

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

<b>Reference:</b>	ANZVGP 106 The Valuation of Partial Interests in Property Held Within Co-Ownership Structures
<b>Published Date:</b>	25 June 2021
<b>Effective Date:</b>	1 July 2021
<b>Owner:</b>	Manager Professional Standards

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## Guidance Papers

### Objectives

The principal objective of a Guidance Paper (GP) and Resource Pack (if applicable) is to clarify professional and industry processes, best practices, and procedures and to discuss their use and implementation.

A GP is designed to be of assistance to Members and those who use Members' services. They serve as a guide and measure of acceptable professional practice and conduct of a Member.

The intention of a GP is to:

- a) provide information on the characteristics of different types of assets that are relevant to the advice;
- b) provide information on appropriate practices and their application;
- c) provide information that assists Members in exercising the judgements they are required to make in specific situations';
- d) convey elements of what is considered "competent professional practice" for Australian Property Institute (API) Members and "best practice" for Property Institute of New Zealand (PINZ) Members and New Zealand Institute of Valuers (NZIV) Members.

A GP is not intended to provide comprehensive training, instruction or prescriptive practices and procedures, or direct that a process, professional approach, or method should or should not be used in any specific instruction or situation.

### Member Obligations

The Member is responsible for choosing the most appropriate approach in a matter based upon the task and instruction. It is a matter for each Member to decide the appropriate practice in any situation, and if they are unclear, seek professional advice from others, or contact the Institute(s). Members have the responsibility of deciding when it is appropriate to depart from the guidance and practices contained in a GP.

The Institute(s) do not warrant that anything contained in this or any GP is the definitive or final statement on any issue. Members must perform their own work pursuant to their own professional expertise and experience and if required, seek additional advice which might include legal advice.

### Court or Tribunal Reliance

A court or tribunal may consider the contents of any relevant GP or other document relating to a recommended professional practice published by Institute(s) in deciding whether the member acted to a standard required by law.

### Currency of Publication

Case law and relevant legislation may change over time and whilst the Institutes(s) consider this GP current at the time of publication, Members and those who use Members' services should have regard to legislative changes and new rulings and if necessary, seek further advice prior to having regard to this GP.

## Departure or Non-Compliance

Where a Member considers that a circumstance exists that warrants the departure from or non-compliance with any of this GP, the Member's report (or other advice) must include a statement that outlines:

- a) the reasons for the departure or non-compliance with this GP; and
- b) any impact the Members departure or non-compliance may have on the content of the report.

Members are advised to seek legal and/or other advice before departing from practice recommended in a GP.

## Enquiries

If any Member considers any information or advice in this GP to not be accurate or up to date, or wish to raise any issue for consideration arising from the contents of this GP, please refer this to

API contact: [standards@api.org.au](mailto:standards@api.org.au)

PINZ/NZIV contact: [standards@property.org.nz](mailto:standards@property.org.nz)

## 1.0 Introduction

### 1.1 Scope of this Guidance Paper

This GP applies to Institute Valuer Members (Valuers) who undertake the valuation of partial interests in property held within co-ownership structures on behalf of known clients with whom those Valuers or their employers have entered into the appropriate valuation services agreement. The purpose of this GP is to detail commonly accepted processes and procedures for the valuation of partial interests in property held within co-ownership structures and to discuss the use of these processes and procedures.

Valuers undertaking valuations of partial interests in property held within co-ownership structures must do so to the standard of professionalism and skill required and consistent with membership of the Institute(s) and in compliance with the law.

This GP should be read in conjunction with other relevant GPs and any other relevant publication from the Institute(s), which are either over-arching or directly applicable to the issues raised in this GP.

### 1.2 International Valuation Standards

International Valuation Standards (IVS) published by the International Valuation Standards Council (IVSC) are adopted by the Institute(s).

It is the Member's responsibility to comply with the IVS applicable at the date of valuation, keep informed of any changes and, apply them appropriately and consistently when providing valuations.

This GP is also intended to be consistent with the concepts and definitions contained in the IVS, however, there may be departures from the IVS to reflect Australian and New Zealand law and practice. This GP refers to and uses IVSC definitions to promote consistency.

## 2.0 Definitions

The definitions contained below and used in this GP are applicable to this GP and have been included to assist with the interpretation and understanding of certain stated terms used within this GP. Where a defined term is included in this GP it is identified as a capitalised term.

Institute(s)	All references to Institute(s) mean, as the context requires, the API, PINZ and/or NZIV.
Member(s)	A Member(s) of the API and/or PINZ and NZIV.

## **3.0 Partial Interests**

### **3.1 Definition**

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

### **3.2 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.

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

### **3.3 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.

### **3.4 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.

## **4.0 Instruction**

### **4.1 Clarity of Instruction**

Valuers should ensure clarity of instructions concerning the interest that is to be valued.

### **4.2 Subject of Instruction**

The subject of the potential instruction to value may comprise:

- (a) all or part of the physical underlying asset unencumbered by the co-ownership structure.
- (b) all or part of the physical underlying asset encumbered by the co-ownership structure;
- (c) the form of entity comprising the co- ownership structure; or
- (d) a partial interest in the form of entity comprising the co-ownership structure.

### **4.3 Competence**

Valuers should not accept instructions beyond their competence.

### **4.4 ASIC Licence**

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

#### **4.5 Exclusion**

Unless holding a relevant licence (being an Australian Financial Services Licence in Australia), Valuers 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.

### **5.0 General**

#### **5.1 Distinction**

For the purposes of valuation, the property (refer 5.2, below) is distinguishable from the co-ownership structure (refer 5.3 and 5.4, below), which are each distinguishable from the property held in a co-ownership structure.

#### **5.2 Property**

The property comprises the physical underlying asset, which is the subject of the valuation (refer 6.0, below).

#### **5.3 Co-Ownership**

The co-ownership structure comprises the form of tenure or entity in which the property is held. This may include a joint tenancy, tenancy in common (divided or undivided), companies, trusts, unincorporated joint ventures, partnerships, or other form of entity (refer 7.0, below).

#### **5.4 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 (refer 8.0, below).

#### **5.5 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.

#### **5.6 Proportional Share**

The value of a partial interest in a co-ownership entity may be greater or less than the value of the proportional share of the physical asset held by the co-ownership entity (refer 7.0 and 8.0 below).

#### **5.7 Sum of Parts**

The sum of the partial interests in a co-ownership entity may be greater or less than the value of the physical asset held by the co-ownership entity (refer 7.0 and 8.0 below).

#### **5.8 Value and Worth**

*IVS 104 Bases of Value*, paragraph 30 defines market value as:

*Market Value is the estimated amount for which an asset or liability should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length*

*transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.*

*IVS 104 Bases of Value, paragraph 60 defines investment value/worth as:*

*Investment value/worth is the value of an asset to a particular owner or prospective owner for individual investment or operational objectives.*

## **5.9 Value vs Worth**

Having regard to 5.8 (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.

## **6.0 Valuation of Physical Underlying Asset**

### **6.1 Property Valuation Approach**

The comparability of the property comprising the physical underlying asset (refer 5.2, above) to sales evidence should be measured against established criteria of quality relative to a property's peer stock and the overall property market.

### **6.2 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.

### **6.3 Cash Flow**

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

### **6.4 Value of Part**

Whilst a valuation of a partial interest may require an assessment of the value of the physical asset underlying the partial interest, it should only address the value of the relevant partial interest in a property held in a co-ownership structure which may not, necessarily, be its pro-rata value (refer 7.0 and 8.0 below).

### **6.5 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.

### **6.6 Marriage Value**

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

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

## 7.0 Co-Ownership Principles

### 7.1 Influences on Value

The form of entity tenure comprising the co-ownership structure (5.3 above) may influence the value of a partial interest in a property held in such co-ownership structure through such factors as:

- (a) the ongoing conduct of the co-ownership relationship e.g. co-operative vs. fractious;
- (b) the available process for resolution of disputes amongst co-owners.
- (c) the ongoing costs of supporting the co- ownership structure.
- (d) the treatment of asset and property management costs.
- (e) the mechanism and basis for treating commitments to capital expenditure.
- (f) the ability to use an interest as security for debt (often a difficulty).
- (g) the timetable for unit pricing calculation, where relevant.
- (h) the basis of and timing of a termination of the co-ownership relationship e.g. risks and unknowns, such as life interests.
- (i) the ease (or otherwise) of disposing of the interest on the open market e.g. in-built restrictions on sale.
- (j) the cost of disposing of an interest in the co- ownership structure.
- (k) the cost of terminating the co-ownership structure and disposing of the underlying asset.
- (l) the basis of and terms applying to any disposal of the underlying asset.
- (m) the constraints and other terms of any disposal of the relevant interest including.
  - i) first and subsequent right of refusal provisions or other priorities of the co-owner.
  - ii) any absolute restrictions on disposal.
- (n) the implications of ongoing liabilities of a co- owner after disposal of the relevant interest.
- (o) taxation implications; and
- (p) the extent to which the co-ownership structure / framework prevents the underlying asset being used for its highest and best use e.g. a long term ground leasehold for 'industrial purposes' in a location now supporting high-rise residential development.

## 8.0 Co-Ownership Issues

### 8.1 Influences on Value

The principal rights and obligations for consideration (5.4 above) which impact upon the value of the co-ownership interest may include:

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

## 8.2 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.

## 8.3 Control Issues

Control issues for consideration may include:

- (a) number of parties in the co-ownership structure.
- (b) voting rights where disproportional to the pro-rata interest.
- (c) cost allocation where disproportional to the pro-rata interest.
- (d) revenue allocation where disproportional to the pro-rata interest.
- (e) complexity of process and time taken to direct.
- (f) protection at law for minority rights.
- (g) use of dispute resolution levels and mechanisms.
- (h) pre-emptive rights; and
- (i) existence of a controlling interest.

## 8.4 Liquidity Issues

Liquidity issues for consideration may include:

- (a) 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.
- (b) 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.
- (c) 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.
- (d) 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
- (e) the reasonable selling period for the interest - both in the context of the ownership structure and any co-ownership agreement selling constraints.

## **9.0 Comparable Evidence**

### **9.1 Comparability**

Comparability of evidence of sales transactions should be considered in the valuation of both the physical underlying asset (refer 5.2 above) and the co-ownership interest (refer 5.4 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.

### **9.2 Available Evidence**

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

In such cases of directly comparable evidence, the level of adjustment of that evidence for application to the subject interest to reflect the differences between each may need to be extensive given the infrequency of these sales.

### **9.3 Relevance of Comparable Evidence**

Valuers 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, Valuers should ensure that adjustment is made to appropriately reflect such differences.

### **9.4 No Available Evidence**

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

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

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

### **9.5 Appropriate Adjustment**

In the absence of directly comparable evidence, the Valuer 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.

### **9.6 Relevant Information**

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

## 9.7 Checklist

Such information may include:

- (a) relevant documents supporting the ownership structure, including amendments to those documents, such as:
  - iii) shareholders/unit holder's agreement.
  - iv) trust deed and trustee structural arrangements.
  - v) joint venture agreement.
  - vi) articles of association.
  - vii) partnership agreement; or
  - viii) any other similar arrangement document.
- (b) co-ownership agreement regulating the relationship between the co-owners; including fee or other co-owners' remuneration arrangements.
- (c) notice of any agreements between the co-owners which vary any of the terms of the agreements including board or management meeting minutes.
- (d) any financing agreements relevant to the entity.
- (e) financial statements, statements of compliance with accounting standards, auditors reports and tax returns.
- (f) 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.
- (g) details of any other agreement, arrangement, or obligation likely to impact on the value of the relevant interest; and
- (h) 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.

## 9.8 Special Comment

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

## 9.9 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.

## 10.0 Effective Date

This TIP is applicable from 1 July 2021. Earlier adoption is permitted and encouraged.

This GP replaces *ANZVTIP 6 The Valuation of Property Interests Held Within Co-Ownership Structures* which was in effect from 15 November 2016 and was withdrawn 30 June 2021.