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I February 2013

By email: CommentLetters@ivsc.org

International Valuation Standards Council
41 Moorgate
LONDON EC2R 6PP
United Kingdom

Dear Sirs

IVSC Discussion Paper: Investment Property

We refer to the Discussion Paper of the International Valuation Standards Council on Investment Property.

Our comments on the specific questions raised in the exposure draft are attached. Should you have any questions, please do not hesitate to contact our Senior Business Manager Ms Caris Wan at 2521 1855.

Yours faithfully

Boey Wong
Secretary

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Response of the Hong Kong Association of Banks (HKAB) to the Specific Questions in the International Valuation Standards Council's (IVSC) Discussion Paper on Investment Property

Definition of Investment Property

1. ***Do you think that the current definition should be retained in full or that an amendment to the definition in IVS 233 is required?***
2. ***If you believe it should be retained in full, what guidance should be given to valuers when valuing for the non-financial reporting purposes referred to above?***
3. ***If you believe an alternative definition is warranted, please give reasons and suggest appropriate wording.***

International Valuation Standard (IVS) currently defines investment property as "*property that is a land or building, or part of a building or both, held by the owner to earn rentals or for capital appreciation or both, rather than for:*

a) *Use in the production or supply of goods or services or for administrative purposes, or*
b) *Sale in the ordinary course of business.*"

This definition closely follows that in IAS 40 *Investment Property*. However, the objective of IAS 40 is not to define investment property for purposes of determining its fair value. IAS 40 specifies the recognition criteria, measurement basis (i.e., fair value or cost), and disclosure requirements for investment property owned by a reporting entity. The definition of investment property in IAS 40 references how that property is used by the owner (i.e., the reporting entity) because the measurement basis is specific to the reporting entity.

The term fair value used in IAS 40 is defined by IFRS 13 *Fair Value Measurement.* (IAS 40 previously provided a definition of fair value; however, IAS 40 has been amended by IFRS 13, which provides a single definition of fair value for all assets and liabilities measured at fair value.) Our key concern as preparers and users of financial statements is that the valuation output should meet the requirements of fair value measurement for financial reporting purposes. Therefore, we suggest that the IVSC Standards Board's (the "Board") indicate that the valuation for financial reporting purposes of investment properties as defined in IAS 40 should follow the principles in IFRS 13.

It is suggested in the discussion paper that the specific exclusions in (a) and (b) from the definition above are too specific to accounting and may need to be amended or removed for valuation purposes. The proposal also mentions that a valuation standard addresses the type of asset, but not how it is used by a particular entity, and an investment property could still be used for one of the excluded purposes, such as by the occupier. We acknowledge that the IVS needs to be applicable for valuations under a range of circumstances; hence we agree to the Board's view on modifying the definition to suit the general needs and to break the existing link with IAS 40, which provides a definition of investment property for a different purpose than the IVS.

In addition, the Board should eliminate the reference to owners in the definition. Because fair value under IFRS 13 and market value under IVS are both from a market participant's viewpoint, whether or not a property is valued as investment property should not be determined from the perspective of the current owner of the property.

The Board should adopt a definition that highlights to the valuer a particular type of property, generally referred to as investment property, that presents specific practical issues in arriving at fair value.

Assets to be included

4. ***Have you encountered valuations that explicitly refer to intangible assets associated with either the property interest or the business in occupation? If so, were these separately valued or not? For what purpose was the valuation required?***
5. ***Have you encountered valuations of investment property where you believe that the value of an intangible asset has been included in the value of the property interest but has not been expressly identified?***
6. ***Do you consider that the IVSC needs to provide guidance on this issue?***

From a financial reporting perspective, determining the correct unit of account (which drives accounting classification, measurement and disclosures) is critical in arriving at the correct fair value measurement. The unit of account defines what is being measured for financial statement purposes by reference to the level at which the asset or liability is aggregated (or disaggregated) for purposes of applying other accounting standards. If separate units of account are aggregated for valuation purposes, it may not be possible to determine the correct fair value to assign to the individual units for financial reporting purposes, which could affect subsequent accounting particularly when different assets have different subsequent measurement bases (e.g., cost, revaluation, etc.).

Whether acquired as part of a group of assets or as part of a business combination, an intangible asset should be separately recognised if it meets the definition and recognition criteria under IAS 38 *Intangible Assets*. Accordingly, when a valuation is prepared to address a measurement need for accounting purposes, any intangible asset associated with a property interest (such as the right to use a particular title that is attached to a lease agreement as mentioned in the discussion paper) should be valued separately.

In normal financial reporting circumstances, entities have to exercise judgment in the degree of aggregation of different assets as a single unit of account. There currently exists an IFRS practice issue related to the appropriate unit of account for investment property as defined under IAS 40. In some cases, an entity provides ancillary services to the occupants of a property it holds. IAS 40 requires that a reporting entity should treat such property as investment property if the services are insignificant to the arrangement as a whole. Practice has differed in delineating the scope of IFRS 3 *Business Combinations* and IAS 40. Some considered both standards as mutually exclusive if the investment property with associated ancillary services is acquired. In other words, the investment property and the assets associated with the ancillary services would be treated as a single unit of account based on IAS 40 without any consideration of the requirements under IFRS 3 to allocate the purchase price to the individual assets acquired (e.g., property, goodwill, other intangibles, etc.) Others did not view IFRS 3 and IAS 40 as being mutually exclusive. They believe that an entity acquiring investment property with ancillary services has to determine whether it meets either or both of the definitions of investment property in IAS 40 or a business in IFRS 3 and then make the appropriate allocation of the purchase price. The IASB has proposed to amend IAS 40 to clarify that judgment is required to determine whether the acquisition of investment property is the acquisition of an asset, a group of assets or a business combination within the scope of IFRS 3. For valuations prepared for financial reporting purposes, the Board should provide implementation guidance that is consistent with the IASB's final amendments to IAS 40.

It would be helpful if the Board highlighted that the unit of account for investments in real estate can vary. In some cases, real estate is owned directly or through a consolidated legal entity by the reporting entity. In such situations, the unit of account is the real estate. In other situations, the reporting entity has a non-controlling interest in a special purpose entity that holds real estate. In such a case, the unit of account is the equity investment, the value of which may vary based on factors other than the real estate (e.g. debt held by the SPE that is above or below market value). Valuers need to understand the unit of account for which they have been engaged to provide a valuation.

Format of IVSC output

7. ***Which of these options do you favour or is there another option that you would suggest?***

Only investment property under construction is within the scope of IVS 233, which does not constitute all investment property as currently defined. We believe that guidance should be provided for all investment property to address the nuances of valuing such property. However, we do not believe it is necessary to address investment property in a separate standard apart from IVS 230. Both IVS 230 and IVS 233 refer to the same three principal valuation approaches (market, income and cost) described in the IVS framework. Therefore, the guidance to be provided for investment property is primarily related to implementation rather than a fundamentally different valuation approach from other property interests.

Valuation Methods and Inputs – Sufficiency of current provisions

8. ***Do you consider the provisions of IVS 230 and IVS 233 in relation to valuation methods to be sufficient?***
9. ***If not, what specific aspects of valuation methodology for investment property do you think should be addressed in any future TIP?***
10. ***Do you consider that additional guidance to that provided in the IVS framework (paragraphs 33-35) is needed to apply the highest and best use concept to investment property?***

As noted above, all three valuation approaches included in the IVS Framework are applicable to investment property. We suggest that the Board consider providing implementation guidance to assist valuers in selecting the appropriate valuation approach.

We welcome the Board providing guidance and examples on how to apply the highest and best use concept to investment property as this is an area that requires judgment. The concept of highest and best use determines whether an asset is measured using an "in-exchange" or "in-use" valuation premise. The in-exchange valuation premise, which is most commonly used for valuing real estate, bases the fair value measurement on the price that would be received for the property on a standalone basis. In some cases, property may be valued on an in-use basis if synergistic value is created when individual properties are valued as a group. We believe there should be sufficient evidence to support the sale of properties as a group.

Though not specific to investment properties, IFRS 13 does contain some illustrative examples on the application of the highest and best use concept, which we view the Board can consider making reference to. We believe that any detailed guidance produced should follow the existing principles which are generally consistent with those included in IFRS.

In addition, the valuation report should also disclose if the property is not in its "highest and best use" in order for the reporting entity to comply with paragraph 93(i) of IFRS 13, which requires disclosure of when and why a non-financial asset is being used in a manner that differs from its highest and best use assumed in the fair value measurement.

We also note that there is a discrepancy between paragraph 33 of the IVS Framework and paragraph 28 of IFRS 13. The highest and best use of a non-financial asset takes into account the use of that asset that is physically possible, according to IFRS 13. The IVS Framework refers to possible rather than physically possible.

Valuation Methods and Inputs - Choice of methods

11. ***Please indicate which of the above most frequently presents a problem in the valuations that you encounter and the most common methods you see being used to address the issue.***
12. ***If you are a valuation provider, please indicate why you prefer these methods. If you are a valuation user, please indicate if you are confident in the result obtained by these methods.***

No or limited comparable sale transactions of a particular type of investment property in a particular region often create questions as to the reliability of a valuation. In addition, the appropriate discount rate to be applied when time value is relevant is another question that frequently arises. Additional implementation guidance in these areas would be particularly welcome.

Valuation Methods and Inputs – Taxes and Costs

13. ***Have you encountered material inconsistency in the approach adapted to the treatment of costs or tax in valuations of investment property? If so please indicate the nature of the inconsistency and its consequences.***
14. ***Do you consider that the IVSC should attempt to set benchmarks that indicate whether inputs and valuations should include or exclude different types of tax or other costs? If so, which specific benchmark would you consider appropriate?***

We do not believe that it would be appropriate to set benchmarks as to the different types of tax or other costs to be reflected in valuations. These should be determined based on the particular facts and circumstances.

For financial reporting purposes, the valuation should reflect fair value, which is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either in the principal market for the asset or liability or, in the absence of a principal market, in the most advantageous market for the asset or liability. The fair value measurement uses the assumptions that a market participant in the appropriate market would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

The discussion paper notes that a particular issue for investment property arises in jurisdictions where there are high transaction taxes but these can be avoided by certain types of buyers or by arranging the sale through a special purpose company. Fair value for such an investment property should be determined, in part, based on whether such taxes could be avoided in the appropriate market (principal or most advantageous) and whether the relevant market participant would include the benefits of such tax avoidance in the assumptions used in pricing the asset.

If market participants would consider estimated costs to be incurred for transferring property when determining the price they are willing to pay, then such costs should be considered in a fair value measurement. A fair value measurement is an exit price from a market participant's perspective and will vary based on the particular market and the nature of the market participants. Therefore, we do not believe that it is possible, nor desirable, to create benchmarks in such regard.

<u>Disclosures</u>

15. Do you consider that an option on where the inputs used in a valuation of investment property fall within the input hierarchy under IFRS (or any other accounting standard that contains a similar hierarchy of inputs) should be provided as part of the valuation report?

16. If so what guidance should the IVSC be providing to enable valuers to comply with the requirements of IFRS 13 in relation to disclosures on inputs?

We do not consider that valuers should provide an opinion as part of the valuation report on where the inputs used in a valuation of investment property should fall within the input hierarchy under IFRS. The reporting entity is responsible for fair value measurements in its financial reporting and for determining whether such measurements are based on observable or unobservable inputs. Currently, IVS 300 'Valuations for Financial Reporting' prescribes that the valuation report shall contain any information that the reporting entity is required to disclose by the relevant financial reporting standards. We believe that the Board should retain the existing approach such that the valuation report needs to contain sufficient details on the inputs to the valuation. However, the judgment on where these inputs should be placed within the fair value levelling should be left to the reporting entity, which would make the determination according to the requirements under the accounting standards in conjunction with the existing practice and policies.

Furthermore, we do not believe that it would be a consistent practice for valuers to provide an opinion on the hierarchy classification of the inputs for investment property only, as valuations are also reported for financial reporting purposes for other asset types. Meanwhile, we encourage the Board to cross reference in the IVS the specific IFRS 13 disclosure requirements on fair value measurements, particularly to those required when unobservable inputs are used. This could assist valuers to include in the valuation report the appropriate information that is required by users for financial reporting purposes.

Reliable Determination

17. ***Do you agree that not all investment property is capable of reliable valuation? Is so please give any additional examples to those above.***
18. ***Please indicate the nature of guidance that you believe IVSC could usefully provide to help determine when a valuation cannot be reliably provided.***

Under IAS 40, there is a rebuttable presumption that the fair value of an investment property can be reliably measured. It indicates that only in exceptional cases would fair value not be reliably measurable. The facts and circumstances under which fair value is concluded to be not reliably measurable can differ on a case by case basis. Therefore, while additional guidance is welcomed, the Board should be cautious in including specific examples into the standards or implementation guidance.

It is again important to emphasize that whether a property is valued as an investment property should be from the market participant's perspective not the current owner of the property. Property originally constructed as investment property but with little or no realistic prospects of investment income in the future may still have value to a market participant under an alternative use. For some properties, it may be fairly certain that only the land, but not the building, has value to a market participant. As previously noted, all of the investment approaches under IVS are applicable to investment property. The lack of data for the income approach should not automatically result in a conclusion that a particular property cannot be reliable valued.

Where it is determined that a property cannot be reliably valued, the valuation report should include an explanation as to why a reliable valuation cannot be made. This will assist the reporting entity to meet the requirements of paragraphs 78(b) and 79(e) of IAS 40 that requires such disclosure.