

## 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

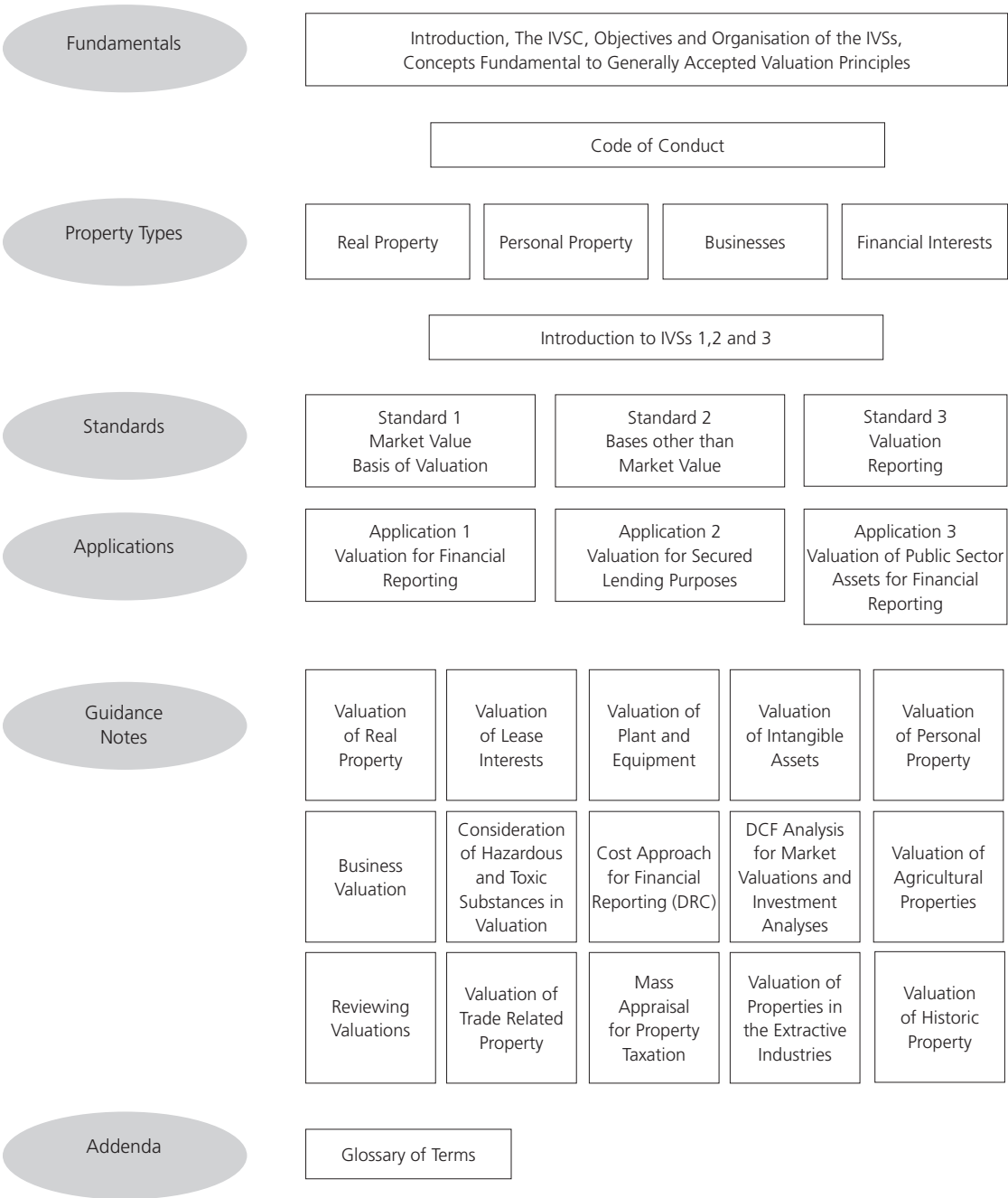
Various valuation principles and techniques are understood within the valuation profession and are well established throughout the global business community. The abbreviated discussions of such principles and techniques included in the Standards, Applications, and Guidance Notes should not be considered 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:

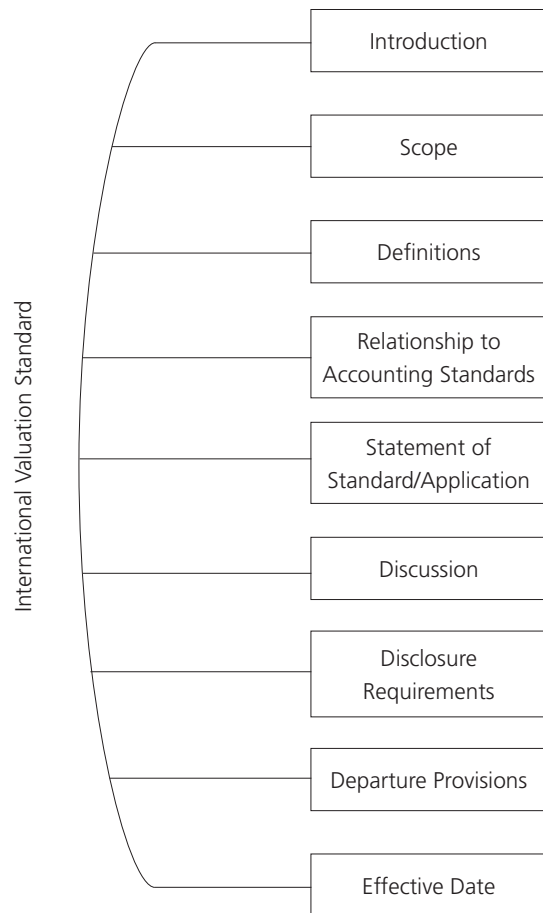
1. Introduction
2. Scope
3. Definitions
4. Relationship to Accounting Standards
5. Statement of Application
6. Discussion
7. Disclosure Requirements
8. Departure Provisions
9. Effective Date

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

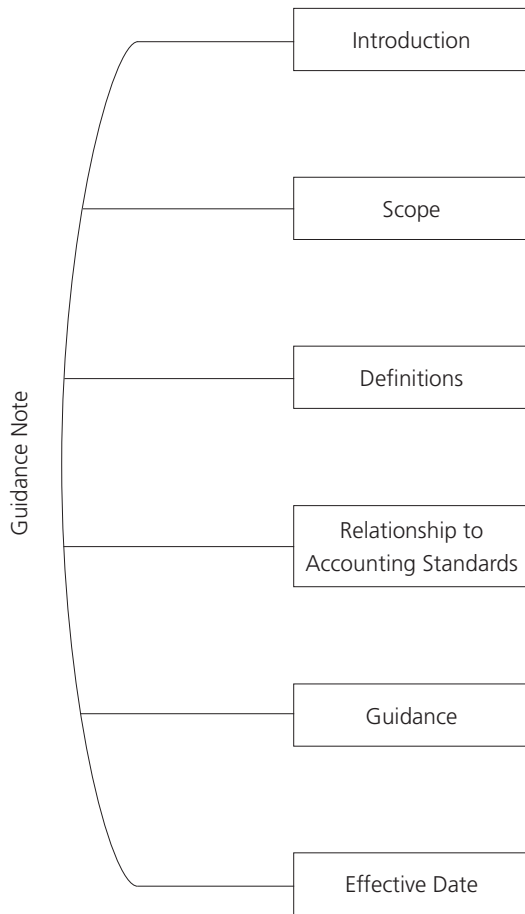
## Format of the Standards and Applications



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.

**THIS PAGE IS INTENTIONALLY LEFT BLANK**

# 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.