AGENDA ITEM 17

IVSC STANDARDS BOARD

Board meeting 30 June 2014

Development Property

The Board is invited to consider the attached analysis report on the comment letters received on the Exposure Draft and discuss the recommendations for changes to be considered by the expert Working Group.

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Summary Report on Responses to Exposure Draft on DEVELOPMENT PROPERTY

1. Currently the IVSs include IVS 233 *Investment Property under Construction*. This was carried forward into the current IVSs from a Guidance Note that had been originally issued in 2009. This had been produced in response to representations that considerable divergence of valuation practice was emerging in response an amendment made to IAS 40[1] to require investment property under construction to be accounted for at fair value. However, some commentators have questioned whether this topic warranted a standard of its own because the guidance it contained was applicable to any type of real property under construction, not just assets classified as investment property under IAS 40.

2. Views on the future of IVS 233 were invited in a Discussion Paper which the Standards Board issued in late 2012, along with a number of other matters concerning the valuation of investment property which had been brought to the Board's attention by industry participants. Following consideration of the responses to the Discussion Paper, the Board agreed that consideration should be given to the retirement of the current IVS 233 and its replacement with more broadly based guidance on the valuation of any type of real property that is either in the course of construction or where construction is contemplated, ie "development property". An Exposure Draft of the proposed new guidance was issued in January 2014, with a comment period ending on 30 April.

3. Eight comment letters were received. The types of respondent can be categorised as follows:

Professional Bodies	3
Valuation and Consulting Firms	3
Others	2

4. The comment letters are displayed on the IVSC web site. Annexed is a table summarising the responses, in particular the answers to the questions asked in the Exposure Draft. Not all comments are referenced. The purpose of this summary is to identify common themes.

5. The responses to the questions in the Exposure Draft are analysed below.

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It is proposed that the specific requirements for valuations of investment property under construction for financial reporting under IFRS be referenced in the guidance on IFRS requirements in IVS 300 Valuations for Financial Reporting, rather than being in a separate standard. The Board considers it more logical to include all the requirements in the IVSs for valuations used in financial reporting and guidance on the requirements under IFRS in the same standard. If this is done the current IVS 233 would be withdrawn.

1. Do you agree with the Board's proposal to move all material in the standards specific to financial reporting to IVS 300?

[1] IAS 40 Investment Property © IFRS Foundation

Yes or mostly agree	No or mostly disagree	Unanswered or response unclear
8	0	0

Additional Comments

No respondent disagreed with this proposal.

This Exposure Draft is of a proposed Technical Information Paper (TIP) that will retain the guidance in the current IVS 233 Investment Property under Construction if the latter is withdrawn. The guidance in this proposed TIP is designed to be more broadly applicable to all development property rather than to the specific case of valuations of investment property under construction under IAS 40. The Board considers that similar valuation considerations and methods are applicable to all types of real property under construction, not just investment property.

2. Do you agree with the Board's view that the valuation techniques described in the commentary to the current IVS 233 are applicable to all types of development property, not just investment property as defined in IFRS?

Yes or mostly agree	No or mostly disagree	Unanswered or response unclear
8	0	0

Additional Comments

Although all indicated that they generally agreed with the Board's view, a few added additional comments and observations.

The intended purpose of the proposed new TIP will be to provide guidance to support the application of the principles in IVS 230 Real Property Interests to development property. Paragraphs 1-4 set out the scope of the proposed guidance.

3. Do you agree with the scope as described? If not, please explain any additional matters that you believe should be added to the scope or matters currently included that you believe should be excluded.

Yes or mostly in favour	No or mostly not in favour	Unanswered or response unclear
4	2	2

Additional Comments

The two who disagreed did so for very different reasons. One wanted the scope extended to expressly include other categories of property with potential for development and wanted changes to the list of purposes for which valuations may be required. The other was opposed to IVSC producing any guidance on this topic (and apparently on any other valuation topic). Of those who expressed agreement, two also suggested that the scope might need clarifying as development property was much wider than property under construction.

Paragraph 7 provides a non-exhaustive list of matters that typically need to be considered when undertaking a valuation of development property.

4. Please indicate if there are any items on this list with which you disagree or any additional matters you believe should be included.

Yes or mostly in favour	No or mostly not in favour	Unanswered or response unclear
7	0	1

Additional Comments

Although all generally agreed with the list of matters to be considered, most suggested additional items to include. Some of these are discussed later in paper but the responses indicate that paragraph might need rewording to clarify what is being discussed here and that other relevant considerations that depend on the required basis or purpose are discussed later.

Paragraph 15 suggests that all three valuation approaches identified in the IVS Framework can be applied to development property.

5. Do you agree? If not, please explain why.

Yes or mostly in favour	No or mostly not in favour	Unanswered or response unclear
6	1	1

Additional Comments

The respondent who disagreed was the one who does not believe IVSC should give any information on valuation approaches. Of those who agreed most indicated that there was a need to emphasise that the choice would depend on the facts and circumstances and that valuer judgement was important. A few indicated a preference for one approach under specific circumstances.

Paragraph 20 introduces the "Residual method". Paragraphs 21 and 22 explain the sensitivity of the residual value due to small changes in the inputs.

6. Do you consider the caution provided here is sufficiently detailed or do you consider further guidance is required?

Yes or mostly in favour	No or mostly not in favour	Unanswered or response unclear
6	1	2

Additional Comments

The respondent who disagreed did so on the grounds that the IVSs should not comment on the merits of valuation methods, not because they considered the statement incorrect. One considered that sensitivity could be overcome by a more granular approach to the inputs and considered more detail could be provided to illustrate this, along with examples to illustrate the use of the residual approach. One who agreed with the caution also requested examples.

Paragraph 24 lists typical inputs into a cash flow forecast for a development property. This list is almost identical to that appearing in the current IVS 233.

7. Do you consider that there are any typical inputs that are not referenced but should be included or items included that would not typically be used? If yes, please identify the input and the reasons for inclusion or exclusion.

Yes or mostly in favour	No or mostly not in favour	Unanswered or response unclear
5	1	2

Additional Comments

The party who disagreed did so because they wanted to see a much more detailed discussion of inputs. Of those who mostly agreed, all suggested additional maters that could be included in the list. Some of these are already discussed elsewhere in the paper. A couple pointed out the need to distinguish “profit” from “risk” and the overlap between them.

Paragraph 25 indicates common sources or methods for determining the appropriate discount rate. More detailed guidance is provided in TIP 1.

8. Do you consider that there are any other methods for determining the interest rate that should be included? If so, please explain these.

Yes or mostly in favour	No or mostly not in favour	Unanswered or response unclear
2	4	2

Additional Comments

Those who disagreed all did so because they wanted more detail, notwithstanding the cross reference to TIP1. One requested the inclusion of a caution that a company’s WACC rate may not be appropriate for valuing an individual asset owned by that company without adjustment. Another suggested including a survey of market participants as a way of determining the appropriate discount rate.

Paragraph 34 includes a list of recommended matters that should be included in a valuation report for development property where relevant and appropriate.

9. Do you agree with this list? If not, please identify any additional matters you would like to see included or matters that are included that you think should be excluded, with supporting reasons.

Yes or mostly in favour	No or mostly not in favour	Unanswered or response unclear
7	0	1

Additional Comments

No one dissented from the list, although a few suggested additional matters, some of which are already covered in IVS 103 and IVS 230. One wanted guidance on the level of detail that should be included in a report.

Paragraph 36 suggests that it may be advisable to include a sensitivity analysis if the valuation is very sensitive to changes in key inputs. This is in order to illustrate the risk of the value changing if, say, market conditions or construction costs were to change during the period required for completion.

10. Do you agree that this type of disclosure is helpful and should be encouraged wherever appropriate?

Yes or mostly in favour	No or mostly not in favour	Unanswered or response unclear
6	**1**	**1**

Additional Comments

Most agreed that such disclosures could be helpful. The one dissenting voice argued that the purpose of the valuation should be the sole determining factor in whether a disclosure should be made, and that further, a more “disaggregated” approach to the valuation inputs would provide more information about sources of inputs.

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General Observations:

6. The number of respondents was disappointing, although representing a good geographic spread and different types of experience. It is notable that only one of the twenty firms or organisations represented on the working group submitted a comment letter.

7. All agreed with the proposal to move all material related to financial reporting to IVS 300.

8. With only one exception all respondents agreed with the proposal to retire IVS 233 and replace it with a TIP providing more broadly based guidance on development property as defined. The dissenter was a professional body which has adopted a policy that opposes the IVSC issuing guidance of any description, so its objections were not specific to the proposed content of this paper.

9. A few respondents pointed out perceived omissions or inconsistencies caused by the widening of the scope of this paper from “investment property under construction”.

10. While most did not disagree with the proposed content a number wanted additional matters to be included, many suggested detailed changes to the existing wording.

11. Many respondents suggested additional matters for inclusion in the lists in paras 7 and 34 and additional information in the discussion of inputs to the residual method in para 24. A common concern was the conflation of profit and risk in this list.

12. A couple of respondents did not seem to recognise that the residual method is a method under the income approach. Two respondents requested examples of the residual method, and one considered that there should be significantly more detail and guidance, to include different assessments of risk as project milestones are reached.

13. Two respondents pointed out in relation to para 32 that not all valuations for financial reporting assume a going concern and not all are under IFRS 13 – the ED states that this is “normally” the case.

14. One suggested a further method be included under the Cost Approach, ie “cost build up”, although did not expand on this or explain how it could overcome some of the inherent problems identified in the ED.

Staff Recommendations for Board:

15. The basic structure and scope of the paper seems to be generally acceptable. The issue of whether the IVSC should be including guidance in the IVSs that was raised by one dissenting professional body is to be the subject of a separate wide ranging consultation on the Scope and Structure of the IVSs. This includes reconsideration of whether the term “Technical Information Paper is appropriate given that this seems to have been a source of some confusion as to the status of the contents. While the outcome of this Consultation may result in changes to the title and Introduction and Scope sections before this paper is finalised, there is clear support for the IVSC producing this guidance and therefore the Working Group should be invited to consider refinements to reflect the comments received,

16. A number of respondents suggested detailed edits to the text which have not all been identified in this summary report. Some of these clearly could potentially improve the paper and therefore need to be carefully considered, although not all are appropriate as the issues raised are dealt with elsewhere in this paper or in the IVSs. Those that help make the paper more

obviously applicable to development property as defined rather than just investment property under construction should be given particular attention.

17. While many suggestions for additional matters to be included were made, particularly in the illustrative lists, care should be taken to ensure that samples in these lists remain generic and widely applicable.

18. The introduction could be strengthened by including a short description of how the paper is organised and on improving cross referencing and signposting as a few seemed highlight omissions when the issue is in fact dealt with elsewhere.

Summary of Comment Letters

001	R Jefferies	1	Yes
		2	Yes
		3	No. The scope list in para 1 should include the subdivision of previously undeveloped land into serviced sites. The scope list in para 2 should include sale and purchase negotiations, which also encompasses acquisitions, mergers or sales of businesses which are listed. Also include property taxation in list of purposes.
		4	Suggests including reference to "environmental consents" alongside constraints on permitted development, and additional points for historic designation and the risks associated with development.
		5	Yes – but suggests additional para referring to market approach.
		6	Yes.
		7	Following additional inputs should be listed: • Reference to anticipated incentives and costs on leases yet to be negotiated should be added. • Forecast timing of sales and holding costs following completion need to be allowed for. • Any long term liabilities that cannot be transferred by developer need to be allowed for. • Additional words suggested for finance costs • Additional words suggested for consultants fees • Profit and risk should be distinguished.
		8	Suggests additional words in para 25 and 26
		9	Yes. But suggests additional words in para 34
		10	Yes
			General Comments: • Amendments suggested to definitions of Development Property and Residual Method • Add "infrastructure" to second line of para 11 • Add required rates of return to last line of para 14
002	Malaysian Accounting Standards Board	1	Yes. It would improve the flow of information and hence ease implementation
		2	Agree that three valuation techniques described are applicable to all types of development property and not specific to the investment property defined in IAS 40, but it is important to clarify that judgment is critical.
		3	n/a
		4	n/a
		5	n/a
		6	n/a
		7	n/a

		8 9 10	n/a n/a n/a
003	RICS	1 2 3 4 5 6 7 8 9 10	Yes. Agree. However, do not consider that valuation approaches should form part of an IVS No. Scope includes guidance which RICS does not consider appropriate. Believes it is wrong to include definitions. Although list is not intended to be exhaustive, flooding might be included. No. The valuation approach to be used must always be that which is most appropriate to the particular facts and circumstances. IVSC should not be attempting to provide such guidance. Suggest para 24 contrasts DCF and market value? Consultants Fees section requires further explanation to ensure it is understood these could relate to fees to be incurred at any stage in the development. Indicate that they believe DCF is used for calculating investment value not market value Matters covered in paragraph 34 are likely to feature but there is a risk in implying that this may be a comprehensive list Yes. Analysis needs suitably detailed explanation to be appropriately applied. **General Comments:** Do not believe IVS should be producing guidance.
004	Australian Property Institute	1 2 3 4 5 6 7 8 9 10	Yes Yes. However, suggest minor modification to definition of development property. Yes Consideration should be given to detailing the list of matters as mentioned in paragraph 3 of IVS 230 *Real Property Interests* Agree. Suggest last sentence be slightly amended Suggest alternative wording for 24(a) to emphasise alternative approaches. The wording is sufficiently broad to satisfy requirements Agree – no additions. Agree.
005	Fédération Française des Experts en Evaluation (FFEE)	1 2	Yes. Scope now includes properties with development potential For such properties it is necessary to estimate the extent to which potential buyers will be prepared to include this

			development potential in their bids. Risks of estimated consents and timetables not being met increases.
		3	Yes- as long as paper takes account of all aspects pertinent to the development of development property – not just property under construction.
		4	Suggest including: • Time required to obtain consents and deal with other preparatory matters • Time required to sell or let completed property • Cost of any demolition • The need for new infrastructure
		5	Yes.
		6	Yes. Add that residual method is often used to estimate the value of a property assuming that it has all consents and that construction can start immediately f consents have not yet been obtained, of if for some reason construction cannot start immediately, the valuer will have to make adjustments to the resulting values in order to allow for this
		7	Sub-paragraph (d), "Construction costs", as currently drafted reflects the fact that IVS 233 concerned only property "under construction". We think that there should also be mention of costs needed to prepare the site, demolish existing buildings, set out infrastructure needed to create individual plots, etc. Also, there may be administrative costs associated with obtaining necessary consents,
		8	In a DCF approach one could also build up a discount rate from "no risk" yields with appropriate risk premiums, including an additional one that reflects the state of advancement of the project, of any pre-letting or pre-sale campaign, etc.
		9	Yes but suggest following in addition: • The stage that has been reached in the application process to obtain planning and any other necessary consents. • The estimated timetable to carry out and/or complete the project. Where in the valuer's opinion the official timetable provided is not realistic, he should comment on this and make clear the assumptions he has adopted. • If the project does not have all the necessary consents or for some other reason cannot be launched at the valuation date, the valuer should give an indication of the time he has allowed before construction works start, if the property is being valued in its current state.
		10	Yes.
006	Duff and Phelps	1	Agree
		2	Generally agree that the techniques described in the current IVS 233 are applicable to all types of development property. Think that the ED does a better job of discussing the appropriate techniques and their pros and cons but have concerns about the discussion of the Residual Method
		3	Agree
		4	Think list is adequate

		5	Agree that all three approaches can be considered and would be applied based on the facts and circumstances. However, we think that the income approach is the most relevant and commonly applied, while the market approach is least suitable. Also believe that the "cost build up method" (not explained) is subject to the same principle of value-creation/profit accretion upon the achievement of defined milestones as the residual method. We recommend strengthening the discussion around the cost approach in that light.
		6	Issue extends beyond the sensitivity of the inputs. The discussion of the Residual Method can be made more robust and supplemented with examples. One might find that some of the sources of sensitivity are in fact in part addressed through a higher quality valuation measurement
		7	Believe Board could provide more depth and detail in the discussion of certain inputs and their relationship to other inputs and the overall valuation, eg • Confusion over value of completed property • Confusion between profit and risk • Whether valuation is pre tax or post tax
		8	The paper should make mention of a survey of market participants as an additional method. Also, the ED should discuss whether the valuations are performed on a pre- or post-tax basis and the relationship to the discount rate.
		9	Agree
		10	We believe that the purpose of the valuation should be the sole determining factor in including disclosures of various kinds. A more disaggregated approach in modeling the valuation of the development property which distinguishes between the major development phases and associated risks, may be more informative about the drivers of value and sources of uncertainty. **General Comments** • The current discussion of the Residual Method and inputs does not give a clear recognition as to when value is created by reference to meeting certain milestones in the development project. As milestones are being achieved, the project becomes de-risked and value accretes, and this underlies the valuation of the project at any distinct point in time • Strongly encourage the Board to include examples illustrating the application of the Residual Method. • Recommend writing the ED in a straightforward, simple language so that the principles, methods and inputs are understandable to not only real estate valuation professionals but to users in general.
007	Ernst & Young	1	Yes
		2	Generally agree guidance should be applicable to all development property
		3	Following the reasoning in paragraph 27 there might be changes in the market that lead to a conclusion that the current use of a property no longer represents the highest

			and best. Such properties may be appropriately considered within this TIP.
		4	Generally agree, but matters that might need to be considered may depend on purpose of valuation and required bases of value. Suggest adding potential encumbrances on title and types of permitted usage and construction limitations.
		5	Yes – depending on the facts and circumstances. However, the market approach would only seem applicable to plots of land.
		6	Agree with the discussion in para 20. However, we would encourage the IVSC to provide similar guidance in paragraphs 13 and 14 to emphasise importance of selecting one or more valuation techniques that are appropriate in the circumstances.
		7	More detail requested eg: • The inputs listed in paragraph 24 may vary depending on the applicable basis of value. For example leases that have been entered into are entity-specific and contain terms that may not be consistent with what market participants generally would receive, such as for anchor tenants, rent-free periods, special fixtures and fittings, discounts • The payment mechanism in a construction contract may not necessarily be a reflection of the stage of completion of the construction contract. However, as currently drafted, the second sentence suggests that past payments should be ignored while the third sentence suggests that future payments are relevant. We would encourage further clarification. • Additional guidance needed on finance costs eg o How effected by basis of value o Interaction between funding through construction period and selection of appropriate discount rate. o Ensuring assumptions consistent with asset being valued not with entire business.
		8	Would like additional guidance on incorporating discount rates or cross refer to other TIPs. Should include caution that WACC derived from company data may not be appropriate to derive discount rate for a single asset without adjustment. Some valuation purposes (eg IAS 36 impairment) require use of pretax rates
		9	Suggest clarification of guidance on appropriate level of detail. For example, if there is an office development property with several planned letting units it might be unclear whether an overall rent level assumption or the rent level assumption per unit should be stated within the valuation. In relation to the risk statement, believe valuer should make a statement about expected duration until completion and potential risks with regard to a possible extension.
		10	Agree but should be up to professional judgement of valuer whether to include **General Comments:** • In situations where a valuer presents two or more values, we would encourage the IVSC to consider requiring a

			valuer to give an opinion as to the most appropriate value. We believe it would be helpful for a valuer to provide additional discussion to explain the differences and which value they believe is most appropriate, • Definitions - We note that, in paragraph 5 of the exposure draft, the definition of the income approach uses the term 'capital value'. The definition of this term may not be clear to all users of the TIP. As such, we would encourage the IVSC to define this term and/or provide additional guidance. • The first sentence in paragraph 19 of the exposure draft states, "The market value of a development property will reflect the expectations of market participants of the value of the property when complete, less deductions for the costs that they will incur to complete the project with appropriate allowances for profit and risk". In our view, this is a general statement that would be more useful earlier in the document, such as before paragraph 6. • As there are more elements to the discount rate than just time value of money, we suggest modifying the last sentence of paragraph 19 of the exposure draft to clarify that the "appropriate discount rate to reflect the anticipated timing and risk of those cash flows...". • It might be helpful to clarify the difference between the income and the residual approach due to the fact that both valuation methods contain similar items and assumptions • Paragraph 32 provides additional considerations for financial reporting. It assumes that: (a) a reporting entity would be a going concern; and (b) the measurement objective/basis of value is IFRS 13 Fair Value. These assumptions may not always be appropriate. We believe this paragraph needs to clarify: o That the measurement objective may not always be IFRS 13 Fair Value and valuers need to ensure assumptions are appropriate in light of the relevant measurement objective o That an entity may not always be a going concern o Why the IVSC believes the fact that an entity may or may not be a going concern is relevant when assuming that contracts would pass to the buyer in a hypothetical exchange
008	KPMG	1 2 3 4	Agree with the Board's proposal to move all material in the standards specific to financial reporting to IVS 300. Agree that techniques apply to other types of property and for purposes other than financial reporting. Agree with scope Suggest other matters for list, ie: • End user demand and projected changes therein. • Supply including existing, under development and potential future developments. • Alternative future uses of a property (taking into account the costs and risks with securing alternative uses). Expected revenues. • Development costs. • Time to develop and realize value.

			• Macroeconomic conditions.
		5	Agree that all three approaches should be considered in valuing development property. However, the relevance of a specific approach will depend on specific factors
		6	It would be useful to provide an example illustrating potential different value estimates as a result of changes in the assumptions in a residual value calculation
		7	Potential overlap between “buyers profit and risk” and the returns included in a discount rate should be addressed. The effect of tax on the calculation should be addressed. This should include how tax is treated in the discount rate as well as the cash flows.
		8	Where it is proposed to use third party equity to fund a project, the pricing of such equity can be used to infer a cost of equity
		9	Valuers should be aware of the purpose for which a valuation is prepared and include matters required to meet such a purpose.
		10	Agree such information may be useful. General Comments • Paragraph 11. As stated in the proposed amendments to IVS 300, special assumptions should not generally be applied in fair value measurements. • Paragraph 24 (d) It may be useful to include a discussion of the unit of account where there is development property with an associated construction contract. Depending on the purposes of the valuation, it may be necessary to separately value these items. • Paragraph 24 (e) This states that finance costs should be included in the residual method. Frequently in corporate finance decision making, the value of a project is separately from the manner in which the project is financed. • Paragraph 24 Generally DCF techniques use after-tax cash flows. The treatment of tax is not addressed in the document • Paragraph 24/25 The document should clarify any overlap between buyer’s profit and risk and the investor return implicit in a discount rate. • Paragraph 32 This paragraph states that because financial statements assume an entity will continue as a going concern it is appropriate to assume that contracts would pass to the buyer. It should be noted that the unit of account and valuation premise of the relevant asset should be considered, e.g., whether the assets would include the relevant contract or not.