ACCA

Technical Factsheet 168

Valuing property and farming companies

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1. INTRODUCTION

1.1 This factsheet aims to provide a summary of the issues that need to be considered when engaged in the valuation of property and farming companies.

1.2 The factsheet will deal with the following; circumstances where an assets approach is appropriate, contingent taxation, the necessity for asset revaluation, issues surrounding hybrid companies, and the levels of discount appropriate in considering minority interests in companies of this nature.

1.3 This factsheet does not deal with break-up, distress or other circumstances where an assets approach may be appropriate in valuing trading companies – these issues are dealt with in Factsheet 167.

1.4 This is one of a series of factsheets numbered 167 to 173 looking at various valuation issues.

1.5 For matters to consider when reporting on valuations refer to technical factsheet 170 section 7.

2. APPROACHES

2.1 In the vast majority of cases property and farming companies are valued on the basis of assets rather than earnings. There will, however, be a few occasions where an assets based approach is not appropriate or needs to be supplemented by other approaches. For example, in circumstances where a farm uses one of its fields as a camping or caravan site this business will need to be valued separately as there will likely be goodwill. The value of the business is then added to the value of the other assets to give a value for the whole.

2.2 An assets based approach may not be appropriate when considering property development or property dealing companies, which may be valued on an earnings basis. Company valuations using earnings are dealt with in Factsheet 167.

2.3 The basic approach in asset valuation is to start from the position of the net assets as expressed in the latest balance sheet. It is then necessary to adjust material assets within the balance sheet (which will usually be expressed either at the lower of cost and market value or at amortised cost) up to market value. Usually the principal items will be freehold property, land and buildings. However it may also be necessary to look at stock, plant and machinery and any other substantive assets. Farming businesses may have significant crops and livestock which need to be valued.

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HM Revenue and Customs, Business Income Manual 55410 entitled "Farming: stock valuation: BEN 19 (now help sheet IR232) gives details which explain the basis of valuation of farm stock which is acceptable to Inspectors of Taxes, this can be found at the following address:

http://www.hmrc.gov.uk/manuals/bimmanual/BIM55410.htm

2.4 Any increase in value may have with it a potential charge to contingent tax and an adjustment may need to be made in this regard.

2.5 For hybrid companies that have within them some trading activity it may be necessary to investigate the trading activity separately. This issue is discussed in greater depth below.

2.6 Finally, if considering a minority interest then the levels of discount appropriate to reflect the disadvantages of holding such an interest in a property company need to be applied. These discounts tend to be lower than the discounts appropriate to trading companies, reflecting the fact that, in general, property companies are considered to be a less risky investment than trading companies.

3. ASSET REVALUATION

3.1 As the assets in the accounts will usually be expressed either at the lower of cost and market value or at amortised cost, and we are valuing on the basis of market value, it will be necessary to check the valuation of appropriate assets in the accounts and if necessary have these re-valued and brought to market value. In terms of land and buildings, it may be that the director's opinion of current market value will suffice, or it may be possible to estimate a current value on the basis of the rental yield. Information is generally available via the web and on the District Valuer's section of the HMRC website with regard to rental yields to enable an estimate to be made in this regard.

The Valuation Office Agency (VOA) is an executive agency of HM Revenue and Customs, one of its functions is to value property in England, Wales and Scotland for the purposes of taxes administered by the HM Revenue & Customs. Its website can be accessed at the following address:

http://www.voa.gov.uk/

3.2 However, in appropriate cases it will be necessary to engage a professional property valuer. Care needs to be taken that the valuer is correctly instructed - in cases of a single property this is not usually an issue, but where a property company owns a portfolio of properties the valuer may be able to provide both a sum of the parts opinion and an opinion on a portfolio basis. Often a portfolio basis will tend to be at a small discount to a sum of the parts valuation and reflects the fact that the entirety of the properties are sold as a block.

3.3 If the company has significant plant and machinery, it may be that a specialist plant and machinery valuer will need to be engaged in order to address this.

3.4 Further specialist valuation advice may be required where there are significant mineral deposits and also in instances where the land has other attributes (such as a derelict quarry that may have value as landfill) or where there are restrictions/covenants which may reduce a valuation (such as rights of way or access restrictions).

3.5 In the case of farming companies it may be necessary to look at the value of the livestock, for example a pedigree herd and/or bull may need to be brought into the equation.

4. CONTINGENT TAXATION

4.1 Most property companies will have within them assets that have increased in value over time, the increase likely being chargeable to tax on the disposal of the asset. In the first instance, the valuer will require a computation of the tax charge. The following issues need to be considered in deciding how much of the contingent tax charge should be deducted in considering the value of the properties at any one period in time:

- What is the likelihood of the property being disposed of in the immediate future? In this regard, the valuer will need to look at the history of property turnover and also the nature of the asset. If the company owns a single commercial property and has no history whatsoever of property disposals, then it might be that only a very small proportion of the contingent tax would be deductible.

- If, however, the company owns many properties and is regularly engaged in disposal and replacement of properties, then a larger percentage may be appropriate.

- It should be borne in mind that when an entire property company is being bought and sold the vendor and purchaser often begin negotiations on the basis of a 50:50 split of the contingent tax within the company between themselves and negotiations will proceed from there.

- If a controlling interest is to be valued and the purchaser will of necessity need to liquidate assets in order to generate any kind of return, then it may be that a deduction of all of the contingent tax on those assets may be a reasonable deduction.

- When negotiating valuations with HMRC an allowance in the range of 10% to 30% is frequently found to be appropriate.

Example
Small property investment company with Net Assets £5million. The property consists of a single commercial building let long term to good quality clients at a top rental. No plans for change so only a small part of the contingent tax likely to be deducted. The property is revalued up from £4million to £6million and contingent tax on the revised value is estimated at £500,000. The contingent tax adjustment is being estimated at 10%.

	£,000
Net Assets	5,000
Uplift (£6m less £4m)	2,000
Contingent tax adjustment (£500k x 10%)	(50)
Valuation	**6,950**

5. HYBRID COMPANIES

5.1 There is some discussion within the profession as to the appropriate approach in considering the valuation of property dealing and development companies. These may be valued on an assets basis or on an earnings basis depending on the circumstances of each individual case. It is not possible to give hard and fast rules or guidance in this regard - each case needs to be judged on its merits.

5.2 However, the minimum value for such companies is likely to be the sum of the assets that they hold - it may be appropriate to add to that minimum value a further sum representing goodwill or other intangible value that would be derived from the ability to drive out profits.

5.3 In addition, the valuer will frequently come across property companies that have within them other forms of trading activity. The example given above (of a farming company with a campsite) is reasonably typical. An example of the approach that might be considered to be reasonable is outlined below:

Example
Farming company with large campsite. Net Asset value £15million and property, land and buildings revalued from £12million to £20million with contingent tax estimated at £2million. Family owned for four generations and no plans for change therefore only a small deduction for tax. Campsite established many years with full Local Authority license. Many repeat bookings. Turnover £500,000 with a pattern of steady growth, pre tax profit £100,000 prior to owners' salary.

	£,000
Net Assets	15,000
Uplift (£20m less £12m)	8,000
Contingent Tax adjustment (£2m x 10%)	(200)
Campsite Goodwill (£100k x 3)*	300
Valuation	**23,100**

***See Factsheet 5 regarding goodwill valuation calculation**

6. MINORITY INTERESTS

6.1 It is generally considered that the level of discount appropriate for interests in property companies that do not constitute a 100% interest will be lower than those appropriate for trading companies. The following range of discounts might be considered to be a reasonable starting point in deciding on the level appropriate in any specific instance:

- **Majority holdings in excess of 50%** - a discount of 5% to 10%.
- **50% interests** - a discount of 15% to 25%, depending on the split of the other interests.
- **Interests of 26% to 49%** - a discount of 30% to 40%.
- **Interests of 10% to 25%** - a discount of 45% to 55%.
- **Interests of less than 10%** - a discount of 60% to 75%.

6.2 In considering the level of discount appropriate it should be borne in mind that the above recommendations are only guidelines. Factors which will influence the level of discount will include the spread and ownership of the other shareholdings within the company and the likelihood of a sale, disposal or floatation or other disposal of the company in the short to medium term.

Example 1
In the example at Para 4 above the Valuation is £6.95million. There are 100 £1 ordinary shares in issue and therefore the value per share is £69,500. The shares are split 50:50 and a valuation is required of one of the 50% interests. As both of the interests are in a deadlock position, with no casting vote for either party, a discount at the upper end of the range for a 50% interest is appropriate of say 25%, valuing the shares at £52,125 per share, and the 50% interest at **£2,606,250**.

Example 2
In the example at Para 5 above the Valuation is £23.1million. There are 1,000 £1 ordinary shares in issue and therefore the value per share is £23,100. There are eight separate holdings of shares, with no holding greater than 35% and we are to value an interest of 5% consisting of 50 shares. This holding gives no material strategic advantage to any of the other shareholders, but the company has paid a regular (though small) dividend for many years. In these circumstances, taking in to account the dividend payments, a discount at the lower end of the range for a 5% interest is appropriate of say 60%, valuing the shares at £9,240 per share and the 5% interest at **£462,000**.