on a property are located within the boundaries of the site. Generally the Member is not qualified to make that certification, unless also qualified and registered as a Surveyor.

## 3.10 Survey Qualification

The Institute suggests that the following qualification may be appropriate for inclusion in reports.

'A current survey has not been sighted. The valuation is made on the basis that there are no encroachments by or upon the property and this should be confirmed by a current survey report and/or advice from a Registered Surveyor. If any encroachments are noted by the survey report, the member should be consulted to reassess any effect on the value stated in this report.'

## 3.11 Town Planning/Resource Management

### Verbal Enquiries

In most instances a member will only make verbal enquiries of the Local Authority or the State Planning Department as to the zoning or planning

area of a property. In some locations - it is not possible to obtain a 'zoning or planning area certificate' and obtaining written confirmation of zoning can take considerably more time than is generally available to the Member and/or the client.

### 3.12 Extent and Nature of Enquiries

It is therefore necessary to set out the extent and nature of the enquiries made in ascertaining the zoning and development requirements of the subject property. For example:

Town planning information was verbally obtained from offices of the Town Planning Department. .... Council, however, we recommend that this zoning or planning area should be verified by application to Council for the issue of a zoning certificate pursuant to Section 149 of the Environmental Planning and Assessment Act, 1979.

### 3.13 Environmental/Contamination Issues

#### Increased Awareness

An increased awareness of environmental issues in the community today has brought about a need for members reporting on property to be conscious of influences which may affect the value of a particular property at the time of reporting or at some time in the future.

#### Issues Include

Those issues may include:

- contamination - through petroleum or chemical products;
- nutrient management for properties adjacent to rivers/ streams or over underground water supply sources;
- conservation - including rare flora and fauna species;
- Native title claims.

#### Examples

Some examples of clauses relevant to this issue include the following:

- Environmental Issues  
Our enquiries at ..... Council indicate that the site has not previously been utilised for any industrial or manufacturing use or for the storage (either above ground or underground) of any chemical substance.

Our verbal enquiries at EPA indicate that the Authority is unaware of the existence of any site contamination. Whilst our inspection of the site surface confirms the results of these enquiries, we have not investigated the site beneath the surface or undertaken vegetation or soil sampling. This valuation is therefore subject to a satisfactory contaminated site assessment report from environmental consultants.

or

The site is (or has been) occupied by an undertaking which, having regard to the nature of process or chemicals used or stored, has a potential to cause soil contamination. Whilst our enquiries at EPA indicate that the Authority is unaware of contamination, we recommend a site inspection by an Environmental Consultant.

- Petroleum products

The subject property is operated as a service station and workshop and therefore fuels, oils and other products capable of causing contamination are used on the site as part of the operation. There are no visible signs of any pollution on the property; however, we are unable to certify that there is no contamination of the property beneath the surface of the soil.

- Asbestos

Inspection of the improvements showed the use of asbestos products in the building. We must point out that we are not experts in this area and therefore, in the absence of an environmental consultant's report concerning the presence of any asbestos fibre within the subject property, this valuation is made on the assumption that there is no health risk from asbestos within the property. Should it subsequently transpire that an expert report establishes that there is an asbestos related health risk we reserve the right to review this valuation.

- Pest Affectation

The subject property is located in an area considered susceptible to termite infestation. Inspection of the subject improvements did not reveal any apparent termite infestation. This should however, be confirmed by a certified pest control firm.

- Right to Review  
The right is reserved to review and if necessary vary the valuation figure if any contamination or other environmental hazard is found to exist.

## 3.14 Improvements

### Extent of Investigations

In describing the improvements to a property, and their condition, it is important to highlight in the report the extent of the member's investigation as to the structural integrity of the building and its plant and equipment. For example:

- An inspection of all readily accessible parts of the improvements on the property has been carried out by the member.
- We have not sighted a qualified engineer's structural survey of the improvements, or its plant and equipment. The member is not a building construction and/or structural expert, and is therefore unable to certify as to structural soundness of the improvements. Prospective purchasers or mortgagees would need to make their own enquiries in this regard.
- We have not sighted a structural report on the property nor have we inspected unexposed or inaccessible portions of the premises. We therefore cannot comment on the structural integrity, defect, rot or infestation of the improvements nor can we comment on any knowledge of the use in construction of material such as asbestos or other materials now considered hazardous.

## 3.15 Tenancy Details

### Extent of Investigation of Lease Details

In reporting the specific lease details of a property it is important to advise the extent of the investigation of lease documents and other supporting documentation undertaken by the Member.

### Valuation of a Proposed Development

On occasions, particularly when undertaking an 'as if complete' valuation of a proposed development, lease negotiations or preparation of documentation may not have been concluded. In those circumstances it is necessary to specify in the report that the valuation is subject to satisfactory conclusion of those lease negotiations and the

sighting by the member of a stamped lease agreement by the parties. For example:

This assessment of Market Value is based on the assumption that the proposed lease agreements outlined earlier in this report are all executed, signed and stamped.

Upon being stamped those documents should be referred to the member for sighting to confirm that the particulars of the document concur with those set out in this report.

## 3.16 Value As If Complete

### Requires a Variety of Assumptions

In Australia it is normal practice in valuing a proposed development for mortgage security purposes to assess the market value of that development as though the property were completed at the date of valuation. Such a process requires a variety of assumptions to be made, which may include:

- construction and development costs;
- in accordance with plans and specifications at the time of valuation;
- the impact of existing and future competition;
- the level of sale prices; and
- in the case of income properties, the likely level of rents, the lease-up period, rental concessions and commissions, capitalisation rates, discount rates, etc.

## 3.17 Set Out in Detail Assumptions Made and Qualifying Clauses

It is therefore imperative that the Member, in undertaking an 'As If Complete' valuation, sets out in detail the assumptions made and inserts a qualifying clause in the valuation report stating that the valuation is subject to the assumptions outlined in the report, particularly where those assumptions are based on purported lease negotiations or pre-sale contracts. These qualifying clauses could include:

- Satisfactory completion of the improvements in accordance with the plans, specifications and details as provided.
- An inspection by the valuer following practical completion of construction.
- Confirmation or variation of the original valuation figure relevant to the original valuation date, following an inspection of



the project and any leases after practical completion.

- Issue of all relevant approvals including a satisfactory building completion certificate under the appropriate legislation.
- Sighting of any reports from other experts who have provided advice in aspects of the construction of the buildings.
- Such other matters/issues that the valuer is of the opinion should be drawn to the attention of the lender.
- The right to review and, if necessary, vary the valuation if there are changes in the project itself or leasing.

An example of what could be stated follows:

'The Value As if Complete assessed herein is the Market Value of the proposed improvements as detailed in the report on the assumption that all construction had been satisfactorily completed in all respects at the date of this report. The valuation reflects the valuer's view of the market conditions existing at the date of the report and does not purport to predict the market conditions and the value at the actual completion of the improvements because of time lag.

Accordingly, the 'As if Complete' valuation must be confirmed by a further inspection by the valuer, initiated and instructed by the lender, on completion of improvements. The right is reserved to review and if necessary, vary the valuation in this report if there are any changes in relation to the project itself or in property market conditions and prices'.

### 4.0 GST Qualification

In analysing the sales and/or leasing evidence referred to herein, it is noted that we have attempted to ascertain whether or not the sale price/rental is inclusive or exclusive of Goods and Services Tax (GST). In relation to sales evidence, it is emphasised that Land Titles Offices in Australia and the Land Registry Offices in New Zealand do not currently differentiate between or record whether or not the sale price is inclusive or exclusive of GST.

Where we have not been able to verify whether or not GST is included in the sale price or rental, we have assumed that the record of sales price or the rental is inclusive/exclusive of GST. Should this not be the case for any particular sale or letting used as evidence, we reserve the right to reconsider our valuation.

# ANZRPGN 2 ACTING AS AN EXPERT WITNESS, ADVOCATE OR ARBITRATOR

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to provide information, commentary, opinion, advice and to Members acting as experts in judicial or quasi-judicial proceedings

### 1.2 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.

### 1.3 Scope of this Guidance Note

This Guidance Note applies to Members acting as experts in judicial or quasi-judicial proceedings and is intended to provide information on what is considered to be good practice where a member is required to give expert evidence.

This Guidance Note has been prepared against a background of court dicta and specified requirements emanating from the Courts regarding the duties and responsibilities of expert witnesses.

An expert witness report should include all facts which the expert regards as being relevant to the opinion which he has expressed and should draw to the attention of the judicial body any matter which would affect the validity of that opinion.

An experts report should include a statement that the report complies with the relevant court practice note, rules or regulation and which will usually include a statement that the expert has read and compiled with the relevant document. The experts duty to the court is emphasised, in contrast to the duty to the client.

## 2.0 Responsibilities

The duties and responsibilities of expert witnesses in civil cases include the following:

- Expert evidence presented to the Court should be, and should be seen to be, the independent product of the expert.
- An expert should provide independent assistance to the court by way of objective unbiased opinion in relation to matters within the experts expertise. An expert witness should not assume the role of an advocate.
- An expert should state the facts or assumptions upon which an opinion is based.
- An expert should state when a particular question or issue falls outside the experts expertise.

## 3.0 General Duty

### 3.1 Duty to the Judicial Body

The duties of an expert witness can be defined as follows:

- The primary duty of the expert witness is to assist the court or tribunal.
- The duty is to be truthful as to fact, honest as to opinion and complete as to coverage of relevant matters. The duty is the same whether or not the Expert is giving evidence in Court or to a Tribunal on oath or not on oath.
- Expert evidence must be independent, objective and unbiased.

### 3.2 Instructions

On receipt of instructions the expert should establish whether any conflict of interest may arise.

If a conflict of interest exists or may exist the expert should either refuse the assignment or seek

written confirmation of instructions following disclosure.

### 3.3 Purpose of Evidence

The purpose of expert evidence is to assist a judicial body in exercising its functions.

The evidence given should, therefore, give all the necessary detail from which conclusions have been drawn in order to enable the judicial body to judge the appropriateness of the conclusions based upon the facts submitted.

### 3.4 Evidence of Fact

The expert witness is often required to assist the judicial body in establishing, clarifying and ordering logically the relevant facts and issues to be addressed.

The expert should be aware that evidence to the judicial body may take precedence over any contractual, professional or other duty.

Where an expert is instructed to give an opinion based on assumption or number of assumptions, the experts report should state the assumption or assumptions.

A written report provided by an expert should include a schedule of the documents relied upon and where necessary, copies of such documents or the relevant portions thereof. The expert should indicate the source of factual information relied upon.

### 3.5 Giving Evidence

Expert evidence must be objective, independent and unbiased. Opinion should not be exaggerated or seek to obscure alternative views.

When experts are instructed to meet to agree facts they may be instructed also to endeavour to agree opinions and, in such instances they should disclose facts and information relevant to their evidence and where they disagree the reasons for disagreement should be recorded and reported.

Where an expert changes their opinion, for whatever reason, such change should be communicated immediately in writing to the appointer, with whom the responsibility will lie to communicate it to other parties and the judicial body.

## 4.0 Acting as an Advocate

A member is entitled to act as an advocate for a client however the advocacy role is subject to proper professional practice in conducting negotiations on the clients behalf and that role must be declared to all parties. A member must not act as an advocate then as an expert in the same matter (see ANZPS 1).

## 5.0 Acting as an Arbitrator

Experts appointed as arbitrators are usually required to act in accordance with the uniform commercial arbitration legislation.

The Institute of Arbitrators and Mediators Australia and New Zealand conducts education and training for arbitrators and mediators and grades arbitrators according to experience.

Experts should not act as arbitrators unless they have the appropriate education, training and experience in relation to the commercial arbitration legislation.

# ANZRPGN 3 LEASING INCENTIVES

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to provide information, guidance and advice on leasing incentives to Members undertaking tasks involving the assessment or analysis of rental and capital values.

### 1.2 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.

### 1.3 Scope of this Guidance Note

This Guidance Note applies to Members assessing the impact of leasing incentives on rental and capital values particularly in relation to commercial property.

### 1.4 International Valuation Standards

This Guidance Note recognises the International Valuation Standards 1 and 2, and the International Valuation Application 2, effective from 2007 by the International Valuation Standards Committee and it is intended to be consistent with the concepts and definitions contained in those standards, however, there may be departures from IVSC Standards to reflect Australian & New Zealand law and practice.

### 1.5 Cyclical Market

Since the 1960's the commercial property market has experienced increased volatility. This is primarily because demand lead time is far shorter than the time needed to create more supply. This cyclical pattern is unlikely to change in the foreseeable future so that valuation methodology and techniques and the practitioners themselves must be able to cope with the varying market conditions – no matter how extreme.

### 1.6 Over Supply Leading to Incentives .... analysis of evidence essential

Oversupply of office space in most of the major cities has led to incentives being offered to prospective and existing tenants. Whilst these incentives are of prime importance to the parties directly concerned, they are also important to the market place as a whole to the extent that they may affect market rental values. The analysis of rental evidence for comparative purposes is an essential part of the valuation process and is of particular relevance where rent reviews and asset valuations are under consideration.

### 1.7 Range of Opinions

The range of opinions amongst valuers and their clients as to how leasing incentives should be interpreted has resulted in a broad ranging public debate.

### 1.8 Intention of Clarifying Principles

In response to specific requests, this Guidance Note has been prepared with the intention of clarifying the principles involved.

### 1.9 No Uniformity of Market Conditions

A review of the situation in the various cities clearly shows that there is little uniformity in market conditions. This tends to be the normal situation and makes it impractical to enunciate Practice Standards on how matters must be evaluated.

### 1.10 Skill of the Valuer is to Investigate

The traditional skill of the valuer is to investigate, report and evaluate the specific situation being considered, taking into account the differing factors which affect rental levels and capital values in the particular location or market.

### 1.11 Many Factors to Consider

These factors include the wording of the pertinent lease clause (of which there are countless variations), the state of the building, the general market, the size and duration of the lease, case law, and many other factors of which incentives granted on new leases are but one.

### 2.0 Leasing Incentives

#### 2.1 Rent Freely Negotiated Between Two Parties

The consideration paid for the right to occupy premises owned by another usually takes the form of a periodic rent which, in the case of new lettings, is negotiated freely between the two parties. Rental value is assessed by various methods. In the case of office space, the method most frequently used in rental review determinations is to analyse rents paid for comparable space, thereby deriving a rental rate to be applied to the subject accommodation. Rental values normally refer to accommodation that has been completed up to the stage of the tenant's fit out.

#### 2.2 Supply and Demand ....excess of supply

The fundamental laws of economics apply and in the case of the office market, it is difficult, given the lead time involved in supplying new space to the market, for supply to respond quickly to rise or fall in demand. Surplus space can be withdrawn from the market place but owners are understandably reluctant to take this course. Accordingly, once a significant excess of supply over demand is demonstrated, rental values may fall.

#### 2.3 Incentives for Leasing New Building

In periods of oversupply of accommodation, incentives are often granted during the leasing up of a new building and these amounts are regarded by the owner/developer as part of the capital costs.

#### 2.4 Incentive to Move

The cost of fitting out and relocating can be high and without an incentive from the landlord which meets all or at least a substantial part of these capital costs tenants would, in many instances, not move to new premises.

#### 2.5 Sustaining Rental Levels in Times of Over Supply

If rentals are to be sustained in times of oversupply, some form of compensatory consideration may be required to achieve new lettings. That consideration, where it occurs, is also part of the incentive in whatever form it may take.

#### 2.6 Incentive Benefit Offset Against Commitment

The consideration of incentive, may take the form of a capital payment or relief from a revenue obligation. In either case the tenant receives a benefit which will be offset against the totality of the tenant's rental commitment and fit out cost.

#### 2.7 Incentives Even in Balanced Market

It is relevant to note that lessors have often given incentives to in-going tenants, even when the leasing market has been balanced in terms of supply and demand.

#### 2.8 Extent Incentive is a Reduction of Rent

What has to be assessed is the extent to which a particular incentive package includes an amount, which might be regarded as a reduction from the stated rent. It is noted that leasing incentives have sometimes increased in anticipation of increasing vacancy factors and may be perceived to create a false rental base, which may cause difficulty in the analysis and assessment of rentals and capital values.

#### 2.9 Valuer to Decide Appropriate Technique

There are several techniques for arriving at a value, which are well known to practising valuers some of which are appropriate to different situations. It is up to the judgment of the Valuer in each case to decide which of the techniques to use. In many cases the Valuer may utilise more than one technique in the process of producing a valuation.

### 3.0 Effective Rental Value

#### 3.1 Converting Incentive Into Periodic Equivalent

Where it is determined that an incentive has been paid, the valuer is called to utilise judgment in the light of the current conditions in the location concerned as to whether any element of the incentive should be regarded as a de facto rent reduction. This element should be converted into a periodic equivalent over the term of the lease. This periodic equivalent should be deducted from the nominated or passing rent in order to arrive at the effective rent. Any effective rental should represent the most valid interpretation of the transaction concerned for comparative purposes, which may not necessarily represent market rent.

### 3.2 Interpretation of an Incentive in Terms of Cash Flow

Care should be taken to ensure the correct interpretation of an incentive in terms of cash flow. For example, a lump sum payment equal to three years rental, paid at the start of the lease, will not equate to an actual rent-free period of three years.

## 4.0 Rent Reviews

### 4.1 Points to Consider in Rent Reviews

In reaching a view as to the rent that should be adopted on review the valuer may take many points into consideration including:

- The specific wording of the subject lease clause.
- Relevant case law.
- The rents being agreed between landlord and tenants on review for similar tenancies in the area.
- The size of the tenancy concerned relative to the size of space of available comparable rentals.
- The fact that a review to market rent may not necessarily be influenced by the level of rent previously passing unless required under the lease conditions.
- Rents on review may fall as well as rise according to prevailing market conditions unless there is provision in the lease to prevent the rental falling.
- Guidance should be sought from a wide range of rentals including rentals freely negotiated at review dates and rentals for new lettings both of which may or may not truly reflect the rent which would be paid in the market. The circumstances of the rentals must be fully investigated and appropriate adjustments may be required up or down in the valuation process.
- The possibility of incentives having an effect on the stated rent as outlined in points 3.1 and 3.2 where new lettings are considered in reaching a view on the current market rent.
- The valuer should have regard to this practice and decide as to whether the amount of the inducement is greater than a reasonable inducement to move and assess as to whether, in all the circumstances, all or part of

the incentive granted would be regarded as a rental rebate.

### 4.2 Deciding the Weighting to Apply to Evidence

From time to time a valuer will be faced with rent reviews occurring, some of which have had regard to the level of effective rent created by incentive payment while others in the same building (or similar buildings) demonstrate a disregard for such consideration. Obviously the Valuer should examine the particular premises, the remainder of the term available and the particular conditions of the lease before deciding the weighting he needs to apply to such evidence in the process of assessing market rent. In fact the lease conditions may require an assessment of a rent level that is not market rent.

## 5.0 Secrecy Clauses

### 5.1 Encouragement for Full Disclosure

Secrecy clauses and side agreements in leasing arrangements are a negative development and every encouragement should be given to lessors and lessees to provide full disclosure of all lease arrangements.

### 5.2 Secrecy Undesirable

Secrecy arrangements are clearly against the operation of an informed market and are thus undesirable.

### 5.3 Serious Repercussions Can Flow

The Institute recognises that two parties have the right to confidentiality of their commercial arrangements. However, the Institute believes that serious repercussions can flow from the use of non-disclosure or secrecy clauses particularly when their use may distort valuations based on inadequate information.

### 5.4 Ascertaining Existence

Before accepting instructions valuers should where possible:

- Enquire in writing as to the existence of any secrecy clauses or side agreements.
- Obtain a written response.

### 5.5 Refuse to Act

The valuer has a right to refuse to act in instances where it is considered that the lack of information

prejudices the valuer's ability to discharge the responsibility of making the assessment.

### 5.6 Professional Responsibility

In discharging this responsibility the valuer should be aware of the liability for potential claims for professional negligence or fraudulent conduct.

## 6.0 Capital Values

### 6.1 Adjustments

The capital value of an income producing property should be arrived at by capitalising the market rent making adjustments for any continuing rent free periods, vacancies, leasing up costs, reversions, outstanding repairs/renovations, the strength of lessees' covenants, lease terms and so forth. In a stable market, the assessment of market rental value and the appropriate capitalisation rate can be undertaken without undue difficulty, notwithstanding the degree of research required. The introduction of incentives coupled with a relatively inactive market makes the valuation process more complicated and, possibly more subjective.

### 6.2 Matters for Consideration

It is recommended that careful consideration should be given to the following matters in addition to the matters referred to above:

- The relativity between the passing rent and market rental value indicated by the long-term rental trend line in the relevant market.
- The need to distinguish between passing rents, market rents and effective rents and their relative growth patterns and the relationship with real net cash flow.
- The proper assessment of the sustainable level of net income.
- Due allowance for the reversionary value of lower than market level rents.
- The capitalisation rate to be applied in the light of market rental levels and the position of the property market in its cyclical movement.
- The danger of applying a capitalisation rate to a passing rent which, for whatever reason, does not represent market rent.
- The precise interpretation of the rent review clause(s).

- Where appropriate, a comparison between the Internal Rate of Return derived from the cash flow as analysed in the above process and the Internal Rate of Return required by buyers in the market place at the date of valuation.
- Adequate allowance for letting up and leasing incentives for vacant areas.
- Adequate allowances for any building works or refurbishments needed.
- Any possible tax implications.

## 7.0 The Market

### 7.1 Valuers Interpret

Valuers do not set the market, they interpret it.

### 7.2 Interpreting Varying Conditions

The market and market practices are subject to continuous change. Consequently, the valuer should interpret these varying market conditions in the application of established methodology.

### 7.3 Market Dictates Value

The Courts have often noted that it is the market that dictates value (*Broken Hill Pty Co Ltd v Australian Mutual Provident Society*, reference *The Valuer*, Vol. 29 at 340).



# ANZRPGN 4 METHODS OF MEASUREMENT

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to provide a national guide to members for the consistent measurement of buildings. It is intended to be used for the purpose of valuations, property management, property analysis, leasing and sales.

### 1.2 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.

### 1.3 Scope of this Guidance Note

In Australia properties covered by this guideline are listed in 6.0, below. For the purpose of consistency, the Property Council of Australia (PCA) Method for the Measurement of Lettable Area (Copyright 1997) has been adopted for the purpose of defining lease space in Commercial, Retail and Industrial premises. Properties not within the scope of the PCA document are included in this guideline and additional properties may be added from time to time. This is a national document and is being harmonised with international practice.

#### New Zealand Members Note:

This guidance note was originally intended for use by Australian Members. Sections are relevant to New Zealand, although some Australian definitions differ from those used in New Zealand. New Zealand Members are specifically referred to the PCNZ/PINZ Guide for the Measurement of Rentable Areas revised in 2006. This publication is an update of the former BOMA/PLEINZ guide

### 1.4 Use of this Guidance Note

The guideline provides definitions of the various

types of measurement generally used in the property industry. It then lists property types in alphabetical order together with the relevant method of measurement.

### 1.5 Limitations

Some building areas (particularly retail) may be defined in some state and territory legislation and will over-ride the definitions in this Guidance Note where appropriate.

## 2.0 Principles of Measurement

### 2.1 Accuracy

Physical measurements are a matter of fact (not opinion) and should be accurate. The degree of accuracy, for example 'rounding' (see 2.2, below), will depend upon the circumstances, but should never be misleading. Where appropriate, an area may be obtained from a registered surveyor to ensure accuracy.

### 2.2 Unit of Measurement

All measurement should usually be in Square Metres (sq m) and/or cubic metres (cub m). There may be some circumstances where cubic capacity may be relevant such as in industrial buildings. Recommended guidelines include:

- Areas <100 sq m usually shown to one (1) decimal place (e.g. 85.6 sq m)
- Areas >100 sq m usually rounded to nearest whole figure (e.g. 120.4=120 sq m)

Measurement of buildings is usually rounded up if '.5' or more

(e.g. 120.5=121 sq m).

### 2.3 Height

In some types of property such as industrial, the height or cubic capacity of the premises can be an important aspect of the measurement of the building. This is usually shown in the building description, with a reference to a 'clear span' building height from the finished floor surface to the underside of a beam or roof truss.

### 2.4 Agreement

Where an area of measurement is to be used for negotiations or determinations, it is important for the parties to agree the method of measurement and the area before entering into negotiations or making a valuation determination.

### 2.5 Analysis

The guidelines seek only to set out an acceptable method of measurement for each type of property. The methodology for analysing market information, including a judgement on the relative building efficiency, design, presentation, quality, etc is generally outside the scope of this guideline. It is either covered by other Standards & Guidelines or left to the professional judgement of the member.

### 2.6 Method Adopted

The method of measurement adopted can vary depending upon the purpose for which it is used. For example, an area may be used for calculating building costs or insurance (gross basis), or it may be used for assessing rents (net basis). Care should be taken to ensure the purpose and method of measurement is clearly stated.

### 2.7 Shared Facilities

Where there are shared or common facilities, a separate area should be provided for the space used as a sole occupancy, with a separate description (and where appropriate) a separate area provided for the shared space.

### 2.8 Use Of Premises

For the purpose of analysis, the use of the property will generally determine the method of measurement, but not in all cases. For example, a house located on a zoned industrial site may be used as a residence and may not necessarily be the highest and best use of the building. In this case the method of measurement could be either (GBA or GLA) depending upon the purpose of the report. The methodology used and reasons for adopting a certain method of measurement should be clearly stated.

## 3.0 Area Definitions (Commonly Used)

### 3.1 Gross Building Area [GBA]

Gross Building Area (GBA) is the most commonly used method of measurement. The Gross Building Area is the area of the building at all building levels, measured between the normal outside face of any enclosing walls (or the centre line of common walls between different properties), balustrades and supports. The enclosed and unenclosed areas (see FECA and UCA definitions for detail) are usually shown separately and added together to give the total GBA.

(Note: Gross Building Area should not be confused with Gross Floor Area)

### 3.2 Strata Area (leases) [Various PCA]

The strata area is usually measured from the inside face of the wall. The area is calculated by a registered surveyor and is shown on a registered strata plan. The strata area is not usually used for the purpose of leases (although this may occur in some markets). Rental valuations and lease negotiations should usually be based upon the appropriate PCA definition for retail, commercial and industrial premises.

### 3.3 Stratum Area [SUA]

The stratum area is the area shown on a registered plan of subdivision as calculated by a registered surveyor. Adopt the same principles as for Strata (sales) and Strata (leases).

### 3.4 Strata Area (sales) [SA]

The market generally adopts the strata area shown on a registered strata plan as the basis of negotiation and sale. The strata area is usually measured from the inside face of the wall and the area calculated by a registered surveyor. The strata area is usually adopted as the basis for negotiations for individual and whole building strata units. Valuations generally show the PCA leasable areas for the capitalisation approach and the strata area for analysis of direct comparables (this may vary in some markets). In all cases, the basis for the method of measurement being used should be clearly stated.

### 3.5 Company Title

Company Title units should generally be treated on the same basis as strata title.

### 3.6 Community Title

Community Title areas definitions should be treated on the same basis as strata title, except where specific legislation over-rides this approach.

## 4.0 Area Definitions (Property Council of Australia)

### Gross Lettable Area Retail [GLAR]

Applies to retail uses.

### Gross Lettable Area [GLA]

Applies to warehouses, industrial buildings, freestanding supermarkets, and showrooms.

### Net Lettable Area Office Buildings [NLA]

Applies to office buildings, offices, and business parks.

## 5.0 Area Definitions (Others)

### 5.1 Building Area [BA]

(See Gross Building Area definition)

### 5.2 Equivalent Main Area [EMA]

The calculation of the EMA of a building is usually used for analysis and costing, with only a \$ rate per square metre to be stated as a single figure, rather than a set of different \$ values on each component of the building. The EMA uses the Gross Building Area as the basis of common measurement. The main building is counted as 100% of the GBA, with the other components of the building counted at lower percentages (see Residential) in accordance with their associated added value. Detached Improvements including rooms, studios, garages, carports, swimming pools and other improvements are not included in the EMA.

The EMA should not be quoted in a report unless its calculation is also shown as it may be misleading. It should also be clearly noted as an EMA.

### Floor Space Area [FSA]

(See Gross Floor Space definition)

### 5.3 Fully Enclosed Covered Area [FECA]

The Fully Enclosed Covered Area (FECA) is the sum of all areas at all building floor levels, including basements (except unexcavated portions), floored

roof spaces and attics, garages, penthouses, enclosed porches and attached enclosed covered ways alongside buildings, equipment rooms, lift shafts, vertical ducts, staircases and any other fully enclosed spaces and usable areas of the building, computed by measuring from the normal inside face of exterior walls, but ignoring any projections such as plinths, columns, piers and the like which project from the normal inside face of exterior walls. It shall not include open courts, light wells, connecting or isolated covered ways and net open areas of upper portions of rooms, lobbies, halls interstitial spaces and the like, which extend through the storey being computed. (See N.P.W.C)

### 5.4 Gross Floor Area [GFA]

The GFA (or FSA) is the sum of the 'Fully Enclosed Covered Area' and 'Unenclosed Covered Area' (as defined by Quantity Surveyors and Architects).

The GFA (also described as the FSA) is often used by councils to define the floor space that can be developed on a site based upon its Floor Space Ratio. It can be used for determining the development potential of sites. Care should be taken that GFA is clearly defined (and not confused with Gross Building Area) if used in analysing values or in negotiations for development sites.

Definitions change in various LGAs and States and individual codes should be checked. A typical definition is as follows:

GFA means the sum of the areas of each floor of a building where the area of each floor is taken to be the area within the inside face of the external walls as measured at a height of 1,400 millimetres above each floor level, excluding the following:

- Columns, fin walls, sun control devices, awnings, and any other elements, projections or works outside the general lines of the outer face of the external wall;
- lift towers, cooling towers, machinery and plant rooms and ancillary space and vertical air-conditioning ducts;
- carparking needed to meet the requirements of the Council and any internal access thereto;
- space for loading and unloading of goods;
- Internal public arcades and thoroughfares, terraces, balconies with outer walls less than 1400 millimetres high and the like.

### 5.5 Unenclosed Covered Area [UCA]

The sum of all such areas at all building floor levels, including roofed balconies, open verandahs, porches and porticos, attached open covered ways alongside buildings, undercrofts and usable space under buildings, unenclosed access galleries (including ground floor) and any other trafficable areas of the building which are not totally enclosed by full height walls. Computed by measuring the area between the enclosing walls or balustrade (i.e. from the inside face of the UCA excluding the wall or balustrade thickness). When the covering element (i.e. roof or upper floor) is supported by columns, is cantilevered or suspended, or any combination of these, the measurements shall be taken to the edge of the paving or to the edge of the cover, whichever is the lesser. UCA shall not include eaves overhangs, sun shading, awnings and the like where these do not relate to clearly defined trafficable covered areas, nor shall it include connecting or isolated covered ways. (See N.P.W.C).

## 6.0 Special Building Types [Method of Measurement]

### 6.1 Backpacker Hostels [GBA]

To be measured using the GBA method. It is also desirable to show both the number of rooms and beds in the description, and indicate whether there is a manager's residence or room, number of bathrooms (showers, toilets per bed), kitchens, living room, laundry area.

### 6.2 Banks (Retail) [GLAR]

To be measured in accordance with the GLAR Method. The building area should include vaults and substantial masonry walls.

### 6.3 Boarding (Guest) Houses [GBA]

To be measured using the GBA method. It is also desirable to show both the number of rooms (singles, doubles, etc) in the description, and indicate whether there is a manager's residence or room, number of bathrooms, kitchens, and laundry area, etc.

### 6.4 Bottle Shops [GLAR or GBA]

If the bottle shop (same as liquor store) is a stand-alone operation it should be measured in accordance with the GLAR method. However, if

it is part of a larger hotel operation, it should be measured using the GBA method.

### 6.5 Carparks (Commercial) [GBA]

To be measured on GBA basis. It is desirable to provide a separate break-up of the parking bays/ vehicle circulation area and the service areas (office toilets and amenities). The parking bays/vehicle circulation can be analysed on the number of cars to gross floor area to show the efficiency ratio (e.g. 1 space to 28 sq.m of gross floor space). Where there is a 'split floor' system, the GBA is calculated on the total gross floor plate area.

### 6.6 Cinemas [GLAR or GLA]

Freestanding cinemas should be measured on a GLA basis. Cinemas located in retail and commercial complexes should be measured on a GLAR basis. Measurement should include the foyer, box office, concessions sales areas, toilets, back of house, 'bio box' or projection area and cinema auditorium area. The seating capacity and cinema screen numbers is usually part of the market analysis.

### 6.7 Clubs (Recreation) [GBA]

Clubs should generally be measured using the GBA method. A description can provide a break-up of the uses in the club including reception, office administration and boardroom areas auditorium, restaurants, gaming areas, recreation facilities such as bowling greens, etc.

### 6.8 Hotels (Accommodation) [GBA]

The accommodation component of hotels should be measured on a GBA basis. A further description of the upper floors is desirable showing the number of rooms, average rooms sizes and net efficiency between the room sizes and common areas (service core and lifts, corridors, linen rooms, etc) on typical upper floors. Specialised uses such as retail arcades, which are attached to the hotel, should be measured as separate components and in accordance with the PCA retail method of measurement.

### 6.9 Industrial [GLA]

To be measured using the GLA method

### 6.10 Liquor Stores [GLAR or GBA]

If the liquor store (same as bottle shop) is a stand-alone property it should be measured in accordance with the GLAR method. However, if

it is part of a larger hotel operation, it should be measured using the GBA method.

**6.11 Motels [GBA]**

To be measured using the GBA method. It is desirable to show separate areas for the following:

- Managers Residence
- Office and Back of House
- Motel Rooms
- Restaurant
- Facilities (games room, pool, etc)

(Market analysis is usually on a per room and/or per bed basis.)

**6.12 Nursing Homes & Hostels [GBA]**

To be measured on a GBA basis. It is desirable to show separate areas for the following:

- Wards (including approved and actual number of bedrooms/beds)
- Managers Residence
- Offices
- Garages
- Parking Spaces Facilities and common area

(A market analysis may also show a component break-up based upon the various levels of care.)

**6.13 Offices [NLA]**

To be measured using the NLA method.

**6.14 Residential (Houses, Units, Town Houses, Flats)**

**1. [GBA]**

Residential property is generally measured on a GBA basis (non strata) or SA (strata) basis where there is a registered strata plan. Investment flats which are not on strata title are usually shown on a GBA basis.

**or 2. [EMA]**

For the purpose of analysis or costing, the GBA can be converted to an Equivalent Main Area (EMA) using the example percentages shown below:

Main Structure - Masonry	(example only)
• Solid construction -under main roof	100%
• Solid Construction -skillion roof	75%
• Timber, cement sheet, iron or	75%

glass wall under main roof	
• Timber, cement sheet, iron or glass wall under skillion roof	66%
• Unlined timber framed walls	33%

Main Structure- Timber or Steel Framed	
• (with external cladding such as timber, cement sheets, etc)	
• Solid construction under main roof	100%
• Solid construction under skillion roof	75%
General (masonry, timber or steel framed)	
• Porch under main roof	33%
• Verandah under main roof	33%
• Verandah not under main roof but true to style	25%
• Extensive Verandah (e.g. homesteads)	20%
• Galvanised Iron verandah attached to dwelling	0%

Car Parking - (Dwellings Only)	
• Garage under main Roof	66%
• Basement Garage and under main roof	66%
• Carport under main roof with brick pillars or timber posts	33%
• Carport under main roof with parapet wall	50%
• Skillion galvanised iron or timber post carport attached to dwelling	0%
• Space under elevated house	0%

These percentages may vary between States and Territories and from region to region due to variations in relative costs.

**6.15 Restaurants [GLAR or GBA]**

If a restaurant is a stand alone operation it should be measured in accordance with the GLAR method. However, if it is an integral part of a larger hotel operation, it should be included in the measurement of the hotel using the GBA method.

**6.16 Retirement Villages [GBA]**

To be measured showing separate areas for the following:

- Residential units
- Garages
- Managers Residence

## ANZ REAL PROPERTY GUIDANCE NOTE 4

- Offices
- Facilities and common areas

### 6.17 Rural Buildings [GBA]

Rural buildings should generally be measured on a GBA basis. Note homesteads should be measured in accordance with the residential guideline. In addition the following information may be used as a further unit of description/comparison.

Type	Additional Unit Of Description/Comparison
<i>Air Strips</i>	Length
<i>Bore</i>	Flow rate (litres per second)
<i>Broiler Sheds</i>	Bird Capacity (number of mature birds accommodated comfortably)
<i>Dairies</i>	Capacity Per Head at any one point in time
<i>Dams</i>	Volume (per cubic metres)
<i>Fruit Drying Racks</i>	Length (and Capacity)
<i>Grain Storage Sheds</i>	Capacity (Tonnes)
<i>Grain Silos</i>	Capacity (Tonnes)
<i>Haysheds</i>	Expressed as either square or round bale capacity
<i>Homestead</i>	See definitions in Residential
<i>Piggeries</i>	Capacity Per (Lactating) Sow at any one point in time
<i>Pipelines</i>	Length (in metres) and Diameter (express in mm)
<i>Shearers Quarters</i>	Number of Shearers plus Cook accommodation
<i>Shearing Sheds</i>	Number of Stands or Per Head Basis
<i>Stables</i>	Number of Stalls i.e. individually subdivided stalls
<i>Stock Yards</i>	Maximum capacity ie, the number of head (cattle or sheep) the yards could hold & remain workable and /or number of panels/rails within each panel
<i>Tanks</i>	Volume in Litres Capacity
<i>Winery SS Store Litres</i>	
<i>Winery Barrel Store</i>	Barrel Capacity
<i>Windmills</i>	Diameter (windmill head) & Height (of Tower)

### 6.18 Service Stations [GLAR]

Service stations are generally to be measured in accordance with the GLAR method. However, some larger service centres may need to be broken into other categories as follows:

<i>Office</i>	NLA Square Metres.
<i>Workshop</i>	GLA Square Metres. Number of Work Bays.
<i>Other</i>	Number of Pumps
<i>Canopies</i>	Covered Roof Area Square Metres
<i>Tanks</i>	Number and volume in litres
<i>Hardstand/Parking</i>	Square Metres

### 6.19 Shopping Centres, Shops (Strip shops, In commercial Buildings, semi-detached, terraces) [GLAR]

To be measured using the GLAR method.

#### Showrooms [GLA]

To be measured using the GLA method.

#### Supermarkets (Freestanding) [GLA]

To be measured using the GLA method.

#### Warehouse [GLA]

To be measured using the GLA method

# ANZRPNGN 5 FEASIBILITY STUDIES

This Guidance Note is divided into three parts:

- Part A - Approach
- Part B - Report Contents
- Part C - Worksheets

## PART A – APPROACH

### 1.0 Introduction

#### 1.1 Purpose

The purpose of this Guidance Note is to provide Members with a framework in which to conduct and prepare feasibility studies and determine the viability of undertaking development of real estate.

#### 1.2 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.

#### 1.3 Scope of this Guidance Note

This Guidance Note covers the preparation and collection of relevant information, the evaluation of development potential, the estimation of development costs, the valuation of the development on completion and the profit margin and rate of return. It should be used in conjunction with other guidance notes and Practice Standards, which are either over-arching or directly applicable to the type of property, purpose or issues involved.

#### 1.4 Feasibility Study

For the purpose of this Guidance Note, a 'feasibility study' is defined as the process of undertaking an assessment to identify the opportunities and risks of a property development project and to estimate the projected costs, revenues and profit potential of the project. This Guidance Note assumes the feasibility study to be in a full report format, clearly

describing the project in all respects and it should include a financial feasibility, using either a static analysis, dynamic analysis or discounted cash flow method of analysis.

#### 1.5 Static Analysis

*Static Analysis* - With this approach costs are generally summated as at the date of completion of the project and income is assessed as at the same date with allowances for vacancies and letting up periods. This is the less complex financial analysis which is suitable for preliminary feasibility studies and for calculating profit and risk or land value. A 'static analysis' assumes no change in prices or costs during the period of development.

#### 1.6 Dynamic Analysis

*Dynamic Analysis* – allows for potential movements in prices and costs over the period of the development.

#### 1.7 Discounted Cash Flow Method

Discounted cash flow method - With this approach, both costs and income are assessed over an appropriate time period and then discounted back to present value, generally being the date of the commencement of the project. This is the more complex financial analysis that should include interest rate calculations based on a 100% funded basis (an equity basis may also be included if required).

#### 1.8 Terminology and Principles

The terminology used in this Guidance Note generally reflects commercial development schemes for investment purposes, but the principles apply equally to owner occupied schemes, to residential developments and developments for other non-commercial uses.

### 2.0 General Considerations

#### 2.1 Choice of Comparables

The preparation of a feasibility study generally relies on comparison of unit costs and rates from similar development schemes which are then applied to the particular development to be



analysed. In using this approach, reasonable care must be taken in the choice of comparables to ensure that unit rates for other schemes do not reflect particular circumstances (e.g. exceptionally poor ground conditions, grossly different building specifications, different planning constraints). Equally, particular circumstances pertaining to the feasibility study being prepared should be carefully considered and reflected in the feasibility analysis.

### 2.2 Number of Variables

In preparing a feasibility study, the number of variables to be considered is large and the Member should be aware of the errors which may arise from using comparable transactions which require a significant number of adjustments. If an attempt is made to adjust for too many variables, the usefulness of the comparison may be destroyed.

### 2.3 Time and Program Constraints

In large, phased schemes the Member should have regard for time and program constraints and should make use of discounted cash flow techniques if appropriate.

### 2.4 Sensitivity Analysis Using Alternative Assumptions

The Member should state clearly the assumptions made and should be in a position to justify them by reference to evidence, research and sound reasoning. If a particular variable cannot be assessed objectively, it will often be appropriate to undertake and provide a sensitivity analysis demonstrating the results that would flow from using alternative assumptions for that variable.

### 2.5 Purpose of Feasibility Study

Any feasibility study to establish site worth that takes account of the client's specific circumstances cannot purport to be an open market assessment. There is an important distinction between an assessment for the purpose of establishing Market Value and one carried out for specific purposes (e.g. to determine how much to bid for a site). The Member should ensure that the instructions are clear as to the purpose of the feasibility study

### 2.6 Limitations of Residual Valuation Process

The Member should, therefore, be wary of presenting the estimate of site worth arising from a residual valuation approach pertaining to a feasibility study as a precise statement of value.

If the instructions permit, it may be preferable to indicate a range of values. In any event the Member should ensure that the client is aware of the limitations of the residual valuation process for development property and should indicate the areas in the calculation carrying the greatest sensitivity.

## 3.0 Agreeing Scope of the Feasibility Study with the Client

### 3.1 Discuss Client's Requirements

Before proceeding with the feasibility study, the Member should discuss and confirm the client's requirements to formulate the brief, i.e. obtain full and proper instructions from the client as to the extent of the feasibility study, the scope of the development and the scope of services to be provided by relevant parties

### 3.2 Concept Plans

The concept plans of the proposed development on which the feasibility study is based need to be clearly agreed with the client.

### 3.3 Changes to Scope of Development

During the feasibility study, information may come to hand which justifies changes to the scope of the development. Any changes in scope or changes in assumptions applicable to the feasibility study must be agreed in writing with the client.

## 4.0 Methodology

### 4.1 Elements in a Feasibility Study

This and the succeeding paragraphs of this Guidance Note focus on the individual elements in a feasibility study.

### 4.2 Stages in Study

The stages in undertaking a feasibility study may be summarised as follows:

- obtaining written instructions agreeing the scope of the development with the client including pre or post taxation assessment and depreciation considerations;
- preparation and collection of information;
- evaluation of development potential;

- estimating development costs;
- assessing value on completion; and
- determining profit margin and rate of return.

#### 4.3 Guidance Note Not Exhaustive

This Guidance Note should not be taken as exhaustive and the Member is responsible for ensuring that all relevant factors are taken into account. The Member should retain satisfactory records to support assumptions made and data used in the evaluation process, to provide an 'audit trail' should it prove necessary to justify the results.

#### 4.4 Level of Detail

The level of detail which is practical, when assessing development potential and costs, will vary according to the circumstances of the feasibility study. This Guidance Note assumes that a comparatively high level of accuracy is to be achieved. The Member will need to make a judgement (perhaps in consultation with the client) as to what is appropriate in each case. If information obtained from other consultants or experts (architects, quantity surveyors, leasing agents, valuers, etc) is relied on, the Member should identify the source and state the information on which he or she has relied.

### 5.0 Preparation and Collection of Information

#### 5.1 The Development Site

Inspection will familiarise the Member with the subject property and will establish a strong visual reference to any matters which affect either value or cost. In the case of development properties, referencing should include, where relevant and practical, the following:

- drawings showing the buildings or site, or measurement of site or buildings to ascertain frontage, width, depth and built measurements;
- shape of site and ground contours;
- plot ratio and site density evaluation;
- existing building height and that of adjoining properties;
- efficiency of existing building (if to be retained);

- access;
- party wall, boundary and rights of light issues;
- ground conditions and evidence of contamination;
- availability and assessment of services; main drainage, water, gas, electricity and telephone;
- any evidence of the existence of rights of way, easements, encumbrances, open water courses, mineral workings, filling, tipping, etc;
- any matters which will affect the cost or practicality of the construction process (e.g. poor access, cramped site conditions);
- sources of all relevant material used to establish underlying assumptions, e.g. building plans and specifications provided by building consultants.

If any of this information is unavailable or cannot reasonably be obtained, the Member should state what assumptions have been made.

#### 5.2 Third Party Interests

In brief, the Member should investigate the following factors which may affect value and the practicality of development:

- the extent and nature of the client's interest in the project;
- other interests in the property (actual or implied by law) including leases and other rights of occupation; and
- easements, restrictive covenants, rights of way, rights to light, drainage or support, registered charges, etc.

#### 5.3 Planning and Other Statutory Requirements

The Member should investigate a range of issues relating to planning permission and policy and statutory controls.

#### 5.4 Planning Permission

A feasibility study may be requested on the basis of an existing planning permission. In other circumstances, it will be necessary to form a view as to the best permission of which there is a reasonable prospect, and the cost of complying with any planning agreements likely to be required in order to secure the permission. Depending

on market conditions, it may be appropriate to discount the site value to reflect the risk of not obtaining such permission and/or the delay that might be caused if it were to prove necessary to appeal against refusal or the imposition of conditions.

### 5.5 Planning Policies

Planning policies are also relevant in that they control future additions to the supply of particular types of building. They may, therefore, affect the Member's opinion of the potential supply of competing buildings and hence the letting or sale period, future rental or price prospects and investment yields.

### 5.6 Particular Issues

Particular attention is drawn to the following issues:

- current planning policies, i.e. zoning/Planning Area and use controls, affecting the subject site and surrounding area. Normally, these will be found in Regional and Local Authority statutory plans; supplementary guidance prepared by the local authority planning officer or an independent Town Planner may be appropriate and prudent;
- any existing valid permission and related conditions or reserved matters;
- the requirements of any legally binding agreements with statutory authorities;
- any special controls that may apply, e.g. heritage restrictions, heritage listing of buildings, conservation area designation, tree preservation orders;
- permitted and non-conforming use approvals relating to existing buildings (if to be retained);
- environmental protection legislation (e.g. noise abatement, control of emissions, requirements for asbestos removal);
- building regulation requirements (e.g. sprinklers, fire escape arrangements, etc); and
- special/specific statutes and regulations affecting the particular type of development proposed;

### 5.7 Development Program

An outline program will be required covering:

- preparation and agreement with client of concept plans for the proposed development;
- the pre-contract period; site assembly, obtaining possession, adjoining owner negotiations, the planning process, architectural and engineering design to the required level, soil investigations, the building contract tender period, etc;
- the building contract, including demolition and any necessary site preparation (it may be appropriate to seek advice from a quantity surveyor, engineer or architect); and
- the post-contract period - usually defined as the period up to the full letting or sale of the completed development.

## 6.0 Evaluation of Development Potential

### Optimum Balance Between Market and Potential

In order to evaluate the development options, the Member will need to consider both the market requirements for the proposed development and the physical potential of the site and will need to determine the optimum balance to maximise the return. The Member should also consider whether there is scope for enhancing the development potential of the site by merging it with adjacent land. Conversely, if it is necessary to acquire adjacent land or rights over it (e.g. for access), allowance will have to be made for the cost of such acquisition. It must be recognised that, in the absence of compulsory purchase powers, it may prove very difficult or expensive (or perhaps even impossible) to acquire such rights and the Member should draw attention to such risks in relevant cases.

### 6.1 Form of Development

The Member will need to make an accurate assessment of the form and extent of physical development which can be accommodated on the site, having regard to the site characteristics and the likelihood of obtaining permission. This assessment may be undertaken in consultation with appointed project consultants, such as architects and quantity surveyors but, if this is not possible, the Member will have to make an independent assessment. The Member should take into consideration and balance the requirements of:

- occupiers' preferences for particular design features, building layouts and specification;
- investors' requirements;
- the time likely to be taken to produce the new buildings, in relation to market requirements, financing and cost; and
- achieving a high efficiency ratio (net internal area expressed as a percentage of the gross external area) without unduly compromising quality.

## 6.2 Demand and Market Analysis

The Member will need to analyse the market, both current and projected, for the proposed new buildings, in order to provide his or her best view of occupier demand for the alternative forms of development that may be possible. Such assessment requires an understanding of economic, fiscal and social trends at national, regional and local level, to the extent that they affect occupier demand for specific types of property at a time relevant to the date that the completed development is due to be marketed. Occupier demand will be influenced by many factors, which are likely to include:

- the location of the property;
- access;
- the availability of transport routes;
- car parking facilities;
- amenities attractive to tenants and/or purchasers;
- the size of the development in terms of lettable packages;
- form of development;
- incentives that may apply currently or in the future that may affect the viability of the project; and
- market supply, including actual or proposed competing developments.

## 7.0 Estimating Development Costs

### 7.1 Land Cost

The land cost should generally be established by reference to actual cost or by reference to

comparable land sales. In some instances, the aim of the feasibility study is to establish land worth by calculating the residual land value after deducting cost of development from value created. Land cost should include ancillary costs such as purchase fees, stamp duty, etc. If the development is to be carried out in stages, the implications for the cash flow and the various categories of cost should be considered.

### 7.2 Site-Related costs

Costs incurred in obtaining vacant possession, acquiring necessary interests in the subject site or adjacent property, extinguishing easements or removing restrictive covenants, rights of light compensation, etc. The allowance should be realistic, recognising the fact that the other party will expect to share in the development value generated by the site assembly.

### 7.3 Building Costs

Estimated costs relating to the construction of the buildings, which should include preliminary survey and investigations, soil testing, demolition, temporary protection and enabling works, hoardings, public utility works, diversion of services, works to adjoining sites, other interested parties' accommodation works, highway improvements, etc.

The accuracy with which costs can be assessed will vary greatly with circumstances. Members should be aware that the use of 'rules of thumb' to estimate costs will compromise the accuracy of the building cost estimate. Ideally, an estimate should be prepared by a quantity surveyor.

A decision has to be made as to whether to adopt a projected out-turn cost (i.e. including increases due to inflation, comparable to a fixed price contract) or a 'day-one' cost (i.e. comparable to the initial contract sum in a fluctuating price building contract). It may be necessary also to consider the effects of any time lapse between the valuation date and the likely placing of the building contract. For further comments on this see 8.0 below. In general, it is advisable to consult a quantity surveyor if any projection of costs is contemplated.

### 7.4 Professional Fees and Expenses

The costs relating to the appointment of professional consultants to secure procurement of the building. The number and type of consultants,

and nature of their appointment, will depend upon the building procurement method chosen. It will normally include an architect, a quantity surveyor and a structural engineer with additional specialist services being supplied as appropriate by mechanical and electrical engineers, a landscape architect, traffic and civil engineers, an acoustic consultant, a project manager and others. More specialised disciplines may be required depending on the nature of the development and allowance for these should be reflected in the assessment of fees. Expenses and costs excluded under the normal conditions of appointment should be added where necessary (e.g. models, printing). Fees vary significantly according to the size and nature of the project and the Member should take care to reflect current fee levels for the type of project envisaged.

### 7.5 Letting Expenses

The costs to be incurred in securing tenants for the completed buildings, generally comprising letting agents' fees and promotion costs (possibly including a show suite). An allowance should be included where necessary for capital contributions or other inducements needed in order to secure lettings, unless these are discounted in the letting terms assumed.

### 7.6 Legal Costs and Fees

Costs incurred for legal advice and representation in connection with such matters as site acquisition, town planning, building contract matters, occupational leases (unless assumed to be recoverable from the tenant) and raising finance.

### 7.7 Planning and Building Regulation Cost

The cost of securing planning permission (development approval), a building licence and concluding any agreement under relevant Town Planning Acts. It may be appropriate to allow for a model and the cost of a planning appeal if one seems likely.

### 7.8 Cost of Raising Finance

Costs related to the raising of development finance, including professional fees for monitoring draw-downs vis a vis construction progress.

### 7.9 Holding Costs

The total attendant costs (excluding interest) in holding the completed building up to the assumed date of letting, including such items as insurance,

security, cleaning and fuel (or a proportion of the service charge on partly let properties) together with rates and taxes.

### 7.10 Sale Costs

Costs to cover the developer's sale fees (agents and legal costs) if the sale of the completed development is intended or assumed. The costs of the purchaser are usually allowed for in the valuation of the completed development, but forward sale agreements may contain different provisions.

### 7.11 Interest Charges

Interest charges reflecting the actual or assumed financing arrangements for the development and the projected program during the pre-contract, contract and post-contract stages. For the purposes of the development appraisal, it is usual to make an allowance for short-term finance during the development period on the assumption that the completed and fully let development will be sold or long-term finance will be obtained on its transfer to the developer's investment portfolio.

It is normal for interest to be treated as a development cost up to the assumed letting date, unless a specific forward sale agreement dictates otherwise. Appropriate assumptions will have to be made regarding cash flow and the rate of draw-down. The rate of interest adopted should be based on realistic assumptions both as to the finance market and the status of the developer (whether the Client or a hypothetical purchaser).

## 8.0 Value 'As if Complete' and 'At Date of Completion'

Capital Value 'As if Complete' or Net Rental Income

The Member may require the services of a qualified valuer for this aspect of the feasibility study, depending on the nature of the study and the parties for whom it is intended. Depending on the profit criterion used (see below) it will be necessary to estimate either the capital value 'as if complete' and/or the net rental income likely to be generated by the completed development. In addition to the usual considerations relevant to such valuations, particular issues arise which are peculiar to development schemes.

## **8.1 Capital Value**

If a capital value is required, it is normal to assume that the building is let and income producing, due allowance having been made in the assessment of development costs for the expenses incurred in achieving the letting(s) and for the finance and other costs of holding the property during the letting period. Rent-free periods granted under the lease are dealt with variously, e.g. by continuing interest charges on the development costs, by treating the 'lost' income as a development cost or by taking account of the rent-free period in the valuation of the completed development. The Member should be aware that the appropriate approach towards voids and rent-free periods may be dictated by financing or forward-sale agreements and should seek information from the Client where appropriate. If the objective of the feasibility is to make an open market assessment of capital value, the appropriate approach would be to take account of rent free periods in the valuation of the income stream likely to be generated by the development.

## **8.2 Take Account of Delay**

Unless the development has been pre-let and/or pre-sold on fixed terms, the Member will not only have to make those normal assumptions which are required in every vacant possession case, but will have also to decide how to take account of the delay between the date of the study and the date on which the eventual letting is expected to take place. The Member should have regard for market conditions at the date of the study and the factors that may cause changes in the future, e.g. supply and demand, inflation, interest rates, etc.

## **8.3 Sensitivity Analysis**

The Member may wish to present an appraisal based on provable values with a sensitivity analysis to show the effect on profit of differing assumptions as to the future rent and yield. The Member should aim to assist the Client in assessing the likely value on completion, by reference to present and future market trends and likely shifts in supply and demand. Wherever possible, the treatment of these issues should be discussed with the Client.

## **8.4 Potential Changes in Rental Values, Yields and Costs**

The treatment of potential changes in rental values and yields, may be influenced by the

extent to which potential cost changes are also reflected, particularly the effect of inflation on building costs, but also likely changes in interest rates. Rather than attempt forecasts, it may be appropriate to adopt a 'current rent, current cost' approach, but it is advisable to accompany this with a sensitivity analysis to show the effect on site value of differing assumptions as to future rents, yields and costs. In any event, unless the Member's instructions specify the basis to be adopted he or she should familiarise himself or herself with common practice at the time of the valuation and adopt a method of valuation, which is consistent with market conditions.

## **8.5 Estimated Value at Date of Completion**

It should be noted that the estimated value on completion should not be discounted back to the valuation date. The inclusion of interest charges within the development cost makes the completion of development the date at which cost and value are to be compared.

## **8.6 Distinction**

Value 'on completion' or 'at date of completion' reflects the anticipated value of the project at the time the project is actually completed. This is in contrast to a value 'as if complete' which assumes the project to be complete at the date of the assessment or feasibility study. It is appropriate to clearly state which basis the assessment has been made on and to provide an appropriate explanation (as well as assumptions and limitations).

## **9.0 Profit Margin and Rate of Return**

### **9.1 Profit as a Percentage of Total Development Cost**

When using the residual method to establish the development site value, it is usual to assume that the developer will seek a capital profit expressed as a percentage of the total development cost (including interest) or of gross development value. This derives from the traditional financing arrangement whereby the development is sold on completion to a long-term investor. It is also common practice for development companies, which retain completed schemes in their investment portfolios to judge the success of a scheme in terms of the enhancement of the



balance sheet (net asset value) rather than the profit and loss account (income).

### 9.2 Other Criteria

There are, however, other criteria that are sometimes adopted, whether as a substitute for profit yield or as an additional test of profitability. These include:

### 9.3 Initial yield on cost

The net rental return calculated as the initial full annual rental on completion of letting expressed as a percentage of the total development cost. This criterion may be significant in establishing whether the developer could service a long-term mortgage loan, or for evaluating the effect of the development scheme on the profit and loss account of a company.

### 9.4 Cash-on-cash (or Equity Yield)

The capital uplift or (more usually) net income (after interest charges on any long-term mortgage loan) expressed as a percentage of the long-term equity finance provided by the developer.

### 9.5 Discounted Cash Flow Methods

The income stream is projected with explicit assumptions about rental growth and end sale value and discounted back to a net present value (NPV) using an appropriate discount rate. The scheme is deemed viable if NPV exceeds the total development cost. The discount rate should include an allowance (profit margin) for the management requirements and risk of investing in a development project rather than an existing fully let property. This approach is particularly appropriate for large, phased schemes.

### 9.6 Internal Rate of Return

The discount rate that equates the present value of the net cash flows of a project with the present value of the capital investment. It is the rate at which the Net Present Value (NPV) equals zero. The IRR reflects both the return on the invested capital and the return of the original investment, which are basic considerations of potential investors.

### 9.7 Amount of cover

The extent to which the rent or sale price can be reduced, or the letting or sale period extended (often expressed as a number of months of rolled-

up interest or loss of rent) without suffering an overall loss on the scheme.

### 9.8 Transition from Non-Viable to Viable

If an appraisal is carried out in the course of advising a Client, it will be appropriate to seek instructions on both the nature of the criteria to be adopted and the critical value, which, to that Client, represents the transition from non-viable to viable. Where this guidance is not available, the Member will have to exercise his or her own judgement, based on experience.

### 9.9 Capital Profit Test or Alternative Criterion

Traditionally, the capital profit test has been the most widely used. However, the Member should acquaint himself or herself with common practice among developers and should be prepared to consider and, if appropriate, adopt an alternative criterion if experience shows it to be in wide use.

### 9.10 Developer's Level of Profit

The level of profit to be assumed in the appraisal cannot be specified as a standard, as market requirements will vary from time to time having regard for the nature of the development. Evidence may be deduced (possibly with difficulty) by analysing transactions, but is better obtained by first-hand experience of developers' requirements.

### 9.11 Appropriate Profit Influenced by Risk Profile

In any event, it must be recognised that the appropriate profit to be expected from a particular development will be influenced by a number of factors, which might lead to a departure from the market 'norm'. High amongst these will be the general risk profile (e.g. whether or not rents and cost are inflated, whether the interest rate is fixed, whether the scheme is pre-let or pre-sold) but also relevant will be the scale of the development, the amount of financial exposure and the time scale.



## **PART B-REPORT CONTENTS FEASIBILITY STUDY CHECKLIST**

It is recommended that a feasibility study report make reference to the following checklist of items. There may be circumstances where not all headings need to be included in the report, but the Member should be satisfied that the omission of a section will not mislead or distort the findings of the feasibility study.

### **Basis of Appointment**

- The person/party for whom the feasibility study is being prepared.
- Details of the instructions including any special conditions and/or assumptions.
- The date and basis of the feasibility study.
- The purpose of the feasibility study.

### **Land Description**

- Title details (including title searches).
- Registered proprietor.
- Encumbrances.
- Lease details.
- Details of any options, conditional contracts, etc

### **Location**

- A general description of the location of the property, transport, shopping, etc.
- Surrounding development and land use.
- Special features such as views, etc.

### **Site Details**

- Dimensions.
- Area.
- Services (water, sewer, drainage, electricity, gas, and communication) detailed analysis of the availability and location of services, relevant authorities, any special problems, etc.
- Geo-technical, filled ground, landslide.
- Flooding.

### **Planning and Other Statutory Requirements**

- Details of current zoning/planning area and allowable uses under statutory planning legislation.
- Details of any existing planning approvals on the site.
- Detailed analysis of all relevant planning requirements affecting the proposed development.
- Heritage details (if applicable).

- Comment on the local community and political environment and the affect this could have on the project.
- The requirements of any legally binding agreements with statutory authorities.

### **Existing Improvements**

- A detailed description of any existing improvements including any compliance problems with the Building Code of Australia (NZ Building Act 2004) and statutory authorities.
- Any comments in relation to demolition, site access, cramped site conditions, etc.

### **Environmental Audit**

- Full history on the types of uses the property has been used for.
- A detailed analysis of any contamination issues including Environmental Assessment by an independent consultant where available. Reference should also be made to the Institute's Guidance Note GN15 Reporting on Contaminated Land.

### **Evaluation of Development Potential**

- Market potential (supply and demand).
- Physical capacity of the site.
- Planning controls on the site, e.g. plot ratio, car-parking controls.
- Potential for merging with adjoining sites.

### **Proposed Development**

- Detailed description of the proposed development, which is the subject of the feasibility analysis.
- Details of any development approvals, building approvals, subdivision plans, etc.
- Comments on proposed Design and Finishes.

### **Development Program**

An outline program will be required covering:

- Concept approval by client.
- Site Assembly.
- Design documentation.
- The building contract period.
- Period for letting up or sale of completed development.

### **Demand and Market Analysis**

- General economic influences.
- Market supply, including actual or proposed competing developments.
- Historic and projected demand.

## ANZ REAL PROPERTY GUIDANCE NOTE 5

### Estimating Development Costs

- Land cost.
- Site-related costs.
- Building costs.
- Professional fees and expenses.
- Letting expenses.
- Legal costs and fees.
- Planning and building regulation costs.
- Cost of raising finance.
- Site holding costs.
- Sale costs.
- Interest charges.

### Income Estimate

- Assumed letting up period.
- Rents.
- Tenancy incentives, e.g. rent free periods, etc.

### Capital Value Estimate

- Capitalisation rates (static analysis).
- Discount rate (discounted cash flow analysis).
- Comparable market evidence.

### Profit Margin and Rate of Return

- Developer's risk and profit margin.
- Initial rental yield on cost.
- Return on capital.
- Capital Profit (cost vs value created).
- Internal Rate of Return.
- Comparison with normal market returns.

### Sensitivity Analysis

The Member may carry out a sensitivity analysis to test the financial assumptions. The results of the sensitivity analysis should be clearly set out in this section of the report.

### Conclusion and Recommendations

The Member should summarise the results of the feasibility analysis in terms of the original brief and instructions.

### Sample Disclaimers

The following disclaimers are illustrative samples for consideration for inclusion in any Feasibility Study report.

It must be recognised that the real estate market and building industry fluctuate with market forces. The results of this feasibility study are based on the information available as at the date of this report and the assumptions stated in this report. Reliance after an extended period from the date of this report or reliance on the findings of this report for modified development plans should only be made after written confirmation that it is appropriate to do so by the Author.

Information furnished by others, upon which all or portions of this report are based, is believed to be reliable but has not been verified in all cases. No warranty is given as to the accuracy of such information.

This report is for the use only of the party to whom it is addressed ..... (instructing party nominated) and is for ..... (reason for the feasibility study) purposes and no other purposes. Under no circumstances will responsibility be accepted to any third party who may use or rely on the whole or any part of the contents of this feasibility study. Any third party wishing to use this report should obtain prior written approval from ..... (name of author or firm preparing the report).

### Attachments

- Feasibility Checklist
- Financial feasibility.
- Development approvals and plans.
- Title searches.
- Planning certificates.
- Surveys (building and site).
- Services diagrams (sewer, etc).
- Any appropriate documentation supporting assumptions.

## **DEVELOPMENT CHECKLIST**

<b>Item</b>	<b>HEADING</b>	<b>Tick Box</b>
<b>1</b>	<b>LAND ACQUISITION</b>	
2	Purchase Price	
3	Stamp Duty	
4	Legal Costs	
5	Vacant Possession	
6	Zoning/Planning Certificate (also see 21)	
7	Services/ Sewer Water Diagram	
8	Geo Technical Report	
9	Title Searches/Easements	
10	Contamination Report	
11	Contract Special Conditions	
<b>20</b>	<b>TOWN PLANNING</b>	
21	Zoning/Planning Certificate (also see 6)	
22	Local /Regional/State Environmental Planning Controls	
23	Development Control Plans (FSR's. height, setbacks, etc)	
24	Car Parking Code	
25	Unhealthy Building Land Certificate	
26	Sulphuric Soils Investigations	
27	Flooding/Earthquake Investigations	
28	Sewerage/Water Diagram	
29	Heritage Local/Regional/State/National	
<b>30</b>	<b>STATUTORY AUTHORITIES</b>	
31	DA Fees/Construction Certificate/Occupation Certificate/Design Assessment	
32	Contributions -Low Cost Housing//Parking/Community/Open Space/etc	
33	Long Service Leave Contribution	
34	Public Signage	
35	Public Art Contribution	
36	Footpaths, Kerbing & Guttering (Repairs & Replacement)	
37	Water/Sewer/Drainage (Section 73 Sydney Water Approval NSW)	
38	Power Authority Fees	
39	Council Bonds (footpaths, etc)	

(continued)

## ANZ REAL PROPERTY GUIDANCE NOTE 5

Item	HEADING	Tick Box
40	<b>CONSULTANTS</b>	
41	Development Manager	
42	Architect (Design, Documentation, Construction Supervision)	
43	Interior Architect	
44	Engineer- Structural	
45	Engineer- Services (water, sewer, AC, hydraulic, lifts)	
46	Project/Construction Manager	
47	Quantity Surveyor	
48	BCA Consultant	
49	Principal Certifying Authority	
50	Town Planner – (Statement of Environmental Affects NSW)	
51	Environmental Design Consultant	
52	Heritage/Conservation Architect	
52	Heritage (photographic record)	
53	Acoustic Report	
54	Surveyor Identification, Survey/Levels, Strata, Floor Areas, etc	
55	Landscape Architect	
56	Traffic Engineer	
57	BASIX Certifier	
58	Accessibility Consultant	
59	Wind & Reflectivity Reports	
60	Economic/Social Impact Statements	
61	Archaeologist Report	
62	Waste Management Plan (Construction/Operational)	
63	Energy Audit Report	
64	Demographics/Market Research Report	
65	Management Operational Consultant/Report (hotels, backpackers, etc)	
66	Model Maker	
67	Feng Shui Report	
68	Endangered Fauna & Flora	
70	<b>CONSTRUCTION</b>	
71	Demolition/Excavation/Hoarding	
72	Construction Contract (Tender, GMP, D&C, Cost Plus, Const Mgt, etc).	
73	Development Approval (Conditions)	

## ANZ REAL PROPERTY GUIDANCE NOTE 5

Item	HEADING	Tick Box
74	Construction Certificate-conditions	
75	Quantity Surveyor/Superintenant	
76	Building Contract/Specification/Bill of Quantities/Cost Plan	
77	Contingency (check QS report)	
78	Rise & Fall/Escalation	
79	Furnishings (Carpets, Blinds, etc)	
80	GST (check if in QS figures)	
<b>90</b>	<b>FINANCE COSTS</b>	
91	Interest	
92	Establishment Costs – Senior Debt	
93	Establishment Costs – Mezzanine Debt	
94	Line Fees	
95	Legal – Financier & Borrower progress payments	
96	Valuation	
97	Financial Planner	
98	Insurance Broker	
99	Construction Contract	
<b>110</b>	<b>ADMINISTRATION</b>	
111	Accounting	
112	Legal- General	
113	Operational Overheads	
<b>120</b>	<b>MARKETING</b>	
121	Advertising	
122	Brochures, models, signs	
123	PR, Research & Consultants	
124	Display Suite	
125	Launch Event	
<b>130</b>	<b>SELLING COSTS</b>	
131	Sales Commissions	
132	Legal Costs	
133	Leasing Commissions	

(continued)

## ANZ REAL PROPERTY GUIDANCE NOTE 5

Item	HEADING	Tick Box
134	Incentives	
135	Rental Guarantee on sale	
136	Cost of Issuing New Title	
<b>140</b>	<b>HOLDING COSTS</b>	
141	Council rates	
142	Water Rates	
143	Land Tax	
144	Insurance	
145	Security	
146	Repairs & Maintenance	
147	Cleaning	
148	Property Management	
<b>150</b>	<b>GST</b>	
151	New Residential Projects	
<b>160</b>	<b>INCOME</b>	
161	Sales Income	
162	Rental Income	

Notes:

1. Feasibility usually carried out on a pre-tax basis (i.e. excluding depreciation allowances, etc)
2. GST is usually shown as a cost for new residential projects (check if the "margin scheme" approach is applicable)

## **Part C-Worksheets**

### **Feasibility Studies**

This section has been drawn from Rawlinsons *Australian Construction Handbook*, and is reproduced with permission.

The purpose of feasibility studies is to calculate the return that will be derived from a particular project.

The return can be expressed as an annual percentage return or as a terminal percentage return. An annual

percentage return will be used where the project will be generating rent for the owner, while a terminal return is used when the project is to be sold.

The calculated returns are important only for comparisons, i.e. to compare one project with another or to compare one project's return with the return that would be achieved by investing elsewhere.

The following pro-forma represents a suggested set out to calculate the return. Item 3.0 is shown in alternative forms. The first alternative is applicable to an annual return and the second to a terminal return.

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## ANZ REAL PROPERTY GUIDANCE NOTE 5

### 1.0 PRIMARY INFORMATION

Site Area	sqm	
Frontages	m	
Gross Floor Area	sqm	
Net Rentable Area	sqm	
Parking Provision	No	(Cars)
Land Purchase Price	\$	
Building Cost	\$	
Vacant Possession Costs	\$	
Preliminary Sketch Plans	Months	
Development Approvals	Months	
(Design Development Stage) to calling of Tenders and including Bill of Quantities)	Months	
Calling Tenders and Awarding Contract	Months	
Construction Time	Months	

### 2.0 CAPITAL EXPENDITURE

LAND COSTS	\$	\$
Purchase Price		
Stamp Duty @ % on first \$		
Plus % on remainder		
Legal Costs		
Vacant Possession Costs		
Soil Tests		
Land Surveyor's Fees	=	
BUILDING COSTS		
Demolitions		
Contract Price		
Architects, Engineers & Consultants Fees		
Project Management Fees		
Quantity Surveyors Fees		
Local Council & Planning Authority Fees		
	=	
	C/fwd	

**2.0 CAPITAL EXPENDITURE (continued)**

	\$ Per Annum	\$ B/fwd
RATES AND TAXES		
Council Rates @     in \$     on the relevant value		
Land Tax @     in \$     on the relevant value		
Water		
Sewerage		
Drainage	=	
(+ 12)	= \$	per month
Planning and Construction Time (     ) months	x _____	months
	=	
ADD		
Interest (@     % per month simple)		
On Land Cost		
On Rates and Charges		
On Building Costs	=	
SUNDRY COSTS		
Owner's Moving Expenses		
Furnishing		
Market Studies		
Advertising and Signs		
Premises Department's Costs		
Owner's Overhead Expenses		
Letting Agent's Fees @     %		
Tenant Inducements		
Contingency	=	
TOTAL CAPITAL EXPENDITURE	\$	*
Allow for G.S.T. on applicable		
Items of the foregoing @ 10% -		
G.S.T. refund for applicable clients/owners		
As defined in TAXABLE on page 790 -		
TOTAL EXPENDITURE INCLUDING G.S.T.	\$	

\* NO ALLOWANCE FOR LIFE CYCLE COSTING

## ANZ REAL PROPERTY GUIDANCE NOTE 5

### 3.0 ANNUAL INCOME AND EXPENDITURE

INCOME		\$		\$
Car Parking	cars @	\$		
Ground Floor sqm	@	\$		
Upper Floors sqm	@	\$	=	
<b>TOTAL ANNUAL INCOME</b>				<b>\$</b>

<b>ANNUAL EXPENDITURE</b>				
Council Rates				
Land Tax				
Water & Sewerage Rates				
Insurance combined @		%		
Electricity to Public Areas				
Garbage Removal				
Caretaker & Cleaning @		per sqm		
Window Cleaning				
Security Service				
Fire Alarm & Sprinkler Service				
Lift Maintenance and Operation				
AC Maintenance and Operation				
Management Fees at Scale (say 4%) of total letting			=	\$
<b>PROVISIONS</b>				
Building Maintenance				
Building Depreciation	years @	%		
Plant Depreciation	years @	%		
Vacancies - say		%	=	
<b>TOTAL ANNUAL EXPENDITURE</b>				<b>\$</b>
<b>NET ANNUAL INCOME</b>				<b>\$</b>
ANNUAL RETURN =	$\frac{\text{Net Annual Income \$}}{\text{Total Capital Expenditure \$}}$	x	$\frac{100}{1}$	= %

## ANZ REAL PROPERTY GUIDANCE NOTE 5

<b>ALTERNATIVE</b>		
<b>3.0 TERMINAL INCOME &amp; EXPENDITURE</b>	<b>\$</b>	<b>\$</b>
SALE PRICE	=	
SELLING EXPENDITURE		
Council Rates		
Land Tax		
Water & Sewerage Rates		
Insurance		
Security Service		
Agents Fees		
Interest	=	
<b>NET SALE PRICE</b>		<b>\$</b>
TERMINAL RETURN =	$\frac{\text{Net Sale Price} - \text{Total Capital Expenditure}}{\text{Total Capital Expenditure}} \times \frac{100}{1} =$	%

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# ANZRPGN 6 DUE DILIGENCE

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to provide a guide to Members as to the due diligence process which a prudent purchaser would undertake prior to entering into a contractual obligation to acquire a commercial property.

### 1.2 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.

### 1.3 Scope of this Guidance Note

This Guidance Note applies to Members performing due diligence or involved in the due diligence process in relation to commercial property.

### 1.4 Comprehensive and Probing Investigation

These guidelines are intended to provide a guide to the due diligence review process which a prudent purchaser would undertake prior to entering into a contractual obligation to acquire commercial property. There is no single definition of "due diligence", although the expression is now in common usage, particularly in relation to securities law where a specific due diligence defence is available to directors of companies in certain circumstances. In general terms, however, a due diligence exercise is taken to involve the type of comprehensive and probing investigation which a prudent adviser would bring to bear on the matter in question.

### 1.5 Numerous Issues ....a checklist

These guidelines also aim to alert interested parties to the numerous issues which ought to be examined and addressed in order to ensure

that such parties are fully informed regarding the attributes of a particular property, and the risks associated with a proposed transaction. Whilst we have aimed to make the guidelines as comprehensive as possible, they have been drafted so as to provide no more than a checklist of points and issues which ought to be considered in a property transaction. (A checklist is included as Annexure 1).

### 1.6 Necessity of Engaging a Team of Experts

It is not intended that these guidelines provide a do-it-yourself checklist for property investors and other relevant parties. Indeed, the numerous issues set out in this document should alert users of the guidelines to the necessity of engaging a team of qualified professionals to undertake the due diligence review. This team may include experts such as valuers, land economists, structural engineers, consulting engineers, solicitors, architects, financial and taxation consultants, quantity surveyors, urban consultants, etc.

### 1.7 Advice on Changes to the Law

Though efforts are made to keep guidance notes current, advice should be obtained regarding any changes to the law and practice in more recent times.

## 2.0 Valuation

### 2.1 General

Advice that may be obtained from a Valuer or Member could include following matters.

### 2.2 Importance of Establishing Value

Any purchaser of property must, of necessity, form a view as to what the particular property is worth. Ultimately, one's assessment of value will be a key factor in determining how much to pay for a property or an interest in property and, from the point of view of a vendor, how much to accept for the sale of a property. Equally, the value of a property will be of critical importance to a lender who proposes to advance money against the security of a property. Valuations may also be

required for the purposes of financial statements, for insurance purposes, and to assist in analysing investment performance.

### 2.3 Appoint a Valuer to establish Market Value

#### [Definitions - Market Value]

In order to obtain an expert and impartial assessment of the value of a property, a suitably qualified, experienced and (where required) registered or licensed valuer (being a Member of the Institute) should be appointed to prepare a valuation of the property on an appropriate basis. Usually, this will involve an assessment of the property's "Market Value" which is defined by the International Valuation Standards Committee (whose definition has been adopted by the API and PINZ).

### 2.4 Forced Sale Price

On occasions, a valuation report may include advice concerning the price that might be achieved for a property in the circumstances of a forced sale. Similarly, an assessment of the replacement cost of a property may sometimes be required.

### 2.5 Valuation Methodologies

There are several valuation methodologies which may be used in assessing the value of a property, and different methodologies may often produce different outcomes. It will often be appropriate for more than one methodology to be considered, and a valuer needs to form a view as to which method or methods best suit the particular property. Methodologies commonly used in valuing a property are:

comparable sales - points to be considered in relation to both the subject property and comparables include:

- location
- size and type of the property
- lease and tenancy characteristics
- rental income
- outgoings
- age and condition of the property and building services
- potential for rental growth / redevelopment

capitalisation of income (market and / or passing rents) - points to be considered include:

- comparable sales evidence
- alternate investments
- rental received / rental growth potential / market rental levels
- lease terms
- types of tenants / financial strength
- type of ownership - freehold or leasehold
- supply and demand
- economic factors / inflation rate / bond yields
- supply and demand

discounted cash flow / target internal rate of return - assumptions need to be made regarding:

- required discount or target rate
- rental income / future rental predictions
- covenant of the tenant(s)
- taxation / capital gains
- outgoings
- inflation
- exit capitalisation rates
- terminal value
- forecast period

hypothetical development (for development sites) - assumptions need to be made regarding

- best permitted development for the site
- time required to obtain approvals, develop and lease
- development cost
- future rental income
- initial yield
- development profit
- valuation on completion of development

summation method (direct comparison) - points to be considered include

- land value rate
- building value rate
- comparable sales evidence

(Note: Care should be taken with the use of this method in relation to properties with investment potential)



## 2.6 Contents of Valuation Report

Although the contents of a valuation report will vary depending on the type of property and the purpose of the valuation, generally speaking, a valuation will need to address the points listed below:

### Basis of valuation

- Market Value
- forced sale
- replacement cost

### Land and title

- title reference
- name of the registered proprietor(s)
- identification of encumbrances such as easements,
- covenants etc
- identification of registered leases

### Location of the property

- description of location
- commentary on access / public transportation
- proximity to major commercial / retail centres
- special features such as views, adjoining developments
- demographics

### Site description and services

- land dimensions and area
- site accessibility
- services
- site problems, ie. drainage, potential flooding, apparent contamination, soil characteristics etc

### Town planning/Resource Management

- current zoning (including restrictions which may affect future potential of the property)
- extent to which use constitutes a non-conforming use
- proposed amendments to planning scheme
- development codes, site ratios, development guidelines
- transferable floor area issues

### Improvements

- description of improvements and materials used in construction including, structure, floors, service core, walls, roof
- description of internal finish including, wall finishes, ceiling finishes, floor finishes, doors
- description of general accommodation including, toilet facilities, tea rooms etc
- commentary on age and condition of improvements and building services including, air conditioning, lifts, fire services, security system, backup power supplies
- analysis of net lettable area
- compliance with current building regulations

### Environmental Issues

#### Tenancy details

- description of all leases, licenses and agreements including commencement date, name of lessee / licensee, demised premises, term / options, current rental, rent reviews, lessee's obligations etc
- commentary as to whether leases have been executed
- comparison of actual rentals and market rentals
- consideration of current and potential future vacancy levels including timing and costs of re-letting premises
- consideration of impact of future rent reviews
- commentary on rental arrears
- review of outgoings
- commentary on financial strength of tenants
- detail current incentives / financial obligation to tenants (ie. carpet, painting, fit out etc)

## 2.7 Market Overview

- general market overview (including legal, political, economic)
- overview of specific region in which property is located
- both overviews would usually address factors including:
  - demand and supply
  - vacancy factors

- rental movements
- demographics / population growth
- any other trends in the market

### Valuation Approach

- rationale behind method or methods of valuation
- details of comparable sales and other market evidence
- reconciliation of the various valuation approaches

### Valuation

- valuation amount and date
- note qualifications, assumptions and disclaimers

## 3.0 Structure

### 3.1 General

Professional advice should be obtained on any structure.

### 3.2 Engage Structural Engineer and others

A Structural Engineer should be engaged to examine and report on the structural condition of the property. It may be appropriate for a structural engineer to be engaged together with other specialist engineering disciplines and / or, depending on the nature of the building, also an architect. For example, on a high rise building with a curtain wall facade, there would normally be a need for an architect with specialist ability in this technology to work with the structural engineer. Clearly, the types of report required will vary, depending on the size and nature of the subject property.

### 3.3 Co-ordination of Reports into one

Where a building is significant, it may be advisable for an architect to co-ordinate all of the reports from the various engineers into one "Condition Report". This report should not only identify problem areas, but also provide an indication of the cost to rectify and when rectification will be required.

### 3.4 Due Diligence Process

The Due Diligence process should involve:

Review of documentation including:

- as built architectural drawings

- structural drawings
- structural calculations
- geotechnical report
- other specialist reports such as wind engineering, facade testing
- shop drawings, particularly of performance specified facades
- construction quality control reports
- any reports on building problems
- warranties

### Building Code Compliance

- Advise on whether the structure meets relevant building code or other legislation as well as cost to upgrade the building to comply (if viable)

### Inspection of Property

- Inspect together with building superintendent (or other person familiar with maintenance of the building)
- Obtain information regarding problem areas, maintenance program, any major maintenance items (i.e. roofing replacement) etc.
- Inspection of tenant fit outs - do fit outs comply with statutory requirements?
- Talk to occupants

### Design Criteria

- Review basic design loads for different parts of the building
- Examine how design loads relate to codes and industry standards, including floor live loads, wind loads and earthquake loading

### Durability

- Report on durability problems, such as rust staining, spalling of the surfaces, and comment on implications and reparability
- Comment on any potential durability problems having regard to specification of the materials, and known general industry practices at the time of construction

### Serviceability

- Examine performance of structures in delivering and maintaining a flat floor

- Consider necessity for confirmation survey to respond to signs of lack of flatness

**Wear and Tear**

- Itemise all items of defect in the structure, floor and wall finishes, and comment on reparability

**Exterior of Building**

- Review all exterior coverings
- Report on condition of the roof and sealants
- Report on availability of a building maintenance unit (BMU)
- Inspection of facade using BMU
- Consider water penetration from all exterior surfaces, both above and below ground

**Building Interior**

- Report on finishes on the interior of the building
- Note presence of cracks in floor or wall finishes, delamination of cladding, poor performance of joint filling materials, condition of tiles in bathrooms, floors and walls, presence of cracks in masonry walls and the like

**Occupational Health and Safety**

- Asbestos survey

**4.0 Mechanical & Electrical Condition**

**4.1 General**

The quality of building services is becoming an increasingly important influence in the value of a property.

**4.2 Condition of Building Services**

The condition of building services is an important factor to be evaluated by a purchaser of property, as it will affect the demand for rental space and the operational costs of the building, with a flow-on impact on the value of the property. Indeed, the quality of the building services is becoming an increasingly important influence in the value of a property, as tenants begin to appreciate the benefits of a “smart” building in terms of productivity and flexibility.

**4.3 Mechanical and Electrical Engineer**

A mechanical and electrical engineer should be engaged to report on the status of the systems within a building, such as:

- heating, ventilating and air conditioning systems
- electrical systems
- fire protection systems
- hydraulics
- lifts
- communication
- security systems

**4.4 Report on Compliance and Cost to Upgrade**

The report should include advice as to the extent of compliance with current regulations and cost to upgrade to comply if systems are currently inadequate.

**4.5 Other Specialists May be Required**

It may be appropriate for other specialists, such as architects, quantity surveyors or building regulation specialists, to also be engaged to report on these systems.

**4.6 Due Diligence Process**

The Due Diligence process should involve:

Review of documentation including:

- architectural drawings
- design drawings for each discipline:
  - heating, ventilating and air conditioning
  - electrical
  - fire protection
  - hydraulics
  - lifts
  - communications
  - security systems
- specifications for each of the above disciplines
- as built drawings for the above disciplines
- maintenance manuals
- maintenance reports and logs
- information in relation to building outgoings

### Inspection of Property

- Inspect property together with building superintendent or other party with experience with the operation of the systems in the building and understanding the maintenance trends
- Talk to occupants

Design Criteria - report on issues such as:-

- air conditioning and heat loads (and after hours capabilities)
- power requirements
- air filtration
- location and maintenance of cooling towers
- life safety systems including sprinkler systems, ventilation for smoke removal, location of fire fighting devices
- flexibility to meet tenants' requirements

Installation - inspect the installation to ascertain:

- consistency between the design and what has been installed
- quality of the installation works
- simplicity of servicing the systems
- years of operation
- life expectancy (if appropriate, report on replacement costs or costs of remedial works).

### Operation and Maintenance

- Review of as built drawings and maintenance manuals to determine how well maintenance and operation has been carried out
- Inspection of maintenance records and logs to ensure there has been regular systematic maintenance of the various systems
- Inspection of records relating to maintenance of fire protection items, e.g. extinguishers, hose reels, fire panels, evacuation systems, etc
- Summary of maintenance contracts and standard of service

## 5.0 Legal Due Diligence

### 5.1 General

The legal aspect of the due diligence process calls for a consideration of the issues relevant to ownership of the property including the ownership

structure, the nature of the title and the various matters listed (GN 3: 5.4) that impact on use, enjoyment and value. In the case of properties which are leased, the legal due diligence process also calls for a detailed review of the lease or leases. Expert legal advice should be obtained in each case. (Note: Legislation relating to property varies from State to State).

### 5.2 Ownership Structures

The following ownership matters should be considered:

Apart from ownership by an individual in his or her own name, there are basically four legal structures that may be used for property ownership, being:-

- company
- trust (unit or discretionary)
- partnership
- joint venture (incorporated or unincorporated)

### 5.3 Joint Ownership

In addition, where interests are being acquired jointly by two or more parties, consideration needs to be given as to whether the owners should be "joint tenants" or "tenants in common".

### 5.4 Importance of Accountants' and Solicitors' Advice

The selection of the wrong ownership structure is likely to have serious implications in terms of the taxation treatment of the investment and costs involved in rectifying the situation may be prohibitive as a result of the likely imposition of stamp duty on the transaction. Accordingly, it is extremely important that advice is obtained from accountants or solicitors regarding the most appropriate ownership vehicle.

### 5.5 Determining Ownership Vehicle

In determining the property ownership vehicle, regard should be had to the following:-

- income tax
- capital gains tax (Australia)
- ability to utilise income and capital losses
- stamp duty (Australia)
- transferability of shares / units
- proposed level of borrowings
- administration and management
- liability of the beneficial owners
- the number and type of beneficial owners.

## 5.6 Types of Title

There are basically four types of title, each of which is briefly described below. When acquiring a leasehold interest, particular care needs to be paid to the terms and conditions affecting the leasehold, including the term of the lease, restrictions on the use of the property, rights to purchase etc.

*Torrens* - This is the modern system of title where a certificate of title issues in the name of the registered proprietor showing all registered interests. This category includes units in "strata" developments.

*General / Old System/Law Title* – In Australia, this is the common law system which was in place before the adoption of the Torrens system by the various States. Pockets of it still remain today. A feature of this system is that "title" is actually a chain of documents tracing ownership backwards from the present owner to either the original Crown Grant or at least to a good "root of title" which, in most jurisdictions, must be at least 30 years old.

*Crown Leasehold* – In Australia this interest is derived from a lease with the Crown which traditionally will be for a long term. The interest may include a right of purchase on the lessee - usually conditional upon the lessee carrying out certain improvements. Since the Wik decision, leasehold interests which do not give exclusive occupancy, are potentially vulnerable to Native Title claims. It should be ascertained:

- whether a claim has been lodged with the NNTT, and/or determined,
- whether it is likely a claim will be forthcoming from potential native title holders
- what the effect of the above is on the activities currently carried out under the lease

*Crown Land* - Vacant Crown Land is also potentially open to a Native Title claim in Australia and Waitangi Treaty claim in New Zealand. Similar inquiries to the first two points above should be made.

*Leasehold* - This is the interest that every lessee acquires whether under a head lease, sub-lease, ground lease, riverbed lease etc.

### Matters Affecting Title and Purchase Price

The following matters should be considered for their effect on Title and Purchase Price:

- Occupation / title boundaries (site survey to determine horizontal and vertical encroachments)

- Mortgages and charges
- Unpaid rates and taxes
- Restrictive covenants
- Easements (expressed and implied)
- State Planning Agreements
- Caveats
- Sewers and drains
- Rules of body corporate (where applicable)
- Leases
- Confirm lettable floor areas (by reference to an accepted method of measurement eg. Property Council of Australia or PCNZ/PINZ)
- Planning status (including rezoning ability, future roads, future flight path, proximity to heritage buildings)
- Heritage status
- Unauthorised structures
- Non-compliance with Building Regulations
- Certificate of Occupancy and classification
- Flood levels
- Notices relating to planning/building matters
- Contamination and hazardous building materials (refer API and PINZ guidance notes relating to contaminated land)
- Retail tenancy legislation
- Notices of resumption
- Quarantine orders (in relation to farm land)
- Filling
- Fencing notices
- Currency of defects rectification rights and plant warranties
- Vegetation protection

## 5.7 Planning Controls / Resource Management

Town Planning matters should be examined.

## 5.8 Value Affected by Town Planning

The value of a property will be directly affected by the town planning/resource management regulations which relate to that property, particularly in so far as those regulations constrain

the development potential of the property. Where it is intended that a property be acquired for the purposes of redevelopment, it is extremely important that detailed inquiries be made to ascertain the planning controls which apply to the particular property by legislation, lease control or some other method.

### 5.9 Use Regulated by Planning Controls

The use to which a property may be put is regulated by the planning controls. The status of a property may vary as follows:

- use as of right - permit not required
- entitlement to permit if premises meets specified requirements
- entitlement to permit if specified conditions satisfied
- prohibited use
- non-conforming use
- amendment of the planning scheme required

#### Issues Affecting Development Potential

There are numerous planning issues which may affect development potential. These include:

- zoning i.e. residential (ranging from single family to high density dwelling), business, industrial, rural
- height controls
- floor space ratio
- transfer of plot ratio
- setback
- overshadowing
- loss of views
- traffic generation
- sight lines
- car parking ratios
- access to the property (proposed road works, traffic islands, restricted highways etc)
- minimum frontages / lot sizes
- density controls / number of employees
- approvals (adjoining owners, cash in lieu payments)
- heritage / conservation issues
- Aboriginal interests / claims

### 5.10 Copy of Development Approval

A copy of the original development approval should be obtained to ensure that the building complies.

#### Foreign Investment Review Board (Australia)

The need for certain proposed real estate acquisitions by foreign interests to be examined by the Foreign Investment Review Board should be considered.

The Foreign Acquisitions and Takeovers Act 1975 is a federal statute regulating foreign investment in Australia. Under the terms of this Act, all proposed real estate acquisitions by foreign interests must be submitted to the Foreign Investment Review Board ("FIRB") for examination, unless the acquisition falls within a specific exemption category.

The Foreign Acquisitions and Takeovers Act defines a foreign interest as:-

- a natural person not ordinarily resident in Australia; and
- any corporation, business or trust in which there is a holding of 15% or more by a single non-resident person or foreign corporation or holdings of 40% or more in aggregate by two or more non-resident persons or foreign corporations.

The exemptions to the requirement for obtaining FIRB approval are set out in the Foreign Acquisitions and Takeovers Regulations and include:-

- Acquisitions of an interest in land on which a dwelling will be constructed where the treasurer has certified that the sale of the interest to foreign persons is not contrary to the national interests (usually conditional on an undertaking from the developer that no more than one half of the units in any development will be sold to foreign interests).
- Acquisitions of industrial or commercial real estate that are wholly and directly incidental to the conduct of the business of the foreign interests.
- Acquisition of direct interest in non-residential commercial real estate with a value of less than \$5 million.
- Acquisitions of residential real estate by intending migrants who have received approval to take up permanent residence in Australia.

- Acquisitions of interest in timeshare schemes where the entitlement of the foreign interest is less than four weeks per year.

### Overseas Investment Commission (New Zealand)

In New Zealand the need for certain proposed real estate acquisitions by foreign interests to be examined by the Overseas Investment Commission, should be considered.

(Note: Both the legislation and rules relating to foreign acquisitions are subject to change)

## 6.0 Taxation Issues

### 6.1 General

Commercial investment properties are generally acquired for the specific purpose of providing short or long term income and capital growth. Prima facie, both income and capital gains are subject to taxation in Australia, and this may significantly alter the after tax rate of return of a particular investment. In New Zealand there is currently no capital gains tax. Both the vehicle, which is used to acquire a property and the manner in which an acquisition is structured and financed may have a significant bearing on the tax effectiveness of the investment, and it is therefore extremely important that expert tax advice is sought prior to entering into a property transaction.

### 6.2 Specific Tax Issues

A range of specific Tax Issues affecting various processes in dealing with property should be examined.

### 6.3 Acquiring Property

Tax Issues on Acquiring Property:

- Ascertain tax depreciable value on purchase of plant and equipment and building
- Determine appropriate allocation of total consideration to plant and equipment (depreciable items should be listed in the contract)
- Application of depreciation deeming provisions to transfers of plant and equipment between parties not dealing at arm's length
- Determination as to whether properties constitute trading stock
- Determination as to whether properties constitute revenue or capital assets

- Deductibility of financing costs

### 6.4 Holding Property

Tax Issues on Holding Property:

- Ascertain level of historical construction costs for purposes of building allowance
- Determine appropriate building depreciation allowance rate
- Consider structural improvements for purposes of building allowance
- Determination of whether fixtures are depreciable and to whom
- Determination of appropriate depreciation rates
- Application of investment allowance to acquisitions of plant and equipment
- Deductibility of financing costs
- Tax deductibility of repairs and particularly initial repairs

### 6.5 Selling Property

Tax Issues on Selling Property:

- Ascertain assessable depreciation balancing charge or tax deductible write-off
- Elections to offset assessable depreciable balancing charge against other plant and equipment
- Ascertain capital gains tax liability on sale of property, plant and equipment
- Application of capital gains tax deeming provisions to transfers of plant and equipment between parties not dealing at arm's length
- Assessability of profits on disposal of plant and equipment as ordinary income
- Disallowance of investment allowance for short term sales
- Ascertain basis of profit realisation for long-term construction contracts
- Assessability and capital gains tax implications of compulsory government acquisitions



### 7.0 Stamp Duty (Australia)

#### 7.1 General

In any property acquisition in Australia, stamp duty is likely to represent a material cost to the purchaser and should be taken into account when evaluating the returns from the property. Stamp duty is levied on legal instruments and, in relation to property conveyancing, will generally be payable on a sliding scale based on the value of the property. (Note: The rate of duty may vary from State to State.) Stamp duty is also payable on leases (being a percentage of the rental payable during the term of the lease) and on loan securities.

#### 7.2 Due Diligence Issues

Issues which may need to be considered for due diligence include:

- Determine appropriate jurisdiction
- Identify dutiable instruments and deemed instruments
- Consider ex gratia, reconstruction and other relief entitlements
- Consider specific exemptions from duty
- Consider specific concessions from duty, such as in relation to off the plan purchases
- Determine rates
- Ascertain stamping requirements for all documentation, including financing and lease documents, with particular emphasis on method of stamping, period for lodgement of documents and period for payment of duty
- When acquiring shares in a company or units in a trust which owns property, regard must be had to the potential application of the land rich entity provisions which may effect the rate of duty payable on such transactions

### 8.0 Locational Influences

#### 8.1 Location Considerations

Locational influences vary according to the type of building. It may be appropriate, particularly in significant commercial property transactions, to commission a suitable qualified consultant to report on the strengths, weaknesses, opportunities and threats (SWOT analysis) in relation to locational

influences. The most important considerations for the major categories of non-residential commercial property are listed below.

#### 8.2 Office Buildings

Location Considerations for Office Buildings:

- Proximity to retail facilities
- Proximity to public transport
- Availability of parking, either on-site or publicly provided nearby
- Proximity to leading hotels and restaurants
- Commentary on surrounding areas including future development and land use, vacancy rates

#### 8.3 Industrial Buildings

Location Considerations for Industrial Buildings:

- Ease of vehicular access to the site
- Proximity to public transport
- Proximity to customers (for minimising transport)
- Proximity to raw materials, supplies and services
- Proximity to vocational training facilities
- Proximity to means of freight transportation (rail terminals, ports, airports)
- Proximity to related industry
- Commentary on surrounding areas including future development and land use, vacancy rates

#### Retail Shopping Centres

Location Considerations for Retail Shopping Centres:

- Population in the primary, secondary and tertiary trade areas
- Demography of trade area population
- Trading mix
- Configuration of the centre
- Any artificial or natural barriers (roads, rivers) which may affect the trade areas
- Ease of vehicular access to the site
- Prospects for competition (both present and future)
- Marketing and promotion

## **9.0 Design Influences**

### **9.1 Design Considerations**

Design influences can affect the ability of a property to operate to its maximum efficiency and effectiveness. Any prospective purchaser should consider engaging the services of a suitably experienced architect to assess the appropriateness of the buildings which are being acquired as well as to assess what capital may be required to rectify any design shortcomings.

### **9.2 Office Buildings**

- Design Influences for Office Buildings:
- Condition of external cladding and ease of cleaning
- Lobby size, configuration, finishes
- Adequate lift facilities (including goods lift)
- Adequate heating and air conditioning
- Column-free floor space (and flexible floor space for tenancy layouts)
- Sound insulated windows
- Adequate car parking
- Adequate security system
- Adequate toilet and shower facilities
- Adequate facilities for the disabled
- Adequate after hours occupation requirements (eg. air conditioning)
- Sufficient floor to ceiling height
- Sufficient stand-by facilities for equipment and/or facility failures
- Compliance with occupational health and safety regulations

### **9.3 Industrial Buildings**

Design Influences for Industrial Buildings:

- Appropriate office to warehouse ratio
- Adequate level of natural light in the warehouse area
- Adequate load bearing capacity of the warehouse floor
- Adequate distance between columns in the warehouse allowing for use of forklift trucks
- Adequate loading and servicing facilities

- Adequate height between spans
- Adequate ingress / egress
- Adequate thickness of driveways
- Adequate room for trucks to manoeuvre once on site
- Ability to install gantries where needed
- Hard stand parking and storage

### **9.4 Retail Shopping Centres**

Design Influences for Retail Shopping Centres:

- Established anchor tenant
- Appropriate tenancy mix between anchor and specialty shops
- Uniform shop fronts and signage
- Width of shopping malls
- Adequate lighting facilities, either natural or artificial
- Appropriate heating and air-conditioning facilities
- Appropriate space allocation to entertainment facilities
- Appropriate sight lines
- Ease of access and egress from retail area to carpark
- Layout to ensure efficient retail operation
- Location of dead frontages
- Provision of adequate car parking and under cover car parking for wet weather conditions
- Provision for expansion

## **10.0 Leases**

### **10.1 General / Legal Issues**

Leases are a vital component in most commercial properties and any due diligence process should include a thorough analysis of all lease covenants effecting the subject property. Issues which would ordinarily be considered include:-

- Financial status of tenant
- Trading strength of tenant
- Whether and to what extent the lease has been stamped
- Term of the lease

## ANZ REAL PROPERTY GUIDANCE NOTE 6

- Is there an option for renewal? If yes, has it been exercised?
- Does the lessee have a right of early termination?
- Is the rent a market rent?
- Is the rent based on turnover?
- What provision is there for adjustment or review?
- Can the rent reduce on a review?
- Procedure for rent reviews
- Outgoings recovery, including plant maintenance and replacement
- Repair obligations
- Tenant's obligation to contribute to a promotion fund
- Tenant's obligation to provide turnover information
- Redecoration obligations
- Make good at end of term
- Insurance obligations - lessor/lessee
- Does the lessor have any non-standard obligations?
- Who owns the fit out?
- Control in relation to use
- Restrictions on assignment and sub-letting
- Does lessor have the right to modify or alter the building?
- Does lease deal with issues relating to base building comfort levels / performance criteria?
- Are the termination and damages provisions adequate?
- What are the provisions relating to damage and destruction?
- Are the premises "retail" premises? If yes, does the lease comply with the relevant legislation?
- Are tenancy areas properly defined in the lease?
- Arrears position
- Licence Agreements (eg. parking)
- What security is held:
  - personal guarantees and indemnities

- security deposit
- performance bonds
- bank guarantee?
- Determine whether the lease deals with issues of:
  - contamination
  - hazardous materials
  - ozone depleting substances

### 10.2 Tax Issues

Tax Issues which would normally be considered include:

- Assessability / tax deductibility of lease incentives received / provided
- Assessability / tax deductibility of lease premiums received / provided
- Assessability / tax deductibility of lease surrender payments received / provided
- Timing of assessability / tax deductibility of lease payments received / paid in advance
- Tax deductibility of lease payments
- Categorisation of "lease" as either genuine lease or instalment purchase for tax purposes
- Consider disallowance of interest, depreciation and building allowance tax deductions for assets leased to public bodies and non-residents
- Application of withholding tax for leases involving non-residents.

### 11.0 Contamination – Environmental Audit

Consider the desirability of having an environmental audit of the land and building, covering matters such as contamination, asbestos, air conditioning, filling, underground tanks etc, to be carried out by specialist environmental companies.

## 12.0 General

The process should also involve a review of the following:

- Access to Building Reports
- Condition Report
- Asbestos Report
- Contaminated Land Report
- Plant and Equipment Report
- Depreciation Report
- Current construction contracts, plans, specifications
- List of goods and chattels to pass with the sale
- Ongoing review of Sale Contract.
- Preparation of rental arrears list
- Agreement as to treatment of rental arrears
- Files, books and financial statements held by owners and managing agents
- Access to files
- Ownership of files on settlement
- Site Survey
- A surveyor should be employed to identify the boundaries of the subject property, and horizontal or vertical encroachments and to confirm the status of any improvements in relation to the boundaries.
- Insurance - Details and claims records
- Bill of Sale over tenant's plant and equipment
- Talk to tenants and other occupiers. In many cases their practical experience will be an important indicator of building problems.
- Property Management
- Outgoings
- Review building outgoing
- Sight receipts
- Review outgoing budget

Consider the managerial styles that may be used for a property, for example:

- owner manager
- joint venture manager
- external manager.

The due diligence process should include:

- Interviewing existing property manager and building manager
- Reviewing maintenance and service agreements (management agreements, cleaning contracts, air conditioning contracts, lift contracts). Can they be assigned? Will they be terminated?
- Management staff entitlements such as long service leave, superannuation, holiday pay.

**Annexure 1- Suggested Due Diligence Check List**

ACTIONS	RESPONSIBILITY	COMPLETION DATE	ESTIMATED COST
1.1 Approval to make Conditional Offer	Executive Level		n/a
1.2 Conditional Offer Delivered	Executive Level		n/a
1.3 Acceptance by Owner	Vendor		n/a
1.4 Selection of Consultants	Management Level		n/a
1.5 Consultant Approvals	Executive Level		n/a
1.6 Consultant Meeting	Management Level		n/a
1.7 Consultant Letters of Appointment	Management Level		n/a
2.0 Valuation	Experienced Valuer		\$
3.0 Building Structure	Engineer		\$
4.0 Building Services Performance Testing Mechanical Services Electrical Services Hydraulic Services Fire Services Lifts and Vertical Transportation Security Technical Efficiency Communication Services	Engineer		\$
5.0 Legal Title Town Planning Service Agreements Insurance Licences General Counsel Site Survey Property Management Agreement Contract of Sale Acquisition Structure Settlement	Legal Consultant		\$
6.0 Accounting and Tax Audit Depreciation Allowances	Accountant Quantity Surveyor		\$

## ANZ REAL PROPERTY GUIDANCE NOTE 6

ACTIONS	RESPONSIBILITY	COMPLETION DATE	ESTIMATED COST
7.0 Stamp Duty	Legal Consultant		\$
8.0 Location Influences	Economic and		
Economic & commercial Overview	Planning Consultant		\$
Traffic Management	Traffic Management Consultant		\$
9.0 Design Influences			
Architectural and Town Planning	Architect & Town Planner		\$
Quantity Surveyor	Quantity Surveyor		\$
10.0 Leases	Legal Consultant		\$
11.0 Contamination - Environmental Audit	Environmental Specialist		\$
12.0 Other Influences			
Documentation	Project Manager Audit		\$
Public Relations Audit	PR Consultant		\$
13.0 Final Approval for Purchase	Executive Level		n/a
14.0 Exchange of Executed Contract	Executive Level		n/a
15.0 Settlement of Contract	Legal Consultant		n/a
16.0 Management Systems	Management Level		n/a

Note: The above list of comprehensive actions is merely a guide, but would be endorsed by Auditors for due diligence examination.

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# ANZRPGN 7 PROPERTY INSURANCE MANAGEMENT

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to assist Members to understand the essential elements of managing insurance programs in relation to existing buildings by broadly outlining issues relating to the insurance environment and risk management.

### 1.2 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.

### 1.3 Scope

This Guidance Note applies to Members who are called upon to advise clients in matters pertaining to the insurance of their properties and, in some cases, arrange the relevant insurances on their behalf. It deals with the management of risk and protection from risk using Insurance as an important element in achieving these objectives. Specifically, the Guidance Note deals with:

- a general background to insurance;
- aspects of risk management;
- relevant classes of insurance; and
- other relevant matters

### 1.4 Not Technical Advice

This Guidance Note does not seek to provide technical advice on specific valuation issues.

### 1.5 Beyond the Scope

Similarly, issues associated with insurances for new construction or major refurbishment projects are beyond the scope of this Guidance Note. Members will need to be aware of these types of insurance

from other sources.

### 1.6 Consultation

Whilst a guidance note of this nature can address the broad issues, it cannot be definitive and you are, therefore, urged to consult with the insurer, an insurance broker or your legal adviser to discuss any aspects requiring clarification or expansion.

### 1.7 Disclaimer

This paper was produced by the Australian Property Institute to provide general information, in summary form to its Members. The contents do not constitute legal advice and should not be relied on as such. Formal legal/insurance advice should be sought in particular matters.

## 2.0 Preamble

### 2.1 Protect From Risk of Loss

Since the beginning of commerce and trade, humankind has sought to protect itself from the risk of loss, be that loss associated with property (real or personal), life or the ability to provide food and shelter for the individual, family or community.

### 2.2 Convey Risk to Another

The need to convey the risk of loss to another party has seen the development of a number of risk transfer mechanisms, the most notable probably being the concept of insurance.

### 2.3 Insurance is a Contract

Insurance is a contract between two parties where, for a consideration (premium), one party agrees to pay for a stipulated loss suffered by the other party. The payment of the claim simply fulfils the contract

### 2.4 Risk Transfer and Risk Combination

Thus, at the heart of insurance is the principle of both risk transfer and risk combination. Risk combination allows the risk to be spread, usually via an insurance fund, over a very large number of individuals or corporate entities.

### 2.5 Common Pool

The combination of many potential risks into a common pool or fund allows the law of averages of large numbers to operate to the benefit of the unfortunate few who suffer loss.

### 2.6 Statistical Data to Predict

With a large number of homogenous items (be they motor vehicles, lives, units or real property, etc) grouped together, it is possible from statistical data to predict within reasonable limits the number and cost of losses that will occur within the group. With this knowledge premiums can be calculated that are needed to pay the losses and the expenses of operating the fund and to provide an acceptable profit.

### 2.7 Offer Long Term Security

So that the insurance fund is able to offer long term security to its policyholders, premiums must be sufficient to enable it to meet both immediate claims and those that arise well into the future. The fund's long term viability is also dependent upon the level of investment income generated, operating expense levels and the sum of returns paid to investors (be those investors shareholders or owners in a mutual organisation).

### 2.8 Premium Rates

Whilst premium rates are determined by many complex factors, most of which are outside the direct control of the purchasers of the insurance protection, property owners can, however, take some actions that will affect the premium they are required to pay.

### 2.9 Modern Risk Management Practices

Modern risk management practices, careful analysis of the risks to be covered, and the level of the risk that the property owner will retain, are but a few of the factors that will determine the amount of money that will be spent on loss prevention and insurance protection.

### 2.10 Insurance Issues

This paper deals with some of the insurance issues that face Members in their management and development of real property.

## 3.0 General Insurance Environment

### 3.1 Premium Rates Fluctuate

Premium rates available to companies and individuals seeking the protection of insurance fluctuate in accordance with both local and international insurance market conditions, the level of natural and man made disasters (ie. claims), the economic climate and business cycles.

### 3.2 Management of Insurance Programs

The management of insurance programs has thus taken on an increased importance for professionals involved in producing satisfactory returns from property investments.

### 3.3 Amount Spent

With the development during the 1980s of very large property assets which in themselves require insurance cover of many hundreds of millions of dollars, the amount spent on property insurance has become very significant, both in aggregate terms and as a cost of operating property portfolios.

### 3.4 Insurance Necessary

Insurance is necessary because it offers:

- security to lenders and other stakeholders;
- comfort to customers;
- continuing of business operations; and
- safeguards to employees' jobs (ie. financial protection following a loss)

### 3.5 Insurance Costs Controlled

To ensure that insurance costs are controlled, it is important that owners and their asset managers are able to demonstrate to underwriters the qualities of their buildings and management controls they maintain.

### 3.6 Risk Management

This is best done by risk management and 'anticipation of risk, rather than by reaction to loss.'

### 3.7 Control Premiums

If this is observed, it will not only assist all property owners to control their risk but also their premiums.

## **4.0 Risk Management Responsibility of Officers and Directors to Owners**

### **4.1 Some Have a Legal Obligation**

Practising effective risk management procedures is not simply a matter of good management, some people have a legal obligation to their employer.

### **4.2 Legal Responsibility**

The officers and directors of a business have a legal responsibility for the proper management of pure risks. Pure risk is the loss of, or damage to, property or injury or death of persons using the property. It can be accidental or fortuitous, foreseen or unforeseen. They have an overall legal duty and a specific obligation to use care and be diligent in the administration of the affairs of the corporation and in the use and preservation of its assets. Courts have recognised that the failure to effect proper insurance coverage, to pay premiums when due, or to keep coverage in force, may well be the basis for personal liability suits against the officers or directors of a business. The legal standard of performance is that officers and directors must exercise the care that an ordinary prudent person would exercise under similar circumstances.

## **5.0 Risk Management**

### **5.1 Process to Identify and Quantify Exposures**

Risk Management of Real Property is the process through which an organisation can identify and quantify its exposures to loss, access priorities and develop strategies to avoid losses or, if they do occur, deal with them effectively.

### **5.2 Benefits**

The benefits of the Risk Management approach are:

- Prior recognition of Real Risks to an Organisation;
- Optimal Insurance/Self Insurance;
- Increased Management Awareness;
- Effective Reporting Mechanism;
- Helps Avoid or Minimise Losses;
- Reduced Cost of Risk;

- Satisfies Due Diligence Requirements;
- Conforms with Best Practice;
- Facilitates Corporate Governance;
- Increased profits;
- Better Management of resources;
- Improved Productivity.

### **5.3 One Objective**

Risk Management has one objective; i.e. to ensure the economic continuity of the goods and services of an organisation whilst minimising the costs of both expected and unexpected losses. The activities of the Risk Manager are influenced by the Owner's general insurance philosophy which can be summarised:

- Eliminate or reduce as far as practicable the conditions and practices may cause insured or uninsured losses'.

Note:

- outsource non-core functions or inappropriate activities;
- transfer contractual liability of consequences, eg. tenants take public liability risk; insurance and/or indemnity is required of contractors working on site or supplying services or goods;
- imposition of insurance, indemnity and hold harmless conditions in agreement with contractors; and
- when premises are rented risks may be transferred from owners to tenants or from tenants to owners, depending on the lease conditions.
- The extent of elimination or reduction affects insurance costs;
- When risk cannot be eliminated or reduced to workable levels;
- Purchase commercial insurance that will provide indemnity for catastrophic losses;
- Either insure or assume those risks not considered to be of major importance to the operating or financial position of the Owner.

### **5.4 Importance and Complexity**

The risk management function continues to grow in importance and complexity. Management is becoming more cost conscious and more aware

of how sound risk management helps to minimise expenses.

### 5.5 Strategy

For this reason, it is always important to have a risk management strategy which can protect tenants as well as the owner and also assist by demonstrating to insurers that the business is aware of potential exposures and is implementing procedures to ensure such exposures are controlled. This will benefit all parties and lead to more economical insurance premiums.

### 5.6 Identifies & Controls Potential Loss

The risk management process identifies and controls potential loss situations which can affect an organisation's financial security, reputation and viability.

### 5.7 Identify Risks

In order to identify the risks, it is important for the owner of the property to be aware of potential hazards and to implement a control to enable management to always be conscious of changes in tenants and likely hazards.

### 5.8 Procedure

The procedure should include risk identification, risk management and risk control.

### 5.9 Specific Risks – Risk Identification

#### Process Systematically and Continuously Identifies

This is the process by which a business systematically and continuously identifies property, liability and personnel exposures as soon as they emerge. Unless these risks are identified, all potential losses will unconsciously be retained by the company.

#### Most Risks Easily Recognised

Most risks are easily recognised, and would be known within an organisation. These should be identified by either the insurance broker or the ownership entity, after discussions with staff and staff should be given on-going support from Management in the identification of risk. The risks shown below are normal within the property industry, and it is in order to insure against perils such as these that an insurance policy is purchased.

- Fire
- Lightning

- Storm and Tempest
- Water Damage
- Flood (not readily available in flood prone areas)
- Sprinkler Leakage
- Explosion
- Business Interruption (including loss of rent)
- Loss of Machinery/Boilers
- Demolition and removal of debris
- Earthquake
- Impact by Vehicles or aircraft
- Malicious Damage
- Theft
- Accidental Damage
- Legal liability to third parties
- Workers' Compensation (compulsory) called 'WorkCover' in some States
- Motor Vehicle (Third Party injury insurance is compulsory).
- Breach of professional duty
- Liability of directors and offices arising out of a wrongful act
- Consultants fees
- Contract works (principal controlled contractor's liability policy)
- Environmental damage
- Pollution

#### Check List

However, to identify all the potential losses, a check list of all assets of the company should be drafted, and a systematic approach used to discover which of the potential losses provide the most exposure to the company. This is best done internally by the person whose responsibility it is to control insurance, or can be carried out by an independent firm, such as a broker/risk management company. Any independent firm should work in liaison with the firm's internal risk Manager when conducting a risk identification survey.

#### Risk Profile

As each property is unique, both as to its operation, usage, location, construction and cash

flow pattern, it is important that a risk profile be developed for each property, ie. Pro-forma profiles may overlook some feature unique to a particular property.

### Exercise Will Correctly Inform

Although this is a time consuming exercise, it is the only means which will correctly inform the company of the risks/exposures it carries, and will:

- identify exposures which can be insured, therefore the exposure is transferred from the company to an insurer;
- where the exposure cannot be insured, management controls can be implemented which will diminish the risk to the company.

### Risks Prioritised

Risks should be prioritised by analysing both the probable frequency of an occurrence and the impact (ie. severity) on the company. Risks that are assessed as having a high likelihood (ie. frequency), together with a high impact, should be fully insured.

### Excess

The starting point is the excess under the policy. This indicates the level of risk the company can absorb.

## 5.10 Risk Management

### Potential Losses Measured

After the risk has been identified, the potential losses must be measured in order to determine their relative importance.

NB. Replacement/reinstatement costs do not necessarily equal market value.

### Calculated Periodically

Asset values should be calculated periodically by consulting professionals who will assess the dollar value at risk to ensure, at the time of a major loss, the value of both property (ie. physical structures excluding land value) and business interruption is adequately insured. This will ensure that the business does not need to fund part of the loss, which could impact on the viability of the organisation. Extra costs may be incurred if regulatory changes are triggered.

### Quantity Surveyor

A quantity surveyor can be used to establish replacement cost estimates. It is generally

believed studies reveal that a significant number of buildings are underinsured. The impact of averaging insurance [GN 22: 9.5] means that exposure previously thought to be insured is now only partially so.

### Engineering Survey

Specialist risk management engineering surveys can be engaged to identify specific, or peculiar exposures at each location.

### Physical Survey

A physical survey, implemented by both management or a risk management consultant, should include a review of:

- management controls
- fire protection systems
- inspection programs for fire hazards and other exposures
- general housekeeping
- staff training
- environmental risks
- security
- emergency evacuation
- bomb threats

Note: extra costs are referred to later in this Guidance Note.

Loss recording is a vital step in the risk management process. If an organisation does not record all losses, it is unable to take an informed decision to carry a risk, ie. higher deductibles, which can minimise premiums.

## 5.11 Risk Control

### Elimination or Minimisation

The aim of risk control is elimination or minimisation. After risks are identified, practical and cost effective recommendations can be made regarding the physical protection of assets.

### Monitored and Investigated

If all losses are monitored and investigated, the organisation is in a position to take effective measures to either eliminate or reduce recurring losses.

### Familiarity Contributes

The organisation is well placed to effectively contribute to risk control due to their familiarity

with the property.

### Tenancy Supervision

Tenancy supervision is also an aspect of risk control and a procedure should be implemented whereby there is regular liaison with tenants to ensure that their standards, or physical protection and housekeeping, are in line with that provided in common areas.

### Controls Influence Premiums

If these controls are achieved, the risk of losses is minimised, which significantly influences premiums.

## 6.0 Risk Financing, Risk Transfer and Insurance

### 6.1 Total Cost of Risk

The Total Cost of Risk includes such items as:

- Capital expenditure on fire protection and security equipment;
- Upgrades to electrical and mechanical plant;
- Repairs and maintenance;
- Insurance policy excesses or deductibles;
- Risk management consultancy fees;
- Insurance premiums; and
- Associated administration costs

The way in which the Total Cost of Risk is absorbed or otherwise paid for can be referred to as Risk Financing.

### Risk Transfer

Risk Transfer of the operational or financial consequences of an event can be effected in several ways, eg:

#### Lease Agreements

Requirement in Lease Agreements that tenants effect Glass and Public Liability insurance.

Note:

- The amount of the policy excess can be greater than the value of the glass;
- Public Liability insurance will generally be restricted to the tenant's operations unless that tenant is the sole occupant;
- Policies should be in the joint names of the Lessor and Lessee;

- Lessor may effect insurance if Lessee fails to insure;
- Lease documents should reflect Lessor's requirements.

### Service Providers

Contacts with service providers to include insurance, indemnity and hold harmless provisions in favour of the owner.

### Purchase of Insurance

Purchase of insurance, ie. transferring the ultimate risk to an insurance company per medium of effecting an insurance policy or policies.

## 7.0 Types of Insurance

### 7.1 Type of Policy Depends on Value

The types of policy or policies of insurance to be effected will to some extent depend on the value of the property. The criteria as to which insurances are appropriate for a given property vary from insurer to insurer but as a general rule:

- Properties with values less than, say, \$1-2,000,000 and perhaps up to \$5,000,000 will be insured under Business Insurance or similarly titled package policies; and
- Properties with values greater than these amounts will generally be insured under individual policies for each category of risk to be covered.

### 7.2 Business Insurance

Business Insurance policies generally offer a range of cover choices and those most relevant to the insurance of property are likely to be as follows:

- Fire, lightning, explosion and other specified perils to cover physical loss or damage to the property caused by those nominated perils;
- Consequential Loss, i.e. loss of gross rentals and increased costs of work arising as a result of a peril insured by the preceding section;
- Breakdown of electrical and mechanical plant and machinery and consequential losses arising there from; and
- Public Liability, i.e. legal liability in respect of claims by third parties for personal injury or death or damage to property arising out of an occurrence in connection with the ownership or occupancy of the property.

### 7.3 Separate Policies for Higher Value Property

The kind of separate insurance policies likely to be effected in the case of a higher value property are as follows:

- Industrial Special Risks (ISR) which insures 'Physical loss or damage (and consequential losses arising there from) not otherwise excluded' - the ISR policy therefore combines and expands upon the first two elements of the Business Insurance policy as above;
- Breakdown of electrical and mechanical plant and machinery and consequential losses arising there from (which are exclusions under the standard ISR policy); and
- Public Liability, i.e. legal liability in respect of claims by third parties for personal injury or death or damage to property arising out of an occurrence in connection with the ownership or occupancy of the property.

### 7.4 Specific Policies

In addition to industrial special risks (ISR) policies on a full reinstatement basis, other specific policies in relation to property can be adopted to suit specific requirements or specific loss categories. The requirement for these will vary according to individual circumstances. These policies include:

- Insurance of contents;
- Loss of master key insurance;
- Capital works insurance as an addition to conventional contract to cover such works as tenancy fit outs or refurbishments.
- Fidelity Guarantee, i.e. misappropriation of money or goods by employees;
- Credit Insurance, i.e. bad debts following tenant insolvency;
- Key person Insurance;
- Professional Indemnity; and
- Directors and Officers Liability;
- Any other appropriate insurance.

### 7.5 Workers Compensation

The requirement for Workers Compensation insurance differs from State to State and Territory to Territory. Care must be exercised to ensure that, if there are any employees, the appropriate insurance or statutory arrangement is put into place.

## 8.0 Issues to Consider in Choosing Insurance Cover

### 8.1 Assessing a Building's Risk

The main criteria for an insurer when assessing a building's risk is:

- The materials used in the construction of the building.
- Compliance with ordinances. For obvious reasons insurers will not provide competitive quotations where a site does not comply with ordinances as the insurer would postulate that the lack of compliance would increase the risk.
- Fire Protection, eg. sprinklers, are always an advantage, as it assists with minimising the risk for insurers and, hence, results in lower premiums.
- Tenancy of buildings. Insurers will always assess the exposure of tenants and quote accordingly, eg. a mechanic is a higher exposure than a bank - this will be reflected in the premium.
- Building security.
- Neighbouring environment - eg. explosives/chemical plant, bushland, etc.
- Limitation of road access.
- Location of premises (eg. on an existing flood plain).
- Compliance with ordinances eg. asbestos contamination (authorised removal is required following an asbestos audit).

### 8.2 Comments at the Planning Stage

Most major insurance brokers and insurance companies are able to provide comments on building design, fire protection and security. Ideally this should be provided at the planning stages, but later if need be. They will also be able to advise on risk management techniques tailored to the individual property.

### 8.3 Three Basic Functions

A core insurance program as discussed fulfils three basic functions for a property owner/manager:

- Conservation of all assets (Property insurance)



- Preservation of income/profits (Consequential loss)
- Protection against liabilities (Public liability)

Note: The extent to which insurance fulfils these functions is subject to the terms, conditions and exclusions of the policy, e.g.

- generally a liability policy will only cover sudden and accidental pollution;
- asbestos is generally an exclusion unless it is in static form.

### 8.4 Extensions to Policies

Taking the above into consideration, there are some extensions to Business Insurance and ISR policies which should be compulsory to any prudent property owner. These are:

#### Indemnity Period

The indemnity period should be long enough to provide for the following in the event of destruction (e.g. by fire):

- planning
- tendering
- approvals
- construction
- letting

### 8.5 Removal of Debris

Removal of debris. At times, the local council tip will not be able to handle all the debris from a building due to either the content (asbestos) or due to the bulk. This may incur very large charges/costs where the debris may need to be removed by specialists and sent to a processing plant which will accept the waste. Always ensure that the insurance limit will adequately reflect the cost of disposal.

As a rule 10% of the value of the asset would be a minimum but this varies dramatically depending on factors such as the height and construction of the building. (Note: Removal of asbestos has extraordinary cost implications and may involve 50-100% of the value of a building).

### 8.6 Reinstatement and Replacement

Always ensure that the policy provides for reinstatement and replacement conditions - including the ability to rebuild on the site where development controls may have changed.

### 8.7 Extra Costs

The policy should include the extra costs of reinstatement, which is the extra costs incurred to comply with any requirement of any Act of Parliament or Regulation, By-Law or Regulation of any Municipal or other Statutory Authority

### 8.8 Increases in Cost of Working

Increases in the costs of working, which covers any reasonable expenses incurred in order to minimise any long-term effect of a loss on profit/revenue, eg. Overtime wages, the costs of leasing other premises, including fees, advertising and promotional expenses.

### 8.9 Flood Insurance

Flood insurance - to cover damage to property caused by flooding. This may be provided subject to strict underwriting guidelines.

### 8.10 Policy Excess

Most policies will be subject to an excess or deductible, i.e. the amount of each loss which must be met by the insured following a claim.

### 8.11 Excess will Vary

The amount of the excess or deductible will vary from insurer to insurer and the nature of the property being insured.

### 8.12 Can Elect Higher Excess

Property owners can elect to assume higher excess or deductible than that being imposed by the insurer although it is recommended that this only be entertained where the insurer is prepared to offer a substantial premium discount in return.

### 8.13 Policy Exclusion

Policy Exclusions: All insurance policies contain exclusions and it is important that owners/managers familiarise themselves with those exclusions applicable to their own policies.

## 9.0 The importance of Valuations and Insurance Average Clauses

### 9.1 Definitions

In the context of insuring property it is important to be cognisant of the definitions which apply to the various types of policy.

### 9.2 Business Insurance

Business Insurance policies generally require separate sums insured to be specified for:

- Buildings, including architects and professional fees (the term 'Buildings' is understood to include the structure itself together with fixed electrical and mechanical plant, sprinkler and fire alarm systems and landlord's fixtures and fittings).
- Contents - in this regard the insurer should be asked to advise if carpeting and floor coverings, for example, would be considered as part of the building or would require a separate sum insured.
- Computer and electrical equipment.
- Costs of demolition and removal of debris.

### 9.3 ISR Policy Covers

An ISR policy covers 'all real and personal property of every description' under a single declared value for each property. Care should however be taken to ensure that the value declared takes all the above items into account.

#### Land Not Included

The value of land is not to be included in either case.

#### Under-insurance

Business Insurance and ISR Insurance are quite different in the way they deal with under-insurance and, irrespective of which policies operate for a particular property or portfolio, care will need to be taken in assessing the sums insured or limit of liability as applicable. Generally properties are insured for their replacement cost and the following aspects should be taken into account.

#### Sum Insured

The sum insured under Business Insurance is the insurer's limit of liability in the event of loss or damage. It is therefore necessary to project the

sum insured nominated at the commencement of the policy period to cater for inflation and other cost variables during the policy period.

#### ISR Policy

An ISR policy does not contain a sum insured per se but has:

#### Declared Value

Declared Value, ie. the estimated value of the property insured at the commencement of the period of insurance - as well as being relevant to the test of coinsurance or average, this amount is utilised for the purpose of premium calculation; and

#### Limit of Liability

Limit of Liability, ie. the maximum liability of the insurer in the event of loss or damage - this need not and should not be the same as the declared value but should represent what the replacement value of the property would be if, for example, it was totally destroyed on the last day of the period of insurance. (Sub-limits are also generally applied to contingencies such as accidental damage, burglary and demolition/removal of debris costs).

#### Coinsurance or Average

However, both Business Insurance and ISR Insurance contain Coinsurance or Average clauses which permit the insurer to reduce the amount of loss if the:

- Sum Insured at the time of loss or damage in the case of Business Insurance; or
- Declared Value at the commencement of the period of insurance in the case of ISR Insurance.

is less than 100%, 90%, 85% or some other specified percentage depending on the insurer's policy wording and/or the value of property concerned.

#### Example

Assuming that there was a 100% Coinsurance or Average Clause in the policy, the following example demonstrates how under-insurance can reduce the amount of a claim.

$$S \times A = \frac{\text{Claimable Amount}}{P}$$

Where

S = the sum insured or declared value in the policy

A = the amount of the loss

P = the correct value of all property

## ANZ REAL PROPERTY GUIDANCE NOTE 7

In this example

S = \$ 50,000

A = \$100,000

P = \$200,000

$\$50,000 \times \$100,000 = \$ 25,000$  (Claim settlement)  
          \$200,000          

This has occurred because, in this example, only 25% of the values were selected as either the sum insured or declared value as applicable. Note that the equation would vary in the case of, for example, a 90% or 85% Coinsurance or Average Clause although the underlying principles are the same.

### Ensuring Fully Insured

The best way of ensuring that a property is fully insured is to have the property valued and the policy figure updated on a regular basis. The valuer should be instructed to prepare the valuation so that the valuation accords precisely with the basis of insurance eg. Reinstatement, replacement and extra costs insurance or indemnity value as applicable and include costs of demolition and removal of debris and professional fees. At the very least, if a professional valuer is not to be utilised, it is recommended that reference publications such as Rawlinsons Australian Construction Handbook or Cordells be consulted.

### Sum Insured or Declared Value for Consequential Loss

It is similarly important to direct considerable attention towards assessment of the sum insured or declared value for Consequential Loss insurance - generally thought of as Loss of Rents insurance in the context of the insurance of property. This insurance is also subject to coinsurance or average provisions.

### Indemnity Basis

It is also possible to seek insurance cover on an indemnity basis being either the market value of the building less the land value or the depreciated value of the property. This can, under certain circumstances, provide greater flexibility in the event of a catastrophic loss but may lead to complications in regard to a partial loss.

### Different Levels of Insurance Within One Complex

It should also be noted that different levels of insurance cover can be taken for structures within one property complex but at different levels of risk,

eg. a factory and its outbuildings on the same site where the factory might be under reinstatement conditions, and the outbuildings insured for their indemnity values.

### Public Liability

Public Liability insurance is subject to a limit of liability for any one occurrence ie. the maximum amount the insurer will pay for all claims arising out of the one event. This means that the limit of liability selected must:

- be sufficient to cover all claims from all claimants arising out of the one occurrence;
- recognise that injuries can take several years to stabilise to the point where some claims can be taken to Court - there can be both inflation and escalation in the amounts of damages awarded in the intervening period; and
- take account of the possibility that at least some of the potential claimants will be juveniles and that claims in respect of such persons cannot be finalised until a juvenile reaches the age of 18.
- The most appropriate limit of liability will be to some extent, influenced by both location and occupancy of the property concerned.

### Contract Waivers Recover Loss Against a Third Party

Contract Waivers: When an insurer has agreed to indemnify a company for a loss, it retains the right to recover its loss against a third party if they caused the loss. If the insured party has contractually waived the insurer's right of recovery against another party, the insurance policy can become null and void. The insured party should ensure that he has neither accepted nor waived liability.

### Hold Harmless

At present there are many contracts that are regularly utilised in the commercial environment that contain 'hold harmless', 'waiver of subrogation' or warranty clauses. These can be found predominantly in maintenance agreements and some lease agreements.

### Negotiate a Wording

Prior to signing or recommending any of these agreements, always refer to either the insurance broker or insurer who will either negotiate a wording which is acceptable to all parties or, if this

is not possible, will endorse the contract on either the property or liability policy.

to ensure that the insurance covers are specifically tailored to individual properties and their risk profile.

## **10.0 Conclusion**

### **Not All Exposures Are Insurable**

Not all exposures are insurable events, eg. wear and tear, damage by vermin.

### **Read Insurance Contract**

It is surprising the number of persons who do not read their insurance contract and/or obtain either legal advice or advice from a professional insurance adviser as this is perhaps the only contract that will ensure the ongoing viability of the business if a major catastrophe occurs. Although an insurance policy can be complex to read, it is important to understand, at the very minimum, the policy exclusions and conditions. If any part of the insurance contract causes concerns to the purchaser, they may be able to negotiate changes to policy conditions and wording. However, this can only be accomplished where the insurance purchaser understands the contract.

### **Very Large Programs**

For very large insurance programs, it may be advisable to recommend that the insurance adviser/broker to meet with the owner, the owner's solicitor and the insurer to design (draft) policy wordings and conditions. It is also reasonably common for a nominated loss assessor acceptable to both the owner and insurer to be agreed, as this can facilitate claims settlement when losses occur.

### **New Products and Changes to Taxation Provisions**

Finally, Members should be aware that as with all market sectors, the insurance industry is subject to continual review and there is the potential for significant change in the future. New insurance products regularly become available, and changes to taxation provisions or other Government regulation can effect the utilisation of insurance.

### **Ensure Insurance Covers are Specifically Tailored**

As indicated, this Guidance Note addresses broad issues, relating to the property insurance environment and risk management. However, just as the property market is not homogeneous and each property has different characteristics, so it is with the insurance market and individual policies of insurance. Thus the professional adviser needs

**ANZ REAL PROPERTY GUIDANCE NOTE 7**

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# ANZRPGN 8 PREPARING PROPERTY FOR SALE

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to provide a general reference to preparing real estate for sale. The Guidance Note addresses the steps taken in preparing property for sale prior to the actual commencement of marketing proper. It covers the period of preparation of the physical state of the property for sale together with any required financial or technical information bought together in a selling document prior to the placement of the property on the open market.

### 1.2 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.

### 1.3 Scope

This Guidance note is applicable to Members involved with most forms of real estate. However, the practitioner should be aware of particular idiosyncrasies which may apply to specialised property e.g. rural holdings, hospitals, nursing homes and other properties of a specialist nature which these notes do not attempt to address.

### 1.4 Schedule

Provided to the rear of the Guidance Note is a schedule of various types of property and an indication of the more specific information which must be assembled when preparing a particular property use for sale.

### 1.5 Preparation of Property

The preparation of the property as covered by this Guidance Note relates to aspects of both physical appearance and accumulation of information

required to provide the market with an immediate description of the asset it is considering to purchase. The information assimilated for the marketing material should be accurate given the responsibility imposed by Section 52 of the Trade Practices Act and preferably, all information should be verified by the Vendor's written certification of its accuracy. Matters relating to title should be requisitioned from the vendor's solicitor so that appropriate documents can be considered and be available for perusal. These could include title search, zoning certificate and current survey report.

## 2.0 Physical Preparation of the Property

### 2.1 Importance of Physical Presentation

The physical condition or state of presentation of the property is generally speaking, very important in achieving the highest possible price. A positive first impression is essential to maximising value, as the buyer is aware that a well-maintained property will not require maintenance expense in the early period of ownership. Pre disposal planning should be agreed with the Vendor and individually tailored to each property's need.

### 2.2 Areas Requiring Physical Attention

The practitioner should identify areas requiring physical attention, list items of physical deterioration, poor state of repair or areas of untidy appearance and discuss these with the vendor with the objective of rectification.

Issues may include:

- Upgrading the external appearance, which may include cleaning, minor repairs, repainting or landscaping maintenance.
- Attention to obvious maintenance requirements such as water damage, cracking to walls, repairs to roofing or down pipes, estate road resurfacing and numerous other possibilities should be noted for discussion.

### 2.3 Redevelopment Potential

Exceptions however do exist where a property has redevelopment potential and the “run down” condition of the improvements would have little effect on the value of the property with the possible exception to a reduction in price due to cost of demolition or removal. In this instance the buyers focus would be more on the characteristics of the location and land itself rather than the condition of the improvements thereon.

## 3.0 Preparation of the Property’s Financial Details

### 3.1 Soundness of Income

The most critical issue in preparing property for sale where it is an investment is the soundness of the income produced by the property. The length of leases, tenant profile and terms and conditions of the leases, including building outgoings, are all issues of paramount importance to the investor.

### 3.2 Tenancy and Lease Status

In preparing a property for sale the practitioner should review a property’s tenancy and lease status and undertake the following checklist to ensure that the property is presented in its best financial position. Be aware of a potential owner occupier who may be looking for space to occupy in a partially vacant building.

### 3.3 Occupancy Levels

- Fully leased property is the most attractive to the broader investment market. If vacancies exist, and the vendor can allow the time, it would be prudent, in order to maximise the selling price, to delay the sale to lease the property.
- If vacancies exist, the owner should be advised of the chances of re-leasing the premises, expected market rental level, and time frame for re-leasing the property.

### 3.4 Tenancy Security

- Ensure that all leases have been signed, stamped and/or registered, and that a comprehensive set of leases is available for scrutiny by potential buyers.
- Ensure that all personal or bank guarantees have been obtained and copies of each are attached to the leases.

- Provide a resume of the tenant(s) business history, number of outlets and other available information as this will assist in the purchasers acceptance of the security.

### 3.5 Lease Tenures

- If lease terms are about to expire, endeavours should be made to secure either new leases or lease renewals over existing tenancies.
- At the very least enter into correspondence with existing or potential tenants to provide a positive outlook as to the future letting of space which may otherwise appear as potential vacancy.

### 3.6 Re-negotiation of Unsatisfactory Lease Terms

- If there are undesirable lease terms and conditions that detract from the value or saleability of the property, it is desirable in the pre-sale period to re-negotiate lease terms, which are more commercially acceptable. This could relate to outgoings provisions, rent reviews or rental levels, for example.

### 3.7 Preparation of Tenancy Schedule

Cross-reference the tenancy schedule with the lease documentation (if available) to ensure that the tenancy schedule presents an accurate record of the leasing status of the property. The tenancy schedule should include at least the following vital information:

- Description to identify the area leased, eg. Shop number, floor level, suite number etc.
- Lessee’s name, (including trading name).
- Area leased in square metres.
- Gross or net rent per annum (including rate per \$/m<sup>2</sup> pa).
- Lease commencement and expiry dates.
- Lease rent review dates and method of rent review ie market rent review or fixed increase or CPI adjustment.
- Tenant’s proportion of recoverable outgoings.
- Comments in relation to particular items of variation of a tenant’s lease to the standard lease, eg. non recovery of certain outgoings.
- Who owns fit-out and if included in sale.



### **3.8 Other Sources of Income**

Details of other sources of income should be summarised. These could include:

- Carparking
- Naming / signage rights
- Licence agreements
- Telecommunication agreements/licences

### **3.9 Outgoing Schedules**

- These can be provided either in the form of past actual outgoings or budgeted outgoings and preferably a combination of both.
- The outgoings budget should identify each item of outgoings together with the annualised amount of past actual outgoings and future budgeted outgoings.
- Trends can be established and analysed if several previous years' outgoings are obtained.

### **3.10 Arrears Schedule**

- This document will provide the Member with an opportunity to address problem tenants with the vendor to ascertain the impact of arrears on the expected achievable price and/ or a program of back rent collection prior to placing the property on the market for sale.
- Every effort should be made to minimise arrears prior to the property being offered to the market otherwise the poor record of tenant payment could have a negative effect on price and marketability.

### **3.11 Depreciation Allowances**

Purchasers of commercial, retail and industrial properties often require information on both building and plant and equipment, depreciation allowances in order to assess the property's after tax payment earning potential. This is a specialist area requiring input from accountants or quantity surveyors specialising in this subject.

### **3.12 Overseas Purchasers**

This situation will require Foreign Investment Review Board approval in Australia and Overseas Investment Commission in New Zealand.

## **4.0 Marketing Strategy and Budget**

### **4.1 Target Market Determines Marketing Strategy**

The target market determines the marketing strategy. For smaller properties there is a greater reliance on brochure mail out, enquiries from advertising and signboards. The larger properties require greater emphasis on direct presentation of the property to identified prospective purchasers.

### **4.2 Discussion with Vendor**

The marketing strategy requires discussion with the vendor in relation to the recommended marketing campaign / procedure and associated costs.

### **4.3 Marketing Costs**

Depending on the marketing strategy adopted, costs may be incurred in relation to a combination of the following:

- Media production
- Advertising costs
- Website
- E-mail
- Internet
- Brochure / video production and cost of circulation
- Cost of producing a comprehensive information memorandum
- Cost to the preparation and erection of signage.
- Mailing and courier costs
- Photographic costs
- Travel expenses
- Cost of other specialists consultants advice (if required)
- Cost of auction venue (if required)
- Auctioneer's fee (if applicable).

### **4.4 Budget**

The marketing budget for a sales campaign will depend on the marketing strategy recommended. There is no direct correlation of the size of the marketing budget to the property but generally the larger the property's dollar value the greater the marketing budget.

There should be a schedule of the agreed marketing strategy as to which newspapers or chosen modes of advertising were agreed to including the agreed dates, costs and the length of the advertising campaign.

### 5.0 Method of Sale

#### 5.1 Decided in Consultation With Owner

The method of sale is decided in consultation with the owner and is determined as part of the marketing strategy. A recommendation as to the method of sale is based on the following factors:

- Potential competition
- Dollar value of the property
- Target market
- Competing properties
- Timing of sale
- Requirements of the vendor
- Complexity of the property
- Confidentiality requirements of the vendor
- State of the market

#### 5.2 Methods

The method of sale will generally comprise one of the following main methods:

- Private treaty
- Public auction
- Public tender
- Calls for expressions of interest.

#### 5.3 Variations

There are also other methods which may apply e.g. international tender, minimum sealed bid, informal tender and declared minimum price tender. The Member would adopt the most appropriate method of sale having determined market demand and target market.

#### 5.4 Primary Methods

The four primary methods of sale are described hereunder:

#### 5.5 Private Treaty

This method of sale requires an opinion of price. Pricing a property for sale may be unacceptable to

the vendor in a rising or falling market. However, providing a price estimate allows the market to judge the vendor's expectations and determine whether or not the vendor is genuine.

#### 5.6 Flexible

The option of private sale allows flexibility in sale terms and conditions and allows each party the opportunity to negotiate to its best advantage. There is no exclusivity afforded to any purchaser. However, the process may be prolonged if the vendor is unrealistic on price expectation.

#### 5.7 Popular at Lower End of Market

##### Public Auction

This method of sale remains popular at the lower end of the market. It may be less suited to larger investment properties but this will depend on your markets' practices. It is less popular with off shore investors whom may not have the ability to attend or the market knowledge necessary to give confidence to bidding at auction. In all cases, purchasers have already procured finance are required to undertake their enquiries prior to auction and therefore bid unconditionally. The benefit of the auction system is to provide a sales outcome to achieve the maximum price through competitive bidding.

#### 5.8 Outcome within Defined Time

The auction system can provide a sales outcome within a defined time period on sales terms acceptable to the vendor, usually an unconditional contract, with 10% deposit and settlement in 30 to 60 days depending on the common practice adopted in your state.

#### 5.9 Seen as Fairest for Estates and Forced Sales

The system is also seen and recognised by the courts as the fairest method for property disposal, especially for deceased estates and "forced sales".

#### 5.10 Unconditional Disadvantages

However, as mentioned there are potential purchasers that are either uncomfortable with the auction process or are unable to bid under an unconditional contract. They may have the ability to pay a higher price with the opportunity to vary the contract in a minor way. The practitioner's judgement as to target market and level of competition for a property is therefore vital to the successful outcome of an auction.

**5.11 Confidential Offer**

**Public Tender**

The Public Tender process allows purchasers to submit a confidential offer without fear of it being disclosed to competing parties. Offers are in the form of an unconditional contract prepared by the vendor’s solicitors and are accompanied by a refundable deposit. Tenders are irrevocable and remain open for acceptance by the vendor for a set period of time. The time period for acceptance is determined having regard to issues like expected level of competition and complexity of the offering. The time frame enables vendors to compare offers, seek clarification or any variations to the terms of an offer, and extract the highest possible purchase price from the marketplace.

**5.12 Used where Propriety is Paramount**

Sale by Public Tender is the formal step beyond Expressions of Interest. It is used in situations where propriety is paramount eg. Government offering property for sale and where the best price is generally accepted on uniform terms and conditions. It is used in the case whereby a property is likely to be keenly sought by a number of purchasers.

**5.13 An Initial Calling**

**Expressions of Interest**

This involves a sale method incorporating an initial calling for Expressions of Interest with suitably qualified parties identified from this initial stage either being subject to direct negotiation following closing of the Expressions of Interest or invited to participate in a further closed bid to determine the most acceptable offer.

**5.14 Benefits**

This method provides the following:

- Greater reliance on due diligence in assessing the property prior to offer.
- National and International market acceptance due to the opportunity to participate in the first stage of the process with limited time and costs associated.
- Flexibility in terms offered can often influence the purchase price. Expressions of Interest allow variations to a standard contract of sale enhancing the prospect of maximisation of price to the vendor.

- Confidentiality of information to the invited bidders.

**5.15 Two Staged Process**

A two staged Expressions of Interest process works as follows:

- The property is offered publicly to the investor market, and interested parties are invited to submit by a nominated date an Expression of Interest form confirming their interest, capability and price range.
- From the Expressions of Interest, suitably qualified parties are selected and invited to submit, on a due date, a formal bid. Final bids would be in the form of a contract.

The highest bidder (having regard to conditions and capability) is then accepted by the vendor and the balance of deposit paid.

**6.0 Preparation of Disclosure Material**

**6.1 Due Diligence an Integral Part of Preparation**

For larger properties in particular, due diligence has become an integral part of an offer to purchase and subject to the outcome of this activity will determine the purchasers preparedness to proceed to an unconditional contract. The due diligence package is now an integral part of the preparatory work for preparing property for sale. If the vendor is unwilling to address this issue before sale, and extended selling period is almost certainly assured.

**6.2 Extent and Complexity Varies**

The extent of material exhibited generally becomes more significant and complicated as the property’s value increases. The due diligence information should include all relevant information relating to the property that is likely to impact on the purchaser’s decision to proceed to settlement.

**6.3 Recommended Prior to Marketing**

Due Diligence information is often assembled after commencement of Marketing. As this process has gained particular relevance (and could potentially de-rail the transaction) it is recommended that preparation of the due diligence material be undertaken prior to commencement of marketing. The Member then has the opportunity to advise the owner of any adverse issues that could effect

both the potentiality of sale and achievable price. It is important to address these issues prior to sale than them becoming an insurmountable obstacle to settlement. It is better that all detrimental issues are dealt with prior to offering the property for sale.

### 6.4 Due Diligence Items ANZRPNG 6

Following is a list of Due Diligence items that are appropriate for inclusion in a "due diligence package":

- Easement Documentation - copies of easement documents and easement plans identifying the location of any easements on the property, the grantee, and requirements of that easement on the property and the owner.
- Leases - copies of all leases on the property or part thereof.
- Encumbrances - all encumbrances on title should be disclosed and relevant evidence provided.
- Contamination - a contamination report from the relevant State Government Department showing the status of the property. If the status indicates the property is contaminated or likely to be contaminated it is important to undertake further testing to provide a contamination report, including the extent of the contaminants and the cost of clearing the site. It may be necessary to undertake decontamination work (remediation) prior to marketing the property.
- Heritage / Land Use Issues - if a property is subject to a Native Title or Waitangi Tribunal claim, information regarding this land claim must be provided. If the property is listed as having some heritage significance, information relating to this must be identified and provided. It is further advisable to include any local government registration as this could have an impact on future dealings with the property.
- Main Roads / Local Government - Any requirements by either of these authorities for road widening, truncation or dedication must be identified and information provided.
- Flood Information - a flood report from the relevant local authority should be provided showing any history of inundation of a property due to flooding.

- Outgoings - an audited report on previous years' outgoings together with the current year's outgoings budget is important to provide an accurate outgoings estimate.
- General Rates and Land Tax Assessment Notices – it is important to include the most recent notices.
- Depreciation Information – both Building and items subject to Depreciation Allowance should be scheduled to provide the purchaser with knowledge of possible deductions against income for tax purposes.
- Council Compliance Certificate – inclusion of this document confirms absolutely Council's approval of the completed development at the time of construction.
- Approvals - any related approvals to the site for development or other future redevelopment.
- Other Reports - any other property reports that are relevant to the property and are likely to influence the purchaser's interest in the property and / or the sale price. This should include a full copy of building plans, any relevant site or soil reports, building structure reports, services reports, engineers reports, etc.
- Other Issues – refer ANZRPNG 6 Performing Due Diligence for guidance on other issues which may be applicable in certain circumstances.

Obviously the type and size of the property will influence the amount of relevant information. For instance, a residential house is unlikely to have any leases encumbering the property and much of the other information detailed above will probably not be appropriate

## 7.0 Marketing Material and Tools

### 7.1 Budget Determines Extent

The marketing strategy and budget will determine the extent of marketing material but in most cases the marketing tools available to the Member will be a combination of:

- Signage
- Advertising
- Brochure / video presentation

- Property information memorandum
- E-mail
- Internet
- Website

## 7.2 Due Diligence Material

The due diligence material would normally be at an accessible location for inspection by prospective purchasers. This could be the vendor's agent's offices or vendor's solicitor's offices.

## 7.3 Information Memorandum

The information memorandum is the most comprehensive marketing tool and addresses the following aspects of the property: -

- Location
  - Issues to be addressed are: -
- Accurate description of the property's location
- Proximity to public transport and amenities
- Quality of surrounding development including description of surrounding uses.
- Benefits of the location to the particular property eg. a high profile site has a considerable volume of passing traffic, an elevated site has unrestricted views, etc.
- Ease of ingress and egress.
- Photograph

The inclusion of a quality photograph highlighting the key aspects of the property is one of the strongest marketing tools available. The photograph should be digital to allow greater flexibility.

- Title Description

The full legal description should be inserted in the document with a photocopy of the title document if possible. Title description would give details of the lot, registered plan, parish and county together with land area and dimensions. This information provides the purchaser with an accurate identity of the property being acquired.

- Building Description

This description can be brief or comprehensive depending on the nature of the asset being sold. Obviously a detailed description gives the purchaser a better understanding of the asset being acquired. Items for mention include, date of

construction, date of additions or refurbishment, extent of built area, style of architecture, building construction methods, materials and finishes, services and maintenance.

- Land Description

Provides the purchaser with an understanding of the physical nature of the land, street access, services and particular features of the site, whether beneficial or adverse, which enable a full understanding of the nature of the land being acquired.

- Tenancy Information

Of more relevance to an investment property, the tenancy profile information and tenancy schedule give a full break down of tenancy information. Income, Outgoings and Financial Analysis complete the picture for the purchaser.

- Financial Details

Information as described under the heading "Preparation of the Property's Financial Details" would be provided in the information memorandum.

- Property Plans

Inclusion of floor plans and elevational drawings is desirable if available.

- Statutory Information

In addition to the financial information provided on an investment property there is usually the inclusion of council rates and tax information.

- Town Planning/Resource Management

This section of the report would cover such aspects as: -

- Current zoning
- Permitted development
- Status of existing uses
- Alternate consent uses and prohibited uses.
- Details of specific approvals obtained and certifications of any completed development.
- Detail of any external issue that is likely to affect the value of the property eg. land resumption due to road widening.
- Market Commentary

The information memorandum for larger properties, particularly of an investment nature can incorporate information on trends in rental values, property yields, competing property, comparable

sales and economic factors which may affect the future likely returns of the property. This, however, is at the discretion of the agent and client. In any event it is prudent for prospective purchasers to make their own enquiries.

### 8.0 Commencement of Marketing

#### 8.1 Conclusion of Preparation

Prior to the commencement of marketing a due diligence review of all information to become public needs to be conducted to ensure accuracy.

The commencement of marketing which may be confirmed by formally placing the property on the open market, press release, or the appearance of the first advertisement offering the property for sale; signifies the conclusion of the preparation of the property for sale.

##### FOOTNOTE:

These notes have been prepared for general guidance. It is acknowledged that various State Governments have similar but not always identical legislation and consequently the practitioner is required to be aware of relevant legislation and local customs in applying these notes eg many of the items set out under headings such as "Preparation of Financial Details" and "Preparation of Disclosure Material" are covered in Victoria in the Vendor's Statement, prepared by the vendor's solicitor pursuant to Section 32 of the Sale of Land Act. The vendor's solicitor will generally liaise with the vendor and the appropriate authorities in collating the material. Nevertheless the practitioner should be familiar with the above prescription in Preparing Property For Sale and should not deviate from scrutinizing the process to ensure that a comprehensive professional and successful outcome is facilitated.

### SCHEDULE

Property Type	Specific Information Required in Preparing Property for Sale
<i>Commercial</i>	<p>Supply / demand statistics</p> <p>Car parking ratios</p> <p>Lift and air conditioning performance criteria and maintenance details</p> <p>Ceiling heights</p> <p>Ownership of fixtures and fittings</p> <p>Asbestos report</p>
<i>Shopping Centres</i>	<p>Trade area statistics and demographics information</p> <p>Percentage rental and turnover rent history.</p> <p>Door counts and other pedestrian traffic statistics</p> <p>Expansion potential of the existing centre</p> <p>Tenancy mix in regard to attraction to shoppers and a proportional breakdown of anchor tenants, national chain specialty shops and sole traders</p> <p>Accessibility, transport and car-parking interface • Arrears history Industrial</p> <p>Contamination report</p> <p>Transportation infrastructure</p> <p>Onsite heavy vehicle movement and access</p> <p>Height and clear span dimensions</p>
<i>Short Stay Accommodation</i>	<p>Trading history</p> <p>Projected performance</p> <p>Performance guarantees</p> <p>List of FF &amp; E together with ownership and age</p> <p>Related facilities and profit centres, eg. food and beverage, conference and recreational</p> <p>Occupancy levels</p> <p>Average room rates</p> <p>Customer profile</p> <p>Licensing issues</p>

<i>Residential Project Marketing</i>	Demonstration suite Finishes options Furniture and fittings package Body corporate provisions Details of common property
<i>Residential</i>	Street appeal Presentation and physical condition Potential for re-characterisation and/or extension Access to amenities
<i>Development Land</i>	Town planning Services available Indicative feasibility Architectural and other layouts/plans Any approved development material Alternate use studies



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# ANZRPNG 9 PROPERTY DEVELOPMENT MANAGEMENT AND 'TERMS OF APPOINTMENT'

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to provide a checklist for Members engaged in Development Management whilst also providing a pro forma 'Terms of Appointment' for those acting as a consultant to a development project.

### 1.2 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.

### 1.3 Scope

This Guidance Note applies to Members appointed as Development Manager in the role of the Principal's representative in the development process, including the initial concept, feasibility and design, obtaining approvals, documentation, construction, compliance, co-ordination of leasing and sales campaigns, (or any part or parts of this development process). It should be used in conjunction with other guidance notes and practice standards which are either over-arching or directly applicable to the type of property, purpose or issues involved.

## 2.0 Development Projects

### 2.1 Diverse Range

There is a diverse range of property development projects undertaken. These mainly include:

- Subdivisions

- Housing Estates
- Commercial
- Retail
- Industrial
- Hotels and Resorts
- Infrastructure

These projects may be new, redevelopment, refurbishment, strata, etc.

#### Managed by Highly Trained Professionals

It is important that this development process is managed by highly trained professionals who understand property development and the principles of delivering the right development, in the right location, at the right time.

## 3.0 The Role of the Development Manager

### 3.1 Responsibilities

The Development Manager's responsibilities are mainly in the following areas:

- Manage the process of defining the client's project goals and objectives.
- Acting as the representative and certifier of the Principal in the co-ordination of all professional, technical, administration and other services to be provided.
- Prepare Consultants briefs, analyse proposals, fees submissions and make recommendations.
- Appointment of Consultants on behalf of the Principal.
- Manage the process of achieving the client's stated goals and objectives.
- Carrying out the functions described in the following "Checklist", either directly or through appropriate consultants.

### 3.2 Broader Development Management Role

It is intended this paper be used as a guide to the broader development management role. It is not intended to be used for the purpose of project or construction management and supervision.

## 4.0 Development Consultancy Checklist

### 4.1 List of Duties

The following is a check list of duties for a development project and may involve the appointment of specialist consultants.

#### Project Site Acquisition/Consolidation

- Negotiations with vendors
- Instruction of Solicitors, Valuers, Surveyors, Town Planners, etc
- Pre-purchase investigations
- Contamination Report
- Due diligence [ANZRPNG 6]

#### Preliminary Feasibility Study

- Preliminary Market Research
- Town Planning/Resource Management Criteria
- Design Criteria
- Services (water, sewerage, drainage, etc.)
- Legal (title, easements, etc.)
- Defining Highest and Best Use Options
- Value Management Exercise on options
- Preliminary Financial Analysis and Cash Flow
- Development Management Strategy and Program

#### Concept Design and Planning

- Design Brief
- Global Planning
- Testing Design Options
- Liaison with Authorities
- Initial Dilapidation Report
- Detailed Site Analysis
- Environmental Audits and Impact Statements
- Insurances (Building, Public Risk, Professional Liability, etc.) [ARPGN 1]

- Appointing Development Team\*
- Redefine Client's Goals and Objectives

(\*Architects, Builders, Engineers, Quantity Surveyors, Town Planners, Surveyors, Environmental Scientists, Solicitors, Selling, Leasing and Managing Agents, Valuers, Financiers, etc.)

#### Financial Feasibility

- Financial Analysis
- Sensitivity Analysis
- Competitive Analysis
- Finance Establishment
- Marketing Options
- Project Cash Flow
- Project Time Charts

#### Approvals

- Liaison with Statutory Authorities
- Liaison with Community, Resident Action, etc
- Development/Building Approvals
- Rezoning Applications
- Court Appeals
- Strata and Stratum Title, Dual Occupancy, Community Title, Cluster, Title, etc.
- Land Subdivision Approvals

#### Pre-Construction

- Value Management Assessment
- Liaison with Existing Tenants
- Working Documents/Alternative Procurement Methods
- Appointing Builder/Construction Manager
- Tender Process
- Environmental Controls
- Construction Staging
- Cost Control and Accounting Systems

#### Construction

- Dilapidation Report
- Monitoring Construction/Variations
- Site Meetings
- Construction Finishes
- Cost Control and Budgets

- Recommendation Progress Payments
- Environmental Controls
- Tenant Co-ordination

#### **Fitout**

- Engaging Tenant Coordinator
- Tenancy Negotiations Overview
- Liaison with Occupants
- Appointing Interior Architects/Designers
- Appointing Builder/Fitout Specialist

#### **Completion & Occupation**

- Defects Liability Management
- Handover To Owner
- Certificate of Compliance
- Liability and Retention Bonds/Defect Periods
- Construction Manual(sub-contractors, specifications, etc)

#### **Leasing and Marketing**

- Leasing/Sales Strategy
- Appointment of Leasing/Selling Agents
- Supervision of Marketing Campaigns
- Rents, Terms and Conditions
- Leases Documentation
- Advising on Sale Prices

## **5.0 Development Management Fees**

### **5.1 Percentage Basis**

The most common method of fee is charged on a percentage basis on the total development cost (including land, building, interest, etc.). This usually ranges between 1% - 3% depending upon the complexity and size of the project.

### **5.2 Methods**

The main methods of calculating fees include:

- Percentage Fees
- Hourly Rates
- Fixed Fee
- Maximum Guaranteed Fee in Agreed Scope of Works

- Incentive Fee
- Disbursements
- Default Interest (in the case of not being paid on time by the Principal).

A detailed schedule is set out in the attached Terms of Appointment (see Appendix).

## **6.0 Feasibility Study**

The Development Manager should prepare a feasibility study, time planning program and cash flow including a financial analysis at the beginning of the appointment. This can be used as the basis of the Development Plan and Strategy for the project and be regularly reviewed during the project. All assumptions should be clearly set out.

## **7.0 Meetings**

It is preferable that the Principal and Development Manager meet at least monthly. The Development Manager should arrange and conduct the meeting, the keeping of records and issuing of minutes including responsibility for actions and a client status report.

## **8.0 Consultancies**

The Development Manager can advise and make recommendations to the Principal on the appointment of and terms of agreement with Consultants. The Development Manager's advice should include details of professional indemnity insurance.

## **9.0 Terms of Appointment**

### **9.1 Guide for Appointment**

The attached Terms of Appointment (see Appendix) is provided as a guide for Members and their clients for the appointment in the role as a Development Manager.

### **9.2 Not All Inclusive**

It is not intended to be an all inclusive agreement but a guide for an agreement between a development manager and his/her client.

## **10.0 Caution**

### **10.1 Guide Only**

This paper is intended as a guide only and all parties should seek their own legal advice as to the basis of specific agreements.

**APPENDIX TERMS OF APPOINTMENT OF DEVELOPMENT MANAGEMENT CONSULTANT**

BETWEEN THE DEVELOPMENT MANAGEMENT CONSULTANT:

[Name of Company] ..... ('the Consultant')

ACN .....

[Registered Address] .....

.....

Represented by ..... ("Development Manager and the Consultant's Representative")

AND THE CLIENT:

[Name of Company] ..... ('the Client')

ACN .....

[Registered Address] .....

Represented by ..... ("the Client's Representative")

**1. Date of Issue**

This Memorandum was issued to the Client by the Consultant on

This ..... day of ....., 20 .....

representation, warranty or condition made by either party prior to the date hereof is expressly excluded except as may be required to establish the date of appointment of the Consultant if such appointment occurs separately from or independently of, this document.

**2. Scope and Intention of this Document**

- i. The purpose of this Memorandum is to confirm the appointment of the Consultant by the Client on a retainer to undertake development management work on terms encompassing or exclusively defined by the following terms and conditions.
- ii. The Client may accept or ratify these terms and conditions either by executing this Memorandum or by other actions described in Clause 4 which may have the effect of confirming the appointment of the Consultant on these terms.
- iii. Upon the happening of the events described in Clause 4 and subject to the operation of that Clause, the Client shall be deemed to have accepted the terms and conditions set out in this Memorandum as applying from the starting date which is established under Clause 3 and these terms shall be binding on the parties from that date.
- iv. This Memorandum shall be dated by the Consultant as at the date of issue of the Memorandum to the Client and that date is not necessarily the date of commencement of the terms of this Agreement.
- v. Where acceptance or ratification by the Client of these terms and conditions occurs by execution of this Memorandum or separately in writing, any statement,

- vi. The terms and conditions contained in this Memorandum which are expressed to be essential may not be varied by either party except in writing signed by both parties.

**3. Starting Date**

The terms of this Agreement are effective and operate to govern the appointment of the Consultant by the Client on the earliest of the dates that correctly appear in either a. or b. or c. below :

- a. The parties agree that the Consultant commenced work at the request of the Client on the following date, namely .....  
 .....  
 [insert date that instructions to start were received or that work started, otherwise leave blank]  
 Or: [delete Clause as applicable]
- b. This appointment shall commence on the following date, namely on .....  
 .....  
 [insert date only if agreed in negotiations, otherwise leave blank]
- c. The date after receipt by the Client of this Memorandum upon which the Consultant is

## ANZ REAL PROPERTY GUIDANCE NOTE 9

requested by the Client to commence or continue work in respect of the project or property the subject of this Memorandum, whether such request is made with reference to or independently of this document.

### 4. Acceptance or Ratification by Client

- i. The Client shall have accepted or ratified the terms and conditions as set out herein either:
  - a. Upon execution of this Agreement by the Client whereupon Clause 4.ii below applies; or
  - b. By conduct of the Client amounting to confirmation or acceptance made at any time after receipt by the Client of this document, whereupon Clause 4.iii below applies.
- ii. In further definition of Clause 4.i.a. above, upon execution by the Client, this document sets out conclusively the agreement between the parties.
- iii. In further definition of Clause 4.i.b. above, even if this document is not signed by the Client, where the Client utilises the services of the Consultant concerning the subject project or property without first expressing non-acceptance of the offer implicit in this Memorandum, a Consultancy Agreement will, to the extent that the context and circumstances permit, come into existence between the parties on the terms and conditions as set out in this Memorandum. If the Client excludes some but not all of the terms and conditions set out herein, and the terms and conditions that remain contain an actionable agreement, the offer remains open to acceptance by conduct of the Client on those terms and conditions that remain.

### 5. Term of Appointment

- i. The term of appointment is for either:
  - a. Such reasonable period as may be required by the Consultant to undertake the work as specified herein and as otherwise requested by the Client.  
  
Or: [delete wording not required]
  - b. The appointment shall terminate either on the happening of the following event or at the expiration of months/years, whichever shall first occur.  
  
Event referred to:
    - ii. In the event of there being any extraordinary delay in implementing the brief for reasons beyond the control of the Consultant, the term of the appointment shall be extended by the period of any such delay. [delete if not applicable]
    - iii. The term of this appointment shall be extended by

any period of delay due to a stand down occurring under Clause 27.

### 6. Nature of Appointment

- i. The Consultant is engaged as an independent contractor and the relationship of employer and employee is expressly excluded as between the client and the consultant or any person engaged by the consultant including the Development Manager and the Consultant's Representative.
- ii. The Consultant takes complete responsibility for employment and engagement by it of the Development Manager and indemnifies the Client in respect of any claim for remuneration the Development Manager may make against the Client related to or arising from the employment of the Development Manager.

### 7. Representatives and Authority

- i. The Client is represented by the person whose name appears in Item 3 of Schedule 1 to whom full responsibility for the subject property and the proposed development has been delegated by the Client including the power to provide instructions to the Development Manager and the Consultant and to vary or waiver the terms of this Agreement.
- ii. The Consultant is represented by the person whose name appears in Item 2 of Schedule 1 in all aspects relating to the interpretation and implementation of this Agreement and that person is the sole person responsible for any variation, terms, amendment or addendum to this Agreement made on behalf of the Consultant.
- iii. The Consultant appoints the person whose name appears in Item 1 Schedule 1 as Development Manager and makes this person available to undertake all of the development management work on behalf of the Consultant required under this Agreement.
- iv. The Consultant and the Development Manager shall report to and accept directions and supervision at all times from the Client's nominated representative or such other person as may be duly authorised by the Client's nominated representative and or the Client to provide such directions or supervision.
- v. Either:
  - a. The Consultant may substitute another person as Development Manager only with the consent of the Client whose consent shall not be unreasonably withheld.  
  
Or: [delete Clause not applicable]



- b. It is an essential term of this Agreement that the person whose name appears in Item 1 of Schedule 1 shall remain as the Development Manager throughout the life of this Agreement.

**8. Qualifications and Experience**

- i. A resume of the qualifications and experience of the Consultant is attached as Schedule 2.
- ii. A resume of the qualifications and experience of the Development Manager is attached as in Schedule 3.

**9. Subject Property**

- i. The street address of the property which is the subject of this Agreement is: .....  
.....  
.....  
.....
- ii. The legal or title description of the property the subject of this Agreement is: .....  
.....  
.....  
.....
- iii. Survey Plan - attached/not attached

**10. General Description of Proposed Development**

- i. Type of Development .....  
.....  
.....
- ii. General Description .....  
.....  
.....
- iii. Number of Storeys .....  
.....
- iv. Proposed Gross Floor Area (where applicable) .....  
.....
- v. Residential (where applicable)  
1br 2br 3br Other  
No. ....  
Size (m=) .....
- vi. Car parking  
No. spaces ..... No. Enclosed .....  
No. Open .....

- vii. Other Details  
.....  
.....  
.....  
.....  
.....

**11. Development Consent Authorities**

- i. The Consent Authority with power initially to approve the proposed development is: .....  
.....  
.....
- ii. If the above Authority refuses the proposed development, a right of appeal or review lies with: ..  
.....
- iii. Other relevant authorities whose consent may be required: .....  
.....  
.....

**12. Planning Instruments**

- i. a. The relevant planning instruments controlling the development potential of the subject property are: ...  
.....  
.....  
.....  
.....  
.....  
Or: [delete wording not required]
- b. The relevant planning instruments as disclosed in the attached Certificate issued by the relevant Consent Authority. [Section 149 in NSW]
- ii. Other relevant planning policies or controls: .....  
.....  
.....

**13. Development Brief**

- i. The Client's objectives in relation to the design and implementation of the proposed development are referred to as "the Brief".
- ii. The Client and the Consultant undertake to the

## ANZ REAL PROPERTY GUIDANCE NOTE 9

extent that each is able, to ensure that the Brief specifies:

- a. The expected or agreed time frame for the happening of critical events;
  - b. The scope of works to be undertaken by the Consultant including any foreseeable additional work due to possible contingencies; and
  - c. Any other essential or agreed assumptions.
- iii. The Brief as it stands as at the date hereof is set out in Schedule 4.
- iv. If Schedule 4 is blank at the date hereof:
- a. The Brief may be inferred from all relevant matters communicated between the parties prior to the date hereof, whether orally or in writing, or both.
  - b. The Client may require that the Consultant prepare the Brief and any document prepared by the Consultant which gives effect to this instruction, becomes the initial Brief.
- v. The Client may vary the Brief at any time provided that:
- a. Any such variation is given to the Consultant in writing; and
  - b. If the variation involves a material or substantial change in either the time frame, scope of works or agreed assumptions, the parties undertake to review the fees payable under Clause 17 and to try to reach an agreement to adjust these amounts to figures that are considered appropriate under these circumstances to be in keeping with any increase or decrease in the scope or complexity of the task. In the event of failure to agree upon any such adjustment, or in the case of arbitration of this issue under Clause 29 where a party does not accept the determination which is made, either party shall be entitled to terminate this Agreement whereupon Clause 28 shall apply.
- vi. The Client undertakes, as far as is possible to provide advance warning of changes to the Brief and to discuss with the Development Manager the implications and effects of any such change including the expectations of the Client in relation to any review of the fees payable under Clause 17.

### 14. General Nature of Work to be Undertaken

The work to be undertaken by the Consultant comprises:

- i. Provide the Client with advice that may reasonably assist the Client to make management and investment decisions directed towards maximising the asset value

of the subject property and or maximising the profits of the Client from the subject property.

- ii. In the case of new development schemes or variation of existing schemes:

Use its professional skill and expertise to attempt to obtain approval where appropriate from the relevant Consent Authority for a development scheme or schemes for the subject property which:

- a. Maximises the development potential of the site.  
And or  
Maximises the residual land value of the site when analysed using a Feasibility Study based on reasonable assumptions.
  - b. Takes account of relevant market factors.
  - c. Takes account of the physical capability and constrains of the site.
  - d. Takes account of planning and development controls.
  - e. Complies with the Brief issued by the Client.
  - f. Follows the express instruction of the Client ("standing instructions") whether in variation of the Brief or otherwise.
  - g. To the extent that the Brief issued by the Client or the standing instructions of the Client compromise or conflict with the objectives stated in a. to d. above, the Brief or the instructions shall prevail.
- iii. In the case of construction:
- a. To ensure the production of detailed working documents and specifications.  
[insert own details]
- iv. In the case of disposal:  
[insert own details]
- v. In the case of detailed costings being required:  
[insert own details]
- vi. In the case of a market study being required:  
[insert own details]
- vii. In the case of feasibility studies being required:  
[insert own details]
- viii. Other  
[insert own details]

### 15. Specific or Special Duties

Specific or Special duties are as set out in Schedule 5 hereto.

**16. Standing Instructions**

- i. The Client may issue instructions from time to time relating to the carrying out of this consultancy which must be followed by the Consultant except where any such instruction is inconsistent with this Agreement.
- ii. Such instructions shall be referred to as the "Standing Instructions". These instructions shall be recorded by the Development Manager when and as issued and shall be maintained in a register of all such instructions.

**17. Fees and Disbursements Payable**

- i. The Development Manager shall be entitled to a fee for those services as follows:
  - a. Percentage Fee (based on the total cost of the development including land, building interest, OR percentage of Gross sales) ..... %  
This is payable in equal monthly instalments estimated to be \$ ..... pcm  
(Payments may also be paid on a staged basis if specified)  
OR
  - b. Rates per Hour:
 

Executive Director	\$ ..... per hour
Development Manager	\$ ..... per hour
Assistant Development Manager	\$ ..... per hour
Other	\$ ..... per hour

 OR
  - c. Fixed Fee \$ .....
  - d. Incentive

The Development Manager may be paid lump sum payments upon achieving certain objectives (e.g Re-zoning, Development Approval, Practical Completion, etc).

- e. Fee Upon Termination  
In the event of termination by the Client under Clause 28 or upon the ruling of an Arbitrator under Clause 29, the Consultant shall be paid a termination fee as specified in Clause 28.
- f. Disbursements  
The Consultant will be reimbursed by the Client for:
  - Telephone and fax expenses including mobile telephone expenses incurred during business hours and at other times if for work related purposes.

- Travelling expenses including fuel expenses incurred in the use of a motor vehicle during business hours and for work related purposes.
- Accommodation where reasonably required or where the project is more than 50 kilometres from the office of the Consultant.
- Photographs, plan printing and document production costs.
- Such other disbursements as may be approved by the Client from time to time.
- Such other disbursement costs as specified below.  
\$ .....
- ii. In the event that the scope or complexity of the brief increases, the Consultant shall:
  - a. Undertake any additional work that may be required at the hourly rates specified in Clause 17.i.b.  
OR
  - b. Give notice to the Client that in lieu of a. above, any additional work shall be undertaken only if the Client agrees to increase the amounts or rates payable under 17.i.a., c. or d. (as may be applicable) in proportion to any such increase in scope or complexity.
- iii. Nothing in Clause 17.ii. shall limit the rights of either party to re-negotiate the fees payable in the event of a material or substantial change in the Brief as set out in Clause 13.v.b.
- iv. The rates set out in Clause 17.i.b shall be increased annually in line with any annual increase in inflation during the year immediately before the relevant date, as published by the Australian Bureau of Statistics in the CPI or such other appropriate indice.

**18. Standard of Conduct**

- i. The Development Manager and the Consultant shall at all times exercise proper or reasonable care in the performance of the duties under this Agreement.
- ii. Work undertaken under this Agreement must always be of a good professional standard.
- iii. The Consultant shall use its best endeavours to perform this Agreement and either:
  - a. The Consultant will try at all times to elicit or promote the best possible outcome for the Client but does not warrant to obtain any particular result.  
Or: [delete Clause not applicable]
  - b. The Consultant warrants that it will procure or achieve the following result by the date specified.

Result Warranted .....

Result Date By: .....

- iv. The loss claimable against the Consultant for failure to procure or achieve the above result by the date specified shall not exceed the total remuneration payable under this Agreement.

**19. Duty to Report**

- i. The Development Manager representing the Consultant will report to the Client on a regular basis and otherwise as may reasonably be requested by the Client.
- ii. The Development Manager and where applicable the Consultant shall seek the directions of the Client on a regular basis and at any time where by the standard of prudent management, it would be appropriate to seek such direction on any relevant issue including but not limited to issues such as the conduct of negotiations for development or building approval, any change in design, change in materials or specifications or documentation, problems arising during contract negotiations or administration, matters affecting construction progress, weather or industrial delays, supply logistics, variations, quality problems, budget changes, cash flow, marketing and leasing and tenancy co-ordination.

**20. Duty Not to Bind Client**

Neither the Development Manager nor the Consultant shall bind the Client to any legal or commercial obligation nor sever or vary any Contract involving or affecting the Client without the express authority of the Client.

**21. Duty to Communicate**

- i. The Development Manager shall keep the Client fully informed of all significant events affecting or concerning the development when and as the Development Manager becomes aware of such events.
  - (a) The Client shall be entitled to communicate with the Development Manager between 7 am and 9 pm on weekdays and 9 am and 5 pm on weekends and holidays.
  - (b) The Development Manager will be available for communication with the Client whenever it is reasonable and practicable to do so between the hours referred to in sub-paragraph (a) of this sub-clause.
- ii. The Development Manager shall promptly suggest in writing to the Client such variations to the Brief or to any standing instructions applicable to the

development as the Development Manager considers from time to time may be desirable or necessary.

**22. Duty to Control and Direct Others**

- i. The Development Manager representing the Consultant is required to direct and have the care and control of other Consultants involved in the development as directed by the Client.
- ii. Except to the extent otherwise agreed between the parties, the Consultant is not responsible for the appointment of any other consultant or for the payment thereof or for any delay or error occasioned by any such consultant, these matters being the sole responsibility of the Client.

**23. Normal Work Load**

The Development Manager shall be available to work on the tasks required or envisaged by this Agreement as follows:

- i. The Development Manager shall undertake work in performance of this Agreement at such times and for such periods as the Consultant considers as may be reasonably required to complete this Agreement.
- ii. The Development Manager shall during the period of this Agreement, work either:
  - a. A minimum of hours per week.  
Or: [delete where applicable]
  - b. An average not less than hours per week.
- iii. The Development Manager shall be available at any time reasonably required by the Client.

**24. Holidays and Leave**

The Development Manager may be absent from active duties on the following occasions and at such time the Consultant shall not be liable to make a replacement person available:

- i. The Development Manager shall be entitled to be absent for the purpose of holidays to a maximum of four (4) weeks per annum to be taken at such times agreed between the Client and the Consultant.
- ii. The Development Manager shall be entitled to be absent from duties on all public holidays so designated in this State.
- iii. The Development Manager shall be entitled to be absent from duty whilst on sick leave for any continuous period not exceeding 10 working days provided that the Consultant must advise the Client of such absence and produce to the Client a Medical Certificate upon request. In the event of sickness exceeding 10 working days, the Consultant shall

make an alternative person of comparable skill available in place of the Development Manager unless exempted from this requirement by the Client.

**25. Health and Medical Condition**

- i. A condition of appointment is that the Development Manager is of good health sufficient to fulfil all reasonable duties.
- ii. The Development Manager must submit to any independent medical examination as may reasonably be required by the Client.

**26. Other Employment or Business**

- i. The Development Manager shall not engage in any other employment or business activity during the continuance of the appointment without the prior approval in writing of the Client whose approval may be given or withdrawn at any time without reasons given.
- ii. The Consultant and Development Manager may during the period of this Agreement take instructions from any other client and be involved in any other development project except where there may be any possible conflict of interest with this Agreement.
- iii. In any event, the Consultant and or the Development Manager must disclose to the Client all other Consultancy appointments relating to projects or properties the undertaking of which that may reasonably be expected to have some bearing on the performance by the Consultant under this Agreement:
  - a. Forthwith, if that other consultancy is current.
  - b. Hereafter, prior to entering any other such consultancy.
  - c. At any time whenever a possible conflict of interest comes to the attention of the Consultant and or the Development Manager.

**27. Stand-Downs**

- i. The Client may suspend this Agreement at any time that the Development Manager cannot usefully be employed because of any strike, mishap, closure of business or stoppage of work or for any other cause for which the Client cannot reasonably be held responsible. This does not break the continuity of this appointment for the purpose of entitlements.
- ii. Upon recommencement following any stand down under this Clause, the Consultant shall be entitled to a reasonable allowance for start up costs payable on an hourly rate (in addition to the amounts to which the Consultant is otherwise entitled under Clause 17).

**28. Termination**

- i. This Consultancy may be terminated by either party for any reason by serving on the other party Notice of Termination in accordance with this clause.
- ii. A Notice of Termination shall specify the date on which this Consultancy is to terminate and the reason if any for such termination, and must be served on the other party personally or by registered mail at the last known or published address of that party.
- iii. In the event of termination by the Client without there having been any Default by the Consultant of a fundamental term of this Agreement:
  - a. If the basis of remuneration includes payment under Clause 17.i.b. (hourly rates), upon termination without default by the Consultant the Client shall pay to the Consultant \$
  - b. If the basis of remuneration includes payment under Clause 17.i.a. or c. (percentage fee or fixed fee), upon termination without default by the Consultant the Client shall pay to the Consultant \$
  - c. If the basis of remuneration includes payment under Clause 17.i.e. (incentive), upon termination without default by the Consultant the Client shall pay to the Consultant \$
  - d. Paragraphs a, b and c above operate independently and any amounts payable thereunder are payable cumulatively.
- iv. In the event of termination by the Client following a default by the Consultant of a fundamental term of this Agreement:
  - a. If the basis of remuneration includes payment under clause 17.i.b. (hourly rates), upon termination the Client shall pay to the Consultant notwithstanding any default, any amount due up until the termination takes effect.
  - b. (1) If the basis of remuneration includes payment under Clause 17.i.a. (percentage fee) or 17.i.b. (fixed fee), upon termination the Client shall pay to the Consultant notwithstanding any default, reasonable remuneration in respect of the work performed up to the date of termination.  
(2) The amount of such reasonable remuneration shall be agreed between the parties or, failing such agreement, shall be determined by an arbitrator appointed by the parties or failing agreement by the parties, by the President of the API at the request of either party.

- (3) In determining the amount of such reasonable remuneration, the parties or the arbitrator as the case may be, shall have regard only to:
- a) The totality of the work required to be performed under this Agreement by the Consultant.
  - b) The percentage of that total work which has been completed by the Consultant.
  - c) Any additional work performed by the Consultant.
  - d) The quality and competence of the work performed by the Consultant.
  - e) The time spent on the work performed by the Consultant.
  - f) The level of remuneration to the Consultant under this Agreement.
  - g) Any other amounts payable to the Consultant pursuant to this Agreement.
  - h) Any other relevant factors including (but not limited to) the difficulty and complexity of the assignment; the value if any added to the profitability or asset value of the Client as a consequence of the work of the Consultant and the nature of the default by the Consultant.
- (4) The Client shall be immediately entitled to payment of incidental expenses incurred in appointing another Consultant to complete the work.
- (5) Other than as provided in Clause b(4) hereof, the Consultant shall not be liable for any loss or damage suffered by the Client as a result of the breach or the termination, whether directly or indirectly and the Client hereby agrees to indemnify and keep indemnified the Consultant in respect of any claim for such loss or damage.
- v. In the event of termination by the Consultant the Client shall pay the Consultant forthwith such amounts under Clause 17.i.b. (hourly rates) and 17.i.f. (disbursements) as may be due to the Consultant. Where termination by the Consultant follows a change in the Brief and failure by the parties to agree on adjusted fees as described in Clause 13.v.b., the Client shall also pay the Consultant the amounts specified in Clause 28.iii.a., b., c. & d.
- vi. Notwithstanding any other provision, this Consultancy may be terminated summarily by the Client for reasons of dishonesty, gross incompetence or neglect of duty, proven criminality involving minors, violence and or dishonesty of the Consultant or the Development Manager, effective upon receipt by the Consultant of a Notice of Termination given under this Clause that states the reason which reason is true.

### 29. Dispute Resolution

If any dispute or grievance concerning this appointment arises, it must be dealt with in the following manner:

- i. A party claiming that a dispute has arisen must give written notice to the other party specifying the nature of the dispute.
- ii. The matter in dispute specified in the notice must be discussed between the nominated representatives of the parties in an attempt firstly to settle the matter.
- iii. If the matter is not resolved within seven (7) days or within such further period as the parties may agree, the dispute or grievance must be submitted for mediation by a Mediator appointed by the parties or failing agreement for such appointment, a Mediator appointed by the President of the Australian Property Institute (API);
- iv. The mediation shall be conducted in accordance with Mediation Guidelines published by the Australian Commercial Disputes Centre Limited (ACDC) or its successor excluding those guidelines dealing with selection of the Mediator;
- v. If after mediation the dispute has not been settled, the dispute shall be submitted to arbitration conducted in accordance with the ACDC's Arbitration Guidelines the terms of which are deemed to be incorporated into this Agreement;
- vi. The parties agree to submit the dispute to arbitration and, if so agreed, to abide by the rules of arbitration administered by the ACDC and will accept any determination made by arbitration subject to any right of appeal on a matter of procedure or law that may be available except if Clause 13.v.b applies in which case either party may refuse to accept the outcome of arbitration;
- vii. Until the matter is determined by mediation or arbitration, or until this Agreement is terminated, the work required under this Agreement must continue at the direction of the Client; and
- viii. The parties must co-operate to ensure that these procedures are carried out expeditiously.

### 30. Confidentiality

- i. The parties must not divulge or use, either for their own benefit or that of others, any confidential information acquired during this appointment. Confidential information refers to any information (written or oral) which is not publicly available and this obligation extends beyond the date the Consultant ceases work for the Client under this Agreement.

- ii. The Consultant must not communicate information of any kind relating to the Client, the Board of Directors, shareholders, Managing Director or General Manager of the Client to staff of the Consultant or to persons outside the Client except as is necessary for the business and objectives of the Client.
- iii. The Development Manager shall not engage in discussions nor communicate with any Member of staff or contractor of the Client concerning the terms of this Agreement or specific details of the work being undertaken pursuant to this Agreement.

**31. Copyright**

- i. All plans, reports, drawing, printed and handwritten documents produced by the Consultant relating to the proposed development shall remain the property of the Client except where otherwise agreed by the Client (e.g Architect’s copyright).
- ii. The Consultant shall be entitled to retain a copy of all such plans, drawings, reports and the like for its own records.
- iii. Copyright in all plans, drawings, reports, documents and the like is vested in the Client subject to such other rights that may exist.
- iv. Copyright in any method or system devised by or owned by the Consultant including any software program, worksheet or spreadsheet shall remain vested in the Consultant.

**32. Notices**

Notices other than notices of termination may be served by either parties by fax subject to machine printed proof of transmission being retained by the sender and being produced on request to the receiver. Notice of termination must be served personally or by mail at the last known or published address of the other party.

**33. Guarantee**

- i. The performance of the obligations of the Client are guaranteed by the following natural person:  
..... (“the Guarantor”)
- ii. The Guarantor unconditionally guarantees the due and punctual performance, any obligation of the Client to pay moneys to the Consultant which are payable.
- iii. This guarantee is a fundamental term of the appointment.
- iv. This guarantee is:
  - a. A principal obligation and is not ancillary or collateral to any other right or obligation.

- b. To be enforced against the Guarantor with/without the Consultant first exhausting any remedy it may have against the Client.
- c. Is a continuing guarantee for all moneys payable as and when the same ought to be paid and for the due and punctual performance by the Client of its financial obligations to the Consultant.
- d. Is irrevocable and will remain in full force and effect until the Consultant has received all moneys due and payable to it by the Client.

**34. Essential Terms**

The following clauses of this document and the annexes thereto are essential terms of this Agreement;

- i. Those clauses expressed to be essential terms.
- ii. Clauses 2, 3, 4, 5, 7.I., 17, 18, 20, 28, 29, 30, 32, 33, 34
- iii. The following clauses;

[Insert Clause No. of any other essential term]

.....

**35. Some Agreed Terminology**

In the interpretation of this document except to the extent the same is excluded or contrary to the construction or intended meaning taken in its context:

- i. This Memorandum shall be referred to as “The Consultancy Agreement” which is further abbreviated in this document as “the Agreement” or “this Agreement”.
- ii. The natural person whose name appears in Item 1 of Schedule 1 shall be referred to as “the Development Manager”.
- iii. Any reference to “the Consultant” is a reference to the Development Management Consultant.
- iv. Any reference to a duty or obligation of the Development Manager is also a reference to the duty or obligation of the Consultant and vice-a-versa.
- v. The Client and the Development Management Consultant may be referred to as “the parties”.
- vi. Any reference to a “person” means a natural person.
- vii. Any reference to “mediation” is a reference to a private negotiation between the parties before an independent third party (the Mediator) as further described in Schedule 6.
- viii. ‘Extraordinary delay’ means delay which is not expected by the parties at the date of this Agreement



**ANZ REAL PROPERTY GUIDANCE NOTE 9**

or is outside any time frame for the happening of events agreed between the parties but excludes any delay that does not impact on the critical time path as expected by or as has been agreed between the parties.

**OFFER & ACKNOWLEDGMENT BY CONSULTANT**

I offer the appointment on the terms and conditions set out above and acknowledge that I agree to be bound by these:

Signed: .....  
 Name Printed: .....  
 Date: .....  
 Address for Notices: .....

**ACCEPTANCE & ACKNOWLEDGMENT BY CLIENT**

I accept the appointment on the terms and conditions set out above:

Signed: .....  
 Name Printed:.....  
 Date: .....  
 Address for Notices:.....

**ACKNOWLEDGMENT & ACCEPTANCE BY GUARANTOR**

I guarantee the performance of the Client under this Agreement.

Signed: .....  
 Name Printed:.....  
 Date: .....  
 Address for Notices:.....

**NOTE: SCHEDULES TO BE ATTACHED**

- Schedule 1 Nominated Representatives
  - Item 1 - The Development Manager
  - Item 2 - The Development Management Consultant’s Representative
  - Item 3 - Client’s Representative
- Schedule 2 Curriculum Vitaé of Development Management Consultant
- Schedule 3 Curriculum Vitaé of Development Manager
- Schedule 4 Development Brief
- Schedule 5 Specific Duties
- Schedule 6 Mediation (attached)

**SCHEDULE 6 – MEDIATION**

- Mediation is a private negotiation between the parties before an independent third party (the Mediator). It is not open to any other party.
- The Mediator’s role is to manage the communication process and assist the parties to resolve the dispute.
- A mediation is generally an informal process.
- The Mediator opens the hearing and invites the person who has requested help to present an outline of the facts. The other party will then be asked to respond.
- Either party may present a proposal to resolve the issues at any time during the mediation.
- The Mediator has no legal jurisdiction to issue orders or give directions. His role is to assist the parties to reach an agreement.
- Following negotiations an agreement may be reached or alternatively the parties may seek an adjournment to consider matter raised in the mediation.
- If agreement is reached during a mediation, a Mediation Agreement should be signed by both parties and the Mediator. The Mediation Agreement is then binding on both parties.
- The cost of the mediation, and sometime the meeting place should be shared equally by the parties.
- In some cases mediation may be unsuccessful. Should this occur, the Mediator will certify that the mediation has failed and if one or both parties requires, the matter may be referred to the Australian Commercial Disputes Centre Limited for a determination by arbitration.
- To the extent that any of the matters set out above are contrary to or inconsistent with the Mediation Guidelines from time to time of the Australian Commercial Disputes Centre Limited ACN 003 042 840 or its successor (“the ACDC”), the ACDC Mediation Guidelines shall prevail.

# ANZRPNGN 10 LEASING AGENT SERVICES

## 1.0 Introduction

### 1.1 Purpose

Members providing Leasing Agent Services must do so to the standard of professionalism and skill required and consistent with membership of the Institute and with compliance to law

### 1.2 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.

### 1.3 Scope of this Guidance Note

This Guidance Note applies to Institute Members providing Leasing Agent Services to Clients. It must be used in conjunction with other practice standards and guidance notes that are either over-arching or directly applicable to the type of property, purpose or issues involved.

### 1.4 Client

In all cases, 'client' shall mean building owner, landlord, lessee or their appointed representative.

## 2.0 Professional Conduct

### 2.1 Standards of a Technical Nature

Members shall abide by any principles or standards of professional conduct of a technical nature laid down in the By-Laws of the Institute's Constitution.

### 2.2 Code of Ethics

Members must at all times conduct themselves in accordance with the standards set out in the Institute's Code of Ethics.

### 2.3 Legislation

Members shall act in accordance with relevant legislation.

## 3.0 Client Relationship

### 3.1 Clients Instructions and Best Interests

Members shall at all times act in the best interests of the client and in accordance with the client's instructions.

### 3.2 Confirm Instructions in Writing

Upon appointment to act for the client, the Member shall immediately confirm in writing to the client the basis of the appointment, the scope of services the Member will provide to the client, and the basis of the fee structure for those services unless covered under a previous agreement.

### 3.3 Frequent and Regular Communication

The Member shall on a frequent and regular basis, or as agreed between Member and client, communicate to the client the progress being made in respect of the instructions issued to the Member.

### 3.4 Act Promptly and Efficiently

The Member shall at all times act promptly and efficiently in the servicing of the clients instructions.

### 3.5 Notice of Illegal or Unethical Concerns

If receiving an instruction from the client, which the Member believes to be illegal or unethical, the Member shall communicate such concerns to the client in writing as soon as possible.

## 4.0 Leasing Agency Appointments

### 4.1 Claim to Act

No Member shall claim to act for a client unless appointed in writing to do so.

### 4.2 Methods of Acting

The Member, when accepting an appointment to act as Leasing Agent for the client shall act generally by one of the following methods:

- Sole agency or exclusive agency appointment
- Co-ordinating or Joint Agency
- General or open agency appointment

### 4.3 Act for Tenant

Where the Member is appointed to act for a tenant, their client shall be deemed to be the tenant and the Member shall not seek a fee from anyone other than the tenant, and shall disclose to all parties that they act for the tenant.

### 4.4 Not Claim to Act Unless Appointed

No Member shall claim to act for a tenant unless appointed in writing to do so.

### 4.5 Not Contact Client of Sole Agent

No Member shall directly contact the client of another agent where that agent has been appointed to act on the basis of either a sole or exclusive or a co-ordinating agency (unless they are also the joint coordinating agent) or have unequivocal consent from the appointed agent to do so.

### 4.6 Not Undermine Another Member

No Member shall seek to undermine the reputation or the ability of another Member.

### 4.7 Not Claim Agency Where None Exists

No Member shall claim to have an agency appointment in the knowledge that no such appointment exists.

### 4.8 Conflict of Interest

The Member must disclose to their client any actual or potential conflict of interest that may arise as a result of their appointment.

## 5.0 Leasing Agency Practice

### 5.1 Seeking to Nominate a Tenant

Any Member seeking to nominate a tenant for a property shall do so to the appointed agent unless the property is available by way of an 'open' or 'general' agency and then the nomination shall be to the client.

### 5.2 Accepting Nominations

Members as sole or coordinating agents may accept nominations from outside agents at their

discretion, but generally shall accept nominations of tenants with whom they have had no prior contact.

### 5.3 Written Nominations

Members shall effect all nominations in writing. Upon receipt of written nomination from an Introducing Agent, Members shall immediately confirm acceptance to Introducing Agent in writing.

### 5.4 Nominations from Agents Exercising Control

In general, Members shall accept nominations only from those agents that can demonstrate, or exercise control over the nominated tenant, by way of a physical inspection of the property.

### 5.5 Joint Coordinating Agent

Where appointed as a joint coordinating agent, the Member will confer with their joint agent prior to accepting any nominations from outside agents.

### 5.6 Tenant Introductions

Where a Member has introduced a tenant to one or more properties by way of nominations or direct introduction, and is not appointed to act for the tenant, that Member must act in the best interest of the lessor and must not advise the tenant or proffer any advice that may be contrary to the lessor's best financial or other interests.

### 5.7 Fee Structure

When nominating or accepting nominations, Members shall confirm the basis of the fee structure applicable for the nomination if successful.

### 5.8 Consent for Inspection

No Member shall inspect a property with a tenant without the consent of the client or the appointed agent.

### 5.9 Commercial Viability of Prospective Lessees

Where a Member has reasonable grounds for questioning the solvency or commercial viability of any party introduced as a prospective lessee of the property, the client should be so advised.

## **6.0 Marketing**

### **6.1 'For Lease' or Other Marketing Board**

No Member shall place a 'For Lease' or other marketing board on a property without client consent, or where another agent has been appointed as sole or co-ordinating agent.

### **6.2 Not Advertise Lease Without Consent**

No Member shall advertise a property as being for lease without client consent.

### **6.3 No Inspection Without Prior Consent**

No member shall conduct an inspection of a tenancy without the prior consent of the tenant in occupation.

### **6.4 Property Information**

Members shall present property information on the basis of fact and not on assumption and shall endeavour to provide full details of the premises to be leased and the lease terms.

### **6.5 Confidentiality**

In spite of the absence of any specific confidentiality provision within the Agency Agreement, a Member shall not issue any press release without the client's written agreement. Any agreement so granted is a specific agreement to the form of words or content that has been submitted to the client for approval.

## **7.0 Other**

### **7.1 Pay Fees Promptly**

Members shall pay fees to nominating agents promptly following payment of their own fees by the client.

### **7.2 Fee on Basis of Written Agreement**

Members must base their fees on the basis of the written agreement with their client and must not seek to knowingly overcharge or take false profits.

### **7.3 Account to Co-ordinating Agent**

When acting as the nominating agent, unless instructed otherwise by the sole or co-ordinating agent, Members must account to the sole or co-ordinating agents for their fees and not to the client direct.

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# ARPGN 1 LAND CONTAMINATION ISSUES

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to outline information, issues, and approaches relating to contamination of land. The Institute recommends that it be used by Members as a guide for the valuation, assessment or reporting of land which is contaminated or whose contamination status is unknown or uncertain. Land includes improvements, structures or additions to the land.

### 1.2 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.

### 1.3 Scope of this Guidance Note

This Guidance Note applies to Members reporting on property and it deals with broad examples of environmental contamination and their potential effect on value and marketability. It offers guidance on general concepts and concerns, and suggests approaches that are considered to have merit. It does not purport to provide a definitive coverage of the environmental issues, which may arise, or the manner in which Members should deal with these issues. Many issues of land contamination are poorly defined and involve complex or unresolved matters. Formulaic approaches to the valuation and assessment of contaminated land, are not adequately developed. The appropriate procedures will vary according to the circumstances of each property being valued or assessed. Members should apply their own skill and judgement in applying the information contained herein to their own practice. This Guidance Note should be used in conjunction with other guidance notes and practice standards that

are either over-arching or directly applicable to the type of property, purpose or issues involved.

### 1.4 International Valuation Standards

This Guidance Note recognises the International Valuation Standards 1 and 2, and the International Valuation Application 2 by the International Valuation Standards Committee and it is intended to be consistent with the concepts and definitions contained in those standards, however, there may be departures from IVSC Standards to reflect Australian & New Zealand law and practice.

### 1.5 Member Involvement

Members are able to provide appropriate skilled advice in relation to valuation and property matters with the assistance of and in accordance with this Guidance Note and bearing in mind the limitations referred to herein.

### 1.6 Marketplace More Aware

Increased environmental consciousness within the general community, environmental protection legislation, litigation associated with pollution and land contamination, and incidents where property users suffer financial loss directly or indirectly from such cases, have made the marketplace more aware of the potential adverse effects of chemical, radiation, noise and other contaminants in air, groundwater, soil and the overall environment. The market can overreact and prices may be artificially depressed. Further, limited information about a particular contaminant that is thought to be present on a property can cause a secondary 'stigma' effect on values. Conversely, the market seems to be increasingly aware that contaminated properties can be redeemed and redeveloped into viable assets.

### 1.7 Advice about Commercial Impact

Clients, whether they are property owners, vendors, purchasers, financial institutions, receiver-managers, holders of major or minor property portfolios, etc, will often look to Members of the Institute for advice and guidance on how land contamination affects their financial security

and asset value. Although Members cannot and should not promote themselves as authorities who are fully capable of measuring, recording and providing detailed scientific advice on behalf of the client, they should be able to provide some level of advice to the client about the commercial impact of suspected or evident contamination.

### 1.8 Problems Requiring Further Investigation

Members of the Institute should take all reasonable care in these matters. Members who attempt to mitigate their responsibilities by adding a disclaimer saying that the property has been valued or assessed 'without regard to the question of presence of contamination', are not providing the level of best practice expected by clients and may not satisfy the standards of practice required by the courts. Therefore, the Institute recommends that its Members become sufficiently knowledgeable about the contaminants, laws and regulations associated with this topic and their effect on property values to meet the above standards. This involves Members qualifying advice, where appropriate, so as to properly inform the client of potential problems which may require further investigation, and thereby meet the Member's professional obligations.

### 1.9 Can Affect Full Spectrum of Property Types

Members will rarely be in command of enough information or evidence to completely rule out the possibility of land contamination. They can, however, through careful research and observation, provide advice about suspected contamination and the potential consequences on a property's Market Value. Environmental contamination can affect the full spectrum of property types, and should be considered in all property valuations and assessments.

### 1.10 Definition of a Contaminated Site

As defined by the Australian and New Zealand Environment and Conservation Council (ANZECC) and the National Health and Medical Research Council (NHMRC), a contaminated site comprises 'a site at which hazardous substances occur at concentrations above background levels, and where assessment indicates it poses or is likely to pose an immediate or long term hazard to human health or the environment'. Point of Reference

Members are encouraged to actively foster professional association with consultants specialising in the identification and treatment of contamination.

## 2.0 Types of Contaminants and Examples

### 2.1 Wide range

There is a wide range of potential environmental contaminants, varying from liquid and solid chemicals to corrosive gases and radioactive substances.

### 2.2 Physical Contaminants

Each contaminant must be considered for its potential physical and non-physical impact. Examples of physical contaminants include asbestos, hydrocarbons, lead, mercury, arsenic, cyanide and pesticides, but are not limited to these substances. Mining by-products can include nutrients and arsenic compounds amongst others. Unexploded ordnance has been another environmental difficulty associated with former defence force lands. Organic compounds such as formaldehyde are problem sources. Coal tars from coal-using powerhouse operations, asbestos, or PCBs can cause toxicity problems. These are but some examples.

### 2.3 Non-Physical Contaminants

These are contaminants that include non tangible, physical substance. However, they should be considered as 'real' as physical contaminants. A typical problem could be forms of radiation, intense radio wave transmissions and excessive heat.

### 2.4 Radon

Radon is a naturally occurring radio-active gas that is responsible for about half our exposure, which is unavoidable, to background radiation. The inhalation of radon and its decay products increases the risk of lung cancer. Radon emanates from particular radioactive materials in the ground and, to a small extent, from building materials. It disperses in the open air, but elevated levels may be found in spaces like poorly ventilated basements and caves, although such levels have not been found to be a health hazard in Australia.



## 2.5 Toxins in the Internal Home Environment

These comprise a long list of substances, including insecticides, lead based paint, wood preservatives, polishes, weed killers, bleaches and numerous other substances. Certain timber related or artificially produced materials used for home insulation, furniture and fittings may release formaldehyde or other traces of preservatives that create health problems for some individuals. (Many of these home toxins are not structural but transient and may be removed through relatively low cost means.) Unless specific circumstances exist such as the use of these products in commercial quantities, comments on domestic use in a valuation report are considered excessive.

## 2.6 Changes in Lists and Definitions of Hazardous Substances

Lists and characteristics of substances constituting hazardous waste and amounts of substances considered detrimental change frequently as new information becomes available. Such information is often available from State or local environment agencies. Preliminary lists are provided in Appendices 1 and 2. The ANZECC/NHMRC Australian and New Zealand Guidelines for the Assessment and Management of Contaminated Sites, January 1992, also contain a substantial list.

## 2.7 Environment Related Court Cases

Environment related court cases, particularly the Federal Court, have the potential to affect value if judgements establish new areas as a result of previous activities or management. Where doubt exists, this case law may prove appropriate investigation.

## 3.0 Identifying and Quantifying Contamination

### 3.1 Information on Possible Contamination

Information on possible contamination of the site is crucial to the property professional. The two main sources of such information are a Historical Land Use Survey and a scientific Survey of Environmental contamination as would be conducted by an Environmental Engineer/Auditor.

## Three Phases of Investigation

### Phase 1: Preliminary Site Investigation

A Phase 1 is the preliminary assessment of any contamination on the site. It includes the following steps:

- An investigation of site history
- A physical site inspection
- A basic sampling and analysis to determine the presence of contamination
- A report prepared

### Phase 2: Detailed Site Investigation

If the Phase 1 investigation shows further investigation is required, a detailed site investigation is carried out to assess:

- The concentration of various contaminations
- The volume of soil to be remediated
- The leachability and mobility of contaminants
- Any contamination of groundwater
- Any possibility of off-site migration of contaminants.

### Phase 3: Health and Environmental Assessment and Determination of Remediation Plan.

The results from Phase 2 investigation provide information to determine the potential 'human exposure and environmental impact' of the contaminants on the existing and intended land uses. If the intended use will cause unacceptable impact on the environment, then, depending on the conditions, a partial or full remediation, or other land contamination management strategy has to be implemented. A health and environment risk assessment has to be carried out, and a site specific remediation plan has to be prepared. (Footnote 4)

### 3.2 Phase I Survey : Background Research & Historical Land Uses

Previous owners and employees can be a good source of information on the property's history. Local councils can provide a wealth of information on more prominent properties, and a search of titles can provide some indication of former use. Many state governments have aerial photos that can assist in identifying some former uses. Government departments such as those involved with mining, public water supply, environment and health, may have regulating records and other useful information.

# AUSTRALIA REAL PROPERTY GUIDANCE NOTE 1

## 3.3 Look for Signs

It is important to look for signs that suggest a former use, if not a present use, which may have lead to, or caused, some form of contamination. Following the preparation of a site history, there will need to be a complete detailed site inspection. There are often tell-tale signs on the site that can indicate the possible presence of some forms of contamination. The member should look for disturbed or coloured soils, disturbed vegetation, the presence of any chemical containers, or chemical odours, and view the quality of any surface water. In addition, surface soils or earth fill may have been introduced to the site from other locations. The potential for contamination from off-site sources should also be considered. An Environmental Assessment Checklist is provided in Appendix 3. The ANZECC/NHMRC Australian and New Zealand Guidelines for the Assessment and Management of Contaminated Sites include a useful chapter on identifying and quantifying contamination.

## 3.4 Member's Role

Members should be aware however, that their role and expertise is limited to the detection and preliminary identification of discoverable contamination by reasonable site inspection and enquiries of appropriate authorities, and subsequent reporting. Detailed identification and quantification of contamination should be left to those who specialise in that field. Where, however, information is available to the Member, this should be provided to the client together with a statement of the source (whether it be a neighbour, former owner or environmental expert) and an appropriate qualification.

## 3.5 Register of Contaminated Sites

Some States compile a register of contaminated sites which is maintained by the relevant State environmental authority and is available for public inspection. Where the Member discovers or suspects that a site may be contaminated it would be prudent to inspect the Contaminated Sites Register in applicable States. This will help to provide the Member's client with useful information, thereby enhancing the level of service provided and discharging the Member's professional obligations. Members should not be over-reliant on these registers as they are not exhaustive, especially in those States where they are not formally required by legislation. Absence

from a register should not be taken to imply that a site is not contaminated. Even in the absence of a register of contaminated sites, Department of Environment staff may still be willing to provide relevant information regarding some sites.

## 3.6 Potential or Actual Contamination Issues

A Member conducting an inspection of a property for the purpose of providing a valuation or other report should be aware of the potential of site contamination of any property. During an inspection for this purpose, the Member should attempt to identify from on-site observations any potential or actual contamination issues and report accordingly, recommending further expert advice where appropriate. Other site factors to initially consider include site layout and contours, storage areas, geology, water features and nearby developments which may affect the subject land.

## 3.7 Report by Suitably Qualified Expert

### Phase 1 of Investigation.

A report on the site history of the property, provided by suitably qualified expert, may address the following issues:

- present and past land uses;
- processes and/or activities carried out on the site;
- major processes and/or activities that were carried out near the site;
- locations within the site of each process and/or activity;
- duration of each process and/or activity;
- waste disposal activities;
- source of contamination and effluent migration pathways;
- presence and purpose of underground tanks;
- signs of spills of hazardous materials.

### Phase 2 of Investigation

If, after carrying out an investigation and inspection, the Member is concerned or suspects that the property is or could be subject to potential contamination that could either restrict the future use of the site or militate against a financial consideration, the Member is obliged to recommend that the client seek more detailed advice from appropriately qualified professionals.

Such advice should be formed having regard to both the current and future use of the site. A Phase 2 Investigation by a specialist environmental engineer or scientist or other suitably qualified professional may include any or all of the following:

- historical land use survey;
- environmental risk inventory;
- evaluation of special contaminants such as asbestos, PCB's, acids, poisons such as arsenic, and radionuclides;
- remote sensing surveys;
- identification of on-site toxic vapours;
- surface soil and water samplings and laboratory analysis;
- sub-surface soil sampling and laboratory analysis;
- groundwater sampling and laboratory analysis;
- a site plan specifying locations of contaminants
- a health and safety plan.

The survey may include, in terms of a particular purpose or specific conditions of a site, a recommendation as to whether or not the contamination has reached an action level where remediation or risk reduction levels are necessary.

### Phase 3 of Investigation

Subsequently, it may be necessary for the appointed environmental consultant to move into a third phase of consultancy including site characterisation, the preparation of a preliminary remedial action plan with cost estimates, the conduct of negotiations with regulatory agencies, the design of remediation systems and continuing management, and the development of suitable future monitoring arrangements.

## 3.8 Whether Expert Engaged

A Member needs to be aware of the process of the Phase 1 investigation sufficient to advise a client as to the need for the engagement of a suitably qualified expert. The Member should also take detailed field notes that may or may not be used in the final report but will nevertheless stand as a record that the valuation or assessment was carried out having regard to the potential presence of contamination.

## 3.9 Not Expert

The Member should not hold himself or herself out as an expert in issues of site or other contamination.

## 3.10 Recommending a Survey of Environmental Contamination Where Detailed Information Cannot Be Obtained

Ultimately, only through scientific testing can the level of contamination be verified properly. Such testing can be both expensive and time consuming and cannot in itself provide a complete guarantee that contamination is not present.

Where contamination is suspected and where detailed information cannot be obtained, the Member should assess on the basis that a property is free of contamination, and qualify that value on the basis that some contamination may be present that could have an impact on the value. The following provides an example of the type of qualification which may be appropriate in these circumstances:

'From our inspection of the property we consider that there is (or could be) a potential for (detail past/current contamination) to exist and would recommend that advice should be obtained from a suitably qualified environmental expert. Please note that our valuation has been assessed on the basis of no on-site contamination. Should the above mentioned environmental advice reveal any contamination our valuation may require revision.'

The greater the perceived risk of contamination being present, the stronger the 'qualification' and the more specific should be the accompanying advice.

## 4.0 Remediation Practices and Techniques

### 4.1 Remediation Techniques Rapidly Changing

The practice of remediation of environmentally contaminated property is rapidly changing. New techniques are being developed, new standards are being set, both by the professions themselves and those who legislate standards.

### 4.2 Remediation Defined

Remediation has been defined as 'an act of attempting to moderate the severity of the

contamination of soil, groundwater, service water or buildings by various measures and methods’.

Note that remediation can include measures that alleviate the effect of contamination without destroying or removing the contaminants, as with ‘clean-up’ technologies.

### 4.3 Influence on Value

The influence of remediation or clean-up on value will depend on such factors as whether the contamination is contained (restricted) on-site, technology available the EPA controls affecting it, the length of time required to make good to permit development and use of the land and the possible need for further analysis and monitoring after the remediation process. The risks associated with achieving remediation in accordance with the defined plans may have to be factored into the value assessment.

### 4.4 Remediation Techniques

Remediation techniques could involve removal of affected soil from the site and replacement with clean fill, the extraction and ‘airing’ of hydrocarbon-affected soil from lower depths, the pumping out of contaminated groundwater or chemical neutralisation, eg. the use of lime to neutralise high acid content, and a wide variety of other measures. One difficulty with soil removal is that local authorities tend to be reluctant to allow disposal of contaminated soil.

### 4.5 New Technology

The new technology that is becoming available may potentially reduce the extent of the negative effect of contaminants on property and its value. Technology that permits safe, efficient and inexpensive clean-up of contaminants tends to minimise impact on value. However, clean-up costs can still be prohibitively expensive because of difficulties in disposing of contaminated soil, toxic waste and chemicals. Members should keep abreast of technological advances relating to this topic. The ANZECC/NHMRC Guidelines (Footnote 5) provide a site-specific approach to the management of contaminated sites, and indicate that remediation can be tailored to the actual proposed use of the land. Such awareness will assist the Member in advising appropriately on the potential risks associated with contaminated sites and the need for their clients to seek further information from appropriately qualified experts. Nevertheless, as previously referred to, Members

should avoid giving advice outside their area of expertise.

### 4.6 Clean Up Methods

As far as the removal of the contaminant source is concerned, there are different clean up methods. The common ones include:

- **On site treatment**

The contaminants are destroyed or broken down while the soil remains in-situ or excavated on site, eg. bio remediation, land farming, vertical mixing and chemical fixation.

- **Off site treatment**

The contaminated soil is excavated, removed from the site and taken to a depot for treatment, eg. high temperature incineration, soil washing, thermal absorption, particle-size separation, chemical treatment like base catalysed dechlorination (BCD), ball-mill pulverisation and super-critical fluid extraction.

- **Off site disposal**

The contaminate soil is excavated and removed from the site for disposal at a controlled landfill. Given that it is a controversial issue to allow transport of a contaminated soil on public roads, it is unlikely that the authority will approve this remediation method today.

- **Containment on site**

This method is to keep the contaminated soil in-situ and to restrict access to it and prevent leaking and leaching by suitable means, eg. encapsulation and capping (Footnote 6).

In addition to the above, recycling may also be an acceptable remediation method, eg. silver is recovered from recycling silver bromide used in the photo processing industry. However, given the high cost of recycling, this method is feasible only for end products with high value.

## 5.0 Impact on Value: General areas of Cost Impact

### 5.1 Responsible Party

Depending upon the relevant legislation, it is usual that the responsible party bear the clean-up costs of contaminated properties. Where responsibility cannot be determined, the chain of title is

generally followed with the current owner most likely to be liable. Members should refer to their relevant state legislation when determining the responsible party and the chain of responsibility.

## **5.2 Effect on Present and Future Utility**

Remediation costs can range from mild instances requiring low expenditure with little impact on value, to severe cases where virtually no use of the property is possible for the present or foreseeable future and prohibitive costs are needed to correct the problem. The degree to which contamination affects the present and future utility of the property must be quantified before a value can be readily assessed.

Due to the specialist work involved in assessing the type, extent and cost of remediation, Members are strongly advised not to provide their own estimate.

## **5.3 Initial Survey Costs**

The first cost associated with environmental contamination is the cost of discovering the extent of any problem.

## **5.4 Cost to Remedy**

The cost of remediation of a particular problem can be major, but care needs to be taken not to understate or overstate the impact on value. For example, property may be able to maintain an income stream while remediation process is in progress. In some cases these costs may be amortised over a period rather than as a one-off cost.

## **5.5 All Costs with Clean-up**

The cost to remedy a contamination problem includes all costs resulting from and associated with the clean-up. These include the cost of the physical clean-up, monitoring remedial measures, legal fees and continuing costs. Costs may also involve a capital improvement such as a more efficient, less polluting system that enhances residual property value significantly.

## **5.6 Develop & Maintain Cost Information File**

Members may develop and maintain files of clean-up cost information. This information should not, however, be used to give detailed environmental advice or cost estimates to clients. Appropriate experts should be retained for this purpose.

## **5.7 Physical Clean-up and/or Remedial Costs**

This can involve a variety of techniques such as simply removing and replacing contaminated soil (recognising that an acceptable location to receive contaminated material is often very difficult to find), extracting harmful chemicals in groundwater by pump extraction, or isolating and permanently sealing off contamination. Neutralising the contaminants with special chemicals is a possible solution in some cases. Environmental engineers and other experts can explain the options for remedial work or hazard reduction and provide cost estimates for undertaking this work.

## **5.8 Legal Costs**

Legal costs associated with contamination may be considered part of the cost to cure the problem. The extent of these legal costs will vary according to the circumstances of each particular property. Members should refer to these costs in their report, where appropriate, and ensure that they are addressed by any expert environmental report obtained. The potential for litigation or pending litigation may affect marketability and further affect

value by deterring prospective buyers. Such effects will usually be included within the Stigma component of environmental liabilities. Alternatively, Members may include a separate 'contingency figure' to cover these effects. Such a figure should either be provided by an environmental expert or estimated by the Member following suitable enquiries of solicitors. It should always be qualified to inform the client that it is a contingency figure only and that it may not reflect the costs actually incurred should litigation eventuate.

## **5.9 Continuing Costs**

Final costs are often unknown before the completion of any clean-up. These costs often exceed original estimates, especially when future, more stringent regulations are anticipated. In addition, perceived or actual risks remaining after completion of clean-up may result in higher insurance costs. Members should ensure that figures obtained from environmental experts make allowance for these continuing costs and that these costs are appropriately spread over a period corresponding to anticipated plant or improvement life or the period of the remediation.

# AUSTRALIA REAL PROPERTY GUIDANCE NOTE 1

## 5.10 Indirect Costs

These can include anything that affect the property's income producing potential during or after the clean-up. For example, tenants may not be able to live in a rental unit during lead paint removal. Another example would occur if one portion of an industrial plant could not be used because of toxic contamination and an intermediate product manufactured in that area was no longer able to be produced on-site. Additional expenses would be incurred and the operation's earnings could suffer accordingly. Holding costs, due to delays in development caused by the need for prior remediation, are another form of indirect cost.

## 5.11 Financing

There can be an adverse effect through financiers applying more conservative lending policies where there is a perception that a property may be secondary due to the effects of contaminants. (A Member, however, has a responsibility to ensure that mortgage clients are adequately informed of risks associated with known contamination.)

## 5.12 Indemnification Agreements

Some indemnification agreements, as set out by the seller, agree to retain responsibility for current and future costs related to environmental contamination. From the point of view of market sales information, the sale price would need to be discounted. The valuer wherever possible makes enquiries to establish the extent of the indemnification.

## 5.13 Stigma

This is an intangible factor that may not be measurable in terms of cost to cure but may have real impact on Market Value. It arises from the effect of present or past contamination upon the market's perception of the property and represents a discount, beyond the direct and indirect costs likely to be incurred, required to compensate for the risks associated with contaminated or previously contaminated property including the risk of achieving the planned remediation.

## 5.14 Market Perception

The market may perceive stigma exists because of:

- Uncertainty affecting the existing or future use of the site;

- Risks associated with the effectiveness of remediation;
- A full 'cure' of the site being unattainable;
- Concern at possible hidden clean-up costs;
- Prejudice arising out of prior site uses;
- Alternative site uses being restricted;
- Legislative issues affecting contaminated sites;
- Possible future financing and marketability difficulties;
- Risks associated with public liability.

Stigma makes property less desirable, even when a complete remediation or cleanup has been carried out. That is, where there is a market perception that a property is or has been contaminated, despite the availability of information that cleanup has taken place, the market will often pay less than normal unaffected values. This situation is similar to obsolescence and represents a lingering detriment to a property. In some cases the stigma effect is variable with time or is transitory.

## 5.15 Effect May be Out of Proportion

The stigma effect on value may be out of proportion to the cost to cure the problem, and can persist at varying levels for many years.

### Main Causes of Market Value Loss

There are three broad categories of market value loss caused by land contamination:

- cost and risk of remediation including consultancy, legal and monitoring costs;
- liability to the public; and
- stigma (affecting marketability and suitability for mortgage security).

## 5.16 Contaminants may not Necessarily Reduce Value

The presence of contaminants within a property may not necessarily reduce its value within the land use class or industry in which it is operating. Under State laws an existing use might be continued without remediation being required. For example, an industrial tailings pond having protective confines within land may contain toxic compounds that form part of a valuable industrial process for which there is a long term market demand. Special licensing generally accompanies these processes and the property can continue to be used as it is. A valuer reporting a value under these circumstances



should also advise the client that the valuation could be significantly different should the current use cease.

## 6.0 Potential Problems for Lenders

### 6.1 Lenders have Potential Exposure

Lenders have potential exposure to risk through land contamination as follows:

- loss of market value of collateral (property);
- a borrower's inability to repay loans because of clean-up costs, penalties or inability to continue business activities;
- lender's liability for clean-up costs following foreclosure of a mortgage, entering into possession as mortgagee in possession, or even exercising control under a scheme of arrangement.

## 7.0 Legislation

### 7.1 Legislation Increasing

Legislation affecting property contamination and related environmental matters is increasing in this country and overseas. A list of some of the relevant legislation and agreements is offered in Appendix 6.

### 7.2 Environmental Protection Authorities in Australia

A list of the internet addresses for the Environmental Protection Authorities in Australia is offered in Appendix 7.1.

### 7.3 Certain State Legislation Embodies 'the polluter pays'

Members who are acting for the vendor of a property should recognise that certain State legislation embodies the principle that in matters of land contamination, there is a principle 'the polluter pays', and this means that if a vendor has caused the land being valued to be contaminated, they may not be able to avoid responsibility for subsequent remediation even though the property has been sold. Members should refer to their own State legislation in this regard. Future Federal legislation may influence liability issues.

### 7.4 Responsibility for Lessees

The lessor could be responsible for the activities of a lessee who is unable to pay remediation costs or penalties. Many leases now contain provisions to prohibit activities that would result in contamination. Where the lessee could be engaging in activities that could result in contamination, the valuation should comment on inadequate provisions of the lease.

## 8.0 Indemnity Insurance

### 8.1 Policy Exclusions

Members should be aware of any exclusions within their professional indemnity insurance policy related to pollution, contamination or specific contaminants. Some policies do not provide cover in relation to claims arising from or in connection with these matters. For example, many policies exclude liability for claims arising from nuclear radiation. Furthermore, a Member may in some instances not be covered by a policy where the Member has failed to confine himself or herself to their field of expertise. Members should consult their professional indemnity insurance brokers in this regard.

### 9.0 GST CAUTION

Since the introduction of the GST on 1st July 2000 specific legal and/or accounting advice will need to be sought regarding the GST implications for this Guidance Note.



## APPENDICES

### APPENDIX 1 United Nations Hazard Classes

1. Explosives
2. Flammable Gas
3. Non-Flammable/Compressed Gas
4. Poison Gas
5. Highly Flammable Liquid
6. Flammable Liquid
7. Flammable Solids
8. Substances Liable to Spontaneous Combustion
9. Substances Emitting Flammable Gases when Wet
10. Oxidising Agents
11. Organic Peroxides
12. Poisonous (Toxic) Substances
13. Infectious Substances
14. Radioactive Substances
15. Corrosives
16. Miscellaneous Dangerous Substances

The categorisation of contaminating substances into these 'Hazard Classes' has been provided by the United Nations. These classes are not necessarily exclusive. Members should not confine their attention to substances falling within these classes.

### APPENDIX 2 Potentially Contaminating Activities, Industries and Land Uses

1. Abattoirs and Animal Processing Works
- 1b. Arsenic
2. Acid/Alkali Plant and Formulation
3. Agricultural Activities (Vineyards, Tobacco, Sheep Dips, Market Gardens). Heavy metals
4. Airports. Trichlore-ethylene from solvent cleaning operations.
5. Alumina Refinery Residue Disposal Areas. Fluoride (atmospheric emissions).
6. Asbestos/Asbestos Production
7. By-Product Animal Rendering. Pesticides.
8. Bottling Works
9. Breweries. Pesticides, oils and greases, underground storage tanks
10. Brickworks
11. Car Wreckers. Oils and greases, TPH and BTEX compounds, TCE (solvent cleaning).
12. Cement Works
13. Cemeteries
14. Ceramic Works. Heavy metals.
15. Chemical Manufacture and Formulation
16. Coal Mines and preparation Plants. Organic compounds – surfactants.
17. Defence Works
18. Docks. Oils and greases, TPH and BTEX compounds, TCE (solvent cleaning), pesticides, heavy metals.
19. Drum Reconditioning Works
20. Dry Cleaning Establishments. Organic compounds.
21. Electricity Distribution. PCB compounds.
22. Electroplating and Heat Treatment Premises. Chrome, heavy metals.
23. Ethanol Production Plants
24. Engine works. TPH, BTEX compounds, organic compounds (associated with solvents).
25. Explosives Industries
26. Fertiliser Manufacturing Plants

27. Gasworks
28. Glass Manufacturing Works
29. Horticulture/Orchards. OCP and OPP pesticides.
30. Industrial Tailings Ponds. Heavy metals, organic compounds, TPH, BTEX.
31. Iron and Steel Works
32. Landfill Sites. Variety of possible contaminants.
33. Limeworks
34. Marinas and Associated Boat Yards. Heavy metals – particularly Tri butyl tin
35. Metal Treatment. Heavy metals.
36. Mineral Sand Dumps
37. Mining and Extractive Industries
38. Munitions Testing and Production Sites
39. Oil Production, Treatment and Storage
40. Paint Formulation and Manufacture
41. Pesticide Manufacture and Formulation
42. Pharmaceutical Manufacture and Formulation
43. Photographic Developers. Heavy metals – Ag Cl used as part of process.
44. Piggeries. Pesticides and heavy metals.
45. Plant Nurseries
46. Plant or Fibreglass
47. Power Stations
48. Prescribed Waste Treatment and Storage Facilities
49. Printed Circuit Board Manufacturers. Solvents and glues – volatile organic compounds.
50. Properties Containing Underground Storage Tanks. TPH, BTEX, PAH, solvents.
51. Radioactive Materials, Use or Disposal
52. Railway Yards
53. Research Laboratories. Metal, organic compounds, radioactive elements.
54. Sawmills and Joinery works. Copper, chrome, arsenic.
55. Scrapyards. TPH, BTEX.
56. Service Stations
57. Sewerage Works
58. Smelting and Refining
59. Sugarmill or Refinery
60. Tanning and Associated Trades (eg. Fellmongery)
61. Timber Treatment works. Formaldehyde, copper, chrome, arsenic.
62. Transport/Storage Depots
63. Tyre Manufacturing and Retreading Works. Glues – volatile organic constituents.
64. Waste Treatment Plants in which Solid, Liquid Chemical, Oil, Petroleum or Hospital Wastes are Incinerated, Crushed, Stored, Processed, Recovered or Disposed of.
65. Wood Storage Treatment. Formaldehyde, copper, chrome, arsenic.
66. Wood Treatment Facility. Formaldehyde, copper, chrome, arsenic.
67. Wood Preservation. Formaldehyde, copper, chrome, arsenic.

### Other Activities, Industries and Land Uses

1. Sites of incidence: road or rail spillage involving hazardous substances; fires involving hazardous substances.
2. 'Hot spots' of likely contamination by agricultural chemicals and their by-products, eg. spray mixing sites; sheep and cattle dips; pesticide disposal sites.

The above lists are illustrative only. They are not intended to be exclusive.

## APPENDIX 3 Suggested Environmental Checklist

The following Checklist 3 is not intended to be exhaustive. It is included to illustrate the type of factors Members should be aware of when undertaking a visual inspection of a property. Members should exercise their own professional judgement in deciding what factors are relevant to the particular property being valued.

### Hazardous Materials, Storage and Disposal

- |   |                |            |                     |
|---|----------------|------------|---------------------|
| 1. Are there any drums, tanks or other holders of hazardous materials like chemicals, pesticides, cleaners, solvents on the property?   | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 2. If so, is there any indication of spills, leaks or discharges to the ground from the drums, tanks, other holders of hazardous material?  | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 3. Are there any areas observed with stains on the ground or with dead or stressed vegetation?  | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 4. Is the facility on the property a generator of hazardous waste?  | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 5. If hazardous waste is generated at the property, does it appear to be improperly monitored or not transported off the property by professional hazardous waste disposal contractors? | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 6. If the property generated hazardous waste, does it have statutory environmental authority approval, or is it licensed to do so?  | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 7. Does the property appear to have any pits, ponds, lagoons (other than normal water retention ponds required by some local councils) or other dumping areas?                          | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 8. Is there any evidence of radioactive products being utilised on the property?  | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 9. Does the facility appear to be free of any obvious sources of air emissions that have chemical odours, fumes or mists?   | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 10. Does the facility appear to be free of any noise pollution and are controls in place?   | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 11. Is there any evidence of any source of infectious waste (medical pathological wastes) on the property?  | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 12. If there is any source of infectious waste, are facilities for its disposal inadequate or not functioning properly?   | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 13. If the current use of the property does not indicate any of the above, could prior uses of the land involve hazardous materials, storage and disposal?                              | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 14. Is the property registered on any Government register of contaminated land or its equivalent?   | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 15. Are the existing or past operations on the property subject to local environmental concerns expressed by the local community, Council, Health Department or EPA?                    | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |
| 16. Do the existing operations comply with current regulatory permits and licensing?  | Y/N<br>Unknown | N/A<br>N/A | Comment:<br>Comment |

17. With reference to storage of hazardous chemicals, are the storage structures designed to minimise contamination in the event of fire or natural disaster?

Y/N	N/A	Comment:
Unknown	N/A	Comment

## Management Controls: Hazardous Waste

1. Does this facility have a policy document and is it available to all staff?

Y/N	N/A	Comment:
Unknown	N/A	Comment

2. Does the facility have an action plan in place for monitoring and reviewing environment controls?

Y/N	N/A	Comment:
Unknown	N/A	Comment

3. Does the facility have an emergency plan and/or procedures in the event of a spill, explosion or break down?

Y/N	N/A	Comment:
Unknown	N/A	Comment

4. Are copies of licenses and/or registrations easily visible and are they up to date?

Y/N	N/A	Comment:
Unknown	N/A	Comment

5. Verify the current status on any current orders

Y/N	N/A	Comment:
Unknown	N/A	Comment

6. Verify the status on current audits

Y/N	N/A	Comment:
Unknown	N/A	Comment

## Extractive Industries

1. Is there any extractive industry currently being operated on the site?

Y/N	N/A	Comment:
Unknown	N/A	Comment

2. If yes, is there an Environmental Impact Statement available for perusal?

Y/N	N/A	Comment:
Unknown	N/A	Comment

3. If yes, is there a current Development Approval available for inspection?

Y/N	N/A	Comment:
Unknown	N/A	Comment

## Asbestos

1. Is asbestos apparent on the property?

Y/N	N/A	Comment:
Unknown	N/A	Comment

2. Does a walk through the facilities reveal any obvious evidence of asbestos in ceilings, pipes, ducts, roofing, boiler insulation or structural beams, etc, that appears to be fireable, flaking or damaged?

Y/N	N/A	Comment:
Unknown	N/A	Comment

3. Were the facilities on the property constructed prior to 1980 when the use of asbestos was banned?

Y/N	N/A	Comment:
Unknown	N/A	Comment

4. Has an asbestos survey/audit of the facilities been conducted?

Y/N	N/A	Comment:
Unknown	N/A	Comment

5. Did the survey find the buildings to be free of asbestos containing materials?

Y/N	N/A	Comment:
Unknown	N/A	Comment

## Polychlorinated Biphenyls (PCBs)

1. Is there any electrical equipment (transformers, capacitors, etc) that contain polychlorinated biphenyls (PCBs) on the property?

Y/N	N/A	Comment:
Unknown	N/A	Comment

2. If PCB containing electrical equipment is presently on the property, is there any evidence of leaks or spills on the ground near the equipment?

Y/N	N/A	Comment:
Unknown	N/A	Comment

## Underground Storage Tanks (USTs)

1. Are there any underground storage tanks (USTs) containing petroleum products or hazardous chemicals on the property?

Y/N	N/A	Comment:
Unknown	N/A	Comment

## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 1

2. If USTs exist on the property, are leak detection equipment or secondary containment systems not installed on the tanks?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

3. Have they ever been tested for leaks?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

4. Has there ever been an incident of a leak, spill or discharge?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

5. Have the owners or lessees of the property undertaken any environmental audit pertaining to underground storage tanks on the property?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

6. Have the proper registration forms been submitted to the designated regulatory authorities?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

### Land Fills

1. Is there any evidence that the site is currently being filled or has been filled?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

2. Have the filling operations been approved by Council and the EPA?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

3. Do the filling operations allow for putrescible, non-putrescible or toxic wastes?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

4. Do the filling operations require a licence and/or Performance Guarantee and License from the EPA?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

### Agricultural-Type Properties

1. If the property has previously been used for horticultural, orchard or market garden purposes, is there any historic evidence of past land uses having involved persistent pesticides, such as dieldrin or DDT?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

2. Are there any environmental audits available evaluating the presence of pesticides?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

### Former Defence-Oriented Property

1. Does the land contain unexploded munitions, radioactivity or other hazardous substances that could be associated with defence works?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

2. Is there any information available from the Department of Defence or local authorities regarding the presence of unexploded munitions?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

### Environmental Hazards on Adjacent Properties

1. Do any adjacent properties appear to have any improper storage or dumping of hazardous materials, drums or containers that could impact on the value of the subject property?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

2. Are there any landfills, dumps or other waste disposal facilities within one kilometre of the subject property?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment

3. Is there any indication of operations such as gas stations, chemical plants, bulk storage tanks, manufacturing plants or other land uses which potentially involve land contamination (as outlined in this document), on any of the adjacent properties?

Y/N                      N/A                      Comment:

Unknown                N/A                      Comment:

## **APPENDIX 4 Sample Environmental Balance Sheet**

The following is a relatively simple non-costed Environmental Balance Sheet for example purposes.

### **IMPAIRED VALUE OPINION BALANCE SHEET**

	UNIMPAIRED	VALUE OPINION	\$
<b>Less : ENVIRONMENTAL LIABILITIES:</b>			
Due Diligence/Initial Environment Consultants Costs		\$	
Quantification & Alternative Strategy Development Costs		\$	
<b>PRESENT VALUE OF ACTION PLAN COMPONENTS:</b>			
Remediation/Clean-Up Action Costs	\$		
Contamination Control and Management Measures	\$		
Redesign of Production Facilities	\$		
Avoidance of Migration of Contamination to Adjacent Sites	\$		
Notification, Training and Record Keeping	\$		
Allowance for Emergency Response Actions	\$		
Legal Costs	\$		
Indemnity Insurance for the Future	\$		
Monitoring Costs	\$		
Licensing Costs where Applicable	\$		
SUBTOTAL: Present Value of Action Plan	\$		
Estimated Negative Intangible (Stigma) Impact		\$	
<b>TOTAL ENVIRONMENTAL LIABILITIES</b>		<b>\$</b>	
<b>OWNER'S IMPAIRED POSITION* \$</b>			

\* The GREATER of Zero or Unimpaired Value LESS any Environmental Liabilities.

## APPENDIX 5 A Method of Assessing Stigma

Unimpaired Value of the Land (a medium hazard risk property)	\$
Present value of remediating costs	\$
Impaired value 1 - not allowing for stigma	\$

### Comparable Case Studies

Case Study Number	Indicated percentage of impaired value 1 lost to stigma	Comparison to the property being valued
1	25.9%	Treatment completed, stigma caused by fear of additional contamination, less severe than the subject property.
2	29.2%	No treatment proposed at present, continued industrial use, similar risk level to subject property
3	20.9%	Site not contaminated but is situated adjacent to a contaminated site
4	32.7%	Similar type of contamination to subject property but slightly more severe
5	45.4%	Heavily contaminated site, derelict land, more severe than the subject property

Range of stigma effects indicated by comparables 20.9% to 45.4%

Comparables closest to subject property, numbers 2 and 4, 29.2% to 32.7%

Therefore percentage stigma applicable to the subject property is 31 %

Amount of stigma @ 31% of impaired value 1	\$
Impaired value 2 (taking account of treatment and associated costs and stigma)	\$
Add value of buildings	\$
Total value of asset	say \$
Percentage reduction in value attributable to contamination	21.60%

Source: Developed from Patchin (1994) and Syms (1995) (UK)



## APPENDIX 6 Environmental Legislation in Australia

For legislation in Australia see Australian Legal Information Institute (AUSTLII) Website

The following list is not intended to be exhaustive. It should, however, illustrate the wide variety of existing environmental legislation which may affect the value of a particular interest in land.

### Commonwealth of Australia

1. The Inter-Governmental Agreement on the Environment.
2. National Waste Minimisation and Re cycling Strategy released by Commonwealth Environmental Protection Authority.
3. Industrial Chemicals (Notification and Assessment) Amendment Act 1989.
4. Ozone Protection Amendment Act 1992.
5. Commonwealth Ozone Protection Act 1988.
6. Petroleum (Submerged Lands) Act 1967.
7. Environmental Protection (Nuclear Codes) Act 1978.
8. Nature Conservation Act 1980.
9. Water Pollution Act 1984.
10. ACT (Planning & Land Management) Act 1988.

### Australian Capital Territory

1. Clinical Waste Act 1990
2. Public Health Act 1982
3. Poisons Act 1993
4. Radiation Act 1983
5. Air Pollution Act 1984
6. Land Planning Act 1991

### New South Wales

1. Environmental Planning and Assessment Act 1979.
2. Environmentally Hazardous Chemical Act 1985.
3. State Environmental Planning Policy No. 33: Hazardous and Offensive Development - Gazetted 11 March 1992.
4. Clean Waters Act 1970.
5. Environmental Offences and Penalties Act 1989.
6. Clean Air Act.

7. Noise Control Act.
8. State Pollution Commission Control Act.
9. Marine Pollution Act 1987.
10. Petroleum (Submerged Land) Act 1982.
11. Coastal Protection Act 1979.
12. Drainage Act 1939.
13. Water Board Act 1987.
14. Pesticides Act 1978.
15. Radioactive Control Act 1990.
16. Rural Lands Protection Act 1989.
17. Soil Conservation Act 1938.
18. Unhealthy Building Land Act 1990.
19. Environmental Restoration and Rehabilitation Trust Act 1990.
20. Protection of the Environment (Operations) Act 1997

### Queensland

1. Local Government (Planning and Environment) Act 1990.
2. The Contaminated Land Act 1991.
3. Nature Conservation Act.
4. Local Government (Planning & Environmental) Amendment Act 1992.
5. Pollution of Waters by Oil Amendment Bill 1992 (Proposed).
6. Local Government Act 1936.
7. Petroleum (Submerged Land) Act 1982.
8. Harbours Act 1955.
9. River Improvement Trust Act 1940.
10. Water Resources Act 1989.
11. Soil Conservation Act 1986.
12. Radioactive Substances Act 1958.
13. National workshop on Health Risk, Assessment and Management of Contaminated Land, November 1991.
14. Clean Air Act 1963-1990.
15. State Environment Act 1988.

### South Australia

1. Planning Practice Circular (distributed by the Department of Environment and Planning to Local

## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 1

- Councils, Planners and Consultants in October 1990).
2. Discussion Paper - Contaminated Land - A South Australian Legislative Approach.
  3. Proposal for South Australian Environmental Protection Authority and Chapter on Environmental Policy.
  4. Dangerous Substances Act 1979/1988.
  5. Environmental Protection Council Act 1972 and Local Government Act 1934.
  6. Marine Environment Protection Act 1990.
  7. Petroleum (Submerged Lands) Act 1982.
  8. Water Conservation Act 1936.
  9. Harbours Act 1936.
  10. Water Resources Act 1976.
  11. Native Vegetation Act 1991.
  12. Soil Conservation and Land Care Act 1989.
  13. Waste Management Act 1987.
  14. Clean Air Act 1984.
  15. Public & Environmental Health Act 1987.

### Tasmania

1. Environmental Protection Act 1973.
2. Chlorofluorocarbons and other Ozone Depleting Substances Control Act 1988.
3. Oil Pollution Act 1961.
4. Public Health Act 1962.
5. Groundwater Act 1985-1988.
6. Water Act 1957-1923.
7. Petroleum (Submerged Lands) Act 1982.

### Northern Territory

1. Conservation Commission Act 1980.
2. Local Government Act 1954.
3. Ozone Protection Act 1990.
4. Public Health Act 1952.
5. Uranium Mining (Environmental Control) Act 1979-1981.
6. Petroleum (Submerged Lands) Act 1982-1986.
7. Environmental Protection (NT Supreme Court) Act 1978.
8. Environmental Assessment Act 1982.

9. Soil Conservation & Land Utilisation Act.

### Victoria

1. Environment Protection Act 1970.
2. Pollution of Waters by Oil and Noxious Substances (Amendment) Act 1991.
3. Marine Act 1988.
4. Heritage Rivers Act 1992.
5. Agricultural and Veterinary Chemicals Act 1992.
6. Environment Protection (Resource Recovery) Act 1992.
7. Various State Environmental Protection Policies made under the Environmental Protection Act 1970 covering air environment, control of noise, ground waters, etc.
8. Local Government Act 1958.
9. Petroleum (Submerged Land) Act 1982.
10. Extractive Industries Act 1966.
11. Land Conservation Act 1970.
12. Soil Conservation and Land Utilisation Act 1958.
13. Occupational Health and Safety (Asbestos) Regulations 1992.

### Western Australia

1. Environmental Protection Act 1986.
2. Local Government Act 1960.
3. Petroleum (Submerged Lands) Act 1982.
4. Marine Harbours Act 1981.
5. Pollution of Waters by Oil and Noxious Substances Act 1987.
6. Waterways Conservation Act 1976.
7. Poisons Act 1964.
8. Radiation Safety Act 1975.
9. Explosives and Dangerous Goods Act 1961.
10. Agricultural Produce (Chemical Residues) Act 1983.
11. Health Act 1911.
12. Aerial Spraying Control Act 1966.
13. Nuclear Activities Regulation Act 1978.
14. Industrial Lands Development Authority Act 1966.
15. Soil & Land Conservation Act 1945.

## **APPENDIX 7 Internet Address of Environment Protection Authorities of Australia**

Environment Australia – Department of the Environment and Heritage (Commonwealth)  
<http://www.ea.gov.au>

Department of Lands Planning and Environment, NT  
<http://www.nt.gov.au/dlpe/>

Department of Environment and Heritage, QLD  
<http://www.env.qld.gov.au/>

Department of Environment, Heritage and Aboriginal Affairs, SA  
<http://www.denr.sa.gov.au/>

Department of Primary Industries, Water and Environment, TAS  
<http://www.dpiwe.tas.gov.au/>

Department of Environmental Protection, WA  
<http://www.environ.wa.gov.au/>

Environment ACT  
<http://www.act.gov.au/enviro/>

Environment Protection Authority, NSW  
<http://www.epa.nsw.gov.au/>

Environment Protection Authority, SA  
<http://www.epa.sa.gov.au/>

Environment Protection Authority, VIC  
<http://www.epa.vic.gov.au/>

Footnotes:

1. Australian and New Zealand Environment and Conservation Council, National Health and Medical Research Council, Australian and New Zealand Guidelines for the Assessment and Management of Contaminated Sites, January 1992, p. 2.
2. Research on Radon is being conducted by Murdoch University in Western Australia.
3. The Institute gratefully acknowledges the assistance of the NSW Property Valuation Department of the Commonwealth Bank of Australia in the preparation of this Appendix.
4. DoE, Queensland 1998.
5. National Environmental Protection Council is to release a National Environment Protection Measure which will supersede the relevant sections of the ANZECC/NHRMC Australia and New Zealand Guidelines for the Assessment and Management of Contaminated Sites 1992.
6. New South Wales EPA 1995.

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# ARPGN 2 NATIVE TITLE ISSUES

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Guidance Note is to outline information and issues, and indicate approaches in cases involving the valuation and management of land subject to native title claims (or where native title may exist, has been claimed or has been determined). The National Council of the Australian Property Institute recommends that it be used by members for the valuation of co-existing property interests subject to native title in Australia. The Institute recognises that Members need to be aware of the potential for native title to coexist with certain tenures, whether there is a claim for native title or not. In this regard, they should obtain a copy of the Native Title Act (Clth) 1993 as amended on 30 September 1998.

### 1.2 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.

### 1.3 Scope

This Guidance Note applies to Members reporting on land and deals with broad examples of the phenomenon, which results when native title coexists on land, and the resultant value effect. It offers guidance on pertinent general concepts and concerns relating to native title, and suggests the approach that ought to be adopted. It does not purport to provide a definitive coverage on the issue of the valuation or management of co-existing rights, or the manner in which Members should deal with these issues. Co-existing property rights where native title exists is a phenomenon which has resulted in much public debate particularly since the decision in *Wik Peoples –v- Queensland* ((1996) 141ALR 129) (*Wik*) on 23rd December 1996 and involves complex and sometimes unresolved matters. However, contrary

to public perceptions of the *Wik* decision, as long ago as September 1993 in *Pareroultja –v- Tickner* ((1993) 42 FCR 32) it was held that:

... the extent to which Native Title over land may co-exist with leasehold tenure is not a question fully explored in *Mabo* (No. 2). Much may depend on the nature and extent of the leasehold estate (eg a monthly tenancy or lease for 99 years) and inconsistency, if any, between Native Title and the lessor's reversionary interest.

'Formula' approaches to the valuation or management of co-existing interests subject to native title are almost certainly inadequate and the procedures for each report will vary according to the circumstances of each parcel of land.

Members should apply their own skill and judgement in applying the suggested approaches contained herein to their own practice.

This Guidance Note should be used in conjunction with other guidance notes and practice standard which are either over-arching or directly applicable to the type of land, purpose or issues involved.

Native Title is different from State and Territory based 'land rights' legislation and cultural heritage protection legislation.

### 1.4 International Valuation Standards

This Guidance Note recognises the International Valuation Standards 1 and 2, and the International Valuation Application 2 by the International Valuation Standards Committee and it is intended to be consistent with the concepts and definitions contained in those standards, however, there may be departures from IVSC Standards to reflect Australian & New Zealand law and practice.

### 1.5 Property Expert Involvement

Members are able to provide appropriate skilled advice in relation to Valuation and property matters with the assistance of and in accordance with this Guidance Note and bearing in mind the limitations referred to herein.

### 1.6 Market Response

Increased awareness within the general community of Indigenous issues, recent legislation, such as the Native Title Act, litigation associated with native

## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 2

title and incidents where property users allege financial loss as a result of native title claims (or the likelihood thereof), have made the marketplace more aware of the potential effect of native title co-existing with existing land titles. Anecdotal evidence may suggest that prices can become artificially depressed. Further, limited information about a particular native title claim (or prospect thereof) that is thought to be present on land may cause a 'stigma' effect on values. Conversely, the market appears to be aware that the impact upon the utility of properties with co-existing native title may vary significantly from case to case.

### 1.7 Advice about Commercial Impact

Clients will be looking to Members of the Institute for advice and guidance on how native title affects their financial security and asset value. Members cannot and should not promote themselves as authorities who are fully capable of measuring, recording and providing detailed advice. However, they should be able to provide a significant level of advice to the client about the commercial impact of the coexistence or likely coexistence of native title in relation to a particular parcel of land.

### 1.8 Issues Requiring Further Investigation

Members of the Institute should take all reasonable care in these matters. Members who attempt to mitigate their responsibilities by adding a disclaimer saying that the property has been valued or assessed 'without regard to the question of the presence of native title', are not providing the level of expertise expected by clients and would not satisfy the standards of practice required by the courts. Therefore, the Institute recommends that its Members become sufficiently knowledgeable about native title processes contained in Commonwealth and complementary State/Territory legislation, and case law associated with this topic and its effect on property values to meet the above standards. This involves Members qualifying advice, where appropriate, so as to properly inform the client of potential issues which may require further investigation, and thereby meet the Member's professional obligations.

### 1.9 May Affect a Broad Range of Non-Exclusive Estates

Except where Members are valuing or managing land identified as an 'exclusive possession grant' which extinguishes native title (s.23B (2)(c) Native

Title Act) (See Appendix 1 of this Guidance Note), Members will rarely be in possession of enough information or evidence to totally discount the presence of native title as a co-existing property right. Items of Indigenous cultural heritage (ie middens, rock carvings etc) can be a useful marker for native title, however this may not be conclusive. Members should be aware that Indigenous cultural heritage is a separate but related issue to native title. Native title as a co-existing property right may affect the full spectrum of non exclusive possession estates (eg. non exclusive possession leasehold or reserve land) and should therefore be considered.

Members should utilise Appendix 1 to assist them in distinguishing the likelihood of coexistence. The majority of ordinary titles, both private freehold and specific leasehold, listed in Appendix 1, have the status of 'exclusive possession grants' which extinguish native title. In these circumstances native title does not need to be considered further.

### 1.10 Definition of Native Title

As defined in *Mabo – v - the State of Queensland (No.2) (1992) (175 CLR 1) (Mabo)*, native title is the term used to describe the rights and interests held by Aboriginal and Torres Strait Islanders to land and waters under their custom and customary law. The National Native Title Tribunal (NNTT) describes native title as:

'.... A common law right that pre-dates European settlement of Australia'

(NNTT Information Bulletin, Feb 1997, at p1).

In addition to the above, native title is defined in the Native Title Act 1993 as:

'the communal, group or individual rights and interests of Aboriginal peoples or Torres Strait Islanders in relation to land or waters, where:

- (a) the rights and interests are possessed under the traditional laws acknowledged, and the traditional customs observed, by the Aboriginal peoples or Torres Strait Islanders; and
- (b) the Aboriginal peoples or Torres Strait Islanders, by those laws and customs, have a connection with the land or waters; and
- (c) the rights and interests are recognised by the common law of Australia.'

(s223(1))

Also,

'[w]ithout limiting subsection (1), 'rights and interests' in that subsection includes hunting, gathering, or fishing, rights and interests.'

(s223(2))

As a useful summary, it should be noted that native title:

- is not necessarily equivalent to other forms of legal tenure;
- is what the common law recognises;
- comprises a range of rights and interests which may vary from group to group and place to place;
- rights and interests to an area of land or waters may be held by more than one group;

when tested for survival (and co-existence), the inconsistency test set out in detail in the judgements of the High Court in *Wik Peoples v Queensland* and *Fejo v Northern Territory of Australia* are to be adopted.

The laws and customs and traditional uses, which define native title, were not frozen at the time of British settlement and as long as physical, cultural and/or spiritual connection with the land is maintained, it is understood that the defining laws and customs are able to evolve. It is often misunderstood that for native title to be intact must be maintained in a manner existing at the time of British settlement.

Conceptually this is not significantly different to the customs and traditions of every other society or group which have evolved or adapted to change throughout the course of history.

The manner in which native title continues to exist may not be given practical expression in a form which is easily recognised by non Indigenous people. That substantial development may have occurred on or near land being considered in a property valuation or assessment, ought not lead to a presumption that native title does not continue to exist, and hence does not exist as a property right.

Kado Muir of the Australian Institute of Aboriginal and Torres Strait Islander Studies (AIATSIS) provides useful guidance as follows:

'... where Indigenous laws are practised and acknowledge[d] then those laws will also contain property rights. The process of inquisition into the nature, extent and incidents of property rights

derived from the Indigenous laws is not essential to establishing the existence of native title.'<sup>1</sup>

The fundamental issues to be addressed by the Court when it is required to determine that native title exists are essentially threefold:

- who holds the interest?
- where is the interest, ie the boundary?
- what are the rights and interests held?

These requirements are set out in s.225 of the Native Title Act 1993, as follows:

A determination of native title is a determination whether or not native title exists in relation to a particular area (the determination area) of land or waters and, if it does exist, a determination of:

- (a) who the persons, or each group of persons, holding the common or group rights comprising the native title are; and
- (b) the nature and extent of the native title rights and interests in relation to the determination area; and
- (c) the nature and extent of any other interests in relation to the determination area; and
- (d) the relationship between three rights and interests in paragraphs (b) and (c) (taking into account the effect of this Act); and

to the extent that the land or waters in the determination area are not covered by a non-exclusive agricultural lease or a non-exclusive pastoral lease – whether the native title rights and interests confer possession, occupation, use and enjoyment of that land or waters on the native title holders to the exclusion of all others.

### 1.11 Point of Reference

Members must obtain relevant initial information from specialist native title sources such as the NNTT Registers, other relevant State and Commonwealth agencies and officials, and native title representative bodies (NTRBs) (see 3.1, below).

Other important points of reference are anthropologists and archeologists. The Australian Anthropological Society, at the University of Sydney tel: (02) 9351 5489 should be contacted for advice as to contacts in these disciplines. In addition, valuable research information can be accessed from the Aboriginal and Torres Strait Islander Commission (ATSIC), traditional owners, and industry organisations who are stakeholders in native title, eg: farm industry organisations.



## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 2

A further useful resource is the Australian Local Government Association (ALGA) publication *Working with Native Title: A Practical Guide for Local Government*, which provides a detailed description of the processes involved.

It is important that members obtain information that is representative of the broad spectrum of issues and views in respect of native title to ensure that they do not negligently disregard research information.

### 2.0 Types of Co-Existing Estates

#### 2.1 Wide Range of Non-Exclusive Estates

There is a wide range of non-exclusive possession estates which may co-exist with native title, varying from State to State in the level of exclusivity, and hence the quality of tenure and/or the potential for co-existing interests or native title in particular.

An example of such estates are the Western Division leases in New South Wales, and two and possibly four types of Queensland pastoral leases, (ie Pastoral Holding, Pastoral Development Holding and possibly Preferential Pastoral Holding and Stud Holding), and possibly Occupation Licences, and Special and Term Leases for grazing purposes.

Members should however note that certain statutory estates now extinguish native title and are referred to in Schedule 1 of the recent Native Title Amendment Act 1998. It is important to ascertain whether the State or Territory has enacted complementary legislation to validate and to confirm the effect on native title of the tenure listed in Schedule 1 of the Commonwealth Act.

Appendix 1 of this Guidance Note lists these estates, and are shown in chronological order of legislation by State or Territory, for ease of reference.

Caution should be exercised when consulting Appendix 1 as some non exclusive possession estates (i.e. Preferential Pastoral Holdings and Stud Holdings in Queensland) may extinguish native title, to the extent of the inconsistency only. Extinguishment by such estates has yet to be considered by the courts, and it is recommended that legal advice be obtained. In addition, some classes of Special Leases (e.g. for watering purposes) are provided for in the Act as extinguishing native title.

#### 2.2 Tenure

Each non-exclusive possession estate must be considered in assessing the impact of the rights being asserted in a native title determination application upon the property. In some States much of the non-urban land is held in private freehold (i.e. Victoria) which extinguishes native title permanently. However, in some States and Territories this land is held under statutory estates, commonly called pastoral leases.

#### 2.3 Conditions of Tenure

There are prerequisites, conditions and obligations attached to various forms of leasehold which define the nature of the ownership. The term of the statutory estate, especially the period unexpired, the rights, if any, of renewal, the capacity and limitations upon transfer, and other terms and conditions are critical to determining the degree of exclusivity of the particular estate, and how closely the tenure approaches the benchmark of private freehold.

The degree of exclusivity granted to a leaseholder has a complimentary effect on the ability of the statutory estate to co-exist with native title. The duration of leases can vary from perpetuity to only a few months, and the issue to be addressed by Members is whether duration per se is fundamental in determining the impact of native title.

Leases of a shorter duration may be more vulnerable to the bundle of rights comprising native title than those of longer duration, given that longer leases may have the 'flavour' of private freehold whilst others may be little more, in practice, than an agistment right.

It should be noted that the length of the term of the statutory estate was only one of a number of deciding issues in the Commonwealth Government's decision as to whether or not to include a particular statutory estate in the Schedule (see Appendix 1 in this Guidance Note). Relevant factors in determining whether a statutory estate was to be listed in the Schedule were, terms and conditions, third party rights, grantee obligations and restrictions, upgrade capacity, purpose, tenure history, location, and size. However, the terms of a lease and the actual activities were not determining factors, whilst all of the above factors were to be balanced to determine whether a lease had eligibility as a Scheduled Interest.<sup>2</sup> Caution should however be exercised regarding

the presence (or lack of) a statutory estate in the Schedule to the Act, as the recent decision in *Ward v State of Western Australia* (1998) 159 ALR 483 (*Miriuwing Gajerrong*) may have clouded the issue of extinguishment.

### 2.4 Consequences of Existing and Past Activities

Since *Mabo*, native title can be extinguished by not only a plain and clear intention to do so (*Mabo* at p.68) but also by the consequences of existing and past activities.

Members should be aware that the consequences of present and previous activities performed on the lease land can have significance for the likelihood of native title surviving. This may be deduced from an inspection of the property and is irrespective of questions of exclusivity, duration or reservations contained in the lease document.

At an extreme level, the complete obliteration of all natural land forms as a result of past mining activity is likely to severely limit the ability of traditional activities to be performed on site, or possibly for any meaningful relationship with the land to continue to exist. Substantial private developments for say, a sporting complex, also provide a further example. Even with less intrusive pursuits such as low impact farming, it is likely that any traditional profits a prendre activities would have been severely curtailed. There is also the category of 'public work' (s253) and lands incidental to the 'public work' (s251D) which also extinguish native title.

Nevertheless, Members should be aware that a direct physical contact with land is not the only medium by which native title is sustained (ie cultural and spiritual).

The *Miriuwung-Gajarrong* decision of the Federal Court in 1998 has however cast doubt upon the extinguishing capacity of existing and past activities. Members should exercise caution and obtain specialist advice in this area from anthropologists, and archeologists, NTRBs and traditional owners in order to identify the level of effect.

### 2.5 Related Court Cases

Members should also pay close attention to important court cases in the Federal or High Courts which have implications for co-existence. These cases have the potential for providing guidance in the valuation of specific types of estates over

which there has been a native title application. The NNTT and the Federal Court have separate functions under the legislation, and the States and Territories can establish their own 'recognised bodies to perform the functions of the Federal Court, and 'equivalent bodies' to perform the functions of the NNTT. However, the NNTT still retains responsibility to maintain the Registers, while the role of the Federal Court is to receive applications, refer them to the NNTT (or equivalent body) for registration, to decide on the parties, to make determinations and orders.

## 3.0 Identifying Co-Existing Native Title

### 3.1 Information on Native Title

Identifying where native title exists or may exist is crucial in all property valuations or assessments. It is important to be aware of the possibility that native title may exist in certain circumstances and in areas where it has not been extinguished regardless of whether there is currently a native title application or determination to indicate its existence.

It is not necessary to have a determination, by agreement or judicially after a contested hearing, for native title to exist. It is an existing right and may continue to exist in areas where it has not been extinguished by legislative or executive acts of government, even though the identity of the native title holders is unknown. In such circumstances it is possible that an area may be subject to an application for a native title determination at a later date.

The main sources of information in circumstances where the holders of native title rights and interests are unknown, are the NTRBs, the local Indigenous peoples with an historical connection with the area in question, local historical societies, local genealogical societies, the relevant ATSIC Regional Council and the local Council historical records.

Where an application for native title has been made, the primary sources of information are the Register of Native Title Claims held by the NNTT or equivalent State/Territory bodies, and the NNTT Schedule of Applications for native title determinations that have not passed the statutory registration test under the Native Title Act 1993 and the Federal Court's records of common law native title applications.

## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 2

The list of Scheduled Interests, together with tenure information held by state government registries is also a major source of information (see Appendix 1 in this Guidance Note).

Native title issues can arise where there has been a determination (by agreement or judicially), where an application for a determination has been made or, importantly, where the native title holders are presently unknown and no application or determination exists.

### 3.2 Searches

There are various searches that should be undertaken.

### 3.3 Tenure Searches.

After undertaking the enquiries mentioned above and prior to conducting a search of the NNTT registers, it is important to prepare a tenure history of the land.

This is best undertaken by a registered surveyor who should provide copies of documentary evidence of the tenure history both by way of title documents and other descriptive sources such as deposited plans and Crown Land survey information.

The tenure search is pivotal in deciding whether native title has survived, the nature of the surviving property rights associated therewith and the nature of impairment or even extinguishment of such rights. Often, it is necessary to closely examine the initial tenure searches and to request more detailed particulars from the surveyor in order to conclude this aspect of the Member's report. Tenures included in Schedule 1 of the Native Title Act 1993, and as enacted in complementary States/Territory legislation are not subject to native title. (See Appendix A of this Guidance Note)

### 3.4 Background Research & Historical Land Use

After undertaking the research referred to above, the use of the land may be relevant if native title has not been extinguished by present or previous grants of tenure Members should be aware that previous grants of freehold title extinguish native title permanently (viz. *Fejo v Northern Territory of Australia*), and that the Native Title Act provides for previous extinguishing acts. Before embarking on a formal search of the Registers held by the NNTT, or equivalent State/Territory body, there are several areas of enquiry to take advantage of

- the existing and previous owners (and employees) are often an excellent source of information on the land use history of a property.
- local councils can provide detailed information from their building planning and subdivision records on past history and land uses.
- aerial photographs can be obtained from the relevant Crown Lands Departments or their equivalent in each State or Territory that can also assist in documenting former uses, such as public works. Such photographs can be obtained as far back as the 1940's and are a much under-utilised resource.
- government departments dealing with utilities, health and environment, industry and mining also have approval and licensing records and other useful information.

### 3.5 Native Title Registers

Four registers are held by the NNTT covering land and waters in each State and Territory and deal respectively with registered claims, determinations, Indigenous Land Use Agreements (ILUAs) and unregistered claims.

Upon request, a formal search of the registers will be conducted by Tribunal staff. The Tribunal's fee to search the registers upon receipt of a request is \$20.00 per 15 minutes, plus photocopying at 50 cents per A4 page.

The NNTT does not have a set application form for written inquiries, however members seeking such information should attempt to follow the format of similar applications, such as those made to roads and electricity supply authorities.

The information provided to the NNTT in support of a written application for a search of the Registers should be as detailed as possible to expedite the search. Details such as county, parish and local government area are a starting point, however the provision of Deposited Plans or other survey information will also assist the Registry staff.

The written application can also be forwarded to the relevant Registry by facsimile, providing a shortening of the response time. Experience suggests that the turn around time can vary from one or two days to three weeks, subject to workload.

### 3.6 Indigenous Records

When the member receives confirmation from

the NNTT Registry that land is subject to a native title claim, (that has or may pass the registration test) or is reasonably confident that native title continues to exist on the land in question, it is prudent to make other enquiries of the relevant Indigenous representative bodies (such as NTRBs) or traditional owners. These interested parties particularly the relevant NTRB will assist the member in gaining an understanding of the ambit of existing or likely native title claims. Also, such enquiries will establish whether or not native title is a consideration for the particular task at hand.

In addition, other Indigenous records and information can be obtained from State or Territory Indigenous heritage authorities and their Registers. The District or Regional Offices of the relevant National Parks and Wildlife Authorities may be able to assist with detailed information about local Indigenous people and their relicry. Local historical societies are also important resources as they often hold rare and valuable information about early non-Indigenous settlement and their interface with the local Indigenous people.

All of the above will assist the member in providing the client with factual and dispassionate information thereby enhancing the level of service provided and discharging the member's professional obligations.

### 3.7 Site Inspection

A Member conducting an inspection of a property for the purpose of providing a valuation or other property assessment should be aware of the potential of coexisting native title prior to the inspection.

During an inspection for this purpose, the Member should attempt to identify from on-site observations any physical evidence of Aboriginal cultural heritage site and items that could suggest the exercise of native title rights. Members should be aware that the presence of physical evidence of Indigenous occupation is not necessarily a good diagnostic marker for native title in many areas of Australia. Whilst not conclusive, nevertheless the Member should look for evidence of camp sites, other occupation sites, natural or introduced food or remains or other disturbance to soils or vegetation. Finally, the Member should look for any evidence of artifacts or in rocky country, stone grooves, rock paintings, or other utilitarian or artistic evidence.

Members should exercise great caution if they suspect the presence of such evidentiary material

prior to an on site inspection. It is possible that offence may be unwittingly given to Indigenous people through either photographing such materials, or even by entering an area which has special significance.

If the Member identifies from onsite observations any potential for native title arising from the presence of Aboriginal cultural heritage items and sites, a recommendation should be made for further expert advice where appropriate, or enquiry of potential native title holders.

### 3.8 Role and Expertise

Members should recognise that their role and expertise is limited to the detection and preliminary identification of discoverable physical evidence of Aboriginal cultural heritage items and sites, which may be a diagnostic marker for native title. It should be remembered that sites of significance to Indigenous people are not necessarily evidenced by the presence of recognisable topographical features such as rock outcrops or caves. Such sites can sometimes be present in apparently featureless tracts of land, which would be otherwise ignored by untrained or uninformed observers.

Evidentiary proof of native title and the ascertaining of the ambit of the property rights must be left to those with specialist qualifications in the fields of anthropology and archeology.

Where information is available to the Member on the likely existence of, (and ambit of) native title, this should be provided as an annexure to the Member's report together with a statement as to the literature source and an appropriate qualification. It is recommended that caution should be exercised where heavy reliance is placed on literature, given that the history of Indigenous occupation was not always properly recorded.

### 3.9 Whether Expert Engaged

A member needs to be aware of the results of site inspection raised in 3.7, above: 'Site Inspection' and 3.8, above: 'Role and Expertise' and to do sufficient research to establish whether an appropriate qualified expert should be recommended for engagement. The Member should take detailed case notes, which may not necessarily be used in the preparation of the final report but will provide evidence that the property valuation or assessment was carried out with full regard to the potential existence of native title.

### 3.10 Engaged Qualified Experts

A report by a suitably qualified expert in the field of anthropology or archeology is required to provide evidence that native title is or is not being exercised on land and/or that connection with the land by Indigenous people is extant. The report is critical to the task of the Member in producing a property valuation or assessment of land where native title is present as a co-existing property right.

In providing a report on the property, the suitably qualified expert should address the following issues based upon inter alia field research, oral evidence, and literature:

- present and past Indigenous and non Indigenous land uses;
- locations on the land where these land uses were carried out;
- duration of the land uses;
- on site Indigenous relicry;
- sites of Indigenous spiritual and/or cultural significance;
- level of co-existence of Indigenous and non-Indigenous land uses.

### 3.11 Qualification if no obvious Native Title

If there is no obvious evidence of native title as a result of research or inspection of land by a Member and no expert report is to be made available to the Member, then the Member's report should be suitably qualified to reflect the relevant extent of the Member's expertise in relation to native title and to place the onus upon parties relying upon the report to make their own enquiries.

Although any qualification used should be specifically worded to suit the particular circumstances of the property valuation or assessment, the following clause provides an example of the type of qualification that should be made:

'A visual site inspection and (detail other research) has not revealed any obvious presence of native title. Nevertheless, we are not experts in native title or the property rights derived therefrom and, have not been supplied with appropriate anthropological, ethnoecological and/or ethnographic advice. Therefore, the property valuation or assessment is made

subject to there being no actual or potential native title affecting:

- The value or marketability of the property; (or...)
- The land (... as applicable).

Verification that the property is not subject to co-existing native title interests should be obtained from a suitably qualified expert. Should subsequent investigation show that the land is subject to existing or potential co-existing native title interests this property valuation or assessment will require revision.'

Once a native title claim has been lodged, irrespective of whether it is registered or unregistered, Members cannot include a disclaimer stating that they have ignored native title.

### 3.12 Not Expert

A Member who has the relevant experience or has undertaken the Institute's approved course of studies is entitled to carry out the valuation of co-existing property interests subject to native title.

### 3.13 Recommending a Detailed Native Title Report

It should be recognised by Members that only through exhaustive research can the ambit of Indigenous property rights be verified properly.

Such research is inherently expensive and time consuming, and cannot in itself provide a complete guarantee that such property rights are, or are not present. Only the courts can provide such a definitive declaration.

If, after carrying out preliminary research and site inspections, the Member is concerned or suspects that the property is or could be subject to co-existing native title that could either restrict the future use of the site or mitigate against a financial consideration, the Member is obliged to recommend that the client seek a detailed native title assessment from appropriately qualified professionals. Such advice should be formed having regard to both the current and future financial considerations as well as the future use of the land. A detailed native title assessment by suitably qualified disciplines will include the issues detailed in 3.8, above: 'Role and Expertise', together with such other information as deemed necessary to provide the fullest description of the presence of native title.

Subsequently, it may be necessary for the appointed disciplinary consultants to move into a third stage of consultancy including the preparation of alternative methods of either non Indigenous land management or the exercise of Indigenous property rights and interests.

### 3.15 Where Detailed Information Cannot be Obtained

Where detailed information cannot be obtained, the Member should prepare his/her report on the basis that the property is not subject to a co-existing native title interest, and qualify that report on the basis that some elements of native title rights and interests may exist, and if present, could have an impact on the value, usage or future development of the property. The following provides an example of the type of qualification which may be appropriate in these circumstances:

'From our inspection of the property we consider that there is (or could be) a potential for (detail possible native title rights and interests) to exist and would recommend that advice should be obtained from a suitably qualified expert. Please note that our valuation (or report) has been prepared on the basis of no survival of native title rights and interests. Should the above mentioned expert advice reveal any evidence of native title our valuation (or report) will require revision.'

It is critical that members be aware that the greater the perceived likelihood of native title rights and interests may exist, the stronger the 'qualification' must be and more specific must be the accompanying advice.

## 4.0 Native Title Predictive Practices

### 4.1 Native Title predictive practices changing

The predictive practices for the determination of the likelihood of native title survival is rapidly changing. New investigative field techniques are being developed by the anthropology and archeology disciplines and those who legislate standards (i.e. the Native Title Act 1998 as recently amended). As Professor Garth Nettheim of the Aboriginal Law Centre UNSW states:

"... although we can readily identify areas held by Aboriginal people and Torres Strait Islanders through grants under various Land Rights Acts

over the past 20 years, the task of mapping those residual areas of Australia held as 'native title' has scarcely started.

... The general characteristics of most forms of land title are reasonably well-known. By contrast, the nature of 'native title' rights and interests depend on the laws of the particular Indigenous peoples concerned, and will vary from place to place."<sup>3</sup>

### 4.2 Native Title predictive

The predictive practices which have developed by the disciplines involved in determining the likelihood of the survival of native title, are founded in both established academic literature and existing field practices, especially in the area of anthropology and archeology. Note that the definition of such practices is notoriously difficult and can present some difficulties for members recommending to a client from a panel of appropriately qualified consultants.

### 4.3 Practices Defined Influence on Value of

The influence on value of such practices, will depend on such factors as whether the native title rights and interests are restricted or more diverse. In addition, there is the effect of the possible need for further detailed analysis after the preliminary research.

### 4.4 Co-Existing Interests subject to Native Title Predictive Practices

Predictive practices could involve a detailed review of existing and historic literature, a search of government survey and tenure records, the obtaining of oral evidence from native title claimants, and/or traditional owners, and the testing of any conclusions against other predictive work already published or otherwise available.

A difficulty with any predictive practice is that Indigenous people tend to be reluctant to share their understanding of native title rights and interests, due often to cultural and spiritual imperatives and due to understandable suspicion. It must be remembered that Indigenous cultural heritage is significantly based on spiritual concepts, and there is the danger that areas of significance may attract unwanted attention which could lead to desecration.



### 4.5 New Practices

New practices in the disciplines of anthropology and archeology are developing in the light of current litigation which will almost certainly result in exhaustive testing in the courts of any opinions expressed by such consultants.

However, the cost of predictive practices are already inherently expensive and time consuming, and it must be recognised that clients may be unwilling to undertake such work if the existing Market Value of a property.

Members should keep abreast of research and technological changes relating to predictive practices. Such awareness will assist the member in advising appropriately on the perceived likelihood of the survival of native title rights and interests and the need for clients to seek further information.

Members must avoid giving advice beyond their area of expertise.

## 5.0 Impact on Value of Co-Existing Interests Subject to Native Title: General Issues

### 5.1 Responsible Party for Compensation

Depending upon the relevant Commonwealth or State/Territory legislation, it is as a general rule the responsibility of government to bear the cost of any compensation if practices on the property are proven to have resulted in the loss, extinguishment or impairment of native title.

Any new activity to be authorised on a property, may result in the consent authority (eg. state and local governments, Western Lands Commission) requiring that any compensation be met by the holder of the co-existing interest subject to native title. However, compensation for future acts by third parties only applies to those acts affecting native title after 23 December 1996.

It is noted that present activities on land subject to a co-existing native title interest (or application for a native title determination) are generally unaffected as regards ongoing present uses conducted on the property. Where land use changes are proposed, minor changes may not cause a claim for compensation for the loss, extinguishment or impairment of native title. The important issue here is not whether there is a change of use, but whether the lease permits the

activity. If the lease allows the proposed action there are no native title implications regardless of how the land is currently being utilised.

Members should exercise caution when forming a view as to the affect that a co-existing native title interest (or application for a native title determination) may have on present and future utility of a property. The activities which are permissible, and the procedural pathways to be followed are set out in s.24 of the Native Title Act.

It is necessary for the Member to be thoroughly aware of these activities and procedures in forming a view as to the affect of co-existing native title on present and future utility. Members should be careful that they are not misled to concluding that minor (or greater) changes in utility may or may not be relevant.

In some circumstances, some changes in the nature of activities may merely have been undertaken negligently, and thus inappropriately without the relevant permits and authorities.

Members should be aware that provided lessees abide by the conditions of their potentially co-existing leases, and have exhibited an awareness of cultural heritage obligations, the procedures under s.24 may not have been transgressed.

Members should be aware that Indigenous Land Use Agreements (ILUAs) are becoming more common place, and can apply to any area or class of activity. ILUAs can impact upon property management as to when they are registered, as it is provided for in the Native Title Act that they are binding on the parties to the Agreement. The NNTT has a register of ILUAs throughout Australia.

Due to the specialist advice required in assessing the impact of future activities on the value of co-existing interests subject to native title, members are strongly advised to seek formal advice from appropriately qualified specialists.

### 5.2 Legal Costs

Legal costs arising from the co-existence of interests subject to native title will vary in extent according to the circumstances of each particular property. Members should refer to these costs in their report, where appropriate, and ensure that they are addressed in any subsequent expert preliminary (or detailed) report obtained.

Members should recognise that the potential for litigation or pending litigation may affect marketability and further affect value by deterring prospective buyers of properties.



It should be recognised that there is very little case law in this area and future judicial direction will clarify whether the current valuation methods are appropriate. When considering the impact of native title on co-existing property rights, some guidance is available in the literature<sup>4</sup> and members should endeavour to keep abreast of legal and practice developments.

The effect of legal costs should be included within any discount, or separate contingency figure for the existence (or likelihood) of co-existing native title. This is not dissimilar to the allowance for the effect of legal costs usually recommended to be included within the stigma component of environmental liabilities when contaminated land is valued.

This discount or separate contingency figure should be based upon information either provided by an appropriately qualified expert (in the disciplines of anthropology, ethnoecology or ethnography) or estimated by the member following appropriate legal advice.

As a warning, such discount or contingency figure should always be qualified to inform the client that it is an estimate only and that it may not reflect the costs actually incurred should litigation for compensation eventuate.

### 5.3 Mortgage Security

It is accepted practice that mortgage lenders prefer to lend funds on freehold rather than lessor tenures. Whilst freehold title may be seen as more definite, it should be noted that there are many secure titles which are listed in Schedule 1, Native Title Act 1993 (Appendix 1). These exclusive possession leases do not require that native title be considered, and mortgage lenders would not require any further enquiry.

Nevertheless, for some particular uses, such as industrial:

Leasehold properties effectively only provide an income stream and the present value of this reduces as the loan term continues. Because of this reducing interest and the lesser acceptance of leasehold properties in the marketplace, lenders will usually charge a higher interest rate for this style of property.<sup>5</sup>

In significant areas of Australia where land is subject to native title, the predominant form of property interest is a statutory estate commonly known as a pastoral leasehold.<sup>6</sup> As of the historic absence of freehold interests in such areas,

the security offered to mortgage lenders is the pastoral lease. Because pastoral rights prevail over co-existing native title rights to the extent of any inconsistency (viz. *Wik Peoples –v– State of Queensland*) ((1996 ) 141 ALR 129), there is little concern that these tenures are not secure.

Nevertheless, the perceived dysfunctional nature of co-existing multiple property rights has resulted in a broad public debate since the *Wik* decision. There may be an adverse effect through financiers requiring higher interest rates where there is a view that a property may be diminished in Market Value due to the perceived effect of native title.

It is reported that whilst mortgage lenders do not appear to have made any changes to existing rural loans, it is anticipated that they will exercise greater caution in granting new loans. Members should be aware that the inclusion of 'land rights' as an 'Event of Default' in some security documents has been reported however, this is probably not unreasonable given the developing nature of due diligence. It should also be noted that the term 'land rights' encompasses a broader area of Indigenous property rights than native title, which is recognised by the common law.

It is important to note that the identification of 'land rights' (more correctly, native title) appears to be only viewed adversely if circumstances arise which materially diminish the value of the mortgage security or effect the financial position of the parties.<sup>7</sup>

Members should be aware that mortgage lenders will seek professional advice from them as to whether the value of the security has been reduced, such that the identification of native title (or the possibility thereof) is grounds for an 'Event of Default'. Members have a responsibility to ensure that mortgage lenders are adequately informed of the likelihood of co-existing native title and the consequences for the Market Value of a specific property. This task is undertaken by examining the market sales evidence.

It should be noted that the effect of co-existing native title upon pastoral leases may be analogous to the relatively nominal value effect which occurs when a high tension transmission line easement is placed over freehold land. This effect often amounts to little more than a blemish upon the freehold title, and its Market Value. This should not be construed however as in any way suggesting that the value of native title is merely a residual.

### 5.4 Indemnification Agreements

Where a member is instructed to specifically ignore native title when valuing a co-existing property right, the Institute recommends that to satisfy the standard of practice required by the Courts, and the member's professional obligations, that a Deed of Release and Indemnity be executed protecting the member.

If a Deed of Release and Indemnity is unable to be obtained from the client, the Institute does not consider that the level of best practice as required of members, will be met and the instructions should be returned with appropriate reference to this section of ARPGN 2.

## 6.0 Valuation Approach

### 6.1 Co-Existing Native Title may or may not impact upon Value

The presence of co-existing native title over a property may not necessarily reduce its value within the current class of use. However, there are two scenarios in respect of the impact of coexisting native title.

Firstly, it can be argued that whilst pastoral leases may be subject to an application for a determination, if the pastoralist is utilising the land in a manner which conforms with the rights (specific or implied) and obligations flowing from the grant of the pastoral lease, then the utility and income flow from the business remains unaffected for which there is a long term market demand. In this scenario, the value of the pastoral lease is unaffected and would be supported by appropriate sales evidence.

Secondly, there may be situations where coexisting native title could reduce the value of a pastoral lease, even though utility and income flow from the business remains unaffected. The mere presence of native title may be viewed by potential purchasers as requiring a discount of the value of the pastoral lease. Again, in this scenario such assertions as to value would be supported by appropriate sales evidence.

Given the above qualifications, Members should advise that the property can continue to be used and developed in accordance with its purpose, terms and conditions and subject to any required permits, licenses and authorities.

### 6.2 Two Main Approaches

Where a co-existing native title claim (or the possibility thereof) is identified, it is recommended that one of the following methods should be utilised depending on the specific circumstances:

- Unaffected valuation approach, comparing like with like;
- Special considerations approach because no suitable comparable basis exists.

### 6.3 Unaffected Valuation Basis

Provide a valuation on an unaffected basis, together with an outline of the likely content of any presence of native title and the inclusion of a qualification in the report indicating that the property valuation or assessment does not reveal any diminution due to the possible presence of native title. The example of the type of qualification that should be made is detailed above in 3.11: 'Qualification if no obvious Native Title'.

### 6.4 Affected Valuation Approach

After obtaining the client's approval, the member should arrange for an expert preliminary (or detailed) report to be prepared to provide affirmation that native title is being exercised on land and/or that connection to the land by Indigenous people is extant together with inclusion of costing for any further reports or negotiations.

The Member should then calculate the property's discounted value upon the above expert report. This is critical to the formation of a view by the member as to whether native title necessitates a discounted value being placed on the co-existing pastoral lease (or other less than freehold estate).

Alan Hyam LFAPI, Barrister has provided useful guidance listing the following matters that regard should be had when members attempt to value property subject to native title:

- "The nature of the rights conferred by the native title. It must be established whether they entitle the native people to access only or other rights are conferred, such as, the right to camp or dwell on the land, the right to fish and hunt game.
- The frequency at which the rights will, or are likely to, be exercised; the number of people who may enjoy the rights.
- The number of occasions upon which the rights have been exercised in the past.

- The impact which the exercise of the rights will have on the interest of the co-existing owner in the land.
- The attitude of the hypothetical prudent purchaser to the co-existing rights...<sup>8</sup>

Assessment of the 'affected value' (and hence discount) indicated above would, where sales are available involve the comparative approach. There may be only limited instances where direct comparison of affected property sales can be made, but endeavours should be made to establish whether this sales evidence is available in order that the comparative approach may be successfully applied. With caution, Members should ensure that properties are being compared truly evidence comparability, both in terms of the pastoral lease and the native title thereon.

Members should not make judgements as to the comparability of affected sales without access to the report of experts in relation to any properties sought to be used as comparables.

### 6.5 Detail on How Valuation Reached

Where a discount attributable to native title is applied by a member, it is strongly recommended that full details should be provided as to how the final valuation figure was reached. It is recommended that care be exercised when applying a discount as it was the view in Wik that native title yields to the statutory rights and interests granted by the Crown. In addition, the interests detailed in Schedule 1 of the Native Title Amendment Act 1998 (see Appendix A of this Guidance Note) confirm that those interests are not vulnerable to native title.

The Member should state clearly in the report that the discount applied was arrived at based upon information obtained from expert reports and that the Member has not formed an opinion as to the veracity of that information. A copy of the expert's report should be annexed to the member's report. The discount may be arrived at through sales evidence, income flows or other appropriate market information.

It should be noted that the Institute is concerned that member's discharge their professional responsibility as regards the determination of the discount arising from the likelihood of co-existing native title. To that end, it is recognised that clients may have a particular (and often strong) personal view concerning the effect of native title rights and interests.

In some cases, these views may not be based upon a factual and dispassionate assessment of the consequences of native title claims (or the possibility thereof) upon Market Value of a specific property. It is recognised by the Institute that such situations may impact upon the professional interpersonal relations of member and client.

Extreme caution should be exercised by members in such situations, and given early recognition it is recommended that the member ensures the client is aware of the impartial and independent nature of the market advice that the member is to provide. In the event that the client does not accept the member's professional standpoint the Institute does not consider that the level of best practice as required of members, will be met and the instructions should be returned with appropriate reference to this section of GN27.

### 6.6 Obtain Cost Estimates of preliminary or detailed Expert Report

Members should not provide their own estimate of the cost of expert's preliminary (or detailed) reports. These estimates should only be obtained from appropriately qualified experts.

A preliminary (or detailed) native title report will include the issues detailed in 3.8, above: 'Role and Expertise' and reflect the recommendations in 3.13, above: 'Recommending a Detailed Native Title Report' and 4.0, above: 'Native Title Predictive Practices'. It should be recognised that such research cannot provide members with a complete guarantee as regards Indigenous property rights and caution should be exercised by Members.

The member should clearly state in his or her report that any conclusions based upon the information contained in the preliminary (or detailed) expert report. The Member should advise that an opinion has not been formed as to the accuracy of that expert report.

A failure to include such a qualification could result in the member being held to have adopted without question the conclusions contained in the expert report.

A qualification in the following form or to a similar effect may be appropriate where this method is adopted:

'The valuation opinion contained herein has been formed utilising information and conclusions as to the identification of native title and the ascertaining of the ambit of such property rights obtained from (state name of

expert) on instructions from you. A copy of the (the expert's report is annexed to this report as Annexure 'A'. (The member) has not formed an opinion as to the accuracy of this information or conclusions and accepts no responsibility for them. Any enquiries in relation to this information or conclusions should be directed to (the expert).'

### 7.0 Legislation

#### 7.1 Commonwealth Legislation increasingly complex

Commonwealth legislation dealing with native title and related administrative matters is growing in line with overseas experience. At present, the primary piece of legislation is the Native Title Act (Cth), 1993 (as amended 30 September 1998).

Members are encouraged to obtain an up to date copy of the 2nd edition of the amended Native Title Act, and be aware of Schedule 1 (See Appendix 1) and s24 in particular. Copies are available from commonwealth government bookshops.

The Act provides members with additional useful information, in particular explaining that private freehold and the majority of leasehold interests provide the right to exclusive occupation and extinguish native title. It also highlights that lessor interests may co-exist with native title.

Importantly, the Act highlights that land held by government authorities does not automatically convey exclusive possession, and extinguish native title although the usage or public works may.

#### 7.2 Complementary State/Territory Legislation

Members should be aware that complementary State/Territory legislation is being enacted dealing with native title.

### 8.0 Indemnity Insurance

#### 8.1 Policy Exclusions

Members should be aware of any exclusions within their professional indemnity insurance policy relating to native title or 'land rights'. Because of the newly emerging law in this area, policies may not provide cover in relation to claims arising from or in connection with these matters. In addition, a Member may in some instances not be covered by a policy even where native title or 'land rights' is within their field of expertise. Members should consult their professional indemnity insurance brokers in this regard.

#### 8.2 GST Caution

Since the introduction of the GST on 1st July 2000 specific legal and/or accounting advice will need to be sought regarding the GST implications for this Guidance Note.

##### Footnotes:

- 1 Muir, K This Earth has an Aboriginal Culture Inside. Land, Rights, Laws: Issues of Native Title Series - Issues Paper No. 23 (Canberra: AIATSIS, July 1998), p4
- 2 Native Title Amendment Bill 1997 Supplementary Explanatory Memorandum (Canberra: The Parliament of the Commonwealth of Australia, The House of Representatives, 1996-1997) Cata.No.969571
- 3 Netheim, G 'Which way now for the Wik judgement?' Sydney Morning Herald, 14 January 1997, p13
- 4 The Attorney General's Legal Practice Legal Implications of the High court Decision in the WIK PEOPLES -v- QUEENSLAND Current Advice, Canberra: Attorney General's Department, 23 January 1997
- 5 Australian Institute of Valuers and Land Economists and Royal Australian Planning Institute, Native Title Background Paper (Deakin/Hawthorne: The Institute, 1997)
- 6 Horrigan, B and Young, S (eds) Commercial Implications of Native Title (Annandale: The Federation Press in association with The Centre for Commercial and Property Law, Queensland University of Technology, 1997)
- 7 Sheehan, J and Wensing, E Indigenous Property Rights: New Development for Planning and Valuation, Discussion Paper No. 17 (Canberra: The Australia Institute, March 1998)
- 8 Fingleton, PG, et al. 'Industrial Property' in Australian Institute of Valuers and Land Economists Valuation Principles and Practice (Deakin: The Institute, 1997)
- 9 Sheehan, J 'Native Title and Statutory Estates' (1998) 4:1 Australian Land Economics Review, pp29-35
- 10 op cit, Sheehan, J and Wensing, E, p43.
- 11 Hyam, A 'A Valuation of Native Title Lands' Paper presented to Native Title Workshop AIVLE, Sydney 22nd May 1997

##### Note

Further useful background on native title can be obtained in the Australian Local Government Association (ALGA) 1999, Working with Native Title: A Guide for Local Government publication The Guide is in two parts: Part A describes a six-step process for determining when native title exists, may exist or has been extinguished, and recommended approaches in dealing with land or waters affected by native title. Part B usefully details other sources of information.

## **APPENDIX 1**

### **Scheduled Interests**

The following is a list of scheduled interests which the States and Territories assert to confer a right of exclusive possession that extinguishes native title rights and interests over the land or waters concerned. The list is included in the amended Native Title Act 1993 (Cth) and forms Schedule 1 to the amended Act. For ease of reference, the list has been rearranged in chronological order of the statute under which the interest was created.

#### **NSW**

Public Parks Act 1854

s.5 lease (defined uses)

Crown Lands Occupation Act 1861

s.30 special purposes lease

Crown Lands Act 1884

s.89 special lease

s.90 special lease (defined uses)

s.92 special lease (defined uses)

conditional lease

Public Parks Act 1884

s.6 lease (defined uses)

Crown Lands Act 1895

s.50 residential lease (original or additional)

homestead selection or grant (original or additional)

settlement lease (original or additional)(defined uses)

Crown Lands Act 1889

s.48 residential lease (original or additional)

Western Lands Act 1901

s.23 lease (defined uses)

s.28A special lease (defined uses)

conditional lease

Public Parks Act 1902

s.7 lease (defined uses)

Crown Lands (Amendment Act) 1905

conditional purchase lease – (original or additional)

Crown Lands (Amendment) Act 1912

Crown lease (original or additional; defined uses)

suburban holding (original or additional)

town land lease within an irrigation area

homestead farm (original or additional)

irrigation farm lease or non-irrigable lease

Crown Lands Consolidation Act 1913

s.69A lease (defined uses)

s.74 special lease (defined uses)

s.75 or s.75B special lease (defined uses)

s.76 special lease (defined uses)

s.80 residential lease (original or additional)

s.82A town land lease

Part 111A lease (defined uses)

Div. 3 (Part 111B) lease (defined uses)

homestead selection or grant (original or additional)

settlement lease (original or additional; defined uses)

conditional lease

conditional purchase lease (original or additional)

Crown lease (original or additional; defined uses)

suburban holding (original or additional)

town land lease within an irrigation area

homestead farm (original or additional)

irrigation farm lease or non-irrigable lease

week-end lease

special conditional purchase lease (original or additional)

Returned Soldiers Settlement Act 1916

s.4 lease

Closer Settlement Amendment (Conversion) Act 1943

group purchase lease

closer settlement lease

settlement purchase lease

Kosciusko State Park Act 1944

ss. 11(3) lease

National Parks and Wildlife Act 1967

para.. 30(1)(a) or (b) lease

National Parks and Wildlife Act 1974

para. 151 (1)(a), (b), (c), (d), or (e) lease

Schedule 9A lease (defined uses)

Crown Lands Act 1989

s34 lease (defined uses).

Division 5 (Part 5) lease (defined uses)

#### **VICTORIA**

Land Act 1862

s..XXI, lease

s.XXIII lease

s.XLVIII lease

s.L lease (defined uses)

Amending Land Act 1865

s.13 lease

s.37 lease (defined uses)

s.38 lease

## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 2

Land Act 1869	s.61 grazing allotment lease
s.20 lease	agricultural allotment lease
s.31 lease	agricultural lease
s.33 lease	perpetual lease
s.46 lease	conditional purchase lease
s.45 lease (defined uses)	
Victorian Water Conservation Act 1881	Land Act 1900
s.75 lease	s.19 lease
Land Act 1884	agricultural lease
s.18 lease	agricultural allotment lease
s.44 lease	perpetual lease
s.49 lease (defined uses)	conditional purchase lease
s.92 lease	Land Act 1900 (No.2)
s.94 lease	agricultural allotment lease, or agricultural lease
s.85 drained and reclaimed swamp land lease (defined uses)	perpetual lease
s.91 lease (defined uses)	conditional purchase lease
agricultural allotment lease	Land Act 1901
agricultural lease	s.18 lease
Irrigation Act 1886	s.50 lease (defined uses)
s.118 lease	s.56 grazing allotment lease
Land Act 1890	s.131 drained and reclaimed swamp land lease (defined uses)
s.18 lease	s.142 lease (defined uses)
lease (non-residence licence conditions)	s.143 lease
s.85 drained and reclaimed swamp land lease (defined uses)	s.144 lease
s.97 lease (defined uses)	s.309 lease
s.100 lease	s.311 lease
agricultural allotment lease	s.402 lease
agricultural lease	s.411 lease
Melbourne and Metropolitan Board of Works Act 1890	agricultural allotment lease,
s.147 lease (defined uses)	agricultural lease
s.148 building or improving lease (defined uses)	village community allotment lease
Water Act 1890	township allotment lease
s.68 lease (defined uses)	homestead section lease
s.243 lease (defined uses)	perpetual lease
s.277 lease	conditional purchase lease
s.292 lease (defined uses)	residential lease (selection purchase allotment)
Settlement on Lands Act 1893	non-residential lease (selection purchase allotment)
village community allotment lease	selection purchase lease
township allotment lease	Land Act 1904
homestead section lease	s.28 lease
Land Act 1896	perpetual lease
s.2 lease	Water Act 1905
Land Act 1898	s.213 lease
s.51 (defined uses)	s.299 lease (defined uses)
	Murray Settlements Act 1907
	conditional purchase lease

## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 2

Land Act 1911	conditional purchase lease
s.73 lease	residential lease (selection purchase allotment)
agricultural allotment lease,	non-residential lease (selection purchase allotment)
agricultural lease	selection purchase lease
perpetual lease	
conditional purchase lease	Melbourne and Metropolitan Board of Works Act 1928
residential lease (selection purchase allotment)	s.209 lease (defined uses)
non-residential lease (selection purchase allotment)	s.210 building or improving lease (defined uses)
selection purchase lease	Water Act 1928
	s.184 lease
Land Act 1915	s.299 lease (defined uses)
s.110 drained and reclaimed swamp land lease	Land Act 1933
(defined uses)	conditional purchase lease
s.125 lease (defined uses)	
s.127 lease	Land (Residential Areas) Act 1935
s.128 lease	residence area occupancy right
agricultural allotment lease,	
agricultural lease	Land Act 1941
perpetual lease	ss.126(2) lease
conditional purchase lease	ss.7(2) lease (defined uses)
residential lease (selection purchase allotment)	s.14 lease (defined uses)
non-residential lease (selection purchase allotment)	agricultural allotment lease
selection purchase lease	agricultural lease
	perpetual lease
Land Act 1915 (No 2)	conditional purchase lease
s.4 lease	residential lease (selection purchase allotment)
residential lease (selection purchase allotment)	non-residential lease (selection purchase allotment)
non-residential lease (selection purchase allotment)	selection purchase lease
selection purchase lease	Soldier Settlement Act 1946
Melbourne and Metropolitan Board of Works Act 1915	settlement interim lease
s.209 lease (defined uses)	settlement purchase lease
s.210 building or improving lease (defined uses)	purchase lease
	North-West Mallee Settlement Areas Act 1948
Water Act 1915	perpetual lease (defined uses)
s.184 lease	Land (Development Leases) Act 1951
s.299 lease (defined uses)	development lease
Forests Acts 1918	Land Settlement Act 1953
s.39 lease (defined uses)	perpetual lease
Land Act 1928	Land (Improvement Purchase Lease) Act 1956
s.110 drained and reclaimed swamp land lease	improvement purchase lease
(defined uses)	
s.125 lease (defined uses)	Education Act 1958
ss.126(2) lease	s.17 lease (defined uses)
s.127 lease	s.20A lease (defined uses)
s.128 lease	
s.352 lease (defined uses)	Forests Act 1958
s.356 lease	s.51 lease (defined uses)
agricultural allotment lease	s.57B lease
agricultural lease	Harbour Boards Act 1958
perpetual lease	s.35 lease (defined uses)



## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 2

### Land Act 1958

- s.110 drained and reclaimed swamp land lease (defined uses)
- s.133B cultivation lease
- s.134 lease (defined uses)
- ss.135(2) lease
- s.136 lease
- s.137 lease
- s.151E lease
- s.222A lease
- s.222B lease
- Subdn.1 Div 9 Pt.I lease (defined uses)
- Div.3 Pt.II) perpetual lease (defined uses)
- agricultural allotment lease
- agricultural lease
- conditional purchase lease
- perpetual lease (defined uses)
- residence area occupancy right development lease
- improvement purchase lease
- industrial lease
- industrial purchase lease
- industrial development lease
- settlement interim lease
- settlement purchase lease
- purchase lease
- residential lease (selection purchase allotment)
- non-residential lease (selection purchase allotment)
- selection purchase lease

### Land Settlement Act 1958

- perpetual lease
- conditional purchase lease

### Melbourne and Metropolitan Board of Works Act 1958

- s.235 lease (defined uses)
- s.236 building or improving lease (defined uses)

### Port of Geelong Authority Act 1958

- ss. 46(1) lease (defined uses)
- para.24(2)(b) lease (defined uses)
- para.26B(1)(a) lease (defined uses)

### Port of Melbourne Authority Act 1958

- s.50A lease (defined uses)
- para.50(2)(b) lease (defined uses)
- para.56(A)(1)(a) lease (defined uses)

### Port of Portland Authority Act 1958

- ss.19(2) lease (defined uses)
- para. 17A(2)(b) lease (defined uses)
- para. 17E(1)(a) lease (defined uses)

### Railways Act 1958

- s.76 lease (defined uses)

### Soldier Settlement Act 1958

- ss.43 lease (pending interim lease grant)
- settlement interim lease
- settlement purchase lease
- purchase lease

### Water Act 1958

- s.200 lease
- s.324 lease (defined uses)

### Land Settlement Act 1959

- s.47 lease
- settlement interim lease
- settlement purchase lease
- purchase lease
- temporary lease

### Land (Surf Life Saving Association) Act 1967

- s.3 lease

### Albury-Wodonga Agreement Act 1973

- ss.7(2) lease (defined uses)
- para.15(1)(f) lease (defined uses)

### National Parks Act 1975

- para.19(2)(a) lease or tenancy
- para.19(2)(b) building tenancy
- s.31AA lease (defined uses)
- s.30AA lease or tenancy
- s.32AB lease or tenancy
- s.32B lease or tenancy
- s.32C tenancy (defined uses)

### Emerald Tourist Railway ACT 1977

- para.41(1)(a) lease (defined uses)

### Melbourne Market Authority Act 1977

- para.7(2)(a) lease or tenancy (defined uses)

### Melbourne Wholesale Fruit and Vegetable Market Trust Act 1977

- para.6(2)(a) lease or tenancy (defined uses)

### Crown Land (Reserves) Act 1978

- s.14D lease (defined uses)
- s.16 lease (defined uses)
- s.17C lease (defined uses)
- s.17D lease (defined uses)
- s.22 lease
- s.23 lease
- s.29A lease (defined uses)

## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 2

Railway Construction and Property Board Act 1979	Gold Fields Homestead Act 1870
subpara.21(1)(f)(l) lease (defined uses)	homestead lease
ss.25(3) lease or tenancy	Homestead Areas Act 1872
ss.26(1) lease or tenancy	homestead selection
Government Employee Housing Authority Act 1981	Crown Lands Alienation Act 1876
para.13(1)(i) lease	s.28 lease
Alpine Resorts Act 1983	s.70 special lease
s.28A lease	homestead selection
ss.28(2) lease (defined uses)	Gold Fields Homestead Act Amendment Act 1880
para.28(2)(c) lease (defined uses)	lease
Transport Act 1983	Crown Lands Act 1884
para.47(2)(b) lease (defined uses)	agricultural farm
Rural Finance Act 1988	Gold Fields Homestead Leases Act 1886
settlement interim lease	homestead lease
settlement purchase lease	Crown Lands Act 1891
purchase lease	unconditional selection
Water Act 1989	Mineral Homesteads Leases Act 1891
s.132 lease (defined uses)	homestead lease
Casino Control Act 1991	Agricultural Lands Purchase Act 1894
s.128K lease	agricultural farm
Docklands Authority Act 1991	Agricultural Lands Purchase Act 1897
ss.20(2) lease (defined uses)	agricultural farm
ss.24(1) lease (defined uses)	Land Act 1897
Royal Botanic Gardens Act 1991	s.188 special lease
ss.24(2) lease (defined uses)	agricultural farm
ss.24(3A) lease	agricultural homestead
Melbourne Sports and Aquatic Centre Act 1994	free homestead
ss.24(2) deemed lease (defined uses)	perpetual lease selection
para.24(1)(b) lease (defined uses)	perpetual town allotment lease
Australian Food Industry Science Centre Act 1995	perpetual suburban allotment lease
Port Services Act 1995	prickly pear frontage selection
para.65(4)(d) lease (defined uses)	prickly pear infested selection
Zoological Parks and Gardens Act 1995	unconditional selection
para.33(2)(a) lease (defined uses)	Mining Act 1898
<b>QUEENSLAND</b>	miner's homestead lease (or pursuant to any Act repealed by this Act.)
Alienation of Crown Lands Act 1860	Prickly Pear Selections Act 1901
s.XII lease	prickly-pear selection
Leasing Act 1866	Special Agricultural Homesteads Act 1901
Lease	agricultural homestead
Crown Lands Alienation Act 1868	Special Agricultural Selections Act 1901
s.51 lease	agricultural farm
s.69 special lease	Closer Settlement Act 1906
Gold Fields Town Lands Act 1869	agricultural farm
lease	

## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 2

perpetual lease selection	perpetual suburban lease
perpetual town lease	auction perpetual lease (that is a perpetual suburban lease)
auction perpetual lease (that is a perpetual town lease)	Workers' Homes Act 1919
perpetual country lease	perpetual town lease
auction country lease (that is a perpetual country lease)	auction perpetual lease (that is a perpetual town lease)
perpetual suburban lease	perpetual suburban lease
auction perpetual lease (that is a perpetual suburban lease)	auction perpetual lease (that is a perpetual suburban lease)
settlement farm lease	Sugar Workers' Perpetual Lease Selections Act 1923
unconditional selection	perpetual lease selection
Land Act 1910	Upper Burnett and Callide Land Settlement Act 1923
s.119A lease	grazing homestead
ss.185(2) lease (defined uses)	perpetual lease selection
agricultural farm	Tully Sugar Works Area Land Regulations Ratification Act 1924
agricultural homestead	perpetual lease selection
designed settlement farm lease	perpetual town lease
free homestead	auction perpetual lease (that is a perpetual town lease)
perpetual lease selection	perpetual country lease
perpetual town lease	auction country lease (that is a perpetual country lease)
auction perpetual lease (that is a perpetual town lease)	perpetual suburban lease
perpetual country lease	auction perpetual lease (that is a perpetual suburban lease)
auction country lease (that is a perpetual country lease)	sugar workers' agricultural farm
perpetual country lease without competition	Prickly-pear Land Acts Amendment Act 1930
perpetual town lease without competition	perpetual lease prickly-pear development selection
perpetual suburban lease	prickly-pear development selection
auction perpetual lease (that is a perpetual suburban lease)	Irrigation Acts Amendment Act 1933
perpetual suburban lease without competition	perpetual lease selection
perpetual lease prickly-pear development selection	perpetual town lease
prickly-pear selection	auction perpetual lease (that is a perpetual town lease)
prickly-pear development selection	State Housing Act 1945
settlement farm lease	s.22B term or perpetual lease (defined uses)
special lease (defined uses)	perpetual town lease
unconditional selection	auction perpetual lease (that is a perpetual town lease)
Miners' Homestead Leases Act 1913	freeholding lease
miner's homestead perpetual lease	perpetual suburban lease
miner's homestead lease	auction perpetual lease (that is a perpetual suburban lease)
Clermont Flood Relief Act 1917	perpetual suburban lease without competition
s.8 perpetual lease	
Discharged Soldiers' Settlement Act 1917	
perpetual lease selection	
perpetual town lease	
auction perpetual lease (that is a perpetual town lease)	

## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 2

City of Brisbane (Flood Mitigation Works Approval) Act 1952	auction perpetual lease (that is a perpetual town lease)
perpetual country lease (without competition)	perpetual country lease
perpetual town lease without competition	auction country lease (that is a perpetual country lease)
perpetual suburban lease without competition	perpetual country lease (non-competitive)
Land Acts Amendment Act 1952	perpetual town lease (non-competitive)
designed agricultural selection	perpetual suburban lease
Harbours Act 1955	auction perpetual lease (that is a perpetual suburban lease)
s.64A lease	perpetual suburban lease (non-competitive)
Crown Land Development Act 1959	settlement farm lease
development lease (defined uses)	special lease (defined uses)
Amoco Australia Pty Limited Agreement Act 1961	special lease purchase freehold
s.3 special lease (cl.3 Agt.)	Industrial Development Act 1963
Brigalow and Other Lands Development Act 1962	ss. 6A(2) sub-lease
agricultural farm	para.24(b) lease
perpetual lease selection	Austral-Pacific Fertilizers Limited Agreement Act 1967
purchase lease	s.3 (cl.4(b) Agt) lease
settlement farm lease	s.3 (cl.4(c) Agt) lease
Irrigation Areas (Land Settlement) Act 1962	s.3 (c.4(d) Agt) special lease
agricultural farm	Gateway Bridge Agreement Act 1980
perpetual lease selection	s.4 (cl.1(5)Pt.III Agt.) special lease
perpetual town lease	Mining Titles Freeholding Act 1980
auction perpetual lease (that is a perpetual town lease)	mining titles freeholding lease
perpetual country lease (non-competitive)	Motorways Agreements Act 1987
perpetual country lease	s.4 (cl.1(4)Pt.III Agt) special lease
auction country lease (that is a perpetual country lease)	Land Act 1994
perpetual town lease without competition	ss.57(1) lease (defined uses)
perpetual town lease (non-competitive)	Sched.6 freeholding lease
perpetual suburban lease	term or perpetual lease (defined uses)
auction perpetual lease (that is a perpetual suburban lease)	grazing homestead freeholding lease
perpetual suburban lease without competition	<b>WESTERN AUSTRALIA</b>
perpetual suburban lease (non-competitive)	Land Regulations 1829
settlement farm lease	town land lease (defined uses)
Land Act 1962	Land Regulation 1872
s.176 lease	special occupation land lease
s.343 lease (defined uses)	Land Regulations 1887
ss.207(7) lease	cl.46-53 conditional purchase lease
agricultural farm	Mineral Lands Act 1892
auction purchase freehold	ss.12(5) lease
development lease (defined uses)	Homestead Act 1893
grazing homestead freeholding lease	homestead farm
grazing homestead perpetual lease	homestead lease
perpetual lease selection	
perpetual town lease	

## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 2

Agricultural Lands Purchase Act 1896 lease	Iron Ore (Mount Newman) agreement Act 1964 lease (other than a mineral lease) (defined uses)
Land Act 1898 s.41a lease (defined uses) s.152 lease (defined uses) s.153 town or suburban land lease (defined uses) s.153a lease Pt.V conditional purchase lease Pt.VI conditional purchase lease homestead farm special settlement land lease working man's block lease	Leslie Solar Salt Industry Agreement Act 1966 lease (other than a mineral lease) (defined uses) Dampier Solar Salt Industry Agreement Act 1967 lease (other than a mineral lease) (defined uses) Evaporites (Lake MacLeod) Agreement Act 1967 lease (other than a mineral lease) (defined uses) Iron Ore (Hamersley Range) Agreement Act Amendment Act 1968 lease (other than a mineral lease) (defined uses) Irrigation (Dunham River) Agreement Act 1968 lease (other than a mineral lease) (defined uses)
Mining Act 1904 Pt.VIII miner's homestead lease (defined uses)	Nickel Refinery (Western Mining Corporation Limited) Agreement Act 1968 lease (other than a mineral lease) (defined uses)
Agricultural Land Purchase Act 1909 lease	Alumina Refinery (Pinjarra) Agreement Act 1969 lease (other than a mineral lease) (defined uses)
Land Act 1933 ss.32(1) lease (defined uses) ss.33(3) lease (defined uses) s.116 lease (defined uses) s.117 town land lease (defined uses) s.117A lease (defined uses) Pt.V conditional purchase lease Pt.IV lease (defined uses) homestead farm special settlement land lease working man's block lease	Nickel Refinery (Westing Mining Corporation Limited) Agreement Act Amendment Act 1970 lease (other than a mineral lease) (defined uses) Poseidon Nickel Agreement Act 1971 lease (other than a mineral lease) (defined uses) Iron Ore (Goldsworthy-Nimingarra) Agreement Act 1972 lease (other than a mineral lease) (defined uses) Iron Ore (McCamey's Monster) Agreement Authorisation Act 1972 lease (other than a mineral lease) (defined uses)
State Housing Act 1946-1974 Pt.V worker's dwelling house lease	Iron Ore (Mount Bruce) Agreement Act 1972 lease (other than a mineral lease) (defined uses)
Oil Refinery Industry (Kwinana Agreement) Act 1952 lease (other than a mineral lease) (defined uses)	Alumina Refinery (Worsley) Agreement Act 1973 lease (other than a mineral lease) (defined uses)
War Service Land Settlement Scheme Act 1954 perpetual lease	Nickel (Agnew) Agreement Act 1974 lease (other than a mineral lease) (defined uses)
Broken Hill Proprietary Company's Integrated Steel Works Agreement Act 1960 lease (other than a mineral lease) (defined uses)	Mineral Sands (Eneabba) Agreement Act 1975 lease (other than a mineral lease) (defined uses)
Iron Ore (Hamersley Range) Agreement Act 1963 lease (other than a mineral lease) (defined uses)	Alumina Refinery (Wagerup) Agreement and Acts Amendment Act 1978 lease (other than a mineral lease) (defined uses)
Iron Ore (Hamersley Range) Agreement Act 1963-1968 lease (other than a mineral lease) (defined uses)	Collie Coal (Griffin) Agreement Act 1979 lease (other than a mineral lease) (defined uses)
Iron Ore (Robe River) Agreement Act 1964 lease (other than a mineral lease) (defined uses)	Collie Coal (Western Collieries) Agreement Act 1979 lease (other than a mineral lease) (defined uses)
Iron Ore (Mount Goldsworthy) Agreement Act 1964 lease (other than a mineral lease) (defined uses)	

## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 2

North West Gas Development (Woodside) Agreement Act 1979	agreement of sale and purchase on credit
lease (other than a mineral lease) (defined uses)	
Diamond (Argyle Diamond Mines) Agreement Act 1981	Crown Lands Amendment Act 1881
lease (other than a mineral lease) (defined uses)	credit agreement
Shark Bay Solar Salt Industry Agreement Act 1983	agreement of sale and purchase on credit
lease (other than a mineral lease) (defined uses)	Crown Lands Amendment Act 1882
Camballin Farms (AIL Holdings Pty Ltd) Agreement Act 1985	s.20 lease with right of purchase
lease (other than a mineral lease) (defined uses)	credit agreement
Western Mining Limited (Throssell Range) Agreement Act 1985	agreement of sale and purchase on credit
lease (other than a mineral lease) (defined uses)	Agricultural Crown Lands Amendment Act 1884
Iron Ore (Channar Joint Venture) Agreement Act 1987	Pt.II lease with right of purchase
lease (other than a mineral lease) (defined uses)	Pt. III selector's lease
Iron Ore (Marillana Creek) Agreement Act 1991	credit agreement
lease (other than a mineral lease) (defined uses)	agreement of sale and purchase on credit
<b>SOUTH AUSTRALIA</b>	Crown Lands Amendment Act 1885
Scrub Lands Act 1866	s.29 lease (other than Aboriginal reserve leases)
lease with right of purchase	Crown Lands Consolidation Act 1886
Scrub Lands Act Amendment Act 1867	Pt.II grazing and cultivation lease (defined uses)
lease with right of purchase	Pt.II grazing and cultivation lands lease (defined uses)
Waste Lands Amendment Act 1868-9	Pt.III selector's lease
credit agreement	Pt.XI working man's block perpetual or term lease
agreement of sale and purchase on credit	(other than Aboriginal reserve leases)
Scrub Lands Act Extension Act 1870 – 71	Pt.XI working man's block term lease (defined uses)
lease with right of purchase	Pt.XI homestead block perpetual or term lease (other
Miscellaneous Leases Act 1872	than Aboriginal reserve leases)
s.1 miscellaneous lease (other than Aboriginal reserve	Pt.XI homestead block term lease (defined uses)
leases) (defined uses)	Pt.II lease with right of purchase
Waste Lands Alienation Act 1872	s. 159 miscellaneous lease (other than Aboriginal
credit agreement,	reserve leases) (defined uses)
agreement of sale and purchase on credit	credit agreement
s.39 lease with right of purchase (defined uses)	agreement of sale and purchase on credit
Crown Lands Consolidation Act (No.86) 1877	Crown Lands Amendment Act 1887
s.58 lease with right of purchase	Pt.III lease with right of purchase
s.92 miscellaneous lease (other than Aboriginal	Crown Lands Act 1888
reserve leases) (defined uses)	Pt.II lease with right of purchase (defined uses)
Pt. III (excl.s.58) lease with right of purchase (defined	Pt.VII working man's block perpetual or term lease,
uses)	(other than Aboriginal reserve leases)
credit agreement	Pt.VII homestead block perpetual or term lease
agreement of sale and purchase on credit	(other than Aboriginal reserve leases)
Crown Lands Amendment Act 1880	s. 118 miscellaneous lease (other than Aboriginal
credit agreement	reserve leases) (defined uses)
	perpetual lease (defined uses)
	right of purchase lease (defined uses)
	Crown Lands Amendment Act 1893
	perpetual lease (defined uses)
	lease with right of purchase (defined uses)
	s.80 villager's lease

## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 2

### Closer Settlement Act 1897

- s.11 miscellaneous lease (other than Aboriginal reserve leases) (defined uses)
- perpetual lease (defined uses)

### Broken Hill Proprietary Company Limited's Hummock Hill to Iron Knob Tramways and Jetties Act 1900

- s.8 perpetual lease

### Crown Lands, Closer Settlement, and Blockholders' Loans Amendment Act 1901

- perpetual lease (defined uses)

### Village Settlements Act 1901

- Pt.IV horticultural or commonage land perpetual lease

### Closer Settlement Act 1902

- s.11 miscellaneous lease (other than Aboriginal reserve leases) (defined uses)

### Crown Lands Act 1903

- Pt.IX agreement
- Pt.IX working man's block perpetual or term lease, (other than Aboriginal reserve leases)
- Pt.IX homestead block perpetual or term lease (other than Aboriginal reserve leases)
- s.80 miscellaneous lease (other than Aboriginal reserves leases) (defined uses)
- s.126 miscellaneous lease (other than Aboriginal reserve leases) (defined uses)
- perpetual lease (defined uses)

### Irrigation and Reclaimed Lands Act 1908

- s.24 miscellaneous lease (other than Aboriginal reserve leases) (defined uses)
- irrigation area block perpetual or term lease

### Irrigation and Reclaimed Lands Act 1914

- s.26 miscellaneous lease (other than Aboriginal reserve leases) (defined uses)
- irrigation area block perpetual or term lease

### Crown Lands Act 1915

- Pt.IX working man's block perpetual or term lease, (other than Aboriginal reserve leases)
- Pt.IX homestead block perpetual or term lease (other than Aboriginal reserve leases)
- Pt.VIII horticultural or commonage land perpetual lease
- s.83 miscellaneous lease (other than Aboriginal reserve leases) (defined uses)
- s.128 miscellaneous lease (other than Aboriginal reserve leases) (defined uses)
- perpetual lease (defined uses)

### Returned Soldiers Settlement Act 1915

- perpetual lease (defined uses)
- term lease (defined uses)

### Discharged Soldiers Settlement Act 1917

- perpetual lease (defined uses)
- term lease (defined uses)

### Lyrup Village Association (District Extension) Act 1921

- horticultural or commonage land perpetual lease

### Agricultural Graduates Land Settlement Act 1922

- perpetual lease (defined uses)

### Irrigation Act 1922

- s.48 miscellaneous lease (other than Aboriginal reserve leases) (defined uses)
- irrigation area block perpetual or term lease
- irrigation area town allotment perpetual or term lease

### Hummock Hill to Iron Knob Tramway Extension Act 1927

- s.5 perpetual lease

### Crown Lands Act 1929

- Pt.IX working man's block perpetual or term lease, (other than Aboriginal reserve leases)
- Pt.IX homestead block perpetual or term lease (other than Aboriginal reserve leases)
- Pt V perpetual lease (defined uses)
- Pt.VIII horticultural or commonage land perpetual lease
- s.77 miscellaneous lease (other than Aboriginal reserve leases) (defined uses)
- s.78B miscellaneous lease (other than Aboriginal reserve leases) (defined uses)
- s.182 miscellaneous lease (other than Aboriginal reserve leases) (defined uses)
- s.66A perpetual lease (defined uses)
- s.199 perpetual lease (defined uses)

### Irrigation (Land Tenure) Act 1930

- s.27 miscellaneous lease (other than Aboriginal reserve leases) (defined uses)
- s.44 miscellaneous lease (other than Aboriginal reserve leases) (defined uses)
- irrigation area block perpetual or term lease
- irrigation area town allotment perpetual or term lease

### Discharged Soldiers Settlement Act 1934

- perpetual lease (defined uses)
- term lease (defined uses)

### Broken Hill Proprietary Company's Indenture Act 1937

- lease (cl.11 Indenture in Schedule to Act) (defined uses)



## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 2

Marginal Lands Act 1940

perpetual lease (defined uses)

National Parks and Wildlife Act 1972

s.35 lease (defined uses)

Crown Lands Development Act 1943-1973

perpetual lease (defined uses)

War Service Land Settlement Agreement Act 1945

perpetual lease (Agt in Schedule to Act)

### TASMANIA

Crown Lands Act 1890

s.81 lease

s.82 lease

s.24 lease (defined uses)

Crown Lands Act 1903

ss.128(1) lease

ss 128(2) lease (defined uses).

s. 24 lease (defined uses)

s.129 lease

Crown Lands Act 1911

ss.108(1) lease

ss.108(2) lease (defined uses)

s.11 lease (defined uses)

s.109 lease

Closer Settlement Act 1929

Pt.V (excl. s.41-2) lease (defined uses)

Crown Lands Act 1935

ss.7(2) lease (defined uses)

ss.77(1) lease

ss.77(4) lease (defined uses)

s.23 lease (defined uses)

s.78 lease

building lease

Crown Lands Act 1976

s.29 lease (defined uses)

### NORTHERN TERRITORY

Northern Territory Land Act 1872 (South Australia)

s.30 lease

s.81 lease

s.83 special purposes lease (defined uses)

Northern Territory Crown Lands Consolidation Act 1882 (South Australia)

s.30 lease

s.77 lease

s.79 special purposes lease (defined uses)

Northern Territory Crown Lands Act 1890 (South Australia)

s.54 lease

s.77 special purposes lease (defined uses)

s.78 special purposes lease (defined uses)

s.78 lease (defined uses)

Pt.II lease

Crown Lands Ordinance 1912 (No.3 of 1912)

Div. 3 Pt.III agricultural lease (defined uses)

Div. 3 Pt.III agricultural land lease (defined uses)

Div. 4 Pt.III town land lease (defined uses)

Div. 5 Pt.III miscellaneous lease (defined uses)

Crown Lands Ordinance 1912 (No.8 of 1912)

Div. 3 Pt.III agricultural lease (defined uses)

Div. 3 Pt.III agricultural land lease (defined uses)

Div. 4 Pt.III town land lease (defined uses)

Div. 5Pt.III miscellaneous lease (defined uses)

Crown Lands Ordinance 1924

s.73A garden land miscellaneous lease

Div. 3 Pt.III agricultural lease (defined uses)

Div. 3 Pt.III agricultural land lease (defined uses)

Div.4 Pt.III town land lease (defined uses)

Div.5 Pt.III miscellaneous lease (defined uses)

Crown Lands Ordinance 1927 (Territory of North Australia)

s.69 garden land miscellaneous lease

Div.3 Pt.III agricultural lease (defined uses)

Div.3 Pt.III agricultural land lease (defined uses)

Div.4Pt.III town land lease (defined uses)

Div.5Pt.III miscellaneous lease (defined uses)

Crown Lands Ordinance 1927 (Territory of Central Australia)

s.69 garden land miscellaneous lease

Div.3 Pt.III agricultural lease (defined uses)

Div.3 Pt.III agricultural land lease (defined uses)

Div.4 Pt.III town land lease (defined uses)

Div.5 Pt.III miscellaneous lease (defined uses)

Crown Lands Act 1931 – 1991 (Northern Territory)

s.6A lease

s.16A experimental farm agricultural lease (defined uses)

s.25CF town land lease (defined uses)

s.25CG agricultural lease (defined uses)

s.25CG agricultural land lease (defined uses)

s.25DAA agricultural lease (defined uses)

s.25DAA agricultural land lease (defined uses)

s.25DAA miscellaneous lease (defined uses)

s.68A lease

s.68B lease

## AUSTRALIA REAL PROPERTY GUIDANCE NOTE 2

s.68C lease	Agricultural development lease (Agt. In Sched. to Act) (defined uses)
s.68D lease	
s.68E lease	Crown Lands Act (Northern Territory)
s.68F lease	s.5 lease
s.68G lease	para.26(a) Crown lease (defined uses)
s.68H lease	para.26(b) Crown Lease (defined uses)
s.70 garden land miscellaneous lease	Special Purposes Leases Act (Northern Territory)
s.74A agricultural lease (defined uses)	s.4 special purposes lease (defined uses)
s.74A agricultural land lease (defined uses)	
s.74A town land lease (defined uses)	Mining Gove Peninsula Nabalco Agreement Act (Northern Territory)
s.74D agricultural lease (defined uses)	s.6 special purposes lease (defined uses)
s.74D agricultural land lease (defined uses)	special purposes lease (subcl.4(2) of Agt. In Sched. to Act)(defined uses)
s.74D miscellaneous lease (defined uses)	
s.74D town land lease (defined uses)	
s.74E miscellaneous lease (defined uses)	
s.112A lease	
para.23(b) lease (defined uses)	
para.23(c) lease (defined uses)	
Div.3 Pt.III agricultural lease (defined uses)	
Div.3 Pt.III agricultural land lease (defined uses)	
Div.4 Pt.III town lease (defined uses)	
Div.5 Pt.III miscellaneous lease (defined uses)	
Div.6 Pt.III town land subdivision lease	
Darwin Leases (Special Purposes) Ordinance 1946	
s.2 lease	
Darwin Short Term Leases Ordinance 1946	
s.3 lease	
Church Lands Leases Ordinance 1947	
s.3 lease	
Darwin Town Area Leases Act 1947-1979 (Northern Territory)	
s.4 lease	
s.16A lease	
s.16AA lease	
s.16B lease	
s.16C lease	
s.16D lease	
s.29A lease	
Agricultural Development Leases Ordinance 1956	
s.14 agricultural lease (defined uses)	
s.14 agricultural land lease (defined uses)	
agricultural development lease (defined uses)	
Rice Development Agreement Ordinance 1956	
Agricultural land lease (Agt. In Sched. to Act) (defined uses)	
Agricultural lease (Agt. In Sched. to Act) (defined uses)	

### APPENDIX 2 GLOSSARY

#### Anthropology

The study of humankind's physical characteristics, historical and present geographical distribution, racial classification, group relationships and cultural history.

#### Application

An application for a determination of native title is the document required to be lodged with the Federal Court and the due processes that follow under the Native Title Act 1993 (Cth) or complementary legislation

#### Claim

The rights and interests being asserted in an application for a determination of native title.

#### Ethnoecology

A two fold discipline that deals with cultural or social anthropology, including the comparative and analytical study of cultures combined with the interrelationship of humankind and its environment focussed on natural cycles and rhythms, community development and structure, interaction between different groups of humankind, geographic distributions and population alterations.

#### Ethnography

A branch of anthropology that deals historically with the origin and family relationships (filiation) of races and cultures.

#### Extinguish

In relation to native title, 'extinguishment' means to permanently extinguish the native title rights and interests. This means there is no possibility of their revival after the extinguishment occurs even if the extinguishing act ceases to exist. (Section 237A of the Native Title Act 1993 (Cth)).

#### Land or Waters

In the context of the Native Title Act 1993 (Cth), land or waters refers to:

- inland waters;
- subterranean waters;
- coastal waters within limits of the State or territory, including areas above the low water mark and waters within some bays, or between the coast and some nearby islands; and
- the bed or subsoil under, or airspace over any waters.

#### Non-extinguishment principle

In relation to native title, the 'non-extinguishment principle' means that an activity does not wholly or partially extinguish native title, and that when the activity ceases or is wholly removed, the native title rights and interests again have full effect. (Section 238 of the Native Title Act 1993 (Cth).)

#### Registered native title claimant

Person or persons whose name or names appear in an entry on the Register of Native Title Claims as the applicant in relation to getting a determination of native title in relation to the land or waters.

#### Representative Body

A representative body is an organisation approved by the Commonwealth Minister under the provisions of the Native Title Act 1993 (Cth) to represent the interests of Aboriginal peoples or Torres Strait Islanders within a particular region on native title matters. These bodies are elected local Indigenous land councils or legal aid services that have special responsibility to assist and represent native title holders and claimants. (Section 202 of the Native Title Act 1993 (Cth).)

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# NZRPNG 1 VALUATION OF CONTAMINATED LAND

*The New Zealand Valuation & Property Standards Board issues the following guidance note to all members of the Property Institute of New Zealand and the New Zealand Institute of Valuers.*

## THE VALUATION OF CONTAMINATED LAND

### Introduction

The growing world wide concern on environmental issues and the impact of hazardous substances on human life and real estate property has lead the New Zealand Institute of Valuers to prepare this guidance note for members.

Various studies have identified potential hazards and contaminated sites within New Zealand and make broad assessments of associated issues (refer bibliography). Valuers should be aware of the types of hazard that should warrant further investigation being initiated by either them or their client (acting on the valuer's advice).

In summary the valuer must

- recognise environmentally sensitive situations
- seek (with the client's consent) expert advice where warranted
- properly reflect in the market value of the property, the effect of any adverse environmental considerations.

### Specific considerations

*This note has been prepared by drawing on the work of The Royal Institution of Chartered Surveyors whose permission to reproduce this material from their paper VGN 11 is acknowledged.*

For convenience, pollution and contamination are taken to be synonymous and the latter is used to describe those environmental factors which may have an adverse effect on human safety or significantly affect the environmental quality of land or buildings.

The importance of contamination to valuers in particular depends upon:

- (a) the state of knowledge at any time of the existence and effect of the particular form of contamination.

- (b) the current interpretation of the law.
- (c) the effect of possible changes in legislation.
- (d) current technology and expected changes in technology.
- (e) the previous use of the land/buildings.
- (f) the existing use of the land/buildings.
- (g) the proposed use of the land/buildings; and
- (h) the financial effect of the above.

### Land

There are essentially three broad respects by which land may be affected by contaminants:

- (a) contaminants attached to and contained within the ground itself;
- (b) contaminated water, which may be static or migrating onto or off the site, in ground;
- (c) airborne contaminated gases emanating from substances in the ground.

Accordingly land itself may be physically unsuitable for particular forms of development due to contamination or other physical factors, for five main reasons.

- (i) Naturally occurring ground problems. These include: groundwater, solution of soluble rocks, land slipping, compressibility, movement, chemical effects (radon and methane). These all tend to be related to geology and since they occur naturally can be distinguished from the remainder of this list.
- (ii) Chemical contamination.
  - Waste tips
  - Industrial sites/buildings
  - Gas works
  - Chemical works
  - Animal product works
  - Shipyards
  - Defence and research Establishments
  - Sewage works

Contamination as a result of these uses may cause contamination to water courses.

## NZ VALUATION GUIDANCE NOTE 1

On site, there may be evidence such as: dead ground, ash, settling tanks, spoil heaps, artificial levels, made ground etc. **Direct or indirect local knowledge is important.**

More recently, modern technologies have introduced a wider range of contaminants, both site specific such as petro-chemical plants, power stations and nuclear facilities, and more dispersed in the form of consumer goods and services involving, such as, CFCs.

### (iii) Mineral extraction and processing.

This description covers both surface and underground workings, much of which can be evidenced from records. Often geographically based its effect will vary according to the type of mineral operation and the extent to which unstable or contaminated materials have been tipped into mineral excavations.

### (iv) Disposal of waste by land fill tipping.

### (v) Agriculture and agricultural related industries.

These can cause both chemical and biological contamination to water and land.

## Buildings

Each generation of building technology has experienced its particular defects and failings, typically the use of asbestos, high alumina cement and wood wool slabs. Some of these have structural implications, others have environmental implications.

Air conditioning systems give rise to various concerns: cost in use, quality of environment, bacteriological problems, chemical problems. In the latter case, the use and replacement of CFCs will be an increasing problem, with a high degree of obsolescence.

Some materials may be considered unsuitable by investors.

Looking further ahead, efficiency in energy use will place additional emphasis on insulation materials and buildings may, in the long term be analysed to establish their carbon generation and potential for recycling.

## Current Use

The actual process of the construction of buildings and civil engineering work can cause contamination or diminished environmental quality, both on and off site and above and below the surface.

The use of a building may cause problems, including:

*Air and noise contamination*

*The escape of hazardous materials Waste management and disposal*

Occupiers, landlords and lenders all need to ensure that any contamination arising from the current use of the site is identified by inspection and/or enquiries of site management and that it is recorded.

Valuers should be aware of the impact of the Health and Safety in Employment Act 1992.

## Valuation Basis

The general principle is that the valuer should reflect all relevant issues in his/her valuation.

Unless otherwise instructed the valuer should cause to be made such enquiries as in his/her professional judgement are necessary to establish any existence of, and the probable extent of contamination.

The enquiries may be undertaken by the valuer, an appropriate consultant appointed by the valuer in consultation with the client, or the client or may be met by the client providing information which the valuer considers adequate. The enquiries will be typically part of the valuation procedure of establishing current and past users of the subject land, including enquiries of the relevant authorities.

The type of enquiries would be a result of any initial on-site evidence of contamination or evidence in the location and the user/proposed user of the site.

Any apparent evidence of possible contamination arising from adjacent property should be noted and considered.

In all cases, the valuer is under a duty to advise the client if an issue has been identified which is outside his/her competence, (and for which the appointment of a consultant is recommended prior to the valuation being completed and/or any commitment being made.)

There is a tendency of lenders, sometimes at the insistence of insurers, to ask of valuers questions in standard forms which the valuer is not qualified or able to answer. The valuer should take care not to commit him/herself in such cases just because the instructions imply that the service to be provided so requires.

## The effect on value

A valuer is unlikely to have the skills to undertake an environmental audit or interpret its significance, as it requires detailed technical knowledge and analysis.

The reduction in value attributable to contamination is generally measurable using the same methods and techniques that are used to measure loss in value or depreciation from other causes, for example residual and "before and after" valuation. Valuers should, however,

bear in mind that the market value of a property after remedial works, less the cost of such works may, for various reasons, be either greater or less than the mathematical sum.

Costs to be taken into account by the valuer include:

- (a) clean-up of on-site contamination;
- (b) effective contamination control and management measures;
- (c) re-design of production facilities;
- (d) penalties and civil liabilities for non-compliance;
- (e) indemnity insurance for the future;
- (f) the avoidance of migration of the contamination to adjacent sites;
- (g) the control of migration from other sites; and
- (h) the regular monitoring of the site.

The valuer should consider whether:

- (a) the source of the contamination or hazard can be successfully and economically eliminated; or
- (b) the contamination or hazard cannot be entirely eliminated but can be covered or contained so as to make the property fit for a particular use for a specified, perhaps limited, period; or
- (c) it is possible to mitigate the effect of the contamination or hazard in any way; or
- (d) the contamination or hazard has no effect on the market value of the property for existing use/ alternative use; or
- (e) a negative value may exist, particularly where an authority has a right to take action and charge the "owner".

In those cases, however, where it may be possible to eliminate the source or rectify the effects of the contamination or hazard, then the reported valuation may be assessed taking into account the market's view of the relevant estimated costs of such elimination or rectification together with other influences affecting market value, such as:

- (a) inability to effect a total 'cure';
- (b) stigma;
- (c) the risk of failure of treatment;
- (d) compensation for disturbance or reduced enjoyment of the property or adjoining sites;
- (e) risk of legislation/remedial standards changing;
- (f) a reduced range of alternative uses of the site;
- (g) uncertainty.

There is a need to avoid double counting in company accounts. Where a contingent liability for clean-up has been provided by the entity there may be no need for the

valuer to make a deduction in the valuation assessment. The valuer should consult with management of the entity where appropriate.

Contaminated land issues do not affect only market values of owner-occupied property. They may affect rental valuations and the valuation of freeholds in respect of leases which subsist, and the valuation of the leasehold interests themselves. Valuations in such cases need to reflect the respective responsibilities of the parties and the likely action of the other in cases of breach of those responsibilities, which will usually depend upon the precise wording in the leases. Particular aspects for consideration include repairing covenants and service charge provisions, which relate to the physical condition of both the site and the buildings; rent review clauses, which typically provide for the assumption that all tenants' covenants and statutory requirements have been complied with; and whether the landlord may be able and wish to refuse an application for assignment or oppose the granting of a new lease on grounds of breach of covenant.

Valuation for acquisitions and disposal (including letting) may attract similar considerations. Moreover the cost to a potential purchaser of procuring a report on possible contamination may limit interest and result in vendors deciding to procure surveys for the information of prospective purchasers, who would, however, need to consider the extent of the legal responsibility to them on the part of the provider of the report. Purchasers of the assets of a business as a going concern may require indemnities relating to past contaminative uses, and such requirements may impact upon the valuation.

The potential availability of grant aid, in particular programmes in respect of derelict land, and the roles of government agencies are factors to be considered in preparing valuations, and it may be appropriate to reflect the potential availability of a grant in the valuation. The valuer will carefully consider the appropriateness of so doing where the agency has not yet committed itself to an approved scheme.

All enquiries should be addressed to:

The Standards Committee  
New Zealand Institute of Valuers  
P O Box 27146  
WELLINGTON



## ENVIRONMENTAL ISSUES

### A Selected Bibliography (compiled August 1994)

All the following articles or publications are held in the NZIV library, Wellington and are available on request

NOTE: Readers may update this readings list by reference to Valuers' NewsLine and the New Zealand Valuers' Journal, and the annual Index to the New Zealand Valuers' Journal

## JOURNAL ARTICLES

### The Appraisal Journal

- April 1991
  - Contaminated Properties - Stigma Revisited  
*Peter J Patchin MAI*
  - An Evaluation of the Impact of a Well-Designed Landfill on Surrounding Property Values  
*Donald H Bleich PhD, M Chapman Findley III PhD, G Michael Phillips PhD*
- July 1992.
  - Lenders' Perspectives on Environmental Issues  
*Patricia R Healy & John R Healy Jnr MAI*
  - Owners Get Tax Refund Due to Asbestos  
*NY Appeals Court decision*
- October 1992
  - The Impact of Hazardous and Toxic Material on Property Value: Revisited  
*Bill Mundy MAI PhD*
- January 1993
  - Issues in the Valuation of Contaminated Property  
*James A Chalmers PhD & Scott A Roehr*
  - Impact of Hazardous Waste Sites on Property Value and Land Use: Tax Assessors' Appraisal  
*Michael Greenburgh PhD and James Hughes PhD*

### The Canadian Appraiser

- Autumn 1990
  - Toxic Real Estate and the Role of the Professional  
*Mary C Hall*
- Summer 1991
  - Legal Liability and Toxic Real Estate  
*Larry O Dybvig*

### The Valuer & Land Economist

- Volume 23
  - Impact of Environmental Planning on the Valuation Process, 23:518-21 *Thomas H O*
  - Re-use of Land to Improve the Environment, 23:330-6 - *Thomas H O*
  - Safeguarding the Environment, 23:39-43 - *Blanch j*
- Volume 24
  - Ecology Movement Effecting Land Values, Environmental Impact Studies and the Valuer, 24:364-5 - *Thomas H O*
- Volume 29
  - Valuations - The Impact on Environment Planning - *Robinson I D* January 1986 p5-8
- Volume 31
  - Valuers and the Environment (August 1991 p500-511)  
The impact of hazardous waste on appraisal - *Kerry Herron FVLE*  
The importance of environmental risk management - *Andrew Marr*  
The Hidden risk of industrial investment - *Bevan Schwaiger*  
Contaminated sites - *John T Mundy*

- Volume 31 - Why Valuers should consider Environmental Contamination and Compliance Issues  
- *Peter Menylees* . (November 1991 p567-571)
- Volume 32 - Environmental Liability: Risks for Valuers - *I Hunt* (February 1993 p359)
- Volume 32 - Environmental Liability: Additional Risks for Valuers - *R R Nathans* (February 1993 p363)
- Contaminated Sites: Remediation, Development and Marketing  
- *Annand P G* (November 1993 p598)
- Contaminated Sites: Assessment, Remediation and Value-Added Strategies  
- *McNamara M* (November 1993 p596)
- Contaminated Sites: Lenders' Concerns and Requirements to Reduce En-vironmental Risks  
- *Schwaiger B* (November 1993 p588)
- Contaminated Sites: Standard for Valuation of Contaminated Land in Australia  
- *Spencer J A* (November 1993 p585)
- Volume 33 No 2 - (AIVLE) Contaminated Land Practice Standard (May 1994)

### New Zealand Valuers' Journal

- June 1992 - Environmental Audits - *J D Lynch*
- March 1993 - Effect of Environmental Factors and Pollution. TIAVSC Information Paper # 11
- March 1994 - Environmental liability and the Banker-Valuer Relationship - *Xan Harding*

### Monographs held by the NZW

- Real Estate Issues (Winter 1991) - Lenders' Perspectives on Environmental Issues
- Environmental Counselling Cases
- Landfills Aren't All Bad: Considerations for Real State Development
- How a Garbage Dump Became a Post Office
- The Effects on Residential Real Estate Prices from Proximity to Properties Contaminated with Radioactive Materials
- Current Legal Issues Raised by environmental Hazards Affecting Real Estate
- A Case for an Environmental Real Estate Market
- The Valuation of Contaminated Properties
- Rationalizing Environmental Cleanup
- IAAO Standard. (August 1992) - Standard on the Valuation of Property Affected by Environmental Contamination
- Appraisal Institute of Canada - Contaminated Real Estate Implications for real estate appraisers
- (NZ) Ministry for the Environment - Potentially Contaminated Sites in New Zealand  
A Broad Scale Assessment (November 1992)
- Appraisal Institute - Measuring the Effects of Hazardous Materials Contamination on Real Estate Values: Techniques and Applications
- Royal Forest & Bird Protection Society - Handbook of Environmental Law
- Australian & NZ Environment & Conservation Council - Australian & NZ Guidelines for the Assessment and Management of Contaminated Sites (January 1992)

## **SEMINAR PAPERS HELD IN THE NEW ZEALAND INSTITUTE OF VALUERS LIBRARY**

### **Distance Teaching Seminar 1993**

Seminar No 2 "Environmental issues", papers covering

- Asbestos
- Dairy effluent disposal and noxious dumps
- Environmental issues impacting on the valuation process
  - What a valuer needs to know from a legal perspective
- Contaminated sites - updates for valuers
- Environmental Risk, valuers, and valuations - a banking perspective

### **1994 Auckland Branch AGM**

"The Environment"

Contaminated Land - associated issues for valuers

Valuers in the environment

Some effects of the RMA on property

Organic

Waste Management

Valuing the Environment

All enquiries should be addressed to:

The Standards Committee  
New Zealand Institute of Valuers  
P O Box 27146  
WELLINGTON

*Issued 1 January 1995*

# NZRPNG 2 COUNTER-SIGNING OF VALUATION REPORTS PREPARED BY UNREGISTERED VALUERS

*The New Zealand Valuation & Property Standards Board issues the following guidance note to all members of the Property Institute of New Zealand and the New Zealand Institute of Valuers.*

Members are referred to the New Zealand Institute of Valuers' Code of Ethics, Clauses 1.4, 1.5, 1.6, 2.4.

## 1.0 Introduction

- 1.1 This Guidance Note has been prepared for all members of the New Zealand Institute of Valuers, in particular those registered valuers counter-signing reports prepared by non-registered valuers, often in a "valuer-in-training" situation.

## 2.0 Registered Valuer Responsibility

- 2.1 A registered valuer who signs a valuation report prepared by another person accepts full responsibility for the valuation and content of the report.
- 2.2 The responsibility of registered valuers cannot be limited by the use of conditional clauses in respect to the valuation.

## 3.0 Counter-Signing of Non-Registered Valuer Reports

- 3.1 A registered valuer, counter-signing a report prepared by a non-registered valuer, unequivocally accepts full responsibility for the valuation and contents of the report. Responsibility cannot be limited by the use of conditional clauses.

## 4.0 Recommendations

- 4.1 It is recommended that the registered valuer counter-signing the report inspect the property being valued and be familiar with all physical and valuation aspects pertinent to the property.
- 4.2 It is recommended that the counter-signer liaise with the other parties responsible for preparing the report to ensure accuracy and competency.

## 5.0 Disclosure

- 5.1 The counter-signing registered valuer is to include in the report a statement specifying the level of their involvement in preparing the valuation report.

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## BUSINESS FOCUS

### Purpose

The purpose of this Business Focus section is to outline for Members some of the measures available to improve their businesses through professional development and various forms of communication including reports.

### Benefits to Members and Clients

Most of the Valuation and Property Standards Manual is intended to firstly benefit Members and secondly their clients. It will give Members a better understanding of what the property profession expects of them as Members of the Australian Property Institute and Property Institute of New Zealand while at the same time assisting them to increase the benefits and relevance of the service provided to clients.

### Clients Needs and Problems

The main reason for being in business is to serve and benefit a client. Benefits come from solving client problems. This requires an understanding of client needs and an awareness that those needs for some of our client groups are frequently changing. If we are to remain relevant to them we must know how to change what we do so we continue to solve their problems.

### Forward Looking

The Australian Property Institute and Property Institute of New Zealand have strengthened their focus on Members' client groups and will assist Members in the process of solving clients' property-related problems. Your Institute is constantly looking forward trying to see what is over the horizon and working on appropriate responses.

### Expansion of Business Focus

This Business Focus section will be expanded in the future to provide greater assistance to Members in meeting clients' needs and solving their property-related problems especially as the era of electronic commerce develops. If Members would like to see anything in particular developed to assist them, the Institute would be pleased to discuss their requirements.

The Institute trusts that the Manual and this Business Focus section in particular, will benefit Members and their clients.

### Want to Know More

Visit the Institute's web site:

[www.api.org.au](http://www.api.org.au) or [www.property.org.nz](http://www.property.org.nz)

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# PROFESSIONAL ACTIVITIES

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Business Focus element is to inform Members of various professional activities that can be undertaken to increase expertise and professional standing as a foundation for improved business and/or career prospects as well as contribution to the advancement of the body professional.

### 1.2 Points towards CPD

Most of the activities listed below will qualify for CPD points. Check Business Focus 4: 'CPD Requirements, Activity Planner & Record' for eligibility details.

### 1.3 Professional Groups

Around Australia & New Zealand are groups of Members of the API & PINZ who meet regularly to discuss matters of interest at a professional level and to network and enjoy professional camaraderie. These are usually low cost activities of several hours duration, often featuring a guest speaker. In metropolitan areas it should be possible to find a group that suits your interests and professional activities. Numbers in non-metropolitan areas usually mean only one group per region. Most groups will have a Chairperson as well as other office bearers. These are further opportunities for professional advancement. Contact your Divisional office/ Branch for details of groups near you.

### 1.4 CPD Modules

The Institute's have developed a wide range of module topics to periodically offer Members. These range from several hours duration to full day workshops and some spread over a number of weeks. New topics are constantly being developed to meet demand in our dynamic property area. Most of these run on a cost recovery basis. Contact your Divisional office/Branch for details of modules coming up (though most will mail out flyers with newsletters).

### 1.5 Risk Management Module (RMM)

To further professionalism as an integral component part of bringing about improved Professional Indemnity Insurance market conditions on behalf of members, the Australian Property Institute initiated a compulsory Risk Management Module (course) for all practising valuers as part of the continuing professional development program.

The Risk Management Module includes topics such as best practice, better communication, better client selection, the stages of valuation, principles of law, a review of the API's Rules of Conduct and Code of Ethics together with disciplinary of proceedings and the regulatory framework, professional office procedures and an awareness of insurance issues.

The intent of the Risk Management Module is to curb the deteriorating Professional Indemnity Market conditions which has been characterised by rapidly rising premiums, rapidly rising self insured excesses or deductibles and deteriorating policy wordings.

### 1.6 Conferences

Most API Divisions will hold conferences with some events long established and attracting hundreds of Members and other interested parties. Some conferences are urban focussed while others are rural. While many are held in capital cities and regional centres as appropriate, others are held at resort destinations for those who like to combine professional activities and tax advantages. PINZ holds an annual national conference which attracts more than 500 property professionals, organises national seminars and an annual national audio conference. PINZ Branches provide local seminars and educational events. International conferences are also available. Conferences are not only an excellent way of earning CPD points and gaining knowledge, but they are also an excellent opportunity for networking and catching up with professional acquaintances. And if cost is an issue, some study groups also organise low cost half and one day conferences and workshops. Details on conferences are usually included in Institute publications.

## **BUSINESS FOCUS 1**

### **1.7 Tapes, Videos and Papers**

From some of the above activities a range of tapes, videos and papers are produced and are available for purchase at low cost from the Divisional/Branch offices while videos are often available for hire. These are excellent ways to learn and gain more CPD points at a time and place of your choosing.

### **1.8 Boards, Councils and Committees**

Most API Divisions have Professional Boards and all have Divisional Councils. Most API Divisional Council positions are member-elected while a few are appointed as are Board positions. Potential exists to progress to National Council, National Professional Board and Australian Valuation and Property Standards Board. PINZ operates an elected Board and NZIV operates an elected Council. Reporting to both of these groups are national Committees and Boards together with Branch Committees, All these are excellent opportunities to contribute to the advancement of the profession. The Institutes are keen to have the benefit of input from more recently qualified Members. Occasionally the opportunity arises for Members to be part of short term 'ad hoc' committees, usually to address specific issues.

### **1.9 Articles for Professional Journal**

The Editorial Board of the professional journal of API and PINZ is interested to receive articles of interest from Members. These do not have to be highly technical but can have broad appeal rather than being narrowly focused on local issues.

# REPORTS, CONTENT AND COMPILATION

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Business Focus element is to provide Members with an indication of some of the types of reports which can be produced for clients, what they could contain and how they might be compiled.

### 1.2 Scope

This Business Focus element applies to Members providing an array of reports to clients on a wide range of property types and issues, and for numerous purposes.

### 1.3 Definition

For the purpose of this Business Focus element, a report is any written or oral communication of a property assessment, analysis, consulting service that is forwarded, conveyed or transmitted to the client upon completion of an assignment.

### 1.4 Oral Report

Where a report is conveyed to a client in an oral communication, it is recommended that the advice be confirmed in a hard copy or other electronic or digital format capable of producing a text version. If instructed not to provide anything in writing, it is important to ensure this is noted in the file along with a written record of the oral advice provided.

## 2.0 Report Purpose

### 2.1 Purpose dictates Report Type, Format and Content

Reports can have many names, but most, if not all, property reports are basically aimed at providing solutions to property problems to meet clients' needs and purposes. The problem may be as simple as not knowing some information about a property, it may involve a client's need to know what would be the best use to which to put the property, whether it is suitable security (what are the risks and Market Value)

for a mortgage advance, or as complex as establishing the feasibility of a mixed category, multi-stage development proposed for a rapidly expanding area where the site needs rezoning and remediation of contamination. The purpose for which the client needs the report and the nature of the problem to be solved will both tend to dictate the:

- type of report,
- format of the report, and the
- content of the report.

## 3.0 Types of Reports

### 3.1 Three Main Categories

Most report styles tend to fall into one of the following three categories:

- Self-contained or comprehensive style
- Summary or short form style
- Restricted or proforma style

The substantive content of a report and not the size of the document alone influences which category a report fits into. Each item in each type of report should be addressed in the depth and detail as appropriate for the item, the type of report and purpose.

### 3.2 Self-contained or Comprehensive

A self-contained or comprehensive style report generally 'describes' its information at a comprehensive level of detail. It should contain all information significant to the solution of the property problem. It will often involve in-depth detail on each of many points under numerous headings in sections containing like information.

### 3.3 Summary or Short Form

A summary or short form style report generally 'summarises' its information in a more concise form. It should contain a summary of all information significant to the solution of the property problem. It will often involve one or

## BUSINESS FOCUS 2

several paragraphs summarising in abbreviated narrative or tabular format, the main points under a major heading or section.

### 3.4 Restricted or Proforma

A restricted or proforma style report 'states' much its information in a minimal presentation. The headings are often decided by the client (who tends to be a volume user of Members reports) who requires information briefly stated. It will often involve a combination of brief narrative statements and simple fact statements or bulleted points.

### 3.5 Deciding type or style

In deciding the type or style of report appropriate in any instance, the following should be considered:

- the client's requirements,
- the client's level of understanding of the particular type of property and its market,
- the purpose of the assignment or task.

## 4.0 Report Formats

### 4.1 Institute does not Dictate Format

While the Institute does not dictate the form, format or style of reports, it may assist Members by indicating what could be provided or it may produce formats for particular client groups to enable the benefits of uniformity to be gained.

### 4.2 Word Processor Report Templates and other Useful Features

Modern word processing programs often provide report templates. They also include many features enabling very professional reports to be produced readily. These include:

- page headers and footers
- automatic page numbering
- automatic table of contents
- great variety of font types, sizes and enhancements such as bolding and italics
- table format control
- spell and grammar checks
- import data and graphs
- and many others.

New features are continually being added to these programs. Even if you have an existing program which appears to still be doing the job after three or four years, the advances are well worth the cost of upgrading. Many packages are offered today which include word processing, spreadsheet, database, graphics, organisers and presentation assistants. The package cost is often less than the cost of a single program just a few years ago and there are many more features. Databases can also be used to produce a report while capturing data to add to the database or using information already in it. Making the move can also be an ideal opportunity to upgrade hardware as well. Often, all a client sees of you is the reports you send in. Don't sell yourself short by submitting poorly presented and formatted reports. The annexure to this Business Focus element will also give an indication of how your report could be formatted.

### 4.3 E-commerce Era

The electronic commerce era is gathering pace. In the US and Canada it is already having significant impact on our profession in the residential mortgage reporting market. e-commerce for our profession is not about e-mailing files as many of us at first thought. Reports are generated out of a database and the content transmitted to the client as data fields. A significant number of Australian lenders are already well advanced in their plans in this area. e-commerce will have a significant impact on our professional lives. Our quick uptake in this area will be necessary if we are to remain relevant to our clients in their new ways of doing business. Initial indications are that it will best suit shorter form reports which will need to be consistent in format.

## 5.0 Report Content

### 5.1 Deciding on Content

The content of reports will vary greatly. With comprehensive and summary style reports the content can be decided by focussing on the subject, the purpose and the client's needs or problems and objectives.

### 5.2 Comment on Extent of Process

It is recommended that in each type of report that you comment on the extent of the process of collecting, confirming and reporting data. However this description should not be out of proportion to the length of the report.

With a comprehensive report the full extent of the process should be apparent to the report reader so such comment can be briefly stated.

With a summary report the full extent of the process may not be apparent to the reader, so to protect yourself, summarise the process.

With a Pro-forma report the full extent of the process will not be apparent to the reader so either the pro-forma or a supporting memorandum referenced in the report should describe the process.

**5.3 Reference to File Material**

It is also recommended with the summary and pro-forma reports that reference be made to the existence of appropriately detailed file material in support of the conclusions and that from these a comprehensive report can be compiled by further arrangement.

**5.4 Caution any Limitation on Content**

Where a client requests less content than is considered appropriate for the purpose, it would be prudent to include a covering comment on this limitation in the report noting that the detail is held on file and can be provided by further arrangement, (while also cautioning if the omission of that content could mislead or not adequately inform the client or any party authorised to rely on the report). If any restriction or limitation is imposed by the client on 'normal processes', great care should be taken.

**5.5 Clearly and Logically Presented and Adequately Detailed**

It is important for the content of a report to be clearly and logically presented and adequately detailed for the purpose. This applies especially to self-contained or comprehensive style reports. These will tend to comprise the following main parts:

- Summary - of the report and its findings or recommendations
- Body of the report comprising:
  - Property and/or Project - adequately described for the purpose.
  - Market - relevant dynamics and data.
  - Assessments, Consideration of Issues and Risk Analysis (if relevant).
  - Solutions if relevant.

- Annexures (addenda, appendices etc.) which are generally support material providing additional detail which has often been gathered from other sources.

**6.0 Report Balance**

**6.1 Focus on the Problem and Solution not the Subject**

It is important to keep reports in balance. The description of the subject should not out-weigh your focus on the market and the development of your solution to the property problem. In the past there has been client comment that some reports provide lots of detail about the property but very little about the market or the solution to the 'property problem', and that the position should be reversed.

As a Member and a property professional, your point of difference is your ability to provide solutions to property problems, not just describing property, - which is sometimes well known to the client anyway.

The key is in 'value adding' - putting content in your report which adds to your client's knowledge, not putting in lots of content which the client already knows or is not relevant to the current problem. The information which you have is not knowledge until it is in the hands of a client who can turn it into value. You can turn it into value for your client by solving his property problems with it.

**6.2 Sufficiently Detailed Summary**

Balance is also achieved by understanding the client's requirements and situation. While a client may require a comprehensive report (or in cases where such is warranted and provided), it is becoming increasingly obvious that busy clients do not have time to fully read the whole document. Though many reports provide an 'Executive Summary', often these do little more than indicate that the property has been inspected, that it contains certain improvements and a brief note of the particular property solution. Some clients then have to go through the whole report to prepare their own summary.

Balanced reporting at the 'stand alone' or 'comprehensive' level should provide a summary sufficiently detailed that it could almost pass as a Summary or Short form Report.

The reader should be able to gain an adequate understanding of the subject of the report, the

## BUSINESS FOCUS 2

relevant market, the main considerations and the solution to the property problem. Any aspect of concern can be explored further in the body of the report, the reader can come back to the balance of the report as time permits, or the report can be referred to someone else to follow up. The 'Summary', which could be 2-7 pages long, should touch on the main points of the report so that the reader will gain an overview of the purpose and subject of the report, the relevant market, the main considerations and the solution to the property problem.

### 6.3 Balance in Issues and Language

Balance in report content also requires a balance in the issues addressed and the language used. The report should:

- Objectively address upside and downside potential;
- Not be over-glowing in the positive aspects or unduly critical in negative aspects;
- Not infer things which should be detailed or explained;
- Not avoid or be silent on important issues;
- Not use jargon, abbreviations or unexplained technical terms unless suited to the client;
- Lead to a conclusion clearly supported by the report content.

### 6.4 Balance in Short-form Reports

Balance is also important in summary or short-form reports. While many practices use standard descriptions of a town or city, it looks obvious and out of balance when one suitable for a comprehensive report is inserted into a short-form report. It too should be scaled down to a summary version only.

### 6.5 Challenge of Pro-forma Reports

Pro-forma reports sometimes pose a challenge in deciding just what and how much information needs to be provided. Pro-formas are often designed or utilised by the client to meet a need (usually to gather just the important information in 'stated' or point form covering key aspects only). However, if a particular key aspect of the subject property is so important that the client should be informed beyond the space provided on a fixed field pro-forma, it is appropriate to provide an addenda to the pro-forma.

## 7.0 Report Content Prompters

There are many ways/combinations of techniques to produce a report. With the benefit of word processors, some people save a duplicate copy of a similar property report and change it as necessary. There are several inherent dangers with this method. Firstly, some detail that should be changed or deleted might not be, and secondly, some points that may not have been relevant in the first might be overlooked in the second. Perhaps a safer method is a report layout template containing any standard content with prompters built in. Annexed to this Business Focus element is a Report Compilation Prompter which you can use to select major section headings for your report and points under a range of sub-section headings from which to choose appropriate content. Out of this you can build a report template or shell with your standard content into which you insert the variables based on a selection of the prompters as relevant. While the headings and points are comprehensive, they are not exhaustive. Whatever system you use you will probably find it handy in building your reports. Add to it as necessary.

## **Annexure 1 - Comprehensive Report**

(Nature of Problem Addressed)

Type of Property/Market Segment

Address of Property

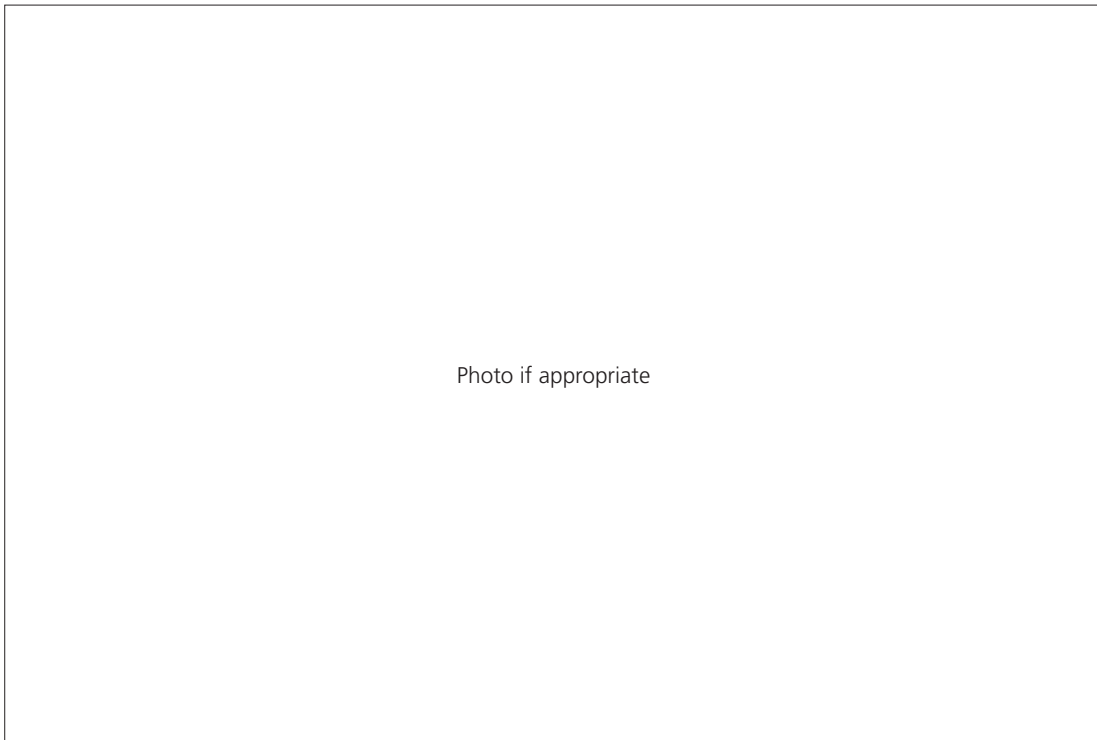


Photo if appropriate

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## BUSINESS FOCUS 2

### TABLE OF CONTENTS

	Page No.
<b>1.0 EXECUTIVE SUMMARY</b> .....	7
1.1 Summary of Report .....	7
(Executive Summary)	
1.2 Recommendations.....	7
1.3 Assessment(s).....	7
<b>2.0 CLIENT</b>	
2.1 Client Details, Purpose and Objectives .....	7
2.2 Required Assumptions and .....	7
Limitations	
<b>3.0 PROPERTY (if appropriate)</b>	
3.1 Title and Property Detail .....	7
3.2 Planning Control .....	7
3.3 City or Town (or nearby main town) .....	7
– by name	
3.4 Location and Locality.....	7
3.5 The Land .....	7
3.6 Services .....	7
3.7 Improvements .....	7
3.8 Construction .....	7
3.9 Occupancy and Outgoings .....	7
3.10 Trading .....	7
<b>4.0 PROJECT (if appropriate)</b>	
4.1 Project Details .....	7
<b>5.0 MARKET ANALYSIS (if appropriate)</b>	
5.1 Marketability .....	7
5.2 Condition of the Market.....	7
5.3 Market Dynamics .....	7
5.4 Market Data (as appropriate).....	7
5.4.1 Property Sales.....	7
5.4.2 Property Rentals .....	7
5.4.3 Rates of Return .....	7
5.4.4 Developer's Profit .....	7
5.4.5 Vacancy Rates .....	7
<b>6.0 ASSESSMENTS (if appropriate)</b>	
6.1 Valuation Approaches .....	7
6.1.1 Sales Comparison Approach .....	7
6.1.2 Capitalisation Approach.....	7
6.1.3 Summation Approach.....	7
6.1.4 Hypothetical Development/ Residual Value Analysis .....	7
6.1.5 Financial Modelling/ Discounted Cash Flow .....	7
6.2 Assessment .....	7
<b>7.0 PROJECT FEASIBILITY (if appropriate)</b>	
7.1 Feasibility Study.....	7
7.2 Sensitivity Analysis.....	7
<b>8.0 ISSUES (as appropriate)</b>	
8.1 Subject Property .....	7
8.2 Project.....	7
8.3 Neighbouring Properties and Neighbourhood .....	7
8.4 Market .....	7
8.5 Assessments.....	7
8.6 Feasibility .....	7
<b>9.0 RISK ANALYSIS (if appropriate)</b>	
9.1 The Property/Project, The Market and Trends.....	7
<b>10.0 STRATEGY (if appropriate)</b>	
10.1 Alternatives.....	7
<b>11.0 RECOMMENDATIONS</b>	
11.1 Recommendations.....	7
<b>ANNEXURES</b> .....	7

## 1.0 Summary

### 1.1 Summary of Report

- Brief summary of client details and objectives
- Note any special conditions, assumptions or limitations required
- Brief summary of the subject of the report
- If includes a project, describe briefly
- Summarise market analysis
- Outline main issues
- Outline main findings

### 1.2 Recommendations

- List Recommendations (or alternatives)
- Report Date
- Signature of Member
- Name, Qualifications etc
- Draw attention to assumptions and limitations contained in report (or list)
- 'Report is for the use only of .....
- 'No extract from this report may be included .....

### 1.3 Assessments

- State the extent of the process of collecting, confirming and reporting data
- What interest has been assessed and for what purpose
- Date of assessment
- Market Value definition
- If a project, define 'as if complete' or 'on completion'
- Assessment in words and figures
- Note any special inclusions or exclusions which are not real property

## 2.0 Client

### 2.1 Client Details, Purpose and objectives

- Client name (if an organisation, include name of instructing representative)
- Purpose for which the report is required
- Statement of understanding of Client requirements and objectives

### 2.2 Required Assumptions and Limitations

- State any assumptions required by client or limitations imposed

## 3.0 Property

In this Section, choose headings as appropriate and re-number

### 3.1 Title and Property Detail

- Known As/Situated
- Legal Description
- Area
- Dimensions
- Title and Reference
- Restrictions, Encumbrances, leases etc. noted therein
- Recorded Ownership
- Nature of interest in the property
- Rating and taxing information

### 3.2 Planning Control

- Zoning and Scheme Reference
- Objectives of the zoning
- Allowable uses without consent
- Allowable uses with consent
- Prohibited uses
- Existing approvals and prior approvals and reference
- Any Heritage implications
- Planning requirements affecting any proposed uses or development
- Community and political environment
- Any Approvals for nearby properties
- Other broad Council policies which could affect the property eg. buffer zones, height restrictions, heritage areas etc.
- Any particularly important State Environmental Planning Policies
- Any proposed changes of zoning or draft plans
- Statutory Charges applicable
- Landscaping requirements

## BUSINESS FOCUS 2

- Carparking requirements
- Sunset clauses
- Subdivision requirements
- Floor Space Ratios
- Site setbacks
- Permitted densities
- Planning Certificates sighted

### 3.3 City or Town (or nearby main town) – by name

- Profile as relevant to the task and client
- Provide extra detail for non-local clients and indicate relative position to main centres

### 3.4 Location and Locality

- Side of street and nearest cross street (distance & direction)
- Nature of street (highway, main arterial, local through street, cul-de-sac)
- Number of lanes, median strip
- Traffic flow
- Locality or suburb name
- Km to CBD
- Nearby development
- Trend - redevelopment
- Changes - traffic flow pattern, population, demographics, new developments, existing traffic generators ceasing or changing operations
- Proximity to beneficial features
- Any particularly adverse features

### 3.5 The Land

- The site has been identified by reference to (DP, Survey Plan etc.)
- Shape
- Size
- Inside/corner
- Elevation in relation to street level
- Slope
- Soil type
- Fill

- Landslip
- Erosion risk
- Drainage
- Flooding or watercourse
- Easements, (or service conduits without easements)
- Suitability for building - geo-technical report required?
- Possible encroachments, setbacks from apparent boundaries
- Impact of adjacent properties
- Aspect
- Views
- Buffer zones
- Other environmental hazards eg. wind, fire, salt air, urban salinity
- Hazardous or offensive development
- Legal access
- Physical ingress/egress for vehicles and pedestrians & ease of
- Passing trade
- Noise Nuisance including flight paths and road noise
- Comment on history of site as a lead in on contamination
- Any apparent cause for contamination concern
- Is any proposed use likely to cause contamination
- Air pollution
- Mine subsidence proclamation area
- Conservation orders or Heritage issues
- Native Title – claim or prospects thereof

#### Rural - (additional to any relevant from above list)

- Altitude (range?)
- Rock
- Millable timber
- Carrying capacity
- Rainfall incidence and variation
- Land slip

- Salting
- Access to & within the property
- Topography
- Original timber
- Average yields crops
- Versatility of land use
- Flooding
- Weeds
- Erosion
- Soil compaction
- Views
- Soil types/areas
- Timber remaining
- Crop types typical and actual
- Drought
- Pests
- Acid soils
- Frost or hail prone
- Home site
- Various SEPP's (NSW) including
- SEPP 14 (Coastal Wetlands)
- SEPP 30 (Feedlots & Piggeries)
- SEPP 37 (Continued Mines & Extractive Industries)
- SEPP 46 (Clearing - Flora & Fauna)

**Farm Improvements (other than main buildings)**

- Internal roads
- Erosion / landslip control measures
- Fencing - boundary & subdivision
- Water - natural, catchment, storage & reticulation, domestic supply
- Irrigation - licences and details, controlling authority, water supply source & cost, reliability & current availability, delivery system & cost, layout, drainage.
- Pasture - types, condition and fertiliser history
- Plantations - type, number/area, age, condition, yields.
- Timber regeneration areas / woodlots

**3.6 Services**

- Electricity
- Gas
- Kerb & gutter
- Schools m/km
- Services adequate
- Water
- Phone
- Footpath
- Shops m/km
- Distance to silos
- Sewer/septic
- Road surface
- Transport m/km
- Parking
- Distance to Markets
- Where relevant, provide location of services

**3.7 Improvements****Main Structure**

- Present use
- Building Type
- Built circa/exact year
- If strata, being one? of x units in the development

**3.8 Construction**

- External walls
- Floors
- Roof covering
- Wall frame
- Footings
- Roof frame
- Internal linings
- Windows
- Ceiling linings
- Shop front
- Ceiling height
- Awning

## BUSINESS FOCUS 2

### Accommodation / Use Areas

- List main rooms / use areas (in a bulleted list or run-on style)

### Approximate Areas

- List each main part of a building and show areas offset to the right

*As applicable:*

Living areas	m2
Patio & Verandah	m2
Garages	m2
Commercial Building	m2 GBA/m2 NLA
Lockup Shop	m2 NLA
Warehouse	m2 GBA

- Functional plan
- Correct design criteria
- If purpose built - adaptable? /alt. uses?
- Adequacy of areas
- Suit current use
- Obsolescence
- Loading areas
- Design aesthetics
- Any obvious non-compliance

### Features and Standard

- Built-in features
- Floor coverings
- Air conditioning
- P.C. Items list/quality
- Window coverings
- Tenant improvements/fit-out
- Light fittings

### Building Services (mainly commercial & industrial)

- Aircond./ventilation
- Special Electrical
- Elevators & escalators
- Sprinklers
- Lighting
- Goods lift
- Hydrants/fire hoses

- Security system
- Special Technology

### Y2000 (Y2K) Compliance CGT Issues Impacting

- Effect on property/business
- Effect on value/security risk
- Market sentiment on issue

### Structural Condition

- List any significant problems or state if none readily apparent.
- Note if engineer's certificate required

### Repairs and Maintenance

- List any significant items/state if no readily apparent major items outstanding
- List major refurbishment or upgrading required and estimated cost

### Pests

- Note any apparent problems/state if no termites or pests evident.
- Recommend inspection by reputable pest control company if warranted

### Occupational Health & Safety

- Asbestos
- Trade Waste
- Un-healthy building

### Farm Buildings and Structures

- Brief description of use, size/capacity of each in bulleted form.

### Ancillary Improvements

- List these in bulleted form broadly classified, (eg. fencing, paving, landscaping, detached minor buildings, carparking, service areas, signage, yard lights etc.)
- If strata, general description of shared amenities, facilities, common property.

## 3.9 Occupancy and Outgoings

Epitome of leases - following detail as available or appropriate

- Premises identification
- Lessee
- Commenced
- Expiry

- Term
- Commencing rent
- Current (passing) rent
- Total occupancy cost
- Area occupied
- Car spaces if included
- Lessee outgoings
- Review method & frequency
- Next review
- Option(s)
- Use permitted by lease
- Unusual provisions
- Option to purchase
- Original or copy
- Sighted
- Signed/Stamped
- Vacancy factor
- Vacancy history
- Standing of major tenants
- Any retail leases legislation compliance
- If a project, asking rents and any pre-commitments
- Incentives offered or required by the market to maintain or attract tenants
- Is the property managed & if so does it appear effective
- Is there any excess land for which no effective rent is paid
- If the property is owner-occupied, what would be reasonable market terms and conditions for a lease
- Term
- Options
- Initial Rent
- Review method
- Review frequency
- Outgoings responsibility
- If the property is not leased at present, allowance for loss of rent and leasing up?

**Comments**

- Occupancy status - vacant/owner-occupied/tenanted
- Note areas unable to inspect and give reason
- Sight rent review documents (comment if not available)
- Terms certain remaining
- Total Passing Rent
- Naming rights rental
- Face rents/effective rents
- Overage rent
- Rack rents
- Reversions
- Characteristics of the income stream
- Security of rental income
- Arrears or non-payment
- Arms length dealing
- Deposits or guarantees held
- Tenant fitouts
- Incentives given
- Highlight leases expiring, options being exercised or new leases pending
- Tenancy mix

Outgoings (*actual or estimated*) and Recoveries (*actual*)

	Outgoings	Recoveries
Rates	\$	\$
Land Tax	\$	\$
Insurance	\$	\$
Repairs and Maintenance	\$	
Cleaning	\$	\$
Air Conditioning	\$	\$
Electricity	\$	\$
Lift Maintenance	\$	\$
Management	\$	\$
Fire Protection	\$	\$
Pest Control	\$	\$
Security	\$	\$
Body Corporate Fees	\$	\$
<b>TOTALS</b>	<b>\$</b>	<b>\$</b>

## BUSINESS FOCUS 2

- Outgoings equate to approximately \$per m2 of **net/ gross** lettable area
- Is major expenditure above normal R&M required to maintain rental levels? Comparison with normal building maintenance costs.

### Rental Income Summary

Rental Income	\$
Plus Recoveries	\$
Gross Rental Income	\$
Less Outgoings	\$
<b>Net Rental Income</b>	<b>\$</b>

### 3.10 Trading

If a specialised trading property and goodwill is included, consider the following:

- Nature of trade and management
- Comments about trade - past, present and trend.
- Outline/summarise trading figures as supplied and/or adjusted
- Adequacy of business records/financial returns kept - if inadequate or not available, what effect on capitalisation rate and marketability.
- Business systems adequacy including Y2K compliance
- Explain any adjustments
- Treatment of chattels, plant and equipment

## 4.0 Project

### 4.1 Project Details

- Describe project/renovation program
- Building approval detail and conditions
- Extent of plans and documentation prepared
- Fees, levies and charges paid to date
- Builder
- Plans & Specifications
- Estimated Cost
- Licence No.
- Engineer's Details
- Work by owner
- Quote/Contract Price

- Construction Period
- Progress Inspections
- Development Program
- If work in progress, indicate:
  - stage of construction
  - Estimated cost of work carried out in relation to contract price
  - Estimated cost to complete the project under the current contract
  - Estimated completion period

## 5.0 Market Analysis

### 5.1 Marketability

- **SWOT** analysis - Strengths, Weaknesses, Opportunities & Threats - go through sections on property and project to address significant aspects especially **location**, and if a project, **timing**
- Overall market appeal and/or status of the property
- Any subdivision potential - position of any structures
- Any onerous encumbrances on title
- If any contamination, is stigma likely after remediation
- Economic/functional obsolescence, costs and merits of remedying
- Code non-compliance - cost and allowable time frame to meet requirements
- Purpose built building - suitability for conversion and cost
- Year 2000 compliance - anything affected e.g. lifts, air conditioning
- CGT Impact on marketability, value and replacement insurance
- Alternative uses
- Is existing use Highest and Best Use otherwise what is
- Physical capacity of site
- If a redevelopment site, demolition, site access problems or cramped site conditions
- Under/over capitalisation

- Any land surplus to current requirements or for which no rental return achieved
- Native Title issues
- Heritage/National Trust issues
- Strength of tenancies
- Any significant reversionary income
- Upcoming vacancies
- Likely tenant profile
- Buyer motivation and requirements
- Vendor motivation
- How good is the total package
- Comparative position in the market place - market segment
- Any measures which would improve the property's market position and advantage
- Is there any 'marriage value' potential
- Is there any potential to fragment or disaggregate the property
- Any inherent factors which could impact favourably or adversely on value
- Any other special factors bearing in mind the purpose of the Report
- Marketing method alternatives
- Marketing strategy
- Any adverse impact of legislation e.g. Disability Discrimination Act

## 5.2 Condition of the Market

- Supply - sales/leasing listings level, private offerings
- Supply trend - new product being constructed/developed, approved
- Asking prices trend
- Demand level - sales/leasing rate, enquiry level, pent up demand
- Demand trend
- Rates of Return (yield) trend
- Buyer's/Seller's market
- Current position in the property cycle
- Prospect of market turning
- Ease of sale/leasing - likely marketing/letting up period

- Vacancy rate and trend
- Rental value trend
- Current marketing/leasing period and trend (if extended, give reasons)
- Incentives being offered/demanded
- Finance availability and cost
- Building cost trend
- Timing of project - anticipated market conditions on completion
- Existing competition - prospects of increased competition
- Prospects of change in Council or Govt. policy or regulations
- General economic indicators - CPI, interest rate climate, bond rate
- Prospect of market rising and/or falling in the short and medium term - local, national or international factors likely to /which might impact on market
- If rural enterprise, price trend for produce - local & global factors affecting
- Current seasonal conditions

## 5.3 Market Dynamics

- Profile of sellers/buyers in this market segment
- Most likely type of buyer
- Profile of lessors/lessees in this market segment
- Most likely type of lessee
- Main market drivers
- Considerations made by typical buyers/sellers, lessors/lessees
- Investor activity
- Mortgagee sales activity
- Motivation of vendors and purchasers/lessors/lessees
- Historical market volatility
- Influence of marketing agents
- Predominate sales/leasing method
- Market sentiment - consumer & business confidence levels & trends, unemployment
- Market price range and typical market segments



## BUSINESS FOCUS 2

### 5.4 Market Data / Market Indicators

#### 5.4.1 Property Sales

- Sources of information
- Sales details and analyses
  - Address/Name of property
  - Legal description
  - Date of Contract
  - Price
  - Land Area
  - Zoning
  - Improvements
  - Lessee
  - Term of lease
  - Net lettable area (NLA) - GBA for industrial
  - Net rent
  - Net Profit
  - Indicates - yield or appropriate unit of value
  - Comments (including any special conditions or circumstances)
- Current/Most recent sale of the subject property - movement since
- Asking prices (including subject property)
- Offers (including for subject)
- Evidence of market movement - recent and long term trend line.

#### 5.4.2 Property Rentals

- General summary of rental levels, or
- When detail readily available and public knowledge:
  - Premises
  - Area occupied
  - Use permitted
  - Car spaces if included
  - Lessee/occupant
  - Term
  - Commenced
  - Expiry
  - Option(s)
  - Review method & frequency

- Next review
- Commencing rent
- Current rent
- Lessee outgoings
- Total cost of occupancy
- State if actual rents on subject are in line with the market
- Any reversionary income for subject property
- If a vacancy exists or occurs at present, could the area be leased at a similar rental and how long could it take to find a new tenant
- If a development project, are the asking rentals achievable and sustainable
- What is level of competition from existing developments and other proposals or developments which could come on-line in a similar marketing period

#### 5.4.3 Rates of Return

- Discuss the relevance and application of each sale which indicates a cap. rate
- Considered range applicable to this property

#### 5.4.4 Developer's Profit

- Where available, provide analysed market evidence of developer's profit
- Where analysed evidence is not available, provide indication of profit expectation

#### 5.4.5 Vacancy Rates

- Historical and current vacancy rate for the subject property
- Historical and current vacancy rate in this market segment
- Vacancy rate trend.

## 6.0 Assessments

### 6.1 Valuation Approaches

Indicate which methods of valuation adopted and why

#### 6.1.1 Sales Comparison Approach

- Brief explanation of what the approach does
- Compare sales with subject property making appropriate adjustments for differences in the property itself and for such factors as movement in the market and in circumstances of sale, or alternatively

- Deduce rates per unit of comparison (m2, unit/flat, hectare etc) and apply to the subject property.
- Indicate value or value range indicated

**6.1.2 Capitalisation Approach**

- Brief explanation of what the approach does
- Set out the approach, which could be along the following lines (adjusted as necessary) and include reference to section of report the figure used was derived from

Rental Income	(section 6.1.2)	\$
<b>Plus Recoveries</b>	(section 6.1.2)	\$
<b>Gross Rental</b>		\$
Less Vacancy	(section 6.1.2)	\$
Outgoings	(section x.x.x)	\$
<b>Net Rental</b>		\$
<b>Capitalised</b> (section x.x.x)	@ % = \$	
	@ % = \$	
	@ % = \$	

**Adjustments**

*Where no effective rent paid for 'excess land'*

<b>Plus</b> Excess land	(section 6.1.2)	\$
-------------------------	-----------------	----

*Where major expenditure required to achieve adopted rental level*

<b>Less</b> Significant		
R & M	(section 6.1.2)	\$
Cost to Convert	(section 6.1.2)	\$

*Where vacant or valued on vacant possession basis*

<b>Less</b> Loss of Rent	(section 6.1.2)	\$
Leasing Fees	(section 6.1.2)	\$
<b>Indicated Value Range</b>		\$

**6.1.3 Summation Approach**

- Brief explanation of what the approach does
- Set out the approach, which could be along the following lines (adjusted as necessary) and include reference to section of report the figure used was derived from

*As applicable:*

Land	\$
Main Structure	\$

Other Improvements	\$
Holding Costs & Entrepreneurial Profit	\$
Goodwill	\$
Licence	\$
<b>Indicated Value</b>	<b>\$</b>

**6.1.4 Hypothetical Development/Residual Value Analysis**

- Brief explanation of what the approach does
- Set out the approach as appropriate to the particular exercise

**6.1.5 Financial Modelling/Discounted Cash Flow**

- Brief explanation of what the approach does
- Set out the approach as appropriate

**6.2 Assessment(s)**

- Explain market sensitivity - value is most probable selling price within a range
- Insert value definition as appropriate:
  - Market Value
  - Alternate use value
  - Value as if complete/Value on completion
  - Rental value etc
- Reconcile the approaches adopted
- Indicate why any of the usual methods may not have been used
- Set out the value(s) adopted

**7.0 Project feasibility (evaluation)**

**7.1 Feasibility Study (Project Evaluation)**

- Refer Real Property Guidance Note 5 [ANZRPGN 5]

**7.2 Sensitivity Analysis**

- Refer Real Property Guidance Note 5 [ANZRPGN 5]

## **BUSINESS FOCUS 2**

### **8.0 Issues**

In this Section, identify and explain the relevance of the issues (under the following headings as relevant) that impact on the needs and objectives of the client or the purpose of the report.

- 8.1 Subject Property
- 8.2 Project
- 8.3 Neighbouring Properties and Neighbourhood
- 8.4 Market
- 8.5 Assessments
- 8.6 Feasibility

### **9.0 Risk analysis**

- 9.1 The Property/Project, The Market and Trends

### **10.0 Strategy (if relevant)**

- 10.1 Alternatives
  - List

### **11.0 Recommendations (if relevant)**

- List

### **Annexures**

- Include as necessary to support and enhance report.

# PROPERTY ACTION PLANS

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Business Focus element is to explain the role of the Member in providing Property Action Planning services to clients.

### 1.2 Scope of this Business Focus Element

This Business Focus element applies to Members providing Property Action Planning services to clients covering any opportunity, threat or problem associated with property.

### 1.3 Definition

Property Action Planning is the provision of suitable and adequate information and sound advice in response to the needs and objectives of a client relevant to any opportunity, threat or problem associated with property.

### 1.4 A Form of Consultancy

Property Action Planning is a form of consultancy which enables Property Professionals to focus their property and market knowledge, apply their research, analytical and technical skills and use balanced judgement in providing sound advice in response to clients' property opportunities, threats and problems. It may relate to purchase or sale of real estate, the development or redevelopment potential of property, or financial management and property planning activities. It can include involvement in purchase and marketing strategies, security risk analysis and risk minimisation, performance analysis and improvement, negotiation and expert representation, project feasibility and sensitivity analysis, potential identification and re-zoning. The range of Property Action Planning consultancy services which Members can offer is very broad given the dynamics of property and their ability to tailor services to a client's particular needs and objectives. Annexed to this Business Focus element is a list of some Property Action Planning scenarios.

## 2.0 Establishing the client's needs and objectives

### 2.1 Develop a Clear Understanding

It is fundamental to develop from the outset a clear understanding of the client's specific needs and objectives. Assuming the initial consultation is in person, this will involve listening to what the client has to say and asking appropriate questions. This will be particularly necessary where the client is a new client or is unsure as to what is required. This process should extend beyond the actual issue to establish the context in which the consultancy is to be carried out. While it may involve developing some understanding of the client's financial arrangements, it should not attempt to supplant the role of a financial planner. A basic understanding of other property assets and longer term objectives of the client will be important in many instances. Other circumstances may need to be considered. The property action plan needs to suit this particular client as well as the property.

It is an action plan for the client, not just for the property.

### 2.2 Confirm in Writing

At the initial consultation, as much information as possible should be taken down at the time in note form. When it appears that the subject has been well covered, summarise the position with the client to ensure you clearly understand his needs and objectives. It would be beneficial to confirm this in writing for the client as well as indicating what plan of action you propose, what type of report you consider appropriate and the basis of your fee. Provide an extra copy of this letter for the client to sign and return as acknowledgment.

### 2.3 Personal Consultation

If initial instructions are received 'in writing', you should arrange an initial personal consultation or if not practical, make verbal contact with the client to help personalise the relationship and open up lines of communication. Any additional information obtained should be noted on file and where appropriate confirmed in writing along with the other matters as referred to above.

## BUSINESS FOCUS 3

### 2.4 The Importance of Communication

Consultancy will often require frequent communication with the client especially if the task is complex, has many phases, involves other experts or involves a development project. If the task will take some weeks or months, it is important to keep your client informed of progress even if no problems are being encountered or you need no additional information from your client. A brief letter every one or two weeks just to let the client know that the Property Action Plan is progressing will do much for the client's peace of mind and your reputation. Of course, it may also be wise to schedule further meetings especially where alternatives need to be considered before progressing the plan.

### 2.5 Obtaining and Relying on Other Experts Reports

Where it is considered that other expert's reports are necessary, you should obtain your client's written approval and an undertaking on payment of the fee (or a confirmation letter signed by the client). You should explain to your client that you will rely on the information provided in arriving at any assessments or recommendations in your Property Action Plan.

### 2.6 An Opportunity to Extend Your Service

At times you may be contacted to simply provide a valuation report, however as you communicate with the client, you may find that the need may actually be for a Property Action Plan. Many clients may not realise just how much assistance you can provide. By letting them know you can increase the benefits you provide and your relevance to them.

## 3.0 Content of Property Action Plans

### 3.1 What Issues to Address

Property Action Planning covers a very broad range of property-related issues addressing clients' needs and objectives. The possible issues to address will therefore be numerous, but by focussing on the subject, the purpose and the client, you will be able to decide what issues to address.

### 3.2 Detailed Report

More often than not, the overall report will be detailed. That is not to say that all sections of the report will need to be detailed. For example, if

the client knows the property well and is primarily interested in development alternatives, planning and timing, then the report on his Property Action Plan should not need a detailed description of the property. It would however, be prudent to include a statement to the effect that 'the property is understood to be well known to the client and for the purpose of the plan is not considered to warrant detailed description, but rather is briefly described as follows'. (Similarly in other cases where only brief or limited detail is provided, some comment should be made as to why this amount was considered adequate.) The report could be expected to be detailed in relation to the specific issues important to the client's needs and objectives. In the above instance, development alternatives, planning and timing and any related assessments, feasibility studies and sensitivity analyses would be detailed. With detailed reports, it is beneficial to provide a very good summary which would probably run to between two and five pages. It should give your client a good overview of the main aspects of the report and the Property Action Plan. As a guide, it should be capable of almost standing on its own as a Summary or Short-form Style Report.

### 3.3 Summary Style Report

Where specifically required by a client, a summary style report can be provided. This could take the form of the first two sections of a detailed report (i.e. summary and client detail) but without a table of contents. In such cases it is recommended that the client section include note of this limitation. This could be to the effect of 'We are instructed to provide a Report Summary only which we are informed is adequate for our client's current requirements. A comprehensive report can be obtained if further and better particulars are subsequently required'.

### 3.4 Checklist

Annexed to this Business Focus element is a short checklist of headings which may be useful as a prompter in the initial consultation. You can use it to decide what the Property Action Plan report will include and the order in which points will appear. In Business Focus 2 [BF 2], there is a Report Compilation Prompter which has a series of dot points as content prompters for each report heading and sub-heading. By no means is the list intended to be exhaustive nor is it intended that you would need to address every point under any selected heading. Use it to help you decide

(or remember) what points to address under the headings you select. You decide the order as well.

### **3.5 Valuation Techniques Applicable but Not Always Required**

Consultancy and Property Action Planning is not divorced from property valuation. Most, if not all of the techniques used in valuation studies are also applicable to the analyses performed in consulting and Property Action Planning. However a Property Action Plan may not require any valuation, or it may use one or more valuations as part of a broader analysis.

### **3.6 Maintain Objectivity and Support Findings**

Although the tools common to valuation and consulting may be used differently in each Property Action Planning assignment, Members should at all times maintain their objectivity and support their findings with facts extracted from competently conducted research. By their nature, Property Action Planning assignments are often more subjective than valuation assignments. Therefore, a Member undertaking a Property Action Planning Assignment should identify and evaluate both facts and judgments and then relate findings to the financial decisions under consideration.

## **4.0 Property Action Plan Workshops**

If you are interested in diversifying your practice by providing this type of service, you may do so as soon as you like. If you wish to be able to use the report formats developed by the Institute, you will need to attend a workshop. This will give you a better understanding of how to provide the service and how to promote it. Contact your divisional office for details of the next workshops nearest to you.

## **Annexure 1 Property Action Plans**

A Property Action Plan is tailored to a client's situation and objectives. It may cover one, or a combination of several, of the following property action plan scenarios involving property, development and construction projects, investments and markets.

- Sale Price Maximisation and Marketing Strategies
- Purchase Price and Purchase Risk Minimisation

- Property Investment Analysis, Assessment and Recommendations
- Property Aggregation Potential and Strategy
- Property Dis-Aggregation to Optimise or Expedite Realisation
- Investment Opportunity Identification and Portfolio Suitability
- Property Portfolio Performance and Composition Review
- Comparative Investment Property Yields and Income Volatility
- Development Alternatives, Planning and Timing
- Re-Development Profit Potential and Risk
- Extension and Refurbishment Cost-Benefit Analysis
- Changing Technology and Regulations Impact Assessment
- Change of Use Potential and Process
- Re-zoning to a more Profitable or Beneficial Use
- Development Consent to Enhance Marketability or Undertake Project
- Highest and Best Use Potential Identification and Capitalisation
- Project Feasibility, Timing and Finance
- Security Risk Analysis, Risk Minimisation and Equity Outlook
- Equity Recovery Maximisation Strategy
- Purchase and Development Funding to Leverage into Opportunities
- Operating Cost Reduction to Improve Return and Add Value
- Holding Cost Minimisation Pending Opportunity Capitalisation
- Specialised Trading Property and Business Opportunity Analysis
- Improving Tenancy Mix to Secure Income and Increase Value
- Public Authority Acquisition Compensation Maximisation
- Property Partition to Resolve Partnership Problems
- Lease Terms and Conditions Advice, Assessment and Negotiation
- Dispute, Tribunal Hearing or Litigation Expert Evidence Presentation
- Insurance Adequacy Advising and Assessment

The range of potential services Members of the API can offer is broad given the dynamics of property and their ability to tailor services to a client's particular needs and objectives.

## **BUSINESS FOCUS 3**

### **Property Action Plan**

Prepared by a Member of the API for

#### **OWNERS**

Sale  
Development Analysis  
Performance Optimisation

Property Action Plans provide relevant, concise and timely advice to meet the needs and objectives of a Client.

Property Action Plans identify and analyse property-specific Strengths, Weaknesses, Opportunities and Threats. A Report sets out recommended client actions to enhance and capitalise on property strengths and opportunities and to minimise and reduce weaknesses and threats. It may also identify areas of uncertainty or concern, recommending specialists reports or production of documents prior to, or as a condition of, any binding agreements. Where warranted, the report also provides appropriate assessments of Market Value or rent.

A Property Action Plan can address such issues as:

- Marketing Strategy
- Purchasing Strategy
- Market Analysis
- Risk Minimisation
- Property Suitability
- Specialists Reports
- Highest and Best Use
- Operating Cost Reduction
- Tenancy Mix
- Yield Analysis
- Holding Cost Minimisation
- Profit Analysis
- Income Volatility
- Development Options
- Timing
- Insurance Adequacy
- Development Consent
- Change of Use
- Cost-Benefit Analysis
- Sensitivity Analysis
- Re-zoning

#### **BUYERS**

Purchase  
Investment Analysis  
Opportunity Identification

**Broad Vision, Balanced Judgement and Sound Advice**

Members of the API look objectively at individual properties or portfolios, initial concepts or development-approved projects. They research and analyse market data and dynamics, bringing broad vision, balanced judgement and sound advice to your Property Action Plan.

**Maximise Profit and Returns**

**Reduce Risks and Expenditure**

**Capitalise on Opportunities**

**Consult a Member of the API for your Property Action Plan**

# CPD REQUIREMENTS, ACTIVITY PLANNER & RECORDER

## 1.0 Continuing Professional Development (CPD) Defined:

Continuing Professional Development is the participation in ongoing education to improve knowledge/skills and develop the personal qualities necessary for the performance of technical, managerial and administrative duties throughout a professional person's career.

## 2.0 Making CPD work for you

Recent years have seen many client-driven changes in the services offered by Property Professionals. Through CPD Members can be certain that they will continue to keep abreast of the knowledge and skills required to successfully compete in an increasingly dynamic and challenging environment. CPD is essential in ensuring that all Members of the API and PINZ maintain a high standard of professionalism. Furthermore a high level of professionalism ensures that clients, employers, the public, government, other professions and relevant parties recognise the Members of the API and PINZ as the premier property professionals in Australia. Therefore CPD is not about collecting points, it is about:

- *Continuing learning throughout your professional life*
- *Professional maintaining knowledge and skills relevant to your work*
- *Development progressing your business, your career and your personal development*

## 3.0 Take stock and plan

Use the Planner in this document to determine:

- Where are you going professionally
- Where do you want to be in one year's time
- What additional knowledge and skills you will need

- Assess your current levels of competence in these areas by using the 'Levels of Competence' table below
- Determine the competence levels you want to achieve by the end of the year
- What CPD will you need to undertake
- What evidence will show that you have achieved your goals.

## 4.0 Levels of competence

### Expert

Acknowledged by others as an authority in the area (subject)

### Skilled

Able to work in the area/use the skills; occasional reference to information is necessary

### Competent

Able to work in this area/use the skills; regular reference to further information is necessary

### Familiar

Some knowledge/skills in the area; requires additional training as well as regular reference to information

### No knowledge/skills

No knowledge/skills in the subject; requires full training

## 5.0 Members choose CPD activities

Each Member can choose the CPD activities from the list below that he/she wishes to undertake. However, a maximum of 10 CPD points (hours) per year will be recognised for on-the-job learning from performing additional/new vocational/professional functions and/or private planned study, i.e., a Member can obtain a maximum of 10 points from private planned study and no



points from learning on-the-job or vice versa or a Member can obtain a maximum of 10 points from a combination of private planned study and learning on-the-job.

### 6.0 CPD Requirements

- CPD is compulsory for all Members who are Graduates, Provisional Members, Associates, Fellows and Life Fellows. Students are not required to undertake CPD since they are already involved in substantial study periods.
- Non-practising and retired Members are only exempt from CPD if they have formally transferred to non-practising or retired status with the API.
- Members must achieve 20 points per calendar year of which at least 10 points must be from Property topics
- Each Member assesses whether or not a given topic qualifies for CPD
- One hour of CPD gives one point
- A maximum of 10 CPD points can be carried over from one year to the next however, Members must obtain a minimum of 10 points per year from Property topics

Property topics cover all areas related to property and can include such areas as the global and Australian economies; foreign language study to service overseas clients; and the study of trends in a particular industry such as cotton if providing valuation or property advice to people engaged in the cotton industry.

If in doubt about whether a topic qualifies as a property topic, Members should contact their Divisional office for confirmation.

- Members who have transferred to the non-practising affiliate class must obtain 20 CPD points prior to their transfer back to their former membership class. They will also be required to complete CPD points for the year of return on a pro-rata basis.
- New Members or Members transferring from affiliate membership part way through the year are required to complete CPD points on a pro-rata basis.
- Members resident overseas may gain 20 CPD points per year from private planned study.

### 7.0 RECOGNISED CPD ACTIVITIES

#### Section 1 of the CPD Record

- attendance at seminars, conferences, workshops, field days, modules as well as breakfasts, luncheons or dinners with keynote speakers on business/property topics conducted by
  - API/PINZ including Study/Discussion Groups
  - other professional associations
  - industry bodies
  - tertiary institutions
  - employers
  - other relevant course providers
- preparation and presentation of papers (one point per hour for both) to API/PINZ, other professional, educational or in-house functions
- authorship of published articles and/or text books or books (one point per hour)
- membership of committees examining technical/professional issues
- membership of an administrative committee of API/PINZ (maximum 2 points p.a.)
- formal individual study provided by distance education courses, programmed learning units, audio and video tapes
- formal study in Property or Business/ Personal Skills resulting in an award such as a certificate or degree

#### Section 2 of the CPD Record

- private planned study in areas relevant to the Property professions

#### Section 3 of the CPD Record

- Additional/New Vocational/Professional Functions

These functions refer to situations where learning takes place on-the-job by performing the function. Undertaking the functions either requires the gaining of new knowledge and/or skills or the improvement of existing knowledge and/or skills.

Examples where the undertaking of additional/new vocational/professional functions can occur include:

- managing the introduction of change (new computer systems, introduction of quality assurance procedures)
- merging with/acquiring a practice/starting your own practice
- being seconded to another organisation/ being seconded or transferred to another department (part) of the organisation
- changed existing job description or new position within same department.

IN SUMMARY, the CPD record contains 3 sections:

Section 1 - record seminars, conferences, in-house training, workshops, modules, papers etc

Section 2 - record private planned study

Section 3 - record learning on-the-job from additional/new vocational/professional functions

To obtain a CPD Certificate of Compliance you are required to complete the relevant sections, total your CPD points, sign and forward your CPD Record to your Divisional Office in Australia or National Office in New Zealand.

## **8.0 Annual CPD Minimum 15% Random Audit of CPD Records**

- A Minimum 15% of Members required to undertake CPD are randomly selected for the audit.

**API/PINZ CPD PLANNER**

New knowledge/skills required or which need updating	Competence Level See table of page 2 Current Desired		Strategies for improving knowledge/skills	CPD Hours	Possible sources of evidence of improvement
<i>Example</i> Cash flow analysis using computers API DCF Practice Standard	Familiar	Competent	Computer course from API or other provider Private Study on API DCF Practice Standard Using cash flows on-the-job	10 3 7	Passing course assessment Acceptance of cash flow analysis by employer/client

**ANNUAL API/PINZ CPD RECORD (for the period 1 January to 31 December 2007)**

Name: .....  
*First Names* ..... *Surname* .....

Address: .....  
 .....  
 Employer: ..... Tel (Work) ..... Fax (Work) .....

Please tick if you wish to receive a CPD Certificate of Compliance

**You must complete the following two questions:**

- Please tick this box if you have completed a valuation during this CPD reporting period (i.e. 1 January to 31 December 2007)
- Please state the last time you completed an API approved Risk Management Module ..... OR  Never  
*Month* *Year*

**Section One**

Date	CPD Activity (eg seminar, conference, workshop, course, tape, technical committee, prepared and presented paper) / Topic / Presenter	CPD Activity Provider (eg API, RMIT, Qld Govt)	CPD Hours	CPD Points (1 point per hour)	
				Property	Non Property
<b>Eg. 20/3/07 Valuation of Specialised Asset Classes – Service Stations</b>					
			2	2	
				Subtotal	

**2007 ANNUAL API/PINZ CPD RECORD** (for the period 1 January to 31 December 2007)

**Section 2 - Private Planned Study Completed During 2007**

Topics Studied	Name of Publication	Author(s)	Publisher	CPD Hours	CPD Points (1 point per hour)	
					Property	Non Property
eg. Easements	Easements – Law & Valuation	Webster, Watkins, Holland	API (Seminar paper)	1	1	-
			Subtotal			

**Section 3 - Additional / New Vocational / Professional Functions Undertaken in 2007**

Additional / New Function(s) Performed	Knowledge/Skills gained or updated from learning on-the-job	Competence Level		Evidence of Improvement	CPD Hours	CPD Points (1 point per hour)	
		2006 Year	End 2007			Property	Non Property
eg. Marketing	Knowledge of marketing strategies for small professional practice	Familiar	Skilled	Developed & implemented marketing plan for small professional practice	8	-	8
Subtotal							
Total 2007 CPD Points							
2006 Points Carried Forward							
Total CPD points							

Note: Maximum of 10 points is recognised for Section 2 plus Section 3

Signature ..... Date .....

## CLIENT FOCUS

### Purpose

The purpose of the Client Focus section is to provide an outline of services available from Members. It also includes tools to assist clients in instructing Members. Additionally it provides advice on feedback to Members and the Institute.

### Benefit Clients, Benefit Members

While it might be said (and rightly so) that the Institute's clients are its Members, the Members' clients (and in some instances their service providers) could be seen as de-facto clients of the Institute. Therefore, anything that the Institute can do to assist or benefit Members' clients should also benefit Members.

### The Valuation and Property Standards Manual for the Benefit of Clients

The Manual is intended both for Members and their clients and interested third parties. It will give them a better understanding of the property profession and what can be expected of Members of the Australian Property Institute and the Property Institute of New Zealand. At the same time it will give Members a clearer focus as to what level of professional performance they should be providing to clients.

### Client Needs

The main reason for being in business is to serve and benefit a client. Normally, benefits come to clients from solving clients' problems. This requires an understanding of clients' needs and an awareness that those needs are frequently changing. The Australian Property Institute and the Property Institute of New Zealand have strengthened their focus on Members' client groups and will assist their Members in the process of solving clients' property-related problems. Sometimes this will require direct dealings by the API or PINZ at high level in client organisations. The API and PINZ welcomes direct contact from clients at this level.

### Expansion

This Client Focus section will be expanded in the future to provide greater assistance to clients in utilising Members' services especially as the era of electronic commerce develops. If clients would like to see anything in particular developed to assist them in dealing with Institute Members, the Institutes would be pleased to discuss requirements.

The Institutes trusts that the Manual, and this Client Focus section in particular, will benefit Members' clients.

### Want to Know More?

Visit the API's Institute's web site at: [www.api.org.au](http://www.api.org.au) and/or the PINZ web site at: [www.property.org.nz](http://www.property.org.nz)

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# TYPES OF SERVICES PROVIDED BY API & PINZ MEMBERS

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Client Focus element is to inform existing and potential clients of API & PINZ Members of the broad range of services Members can provide.

### 1.2 Property is Diverse

It is easy to think of property as real estate alone, yet there are many different classes of property. Property in a broad sense is anything which can be owned or in which an interest can be held, over which some control can be exercised, which can be traded or left in an estate or from which current or future rights to receive benefits can be held. Property can include, but is not limited to, real estate and associated interests therein, personal property, intellectual property, rights, licences and options, plant and machinery, art and jewellery, goodwill and shares. While the majority of Member activities are related to real estate and plant and machinery, the other areas are attracting some specialist focus.

### 1.3 Many Different Capacities

Members of the API & PINZ are involved with property in many different capacities in both the private and public sectors. You will find API & PINZ Members who are:

- Investment trust managers
- Rural property brokers
- Property developers
- Business brokers
- Property finance consultants
- Valuers (real estate and/or plant and machinery)
- Property researchers
- Asset managers
- Sales and leasing negotiators
- Portfolio managers

- Property managers
- Litigation specialists
- Legal practitioners (dual qualifications)

And within each of these capacities you could find Members who specialise in a particular type of property and/or activity. For example, a property developer may specialise in inner city commercial developments or residential land subdivision; a property manager may specialise in shopping centres; a valuer may specialise in hotel or motel valuation or in property acquisition or specialise in certain plant and machinery valuation.

### 1.4 Many Different Services

Many Members have extensive and varied experience in property. This enables them to perform a wide range of tasks on different types of property for varying purposes. You will find Members of the API & PINZ who can provide:

- Property and Advisory Services (see Business Focus 3 – Property Action Plans)
- Valuations and Feasibility Studies
- Sales, Acquisitions and Leasing
- Investment Analysis, Corporate Advisory and Research
- Property and Asset Management
- Property Funds Management
- Development and Project Management
- Plant and Machinery Valuations

API & PINZ Members are skilled, knowledgeable and experienced to identify and capitalise on opportunities, deal with threats and facilitate solutions to property problems. No matter what type of property, no matter what your purpose, needs or objectives, you will find a Member of the API or PINZ who will be able to assist you.



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# INSTRUCTING VALUERS

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## **A Guide for the Mortgage Industry**

This Element of Client Focus is divided into two parts:

- Part A – Instructions and Supporting Documentation (what you should provide when instructing)
- Part B – Report Content (what valuers should provide in their reports)

plus Annexures:

- 1 – Model Standing Instructions (part of terms of engagement)
- 2 – Model Instruction Proforma (individual valuation instruction)

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# PART A – INSTRUCTIONS AND SUPPORTING DOCUMENTATION

## 1.0 Introduction

### 1.1 Purpose

The purpose of this Client Focus element is to provide clients in the mortgage industry who are involved in instructing Valuers, with an understanding of what information should be supplied when ordering a valuation. It also provides an understanding of what information could be expected to be included in the Valuer's report.

### 1.2 Scope

The information contained in this element is for the understanding and benefit of clients in the mortgage industry who instruct Valuers or rely on their reports. This document may also be used by Valuers to assist in the service they provide to clients.

### 1.3 Expert and Impartial Report

For mortgage purposes, a Valuer provides an expert and impartial report on the property, highlighting the security risks associated while incorporating an estimate of the Market Value of a property. Valuers also assess, classify and reflect the separate influences that create, maintain or diminish value. Instructions to Valuers are an essential part of the process of obtaining a report that meets a lender's requirements and which addresses all the relevant issues.

### 1.4 Seek Further Advice In Areas Outside Valuer's Expertise

There are many areas in which Valuers do not claim to be experts. These include, for example, contamination matters, land surveys and legal interpretation of titles. Valuers will, however, if properly instructed report within the extent of their expertise, on the understanding that lenders will seek further advice where necessary on matters outside the Valuer's area of expertise.

### 1.5 Responsibility and Disclaim or Limit Liability

Valuers should be encouraged to view, enquire, analyse and report. This will only occur if there is a clear understanding between lenders and Valuers of their respective areas of responsibility in relation to the lending and valuation process and of the Valuer's right to disclaim or limit liability for matters outside the Valuer's area of expertise.

### 1.6 Market Value

The Australian Property Institute and Property Institute of New Zealand have adopted the International Valuation Standards Committee definition of Market Value:

*the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arms' length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion".*

"Asset" includes property.

[Def. Market Value ]

It is considered that the definition paraphrases the elements of Market Value as defined in *Spencer v The Commonwealth* and it is intended that it includes the essential elements of that definition.

### 1.7 Alternative Value

When preparing mortgage valuations, valuers should exercise caution in understanding valuations based on the doctrine of continuation of the existing use where that used is a specialised use which is not regularly traded in the market place (i.e it can not be supported by a body of market transaction sales evidence).

In circumstances where a valuation is to be relied on for mortgage purposes of a property which is not regularly traded in the marketplace, a valuation on the basis of highest and best alternative use as zoned should be undertaken for mortgage fund advancement purposes. In other words, in the even that the specialised use which is not regularly

## CLIENT FOCUS 2

traded in the market place were to cease, a mortgagee in possession would most likely sell the property based on its highest and best alternative use as zoned.

The definition of alternative use value is one in the same as market value, however ignoring the existing use and adopting the highest and best use of the property under the existing zoning, town planning and development constraints.

### 1.8 General Purpose Instructions

These model instructions are for general purpose properties including commercial, industrial, retail, residential and other urban properties.

### 1.9 Going Concern

A valuation of a property and business trading as a going concern may require the use of further headings, information and documents.

## 2.0 Instructions to the Valuer

### 2.1 Letter of Instruction to the Valuer

A letter of instruction to the Valuer should state the Mortgagee's requirements and provide information to the Valuer in order to assist in the valuation. The information provided can reduce the time taken to complete the valuation, and, more importantly, provide the Valuer with information necessary to provide sound advice to the potential mortgagee. Set out hereunder, are the key elements of the letter of instruction, and the supporting documentation which, if available, should be provided. With specialised properties, such as hotels, motels and similar trading concerns, trading figures constitute essential information.

### 2.2 Form and Content

Instructions to a Valuer should issue from the Mortgagee or its representative, not the borrower. In New Zealand it remains common practice for instructions to be issued by either the borrower or mortgage broker. They should be in writing (or confirmed in writing if verbal initially) and should clearly specify:

- The instructing party and/or,
- The party or parties to whom the valuation is to be addressed.
- The use to which the valuation will be put, ie. mortgage lending, provisioning decisions on

existing loans, mortgage sale advice or other purpose.

- The basis of the valuation will be Market Value (unless requested otherwise).
- The interest to be valued, ie. freehold – fee "fee" simple; leasehold – lessor or lessee's interest; fractional freehold – partial interest.
- The nature of the property - owner occupied or subject to tenancy.
- The date of valuation will be the date of inspection (unless requested otherwise).
- That the valuation should be in accordance with appropriate API & PINZ Practice Standards and Guidance Notes.
- Any additional matters which the valuation should address.
- The basis of and responsibility for the Valuer's fee if not already agreed.
- Details for access and contacts for information and supporting documentation.
- Requirements in relation to supporting documentation.

### 2.3 Fee Paid by Instructor not Borrower

If there are difficulties in determining the basis of the valuation, advice should be sought from the Valuer. The Valuer's fee should be negotiated and paid by the instructing party, not the borrower. In New Zealand it remains common practice for the borrower to issue instructions and pay the fee.

### 2.4 Frequent Instructions warrant Standing Instructions

Where instructions are issued frequently to the same valuer or firm, it may be appropriate to incorporate terms of engagement into a set of Standing Instructions. As firms often have many clients, there is therefore the likelihood of multiple sets of instructions. The Institute therefore supports the adoption of the Model 'Standing Instructions' which are provided for you as Annexure 1 to this element.

### 2.5 Instruction Pro-forma

Where instructions issue frequently and are of a consistent nature, it may be expedient to use a pro-forma. A Model Instruction Pro-forma is provided as Annexure 2 to this element and may be used or adapted for your use. The API will

forward the layout by E-Mail or on disc should you wish, email national@api.org.au

### **3.0 Supporting Documentation**

#### **3.1 Supporting Documentation**

The Valuer will review a number of documents in his investigations and is required to consider all matters affecting the value of the proposed security. Delays in completing a valuation are sometimes caused by the failure to provide all relevant details. The following discussion on individual documents should assist in determining those which should be available and provided with the letter of instruction. Information and documentation provided by the borrower to the Instructor should be identified as such by the Instructor when forwarding this to the Valuer, with where appropriate, an indication as to whether the Valuer should rely on the information or documentation or make further inquiries.

#### **3.2 Certificate of Title Folio Identifier Survey**

It is highly preferable that a current title search is considered by the Valuer and commented upon. Should a current search be available, it should be provided by the Instructor. If this is not available, the correct title description including Lot and Plan number, together with the Folio Identifier or Certificate of title reference, should be provided. If a site survey is available this should also be included.

#### **3.3 Encumbrances**

The Instructor should provide all details within its knowledge on matters affecting the title, for example, details of encumbrances, restrictions or encroachments. It is the Instructor's and/or solicitor's responsibility to confirm title information, encumbrances and restrictions set out in the Valuer's report and any divergence should be referred to the Valuer for comment and amendment of the valuation if necessary.

#### **3.4 Town Planning**

Obtaining a zoning certificate is time consuming and costly and often an excessive requirement for valuation purposes. The Valuer may make independent investigations but should qualify the valuation appropriately. If a current zoning

certificate is available it should be provided to the Valuer. The Valuer should be requested to indicate the source of town planning inquiries and to comment on the current use of the property in relation to the zoning.

#### **3.5 Certificate of Compliance**

Unless construction is obviously not in accordance with building regulations and other ordinances, the Valuer is likely to qualify the valuation to the effect that it is assumed that a Certificate of Compliance is available. Lending institutions may delay advancing funds until the certificate is obtained. It is important, therefore, for intending mortgagees to determine and advise the extent of documentation required. The borrower may be requested to provide information on compliance in some cases.

#### **3.6 Building Plans & Specifications**

Where a proposed or recently completed building or development is involved, detailed building plans and specifications if available, or schematic plans to scale, are of great assistance to the Valuer, and should preferably be a council-approved copy.

#### **3.7 Tenancy Details**

In most circumstances, depending on the nature of a valuation, the Valuer should not be requested or encouraged to rely solely on a tenancy schedule. The Valuer will usually need access to all lease documents and any supporting documents or collateral agreements of which the lender is aware. If only one or two leases exist, copies should be provided otherwise arrangements should be made for all leases and associated documentation to be available in one location for detailed analysis by the Valuer. A vacancy history should be provided. The Valuer may require the owner's consent to verify some lease details with tenants. Any tenancy which is not at arms length from the owner of the property should be identified to the Valuer.

#### **3.8 Outgoings**

For income producing properties, year-to-date budgeted outgoings with actual year-to-date comparisons, are required. If available, actual outgoings for the previous year and estimated outgoings for the ensuing year should also be provided. Any extraordinary items, such as capital works, should be brought to the attention of the Valuer.

## CLIENT FOCUS 2

### 3.9 Miscellaneous Documents

Documentation on pest control, structural stability reports, environmental audits, Department of Main Roads searches, soil surveys, permissive occupancies, licences, environmental impact statements, engineering reports on plant and machinery, should all, if possible, be made available to the Valuer. It is rare for all these to be made available, however, if they are, the end report will give the user more confidence in the property as a security. If any of these searches is not provided, the Valuer may qualify the report appropriately.

### 3.10 Trading Figures

Where the property and business operates as a "going concern", trading figures must be supplied or made available. Ideally an audited three year history of trading figures should be provided. Insufficient or poorly documented trading figures are likely to affect the marketability and the value of the going concern and its suitability as a security.

### 3.11 Turnover

Shopping centre leases often contain clauses where rent is based on turnover. To assist the Valuer to assess the potential rental growth, a full history of turnover should be available. Three years or more is preferable. However, due to changes of ownership and the constant re-mixing of centres, the Valuer may only have one or two year's trading results to consider.

### 3.12 Environmental Issues

Where an Instructor has an environmental assessment report or other environmental documentation which may affect the value of the property, this should be provided. Should the Instructor be aware of any matters which could affect value, or should they have specific environmental policy directives for the type of property, or for the type of industry located on the property, the Valuer should be advised before the time of inspection.

The Valuer is not usually able to provide expert advice on site contamination and this should be acknowledged by lenders so as to encourage Valuers to attempt to identify and report on any possible problems.

The Lender or its solicitor should carry out a search of the STATE or LOCAL AUTHORITY

CONTAMINATED SITES REGISTER where it deems it necessary and advise the Valuer of the results.

### 3.13 Properties Under Construction 'As if Complete'

Where the Valuer is required to value a property under construction on the assumption of 'as if complete' (which assumes the development to be in a completed state as at the date of valuation and reflects current market conditions), the Instructor should provide or arrange supporting documentation for the development. The Valuer should always be requested to provide an 'as-is' valuation (valuing the property with the project to its current stage) as well as the 'as if complete' value.

### 3.14 Report Qualifications

Where a Valuer has been instructed to value a property subject to certain assumptions (completion of construction, signing of leases, etc) the Valuer should qualify the report accordingly. It is important that the lending officer confirms such events (in the case of lease signing) or withholds funds (in the case of construction).

### 3.15 Verbal Enquiries

Due to time delays in obtaining certain information (eg. town planning information) the Valuer may rely on verbal inquiries in these circumstances and the report should be qualified accordingly.

# PART B – REPORT CONTENT

## 4.0 Report Content

### 4.1 Comply with Institute Standards and Guidance

The Australian Property Institute and the Property Institute of New Zealand have developed and continues to develop Practice Standards and Guidance Notes as well as Client and Business Focus sections. These elements, along with the Code of Ethics and Rules of Conduct are incorporated in the Valuation and Property Standards Manual. A lender may elect to simply instruct that the valuer should comply with, and give due recognition to, these elements as far as they apply to the type of property, purpose, issues and professional conduct in the provision of the service including the content of the report.

### 4.2 Report Headings

Alternatively, the Instructor may choose to indicate to the Valuer what should be included or emphasised in the valuation report. This may be done conveniently by the provision of a list of headings indicating matters to be reported upon.

### 4.3 Common Report Headings

The matters considered by a Valuer will vary according to the type of property (industrial, retail, commercial, special purpose, etc) being valued and the purpose of the valuation. They could include the following:

- Valuation Summary
- Introduction
- Land & Title
- Location
- Site Description & Services
- Town Planning/Resource Management
- Statutory Valuation & Charges
- Improvements
- Environmental Matters
- Comments on the Property
- Basis of Valuation
- Tenancy Details

- Valuation Rationale or Approach
- Market Review or Summary
- Risk Analysis
- Valuation
- Qualifications and Disclaimers

The degree of detail provided may also be varied to suit the clients' requirements. The Valuer should consider the property in relation to relevant Institute Practice Standards and Guidance Notes. Pro-forma reports may be provided on some properties. The Australian Property Institute has a pro-forma report format known as PropertyPro

Residential Valuation and Security Assessment (with attendant Supporting Memorandum) specifically for mortgage purposes. Its use is encouraged where a brief report is required on individual residential properties.

PropertyPro is not applicable in New Zealand at this stage.

### 4.4 Annexures or Report Inclusions Where Appropriate

The report may be supplemented by annexures:

- Location Map
- Certificate of Title or Folio Identifier
- Other Searches
- Deposited Plan
- Strata/Unit Plan
- Zoning Certificates (if available)
- Tenancy Schedule
- Sales Evidence\* \* If not in the body of report.
- Rental Evidence\*
- Valuation Calculations\*
- Any Other Relevant Documentation
- Photographs
- Authorities/Persons Consulted

### 4.5 Report Content

The Valuer should incorporate the headings required by the Instructor and address points contained within each heading where such points are appropriate for consideration. Information



## CLIENT FOCUS 2

supplied by the Instructor and assumptions required to be made should be treated as follows:

### 4.6 Information Provided Critically Appraised

Information provided by a borrower or by any other party (including the lender) should be verified by the Valuer as far as possible and critically appraised.

### 4.7 Defined Assumptions

If instructions include the requirement to base the valuation on defined assumptions, the assumptions should be acknowledged and included in the Valuer's report.

### 4.8 Unrealistic or Unusual

Any assumptions or instructions which are either unrealistic, unusual or abnormal should be drawn to the attention of the lender and highlighted in the report. In some circumstances the requirements of the instructing party may be such that the instructions should be declined.

### 4.9 Contents

#### Valuation Summary

A comprehensive style report will usually feature an executive style summary prior to the body of the report. As well as capturing the essence of the report and highlighting any significant risks, it will usually include a certified valuation.

#### Introduction

- The person/party for whom the valuation is being prepared.
- Details of the instructions including any special conditions and/or assumptions.
- The date and basis of the valuation.
- The purpose for which the valuation is to be used, e.g. mortgage purposes.

#### Land and Title

- The title reference of the property and the title description.
- The name of the registered proprietor(s).
- The identification and reporting of title encumbrances such as easements, covenants, rights of carriageway. Comments should be made on the effect of any such matters under the valuation section of the report.

- Note which leases are registered on title and also note their expiry dates.

#### Location

- A general description of the location of the property and its access, the availability and accessibility of public transport.
- Comments on the nature of the surrounding development and land use.
- Proximity to major centres, educational facilities and retail facilities.
- Special features relating to the property such as views, adjoining developments, recreational facilities, etc.
- Any signs of apparent potential contamination from surrounding properties.

#### Site Description and Services

- Comment on the nature of the site, the dimensions and area, any positive or negative features and the siting of any buildings.
- Identify the services connected and available to the property.
- Comment on any potential flooding or landslip problems.
- Comment on site accessibility, roads and the nature of the traffic in the area.
- Visually identify any site problems such as any readily apparent contamination, drainage problems, obvious encroachments, filled ground.

Comment on any other relevant factors such as alternative access, impact on property of adjoining or neighbouring development.

#### Town Planning/Resource Management

- The report should provide details on the current zoning/planning area.
- Comment if the use of the property constitutes a non-conforming use under the town planning guidelines and whether the property has the apparent benefit of existing use rights.
- Comment on development codes, site ratios, development guidelines and densities where appropriate.
- The Valuer should inquire, if possible, as to any intention of Council to amend the planning scheme and if the property is

affected by any detrimental or beneficial planning proposals.

The Valuer should provide brief details of any current development consent affecting the property and any conditions to that consent affecting the valuation or the proposal.

### Statutory Valuation and Charges

- Provide relevant information regarding statutory valuations and assessments for rating and taxing purposes.

### Improvements

- Provide a description of the improvements including the materials used in construction and the accommodation provided with, where appropriate, gross building areas and/or net lettable areas. It may be necessary to define these terms.
- Comment on any detrimental features or unusual matters and the requirement for refurbishment or upgrading.
- Comment on the age and condition of the improvements including observable building deterioration and any recent upgrading/ refurbishment works. Emphasise any adverse structural features.
- Where appropriate the Valuer should comment on the suitability of the improvements to the current use of the property and on any economic or functional obsolescence factors.
- Comment on the specialised nature of any of the improvements or features of the property.
- Comment on possible alternative uses particularly for specialised properties.
- Comment on any obvious non-compliances with statutory codes or fire provisions and recommend any expert advice where necessary.
- Comment on the effect of any outstanding orders where these are discoverable by reasonable verbal enquiry.
- For development proposals a description should be provided under the heading 'Proposed Improvements' and comment should also be made on any condition of the development consent affecting the proposal.

### Environmental Matters

- The existence of any past, current or potential environmental hazard or contamination

should be reported to the lender if identified by the Valuer. If necessary the Valuer should advise the requirement for an environmental audit before proceeding with the valuation. Where an adequately detailed environmental assessment report is available the Valuer should comment, if possible, on the effect of the contamination on the value and marketability of the property.

### Comments on the Property

- A summary comment on the property may be appropriate especially relating to how they affect the marketability of the property:
- Locational factors both positive and negative.
- The overall state of the improvements and their functionality.
- Foreseeable or likely changes to or affecting the property.
- Actual or potential obsolescence factors affecting the buildings and the property.
- Observations in relation to statutory compliances.
- Any other features, disadvantages or unusual features.

### Basis of Valuation

- The Valuer will provide an assessment of the Market Value of the property as at the date of inspection.
- Owner occupied properties shall be valued on a vacant possession basis for valuations for lending purposes.
- Tenancies or leases which are not at arms length should be ignored.
- The valuation should (where applicable) indicate inclusions and exclusions within the valuation assessment.
- The Valuer should consider the highest and best use before arriving at the valuation.
- Any assumptions made by the Valuer should be clearly highlighted under this heading.
- Information provided by the intending borrower must be critically assessed by the Valuer and acknowledged in the report.

### Tenancy Details

- The valuation shall have regard to the existing tenancy position, subject to the points under 'Basis of Valuation'.

## CLIENT FOCUS 2

- Where the property has lease structures in place, the Valuer will provide details of tenancy information either within the body of the report, or as an annexure.
- The Valuer will have regard to and confirm the actual rentals received, and should comment on current market rental levels, potential future vacancies, re-lettability, letting-up allowances and costs and the tenants' liability for the payment of outgoings.
- The Valuer will have regard to the impact of impending and other rental reviews, the basis of such reviews, the remaining term of each lease (and option periods) and other relevant matters. If leases have not been sighted the Valuer should clearly state this in the report.
- A schedule of arrears of rental and outgoings should be obtained if applicable and details of any tenancy disputes.
- The Valuer is to comment on achievability of rental levels for proposed developments, letting up periods, incentives required and competition in the market from other similar developments.

### Valuation Rationale Or Approach

- The Valuer will indicate to the mortgagee the basis upon which the valuation has been assessed, i.e. capitalisation of net income, direct comparison, summation or discounted cash flows.
- Details of comparable sales and other market evidence should be discussed in relation to the subject property. Where the Valuer has selected one or more methods of valuation, all matters considered in these methods should be outlined or detailed for the mortgagee, eg. rental shortfalls or overages, identification of outgoings, allowances for continuing vacancies, items identified as being of a capital nature for which an allowance must be made, monies required to complete the construction of the property, profit and risk factors, letting up periods, note of salient assumptions made within the discounted cash flows as to rental growth, outgoings growth, terminal yields and discount rates.
- A reconciliation of the various valuation approaches used may be required and the Valuer should justify the conclusions accordingly.

- Advise on what level of current and potential competition exists in the market for the letting and sale of the property.

### Market Review or Summary

- Valuers should provide an overview of market conditions in relation to the property being considered and comment in relation to supply and demand. There should be some identification of the kind of demand, ie. owner occupier, investor or other and the general trends in the market which are apparent at the time.

### Risk Analysis

- Valuers should provide a Risk Analysis appropriate for the type of property and its Market Value.

### Valuation

- This will certify the Market Value of the property at the relevant date for mortgage lending purposes subject to any qualifications in the report.
- The Valuer should certify if requested that neither the valuer nor the firm has any interest, financial or otherwise in the property or the outcome of the loan application.
- For properties under construction or development the valuation figure should be CLEARLY IDENTIFIED AS A VALUATION 'AS IF COMPLETE'. This should be subject to the issue of the appropriate building or other certificates and a final confirmation by the Valuer at completion.

### Qualifications and Disclaimers

- The Valuer may include a qualification as to the intended use of the valuation identifying the party or parties relying on the report.
- Any qualifications on other matters contained in the report, should be included within the body of the report at the appropriate place, and/or next to the valuation, and/or as an annexure.
- Any disclaimer required by the Valuer's professional indemnity insurer should be included.
- Any other disclaimer.

## **Annexure 1 – Model ‘Standing Instructions’**

**<Lender’s Name>**

### **PREAMBLE**

This document serves to set down the professional and service standards required by <Client Name> as lenders, engaging <Firm Name> as valuers to report on property for mortgage purposes.

It is set down in two parts:

Part A – Professional Standards

Part B – Service Standards

### **PART A – PROFESSIONAL STANDARDS**

1. <Client Name> recognises that the Australian Property Institute (API) / Property Institute of New Zealand (PINZ) is the representative professional body for property professionals including valuers.
2. The API/PINZ has developed and continues to develop Practice Standards and Guidance Notes as well as Client Focus and Business Focus sections. These elements, along with the Code of Ethics and Rules of Conduct are incorporated in the Valuation and Property Standards Manual.
3. <Client Name> requires <Firm Name> to comply with, and give due recognition to, these elements as far as they apply to the type of property, purpose, issues and professional conduct in the provision of services to <Client Name>.

### **PART B – SERVICE STANDARDS**

#### **The Lender**

For its part <Client Name> as lender, agrees to supply:

- Instructions in writing which will normally be forwarded by <means>.
- Information as recommended in the API / PINZ document Client Focus 2 sufficient for <Firm Name> to undertake its instructions. Should <Firm Name> consider that insufficient information has been provided for the purpose of the assessment and the type of report required, <Client Name> should be contacted immediately.

<Client Name> will pay accounts by <method> and on a <time> basis.

#### **The Valuer**

For its part, unless specifically instructed to the contrary, <Firm Name> as valuers, will delegate specific instructions to a qualified and appropriately experienced member of the firm (unless a particular valuer is nominated) and agrees to provide:

Report Format           <specify>

Turn Around Time    <specify if appropriate>

Report Delivery       <specify method(s) if appropriate>

<Firm Name> encloses evidence of its current Professional Indemnity Insurance Policy in the sum of \$<amount>.

---

Signed: \_\_\_\_\_ <Client>

---

Signed: \_\_\_\_\_ <Firm>

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## CLIENT FOCUS 2

### Annexure 2 - Instructions for Valuation & Security Assessment

To VALUER:	<Firm Name>	Fax/E-Mail		
From LENDER:	<Client Name>	Date:		
Business Unit:		Phone: <Personal Contact>		
Postal Address:		Fax:		
Street Address:		Reference 1:		
(for courier)		Reference 2:		
Borrower:		Reference 3:		
		Reference 4:		
Loan Amount:	\$			
Contract Price:	\$	E.M.V.:\$		
Purchaser's Solicitor:		Phone:		
<b>REQUEST: Please provide a Valuation and Security Assessment on the following property:</b>				
Type of Property:				
Address:				
Legal Description:				
Please Provide for	<input type="checkbox"/> PropertyPRO Residential Valuation & Security Assessment (RV&SA)			
Mortgage Purposes:	<input type="checkbox"/> Short Form Valuation & Security Assessment			
	<input type="checkbox"/> Comprehensive Valuation & Security Assessment Report			
Special Instructions:				
<b>FOR THE REPORT:</b>				
Date of Valuation:	<input type="checkbox"/> Date of Inspection	<input type="checkbox"/> Other: / / <Year>		
Interest to be Valued:	<input type="checkbox"/> Fee Simple vacant possession basis	<input type="checkbox"/> Other:		
If subject to Lease(s):	<input type="checkbox"/> Yes – Rent \$	Expires: / / <input type="checkbox"/> No		
Copy of Lease(s):	<input type="checkbox"/> Enclosed	<input type="checkbox"/> Available From:		
Plans & Specs:	<input type="checkbox"/> Enclosed	<input type="checkbox"/> Available From:		
Tender/Quote:	<input type="checkbox"/> Enclosed	<input type="checkbox"/> Other Documents Enclosed:		
<b>ACCESS/KEYS:</b>				
Contact's Name/s:		Phone – am/pm:		
		Phone – am/pm:		
Directions:				
Vendor:		Phone – am/pm:		
Tenant's Name:		Phone – am/pm:		
REQUIRED:	<input type="checkbox"/> URGENTLY	<input type="checkbox"/> BY	<input type="checkbox"/> A.S.A.P.	
REPLY:	<input type="checkbox"/> FAX	<input type="checkbox"/> E-Mail	<input type="checkbox"/> COURIER	<input type="checkbox"/> POST
FEE:	\$	<input type="checkbox"/> PLEASE QUOTE		
PAYMENT:	<input type="checkbox"/> ON ACCOUNT	<input type="checkbox"/> HEREWITH	<input type="checkbox"/> IN MAIL	<input type="checkbox"/> COLLECT

# RESIDENTIAL DESKTOP ASSESSMENT - ADVISORY NOTE

## Table of contents

Section A: INTRODUCTION .....	15.4.3
Preamble .....	15.4.3
Status and Scope .....	15.4.3
Terminology .....	15.4.3
Section B: PRELIMINARY ISSUES .....	15.4.5
Contractual arrangements .....	15.4.5
Understanding .....	15.4.5
Valuer qualifications .....	15.4.5
Section C: DESKTOP PROCUREMENT AND RISK .....	15.4.7
General .....	15.4.7
Allocation of risk .....	15.4.7
Risk management .....	15.4.8
Risk categories .....	15.4.8
Section D: DESKTOP PROCESS .....	15.4.9
Information .....	15.4.9
Essential .....	15.4.9
Sales Evidence .....	15.4.9
Indicative Assessment .....	15.4.9
Reporting requirements .....	15.4.10
Security .....	15.4.10
Annexure A: DEFINITIONS .....	15.4.11
Annexure B: UNACCEPTABLE PROPERTY TYPES .....	15.4.12

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# SECTION A - INTRODUCTION

## Preamble

- 1 The purpose of this Advisory Note is to provide a basis upon which Members of the Australian Property Institute (API) (**Members**) should prepare residential Desktop Assessments.
- 2 The Advisory Note may also be used by Members' **Clients** to understand the procedures adopted in preparing Desktop Assessments and how they should be used.
- 3 The API considers that Desktop Assessments are suitable only for use by Members or Members' **Clients** for mortgage security valuations of residential property. In addition Desktop Assessments should only be used in connection with transactions which represent a low to moderate lending risk and, then, only where the requirements of this Advisory Note have been otherwise met.
- 4 The Valuer is providing an Indicative Assessment (with conditions) of the Subject Property, based on the information obtained, following the procedures set out in this Advisory Note and / or contractual agreement.
- 5 The Indicative Assessment is not, and should not be construed to be, a representation as to the Market Value of the Subject Property, as defined in the Valuation and Property Standards Manual and the Practice Standards and Guidance Notes contained therein. A Desktop Assessment is merely an Indicative Assessment made without the benefit of an inspection of the subject property. If a formal valuation of the subject property is made based on an inspection it may vary significantly from the results of any Desktop Assessment. Clients should be aware that the Desktop Assessment methodology carries with it risks which entail a degree of likely variation greater than might be expected to be produced by a Valuation.
- 6 The subject property is not inspected by the valuer.

## Status and Scope

- 7 Members undertaking Desktop Assessments should comply with this Advisory Note.
- 8 Compliance with the Advisory Note means Members should:
  - 8.1 make their Clients aware of this Advisory Note;
  - 8.2 meet minimum qualifications criteria;
  - 8.3 ensure that sufficient Information is obtained; and
  - 8.4 follow all procedures required by this Advisory Note.

## Terminology

- 9 A Desktop Assessment is a report prepared:
  - 9.1 by Valuers relying on specified documents and information; and
  - 9.2 that does not involve an inspection of the Subject Property; and
  - 9.3 that produces an Indicative Assessment (with conditions) of value of the Subject Property.
- 10 Other definitions which apply to the terminology used throughout the Advisory Note are contained in Annexure A. Defined terms are indicated by use of highlighting.



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## SECTION B - PRELIMINARY ISSUES

### Contractual arrangements

- 11 Clients requesting Desktop Assessments should be made aware of the process being undertaken by the Valuer in preparing a Desktop Assessment (as distinct from any other Valuation Services provided by Members). The Valuer should provide a copy of this Advisory Note to Clients instructing the Valuer to prepare Desktop Assessments.
- 12 If the Valuer is not able to comply with this Advisory Note in preparing the Desktop Assessment, the Valuer should:
- 12.1 confirm that a Desktop Assessment cannot be completed;
  - 12.2 recommend an alternative Valuation Service or Restricted Valuation if appropriate; and
  - 12.3 not issue the Desktop Assessment (complete or incomplete) to the Client.

### Understanding

- 13 Valuers preparing Desktop Assessments should be familiar with this Advisory Note.
- 14 API members using Systems to prepare Desktop Assessments should ensure that there is adequate training of the System prior to undertaking a Desktop Assessment using the System.

### Valuer qualifications

- 15 Desktop Assessments should only be prepared by Valuers who are:
- 15.1 current members of the API (CPV or RPV); and
  - 15.2 registered Valuers (in accordance with the relevant State/Territory requirements); and
  - 15.3 continuously engaged in the provision of Valuation Services for at least 50% of their overall practising time; and
  - 15.4 continuously engaged in the provision of Valuation Services within the appropriate postcode. The valuer should have sufficient knowledge of the area within which the subject property is located for a period of not less than 6 months.
- 16 Where a Valuer is not able to satisfy the requirements set out in paragraph 15, the instruction to prepare a Desktop Assessment should be declined. The Valuer may, however make recommendations and accept alternative instructions from the Client to provide Valuation Services and/or a Restricted Valuation.

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# SECTION C - DESKTOP PROCUREMENT AND RISK

## General

- 17 Desktop Assessments require the Valuer to be specifically instructed not to perform certain aspects of the processes involved in preparing Valuations including, but not limited to the inspection of the Subject Property. The aspects of the usual valuation that are not completed in preparing a Desktop Assessment include, inter alia, the following:
- 17.1 An internal or external inspection;
  - 17.2 Land Topography and Aspect;
  - 17.3 Roads and Access;
  - 17.4 Site Defects;
  - 17.5 Impact of adjoining development;
  - 17.6 Environmental Risks;
  - 17.7 Encumbrances;
  - 17.8 Permissible Land Uses and Land Use Conformity;
  - 17.9 Improvements; and
  - 17.10 Leases and Tenancies.
- 18 Due to these aspects of the usual valuation process not being completed there are risks that the outcome of a Desktop Assessment may be inaccurate. These include:
- 18.1 the risk of inaccuracy of information contained in the Desktop Assessment as compared to Valuations is increased;
  - 18.2 the fact that the Valuer cannot verify the accuracy of information contained in a Desktop Assessment as would be provided in a Valuation; and
  - 18.3 the fact that Desktop Assessments will have significant limitations when compared to Valuations, including a greater degree of variation in the resulting Indicative Assessment.

## Allocation of risk

- Acceptance of Commercial Risks of a Desktop Assessment.
- 19 The API considers that there are inherent risks to a Lender / Client who relies on a Desktop Assessment but acknowledges that the Lender / Client has expressed a commercial need for such an assessment to be carried out by Valuers.
- 20 The Lender / Client expressly acknowledges and confirms that:
- 20.1 in producing the assessment contained in the Desktop Assessment, the Valuer has not carried out the usual range of enquiries that a Valuer is required to make by professional practice standards (as determined by the API and at law) in carrying out a Valuation of property and that this is at the specific request of the Lender / Client; and
  - 20.2 the Lender / Client fully understands and accepts the risks inherent in such circumstances.
- 21 Accordingly, but subject to compliance by the Valuer with the requirements of the Desktop Assessment, this Advisory Note and the stated instructions of the Lender / Client, the Lender / Client agrees that it will have no cause of action against the Valuer whether in contract tort or otherwise by reason only that the Lender / Client suffered loss or damage by relying upon a Desktop Assessment.
- 22 Furthermore the Lender / Client acknowledges that it accepts that a Desktop Assessment is not and will not be construed to be a valuation in the same meaning as a valuation conducted in accordance with the General Concepts, Principles and Definitions as detailed in the standards promulgated by the API, which is based on an inspection of the subject property.
- 23 The Lender / Client further agrees that it will indemnify the Valuer against any claim for loss or damage by a third party invited or permitted by the Lender / Client to rely upon a Desktop Assessment, whether arising in contract tort or otherwise and

## CLIENT FOCUS 3

arising out of or in conjunction with reliance by that third party on a Desktop Assessment.

- 24 The Indemnity to be provided by the Lender / Client will not apply where the valuer has been fraudulent or dishonest.
- 25 Valuers shall not assign, readdress or re issue Desktop Assessments.

### Risk management

- 26 In an effort to reduce the risks associated with the use of Desktop Assessments (as described in this Section C), the Valuer should adopt a procedure whereby:
  - 26.1 the instruction from the Client is checked to ensure that the Subject Property is not of a type considered unacceptable by the API (Annexure B);
  - 26.2 sufficient Information is obtained before a Desktop Assessment can be completed or issued.
- 27 It is the responsibility of Lenders / Clients to prepare appropriate and prudent risk management protocols to ensure that Desktop Assessments are used only in low to moderate risk categories.

### Risk categories

- 28 The API considers that the following transaction types are unacceptable for Desktop Assessment:
  - 28.1 all non-residential mortgage lending;
  - 28.2 all lending on security other than a first registered mortgage;
  - 28.3 all lending transactions connected with non-arms length sales; and
  - 28.4 transactions where the security consists of, or includes, more than one security property located within a single development.

This list is not intended to be exhaustive.

- 29 The API considers certain categories of property to be unacceptable for Desktop Assessment. Annexure B to the Advisory Note is a non-exhaustive list of these unacceptable properties.
- 30 It is expected that the Client/Lender should implement procedures to monitor:
  - 30.1 the compliance of their internal procurement practices with this Advisory Note and / or specific contractual arrangements;
  - 30.2 the compliance of Valuers and/or Valuation Firms retained by the Client/Lender to provide Desktop Assessments with this Advisory Note and / or specific contractual arrangements.

# SECTION D: DESKTOP PROCESS

## Information

### Essential

31 It is essential for a Lender / Client instructing a valuer to prepare a Desktop Assessment to provide to the valuer, at the time of first issuing instructions, all information required in this section. The essential Information to be provided by the Lender / Client to enable a Valuer to complete a Desktop Assessment is:

31.1 The Subject Property data, namely:

31.1.1 full property address;

31.1.2 legal description<sup>1</sup>;

31.1.3 purchase price (if applicable);

31.1.4 land area or plan with measurements;

31.1.5 property type (vacant land, residential dwelling, townhouse, unit);

31.1.6 external improvements (eg, swimming pool);

31.1.7 main building type;

a) approximate build date;

b) details of significant renovations including date;

31.1.8 main walls and roof;

31.1.9 number bedrooms, bathrooms;

31.1.10 car accommodation (eg, garage, car port or car space); and

31.1.11 services;

31.1.12 a full copy of the contract (where Desktop Assessment sought in connection with a purchase or proposed purchase) and any other contractual arrangement affecting price.

(Collectively referred to as Subject Property Data); and

31.2 At least two visual identifiers of the Subject Property from the following categories:

31.2.1 Location map;

31.2.2 property frontage photograph; or

31.2.3 aerial/cadastral photograph.

32 The Valuer should obtain all Subject Property Data from the Client and/or the Customer (or Third Party) collectively. In the event that not all Subject Property Data can be obtained from the Client and/or Customer (or Third Party) collectively, the instruction to prepare a Desktop Assessment should be declined. The Valuer may, however make recommendations and accept alternative instructions from the Client to provide Valuation Services or a Restricted Valuation.

### Sales Evidence

33 Sales Evidence is to be collected for 4 comparable properties each of which should:

33.1 have transacted within the last six months; and

33.2 be known to the Valuer based upon a prior inspection by the Valuer or by a qualified valuer within the Valuer's firm.

### Indicative Assessment

34 The Valuer is providing an indication of the value of the Subject Property, based on the information obtained, following the procedures set out in this Advisory Note (Indicative Assessment).

35 The Indicative Assessment (with or without conditions) is not a representation as to the Market Value of the Subject Property, as defined in the Valuation and Property Standards Manual and the Practice Standards and Guidance Notes contained therein. Clients should be aware that the Desktop Assessment methodology carries with it risks which entail a degree of likely variation greater than might be expected to be produced by a Valuation.

<sup>1</sup> Unless stated otherwise, fee simple with vacant possession is to be assumed. The Valuer is not expected to search the title or to enquire about any leases or occupancy rights.

## CLIENT FOCUS 3

### Reporting requirements

- 36 All notes, revised instructions and changes made to documents provided and collated as part of the Desktop Assessment process are to be maintained on the Valuer's file (hard copy or electronic).
- 37 Systems used to prepare Desktop Assessments may provide an audit trail of any changes made to System during the Desktop Assessment process. All changes should be logged by reference to the user, time and date of change. The Valuer should have access to this log trail at all times.

### Security

- 38 Valuers using a System to prepare Desktop Assessments should ensure that:
  - 38.1 details necessary to access the System are kept secure and not misused; and
  - 38.2 any electronic signature generated as part of the System is used only by the Valuer.

# ANNEXURE A: DEFINITIONS

Term	Meaning
Certified Practising Valuer (CPV) or Valuer	A Valuer meeting the requirements for Certified Practising Valuers as defined by the API.
Client	The party instructing the Valuer to prepare the Desktop Assessment. The Client may be the Supplier, Lender or a financial intermediary.
Continuously engaged	A Valuer is continuously engaged in the relevant postcode where the Valuer has undertaken multiple valuations of that type over the whole (and note merely some part) of the period specified.
Customer	A person who seeks to grant a mortgage over the Subject Property to the Lender in support of a proposed Loan.
Desktop Assessment	A report prepared: <ol style="list-style-type: none"> <li>1) by Valuers relying on specified documents and information; and</li> <li>2) that involves no inspection of the Subject Property; and</li> <li>3) that produces an Indicative Assessment of value of the Subject Property.</li> </ol>
Indicative Assessment	An indication of the value with any limiting conditions of the Subject Property, based on the information obtained, following the procedures set out in this Advisory Note.
Lender	The financial institution issuing instructions (or on whose behalf instructions are issued) to the Valuer. The Lender may have the same meaning as the Client.
Essential Information	Essential information, specified in the Advisory Note, that the Valuer requires in order to conclude the Desktop Assessment.
Non-Essential Information	Information that may be of assistance to the Valuer in preparing the Desktop Assessment but is not Essential information.
One-Off Services	Desktop Assessments requested by a Client where the instructed Valuer is not part of a panel of approved Valuers who provide Valuation Services to that Client.
Advisory Note	This Desktop Assessment Advisory Note produced by the API (including any API revisions, updates or additions from time to time).
Property PRO™	Valuations prepared in accordance with the API Property PRO™ Residential Valuation and Security Assessment Supporting Memorandum.
Restricted Valuation	A valuation prepared in accordance with the API Restricted Valuation Supporting Memorandum.
Sales Evidence	Sales data that relates to properties that have characteristics comparable to the Subject Property.
Subject Property	The property for which the Client instructs the Valuer to prepare a Desktop Assessment report.
Supplier	A party that acts as an intermediary between Lenders and Valuers in connection with the procurement by the Lender of Valuation / Desktop Assessment services. The Supplier typically: <ul style="list-style-type: none"> <li>• issues instructions to Valuers to prepare Valuations and/or Desktop Assessments for Lenders.</li> <li>• owns the System.</li> </ul>
System	Any computer system, portal, database, application service, program or any other technology utilised: <ul style="list-style-type: none"> <li>• in preparing Desktop Assessments; and/or</li> <li>• to track, deliver, produce and coordinate Desktop Assessments.</li> </ul>
Valuation	A valuation carried out in accordance with the General Concepts, Principles and Definitions of the Valuation and Property Standards Manual, excluding Desktop Assessments and Restricted Valuations.
Valuation Services	Preparing market valuations based on inspecting the subject property (including sales analysis and property inspections and other ancillary work) required for the preparation of Valuations.



# ANNEXURE B: UNACCEPTABLE PROPERTY TYPES LISTED BY API

- 1) Any property under construction or a new house and land package.
- 2) Any security property known or disclosed to be greater than 2.2 hectares in land size.
- 3) Any property known or disclosed to be zoned for other than residential purposes.
- 4) An income-producing rural property.
- 5) Part of a development which has been converted from another usage.
- 6) Serviced apartments.
- 7) Properties designed, zoned or used for commercial purposes (excluding residential usage units in a commercially zoned development).
- 8) Properties that are unique, or have restricted usage.
- 9) Properties to be constructed by an owner-builder (in whole or part).
- 10) Leasehold properties other than Crown lands in the ACT.
- 11) Purple title (WA) or Moiety title (SA).
- 12) Under a 'timeshare' arrangement.
- 13) Land subject to licence to occupy.
- 14) Limited title (any defects).
- 15) Mobile or temporary homes.
- 16) Boarding houses/homes supporting residential services.
- 17) Land/improvements contaminated.
- 18) Properties 'leased for life' covenants on title.
- 19) A strata unit of less than 40 square metres.
- 20) Crown land (excluding the ACT).
- 21) Properties under the Western Lands Act.
- 22) Properties purchased off-the-plan.
- 23) Properties within a known flood height level higher than the lowest floor level.
- 24) A multiple occupancy security that is a single property comprising of more than one unit of living accommodation.
- 25) A property located on an island without sealed road connection to the mainland (excluding Tasmania).
- 26) A studio apartment or bed-sitter (no separate bedroom).

# FEEDBACK TO API AND PINZ MEMBERS AND/OR THE API/PINZ

## 1.0 The Importance of Relevant and Timely Feedback

### 1.1 Purpose

The purpose of this Client Focus element is to outline for clients of API or PINZ Members the importance of providing feedback on the services provided and to let it be known that the Australian Property Institute and New Zealand Property Institute is also interested in receiving feedback, not only on the performance of its Members but also on the Institute's itself.

### 1.2 Importance of Clear and Precise Instructions

Clear and precise instructions are an important part of receiving service that delivers the level and type of output clients require. Sometimes, though what is delivered may not meet requirements. Causes may include misunderstanding or failure to comply with API or PINZ Code of Ethics, Rules of Conduct, Practice Standards or reasonably align with Guidance Notes.

### 1.3 Feedback before Acting on Advice if Concern

It is important for clients to realise that it is totally reasonable and preferable for them to check back with the service provider for clarification, correction or supplementation whenever it is perceived that any output does not meet requirements of the instructions or professional expectations. This feedback should be done before acting on the advice provided.

### 1.4 Members to Respond

It is the Member's professional responsibility to respond to any reasonable queries or feedback even though no additional fee is offered. However the Institute recognises that in the case of additional work resulting from unclear original instructions or variation to the original instructions, it may be appropriate for the Member to seek an additional fee.

### 1.5 Positive Response to Exceptional Service

The Institute also encourages clients to respond positively to its service providers where the level of service or advice is considered to be exceptional. Further if this feedback is provided to the Institute, it can develop a better understanding of what clients would like to receive and look to measures that might raise the overall standard of its Members.

### 1.6 Feedback to Institute if Concern

At the same time the Institute recognises that there will be occasions when a client considers that the quality of the service provided seriously falls short of its expectations or those of the Institute's Code of Ethics, Rules of Conduct, Practice Standards or Guidance Notes. While a client may be reluctant to lodge an official complaint, the Institute would nonetheless like to be made aware of the client's perception. This can even be done without advising the Member's name if so desired. The communication may include all or part of a report to highlight any concern. It should be addressed to the Divisional Office of the API in the state in which the Member's office is located or national office of the PINZ.

### 1.7 Importance of Feedback

It is important for the reputation of the membership at large that the Institute is informed. This way it can consider if what is raised is a one-off issue or something that is becoming a more widespread issue to be addressed with the membership at large. If the Institute considers it important for the Member involved to be counselled, it may request that the Member's name be revealed, but this will ultimately be up to the client.

### 1.8 Institutes Performance

The Institutes would also like to know how Member's clients as well as Members feel about the performance of the each Institute. Again it is by being aware of how the Institutes are

## **CLIENT FOCUS 4**

perceived that they can review what they do and how they do it so as to benefit and be relevant to Members and their clients. Such comments should be forwarded to the API National Secretariat in Canberra or the PINZ National Secretariat in Wellington.

Contact Details for the API and PINZ are located on page 16.5.1.

# *PropertyPRO*<sup>TM</sup> RESIDENTIAL VALUATION AND SECURITY ASSESSMENT PRO-FORMA SUPPORTING MEMORANDUM

## 1.0 Introduction

### 1.1 Purpose

This Supporting Memorandum provides the basis upon which Members of the Australian Property Institute (API), who are a Certified Practising Valuer or Residential Property Valuer, will provide valuations on residential properties for mortgage purposes using the PropertyPRO 'Residential Valuation and Security Assessment' Pro-forma Report for Mortgage Purposes. It is also the basis on which their lender clients will accept and use such valuations.

### 1.2 Scope

This Supporting Memorandum sets out limitations and qualifications inherent in valuations, and in particular the Risk Analysis, provided in the PropertyPRO 'Residential Valuation and Security Assessment' Pro-forma Report for Mortgage Purposes format. A lender-client who instructs a valuer to provide a PropertyPRO Proforma Report agrees to accept and be bound by the process contained within this Supporting Memorandum. In particular, it provides important information to lender-clients and Valuers in relation to:

- initial instructions to the Valuer and what information should be provided,
- the information the Valuer should provide in the report,
- the matters the Valuer may provide restricted comment on,
- what the Valuer should do in the event of a departure from any provision,
- matters the Valuer understands will be checked by the lender and/or its solicitor (and which may subsequently be referred back to the Valuer for comment), and

- the information and documentation the Valuer could be expected to hold on file.

Valuations using the PropertyPRO 'Residential Valuation and Security Assessment' Pro-forma Report for Mortgage purposes are provided for and may be relied on by lender-clients and their mortgage insurers and/or securitisers only. It is the lenders responsibility to ensure that its mortgage insurers and/or securitisers are aware of and agree to accept the basis contained in the Supporting Memorandum on which these valuations are provided, and the lender-client will indemnify the valuer against claims made against the valuer as a result of the lender failing to do so.

### 1.3 Copyright

The Institute reserves Copyright of the *PropertyPRO* 'Residential Valuation and Security Assessment' Pro-forma Report. This has been deemed necessary to retain the integrity and consistency of the report format. The Report format is available through the Institute under the PropertyPRO Trademark. It is produced out of a database program that is only available to Institute Members.

### 1.4 Certification

A Valuer who provides a PropertyPRO Proforma report must do so in accordance with this Memorandum. A lender-client who instructs a valuer to provide a PropertyPRO Proforma report must do so in accordance with this Supporting Memorandum.

### 1.5 Brief Report For Residential Mortgage Purposes Only

It should be noted that the format is specifically designed for the purpose of providing a brief report on a single residential property for mortgage purposes.

# PROPERTY PRO SUPPORTING MEMORANDUM

## 2.0 Initial Instructions to Valuer and Supply of Information

### 2.1 Standing Instructions

Valuers should ensure that instructions to provide a PropertyPRO proforma report are on the basis of a standing instruction or a specific instruction that the provision of the PropertyPRO proforma report will be subject to the terms of this Supporting Memorandum.

### 2.2 Instructions in 'writing'

Instructions for individual reports are normally provided in 'writing'. Any instructions transmitted electronically should be produced in a hard copy form for retention in the Valuer's file. Any instructions provided verbally in the first instance should be confirmed in 'writing' by the client, or failing that, the valuer should confirm the instructions in 'writing' and retain a file copy.

### 2.3 Desirable and Necessary Detail

While a Valuer can in due course produce a report after being provided with very little information by the client, considerable extra time and cost will be involved for the Valuer in ascertaining necessary detail. Where some information is not readily available to the Valuer, the report may be qualified. The lender shall provide to the valuer all information in its possession that may impact on the valuation of the property. As much of the following information and documentation as possible should be provided in or with the instructions for a Residential Valuation and Security Assessment. Some of the information may be obtainable by the intending borrower from the selling agent where the property is for sale. The information shown below in bold is considered the most important information required.

- **Valuer**  
The name of the firm to which the instructions are addressed
- **Date(s)**  
Date of request  
Date required (if applicable and not a contract condition)
- **Lender**  
The name of the instructing organisation  
Appropriate references and organisation contact details

- **Borrower**  
Name(s) of borrower(s) and any reference number(s)
- **Loan Amount**  
\$
- **Property Address**  
Full street address, locality name and postcode
- **Title detail**  
Legal description  
Copy of search or title document including encumbrances etc. The valuer will not be required to obtain or refer to a Title search unless specifically instructed.  
Copy of deposited or registered plan, strata or unit plan or survey report.
- **Property Type**  
e.g. Dwelling, unit, hobby farm
- **Contract Price**  
If current sale involved (or price and date if recent sale)
- **Extracts from Copy of Contract**  
Copy of any special conditions, certificates, etc.  
For residential investment properties and community title, access to the contract should be arranged for the valuer. A special fee may be appropriate for perusal of any substantial extra documentation.
- **Borrower's Estimate**  
If no current or recent sale is involved.
- **Contact for Access**  
Contact's name (if property has been sold or leased, the names of any real estate or leasing agents involved should be provided)  
Contact's Phone number(s) – and whether am or pm
- **If Tenanted**  
Tenant's name, rent being paid and expiry date of any lease
- **Special Instructions**  
Any applicable
- **Tender Details**  
If proposed dwelling, renovation or extension:  
Arrange for the valuer to receive:  
Copy of building contract, latest tender or quote with priced schedule of fittings/PC items.

Copy of plans and specifications preferably approved.

Builder's name and licence details and phone number(s).

- **Any Other Relevant**  
E.g. Zoning certificate, development approval, pest report, affectations, etc.
- **Report Dispatch**  
To where and how the report should be forwarded.

### **3.3 Information which should be provided in the report**

The valuer should provide in the report under each sub heading in each main section the information and comment referred to below, but subject to any limitations and qualifications set out below and subject to the information being common knowledge and or readily ascertainable and or provided by the lender within the time frame available to complete the report.

## **3.0 Format of Reports**

### **3.1 Layout Designed to Facilitate Easy Checking**

The PropertyPRO Residential Valuation and Security Assessment Pro-forma report layout intentionally has most of the key information, the risk analysis, valuation and assessments (and their certification) on the first page, while supporting information, data and comments follow. While this is primarily to facilitate easy checking by the lender and/or trustee and mortgage insurer, it is essential that the whole report be read. The risk analysis on the front page with its graphic presentation particularly serves to draw immediate attention to any risks rated 'Medium to High' or 'High', and to appropriate comments later in the report.

### **3.2 Brief Facts, Points and Concise Statements**

As the report is a pro-forma report, it presents its information in brief pertinent facts, points and concise statements. However, features impacting significantly on the property should be adequately noted. The format has been designed to suit a majority of situations. Where required, the 'Comments' section can be expanded to cover less common properties. While the first page is fixed length, some fields on the second page have the capacity to expand, creating an extra page (or more) if needed.

There are formats for strata and proposed dwellings/extensions/renovations, vacant land and for properties subject to long term lease. Some label variations are available to suit particular situations, e.g. 'Built About'/'Year Built', while others only appear if relevant, e.g. 'Actual Rent'. A 'vacant land' variation deletes a number of headings.

## PROPERTY PRO SUPPORTING MEMORANDUM

ITEM	REQUIREMENT
Lender	The lending organisation's name. Where lender's, mortgage insurers and/or securitisers are required to be noted on the report, these will be inserted at the end of the document.
Lender and Borrower References	Provide field labels relevant to those used by the lender.

### 1. PROPERTY SUMMARY

PROPERTY ADDRESS:	Street Address, including State and Postcode
TITLE DETAILS:	Description of land and title details where available.  Note: The valuer is not required to obtain or comment on a title search unless specifically requested.
Encumbrances/Restrictions:	Type, extent and location of encumbrances or restrictions (where provided by the client)
Site Dimensions:	Where available or able to be described use the convention of frontage/rear then one side/other, ( where no ' / ' is shown, this indicates same dimension for each), or otherwise provide site area.
ZONING/INSTRUMENT:	Status of zoning and name of most relevant planning instrument
LGA:	Local Government Area name
MAIN BUILDING:	Broad type classification e.g. Dwelling, Residential Unit, Duplex, Vacant Land, Other
No. of Bedrooms	
No. of Bathrooms	Include ensuites
Current Use:	Advise where main building not used for its designed purpose.
Built About/Year Built:	'About' is used more often as the exact year built is often not readily ascertainable. An alternative label 'year built' is available for selection in instances where the exact year is known.
Addition(s):	Approximate age of major extensions.
Actual Rental/until:	Note actual rent and expiry date subject to lenders requirements and availability.
AREAS:	Area measured or ascertained. Practical use of most measuring systems will produce an approximate result.  Outdoor areas include areas of open verandahs, patios, pergolas, porches, etc. Their individual areas are aggregated for the purpose of these reports.
MARKETABILITY:	A brief comment as an overall rating of the ease of sale of the property i.e. how saleable is the property? This should be based on any inherent or external features favourably or adversely affecting the marketability of the property. Low or below average ratings need to be explained in 'Additional Comments'. (Marketability in this instance is not intended to be a comment on the condition of the market). Expand as necessary in 'Additional Comments'
Heritage Issues:	A comment as to whether any heritage issues, either adverse or beneficial affect the property within the knowledge of the valuer. (comment on the form "Known" or "Not Known"). If 'known, further comment required over page.

## PROPERTY PRO SUPPORTING MEMORANDUM

ITEM	REQUIREMENT
ENVIRONMENTAL ISSUES	<p>This should record any significant/observable/visual and/or known defects or hazards or observable or known site contamination. Where a defect or hazard is recorded, further comment is required.</p> <p>Any identified matters may warrant a report by appropriately qualified experts or a certificate from an appropriate authority.</p> <p>The Valuer is not normally an expert in these matters. The Valuer's role is to assist in identifying issues in the first instance and to recommend any further reports or certificates for confirmation or clarification. (Any issues or uncertainties should be explained more fully in 'Additional Comments'). Should any issues be subsequently confirmed, the Valuer should be asked for further comment in view of any certificates or other experts' reports (and their estimated costs of remediation or recommended work).</p> <p>Where no defect or hazard is identified the Valuer may comment 'none readily apparent' or 'unlikely in this area' or similar.</p>
ESSENTIAL REPAIRS	<p>The valuer should identify only those items observed by the valuer, and which, in the valuers opinion, if not attended to, could cause significant deterioration and loss in value or could have a significant adverse effect on marketability. The report is not intended as a structural or building survey report though the Valuer may report on observed defects or other matters of concern.</p> <p>The 'Existing Property' value reflects the current condition.</p>
TBE (To Be Erected)/ Extension/Renovation	<p>TBE will show and applies only where a building project is involved, i.e. a new building. A separate heading is available for an extension or substantial renovation. The valuation provided in each instance will be on the basis of 'As if Complete'. In each case builder's name and building contract or tender details should be shown.</p>
Check Cost	<p>A Check Cost will only be provided by the valuer where the valuer has adequate cost indicators for that style of construction. The purpose is primarily to identify if the tender is broadly in line with market costs. It is not expected that a detailed costing will be conducted. If the Check Cost is significantly different to the tender then this matter will be drawn to the lenders attention.</p>
Information Supplied	<p>The Valuer should indicate what information has been supplied including an indication as to whether the plans and specifications sighted have been 'Council approved'.</p>

## 2. RISK ANALYSIS

The risk analysis in the PropertyPRO format is the valuers assessment of the impact on the property of a number of specified factors presented in a numerical/ graphical format.

This is a simplified analysis based on the current experience of the valuer and is not a technical analysis. The lender client cannot expect that the valuer brings to the task any greater level of common knowledge or ability to foresee events than can be expected of persons experienced in the market for that class of property in its market place (which may be local or broader). The risk analysis is the product of the current experience of the valuer based on information that is common knowledge and /or readily ascertainable in the market for that class of property in its market place. The risk analysis does not reflect information that is privileged or to which the market for that class of property in its market place does not have ready access and it does not reflect decisions, announcements, releases, articles and the like that the valuer has not had reasonable time and opportunity to assess and consider. Subject to these limitations, the Risk Analysis indicates the level of adverse impact each stated aspect has, or in the near future, might have on the property's value and marketability. In the case of higher level ratings, it can also provide an indicator of the presence of relevant comments in the 'Additional Comments' section on the following page.



## PROPERTY PRO SUPPORTING MEMORANDUM

ITEM	REQUIREMENT
.... Risk Ratings	Risk Ratings focus on four property-specific aspects and four market-related aspects. Each of these aspects can involve consideration of a range of elements relative to it.
. . . level of adverse impact or risk	It is accepted that each aspect is likely to have some possibility of adverse impact or risk, however low or nominal. The assessment of the level of adverse impact or risk includes assessment of both the probability and consequence of the risk. A Risk Rating of 1 equals normal or no influencing factors and risk factors elevate from that point.
..... the risk ratings	<p>The ratings which are outlined below the bar graphs are:</p> <p>'1' - Low</p> <p>'2' - Low to Medium</p> <p>'3' - Medium</p> <p>'4' - Medium to High</p> <p>'5' - High</p> <p>Any Risk Ratings of 4 or 5 or the existence of three or more '3' Risk Ratings MUST BE COMMENTED UPON in the 'Additional Comments' section.</p> <p>For the purpose of these reports, the risk rating reflects the valuers assessment of:</p> <ul style="list-style-type: none"> <li>• the level of adverse impact the stated aspect has upon the current value and/or marketability of the security property, and/or</li> <li>• the currently perceived level of adverse impact the stated aspect could have on the value or marketability of the security property within the initial 2-3 year period of the security.</li> </ul>
. . . adverse and favourable impacts offset	The rating adopted for each of the listed aspects requires a balanced overview for that aspect. Properties often have many beneficial features. Adverse impacts need to be weighed against strengths or favourable impacts under the same aspect.
..... cumulative impacts	While there can be offsets in the overall rating for an aspect heading such as the above, there may also be cumulative effects from several adverse impacts.
..... common knowledge and reasonably foreseeable events	The basis of any 'forward-looking' element of a rating is restricted to information that is currently common knowledge and/or readily ascertainable in the market and to events that are reasonably foreseeable. Information which is 'privileged' in the valuer's hands or to which the market itself does not have ready access cannot be reflected in the rating.
. . . . elements	The elements of the Risk Analysis are:
<b>Property Risk Ratings</b>	
Location & Neighbourhood	This Risk Rating reflects an overall rating for these two aspects.
Land (incl. planning, title)	Land in this instance refers not only to the land physically, but also to access, services, planning and title.
Environmental Issues	This aspect of the Risk Analysis covers a range of environmental issues including contamination (refer Environmental Issues heading above).
Improvements	This aspect refers to all improvements, whether the main building or ancillary improvements (and for a TBE - Proposed Dwelling, Extensions or Renovations, would include concerns about aspects of the project or tender).

## PROPERTY PRO SUPPORTING MEMORANDUM

ITEM	REQUIREMENT
<b>Market Risk Ratings</b>	
Reduced Value next 2 - 3 yrs	This Risk Rating is an indication of the level of risk of this property reducing in value over the next 2-3 years. It is a forward-looking summary rating taking into account aspects affecting, or likely to affect, the value of the property. The assessment is made on the basis of information that is common knowledge and/or readily ascertainable in the market and having regard to reasonably foreseeable events as at the date of the assessment. The rating cannot be expected to reflect information that was not common knowledge, or conditions, events or circumstances that occur subsequently or unexpectedly.
Market Volatility	This aspect reflects the risk of significant adverse impact on the value of the property of the market changing direction rapidly. While this will reflect historical performance, reasonably foreseeable events should also be taken into account.
Local Economy Impact	This aspect reflects the extent to which a significant change in the local economy is impacting adversely and/or the risk that it may impact adversely on the value of the property in the 2-3 year time frame.
Market Segment Conditions	This aspect reflects the extent to which the condition of the market in this particular market segment is impacting or may impact adversely on the property.

### 3. EXPLANATORY MATERIAL

The valuation will be carried out in accordance with the General Concepts, Principles and Definitions section of the Valuation and Property Standards Manual and the Practice Standards and Guidance Notes contained within the guide. The comments below relate specifically to the PropertyPro Residential Valuation & Security Assessment.

Market Value	<p>A single figure amount is recorded for the Market Value in line with traditional valuation practice. The figure will normally be arrived at after consideration of several valuation approaches such as Sales Comparison and Summation. The Capitalisation approach may be used for investment property that is subject to a long-term lease. Immediately above the Market Value is an apportionment of that value into its main components - the value of the land and the added value of the improvements. For Strata Title property a single value only is recorded, as an apportionment is inappropriate.</p> <p>As an additional security measure, the 'Market Value' is also provided in words.</p> <p>The Market Value assessed by the Valuer relates to the market conditions existing at the date of valuation (which will normally be the date of inspection).</p>
(Chattels)	<p>PropertyPro valuations include the following chattels:</p> <ul style="list-style-type: none"><li>• fixed floor coverings,</li><li>• window coverings, and</li><li>• light fittings.</li></ul>
Rental Assessments	<p>Rental Value Unfurnished. This reflects the most probable market rental for the property assessed in the same condition as the property is valued. The rental is not to include rent for furniture unless:</p> <ul style="list-style-type: none"><li>• a charge is held over the items,</li><li>• the charge is sighted by the valuer,</li><li>• a copy is annexed to the report, and</li><li>• the valuer makes specific note of the inclusion of furniture in 'Additional Comments'.</li></ul>

## PROPERTY PRO SUPPORTING MEMORANDUM

ITEM	REQUIREMENT
Insurance Assessment	<p>Replacement Insurance. This is an assessment of an insurable sum under replacement and reinstatement conditions. This would normally include:</p> <ul style="list-style-type: none"> <li>• estimated current construction cost,</li> <li>• provision for cost escalation during period of insurance and rebuilding process,</li> <li>• allowances for demolition and clean up, and</li> <li>• professional fees.</li> </ul> <p>Cost of alternative rental accommodation is not included.</p> <p>Where a TBE, Extension or Renovation is involved, the assessment for Replacement Insurance should include the proposed work.</p> <p>No assessment is provided for a strata unit as insurance will normally be the responsibility of the Body Corporate for the whole development.</p>
Recommendation	<p>It might be noticed that no provision for a security recommendation is included in the report. The decision as to the suitability of the security is a commercial decision for the lender. That decision may not only be based on the content of the report but may also extend to factors beyond the property itself.</p> <p>It is not normally appropriate for the Valuer to recommend a loan to valuation ratio (LVR) or percentage to advance.</p>
Lenders Reference to Valuer	<p>The lender client may obtain documents (whether on the recommendation of the valuer or not), which may reveal matters not disclosed in the valuer's report. If they might impact on the value, marketability or risk analysis, they should be referred back to the valuer for further consideration, comment and confirmation or otherwise of the valuation.</p> <p>While the report may identify or comment on various aspects to alert the reader to various issues, it does not substitute for recommended reports by appropriate experts, specialists or authorities.</p>
Authorised for Issue By	<p>This is included to address instances where a director of the valuation firm is required by the client to also sign the report. A person signing in this capacity is merely authenticating the report as from that firm. It should not be construed as endorsing or co-signing the valuation. This would be inappropriate unless the co-signatory had, at the date of valuation, also inspected the property and been actively involved in the research and assessments. As a safeguard, the person authorising may choose not to include professional qualifications so as to avoid giving the false impression of being a co-signatory to the valuation.</p>

### 4. THE LAND

Property Identification	<p>This is to provide an indication of the means, other than street address, by which the property has been identified where this is the case. Where no such means other than street address has been used, the valuer should indicate 'identification not confirmed'.</p> <p>Valuers are not normally experts in survey matters and therefore no part of the report should be construed as a survey report. If the valuer's inspection indicates there is a reasonable possibility of any encroachment over easements or boundaries, it would be appropriate for the valuer to recommend a survey report to clarify the issue.</p>
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## PROPERTY PRO SUPPORTING MEMORANDUM

ITEM	REQUIREMENT
Has title search been sighted?	This requires either a 'yes' or 'no' answer to inform the lender if the Valuer has had the benefit of a search, however obtained. It in itself is not indicating any requirement for the Valuer to carry out a search. If the answer is 'no', the lender could consider obtaining a current title search to confirm appropriate content in the valuer's report.
Zoning Effect	This should provide an indication as to whether the development is considered (subject to confirmation by appropriate certificate) to be a permitted development and use. Note should also be made as to whether the zoning has any significant adverse effects on the property. Any known proposed rezoning directly or indirectly affecting the property should be noted.
Location	This requires a statement as to the position of the property relative to the nearest town centre (CBD) and, if not a significant town, distance to the nearest main town or regional centre. It should indicate distances from other features such as schools, public transport and beaches. It does not require a description of the locality (this is provided under 'Neighbourhood').
Neighbourhood	This requires a description of the immediate locality and neighbouring development, drawing particular attention to any positive or negative features or aspects that impact on the value or marketability of the property including significant demographic changes.
Site Description & Access	This requires a brief description of the shape and topography of the site, its relationship to road level, its suitability for building, its aspect and any significant views, adverse outlooks or 'features' as relevant. Access should be described if difficult legally, physically or due to traffic.
Services	Requires notation of the utilities connected to the site or those provided on-site such as septic, bottled gas or tank water. It also requires detail on street surfacing, kerbing and guttering and footpaths.

### 5. MAIN BUILDING

Style	This comprises a two-part description defining the building in terms of its number of levels and/or elevation and degree of attachment, e.g. split level detached; two storey terrace; high rise part floor; high-set multi-level detached, etc. (Other style aspects such as architecture or period, can be noted in 'Additional Comments' if the valuer considers this relevant ).
Street Appeal	This relates to the kerb-side appeal or attractiveness of the building. For consistency, it has a five level rating ranging from 'high appeal' to 'low appeal'. It is not meant to describe its presentation, which is reflected more in 'external condition'.
Main Interior Linings	If there are numerous interior linings used, only the dominant ones are noted. Any feature linings such as timber panelling can be noted in 'Fixtures & Features'.
Internal Condition	For consistency, this has a five level rating ranging from 'excellent' to 'poor' and reflects both repair and apparent physical condition including cracking and movement.
External Condition	For consistency, this has a five level rating ranging from 'excellent' to 'poor' and reflects both repair and apparent physical condition including cracking and movement.
Accommodation	Number of bedrooms is stated first, followed by number of bathrooms (includes ensuites), other main rooms, then service or utility rooms and outdoor areas.

## PROPERTY PRO SUPPORTING MEMORANDUM

ITEM	REQUIREMENT
PC Items	<p>A list of the Prime Cost Items preferably starting with those in the kitchen, then laundry, bathroom(s), toilet and others servicing the whole building such as hot water service, air conditioning and ducted vacuum cleaner.</p> <p>It is not meant to cover all items that might be included in a specification as 'Provisional Cost' items e.g. wall and floor tiles, door furniture, etc.. These can, if unusual or particularly expensive, be included in Fixtures and Features.</p>
Fixtures and Features	<p>A list of built in items (such as cupboards and robes) and main feature finishes (such as non-wet area tiled floors and wood panelling).</p>

### 6. ANCILLARY IMPROVEMENTS

A list of ancillary improvements other than the 'main building', starting with significant items such as in-ground pool, tennis court, shed, etc., followed by secondary ancillary items such as fencing, paving, driveway, landscaping.

### 7. SALES EVIDENCE & THE MARKET

Sales Evidence	<p>The three most recent comparable sales available should be provided. More sales may be considered. Details of these should be retained on file but should not be included in the report.</p> <p>Where in the Valuer's opinion there are insufficient or no recent comparable sales, older sales should be included and adjusted. Where sales quoted are older than 6 months (three months in a rapidly changing market), this should be noted in 'Additional Comments'. An explanation should be provided as to the method of valuation, the market dynamics and likely movement of the market since any older sales that have been relied on.</p> <p>Sales relied upon should, as far as possible, be realistic comparisons in price range, type of property and location. Where the sale price evidence differs significantly (say +/- 15%) from the value adopted on the subject property, the valuer should provide suitable comment on the dynamics of the market to explain why it has been necessary to rely on such evidence. Similarly if a different class of property is used as evidence, or if a sale in a substantially different location is relied on, reasons should be stated in 'Additional Comments'.</p>
Brief Comments	<p>Each comparable sale should be briefly described.</p>
In Comparison to Subject	<p>For consistency and clarity, the comparison should be the sale property compared to the subject property (not the other way around). For example, if the comparison states 'generally inferior' it should mean that the sale property is generally inferior to the subject property. Where warranted, it should also contain a brief note of any major differences not apparent from the description, eg. 'steeper block' or 'badly needs paint'.</p>
Latest sale of subj. property	<p>Where a sale of the subject property has occurred in the past 3 years, it should be noted. Specific comment should be made if a current sale is not considered to be in line with the market or is known to be affected by special circumstances or incentives.</p> <p>The valuer is not required to sight a copy of the contract. If the lender is aware of special circumstances or incentives, the valuer could be supplied with details and asked to comment.</p> <p>Where the valuation varies significantly from a current or recent sale of the subject property, the reasons should be outlined in 'Additional Comments'.</p>

## PROPERTY PRO SUPPORTING MEMORANDUM

ITEM	REQUIREMENT
	It is not uncommon for the subject property to be valued 'at purchase price'. If there is a known current sale of the property, the valuer is expected to consider it against other evidence, as it has been a test of the market. As most properties sell within the normal Market Value range or tolerance, it will be reasonable for the purchase price to be adopted if it is considered to be within that range. Where the price has been at the top end of the range, additional comments would be warranted and the risk rating considered for any resultant increase in the risk of 'reduced value next 2 -3 years'.
Level of Market Activity	A brief note to describe the level of market activity as an indicator of the condition of the market. Adverse market conditions will reflect in the Risk Analysis and should be further commented on within the requirements of that section.
Recent Market Direction	A brief note of the recent direction (and strength) of movement in prices.
Two or multi- tiered market?	Is the property within a tiered market that includes two-tier and multi-tier markets. A 'Yes' or 'No' answer is required. If 'Yes', the Valuer should confirm that the valuation of the subject property is based on evidence that is reflective of informed purchasers and realistic marketing conditions or strategies such as would be readily available to an individual owner on resale.

### 8. ADDITIONAL COMMENTS

Any Risk Ratings of '4', or '5' or the existence of three or more '3' Risk Ratings from Section 2 'RISK ANALYSIS' should be commented on here . Additional comments can be made about the content of other sections of the report but it should be comment that enhances or elaborates on what has already been provided and not merely repeats what has already been stated. This section can be expanded on to another page if necessary. It can also be used to explain any unusual aspects that the format does not specifically address.

Comments can be in either narrative or dot point form.

### 9. SECURITISATION REQUIREMENTS

This section appears only if selected. It provides brief comment on issues specifically required by some mortgage securitisers and conveniently groups them under one heading even though some will have been addressed elsewhere in the report. Where any of the statements are adverse, they should be further commented on in section 8 'Additional Comments'.

### NOMINATED ADDITIONAL PARTIES

This section appears only if it contains information. If the instructing Organisation/Lender requires the report to nominate mortgage insurers and/or securitisers as additional parties who may rely on the report, they can be stated in this section.

### Report Clarification - Amended Report

If parties entitled to rely on a report are unclear on any aspect of its content, or consider that inadequate information has been provided, the valuer should be contacted before acting on the report. If additional information is supplied to clarify or enhance the report, an amended report should be issued with a note that the original report is withdrawn and should be returned to the valuer. There should be no additional fee unless the valuer was incorrectly instructed in the first instance.

### ANNEXURES

Photo(s)	The report should be accompanied by a coloured photograph of the front (or other appropriate) elevation of the property unless the Client directs that one is not required (in which case a photo should be taken and retained on file or electronically stored). Where significant adverse features are apparent it may be appropriate to provide additional photos showing relevant detail. These may include features nearby which impact on the property.
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### 4.0 Matters the Valuer may provide Restricted Comment on

#### 4.1 Aspects Requiring Specialists Reports

The Valuer's report may provide restricted or limited comment on a range of matters primarily to draw attention to aspects that may require action by others before confirmation of the report by the valuer. These tend to be in specialist areas where the Valuer often will have some knowledge but in which the Valuer is either not an expert or is not permitted under some act or regulation, to express a definitive opinion. The comments could note some observed condition or indication of a possible problem area and could lead to recommendations for reports from such experts as:

- Pest Controllers
- Land Surveyors
- Geo-technical Engineers
- Structural Engineers
- Building Inspectors
- Solicitors
- Environmental Surveyors
- Solicitors
- Town Planners
- Regulatory Bodies and Authorities

#### 4.2 Valuers Initial Comments Indicative Only

The Valuer's comments should be taken as indicative only and not definitive on the particular matter. For example, the Valuer's inspection may note that the building appears to be too close to what appears to be the boundary. The Valuer's report may then note this and recommend that a surveyor's report be obtained. In this way the Valuer serves to highlight need for a particular action. Any valuation or risk assessment provided will normally be subject to such reports being satisfactory.

#### 4.3 Refer Back to Valuer

When the specialist's report has been obtained, it should be referred back to the Valuer for comment as to how it impacts on the valuation, the risk analysis or the marketability of the property.

### 5.0 Departure Provisions

When circumstances arise which the valuer considers warrant departure from the provisions of this Supporting Memorandum, the reason for the departure should be clearly stated in 'Additional Comments'. The lender should be adequately advised of the possible impact of such action on the assessments and the report contents.

### 6.0 Matters to be checked by Lender and/or its Solicitor

#### 6.1 Refer Back to Valuer

Some of the information provided in the report may be obtained by expedient means or from sources with no evidentiary value, rather than applying, paying and awaiting receipt of, appropriate official documentation such as a solicitor would request in carrying out a conveyance or creating a mortgage. This is not only to expedite the Valuer's process, but also to reduce duplication and save extra expense. Sometimes a report will provide information, which documentation or certificates subsequently obtained by the lender or its solicitor reveal to be either incorrect or incomplete or not commented upon at all in the report. When any of these occurrences is discovered by subsequent checking, it would be appropriate to refer the matter back to the Valuer for further comment and advice as to how it affects the valuation and security assessment.

#### 6.2 Lender or Solicitor to Check

Matters reported in the Valuation and Security Assessment Report, which the Valuer assumes the lender and/or its solicitor will confirm or ascertain by checking appropriate documentation or certificates include:

- Title details including restrictions and encumbrances
- Zoning or town planning
- Building Contract
- Matters arising from the numerous searches a solicitor may conduct including, where relevant, searches of Body Corporate records and amounts held in sinking funds.
- Matters arising from any certificates or documents that the report specifically recommends are obtained.

## 7.0 Information the Valuer could be expected to hold on file

### 7.1 Valuer's File Should Contain

A Valuer's file for any valuation report using the PropertyPRO 'Residential Valuation and Security Assessment' Pro-forma could be expected as a good practice to contain:

- Copy of Instructions,
- Copy of the Report,
- Copy of any documents provided by the client, its solicitor or the borrower,
- Copy of any block, subdivision or strata plans relied upon,
- Copy of Valuer's inspection notes for the subject property including:
  - a plan of the main buildings, (recording external wall dimensions). Building areas required in the report are to be based on measurement and calculation.
  - adequate notes to record any necessary detail beyond that required in the report covering construction of the main building, its quality, finishes, condition and any essential repairs,
  - adequate notes of ancillary improvements.
- Copy of Valuer's inquiry sheet if appropriate adequately recording any additional research information obtained and preferably from whom and/or where,
- Print of photo (or photocopy of original),
- Copy of Valuer's work sheet. Where a TBE/ Extension/Renovation is involved, calculations for the Check Costing should also be on file.
- Copy of any special document relied on that the Valuer considers relates to the property specifically rather than properties in general.

#### NOTE:

Where any of these notes are recorded on tape or by other electronic means, either the tape should be retained with the file or a hard copy of the recording or electronic record should be produced and retained with the file.

While valuers may use a variety of methods to record their field notes, as a guide, information

recorded and retained on file should be adequate:

- to demonstrate that a proper inspection has been carried out, and
- to allow the valuer to discuss the property and the report with the client or its service providers at some point in the future (which may be some years hence).



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# RESTRICTED VALUATION SUPPORTING MEMORANDUM

## 1.0 Introduction

### 1.1 Purpose

This Supporting Memorandum (“Memorandum”) provides the basis upon which Members of the Australian Property Institute (API), who are a Certified Practising Valuer (CPV) or Residential Property Valuer (RPV), will carry out Restricted Valuations for residential mortgage purposes and the basis upon which their Lender clients will use and accept Restricted Valuations.

### 1.2 Definition

A Restricted Valuation is a valuation carried out in accordance with this Supporting Memorandum in the format titled “Restricted Valuation – Residential Property” Copyright API 2001.

### 1.3 Scope

A CPV/RPV who provides a Restricted Valuation for residential mortgage purposes must do so in accordance with the provisions of this Memorandum. Any CPV/RPV carrying out a Restricted Valuation in accordance with the provisions of this Memorandum and the Restricted Valuation - Residential Property pro-forma report will not be in breach of the Institute’s Constitution, By Laws, Rules of Conduct or professional practice standards.

1.4 CPV/RPVs undertaking a Restricted Valuation do so pursuant to the API’s Rules of Conduct.

1.5 A Lender client who instructs a CPV/RPV to do a Restricted Valuation must do so in accordance with the provisions of this Memorandum and in doing so agrees to accept the commercial risks inherent in relying upon a Restricted Valuation as described in this Memorandum and the immunities and indemnities in favour of the CPV/RPV provided within this Memorandum.

1.6 This Memorandum sets out the requirements that Lender clients must comply with in requesting, and CPV/RPV must comply with in providing, a Restricted Valuation for residential mortgage purposes. In particular, it provides important

information to Lender clients and CPV/RPV in relation to:

- Prerequisites for the provision of a Restricted Valuation,
- The type of property it is intended for,
- Information to be provided to the CPV/RPV by the Lender client,
- The Restricted Valuation process and responsibilities of the Lender client and CPV/RPV,
- The provision of an Indicative Market Value Range,
- The circumstances when a PropertyPRO Residential Valuation and Security Assessment is required in place of a Restricted Valuation,
- The commercial risks upon the Lender client of relying on a Restricted Valuation, and
- The restriction on the release of a Restricted Valuation report to third parties.

## 2.0 Background

- 2.1 The Institute acknowledges that Lender clients will not always require a PropertyPRO Residential Valuation and Security Assessment report but instead may have the need for a lower level of valuation assurance which the Institute and the Lender client recognises as a Restricted Valuation
- 2.2 The Institute reserves Copyright of the Restricted Valuation Residential - Property’ pro-forma report. This is deemed necessary to retain the integrity and consistency of the report format. The report format is available through the Institute.
- 2.3 Although the Institute has approved the use of Restricted Valuations in the manner contemplated by this Supporting Memorandum it does not accept any responsibility for the content of any Restricted Valuation.
- 2.4 Any CPV/RPV who provides or any Lender client who uses or relies upon a Restricted Valuation agrees to be bound by all of the provisions of this Supporting Memorandum.

## RESTRICTED VALUATION SUPPORTING MEMORANDUM

### 3.0 Provision of the 'Restricted Valuation' Service

- 3.1 In providing a Restricted Valuation, a CPV/RPV is not required to exceed the terms of the Lender clients' instructions as noted on the Restricted Valuation - Residential Property pro-forma report and as further explained in this Supporting Memorandum.
- 3.2 A Restricted Valuation must only be provided by a CPV/RPV who has had recent relevant valuation experience in the locality (within, at a maximum, the past six months or, in rapidly changing market conditions, within the past three months), and has researched that market place for the purpose of valuing similar properties.
- 3.3 Where a CPV/RPV is not able to satisfy the requirements of RV: 3.2 the instruction must be declined. In these circumstances the CPV/RPV may alternatively advise the lender that the CPV/RPV is prepared to undertake a PropertyPRO Residential Valuation and Security Assessment of the Property.

### 4.0 Restrictions on the Provision and Use of a Restricted Valuation

- 4.1 A Restricted Valuation must only be carried out by CPV/RPV for the valuation of existing single residential dwellings, strata or community plan units, vacant single residential sites and hobby farms for mortgage security purposes. A Restricted Valuation must not be used for the valuation of proposed dwellings or extensions/renovations to existing dwellings and must not be used for the valuation of unique residential properties or those falling within upper market levels. A Restricted Valuation must not be provided for a valuation of any other type of property for any purpose.
- 4.2 A Restricted Valuation as defined in this Supporting Memorandum must only be provided on the Restricted Valuation - Residential Property pro-forma report annexed hereto after Part A has been completed (as far as possible) by the Lender client, as the pro-forma constitutes both a letter of instruction and a report format. The Restricted Valuation - Residential Property pro-forma report is copyright by the Australian Property Institute and must not be modified in any way without approval in writing from the Australian Property Institute.
- 4.3 The Institute considers that a Restricted Valuation is not suitable for high percentage lending. A

Restricted Valuation undertaken by a CPV/RPV must not be used by a Lender client to approve a mortgage loan where the Loan to Current Purchase Price Ratio (if any) exceeds 80%.

- 4.4 A Restricted Valuation must not be used for mortgage insurance purposes.

### 5.0 Information to be provided to the CPV/RPV

The CPV/RPV requires certain information to undertake a Restricted Valuation. The Lender client is required to provide the following minimum information to the CPV/RPV:

#### Essential information:

- full property address (lot number is insufficient unless plan number also supplied).
- Number/type of rooms, number of bedrooms and bathrooms,
- Estimated living area
- External improvements (eg Swimming pool)
- Land area.

#### Important information:

- title detail / legal description / survey or registered plan.

Provision of both the property address and the title detail / legal description are important to enable the correct property to be identified and confirmed as other normal means of confirmation will not be available to the CPV/RPV conducting a Restricted Valuation. Where the Lender client is unable to supply title detail / legal description, the CPV/RPV is entitled to assume that the address supplied by the Lender client is correct and to rely upon it. The Lender client acknowledges that where only an address is provided to the CPV/RPV, the risk of incorrect identification increases and the Lender client indemnifies the CPV/RPV against any such mis-identification.

Should the CPV/RPV consider that there is a possibility that a property address has been incorrectly described by the lender, the CPV/RPV will notify the Lender client of such in the Restricted Valuation report and will recommend that the Lender client obtains a PropertyPRO Residential Valuation and Security Assessment.

#### Desirable information:

- Main building type
- Main walls and roof.

## 6.0 Limitations and Requirements of a Restricted Valuation

6.1 It is important that both CPV/RPV and Lender clients are aware of the extent and limitations of a Restricted Valuation provided by the CPV/RPV. In utilising this service, the Lender client agrees to waive the requirement for many of the processes that a CPV/RPV would undertake in carrying out a full valuation of a property. (An appreciation of extent by which a Restricted Valuation falls short of the valuation methodology required to be employed by a Member in valuing a residential property can be gained by reference to the PropertyPRO Residential Valuation and Security Assessment Supporting Memorandum).

6.2 A Lender client requesting a CPV/RPV to carry out a Restricted Valuation does so on the express understanding and agreement that the CPV/RPV is instructed not to conduct a comprehensive inspection of the property. The Lender client agrees to accept the Restricted Valuation having regard to the risks inherent in relying upon a valuation which does not have the benefit of a comprehensive inspection.

6.3 The Lender clients requirements for CPV/RPVs providing this Restricted Valuation service are set down in point form within the Instruction section of the Restricted Valuation - Residential Property pro-forma report. For the guidance of both Lender clients and CPV/RPVs these requirements are elaborated upon below:

- *'any records that you may possess in respect of the property should be checked. This includes registered plans, zoning information and any sales of the property in the past three years'*

This extends only to existing records that are held at the time of instruction in the CPV/RPV's office.

- *'the property must be identified at its street frontage'*
- *'an external inspection only of the property is to be conducted'*

The extent of the inspection of the property is to be limited to a point or points at or near its

legal frontage(s). The CPV/RPV must not enter onto the property. Where this inspection and the information provided to the CPV/RPV do not enable the CPV/RPV to gain a reasonable impression of the property, the CPV/RPV will be entitled to either increase the market range of the value for the property and/or recommend that a PropertyPRO Residential Valuation and Security Assessment be conducted.

- *'the property is to be photographed and the photo retained on file'*

This should be taken, without entering the property, from a point or points near the property's legal frontage.

- *'any property information supplied above that is known to be incorrect should be corrected, otherwise assume all information supplied to be correct'*

The CPV/RPV will not be held responsible if the information provided by the Lender client is incorrect, but where the CPV/RPV knows information supplied by the Lender client to be incorrect, the CPV/RPV must correct it. There is no obligation on the CPV/RPV to supply any missing information.

- *'the condition and quality of what is visible is to be assumed as indicative of the nature and condition of the property'*

If, for example, the visible part of the exterior appears in good condition and of above average quality, the CPV/RPV is entitled to assume that the remainder of the exterior and the interior is of the same condition. The Lender client acknowledges that such assumptions will not always be correct, but for the purpose of a Restricted Valuation, the Lender client agrees that the CPV/RPV is entitled to make that assumption.

- *'unless stated otherwise, fee simple with vacant possession is to be assumed'*

The CPV/RPV is not expected to search the title or to enquire if there are any leases or occupancy rights.

- *'unless ascertained within these limitations or physically obvious, it is to be assumed that there are no easements or encumbrances'*

The CPV/RPV is not expected to search the title, but must take into account any title

## RESTRICTED VALUATION SUPPORTING MEMORANDUM

information supplied or easements noted on plans already in the possession of the CPV/RPV or which are obvious from the restricted inspection.

- *'recent comparable sales from your records must be reviewed'*

Available sales data held in the CPV/RPV's office should be considered.

In agreeing to undertake a Restricted Valuation the CPV/RPV is required, in accordance with RV: 3.2 above, to have recently researched the relevant market place and to be familiar with the most recent sales and market direction. The Lender client agrees that it is therefore not necessary for the CPV/RPV to carry out additional comparable sales research.

- *'within the above limitations you are to provide (the client) with an indicative market value range for the property.'*

The Lender client acknowledges that the limitations imposed by the Lender client on the CPV/RPV in relation to inspection, research, enquiry and other aspects of due valuation process prevent the CPV/RPV from carrying out a fully researched valuation assessment of the property. The Lender client also acknowledges that, based upon the limited known information available to the CPV/RPV, an indicative market value range is more appropriate than a single valuation figure and the Lender client further acknowledges that the market value range is likely to be sufficiently wide to reflect the above limitations.

- 6.4 Any material relied upon or notes taken should be retained on file by the CPV/RPV Member with a copy of the Restricted Valuation report.
- 6.5 All information provided by the Lender client, including instructions, is to be in writing in Part A of the Restricted Valuation - Residential Property pro-forma report.
- 6.6 The Restricted Valuation is to be provided by the CPV/RPV to the Lender client in writing in Part B of the Restricted Valuation - Residential Property pro-forma report.

### 7.0 Indicative Market Value Range

- 7.1 It should be noted that a market valuation is property-specific and provides a single point

assessment in accordance with the definition of Market Value as follows:

*'The estimated amount for which an asset 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.'*

- 7.2 A Restricted Valuation is a qualified opinion of value of a property provided in accordance with this Supporting Memorandum in response to a specific instruction by the Lender client not to carry out the usual enquiries and investigations associated with a market valuation.

A Restricted Valuation is:

*an indication of the value range that the market value of the property is likely to fall within should a CPV/RPV be requested to carry out a fully researched valuation assessment of the property in accordance with the PropertyPRO Residential Valuation and Security Assessment' and the definition of market value in 7.1'.*

- 7.3 The value range provided by the CPV/RPV should be sufficiently wide to reflect the limitations of the Restricted Valuation process such as, but not limited to, the extent to which the property is visible, the degree to which it can be gauged within the limitations of the Restricted Valuation, the very limited research and enquiry and the limited known information. The greater the level of uncertainty that results from those limitations, the wider the range will likely be.

Where that range is greater than 20% (of the difference measured against the lower figure), the CPV/RPV should also recommend that the Lender client obtains a PropertyPRO Residential Valuation and Security Assessment of the property in question. A market value range should still be provided, even if broader than 20%, as it may be adequate for the Lender clients requirements.

It is specifically acknowledged by the Lender client that, based on the limited known information available to the CPV/RPV, the CPV/RPV will not be able to undertake a Restricted Valuation to the same level of accuracy as a PropertyPRO Residential Valuation and Security Assessment.

- 7.4 If a Restricted Valuation is provided in a marketplace where two-tier or multi-tier markets are in existence, the range provided should reflect an informed purchaser's and realistic marketing

conditions such as would be available to an individual owner on re-sale.

### 8.0 Recommending PropertyPRO Residential Valuation and Security Assessment Report

- 8.1 Aware of factors which impact or could impact adversely on the property. Where it is thought this adverse impact could be significant, but can only be established or confirmed by inspection, research and/or enquiry beyond the intended scope of a Restricted Valuation, the CPV/RPV should recommend that a PropertyPRO Residential Valuation and Security Assessment report be prepared. The recommendation can be made by ticking the box provided.
- 8.2 Where a recommendation is made for the preparation of such a report, the CPV/RPV should also briefly note the main reason for the recommendation.

### 9.0 Acceptance of Commercial Risks of a Restricted Valuation

- 9.1 The Institute considers that there are inherent risks to a Lender client who relies on a Restricted Valuation but acknowledges that the Lender client has expressed a commercial need for such a valuation to be carried out by CPV/RPV Members of the Institute.
- 9.2 A Lender client, in providing its instructions for a Restricted Valuation using the Restricted Valuation - Residential Property pro-forma report, agrees to accept and be bound by the process contained within this Supporting Memorandum.
- 9.3 The Lender client expressly acknowledges and confirms:
- (a) in producing the valuation advice contained in a Restricted Valuation the CPV/RPV has not carried out the usual range of enquiries that a CPV/RPV is required to make by professional practice standards in determining a valuation of property, and that this is at the specific request of the Lender client.
  - (b) that the Lender client fully understands the risks inherent in relying upon a valuation carried out in such circumstances.

Accordingly, but subject to compliance by the CPV/RPV with the requirements of the Restricted Valuation - Residential Property pro-forma report, this Supporting Memorandum and the stated instructions of the Lender client, the Lender client agrees that it will have no cause of action against the CPV/RPV whether in contract tort or otherwise by reason only that the Lender client suffered loss or damage by relying upon a Restricted Valuation.

The Lender client further agrees that it will indemnify the CPV/RPV against any claim for loss or damage by a third party invited or permitted by the Lender client to rely upon a Restricted Valuation, whether arising in contract tort or otherwise and arising out of or in connection with reliance by that third party on a Restricted Valuation.

Nothing in this clause 9.3 shall affect the liability of the CPV/RPV in relation to a Restricted Valuation where the CPV/RPV failed to carry out a Restricted Valuation in accordance with the provisions of the Restricted Valuation - Residential Property pro-forma report, this Supporting Memorandum and the stated instructions of the Lender client.

- 9.4 The Lender client will not convey a Restricted Valuation or any part of it to the borrower or other third parties, and will keep it confidential and will use it for its mortgage-related purposes only.



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**ANNUAL API/PINZ CPD RECORD** (for the period 1 January to 31 December 2007)

Name: .....  
*First Names* ..... *Surname* .....

Address: .....

Employer: ..... Tel (Work) ..... Fax (Work) .....

Please tick if you wish to receive a CPD Certificate of Compliance

**You must complete the following two questions:**

Please tick this box if you have completed a valuation during this CPD reporting period (i.e. 1 January to 31 December 2007)

Please state the last time you completed an API approved Risk Management Module ..... OR  Never  
*Month* *Year*

**Section One**

Date	CPD Activity (eg seminar, conference, workshop, course, tape, technical committee, prepared and presented paper) / Topic / Presenter	CPD Activity Provider (eg API, RMIT, Qld Govt)	CPD Hours	CPD Points (1 point per hour)	
				Property	Non Property
Eg. 20/3/07	Valuation of Specialised Asset Classes – Service Stations	API -VIC	2	2	
<b>Subtotal</b>					

**2007 ANNUAL API/PINZ CPD RECORD** (for the period 1 January to 31 December 2007)

Section 2 - Private Planned Study Completed During 2007

Topics Studied	Name of Publication	Author(s)	Publisher	CPD Hours	CPD Points (1 point per hour)	
					Property	Non Property
eg. Easements	Easements – Law & Valuation	Webster, Watkins, Holland	API (Seminar paper)	1	1	-
			Subtotal			

Section 3 - Additional / New Vocational / Professional Functions Undertaken in 2007

Additional / New Function(s) Performed	Knowledge/Skills gained or updated from learning on-the-job	Competence Level		Evidence of Improvement	CPD Hours	CPD Points (1 point per hour)	
		2006 Year	End 2007			Property	Non Property
eg. Marketing	Knowledge of marketing strategies for small professional practice	Familiar	Skilled	Developed & implemented marketing plan for small professional practice	8	-	8
Note: Maximum of 10 points is recognised for Section 2 plus Section 3							
Subtotal							
Total 2007 CPD Points							
2006 Points Carried Forward							
Total CPD points							

Signature ..... Date .....

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## INDEX

## A

- AAS *see* Australian Accounting Standards
- AASB *see* Australian Accounting Standards Board
- Aboriginal and Torres Strait islander Commission (ATSIC), 12.2.3
- acceptance of instructions, 3.3.3
- accessibility
  - agricultural properties, 8.10.2
- accommodation hotels *see* hotels
- accounting framework
  - for valuations for use in Australian financial reports, 9.1.1–9.1.2
- accounting standards
  - and agricultural property valuation, 6.10.2–6.10.3
  - and business valuation, 6.6.3
  - and consideration of hazardous substances in valuation, 6.7.2
  - and depreciated replacement cost, 6.8.2
  - and discounting procedures, 6.9.2
  - and intangible asset valuation, 6.4.3
  - international equivalents to the IFRSs, 5.1.4
    - see also* New Zealand Equivalents of International Financial Reporting Standards
  - and leased property valuation, 6.2.3
  - and mass appraisal, 6.13.2
  - New Zealand, 10.1.1–10.1.5
  - and personal property valuation, 6.5.3
  - and plant and equipment valuation, 6.3.2
  - and public sector asset valuation, 5.3.3
  - and real property valuation, 6.1.3
  - relationship to IVSs, 4.2.3, 4.3.1, 4.4.2
  - standards setting process in Australia, 9.1.2
  - and trade related properties, 6.12.2
  - and valuation for financial reporting, 5.1.3–5.1.4
  - and valuation for lending purposes, 5.2.1
  - and valuation of properties in extractive industries, 6.14.5–6.14.6
  - and valuation practice, 5.1.3–5.1.4, 6.11.2
  - see also* Australian Accounting Standards; International Accounting Standards; International Financial Reporting Standards; International Public Sector Accounting Standards
- Accounting Standards (Australian) *see* Australian Accounting Standards
- accuracy and uniformity of valuation, 8.4.3, 8.4.5–8.4.7
- ad valorem property taxation, 6.13.1–6.13.3
- adjusted asset approach, 6.4.6
  - see also* cost approach
- adjusted book value, 6.6.1
- administrative (compliance) review, 6.11.1, 6.11.2
- adverse impact, 8.1.9
- advertising, 2.2.3, 2.4.3, 2.4.5–2.4.6
- advocate, 8.9.4, 11.2.1–11.2.2
  - and valuations for compulsory acquisitions, 7.1.1
- affected valuation approach
  - to valuation in light of contamination, 6.7.5
- agent (leasing agent), 11.10.1–11.10.3
- agricultural activity, 6.10.2
- agricultural properties, 5.1.6, 6.10.1–6.10.4, 8.10.1–8.10.5
  - asset classes, 6.10.3
  - and environmental checklist, 12.1.14
- allocation (indirect comparison technique), 6.1.10
- alterations (leasehold alterations) *see* leasehold alterations
- alternative use value, 5.1.7, 8.2.2
- ambit claims
  - and valuations for compulsory acquisitions, 7.1.1
- antiques, 6.5.6
  - see also* fine art valuation
- ANZ Practice Standards
  - ANZPS 1 Valuations for Compulsory Acquisitions, 7.1.1
- ANZ Real Property Guidance Notes
  - ANZRPGN 1 Disclaimer Clauses and Qualification Statements, 11.1.1–11.1.6
  - ANZRPGN 2 Acting as an Expert Witness, Advocate or Arbitrator, 11.2.1–11.2.2
  - ANZRPGN 3 Leasing Incentives, 11.3.1–11.3.4
  - ANZRPGN 4 Methods of Measurement, 11.4.1–11.4.6
  - ANZRPGN 5 Feasibility Studies, 11.5.1–11.5.19
  - ANZRPGN 6 Due Diligence, 11.6.1–11.6.15
  - ANZRPGN 7 Property Insurance Management, 11.7.1–11.7.11
  - ANZRPGN 8 Preparing Property for Sale, 11.8.1–11.8.9
  - ANZRPGN 9 Property Development Management, 11.9.1–11.9.14
  - ANZRPGN 10 Leasing Agent Services, 11.10.1–11.10.3
- ANZ Valuation Guidance Notes
  - ANZVGN 1 Valuations Procedures - Real Property, 8.1.1–8.1.9, 8.10.1

## INDEX

- ANZVGN 2 Valuations for Mortgage and Loan Security Purposes, 8.2.1–8.2.3
- ANZVGN 3 Valuations for Mortgage and Loan Security Purposes (Forced Sale), 8.3.1–8.3.2
- ANZVGN 4 Valuations for Rating and Taxing, 6.13.2, 8.4.1–8.4.7
- ANZVGN 5 Valuations for Compulsory Acquisitions, 8.5.1–8.5.5
- ANZVGN 6 Valuations of Accommodation Hotels, 8.6.1–8.6.5
- ANZVGN 7 The Valuation of Partial Interests in Property Held within Co-ownership Structures, 8.7.1–8.7.5
- ANZVGN 8 Valuations for use in Offer Documents, 8.8.1–8.8.8
- ANZVGN 9 Assessing Rental Value, 8.9.1–8.9.5
- ANZVGN 10 Valuation of Agricultural Properties, 8.10.1–8.10.5
- ANZPSs see ANZ Practice Standards
- apartments, 8.6.1–8.6.5
  - see also hotels
- API see Australian Property Institute
- appliances, 3.5.3
- apportionment of value, 10.1.9
- appraisal level standards, 6.13.3
- appraisers, 3.4.1
- appropriateness of rating and other valuations, 10.1.11
- approvals and authorities
  - hotel valuation, 8.6.2
- arbitrators, 8.9.4, 11.2.1–11.2.2
- area definitions, 11.4.2–11.4.4
- arm's-length transaction, 4.2.2
- artworks see fine art valuation; heritage assets
- as of date, 6.4.2
- asbestos see hazardous and toxic substances
- assessed annual value, 8.4.2–8.4.3
- assessment lists, 6.13.3
- asset class, 5.1.6–5.1.7
- asset valuation, 5.1.1–5.1.10
- asset valuers, 3.4.1
- asset-based approach, 6.6.1, 6.6.10
- assets, 3.4.2–3.4.3, 3.5.2
  - of businesses, 3.5.4–3.5.5
  - categorisation of, 9.1.7–9.1.8
  - classification of, 5.1.4
  - definition, 3.4.2
  - leased see leases
  - NZ, 10.1.1–10.1.2
  - see also asset valuation; personal property; real estate
- assumptions
  - definition, 3.3.1
  - disclosure of, 8.8.5
  - special, unusual, or extraordinary assumptions, 4.4.1
- auction price, 6.5.1, 6.5.4–6.5.5
  - see also hammer price; private treaty sale
- auditors, co-operation with, 5.1.6, 5.3.6, 9.1.8, 10.1.6
- Australia
  - financial reporting see financial reporting
  - legislation see legislation
  - regulatory observance see regulatory observance
  - standard setting arrangements, 9.1.2
- Australia Real Property Guidance Notes
  - ARPGN 1 Land Contamination Issues, 12.1.1–12.1.19
  - ARPGN 2 Native Title Issues, 12.2.1–12.2.27
- Australian Accounting Standards, 6.3.3
  - AASB 3 Business Combinations, 9.1.4
  - AASB 5 Non-current Assets Held for Sale and Discontinued Operations, 9.1.4
  - AASB 116 Property, Plant and Equipment, 5.1.7, 6.15.3, 9.1.3
    - fair value in, 9.1.4–9.1.5
  - AASB 117 Leases, 9.1.3
  - AASB 136 Impairment of Assets, 9.1.3–9.1.4
  - AASB 140 Investment Property, 9.1.4
  - and IVA 1 Valuation for Financial Reporting, 5.1.3
  - relationship between old and new standards, 9.1.3
  - relationship with International Standards, 9.1.2, 9.1.3–9.1.7
  - standards setting process in Australia, 9.1.2
  - status of, 9.1.1
- Australian Accounting Standards Board, 9.1.1–9.1.2
- Australian Anthropological Society, 12.2.3
- Australian Construction Handbook* (Rawlinson), 11.5.15
- Australian Financial Services Licence, 8.8.6
- Australian Institute of Aboriginal and Torres Strait Islander Studies, 12.2.3
- Australian Local Government Association
  - Working with Native Title: A Practical Guide for Local Government*, 12.2.4
- Australian Property Institute, 1.1.1
  - Code of Ethics, 2.1.1
  - feedback to, 15.5.1–15.5.2
  - offices, 16.5.1–16.5.2
  - property types unacceptable for desktop assessment, 15.4.12
  - Rules of Conduct, 2.2.1–2.2.3
  - services provided by members, 15.2.1
- Australian Real Property Guidance Notes see Australia Real Property Guidance Notes
- Australian Valuation & Property Standards Board, 1.1.2

Australian Valuation Guidance Notes  
 AVGN 1 Valuations for Use in Australian Financial Reports, 9.1.1–9.1.8  
 AVGN 2 Valuations for Insurance Purposes, 9.2.1–9.2.8  
 AV&PSB see Australian Valuation & Property Standards Board  
 average competent management, 6.12.1

## B

banks (retail), 11.4.4  
 bases of value, 4.1.1–4.1.2, 4.3.1–4.3.4, 6.1.3, 10.1.5–10.1.6  
 definition, 3.4.3, 4.3.1  
 for rating and taxing, 8.4.1–8.4.3  
 see *also* fair value; special value; synergistic value  
 basis of settlement (insurance), 9.2.3  
 bibliography  
 environmental factors and hazards, 13.1.4–13.1.6  
 bidder's statement see offer documents  
 biological assets, 5.1.6, 5.3.6, 5.3.7, 6.10.2  
 inclusions with agricultural properties, 8.10.4  
 boarding (guest) houses, 11.4.4  
 boards, councils and committees, 14.2.2  
 book value, 6.4.1, 6.6.1  
 borrowing costs  
 New Zealand, 5.1.8, 10.1.3–10.1.4  
 bottle shops, 11.4.4–11.4.5  
 brands see intangible assets  
 broad acre (agricultural land), 8.10.5  
 building costs, 11.5.5  
 building plans and approvals, 8.6.2  
 buildings  
 area definitions, 11.4.2–11.4.4  
 of cultural and historic significance see heritage assets;  
 historic properties  
 historical see heritage assets  
 leases see lease interests; leases  
 measurement of, 11.4.1–11.4.6  
 replacement/reinstatement, 9.2.4–9.2.7  
 state of repair and condition of, 8.6.2, 11.6.4–11.6.6  
 types of, 11.4.1–11.4.6  
 valuation for insurance purposes, 9.2.1–9.2.2  
 see *also* houses  
 bundle of rights (ownership of real property), 3.4.1, 3.5.1  
 business activities, 3.5.4  
 business combinations, 5.1.6, 5.3.5, 9.1.4  
 business entities, 6.6.1  
 definition, 6.4.1

NZ, 10.1.1  
 see *also* businesses; financial reporting  
 Business Focus, 14.1.1  
 BF 1 Professional Activities, 14.2.1–14.2.2  
 BF 2 Reports, Content and Compilation, 14.3.1–14.3.16  
 BF 3 Property Action Plans, 14.4.1–14.4.4  
 BF 4 CPD Requirements, Activity Planner and Recorder, 14.5.1–14.5.6  
 business insurance, 11.7.6, 11.7.9  
 business valuation, 3.5.4–3.5.5, 5.1.1–5.1.10, 6.6.1–6.6.11  
 Business Valuer, 6.6.1  
 businesses  
 definition, 3.5.4  
 directors' responsibilities, 11.7.3  
 financial reporting see financial reporting  
 types of, 3.5.4–3.5.5  
 valuation of see business valuation  
 see *also* government business enterprises

## C

calibration, 6.13.2  
 capital structure, 6.6.2  
 capital value  
 income producing property, 11.3.4  
 rating and taxing, 8.4.3  
 capitalisation, 3.4.7, 6.1.6–6.1.7, 6.4.1, 6.12.1  
 in business valuation, 6.6.1–6.6.2  
 see *also* income capitalisation approach  
 capitalisation factor, 6.4.1, 6.6.2  
 capitalisation rates, 3.4.7, 6.4.1, 6.4.6, 6.6.2  
 car parks (commercial), 11.4.4  
 carrying amount, 5.1.10, 5.3.5  
 definition, 5.1.2, 10.1.4  
 carrying capacity of agricultural properties, 8.10.4  
 cash flow, 5.3.7–5.3.8, 6.1.6–6.1.7  
 definitions, 6.4.1–6.4.2, 6.6.2  
 see *also* discounted cash flow analysis  
 cash-generating assets, 5.3.5, 5.3.6–5.3.7  
 definition, 5.3.2  
 cash-generating units, definition, 5.1.2  
 chattels, 8.1.1–8.1.2, 8.2.3  
 see *also* goods and chattels personal; non-fixtures/  
 chattels  
 checklists  
 development consultancy checklist, 11.9.2–11.9.3  
 due diligence, 11.6.14–11.6.15



## INDEX

- environmental/contamination issues, 12.1.12–12.1.14
- for feasibility studies, 11.5.15–11.5.19
- property action plans/planning, 14.4.2–14.4.4
- cinemas, 3.5.4, 11.4.4
- classification of assets, 5.1.4, 5.3.3
  - agricultural property assets, 6.10.3
  - New Zealand
    - under Financial Reporting Standards, 10.1.5
  - see also asset class
- classification of land, 8.10.3
- client considerations, 6.7.7
- Client Focus, 15.1.1
  - CF 1 Types of Services Provided by API and PINZ Members, 15.2.1
  - CF 2 Instructing Valuers, 15.3.1–15.3.12
  - CF 3 Residential Desktop Assessment Advisory Note, 15.4.1–15.4.12
  - CF 4 Feedback to API and PINZ Members and/or the API/PINZ, 15.5.1–15.5.2
- client relationships, 2.2.2–2.2.3, 2.4.2–2.4.3, 2.4.4–2.4.5, 8.8.4
- client's instruction, 6.1.4
- climate impact on value of agricultural land, 8.10.2
- clubs (recreational), 11.4.4
- CMBs see commercial mortgage-backed securities
- CMOs see collateralised mortgage obligations
- Code of Conduct
  - IVSC, 3.3.1–3.3.4
- Code of Ethics
  - API, 2.1.1
  - PINZ, 2.3.1
  - see also Rules of Conduct
- co-existing estates, and Native Title, 12.2.4–12.2.9
- coinsurance, 9.2.5, 11.7.9–11.7.10
- collateralised mortgage obligations, 3.5.6
- collectibles, 3.5.3, 6.5.1
- Combined [Mineral] Reserves International Reporting Standard Committee mineral reserve/resource definitions, 6.14.3–6.14.4
- Commercial Leases in Australia* (Duncan), 8.9.4
- commercial mortgage-backed securities, 3.5.6
- commingled accounts, 3.5.6
- committees, 14.2.2
- commodity production see agricultural properties
- common householders policy (insurance), 9.2.2
- Commonwealth Institute of Valuers see Australian Property Institute
- communication see Valuation Report
- companies
  - inter-company leases, 6.2.3
  - company title, 11.4.2
- comparable data, 6.1.2, 6.1.8
- comparable evidence, 8.7.4
  - is assessing rental value, 8.9.3
  - physical underlying asset and co-ownership interest, 8.7.4–8.7.5
- comparative approach to valuation in light of contamination, 6.7.6–6.7.7
- compensation assessment
  - compulsory acquisitions, 8.5.2–8.5.3
- competence (professional standards), 2.1.1, 2.3.1, 2.4.5, 3.3.3
  - for valuations of properties in extractive industries, 6.14.7
- compliance, 4.2.3, 4.3.1–4.3.2, 4.4.2
- Compliance Statement, 4.2.3
  - definition, 4.4.1
- component value, 3.5.3
- compound (financial) instrument, 3.5.7
- compulsory acquisitions, 7.1.1, 8.5.1–8.5.5
- conditions of sale, 6.1.8
- conduct, professional see professional conduct
- conferences, 14.2.1
- confidentiality, 2.1.1, 2.2.2–2.2.3, 2.3.1, 2.4.2–2.4.3, 3.3.2
- conflict of interest, 2.1.1, 2.2.2, 2.3.1, 2.4.2, 3.3.2, 8.8.4
- conservation assets see heritage assets; public sector assets
- consultancy
  - development consultancy
    - checklist, 11.9.2–11.9.3
    - terms of appointment, 11.9.5–11.9.14
  - post consultancy report, 8.5.2
  - post valuation consultancy, 8.1.9, 8.5.5
  - property action plans/planning, 14.4.1–14.4.4
- contact details
  - API and PINZ offices, 16.5.1–16.5.2
- contaminated land, 6.7.5, 8.1.9, 11.1.4–11.1.5, 12.1.1–12.1.19, 13.1.1–13.1.6
  - agricultural properties, 8.10.3
  - Australia
    - legislation, 12.1.9, 12.1.17–18
    - remediation practices and techniques, 12.1.5–12.1.6
    - value/cost impact of contamination, 12.1.6–12.1.9
  - bibliography, 13.1.4–13.1.6
  - environmental audit, 11.6.12
  - environmental checklist, 12.1.12–12.1.14
  - New Zealand
    - valuation, 13.1.1–13.1.6
    - value/cost impact of contamination, 13.1.2–13.1.3

valuation approaches, 6.7.5–6.7.7  
 see *also* environmental factors and hazards; hazardous and toxic substances

contamination see hazardous and toxic substances

continuing professional development, 14.2.1–14.2.2, 14.5.1–14.5.6  
 activity planner, 14.5.4  
 record sheets, 14.5.5–14.5.6, 16.1.1–16.4.2

contract provisions, 4.3.3

contract rent, 6.2.2–6.2.3, 8.9.5

contractor's method see cost approach

control  
 businesses, 6.6.2, 6.6.5  
 issues in property held within co-ownership structures, 8.7.4  
 see *also* majority control

control premium, 6.6.2

co-ownership  
 partial interests in property held within, 8.7.1–8.7.5  
 principles and issues, 8.7.3–8.7.4

copyright sections, 1.1.1–1.1.2

Corporate Law Economic Reform Program (Australia), 9.1.2

cost, 3.4.3–3.4.4, 4.1.1–4.1.2  
 definition, 3.4.3  
 elements of, 5.1.7

cost approach, 3.4.7  
 definition, 6.1.3  
 fine art, 6.5.1  
 intangible assets, 6.4.6  
 personal property, 6.5.5–6.5.6  
 real property, 6.1.5, 6.1.7, 6.1.8, 6.1.11  
 see *also* depreciated replacement cost

cost estimate for property development, 11.5.1–11.5.6

cost model, 5.1.4  
 investment property, 5.1.9

court decisions  
 compulsory acquisitions, 8.5.2  
 Native Title (Australia), 12.2.1, 12.2.2, 12.2.5

CPD see continuing professional development

CRIRSCO see Combined [Mineral] Reserves International Reporting Standard Committee

crop(ping) farms, 6.10.1  
 see *also* irrigated land; perennial plantings

cultural heritage, definitions, 6.15.2  
 see *also* heritage assets; historic properties

current assets, 3.5.2  
 definition, 3.4.2

current forced sale assessment, 8.3.2

current market value, 10.1.4  
 see *also* market value

## D

dairy farms, 6.10.2

data selection and collection, 6.1.4–6.1.5, 6.2.4, 6.5.4, 6.13.2–6.13.3, 6.14.4, 6.14.8, 11.6.13  
 in assessing rental value, 8.9.1  
 feasibility studies, 11.5.3–11.5.4  
 properties held in co-ownership structures, 8.7.5  
 records of, 6.1.3, 6.13.2–6.13.3

data sources, 3.4.7, 6.4.3–6.4.4, 6.5.3  
 see *also* market data

date of valuation, 4.2.2, 4.4.3, 6.4.2  
 see *also* effective date

DCF analysis see discounted cash flow analysis

debt recovery, 3.5.3

deed restrictions, 3.5.1

definitions  
 area definitions, 11.4.2–11.4.4  
 in assessing rental value, 8.9.4–8.9.5  
 IFRS definitions, 5.1.2–5.1.3  
 included in reports, 8.8.3  
 insurance valuation terms, 10.2.3–10.2.4  
 IPSAS definitions, 5.3.2–5.3.3, 6.15.2  
 IVS definitions, 5.1.1, 5.2.1, 5.3.1–5.3.2  
 IVSC definitions  
 depreciated replacement cost, 9.1.5–9.1.7  
 Native Title (Australia), 12.2.27  
 primacy of lease definitions (in assessing rental value), 8.9.2  
 for residential desktop assessments, 15.4.11

demand, 4.1.1

demolition estimate, 10.2.3, 10.2.4

depreciable amount, 5.1.2, 5.3.2

depreciated replacement cost, 3.4.7, 5.1.5, 5.3.7, 9.1.5–9.1.7  
 definition, 5.1.1, 5.3.1–5.3.2, 6.1.3, 10.1.4  
 for financial reporting, 6.8.1–6.8.4  
 New Zealand, 5.1.8  
 see *also* cost approach

depreciation  
 in asset valuation, 3.4.3  
 definition, 5.1.2, 5.3.2, 10.1.4  
 in financial reporting, 3.4.3  
 property, plant and equipment, 5.1.7

derivative financial instruments, 3.5.7

design influences

## INDEX

commercial investment properties, 11.6.11  
desire, 4.1.1  
desk review, 6.11.1, 6.11.2  
desktop assessments of residential property,  
15.4.1–15.4.12  
development margin  
definition (SSAP-17), 10.1.4  
development of real estate, 5.2.4  
checklists, 11.5.11–11.5.14, 11.9.2–11.9.3  
development consultancy checklist, 11.9.2–11.9.3  
development management fees, 11.9.3  
development manager  
role of, 11.9.1–11.9.2  
terms of appointment, 11.9.7–11.9.14  
estimation of costs, 11.5.5–11.5.6  
evaluation of potential, 11.5.4–11.5.5  
feasibility studies, 11.5.1–11.5.19  
sale in one line or single transaction, 4.4.4  
value 'as if complete', 4.4.4, 5.2.2, 8.8.6,  
11.5.6–11.5.7  
value 'at date of completion', 11.5.6–11.5.7  
development property see development of real estate  
definition (SSAP-17), 10.1.4  
diligence see due diligence; efficiency and diligence  
direct capitalisation, 6.1.7  
directors' responsibilities, 11.7.3  
disclaimers and qualifications, 11.1.1–11.1.6  
see also qualification statements  
disclosure, 3.3.3–3.3.4  
concerning financial assets and liabilities, 3.5.6  
disclosure material  
preparing for sale of property, 11.8.5–11.8.6, 11  
disclosure requirements  
in extractive industries valuation reports, 6.14.8–6.14.9  
IVA 1 Valuation for Financial Reporting, 5.1.10  
IVS 1 Market Value Basis of Valuation, 4.2.5  
IVS 2 Valuation Bases Other Than Market Value, 4.3.4  
IVS 3 Valuation Reporting, 4.4.4  
market-based valuations, 4.2.5  
in mass appraisals, 6.13.3  
NZVGN 1 Valuations for Use in New Zealand Financial  
Reports, 10.1.6  
in public sector asset valuation, 5.3.8  
valuation bases other than market value, 4.3.4  
in valuation for financial reporting, 5.1.10, 10.1.6  
in valuation for lending purposes, 5.2.5  
in Valuation Reports, 4.4.4, 10.1.11  
discount for lack of control, 6.6.2  
discount rates, 3.4.7, 6.4.2, 6.4.6, 6.6.2, 6.9.1

discounted cash flow analysis, 4.2.1, 6.1.7, 6.6.9–6.6.10,  
6.12.1  
definition, 6.9.1–6.9.2  
extractive industries, 6.14.8  
for market and non-market based valuations,  
6.9.1–6.9.5  
disposal group, 5.3.5  
disrupted markets, 5.1.10  
dividends method, 6.6.9–6.6.10  
documentation see data selection and collection; Valuation  
Report  
dry sheep equivalents, 8.10.5  
due diligence, 11.6.1–11.6.15  
checklist, 11.6.14–11.6.15  
and preparation of property for sale, 11.8.5–11.8.6  
process, 11.6.4–11.6.5  
Duncan, WD *Commercial Leases in Australia*, 8.9.4  
duty of care, 10.3.2, 11.1.1, 11.1.3

## E

Earnings Before Interest, Taxes, Depreciation and  
Amortisation, 6.12.2  
earnings potential, of hotels, 8.6.4  
easements, 3.5.1–3.5.2, 6.15.4  
e-commerce, 14.3.2  
economic feasibility studies see investment analyses  
economic life, 5.1.2, 6.4.2, 6.4.6, 6.6.2  
effective date, 6.4.2, 6.6.2  
efficiency and diligence, 3.3.3  
elements of comparison, 6.1.6, 6.1.8  
definition, 6.1.2  
elements of cost, 5.1.7  
enforcement of standards see standards enforcement  
enterprise see business entities  
environmental audit, 11.6.12, 12.1.12–12.1.14  
environmental balance sheet approach  
sample balance sheet, 12.1.15  
valuation in light of contamination, 6.7.5–6.7.6  
environmental factors and hazards, 6.7.1–6.7.7, 8.1.9,  
11.1.4–11.1.5, 12.1.1–12.1.19  
bibliography, 13.1.4–13.1.6  
environmental audit, 11.6.12  
environmental checklist, 12.1.12–12.1.14  
see also contaminated land; hazardous and toxic  
substances  
environmental protection authorities, 12.1.9, 12.1.19  
equipment see plant and equipment  
equitable or equity interest, 3.5.2

- equity instrument, 3.5.7
  - equity net cash flow, 6.6.2
    - definition, 6.4.2
  - equivalent main area, 11.4.3
  - erosion, 8.10.2–8.10.3
  - estates, merger of, 3.5.3
  - estimated amount, 4.2.2
  - estimated annual value, 8.4.3
  - ethical conduct, 2.1.1–2.4.6, 3.3.2–3.3.4
  - experts, 8.9.4
    - expert witnesses, 8.5.5, 11.2.1–11.2.2
    - technical experts (extractive industries), 6.14.5, 6.14.7
  - expert's report
    - and valuations for compulsory acquisitions, 7.1.1
  - exploration and evaluation costs, 6.14.5
  - exploration properties or area (extractive industries), 6.14.2, 6.14.3
  - external valuations, 5.1.9
  - external valuer, 3.3.2
  - extraction (indirect comparison technique), 6.1.10
  - extractive industries, 6.14.1–6.14.9
    - and environmental checklist, 12.1.13
    - property types, 6.14.6–6.14.7
  - extraordinary assumptions *see* special, unusual, or extraordinary assumptions
- F**
- facsimiles, 6.5.2, 6.5.6
  - fair market value, 3.4.4
    - see also* market value
  - fair value, 3.4.6, 3.5.5, 4.1.2, 4.3.2, 9.1.7, 10.1.3
    - and AASB 116 Property, Plant and Equipment, 9.1.4–9.1.5
    - definition, 4.3.1, 5.1.2, 6.3.1, 10.1.4
    - specialised assets, 9.1.8
    - see also* market value
  - fair value less costs to sell, 5.1.10, 9.1.6, 9.1.8
    - definition, 5.1.2
  - fair value model, 5.1.4, 5.3.4
    - investment property, 5.1.9
  - farms *see* agricultural properties
  - fauna and flora *see* biological assets
  - feasibility studies
    - checklist, 11.5.9–11.5.14
    - in extractive industries, 6.14.3
    - real estate development, 11.5.1–11.5.19
    - worksheets, 11.5.15–11.5.19
    - see also* investment analyses
  - fee simple estate, 3.5.1, 6.1.8, 6.2.1
  - feedback to API and PINZ, 15.5.1–15.5.2
  - fees and payments, 2.4.1–2.4.2, 2.4.5, 8.5.2, 11.9.3
  - Fejo decision (Fejo -v- Northern Territory Australia), 12.2.3
    - see also* Native Title (Australia)
  - FFEs *see* furniture, fixtures and equipment
  - field review, 6.11.1, 6.11.2
  - final payment inspections, for houses under construction, 10.3.2
  - finance lease, 3.5.7
  - finance leases, 3.5.7, 5.1.8, 5.1.11–5.1.12
    - definition, 6.3.1
    - and plant and equipment, 6.3.3–6.3.4
  - financial assets, 3.5.6–3.5.7
  - financial instruments, 3.5.7
    - see also* derivative financial instruments
  - financial interests, 3.5.2, 3.5.5–3.5.8
  - financial liabilities, 3.5.7
  - financial modelling, 6.9.2
  - financial projection studies *see* investment analyses
  - financial reporting
    - and depreciated replacement cost, 6.8.1–6.8.4
    - depreciation (definition), 3.4.3
    - and market value methods, 3.4.4, 3.4.6, 4.4.3
    - valuations for use in, 3.4.4, 3.4.6, 4.4.3
      - Australian financial reports, 9.1.1–9.1.8
      - business valuation, 5.1.1–5.1.10
      - NZ financial reports, 10.1.1–10.1.17
      - public sector asset valuation, 5.3.1–5.3.8
    - see also* International Financial Reporting Standards
  - Financial Reporting Council (Australia), 9.1.2
  - financial reporting standards
    - Australian *see* Australian Accounting Standards
    - international *see* International Financial Reporting Standards
    - New Zealand, 10.1.1–10.1.5
  - financial reports *see* financial reporting
  - financial services legislation, 5.2.4, 8.8.6–8.8.8
  - financial statements
    - NZ, 10.1.3
    - use of, 6.6.6–6.6.8
  - financing terms, 6.1.8
  - fine art valuation, 6.5.1–6.5.2
  - fixed assets, 3.5.2 *see* non-current assets
  - fixtures and fittings, 3.5.3, 6.5.2, 8.1.1–8.1.2
  - flora and fauna *see* biological assets
  - forced sale, 4.3.3, 5.2.5, 6.3.4, 8.1.8, 8.3.1–8.3.2
  - forced sale price, 8.3.2
  - forecasts, 8.8.5

## INDEX

forestry, 5.1.6, 6.10.2  
for-profit sector assets, 6.3.3  
fractional interests see partial or fractional interests  
freehold, 3.5.1  
freehold interest, 6.1.8, 6.2.1  
    see also fee simple estate  
freehold subject to lease interest, 6.2.1  
fuel stations, 3.5.4  
full cost approach (extractive industries), 6.14.5  
fully enclosed covered area, 11.4.3  
functional replacement, 10.2.2, 10.2.4  
furnishings, 3.5.3  
furniture, fixtures and equipment, 3.5.3, 6.5.2, 8.6.2  
future date, 4.4.3  
future liability, 6.7.7  
future life, 5.1.7  
future value, 8.2.2

## G

GAVP see Generally Accepted Valuation Principles  
GBEs see government business enterprises  
general economic data, 6.1.5  
general partnership, 3.5.5  
Generally Accepted Valuation Principles, 3.2.1, 3.4.1–3.4.8  
    fundamental principles, 3.4.1–3.4.8  
    and rating and taxing, 8.4.2, 8.4.4  
glossary  
    Native Title (Australia), 12.2.27  
    see also definitions  
going concern value, 4.3.3  
going concerns, 3.5.4, 3.5.5, 6.4.2, 6.6.2, 6.6.4, 8.1.8  
goods and chattels personal, 3.5.3, 6.5.2  
    see also personal property  
Goods and Services Tax  
    explicit treatment of, 4.4.4  
    and forced sales, 8.3.2  
    hotel valuations, 8.6.5  
    treatment of, 8.3.2, 8.6.5, 8.9.4, 8.10.5, 9.2.2, 11.1.6, 12.1.9  
goodwill, 3.5.5, 6.4.2, 6.6.2, 6.6.5, 6.12.1  
    see also intangible assets; personal goodwill;  
    transferable goodwill  
government business enterprises, 5.3.1, 5.3.6  
    definition, 5.3.2–5.3.3  
gross building area, 11.4.2  
gross cash flow, 6.4.1, 6.6.2  
gross floor area, 11.4.3  
gross rental value, 8.4.2

ground lease, 6.2.1  
ground rent capitalisation, 6.1.10  
grouped intangibles, definition, 6.4.2  
    see also goodwill  
guidance notes (API)  
    development process, 1.1.2  
Guidance Notes (IVSC), 1.1.1, 3.2.1–3.2.5

## H

HABU see highest and best use  
hammer price, 6.5.2  
    see also auction price; private treaty sale  
hazardous and toxic substances, 6.7.1–6.7.7, 12.1.2–12.1.3, 13.1.1–13.1.2  
    activities, industries and land uses, 12.1.10–12.1.11  
    environmental checklist, 12.1.12–12.1.14  
    UN Hazard Classes, 12.1.10  
    see also contaminated land; environmental factors and hazards  
headlease, 6.2.1  
headleasehold interest, 6.2.1, 6.2.3  
heritage assets, 5.3.7, 6.15.1–6.15.4, 9.1.3, 9.2.7–9.2.8  
    definition, 5.3.3, 6.15.2  
    see also public sector assets  
highest and best use, 4.1.2, 4.2.3, 6.1.5, 6.1.9–6.1.10  
    agricultural properties, 6.10.3, 8.10.2  
    definition, 3.4.5, 6.1.2, 10.1.5  
    extractive industries properties, 6.14.6  
    historic properties, 6.15.3–6.15.4  
    of land, 3.4.4–3.4.5, 8.4.2  
historic house owner associations, 6.15.1  
historic properties, 6.15.1–6.15.4  
    definition, 6.15.1–6.15.2  
    see also heritage assets  
historic properties register, 6.15.2  
holding companies, 3.5.4, 6.6.2  
    see also investment businesses  
hotels, 3.5.4, 8.6.1–8.6.5, 11.4.4  
houses, 11.4.5  
    under construction and houses to be built (NZ), 10.3.1–10.3.2  
Hyam, A *The Law Affecting Rent Review Determinations*, 8.9.4

## I

IASB see International Accounting Standards Board  
IASs see International Accounting Standards

- ICANZ see Institute of Chartered Accountants of New Zealand
- IFRSs see International Financial Reporting Standards
- ILUAs see Indigenous Land Use Agreements
- impaired assets, 5.1.3, 5.1.6, 5.1.9–5.1.10, 5.3.5
- impairment, 5.3.3, 6.8.4, 9.1.3–9.1.4
- impairment loss, 5.1.2, 5.3.5, 6.8.4
- impairment reviews, assistance with, 10.1.10
- impartiality, 3.3.2–3.3.3, 6.1.4.7
- improved value
  - rating and taxing, 8.4.3
- improvements, 3.4.5, 5.2.2, 6.2.4, 6.8.1, 10.2.3, 11.1.5
  - agricultural properties, 6.10.4, 8.10.4, 11.4.6
  - definition, 5.1.1
  - hotels, 8.6.1–8.6.2
  - value of improvements (defined), 5.3.2
  - see also value ‘as if complete’
- inclusions with agricultural properties, 8.10.4
- income capitalisation approach, 3.4.7, 4.2.1
  - business valuation, 6.6.2, 6.6.9–6.6.10
  - businesses, 5.1.7
  - intangible assets, 6.4.2, 6.4.5–6.4.6
  - personal property, 6.5.2, 6.5.5
  - real property, 6.1.5, 6.1.6–6.1.8
  - see also discounted cash flow analysis
- income streams, 6.3.2
- incorporated entities, 3.5.4
- incorporeal interests see nonpossessory interests
- indemnification, 10.2.2, 10.2.4
- indemnity basis, 6.5.2
- indemnity insurance, 12.1.19
  - and environmental/contamination issues, 12.1.9
  - and Native Title issues, 12.2.14
- indemnity value assessment, 9.2.7
- independent determinations of rental value, 8.9.3–8.9.4
- independent review of employee valuations, 10.1.11
- Indigenous Land Use Agreements, 12.2.10
  - see also Native Title (Australia)
- indirect comparison techniques (land valuation), 6.1.10
- inducements, 2.2.3, 2.4.3
- industrial buildings
  - design influences, 11.6.11
  - locational influences, 11.6.10
  - measurement of, 11.4.5
- industrial special risk policy (insurance), 9.2.2, 11.7.9–11.7.10
- inflationary provision
  - insurance valuation reports (NZ), 10.2.2, 10.2.2–10.2.3, 10.2.4
- information memorandums see offer documents
- information sources see data sources
- infrastructure assets, 10.1.11
  - definition, 5.3.3
  - see also public sector assets
- inspection and enquiry guidelines
  - compulsory acquisitions, 8.5.3–8.5.4
  - real property, 8.1.5–8.1.6
- inspections, 2.4.1–2.4.2
- Institute of Chartered Accountants of New Zealand
  - NZ IAS-40 Investment Property, 5.1.3
  - SSAP-17 Accounting for Investment Property and Properties Intended for Sale, 5.1.3, 10.1.2–10.1.9
- instructing valuers (guidance for clients), 15.3.1–15.3.12
- instructions, 15.3.3–15.3.4
  - model ‘standing instructions’, 15.3.11
  - pro-forma, 15.3.12
- PropertyPRO Residential Valuation and Security Assessment Pro-forma Supporting Memorandum, 16.1.2–16.1.3
- report content, 15.5.7–15.5.10
- supporting documentation, 15.3.5–15.3.6
- instructions, 2.4.1–2.4.2
  - in assessing rental value, 8.9.1–8.9.2
  - from clients, 6.1.4, 8.2.2, 15.3.1–15.3.12
  - compulsory acquisitions, 8.5.1–8.5.2
  - valuation for use in offer documents, 8.8.2–8.8.3
  - valuation of accommodation hotels, 8.6.1
  - valuation of partial interests in property held within co-ownership structures, 8.7.1–8.7.2
  - valuations for mortgage and loan security purposes, 8.2.1
- instructions, acceptance of see acceptance of instructions
- insurance, 11.7.3–11.7.11
  - importance of valuations, 11.7.9–11.7.11
  - types of, 11.7.6–11.7.7
- insurance average clauses, 11.7.9–11.7.10
- insurance policies
  - Australia, 9.2.2–9.2.5, 11.7.7–11.7.12
  - indemnity, 9.2.3
  - see also basis of settlement (insurance)
- insurance valuation reports
  - Australia, 9.2.1–9.2.8
  - New Zealand, 10.2.1–10.2.5
    - definitions of terms, 10.2.3–10.2.4
    - form, 10.2.5
- intangible assets, 3.4.2–3.4.3, 3.5.3, 3.5.4–3.5.5, 3.5.6
  - businesses, 6.6.5
  - definition, 6.4.2

## INDEX

- and plant and equipment, 6.3.3
- valuation of, 6.4.1–6.4.6
- see *also* goodwill; grouped intangibles; intellectual property
- intangible property, definition, 6.4.3
- intangible value
  - businesses, 6.6.5
  - personal property, 6.5.4
- integrated unit (agricultural entity), 6.10.2
- integrity see ethical conduct
- intellectual property, 3.5.3, 3.5.4–3.5.5, 6.3.3
  - definition, 6.4.2
  - see *also* intangible assets
- inter-company leases, 6.2.3
- Interim valuations, 8.4.4
- internal rate of return, 6.9.2
- internal valuers, 9.1.8
  - definition, 3.3.2
- International Accounting Standards, 4.4.2, 5.1.1, 6.2.3
  - IAS 2 Inventories, 5.1.3, 5.1.6
  - IAS 16 Property, Plant and Equipment, 5.1.3, 5.1.4–5.1.5, 5.1.6–5.1.8, 6.14.5, 6.14.6
  - IAS 17 Leases, 5.1.3, 5.1.5–5.1.6, 5.1.11, 5.1.11–5.1.12
  - IAS 29 Financial Reporting in Hyperinflationary Economies, 5.1.10
  - IAS 32 Financial Instruments: Presentation, 3.5.6, 3.5.7
  - IAS 36 Impairment of Assets, 5.1.3, 5.1.6, 6.14.6
  - IAS 38 Intangible Assets, 6.14.5
  - IAS 40 Investment Property, 5.1.3, 5.1.5–5.1.6, 5.1.8–5.1.9, 5.1.11, 6.2.3
  - IAS 41 Agriculture, 5.1.6
  - relationship with Australian Accounting Standards, 9.1.2
  - see *also* accounting standards; Australian Accounting Standards; International Financial Reporting Standards; New Zealand accounting standards
- International Accounting Standards Board, 3.1.2, 5.1.1
  - Improvements Project, 5.1.3, 5.3.1
  - relationships with other bodies, 3.1.2, 9.1.2
  - standards see International Accounting Standards; International Financial Reporting Standards
- international agencies, 3.1.2
- International Auditing and Assurance Standards Board, 3.1.2
- International Equivalents to the International Accounting Standards (IFRSs), 5.1.4
- International Federation of Accountants' International Public Sector Accounting Standards Board see International Public Sector Accounting Standards Board
- International Financial Reporting Standards, 3.1.2, 5.1.1, 5.3.1
  - changes in respect to property assets in NZ IFRS, 10.1.12–10.1.17
  - IFRS 3 Business Combinations, 5.1.6, 6.14.6
  - IFRS 5 Non-current Assets Held for Sale and Discontinued Operations., 5.1.3, 5.1.6
  - IFRS 6 Exploration for and Evaluation of Mineral Resources, 6.14.5–6.14.6
  - International Equivalents to, 5.1.4
  - IVA 1 Valuation for Financial Reporting, 4.3.1, 4.4.2, 5.1.1–5.1.10
  - relationship with Australian Accounting Standards, 9.1.2
  - see *also* International Accounting Standards; New Zealand Equivalents of International Financial Reporting Standards
- International Public Sector Accounting Standards, 3.1.2, 4.4.2, 5.3.1
  - IPSAS 12 Inventories, 5.3.5
  - IPSAS 13 Leases, 5.3.5
  - IPSAS 16 Investment Property, 5.3.5
  - IPSAS 17 Property, Plant and Equipment, 5.3.3–5.3.4, 5.3.6–5.3.8, 6.15.2–6.15.3
  - IPSAS 21 Impairment of Non-cash-generating Assets, 5.3.5, 5.3.6–5.3.8
- International Public Sector Accounting Standards Board, 3.1.2
- International Valuation Applications, 3.2.1–3.2.5
  - IVA 1 Valuation for Financial Reporting, 4.2.3, 5.1.1–5.5.10, 5.3.1, 5.3.5, 9.1.2
  - IVA 2 Valuation for Lending Purposes, 5.2.1–5.2.5
  - IVA 3 Valuation of Public Sector Assets for Financial Reporting, 5.3.1–5.3.8
  - see *also* International Valuation Guidance Notes; International Valuation Standards
- International Valuation Guidance Notes
  - IVGN 1 Real Property Valuation, 6.1.1–6.1.11
  - IVGN 2 Valuation of Lease Interests, 6.2.1–6.2.4
  - IVGN 3 Valuation of Plant and Equipment, 6.3.1–6.3.4
  - IVGN 4 Valuation of Intangible Assets, 6.4.1–6.4.6
  - IVGN 5 Valuation of Personal Property, 6.5.1–6.5.6
  - IVGN 6 Business Valuations, 6.6.1–6.6.11
  - IVGN 7 Consideration of Hazardous and Toxic Substances in Valuation, 6.7.1–6.7.7
  - IVGN 8 The Cost Approach for Financial Reporting (DRC), 6.8.1–6.8.4, 9.1.2
  - IVGN 9 Discounted Cash Flow Analysis for Market Valuations and Investment Analyses, 6.9.1–6.9.5
  - IVGN 10 Valuation of Agricultural Properties, 6.10.1–6.10.4, 8.10.1



- IVGN 11 Reviewing Valuations, 6.11.1–6.11.3
  - IVGN 12 Valuation of Trade Related Property, 6.12.1–6.12.3
  - IVGN 13 Mass Appraisal for Property Taxation, 6.13.1–6.13.3
  - IVGN 14 Valuation of Properties in the Extractive Industries, 6.14.1–6.14.9
  - IVGN 15 Valuation of Historic Property, 6.15.1–6.15.4
  - International Valuation Standards, 3.2.1–3.2.5, 3.4.8, 9.1.2, 9.1.3–9.1.7
    - adoption dates, 3.2.5
    - and Australian and New Zealand practice, 8.2.1
    - evolution of, 3.1.1
    - format and structure, 3.2.4–3.2.5
    - organisation of, 3.2.1–3.2.3
    - relationship with national standards, 3.2.1, 9.1.2, 9.1.3–9.1.7
  - IVS 1 Market Value Basis of Valuation, 4.2.1–4.2.5, 5.1.10, 6.1.1, 10.1.3
  - IVS 2 Valuation Bases Other Than Market Value, 4.3.1–4.3.4, 10.1.3
  - IVS 3 Valuation Reporting, 4.4.1–4.4.5
    - see also International Valuation Applications
  - International Valuation Standards Committee, 3.1.1–3.1.2
    - Code of Conduct, 3.3.1–3.3.4
    - Guidance Notes see International Valuation Guidance Notes
    - and International Valuation Standards
      - see also International Valuation Standards
    - relationships with other bodies, 3.1.2, 9.1.2
    - standards and guidance notes, 1.1.1–1.1.2
  - intrinsic value, 6.5.2
  - invested capital, 6.6.2
  - invested capital net cash flow, 6.6.2
    - definition, 6.4.2
  - investment analyses, 6.9.1–6.9.5
  - investment assets, 3.4.2–3.4.3
  - investment businesses, 3.5.4
  - investment property, 5.1.5, 5.1.8–5.1.9, 5.1.11–5.1.12, 5.2.3, 6.2.3, 9.1.4, 10.1.8
    - definition, 5.1.2
    - definition (SSAP-17), 10.1.4
  - investment value, or worth, 3.4.7, 4.1.2, 4.3.2
    - definition, 4.3.1
    - and partial interests, 8.7.2
  - IPSAB see International Public Sector Accounting Standards Board
  - IPSASs see International Public Sector Accounting Standards
  - IRR see internal rate of return
  - irrigated land, 6.10.2
  - ISR policy see industrial special risk policy (insurance)
  - IVSC see International Valuation Standards Committee
  - IVSs see International Valuation Standards
- ## J
- joint ventures, 3.5.5
  - Joyce, L and Norris, K, *The Legal Liability of Valuers*, 8.8.8
- ## L
- land, 5.1.8
    - agricultural see agricultural properties
    - classes of, 8.10.3
    - remediation costs, 6.7.7
    - valuation of, 3.4.5, 5.1.8, 6.1.5, 6.1.10
  - land and property concepts, 3.4.1–3.4.3
    - see also real estate
  - land contamination see contaminated land
  - land fills see hazardous and toxic substances
  - land residual technique, 6.1.10
  - land tenure
    - agricultural land, 8.10.1
  - land use see highest and best use; Indigenous Land Use Agreements
  - land value
    - negative, 6.7.7
    - qualifications see qualification statements
    - and rating and taxing, 8.4.1–8.4.3
  - landlord, 8.9.5
  - law see legislation
    - The Law Affecting Rent Review Determinations* (Hyam), 8.9.4
  - lease accounting, 5.1.11–5.1.12
  - lease classification see leases
  - lease fee value, 6.2.3
  - lease interests, 3.5.1, 5.1.8, 6.2.1–6.2.4
    - defined, 6.2.2
  - lease purchase options, 3.5.6
  - leased fee estate, 3.5.1
  - leased fee interest see freehold subject to lease interest
  - leasehold alterations, 6.2.4
  - leasehold estate see lease interests
  - leasehold improvements, 3.5.3, 6.5.2
  - leasehold interests see lease interests
  - leasehold investment property, 5.1.8–5.1.9
  - leasehold title, of hotels, 8.6.5
  - leases, 3.5.1, 5.1.5–5.1.6, 9.1.3, 11.6.11–11.6.12



## INDEX

and assessment of rental value, 8.9.3  
definitions, 6.2.1–6.2.2, 8.9.5  
finance leases, 3.5.7, 5.1.8, 5.1.11–5.1.12, 6.3.1  
inter-company, 6.2.3  
of land and buildings, 5.1.8  
onerous covenants, 6.2.3  
operating leases, 3.5.7, 5.1.8, 5.1.11–5.1.12, 6.2.3, 6.3.1  
proposed, 4.4.4  
between related parties, 5.2.3  
taxation issues, 11.6.12  
useful life of, 5.1.2  
see also lease interests  
leasing agent services, 11.10.1–11.10.3  
leasing incentives, 8.9.5, 11.3.1–11.3.4  
legal due diligence, 11.6.6–11.6.9  
legal estates, 3.5.1, 6.2.1  
*The Legal Liability of Valuers* (Joyce and Norris), 8.8.8  
legal life, 6.4.3, 6.4.6  
legal responsibilities of officers and directors, 11.7.3  
legislation, 12.1.17–18, 12.2.12–12.2.14  
in assessing rental value, 8.9.2–8.9.3  
compulsory acquisitions, 8.5.2  
environmental/contamination issues, 12.1.9, 12.1.17–12.1.18  
Native Title (Australia), 12.2.14  
scheduled interests, 12.2.15–12.2.26  
and valuations for use in offer documents, 8.8.6–8.8.8  
legislative requirements  
in ad valorem property taxation, 6.13.2, 6.13.3  
impact on value of agricultural land, 8.10.2  
and valuation principles, 8.4.2, 8.4.4  
lenders, instructions from, 8.2.1  
lender's solvency ratio, 5.2.5  
lending purposes, valuation for see loan security  
lessee interest see lease interests  
lessees, 8.9.5  
lessor interest, 6.2.2, 6.2.3  
royalty or royalty interest (extractive industries), 6.14.4–6.14.5  
see also lease interests  
lessors, 8.9.5  
liabilities associated with assets, 10.1.10  
licences, rights and permits, 8.1.8, 8.6.2  
licences to value securities, 8.7.2  
water resources, 8.10.3  
see also rights  
licensing, of advisers, 5.2.4  
limited partnership, 3.5.5

limiting conditions, 3.3.1  
limits of liability (insurance), 9.2.5  
liquidation value, 4.3.3, 5.2.5  
businesses, 6.6.4  
liquidity issues  
issues in property held within co-ownership structures, 8.7.4  
liquor stores, 11.4.4–11.4.5  
listing of heritage buildings, 6.15.2  
livestock ranches/stations, 6.10.2  
loan security  
valuation for, 5.2.1–5.2.5, 8.2.1–8.2.3, 8.3.1–8.3.2  
locational influences, 6.1.9, 11.6.10  
agricultural properties, 8.10.2  
long-term assets see non-current assets

## M

Mabo decision (Mabo -v- the State of Queensland (No. 2) (1992) 175 CLR 1), 12.2.2  
see also Native Title (Australia)  
machinery  
definition, 6.3.1  
see also plant and equipment  
majority control, 6.6.2  
majority interest, 6.6.2  
management  
average competent management, 6.12.1  
styles, 11.6.13  
management agreement/tenancy details  
hotels, 8.6.3–8.6.4  
market/markets  
definition, 3.4.3, 4.1.1, 6.1.2  
see also real estate market  
market approach  
business valuation, 6.6.2–6.6.3, 6.6.8–6.6.9  
definition, 6.4.3  
intangible assets, 6.4.4–6.4.5  
market conditions, 6.1.8–6.1.9, 11.3.4  
valuation of accommodation hotels, 8.6.4  
market data, 4.1.2, 6.1.5–6.1.6, 6.6.5, 6.14.7–6.14.8  
market evidence  
absence of, 5.3.6  
and market analysis, 8.1.6–8.1.7  
market rent, 6.2.2, 6.2.4, 8.9.4–8.9.5  
market research, 6.1.6  
market value, 3.4.4–3.4.6, 4.3.2  
agricultural properties, 6.10.3–6.10.4  
of businesses, 3.5.4–3.5.5, 6.6.3–6.6.4

consideration of hazardous and toxic substances, 6.7.1–6.7.7

cost approach *see* cost approach

definition, 3.4.4, 3.4.6, 4.2.1, 5.1.1, 5.2.1, 5.3.2, 6.1.2, 6.3.1, 10.1.5

definitions of terminology, 4.2.1–4.2.2

estimation of *see* valuation approaches

extractive industries, 6.14.6, 6.14.8

income capitalisation approach *see* income capitalisation approach

and investment value, or worth, 8.7.2

negative, 6.2.4

and personal property, 3.5.3

sales comparison approach *see* sales comparison approach

as value basis, 3.5.2–3.5.3, 4.2.1–4.2.5

and value in use *see* value in use

*see also* fair value; highest and best use

market value as if complete *see* value ‘as if complete’

marketability, adverse impact on, 8.1.9

marketability analysis *see* investment analyses

marketability discount, 6.6.3

market-based valuations, 4.1.2, 4.2.1–4.2.5

and discounted cash flow analysis, 6.9.1–6.9.5

methods of, 4.2.1

marketing of property for sale, 11.8.3–11.8.9

marketing period, 8.1.7–8.1.8

marriage value, 6.2.2, 6.2.3

*see also* synergistic value

mass appraisal, 6.13.1–6.13.3

master lease, 6.2.1

materiality, 6.3.4, 10.1.3

MEA *see* modern equivalent asset

measurement of buildings/rentable areas, 11.4.1–11.4.6

mechanical and electrical condition of building, 11.6.4–11.6.5, 11.6.5–11.6.6

members’ obligations *see* professional conduct

merged interests value, 6.2.2, 6.2.3

mineral reserves, 6.14.3

minerals, 6.14.3

minerals industries, 6.14.1–6.14.9

definition, 6.14.4

*see also* wasting assets

minority discount, 6.6.3

minority interest, 6.6.3

modern equivalent asset, 6.8.2

*see also* replacement cost

monopolies, 5.3.7–5.3.8

monuments *see* heritage assets

mortgage industry

guide to instructing valuers, 15.3.1–15.3.12

mortgage lending value, 5.2.1, 5.2.5

mortgage security, 5.2.5

mortgages, 8.2.3

definition, 5.2.1

valuation for, 5.2.1–5.2.5, 8.2.1–8.2.3, 8.3.1–8.3.2

motels, 8.6.1–8.6.5, 11.4.5

*see also* hotels

movie theatres, 3.5.4, 11.4.4

multiple entities, 3.5.4

## N

National Native Title Tribunal

on Native Title, 12.2.2

registers, 12.2.3, 12.2.6

National Professional Board, 1.1.2

Native Title (Australia), 6.14.8, 8.1.9, 8.10.1, 12.2.1–12.2.27

co-existing, identification of, 12.2.5–12.2.9

co-existing estates, types of, 12.2.4–12.2.5

definition, 12.2.2–12.2.3

glossary, 12.2.27

impact on value, 12.2.10–12.2.12

information on, 12.2.5–12.2.9

legislation, 12.2.14

scheduled interests, 12.2.15–12.2.27

predictive practices, 12.2.9–12.2.10

site inspection, 12.2.7

valuation approaches, 12.2.12–12.2.14

natural resources, 6.14.1

*see also* extractive industries

net annual value, 8.4.3

net assets, 6.6.3

net book value, 6.6.1

net cash flow, 6.4.1–6.4.2, 6.6.2

net current value

definition (SSAP-17), 10.1.4–10.1.5

net income, 6.6.3

net market value, 10.1.4

net present value, 6.9.2

net present value analysis, 6.14.8

net realisable value, 5.1.2, 5.3.5, 10.1.5

*see also* net current value

net worth, 6.6.1

new for old, 6.5.2

new houses, 10.3.1–10.3.2

New Zealand

## INDEX

- explicit treatment of GST, 4.4.4
  - financial reporting *see* financial reporting
  - financial services legislation, 8.8.7–8.8.8
  - mortgage security recommendations, 5.2.5
  - Resource Consents, 8.10.4
  - Treaty of Waitangi, 8.1.9, 8.10.1
  - New Zealand accounting standards
    - and IVA 1 Valuation for Financial Reporting, 5.1.3
  - New Zealand Equivalents of International Financial Reporting Standards, 10.1.1, 10.1.12–10.1.17
    - NZ IAS 2 Inventories, 10.1.13
    - NZ IAS 16 Property Plant and Equipment, 5.1.3, 5.1.8, 10.1.13–10.1.16
    - NZ IAS 36 Impairment of Assets, 10.1.16
    - NZ IAS 38 Intangible Assets, 10.1.16
    - NZ IAS 40 Investment Property, 10.1.16–10.1.17
    - NZ IFRS 1 First-Time Adoption of New Zealand Equivalents to International Financial Reporting Standards, 10.1.12
    - NZ IFRS 4 Insurance Contracts, 10.1.12–10.1.13
  - New Zealand Financial Reporting Standards
    - FRS-3 Accounting for Property, Plant and Equipment, 5.1.3, 10.1.2–10.1.11
    - Statements of Standard Accounting Practice *see* Institute of Chartered Accountants of New Zealand: SSAP
  - New Zealand Institute of Valuers
    - Code of Ethics, 2.4.4–2.4.6
    - library, 13.1.4
    - see also* Property Institute of New Zealand
  - New Zealand Real Property Guidance Notes
    - NZRPGN 1 Valuation of Contaminated Land, 13.1.1–13.1.6
    - NZRPGN 2 Counter-signing of Valuation Reports Prepared by Unregistered Valuers and, 13.2.1
  - New Zealand Statements of Standard Accounting Practice
    - see* Institute of Chartered Accountants of New Zealand: SSAP
  - New Zealand Valuation & Property Standards Board, 13.1.1, 13.2.1
    - NZ Real Property Guidance Notes *see* New Zealand Real Property Guidance Notes
  - New Zealand Valuation Guidance Notes
    - NZVGN 1 Valuations for Use in New Zealand Financial Reports, 10.1.1–10.1.17
    - NZVGN 2 Insurance Valuation Reports, 10.2.1–10.2.5
    - NZVGN 3 Valuation of Houses under Construction, Houses to be Built or Previously Unoccupied New Houses, 10.3.1–10.3.2
  - NNTT *see* National Native Title Tribunal
  - non-cash-generating assets, 5.3.5, 5.3.8
    - definition, 5.3.3
  - non-current assets, 3.4.2, 9.1.4
    - revaluation of, 10.1.5–10.1.6
  - non-exclusive estates
    - and Native Title *see* Native Title (Australia)
  - non-fixtures/chattels, 8.1.1–8.1.2
    - see also* chattels; fixtures and fittings
  - non-operating items, 6.6.7
  - non-operational assets, 5.3.1
  - nonpossessory interests in landed property, 3.5.1–3.5.2
  - non-realty elements, 6.1.9
    - agricultural property valuation, 6.10.3–6.10.4
  - non-recurring events, 6.6.6–6.6.7
  - non-specialised assets, 9.1.7
  - not-for-profit sector assets, 6.3.3
  - NPV *see* net present value
  - nursing homes and hostels, 11.4.5
  - NZ IFRS *see* New Zealand Equivalents of International Financial Reporting Standards
  - NZIV *see* New Zealand Institute of Valuers
- ## O
- obligatory alterations (leasehold alterations), 6.2.4
  - obsolescence, 5.3.2, 6.8.2, 10.1.5
  - offer documents, 8.8.1–8.8.8, 11.8.7–11.8.8
  - office buildings
    - design influences, 11.6.11
    - locational influences, 11.6.10
    - measurement of, 11.4.5
  - open market value, 10.1.4
    - see also* market value
  - operating companies, 3.5.4
  - operating company, 6.6.3
  - operating leases, 3.5.7, 5.1.8, 5.1.11–5.1.12, 6.2.3
    - definition, 6.3.1
  - operational assets, 3.4.2–3.4.3, 5.3.1, 9.1.7
  - operational entities, 3.5.4
  - optimisation, 5.3.2, 6.8.1, 10.1.4
  - options, 3.5.6, 3.5.7
  - options to buy, 3.5.8
  - oral report, 4.4.1
    - see also* reports
  - outgoings, 8.9.5
  - outside assistance, 3.3.3
  - overriding royalty, 6.14.4–6.14.5
  - owner-occupied property, 5.1.2, 5.1.7, 5.2.3, 6.1.7, 8.1.7, 10.1.10

ownership

- concepts, 3.4.1–3.4.2
- interests, 3.5.5, 3.5.8
  - see *also* financial interests
- rights and limitations, 3.5.1–3.5.2
- taxation issues, 11.6.9
- valuation of, 3.5.2
  - see *also* co-ownership

**P**

Pareroutlja decision (Pareroutlja –v- Tickner (1993) 42 FCR 32), 12.2.1

parks see recreational assets

partial or fractional interests, 3.5.2
 

- in property held within co-ownership structures, 8.7.1–8.7.5

participation rent, 6.2.3, 8.9.5

partnerships, 3.5.4, 3.5.5, 3.5.8

passing rent, 8.9.5

pastoral lands see agricultural properties

patents see intangible assets

payments see fees and payments

peppercorn rent, 8.9.5

percentage rent, 6.2.3, 8.9.5

perennial plantings, 6.10.2
 

- see *also* forestry

performance fees, 8.8.4

permitted use, 8.9.5

personal goodwill, 6.4.2, 6.6.2, 6.12.1

personal property, 3.4.1
 

- definition, 3.4.2, 6.5.2
- licences, rights and permits, 8.1.8
- types of, 3.5.3–3.5.4, 6.5.2
- valuation of, 3.5.3–3.5.4, 6.5.1–6.5.6
- water resources as, 8.10.3

personalty, 3.5.1, 6.5.2
 

- see *also* personal property

pests and weeds, 8.10.3

petroleum, 6.14.4

petroleum industries, 6.14.1–6.14.9

petroleum reserves, 6.14.4

petroleum resources, 6.14.4

physical assets, 3.4.2–3.4.3

physical condition
 

- of assets, 6.8.2
- of buildings, 11.6.4–11.6.6

physical contaminants see hazardous and toxic substances

physical underlying asset, 8.7.3

PINZ see Property Institute of New Zealand

planning controls
 

- impact on value of agricultural land, 8.10.2

plans/planning
 

- property action plans, 14.4.1–14.4.4

plant and equipment, 3.4.2, 4.4.3, 6.3.1, 6.3.1–6.3.4, 6.5.2, 6.8.1
 

- in hotel valuations, 8.6.5
- inclusions with agricultural properties, 8.10.4
- valuation for insurance purposes, 9.2.1–9.2.8

pollution see hazardous and toxic substances

polychlorinated biphenyls see hazardous and toxic substances

portfolios, 5.1.9

post consultancy report
 

- compulsory acquisitions, 8.5.2

post valuation consultancy, 8.1.9, 8.5.5

practice standards
 

- development process, 1.1.2

prefeasibility studies (extractive industries), 6.14.4

preliminary analysis, 6.1.4

previously unoccupied new houses see new houses

price, 4.1.1–4.1.2
 

- definition, 3.4.3

principle of substitution, 3.4.6, 6.1.5, 6.4.6

principle of supply and demand, 4.1.1

principles of measurement, 11.4.1–11.4.6

principles of valuation see Generally Accepted Valuation Principles

private sector assets, 6.3.3

private treaty sale, 6.5.2
 

- see *also* auction price; hammer price

privatisation under statutory provisions, 8.5.1

privileges see rights

production performance of agricultural properties, 8.10.4

professional activities, 14.2.1–14.2.2

professional conduct, 2.1.1–2.4.6, 8.8.2, 8.8.4

professional development, 14.2.1–14.2.2, 14.5.1–14.5.6
 

- activity planner, 14.5.4
- record sheets, 14.5.5–14.5.6, 16.1.1–16.4.2

professional journal, 14.2.2

professional property valuers, 6.5.3–6.5.4
 

- definition, 6.5.2
- see *also* valuers

professional responsibility, 8.4.4

profit margin
 

- real estate development feasibility studies, 11.5.7–11.5.8
- see *also* rate of return

## INDEX

- profit oriented entities, and NZ IFRS, 9.1.1
    - see also business entities
  - profit rent, 8.9.5
  - pro-formas
    - instruction pro-forma, 15.3.12
    - model 'standing instructions', 15.3.11
    - PropertyPRO Residential Valuation and Security Assessment Pro-forma Supporting Memorandum, 16.1.1–16.1.13
    - restricted valuation pro-forma, 16.2.1
      - Supporting Memorandum, 16.3.1–16.3.5
    - terms of appointment of development management consultant, 11.9.7–11.9.14
    - see also worksheets for feasibility studies
  - promotion see advertising
  - proper marketing, 4.2.2
  - properties associated with a business entity, 3.5.4
  - properties held for sale in the ordinary course of business, 5.1.6, 5.3.5
  - properties with trading potential, 3.5.4
  - property
    - definition (SSAP-17), 10.1.4
    - sales see sale of property
  - property, plant and equipment, 5.1.3, 5.1.7, 9.1.3, 10.1.4, 10.1.5–10.1.6
    - definition, 5.1.2, 6.3.2
    - and NZ IFRS, 10.1.6–10.1.8
    - useful life of, 5.3.3
    - see also depreciated replacement cost; plant and equipment
  - property action plans/planning, 14.4.1–14.4.4
  - property concepts, 3.4.1–3.4.3
  - Property Council of Australia
    - area definitions, 11.4.3
  - property development management, 11.9.1–11.9.14
    - development consultancy checklist, 11.9.2–11.9.3
    - development manager
      - role, 11.9.1–11.9.2
      - terms of appointment, 11.9.7–11.9.14
    - fees, 11.9.3
    - see also development of real estate
  - Property Institute of New Zealand, 1.1.1
    - Code of Ethics, 2.3.1
    - feedback to, 15.5.1–15.5.2
    - offices, 16.5.2
    - PINZ Valuation Standard 3 see New Zealand Valuation Guidance Notes: NZVGN 1
    - Rules of Conduct, 2.4.1–2.4.3
    - services provided by members, 15.2.1
  - property insurance, 9.2.1–9.2.8
  - property insurance management, 11.7.1–11.7.11
  - property intended for sale, 10.1.5
  - property investment trusts, 3.5.6
  - property rights, 6.1.2
  - property types, 3.5.1–3.5.8, 6.1.1
    - NZ, 10.1.1–10.1.2
  - property utility see utility
  - property valuation under new NZ IFRS, 10.1.1–10.1.2
  - property valuers, 3.4.1
    - see also valuers
  - PropertyPRO Residential Valuation and Security Assessment Pro-forma Supporting Memorandum, 16.1.1–16.1.13
  - property-specific data, 6.1.5
  - prospectuses see offer documents
  - provenance, 6.5.4
  - prudence, 4.2.2
  - public authority compulsory acquisitions see compulsory acquisitions
  - public benefit entities, 5.1.4, 5.1.5
    - definition (NZ), 5.1.3
    - and NZ IFRS, 10.1.1
  - public buildings, 5.3.2
  - public sector assets, 5.3.1–5.3.8, 6.3.3, 10.1.11
    - definition, 5.3.2
  - public utility, definition, 5.3.2
    - see also public sector assets
  - publicly designated historic properties, 6.15.2
  - purchasing power, 4.1.1
- ## Q
- qualification statements, 4.4.3, 6.7.6, 6.7.7, 8.8.5, 11.1.1–11.1.6
  - quarries see extractive industries; wasting assets
- ## R
- rate of return, 6.4.3, 6.6.3, 11.5.7–11.5.8
    - see also profit margin
  - rating and taxing, 6.13.2, 8.4.1–8.4.7
  - Rawlinson, *Australian Construction Handbook*, 11.5.15
  - real estate, 3.5.1–3.5.3
    - concepts, 3.4.1–3.4.3
    - definition, 3.4.2, 6.1.2
    - development see development of real estate
    - market value, 3.4.4, 3.5.2–3.5.3
    - see also land and property concepts
  - real estate investment trusts, 3.5.6

- real estate market, 6.1.10–6.1.11
- real estate operating companies, 3.5.6
- real property, 3.4.1, 3.4.4, 3.5.1–3.5.3
  - of cultural and historic significance see historic properties
  - definition, 3.4.2, 6.1.2–6.1.3
  - valuation of, 6.1.1–6.1.11, 8.1.1–8.1.9
  - see also lease interests
- real property rights conveyed, 6.1.8
- realty, 3.5.1
  - see also real estate; real property
- reasonably efficient operator, 6.12.1
- reconstructed operating statements, 6.1.6–6.1.7
- record keeping, 6.1.3, 6.13.2–6.13.3
- recoverable amount, 5.1.2, 5.1.10, 10.1.4
- recoverable service amount, 5.3.3
- recreational assets, definition, 5.3.2
  - see also public sector assets
- registered valuer
  - countersigning of unregistered valuers' reports (NZ), 13.2.1
- registration, of advisers, 5.2.4
- regulatory observance, in valuations for use in offer documents, 8.8.6–8.8.8
- reinstatement (insurance), 9.2.4
- reinstatement cost (insurance), 9.2.4–9.2.7
- reinstatement estimate, 10.2.2, 10.2.4
- REITs see real estate investment trusts
- relationships between parties, 6.4.2
- remediation of land see contaminated land; hazardous and toxic substances
- rent
  - definitions, 8.9.4–8.9.5
  - in excess of market rent, 5.2.4
- rent reviews, 8.9.5, 11.3.3
- rent types, 6.2.2–6.2.3
- rental shortfall, 8.9.5
- rental values
  - assessing, 8.9.1–8.9.5
  - and leasing incentives, 11.3.2–11.3.3
  - and rating and taxing, 8.4.2
- REOCs see real estate operating companies
- repair and condition see physical condition
- replacement (insurance), 9.2.4, 10.2.2, 10.2.4
- replacement cost, 3.4.4, 5.3.7, 6.5.5–6.5.6, 6.8.2
  - buildings, 9.2.4–9.2.7, 11.7.9–11.7.10
  - see also depreciated replacement cost
- replacement cost new, 6.6.3
  - definition, 6.4.3
- replicas, 6.5.2
- report date, 6.4.3, 6.6.3
- reporting requirements, when providing allocations, 5.1.7
- reports, 2.4.1–2.4.2, 3.3.4, 8.8.2
  - balance, 14.3.3
  - content, 14.3.2–14.3.3
    - prompter, 14.3.4–14.3.16
  - definition (BF 2), 14.3.1
  - formats and templates, 14.3.2
  - purpose and intended use, 3.4.6, 14.3.1
  - style, 8.8.3
  - transmission, 8.1.8–8.1.9, 14.3.2
  - types of, 4.4.1–4.4.2, 14.3.1–14.3.2
  - see also Valuation Report
- reproduction cost, 3.4.4, 5.3.7, 6.5.6
- reproduction cost new, 6.4.3, 6.6.3
- research see data selection and collection; market evidence; sales evidence and analyses
- residential (houses, units, town houses, flats), 11.4.5
  - desktop assessments, 15.4.1–15.4.12
- residual value, 5.1.7
  - definition, 5.1.2
- Resource Consents (NZ), 8.10.4
- responsibility of officers and directors to owners
  - risk management, 11.7.1–11.7.11
- responsibility to clients see client relationships; professional conduct
- restaurants, 3.5.4, 11.4.5
- restoration cost approach, 5.3.7
- restricted valuation pro-forma, 16.2.1
  - Supporting Memorandum, 16.3.1–16.3.5
- restrictive covenants, 3.5.1, 6.15.4
- resumption, 8.5.1
  - see also compulsory acquisitions
- retail shopping centres see shopping centres
- retirement villages, 11.4.5
- reevaluation
  - frequency of, 5.1.8, 5.3.8, 10.1.9
  - agricultural properties, 6.10.3
  - of non-current assets, 10.1.5–10.1.6
- Revaluation Reports, 8.4.3
- revalued amount, 5.1.2
- review of improvements see improvements
- Review Valuer, 6.11.2–6.11.3
- rights, 6.4.2
  - agricultural land, 8.10.1–8.10.2
  - businesses, 6.6.4
  - intangible assets, 6.4.4
  - Native Title (Australia) see Native Title (Australia)

## INDEX

personal property, 6.5.4, 8.1.8  
real property, 3.5.1, 6.1.8, 8.1.8  
Resource Consents, 8.10.4  
statutory (related to leases), 6.2.3  
Treaty of Waitangi (NZ) *see* Treaty of Waitangi (NZ)  
to use property, 3.5.1–3.5.2  
*see also* licences, rights and permits; ownership  
risk analysis, 8.2.2, 11.7.4  
risk financing, 11.7.6  
risk management, 11.7.1–11.7.11  
Risk Management Modules (course), 14.2.1  
risk statement, 8.8.6  
royalty or royalty interest (extractive industries),  
6.14.4–6.14.5  
Rules of Conduct, 2.1.1  
API, 2.2.1–2.2.3  
NZIV, 2.4.4–2.4.6  
PINZ, 2.4.1–2.4.3  
rural buildings, 11.4.6

## S

sale and leaseback, 6.2.3  
sale in one line or single transaction, 4.4.4  
sale of property  
conditions of sale, 6.1.8  
preparation for, 8.8.1–8.8.8, 11.8.1–11.8.9  
taxation issues, 11.6.9  
*see also* properties held for sale in the ordinary course  
of business  
sales comparison approach, 3.4.7, 3.5.8  
historic properties, 6.15.3  
intangible assets, 6.4.4–6.4.5  
personal property, 6.5.2, 6.5.4–6.5.5  
real property, 6.1.5–6.1.6, 6.1.8, 6.1.9–6.1.10  
sales evidence and analyses, 8.1.6–8.1.7  
agricultural properties, 8.10.5  
extractive industries valuations, 6.14.7–6.14.8  
hotel valuations, 8.6.5  
sales incentives, 5.2.3  
salinity, 8.10.2–8.10.3  
salvage value, 4.3.3  
sandwich lessor interest, 6.2.1  
*see also* headleasehold interest  
scarcity, 4.1.1  
secrecy clauses, in leasing arrangements, 11.3.3–11.3.4  
securities  
for loan, mortgage or debenture, 5.2.1–5.2.5  
real estate, 3.5.6  
securitised investment instruments, 3.5.6, 3.5.8  
security for lending *see* loan security  
security or financial interests, 3.5.2  
selling costs, 5.1.6, 5.3.6  
sensitivity analysis, 8.8.5  
separate accounts, 3.5.6  
separation of interest in property, 3.5.3  
service potential, 5.3.2, 5.3.8, 6.8.1, 10.1.5  
service stations, 11.4.6  
service units approach, 5.3.7  
serviced apartments, 8.6.1–8.6.5  
*see also* hotels  
services provided by API and PINZ members, 15.2.1  
shareholder's equity, 6.6.1  
shopping centres  
design influences, 11.6.11  
locational influences, 11.6.10  
measurement of, 11.4.6  
showrooms, 11.4.6  
site contamination *see* contaminated land  
site improvements *see* improvements  
soils, 8.10.2–8.10.3  
solvency ratio, 5.2.5  
special, unusual, or extraordinary assumptions, 4.4.1  
special purchaser, 4.3.1  
special purpose property (agricultural uses), 6.10.2  
special value, 3.4.7, 4.1.2, 4.3.2–4.3.3  
definition, 4.3.1  
specialised assets, 6.8.2–6.8.4, 9.1.7–9.1.8  
specialised property, 3.4.6, 5.1.1, 5.1.7–5.1.8, 5.2.1,  
5.2.3–5.2.4, 6.8.1, 6.8.2, 8.1.7, 9.1.6–9.1.7  
special purpose agricultural properties, 6.10.2  
specifications for the valuation assignment, 4.4.1–4.4.2  
sports facilities *see* recreational assets  
stamp duty (Australia), 11.6.10  
standards *see* International Valuation Standards  
standards, national  
relationship with International Valuation Standards,  
3.2.1  
standards enforcement, 3.2.1  
standards of appraisal level and uniformity, 6.13.3  
standards of professional conduct *see* professional conduct  
state of repair *see* physical condition  
statutes *see* legislation  
statutory bases of valuation, 4.3.3  
statutory requirements *see* legislative requirements;  
regulatory observance  
statutory rights (related to leases), 6.2.3  
stigma effect on values

from environmental contamination, 12.1.1, 12.1.8  
     method of assessing, 12.1.16  
 from Native Title (Australia), 12.2.2  
 stock units (agricultural land), 8.10.5  
 strata area (leases) (SA), 11.4.2  
 strata area (sales) (SA), 11.4.2  
 stratum area (SUA), 11.4.2  
 strip shops, 11.4.6  
 structural condition of buildings, 11.6.4  
 subdivision development technique (land valuation), 6.1.10  
 subleaseholds *see* lease interests  
 supermarkets, 11.4.6  
 supplementary valuations, 8.4.4  
 supply and demand, 4.1.1  
 supply and demand data, 6.1.5  
 surplus assets, 5.3.5  
 suspended markets *see* disrupted markets  
 swimming pools *see* recreational assets  
 syndications, 3.5.5  
 synergistic value, 3.5.3, 4.1.2, 4.3.2–4.3.3  
     definition, 4.3.1

**T**

tangible assets, 3.4.2–3.4.3, 3.5.4  
 tapes, videos and papers, 14.2.2  
 target's statement *see* offer documents  
 taxation  
     and commercial investment properties, 11.6.9  
     and leases, 11.6.12  
     mass appraisal for property taxation, 6.13.1–6.13.3  
     *see also* rating and taxing  
 technical assessments (extractive industries), 6.14.5  
 technical experts (extractive industries), 6.14.5, 6.14.7  
 technical review, 6.11.2  
 tenant, 8.9.5  
 tenant's fixtures, 3.5.3, 6.5.3  
 tenant's improvements, 3.5.3  
 tenant's interest *see* lease interests  
 terminology definitions *see* definitions  
 terminology differences, 3.4.3, 3.4.6, 3.5.5, 4.3.2  
     in rural sector, 8.10.5  
 terms of appointment  
     development management consultant, 11.9.7–11.9.14  
 timberland *see* forestry  
 topography, impact on value of agricultural land, 8.10.2  
 toxic substances *see* hazardous and toxic substances  
 trade fixtures, 3.5.3, 6.5.3

trade related properties, 3.5.4, 5.2.4, 6.12.1–6.12.3  
     definition, 5.2.1, 6.12.1  
 trademarks *see* intangible assets  
 trading environment, of hotels, 8.6.2–8.6.3  
 trading performance  
     agricultural properties, 8.10.4  
     hotels, 8.6.2–8.6.3, 8.6.5  
 transferable goodwill, 6.4.2, 6.6.2, 6.12.1  
 Treasury guidelines, 5.1.10  
 Treaty of Waitangi (NZ), 8.1.9, 8.10.1  
 trust arrangements, 3.5.4  
 trusts, 3.5.2  
 turnover rent, 6.2.3, 8.9.5

## U

unaffected valuation approach, to valuation in light of  
     contamination, 6.7.5, 6.7.7  
 underground storage tanks *see* hazardous and toxic  
     substances  
 unenclosed covered area, 11.4.4  
 UNESCO  
     'cultural heritage' definition, 6.15.2  
 uniformity of valuation *see* accuracy and uniformity of  
     valuation  
 unincorporated entities, 3.5.4  
 United Nations Framework Classification  
     mineral reserve/resource definitions, 6.14.3–6.14.4  
 United Nations Hazard Classes, 12.1.10  
 units of comparison, 6.1.6, 6.1.8  
     definition, 6.1.3  
 units trusts, 3.5.6  
 unoccupied new houses *see* new houses  
 unregistered valuers (NZ), 13.2.1  
 unusual or extraordinary assumptions *see* special, unusual,  
     or extraordinary assumptions  
 upstream activities (extractive industries), 6.14.5  
 use of property  
     rights and privileges, 3.5.1–3.5.2  
     *see also* Indigenous Land Use Agreements  
 useful life, 5.1.2, 5.3.3  
 utility, 4.1.1  
     of property, 3.4.5–3.4.6

## V

vacant land  
     rating and taxing, 8.4.2  
 vacant possession, 8.9.5  
     hotels, 8.6.5



# INDEX

## valuation

accuracy and uniformity, 8.4.3, 8.4.5–8.4.7  
agricultural properties see agricultural properties  
approaches to see valuation approaches  
appropriateness of rating and other valuations, 10.1.11  
on ‘as if complete’ basis, 4.4.4, 5.2.2 see value ‘as if complete’  
of businesses see business valuation  
communication of, 4.1.1–4.1.3  
    see also Valuation Report  
of contaminated land see contaminated land;  
    hazardous and toxic substances  
date of see date of valuation; effective date  
distinguished from a Valuation Report, 6.1.3  
effective date of see effective date  
by employees see independent review of employee valuations  
external, 5.1.9  
for insurance purposes see insurance valuation reports  
for lending purposes see loan security  
and market data see market data  
mass appraisal, 6.13.1–6.13.3  
of personal property see personal property  
post valuation consultancy, 8.1.9  
principles see Generally Accepted Valuation Principles  
process (illustrated), 6.1.4  
properties in extractive industries, 6.14.1–6.14.9  
public sector assets see public sector assets  
purposes, 3.4.7, 3.5.2, 3.5.4–3.5.5, 6.1.3  
qualification, 6.7.6, 6.7.7  
real property see real property  
records, 6.1.3  
residential desktop assessments, 15.4.1–15.4.12  
restricted see restricted valuation pro-forma  
reviewing see valuation review  
specifications for the assignment, 4.4.1–4.4.2, 6.1.4  
supplementary or interim, 8.4.4  
for use in financial reporting see financial reporting

valuation approaches, 3.4.6–3.4.7, 4.1.2, 6.1.5, 8.1.7, 11.6.2  
    businesses, 6.6.3, 6.6.8–6.6.11  
    definition, 6.4.3  
    extractive industries, 6.14.6–6.14.7  
    intangible assets, 6.4.4–6.4.5  
    in light of contamination, 6.7.5–6.7.7  
    and Native Title (Australia), 12.2.12–12.2.14  
    personal property, 6.5.3  
    see also asset-based approach; bases of value; cost approach; income capitalisation approach

valuation contracts, 8.4.4–8.4.5  
valuation date see date of valuation  
valuation list or roll, 8.4.3–8.4.4  
valuation methods, 6.4.3, 6.5.3, 6.6.3, 6.14.7  
    see also valuation approaches  
valuation procedure, 6.4.3, 6.5.3, 6.6.3  
valuation ratio, 6.4.3, 6.4.4–6.4.5, 6.6.3  
Valuation Report, 4.1.1–4.1.3, 4.4.1–4.4.5, 8.1.8–8.1.9, 8.8.3–8.8.6  
    compulsory acquisitions, 8.5.4–8.5.5  
    contents, 11.6.3  
    countersigning of unregistered valuers’ reports (NZ), 13.2.1  
    definition, 4.4.2  
    distinguished from a valuation, 6.1.3  
    insurance see insurance valuation reports  
    for mortgage and loan security purposes, 8.2.1–8.2.2  
    qualifications see qualification statements  
    for rating and taxing purposes, 8.4.3–8.4.4  
    real property, 6.1.7, 8.1.2–8.1.5  
    style and terminology, 8.8.3  
    transmission of, 8.1.8–8.1.9  
    see also disclosure requirements  
valuation review, 6.11.1–6.11.3  
    definition, 6.11.2  
value, 3.4.3–3.4.4, 6.1.7, 8.1.7  
    adverse impact, 8.1.9  
    apportionment of value, 10.1.9  
    basis of, 3.4.3, 4.1.1, 4.1.1–4.1.2  
    definition, 3.4.3  
    stigma effect see stigma effect on values  
    supply and demand factors, 4.1.1  
    see also market value  
value ‘as if complete’, 4.4.4, 5.2.2, 8.1.8, 8.2.2–8.2.3, 8.8.6, 11.5.6–11.5.7  
value ‘at date of completion’, 11.5.6–11.5.7  
value in use, 5.1.3, 5.1.10, 5.3.3, 6.4.3, 6.8.4, 9.1.8, 10.1.4  
    of businesses, 3.5.5  
    and public sector asset valuation, 5.3.7

valuers  
    co-operation with auditors, 5.1.6, 5.3.6, 9.1.8, 10.1.6  
    countersigning of unregistered valuers’ reports (NZ), 13.2.1  
    definition, 3.3.1–3.3.2, 6.5.2  
    instructing (guidance for clients), 15.3.1–15.3.12  
    licences to value securities, 8.7.2  
    role of, in valuation for lending purposes, 5.2.4–5.2.5  
    unregistered (NZ), 13.2.1

valuer's report see Valuation Report  
 videos and tapes, 14.2.2  
 voluntary alterations (leasehold alterations), 6.2.4

## W

"walk in walk out" valuations, 8.10.4  
 warehouses, 11.4.6  
 wasting assets, 5.2.4, 6.14.1  
     see *also* extractive industries  
 water resources  
     extraction, 6.14.1, 6.14.3  
     factor in agricultural property valuation, 8.10.3  
     water rights, 6.14.3  
 wear and tear see physical condition  
 weeds and pests, 8.10.3  
 Wik decision (Wik Peoples -v- Queensland (1996) 141ALR 129), 12.2.1, 12.2.3  
     see *also* Native Title (Australia)  
 willing buyer, 4.2.2  
 willing seller, 4.2.2  
 without compulsion, 4.2.2  
 workers compensation, 11.7.7  
 working capital, 6.6.3  
*Working with Native Title: A Practical Guide for Local Government* (ALGA), 12.2.4  
 works of art see heritage assets  
 worksheets for feasibility studies, 11.5.15–11.5.19  
 World Heritage Convention  
     'cultural property' definition, 6.15.2  
 worth see investment value, or worth  
 written report, 4.4.2  
     see *also* Valuation Report

## Y

yield capitalisation, 6.1.7  
 yield rate see discount rates

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