

IVS ED 2010: RICS RESPONSE FINAL VERSION

Chris Thorne
Chairman
International Valuation Standards Board
41 Moorgate
LONDON
EC2R 6PP

2nd September 2010

Dear Chris

IVSC Exposure Draft: Proposed new International Valuation Standards

RICS has noted with interest the publication of the proposed new international valuation standards (IVS) and welcomes the opportunity to comment.

As you are aware RICS is a global professional body, with around 100,000 qualified members and over 50,000 students and trainees in some 140 countries – and a large proportion of that membership undertakes valuations. You will also be aware that in its own “Red Book” standards RICS explicitly adopts the valuation principles and procedures set out in IVS, albeit in a slightly different presentation due to the need for members to comply with additional RICS-specific requirements.

RICS welcomes and supports the IVSC’s efforts to continue to develop and refine international standards that improve consistency, transparency and confidence in the valuation process.

Overall, RICS is strongly in favour of IVSC’s declared intention to develop standards that are “principles-based, setting high level requirements that are both applicable globally and that can be applied globally” and that are accessible to, and understandable by, valuation users as well as valuation providers. We believe that the proposed new edition, set out in the Exposure Draft, represents a significant step forward and we would expect to adopt the new standards, once finally settled, as part of the valuation and practice standards with which RICS members must comply. We can raise and discuss with IVSC separately the practical considerations regarding reproduction and presentation that may arise.

We are pleased to set out in the two attachments to this letter:

1. A response to the specific questions asked in the Overview, and
2. Some more detailed, specific comments on certain of the individual standards

With our agreement, in order to ensure that the consultation deadline is met, RICS Americas will be submitting directly to you some additional points of detail, *inter alia* reflecting aspects of particular relevance to their world region.

We would be very happy to expand on any of the points in these submissions, should clarification be needed, and indeed to attend any meeting to discuss them if that might prove helpful.

For the avoidance of doubt the RICS will be providing a separate response to the Exposure Draft on the proposed Code of Ethics and to the Discussion Paper on the proposed Definition of a Professional Valuer.

David Rusholme FRICS
Director of Valuation
Valuation and Commercial Professional Groups
RICS

ATTACHMENT 1 to RICS letter of 2nd September 2010

For convenience we have reproduced the Questions for Respondents (but not the explanatory text preceding them) and answered each separately.

General questions

1. Do you find the new structure of the Standards to be logical and easy to follow? If not, what alternative would you propose?

The division into General Standards, Application Standards and Asset Standards is clear and logical. We have no alternative that we would wish to offer in terms of structure, but make a suggestion on presentation below.

2. Do you consider the combination of background information and specific directions to be helpful? Would you prefer all background information and explanatory information on asset classes to be removed from the standards so that only the specific directions applicable to each application or asset type remained?

Given the stated intention to assist valuation users as well as valuation providers, which we endorse and encourage, the inclusion of background and explanatory information is helpful. It would potentially aid clarity even further if it were possible to distinguish (perhaps through formatting) between the standard per se and the supporting information.

3. Which delivery method for the new edition of the standards are you or your organisation likely to use?

We would envisage using both electronic and hard copy delivery channels, since these will continue to be used for the RICS "Red Book" standards that apply to all our practising valuation members. We have various options to consider in terms of the presentation of material within these formats and the precise arrangements will be subject to separate discussion between IVSC and RICS.

IVS 101 Concepts and principles

4. Do you consider that this objective has been met? Do you consider that there are any additional valuation concepts and principles that should be considered and discussed in this standard?

The basic concepts and principles are sufficiently set out in the draft. It might be questioned whether this is a standard per se as opposed to an introduction to the standards that follow.

No additions are suggested at this stage

5. Are you in agreement with this approach or would you prefer the word “valuation” either not to be used at all or always used with qualifying words to indicate the intended meaning, for example “valuation process” or “valuation result”?

We endorse the removal of the several definitions of ‘valuation’ from the Glossary and agree that the term should be interpreted in accordance with normal usage. We are therefore content with the use of the word “valuation” both as verb and noun. Its meaning will normally be sufficiently clear from the context, but as the Exposure Draft suggests, this can always be clarified through additional wording in any case of ambiguity

IVS 102 Valuation approaches

6. Do you agree that these three approaches encompass all methods used in the assets or liabilities that you value? If not, please describe what approaches you feel have been omitted

Yes, as a summary of the principles they are sufficient

7. Do you agree with this hierarchy and do you consider it helpful? If not explain if you would prefer to see no reference to a hierarchy or would prefer an alternative hierarchy.

We have some reservations about a hierarchy unless placed in context. Thus although we do not disagree with the overall sentiment of this paragraph (IVS 102 Para 6) it is very important that it is read together with the paragraphs that follow (namely 7 and 8). In particular the last sentence of paragraph 7 is highly relevant.

As the material in Paras 7 and 8 sufficiently sets out the principle that all methods may need to be considered, depending on the nature of the asset, we suggest that the first sentence of paragraph 6 be combined with them and the rest of paragraph 6 be deleted.

8. Do you find this change of terminology to be helpful? If not please explain what alternative you would prefer and why.

We consider that this term is an improvement but would suggest a revision as follows of the second sentence of paragraph 2 of IVS 102 to make it clearer that asking prices need to be treated with caution:

‘In general, an asset being valued is compared with similar items that have been transacted in the market. Where directly observable prices for similar or identical assets are available at or close to the valuation date, this approach is generally preferred. Where market data is related to listing prices or asking prices, care has to be taken to establish if such prices are representative of the market at large. Appropriate adjustments may also need to be made to reflect different properties or characteristics.’

IVS 103 Bases of value

9. Do you agree with the proposed change to the definition? If not indicate what alternative you prefer and why.

We believe “assumptions” is more accurate than “principles” or “objectives” and therefore would support the definition change.

10. Do you agree with this proposed change? If not, please explain why and what you believe the distinction is between investment value to a prospective purchaser and special value to a prospective buyer who can realise that special value to be?

It is our experience that there is indeed confusion around the meaning of the term “investment value”. It is commonly used (particularly in the residential sector) to mean the ‘value as an investment’ - in other words, the market value - rather than the value (or worth) to a particular owner.

We have no difficulty with the proposed definition in the Glossary that includes the words ‘prospective owner’ but this does not accord with the suggestion made in the Overview paper that the definition should not reflect the value to prospective purchasers, who may also - in certain circumstances - be special purchasers.

There is therefore a need for greater clarity, perhaps by using one or more illustrative examples. A special purchaser will have a unique motivation for acquiring a particular property interest (eg the purchase of an access strip by an owner of a “landlocked” site that has development potential). Investment value is a more general concept “reflecting the particular circumstances and financial objectives of the entity for which the valuation is being produced” and could properly be seen from the perspective of both current and prospective owners.

11. Do you support the continued use of the term “Investment Value” or would you prefer an alternative? If so, what would that alternative be?

The current IVS include ‘worth’ in the definition and also make clear the distinction from value as an investment. We do not object to the continued use of ‘investment value’ but would suggest that the commentary also includes an appropriate reference to ‘worth’

12. Do you agree with the approach taken in IVS? If not, explain why not and give examples where you believe the highest and best use may be different from the market value.

The IVS approach regarding highest and best use is agreed and supported

13. Do you consider this proposed change in the definition to be helpful? If not, please indicate how you believe it could be improved.

This change regarding the definition of fair value is helpful even if the potential for some confusion continues because of the IFRS use of the same terminology.

IVS 104 Scope of work

14. Do you:

- a) Agree with the inclusion of a standard for scope of work in IVS?**
 - b) That the minimum contents identified in the draft are proportionate and represent a realistic minimum standard?**
- If you disagree, please explain why.**

Regarding a), whilst the material is not exclusively principles-based, it nevertheless supports the overall objective of consistency and transparency in the valuation process and therefore merits inclusion.

Regarding b), the coverage – taken together with IVS 303.01 – is considered to be proportionate and realistic in terms of specifying a minimum standard.

IVS 105 Valuation reporting

15. Do you agree with the changes that have been made? If not, please explain what provisions of the current IVS3 you believe should be carried forward into the new standard.

This new draft is a logical counterpart to IVS 104, and the minimum requirements are sufficient

Application standards

16. Which view do you support? If you consider that future IVS should contain application standards, do you consider that the degree of detail of those in the draft is appropriate and help the better understanding of the valuation requirements?

Whilst it is true that the fundamental principles of valuation are wholly or largely unaffected by the purpose for which a valuation is being prepared, nevertheless it is an aid to consistency and transparency – in particular of potential assistance to valuation requesters and users – to have standards directed to key applications (such as under IFRS). The general level at which these are pitched in the draft is considered appropriate

17. Which of these views do you support?

View b) is generally favoured, being of potential benefit to accountants and other financial industry professionals as well as to valuers, and supporting also the desire of governments to achieve clarity and consistency in the application of valuation standards internationally.

Asset standards

18. Do you have any other comments on the general structure of the Asset Standards?

The structure is clear, but it might further aid clarity if background information and specific directions or standards were distinguished as per the response to Question 2.

19. (18 in error) Do you consider that a class of “personal property” can be identified that is not already covered by the proposed new asset standards? If so, do you consider that it has distinct characteristics that need to be considered in valuations that would benefit from a new IVS asset standard being developed?

In general the term 'personal property' defines the nature of the assets and we agree that as such it does not warrant any specific guidance.

20. (19 in error) Do you agree that a standard on valuing non financial liabilities is required and what topics should it cover?

As liabilities that are attached to the ownership of a property interest, for instance the liability to leave a property in good repair at the end of a lease, or capital payments connected with development approvals, would be reflected in the valuation it is not clear what 'non-financial' liabilities are envisaged. Though we doubt a standard as such would be needed, should IVS decide to set up a project to consider this topic further we would be pleased to contribute.

21. (20 in error) Please identify any additional types of asset or liability that you believe should be considered for future inclusion in IVS, together with an indication of the benefits that you consider a new standard would bring.

We have not identified any additional types of asset (or liability) at this stage.

ATTACHMENT 2 to RICS letter of [2] September 2010

Detailed drafting points on IVS Exposure Draft of June 2010

IVS 103

It is noted that in 7 (a) the words ‘and the most advantageous price reasonably obtainable by the buyer’ has been deleted. Because the definition includes ‘willing buyer’ we consider that these words should be reinstated.

It is assumed that the removal of the last sentence on 7 (d) is related to the inclusion of the principle in the separate (exposure draft) paper on conduct and ethics.

We agree with the additional sentence in 7(g)

Although there is a definition of Market Rent in the glossary the text relating to it appears only in IVS 303.1. As this term is a basis of value we suggest that it is included in this IVS with a cross reference from IVS 303.1

IVS 201.02

In paragraph 2 we suggest that this could be extended to make a clearer distinction between depreciation for accounting purposes and depreciation for valuation. Our suggested revision is:

“The term depreciation is used in different contexts in valuation and financial reporting. When applied as a component of a valuation exercise (as opposed to, and not to be confused with, depreciation for accounting purposes) it takes due account of the asset’s age, condition, functional and economic obsolescence, environmental and other relevant factors.

Valuation depreciation also represents the measure of economic benefit derived from a tangible asset as it is consumed over its total useful economic working life and the corresponding demand for goods and services produced by the asset and the related markets and/or regulatory environment, including any residual value at the end of the asset’s useful economic working life.

Depreciation is often used to refer[as drafted]”

IVS 202.01

Under paragraphs 9 and 10 we assume that the requirement in the case of a specialised property is to either report an alternative use or replacement as a going concern, subject to profitability. There is a slight mismatch here with the definition in the Glossary.

IVS 301.01

Para 1(a). We think that ‘including’ could be misleading. A preferred phrase would be ‘the value of the assets before any debt is taken into account’.

Para 1(d). We do not discern any difference between this term and ‘enterprise value’

We think that there may be some ambiguity between Para 2 of this standard and Para 2 of IVS 303.04. See comments in IVS 303.04

Para 7-9. There is no reference to the management of the business.

IVS 301.02

This standard, and several others, makes reference to goodwill. There is a conflict between Para 2 and Para 5. Para 2 states that an intangible asset is “distinguishable from goodwill” whereas Para 5 states that “any unidentifiable intangible asset associated with a business or group of assets is generally termed goodwill”. See linked comments in IVS 304.1

In paragraph 5 we suggest adding the words ‘in its entirety’ as elsewhere.

Para 26 is thought to be misleading. A suggested alternative is ‘Valuation methods under the income approach rely on a proper understanding and assessment of the financial aspects of the entity being valued’

IVS 303.01

There is an implication in Para 16 that trade related property is a specialised property but in our view that is not necessarily the case as, for instance the different treatment in IVS 202.01 Paras 9/10 and 11 . There may be some ambiguity here that could be dealt with by giving a different example, for instance a privately run sports centre.

IVS 303.03

We suggest that paragraph 15 could be revised as follows to make its intention clearer:

“As indicated ... as its objective. However many contracts may be ~~are either...~~ proceedings. ~~Therefore an assumption ...for this purpose.~~ It is important that the lender’s legal advisers specifically advise on this matter. However, where legal advice is not available not available a valuer should clearly state that an assumption has been made that a partially completed project will have the benefit of the existing building contract and any associated warranties. The report should also state that if this assumption proves to be no longer valid this is likely to have a detrimental affect on the value reported. Likewise to a buyer.

IVS 303.04

The preamble to IVS 303.04 makes clear that “this standard describes the valuation approaches for valuing the property [*ie real estate*] interest where the

buildings are specifically designed for a specific type of business activity. It does not apply to the valuation of any business in occupation. It might be better at IVS 303.04 para 2 to re-emphasise that the standard is directed not to the value of the business as a whole (covered in IVS 301.01) nor to the valuation of intangible assets (covered by IVS 301.02) but to the valuation of the tangible assets, namely the interest in the property itself which will have regard to its trading potential, plus – where it is actually trading - any other physical components (such as furniture or equipment), all on the basis of stated assumptions (as in para 4).

In Para 3 we consider that there should then be no reference to either ‘goodwill’ or ‘stock’ as neither are part of the value of the property. Also in Para 3 the implication of the note under the bullet points is that the individual elements should be valued separately. This is not the case - a trade related property is valued taking the individual elements as a single operational unit. We believe this paragraph therefore needs some revision.

In Para 4.d ‘stock’ should also be deleted.

In Para 4 (e) the title should include ‘(g) and’ .). In addition, we note that more detailed script is included in IVS 301.01 (Valuations of Businesses and Business Interests) and IVS 301.02 (Valuations of Intangible Assets). We would favour inclusion of these additional paragraphs within IVS 303.04. The paragraph under 4 (e) – *‘the sources of information on current and historic levels of trade and other financial information should be confirmed, together with the valuer’s duty to investigate or verify’* is not correct. The valuer’s responsibility, or duty, is to assess the trading potential - there is no duty to investigate or verify information provided. The paragraph (17) in IVS 301.02 relating to the source of any information, slightly amended, should be included.

Paragraph 4 (i) – under examples of Special Assumptions, second bullet point, the final line should be amended such that any necessary licences or permits *may be in jeopardy* rather than *were not available to a buyer*.

Paragraph 6 – we believe the final sentence – *the direct market comparison approach is often a less reliable indicator of value than the income approach* should be deleted. This is essentially a valuer judgement in each instance.

Paragraph 7 – this paragraph is, we believe, incorrectly drafted. There is a different approach between a valuation for owner occupation and one for investment (ie letting out for an income) or a potential tenancy. Trade related property for owner occupation is valued by capitalisation of the net profit potential and this means that in such cases there is no need to estimate a rent. For investment property the investment depends on the income stream and as a check the valuer needs to estimate the potential rent before capitalisation.

The net profit to be capitalised is ‘the level of profit, stated prior to depreciation and finance costs (relating to the asset itself), that the reasonably efficient operator would expect to derive from the Fair Maintainable Turnover based on an assessment of the market’s perception of the potential earnings of the property. It should reflect all of the costs and outgoings of the reasonably efficient operator and an appropriate annual allowance for periodic expenditure such as decoration,

refurbishment and renewal of the trade inventory'. The capital value of the property interest is assessed by applying an appropriate capitalisation rate or by adoption of a discounted cash flow model.