

International Valuation Standards Board
41 Moorgate
London
EC2R 6PP
United Kingdom

October 30st 2009

Dear Sir/Madam

Exposure Draft - The Valuation of Investment Property under Construction

The European Public Real Estate Association (EPRA) is pleased to respond to the above Exposure Draft. EPRA is the voice of the European publicly traded real estate sector. EPRA represents property investment companies, Real Estate Investment Trusts (REITs), investment institutions and the firms and individuals who advise and service those businesses. Between them, our 200 members represent over €300bn of real estate investments.

Our core membership consists of property investment companies (including REITs) who are in the business of owning and operating portfolios of investment property. These companies create value by actively managing, financing and developing property to provide the environment for modern business to operate from.

The valuation of Investment Property Under Construction (IPUC) is complex and judgemental and there is relatively little detailed guidance on the subject. There is also considerable diversity observed in the methods and principles used in estimating the fair value of IPUC in Europe. EPRA consider that guidance is needed to ensure consistency among preparers of financial statements, advisers and investors. We are therefore strongly supportive of the IVSB's efforts in responding to the recent amendment to IAS 40 and addressing diversity of practice in the valuation of IPUC.

As highlighted in the Exposure Draft, in the January 2009 Interim Position Statement the Board set out that, since property under construction will be developed either for income or capital appreciation, the cash flows associated with its construction and completion should normally be readily identifiable and capable of reliable estimation. Consequently, the Board opined that it will be rare for the fair value of an investment property under construction not to be capable of reliable determination. We very much support the exclusion of this latter comment from the Exposure Draft as we believe that it should remain clear that it is the ultimate responsibility of the company management to determine whether or not a valuation is sufficiently reliable to provide decision useful information for users of the financial statements. Removing this comment also avoids the suggestion that any IPUC could be reliably valued; a suggestion to which we otherwise would have to seriously disagree with because there could be facts and circumstances where the range of likely outcomes is too great to reliably fair value IPUC for financial reporting purposes.

Notwithstanding the above, we are already seeing evidence of diversity in practice in this area and believe the Exposure Draft could help to enhance consistency and address this issue by providing:

- Qualitative guidance by the IVSB as to the circumstances in which a valuation of property under construction might not be reliable; and
- A statement by the IVSB to the effect that, if an appropriately accredited professional valuer reporting under recognised professional standards provides a valuation of a property under construction for financial reporting purposes, then that valuer must be reasonably confident that the reported value is, with reference to framework of qualitative guidance, sufficiently reliable to form the basis of measurement in financial statements, unless specifically indicated otherwise.

- Guidance to appraisers on how to comment on the reliability of the valuation and sensitivity/likely range of outcomes, based on the remainder of project risk and the impact of the inherent uncertainty of input parameters.

Our responses to the specific questions in the Exposure Draft are set out in the Appendix to this letter. We would be pleased to discuss our comments further with the Board or their respective staff at your convenience.

Yours sincerely



Gareth Lewis

Director of Finance
EPRA
T +32 (0)2739 1014
gareth.lewis@epra.com
www.epra.com

1) Do respondents agree that it is appropriate that the Exposure Draft extends to include the valuation of investment property under construction for all purposes but not to other types of property under construction?

We consider that the scope of the guidance note should be extended to include the valuation of property under construction for all purposes. It would consequently be appropriate for guidance to be given for the specific application of the valuations principles therein, such as for the purposes of financial statements or secure lending purposes.

We would also welcome guidance from the Board on the valuation principles for property under construction that are not classified as investment property, as these too are regularly provided for use in, or as a basis for, carrying amounts in financial statements. Other reporting standards where valuers may be instructed to assist with measuring the carrying amount of property under construction include:

- IFRS 5 - Non-current assets held for sale;
- IAS 16 - Property, Plant and Equipment - properties being developed for an owner occupier; and
- IAS 2 - Inventory - property held for sale in the ordinary course of business.

The Exposure Draft would, therefore, benefit from highlighting circumstances where a valuation of a property under construction may be required, other than where the property is intended to be held as an investment property, and outline the principles that need to be considered by a valuer in those circumstances.

2) Do respondents consider that the level of detail on the types of valuation approaches that may be appropriate is sufficient to eliminate significant differences in practice or do they consider that it would be appropriate to expressly identify approaches that would be acceptable or unacceptable by name? If respondents agree with the latter, it would be helpful if examples of named approaches that it is considered to be expressly referenced could be provided.

In our view, the purpose of a valuation guidance note is to provide the underlying principles that should be considered in undertaking a valuation, rather than to stipulate a specific technique, as the latter is the responsibility of the valuer.

Valuation techniques are subject to adaptation and refinement over time, based on changes in the market and professional norms. Prescriptive guidance notes at an international level would not take account of differences in legal frameworks and market mechanisms between countries or even continents.

We therefore support the view that it is not the role of the IVSB guidance notes to expressly identify by name approaches that would be acceptable or unacceptable.

3) The Board is interested in learning the extent to which the two approaches to estimating the value and cost inputs to the valuation of a part completed project are used in different markets. It would therefore be helpful if respondents could indicate the market or markets in which they operate and the approach that is generally used.

The United Kingdom market has historically adopted a current data approach to development property valuations, with the resultant residual value 'present valued' to reflect the time value of money.

With the greater availability of complex software packages such as Argus Developer, many valuers now use complex development valuation models that adopt more explicit forecast cash flows. These models are more commonly used for large scale complex development valuations/appraisals,

especially for long term and phased developments. However, our experience indicates that the use of the current data approach remains the predominant method in the UK.

The property valuation profession in Germany, France and the Netherlands have historically preferred the investment value approach with deduction of the outstanding development costs at the date of valuation. However, the DCF model has become more widely used (particularly for the valuation of large development projects and for foreign investors) because it is perceived to have the advantage of showing the significant assumptions during both the development and holding periods.

In Sweden, the common practice is to value an IPUC in the same way as any other investment property, but with deductions for remaining investments. That means that for each IPUC there is a net operating income which is discounted with a required yield for that property - the required yield is the weighted cost of borrowed capital and equity. The cost of borrowed capital is based on the interest rate for loans and the cost of equity is based on a "risk-free interest rate" equivalent to the long-term government bond rate with the addition of a "risk premium".

4)

a) Do respondents consider that there is scope for confusion between finance risk as reflected in the interest rate charged to the developer and the return that the developer requires to reflect total development risks (which may include fluctuations in the cost of finance)? If so, is the cautionary note adequate or is more detail required on this point?

We consider that the Exposure Draft currently confuses the issue of finance costs and does not provide useful guidance. In our view, there should be little scope for confusion between finance risk and developer return in development valuations.

The 'risk' inherent with the finance rate for the project is not normally considered to have an impact on the return required by a developer, as this is seen as the required risk return to the lender.

The developer's return is assessed by the valuer and reflects the reward required to undertake the project, either as a return on cost of development or as a percentage of the Development Value. Few valuers explicitly make adjustments to the level of development profit (developer's risk return) requirement in relation to finance risk.

A transaction will not take place if the return of the transaction is lower than the required return of the buyer. Therefore a discount rate must reflect the required return, reflecting both the risks associated with the costs of completion and the risk associated with the income or capital appreciation of the completed property. A required return of a hypothetical buyer is incorporating the way the market generally would finance such a transaction. Therefore finance costs and the capital structure of a developer or of a particular buyer are not relevant in determining the fair market value.

Finance costs are therefore only relevant as a factor of project costs; interests capitalised, whether paid or opportunity. We believe the exposure draft should more clearly state so.

b) Do respondents agree that the guidance note should expressly refer to the potential for different interest rates at various stages before the investment reaches its normal income generating potential?

Using different discount rates as a reflection of a required developers' return, for different stages could be useful because risks will generally decrease during the lifetime of the property. However, if this approach is taken, the Exposure Draft should state that the risks are factored into the discount rate and not into the cash flows.

Notwithstanding the above, again there is no relation with finance costs and care should be taken that this is not in any way suggested.

5) Do respondents agree that it is outside the scope of this guidance note to consider whether a valuation can be reliably determined for the purpose of IAS 40?

We agree that the principal role of the IVSB is to advise valuers on the general principles of valuation, not to interpret standards set by other bodies, such as IAS 40 – *Investment Property*. We acknowledge that it is, of course, the preparer of the financial statements who must make a judgement about the level of reliability imparted by a valuation report and its suitability for its intended purpose. However, in practice, where valuation standards give guidance to those preparing valuations for financial reporting purposes, there must be a relationship between those valuation standards and financial reporting standards. It is likely therefore that preparers of financial statements will look to the valuer for guidance or advice on this point.

We would therefore support:

- Qualitative guidance by the IVSB as to the circumstances in which a valuation of property under construction might not be reliable; and
- A statement by the IVSB to the effect that, if an appropriately accredited professional valuer reporting under recognised professional standards provides a valuation of a property under construction for financial reporting purposes, then that valuer must be reasonably confident that the reported value is, with reference to framework of qualitative guidance, sufficiently reliable to form the basis of measurement in financial statements, unless specifically indicated otherwise.

We also note that valuation reports are required to provide clear guidance to the client in relation to its reliability stating the assumptions adopted and the reasonableness thereof, including an indication of the availability of data in the context of the current market conditions. Consequently, to ensure valuers provide sufficient disclosure of the inherent risks of, and assumptions made in, their valuations, it is our view that the Guidance Note should indicate to valuers:

- how their valuations will be utilised in the application of financial reporting standards; and
- the disclosures required in financial statements in respect of such valuations.

We would also support a requirement for valuers to disclose in their reports their significant judgements and methodology. For example the EPRA recommendations to the IVSB in respect of IPUC take the position that substantially all development risks should be eliminated before development gain can be realised (i.e. before the fair value of the project is said to in excess of cost). Another example given by the IASB is a situation where the range of likely outcomes is too great. How this is addressed may be an example of such disclosures.