



INTERIM POSITION STATEMENT

The Valuation of Investment Property under Construction under IAS 40

(published January 2009)

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Introduction

1. In May 2008 the IASB approved changes that brought investment property under construction into the scope of IAS 40 *Investment Property*. From 2009, entities reporting under IFRS will be required to re-classify investment property under construction as investment property.
2. This means that any entities who measure their completed investment property at fair value will also need to measure any investment property that is under construction on the date of the financial statement at fair value, subject only to the value being reliably determinable.
3. Even if an entity measured its investment property using the cost model (the other measurement option available in IAS 40) it would still need to provide a fair value estimate of the partially completed property, since IAS 40 requires the disclosure of the fair value of investment property when the cost model for accounting is applied.
4. It has been brought to the attention of the Board that there is some diversity in the approach that entities or their advisors are adopting to the valuation of partially completed projects for the construction of investment property. In the light of this, the Board has agreed to issue a draft Guidance Note during 2009 that will be subject to public exposure. However, in the light of the need for entities to start reflecting investment property in IFRS statements produced after 1 January 2009, the Board has issued this interim statement that summarises the major valuation issues and its preliminary view of the valuation principles that should be adopted.

Valuation Approach

5. IAS 40 (para 38) provides that the fair value of investment property shall reflect market conditions at the end of the reporting period. Para 39 further provides that the value is time-specific as of a given date. Because market conditions may change, the amount reported as fair value may be incorrect or inappropriate if estimated as of another time.

6. The fair value has therefore to reflect a hypothetical exchange of the partially completed property in the market as of the date of the financial statement.
7. In practice, few investment properties are transferred between market participants in a partially completed state, except as either part of a transfer of the owning entity or where the seller is either insolvent or facing insolvency and therefore unable to complete the project. Even in the unlikely event of there being evidence of a transfer of another partially completed investment property close to the valuation date, the degree to which work has been completed would almost certainly differ, even if the properties were otherwise similar.
8. In the absence of directly comparable sales evidence, the fair value therefore has to be estimated using one or more alternative valuation approaches.
9. The Board considers that it would be inappropriate to arrive at a “fair value” estimate by reference to the original project plan or feasibility study. Once the project has commenced, this cannot be relied on as a reliable tool for measuring value as the inputs will be historic. The valuation should reflect market conditions at the valuation date.
10. The Board considers that the starting point of any valuation of an investment property under construction should be based on the current market value of the property on the assumption it had already been completed at the valuation date. From this figure a current estimate of the costs still required to complete the project, including an appropriate adjustment for risk, is deducted to arrive at the value of the partially completed project. Appropriate parameters for inputs into this valuation process are discussed below.
11. IAS 40 provides that investment property under construction may be carried at cost if the entity determines that its fair value is not reliably determinable. Since the property will be being developed for either income or capital appreciation, otherwise it could not be classified as investment property under IAS 40, the cash flows associated with its construction and completion should normally be readily identifiable and capable of reliable estimation. The Board therefore considers that it will be rare for the fair value of an investment property under construction to be not capable of reliable determination.
12. If the time required from the valuation date to complete construction of a new investment property is such that the anticipated cash flows will occur over a period of time, and if the time cost of money is likely to be a significant factor, the Board considers that it would be appropriate to use a valuation method that reflects the probable timing of those cash flows.

Valuation Inputs

13. The following inputs will normally be required in order to reliably estimate the value of an investment property under construction;
14. **Completed building:** This is the value on the assumption that the project had been completed as of the date of valuation. It should reflect the concurrent market value of existing investment property of a similar type and specification to the proposed project once it has been completed and leased.
15. **Leasing:** If lessees for the property after completion have still to be identified, allowance will need to be taken of the time that it would be realistic to allow for the maximum potential income or capital to be generated from the project in current market conditions. If there are leasing agreements in place that are conditional on the project, or a relevant part, being completed, these should be reflected.
16. **Construction Costs:** Costs already incurred prior to the valuation date are irrelevant to the determination of the current market value. Since financial statements under IFRS are prepared on the going concern assumption, the sums remaining to be paid by the entity under any binding construction contract in existence at the valuation date will normally be best evidence of these costs, regardless of whether that contract could be assigned or transferred to a third party in practice. However, if there is a material risk that the contract may not be fulfilled, eg due to a dispute or contractor insolvency, it may be more appropriate to reflect the cost of engaging a new contractor to complete the outstanding work.
17. **Finance costs:** The cost of providing finance to cover the remaining costs of construction, and of any period following completion until the property has achieved its maximum letting potential. Even if the entity is self funding the project, an appropriate market rate of interest should be allowed to reflect that which would be obtainable by a buyer of the property in the market at the date of valuation.
18. **Other Costs:** These will include legal and professional costs that would be reasonably incurred by a buyer in completing the construction and in letting the investment property. Except where there are leasing agreements in place, allowance will also need to be made for the reasonable costs of marketing. However, any costs that would be incurred in an actual transfer of the property on the date of valuation should be ignored, see IAS 40 para 37.

19. **Development Profit:** Allowance should be made for the return that would be required by a buyer of the partially completed investment project in the market place. This should reflect the risks associated with the completion of the construction programme and in achieving the anticipated income or capital appreciation. All significant risks should be identified and evaluated. The profit anticipated by the entity at the commencement of the development project is irrelevant to the valuation of its interest in the project once construction has commenced. The valuation should reflect those risks remaining at the valuation date and the discount or return that a buyer of the partially completed project would require for to bring it to a successful conclusion.
20. **Other considerations:** In situations where there has been a change in the market since a project was originally conceived, the project under construction may no longer represent the highest and best use of the land. In such cases the costs to complete the project originally proposed may be irrelevant as a buyer in the market would either demolish any partially completed structures or adapt them for an alternative project. In such cases, the value of the investment property under construction would need to reflect the current value of the alternative project as if it had been completed and the costs associated with completing that project.

Reporting

21. The valuation report should include a description of the project under construction, the stage of development reached, the valuation methods used and the key assumptions made in arriving at the valuation. In particular, the report should identify the remaining risks and costs associated with the project and how these have been reflected in the valuation.