



Australian Property Institute

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Marianne Tissier
International Valuation Standards Board
41 Moorgate
LONDON EC2R 6PP
UNITED KINGDOM

**RE: EXPOSURE DRAFT – THE VALUATION OF INVESTMENT PROPERTY UNDER
CONSTRUCTION**

Dear Marianne,

Further to previous email correspondence please find attached the Australian Property Institute submission in response to the IVSB release of the Exposure Draft on the proposed Guidance Note on The Valuation of Investment Property under Construction.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Grant Warner', written in a cursive style.

Grant Warner
National Director
Australian Property Institute

Purpose

The IVSC published its Proposed Guidance Note in August 2009.

It has invited comments on the Exposure Draft by 31 October 2009.

The Purpose of this paper is to detail the API's comments – initially prepared by the Victorian DPB for final consideration by the National DPB.

Background

In May 2008, the IASB approved changes that brought investment property under construction into the scope of IAS 40 *Investment Property*. For periods beginning on or after 1 January 2009, entities reporting under IFRS have been required to account for investment property under construction as investment property.

This effectively means that any entity that measures completed investment property at fair value also needs to measure any investment property under construction on the date of the financial statement at fair value, subject only to the value being reliably determinable. This is true even if the entity measures its investment property using the cost model.

The IASB has considered it prudent to extend the scope of the new Guidance Note to include all valuations of investment property under construction, and not confine the scope just to valuations required under IAS 40.

The IASB has outlined specific questions which it is particularly interested in receiving responses. Respondents are encouraged to address these and provide generic feedback.

Question 1 – Scope of Guidance Note

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?

API Response – Agree that the Guidance Note should apply to valuations of investment property under construction for all purposes. The IVSB develops standards for valuations generally – it should not be limited to developing principles exclusively for IFRS.

Question 2 – Valuation Approaches

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 is considered should be expressly referenced could be provided.

API Response – Agree with the Guidance Note, that is, provide guidance to valuers about how to approach the absence of directly comparable sales evidence dilemma, rather than explicitly identifying approaches the valuer should take in the absence of directly comparable sales. It is difficult to see how guidance can be customised beyond the provision of general principles to be followed, given the circumstances surrounding the valuation, the nature of the property and the market conditions are factors that vary on a case by case basis.

Question 3 – Current versus Prospective Values

The Board is interested in learning the extent to which the two approaches (i.e. valuation input to reflect the completed project may either be based on the current value assuming it is already completed or a prospective value based on an estimate of the value at the time completion is anticipated) 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.

API Response – The API believes that the correct approach to take in this example is to assume the project has already been completed on the date of valuation. The reason is this approach is aligned to the residual value method, as opposed to the DCF method. If the valuer was also undertaking a DCF of the project, then an estimate of the prospective value of the project on completion, at the date of expected completion, will be made, with an appropriate discount rate applied to these “forecast” values.

Question 4 – Finance Cost and Risk

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?*

API Response – It is appropriate to allow explicitly for the costs of financing the project during construction. It is also appropriate (in Clause 3.7 of the Exposure Draft) to include commentary on identifying and evaluating all significant risks, including variations in finance costs. As financiers would typically have covenants attached to their project facility, financing risk remains throughout the project and is not eliminated when the finance is procured.

Clause 3.5 of the Exposure Draft states the “cost of providing finance to cover the remaining costs of construction, and of any period following completion until the

property has achieved its full income potential” should be allowed. It is silent on the financing of the cost of acquisition of the land and project works completed to date. Clarity needs to be provided on whether this component would be externally financed, or whether this would form the equity component of the assumed transaction. The API position is that it should be debt finance that funds the cost of acquisition.

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?

API Response – Whilst it would be appropriate to distinguish between financing during construction and financing post practical completion of the construction works, it is inappropriate to specifically allow for external financing post practical completion, as this would be inconsistent with the convention of assuming full equity funding for completed properties in typical valuation assignments. The value on completion assumes a hypothetical sale, the proceeds of which would partly be used to pay-out the construction finance. If the developer intends to hold the project post completion, the assumption is this will be equity funded.

In contrast, given the complexities of construction and the nature of developers, and the expected leverage benefits of debt financing during the construction phase of projects (due to the significant “value add” over a short period), valuation convention in Australia has provided for the assumption of 100% debt financing during this period.

Question 5 – Valuation Reliability

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?

API Response – Agree.