Property Types

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International Valuation Standards Committee

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 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 owner's 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.

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 (*Marriage,* or *Assemblage 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 characterized 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.

2.7 The cost, sales comparison, and income capitalisation approaches and the methods associated with these approaches are generally applied to the valuation of real property. A Valuer will commonly reconcile the indications derived from two or more of these approaches and associated methods. All three approaches are based on the principle of substitution, which holds that when several similar or commensurate commodities, goods, or services are available, the one with the lowest price attracts the greatest demand and widest distribution.

2.7.1 The *cost approach* establishes the value of the real property by estimating the cost of acquiring land and building a new property with equal utility or adapting an old property to the same use with no undue cost due to delay. An estimate of entrepreneurial incentive or developer's profit/loss is commonly added to land and construction costs. For older properties, the cost approach develops an estimate of depreciation including items of physical deterioration and functional obsolescence.

2.7.1.1 In some States, a *Depreciated Replacement Cost* (DRC) methodology is applied to arrive at a surrogate for the *Market Value* of specialised properties (see IVS General Valuation Concepts and Principles, para. 8.2 and the Guidance Note on Real Property Valuation, GN 1, para. 5.11.1).

2.7.1.2 An estimate derived from the cost approach represents the value of the fee simple, or freehold, interest in the property. If the property is leased/held in leased fee, or is subject to other partial interests, the Valuer must make an adjustment to reflect the specific real property rights being valued.

2.7.1.3 Cost and *Market Value* are most closely related when properties are new. The cost approach is often

applied in valuations of new or recent construction, and proposed construction, additions, or renovation. Cost estimates, however, tend to establish the upper limit of what market purchasers would pay for such properties. The *cost approach* is also useful in the valuation of specialised or special purpose properties, which are rarely sold. Applied to older properties where market support for estimates of costs and depreciation is difficult to obtain, the cost approach may produce a non-market indication of value.

2.7.2 The *sales comparison approach* establishes limits on the *Market Value* for real property by examining the prices commonly paid for properties that compete with the subject property for buyers. Sales are investigated to ensure that the parties to the transaction were typically motivated. Sale prices reflecting motivation other than that of a typical market participant, i.e., transactions of special purchasers who are willing to pay a premium for a particular property, should be eliminated.

2.7.2.1 The subject property (property being valued) is compared with the sale prices (and listings and offerings) of similar properties that have recently been transacted in the (open) market. Sale prices are analysed by applying appropriate units of comparison and are adjusted for differences with the subject on the basis of elements of comparison (see the Guidance Note on Real Property Valuation, GN 1, para. 5.12.4 and 5.22).

2.7.2.2 In applying the *sales comparison approach,* a Valuer must consider the property rights to be valued to ensure that the property rights in the subject property are the same as those associated with the comparable properties. If this is not the case, (an) appropriate adjustment(s) to the comparable sales is necessary.

2.7.2.3 The *sales comparison approach* has especially broad applicability and is persuasive whenever sufficient

market data are available. Data obtained by application of this approach may be applied in the income capitalisation and cost approaches. The reliability of sales comparison may be limited, however, when market conditions are marked by rapid change or volatility, or in valuations of specialised, or special purpose, properties that are rarely sold.

2.7.3 In the *income capitalisation approach,* the Market Value for the real property is established by the income-producing capacity of the real property. The *income capitalisation approach* also relies on the principle of anticipation, which perceives value as created by the expectation of future benefits (income streams).

2.7.3.1 Income capitalisation considers comparative income and expense data to establish the net (operating) income for the subject property. Capitalisation is performed either by application of a single rate (overall capitalisation rate, or all risks yield) to a single year's income or by application of a yield or discount rate (reflecting measures of return on investment) to a series of incomes over a projected period (see the Guidance Note on Real Property Valuation, GN 1, para. 5.13 to 5.13.5).

2.7.3.2 Because investors generally focus on the rate of return, the assumptions or inputs underlying value estimates obtained by income capitalisation may be compared with the performance of alternative property and financial investments.

2.7.3.3 Income capitalisation is most often applied to 100% ownerships (inclusive of all shareholders or partners) of equity interests in a leased property.

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 rep-

resents interests in items that are not permanently attached or affixed to real estate and are generally characterized 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.

3.2.1.1 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, which in some States is called *Plant and Machinery.*

3.2.2.2 In other 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, Salvage Value,* or *Liquidation Value,* e.g., the value of personal property in a hotel that was sold as a trading entity versus the value of personal property in a hotel that was sold after the hotel went out of business. (See IVS 2, para. 3.9 and 3.10.)

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.

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 economic 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 enterprises operating to provide consumers with products or services. Closely related to the concept of business enterprise 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 enterprise 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 enterprises are constituted as legal entities. A business may be unincorporated or incorporated.

4.2.1 Examples of unincorporated enterprises include sole proprietorships, joint ventures, and general and limited partnerships.

4.2.2 Examples of incorporated enterprises 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 enterprises 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 enterprises 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 enterprises 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; gasoline, or petrol, stations; restaurants; and movie theatres, or cinemas, variously called *properties associated with a business enterprise, properties, with trading potential, specialised trading 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.

4.4 Under the terminology of accounting, both tangible and intangible assets are included among the assets of a business enterprise.

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 includes two distinct components: goodwill that is property-specific, or inherent within the property, and personal goodwill that is associated with the proprietor or manager.

4.5 The valuation of businesses is undertaken for a variety of purposes including: (See the Guidance Note on Business Valuation, GN 6, para. 5.0)

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* (see International Valuation Standard 2, para. 3.1) 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 General Valuation Concepts and 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, specialised 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.)

4.8.1 An *asset-based approach* to value examines a balance sheet for the business that reports all assets, tangible and intangible, and all liabilities at *Market Value,* or an appropriate carrying amount. When an asset-based approach is used in assignments involving operating businesses valued as going concerns, the value estimate obtained should be considered together with the value estimate(s) from (an)other approach(es).

4.8.2 An *income capitalisation approach* to value calculates the present value of anticipated income or benefits in view of their expected growth and timing, the associated risk, and the time value of money. Income is converted into an indication of value either by means of direct capitalisation of a representative income level, or a discounted cash flow analysis, or dividend method, in which cash receipts estimated for a sequence of future periods are converted to present value by application of a discount rate.

4.8.3 A *sales comparison approach* to value compares the subject business to similar businesses, business ownership interests, or securities that have been sold in the open market. The comparable businesses should be in the same industry as the subject and responsive to the same economic variables. Typical sources of data include the acquisition market in which entire businesses are bought and sold, prior transactions in the ownership of the subject business, and public stock markets in which ownership interests of similar businesses are traded.

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.

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.

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. 5 defines *financial asset, financial liability, financial instrument, equity instrument, compound (financial) instrument,* and *monetary financial assets and liabilities*. Under IAS 32, an enterprise shall disclose information about *Fair Value* for each class of financial asset and financial liability, both recognised and unrecognised. When a financial instrument is traded

in an active or liquid market, its quoted market price provides the best evidence of *Fair Value* (IAS 32, 77, 81).

5.4.1 A *financial asset* is any asset that is a) cash; b) a contractual right to receive cash or another financial asset from another enterprise; c) a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favorable; or d) an equity instrument of another enterprise.

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 contractual obligation a) to deliver cash or another financial asset to another enterprise; or b) to exchange financial instruments with another enterprise under conditions that are potentially unfavorable. (An enterprise may have a contractual obligation that it can settle either by payment of financial assets or by payment in form of its own equity securities.)

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 enterprise and a financial liability or equity instrument of another enterprise. 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. Contractual rights and obligations that do not involve the transfer of a financial asset but provide for settlement by receipt or delivery of a physical asset only (e.g., an option, futures, or forward contract on a commodity such as silver) do not fall within the scope of the definition of a financial instrument (IAS 32, A9, 14, A13).

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 (i.e., price risk, credit risk, liquidity risk, cash flow risk) inherent in an underlying financial instrument (IAS 32, 10).

5.4.3.3 Many types of derivative financial instruments embody a right or obligation to make a future exchange, including interest rate or currency swaps, interest rate caps, collars and floors, loan commitments, note issuance facilities, and letters of credit (IAS 32, A12).

5.4.3.4 A *finance lease* is considered to be a financial instrument but an operating lease is not considered to be a financial instrument (IAS 32, A6).

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

5.4.4.1 Common examples of equity instruments include common shares, certain types of preferred shares, and warrants or options to subscribe for or purchase common shares in the issuing enterprise (IAS 32, A7).

5.4.4.2 An option or other similar instrument acquired by an enterprise that gives it the right to reacquire its own equity instruments is not a financial asset of the enterprise (IAS 32, A7).

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.

5.4.6 *Monetary financial assets and financial liabilities* (also referred to as *monetary financial instruments*) are financial assets and liabilities to be received or paid in fixed or determinable amounts of money.

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 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 consider 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.