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International Valuation Standard Council
41 Moorgate
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Dear Sirs

Invitation to comment – Investment Property Discussion Paper

Thank you for the opportunity to respond to your discussion paper on the valuation of investment property.

We acknowledge the validity of the arguments put forward by EPRA and others for the development of a specific valuation standard for investment property. Consequently we warmly welcome this discussion paper by the IVSC and strongly encourage its aim to further develop a global valuation standard for investment property.

We provide our answers on the specific questions raised in the discussion paper in the Appendix to this letter.

Please contact Matt Williams (+44 207 951 0098) if you have any questions or wish to discuss our responses further.

Yours faithfully

Ernst & Young

Appendix - Responses to questions in the Discussion Paper

Project Scope – 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.

1. We consider that the over-riding principle should be one universal definition of Investment Property ('IP') and one universal definition of fair value. We also consider that a fair value for IP calculated for financial statements should not differ from a fair value calculated for other purposes.

   Given the copious amount of explanation in accounting literature as to the definition of IP, we consider it would make little sense for the IVSC to use a separate definition. It may also cause confusion. The questions about the inclusion of certain assets in the definition – healthcare, cell towers etc are dealt with (or are being dealt with) in accounting literature. Consequently, the current accounting definition should be used.

   However, the standard should explain that the principles in the paper may be applied to other properties that may be excluded from the accounting definition if the valuer considers it appropriate. For example if a valuer is asked to estimate the investment fair value of an otherwise owner occupied property.

2. Given our principle that fair value should not differ just because it is being used for different purposes, there should be no need for different guidance for non-financial reporting purposes. We also consider that the current accounting definition should be used, but it may be appropriate to explain that the principles may be applied to other properties as valuers consider appropriate.

3. As above

Project Scope – 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?

4. We understand that IP is often sold with other assets, including intangible assets. While such guidance may be helpful, in our view, focus should remain on IP. Therefore, these assets should be outside the scope of this project. In this context, we would also emphasise the challenge of opco/propco structures built around trading entities where value is only delivered by a sustainable profit potential. There is a consequent danger of intangible asset value being drawn into being part of the IP – this is a common issue with hotels, for example. We would urge the IVSC to provide high level guidance upon the boundaries (or cross over points) where real estate and business valuers often value all or part of the same assets.

   Finally, we note that in a valuation context intangibles can be said to include 'in place leases' which, of course, must be included in a valuation. This should be made clear in the standard. Apart from these situations, in our view, it is rare to encounter a valuation of an IP that includes an intangible that should be separately identified.

5. As above. We note here that this standard may not be appropriate for valuers if assisting with purchase price allocations for financial reporting.

6. As noted above, we would urge the IVSC to provide guidance as set out in 4 above. However, we recommend that any commentary should reflect the guidance in accounting literature, which is, itself, quite comprehensive.

Project Scope – Format of IVSC output

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

7. We strongly believe that a specific standard/guidance is necessary for IP and IP under construction to explicitly deal with the requirements of IAS 40/IFRS 13 and allow valuers to confirm that their valuations are in accordance with those standards.

   We understand, for example, that in The Netherlands there has been agreement that valuers would obtain accreditation in IFRS as part of being able to provide valuations for those purposes. We believe that only making amendments to IVS 230 and 233 would be inadequate in that context.

Valuation Methods and Inputs – sufficiency of current provisions

8. Do you consider the provisions of IVS230 and IVS233 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 the additional guidance to that provided in the IVS Framework (paras 33-35) is needed to apply the highest and best use concept to investment property?

8. We do not consider the IVSC should provide additional comment on methods and where these are applicable. The markets and practices around the world vary

enormously and they may court challenges if they tried either to adequately cover these or to say which were applicable. The IVSC is a global organisation and should stay at the principles level.

9. Items of principle to address should include:

- Purchasers costs and taxes (this is specifically dealt with in question 13 below)
- Valuation of entities/legal structures rather than real estate assets
- Valuations in the context of observable transaction being considered to be fire sales. We note for example that IFRS 13 sets a high hurdle for concluding that observed transactions do not indicate market price.

10. The over-riding principle we consider is appropriate in respect of this concept is to estimate the amount that a market participant would pay for an asset. We would expect valuers to already have to assess technical, financial and legal feasibility of a development when assessing hope value (or similar). If so, the paper should acknowledge this and consider whether IFRS 13 requires a different approach to that currently taken. It is important that the assessment of technical, financial and legal feasibility does not become a theoretical exercise, but rather is used as a tool to estimate fair value.

If the IVS Framework is expanded to include considerations of highest and best use, we would strongly encourage the IVSC not to limit it to IP. In addition, we would strongly encourage the IVSC develop such guidance in conjunction with the IASB.

Valuation Methods and Inputs – choice of method

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.

11. In markets with few observable transactions, a major issue continues to be how to value Investment Property reliably. In such a market, assuming a long marketing period and a future sale in a better market may mean that values are overstated, especially in the context of IFRS 13 requiring fair value to be based on exit values. The important principle though is that a reader of a valuation can understand the methods and the inputs used in arriving at it.

Some jurisdictions operate in a mark to market culture, yet others operate in a more managed way. If a valuation which aims to mark to market contains material uncertainty (perhaps due to lack of market activity) then the requirements of the valuer should also be to provide some commentary on activity, transparency and certainty in the market against which it is being priced. IFRS 13 has introduced an input hierarchy (see 16 below) but the IVSC may consider this should be made more sophisticated.

12. We have no particular comment because we believe the IVSC should not get too involved in the detail of methods. We repeat, however, an emphasis on the principle of transparency of method and inputs.

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 valuation should include or exclude different types of tax or other costs? If so, which specific benchmarks would you consider appropriate?

13. Yes, we do observe there to be inconsistency of approach in particular in respect of purchaser costs. We strongly believe the valuer should not avoid the issue of whether it is appropriate or not to deduct purchaser costs from 'gross' valuations. In our view, it is wrong for a valuer to present two values. We consider that the benchmark should be that purchaser costs are always deducted - unless the valuer is convinced that market practice is patently such that those costs are not reflected in the price. In which case they should be explicit that this is their view and present the valuation accordingly. An added complication is to what extent the purchaser would share the saving with the vendor (as does happen in some markets). The valuer must make all these assessments with reference to his knowledge of the market.

    The valuer should also acknowledge that, by not deducting purchaser costs, they are valuing a vehicle (SPV), not the property asset and as a consequence should also factor in (to the one valuation that is presented) how other elements in the vehicle will effect value, such as a latent tax. Otherwise the valuer is only presenting a partial picture. I believe the question in the DP should be posed in this context. I think this hints at a wider question as to what it is that is being valued - and this wider question should also be addressed.

    In respect of taxation, we generally believe that a valuation should not have reference to the individual tax circumstances of market participants.

14. We would always encourage better practice and guidance where it is required. However we would urge caution about providing specific guidance upon methodologies and practice which varies from country to country. This is particularly so in the context of tax treatment. As stated earlier we believe that the IVSC as the global standard setter should stay at the principles level.

Disclosures
15. Do you consider that an opinion 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?

In our view, this issue is not limited to IP and should therefore be dealt with in a broader context (i.e. not limited to the IP project).

To answer the specific point, we acknowledge that not all valuations are prepared for financial reporting purposes and it is not a valuer's obligation to comply with accounting standards. Consequently, the valuation standards should not require that valuers provide an opinion regarding compliance with accounting requirements for categorisation of inputs. However, we are conscious too that entities will likely look to valuation experts to provide assistance with determining where inputs fall within an input hierarchy and where the valuation as a whole should be categorised within a hierarchy (as is required by IFRS 13).

Indeed, a valuer may be the principal party with sufficient knowledge to advise on assumptions, sensitivities and the extent of unobservable inputs. Therefore when valuations are prepared for financial statements, valuers should be strongly encouraged to assist the preparers of financial statements to comply with financial reporting standards. In the context of IFRS 13 this would include an opinion on the input hierarchy (or at a minimum provide sufficient information on the adjustments made to observable inputs for the preparer to make their own judgement) but also a summary of key judgements and estimates and assistance with sensitivity analyses.

However, the extent to which this assistance is needed will likely to be addressed in the agreed scope of valuation work.

15. See above

Reliable Determination
17. Do you agree that not all investment property is capable of reliable valuation? If 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.

16. The reliability discussion cannot be solved unless it is first defined what an acceptable range of outcomes is. When the range determined by a valuer in their valuation is outside of this acceptable range, then the valuation would be consider unreliable. We refer to the IVSC exposure draft on valuation uncertainly.

Properties may generally be considered to be of reliable valuation, but inevitably to different degrees of certainty. Consequently valuations should not be delivered in the same two dimensional way. Rather valuers should provide narrative on both the context and certainty associated with their valuation.

That notwithstanding, we note that IAS 40 sets out that the inability to reliably estimate a fair value in respect of completed IP is extremely rare. We agree with that. In fact, we do not consider that the incidence of being unable to fair value completed IP is sufficient to justify inclusion in this paper. The debate of 'unreliability' is primarily in respect of IP under construction. In this respect we reflect that an entity would rarely commence development/construction of an IP without an estimate of its likely value on completion or the cost of its construction - albeit we acknowledge that some entities validly establish hurdle rates of pre-letting and construction completion, for example, before recognising fair value gains. We would expect IVSC guidance to be given in this context.

17. We believe that in circumstances of less than certain market conditions valuers should be required to provide at least some context for the valuation and the conditions prevailing.