EUROPEAN PUBLIC
REAL ESTATE ASSOCIATION

International Valuation Standards Council
41 Moorgate
London EC2R 699

March 1, 2013

EPRA response to Investment Property Discussion Paper

Dear Sir,

The European Public Real Estate Association (EPRA) is the voice of the European publicly traded real estate sector. EPRA represents publicly listed property companies (including REITs), the investment institutions that invest in the sector and the firms and individuals that advise and service those businesses. The institutional investors that EPRA represents include the largest pension funds in Europe with a long track record of investment into the real estate sector. Between them our 200 members represent over €250bn of real estate investments.

Since its establishment in 1999, EPRA have been representing the European listed property sector in its discussions with those bodies that are responsible for the regulatory framework within which the sector operates, including the European Commission, the International Accounting Standards Board, the OECD, CEIOPS, ESMA, national governments and regulators. EPRA also actively engages with its equivalent organisations around the world including Asia and the US to provide a coherent voice for the global REIT sector, via the Real Estate Equity Securitisation Alliance (REESA).

Executive Summary

We welcome the development of the IVSC Discussion Paper on Investment Property. As indicated in our original letter to the IVSC (dated 28th November 2011) we believe that this project could help to raise consistency in approaches and transparency, provide clarity, and promote alignment with IFRS. This is timely given the increasing adoption of IFRS globally and the focus on fair value.

Below is a summary of our response to key questions:

1. We strongly believe that the current IFRS based IVSC definition should be retained in order to maintain clarity in valuations for financial reporting and avoid unhelpful discussions on how IVS relates to IFRS (Q. 1).
2. Providing guidance on intangibles would be helpful, given the uncertainty and subjectivity around this subject. This should aim to ensure that there is no double counting in financial reporting and should reflect the comprehensive guidance in accounting literature (Q. 4-6).
3. We would favor producing one standard that merges ISVS 230 and 233, including guidance on Investment Property, and producing TIPS on the integrated paper (Q.7).

4. Providing more guidance on valuation methods through TIPS would be helpful. The most pertinent issues include guidance on purchaser's costs (e.g. transaction taxes), 'highest and best use', and intangibles (Q. 8-10);
5. Aside from the key issues raised above, we are wary of following a path which is too prescriptive and believe that companies should be able to rely on the professional judgement and expertise of valuers in dealing with various scenarios (markets with few transactions, construction of discount rates, etc). (Q. 11-12).
6. We do believe that there is some inconsistency of approaches with regards to the treatment of transaction taxes (e.g. in Belgium). We believe that the IVSC should be looking strictly at the sale of the asset (as per IFRS) – without any adjustment for tax structuring. In markets where it is generally available and utilised for all participants to structure the sale so as to reduce taxes, this should be reflected in the valuation. Clearer guidance would be beneficial to reflect the above, including an assumption that where the dominant practice is to pay reduced tax, that this should, in principle, be reflected in the market price. (Q.13-14).
7. We believe that the valuation report should <u>not specifically</u> include an opinion on the fair value hierarchy but rather should contain sufficient information on the inputs used to enable the reporting entity to categorise the assets within the IFRS 13 *Fair Value Measurement* hierarchy. It is a company's management that should decide the IFRS 13 hierarchy. Nevertheless, we recognise that alongside management, a valuer may be the principal party with knowledge to advise on assumptions, sensitivities and the extent of unobservable inputs. They should therefore be encouraged to provide the right information to support the decisions and disclosures required under IFRS 13. (Q. 15-16).

We have provided our detailed responses to the questions in the Discussion Paper in the Appendix.

If you have any questions please do not hesitate to contact me using the details below or Mohamed Abdel Rahim, EPRA Financial Reporting Manager, at mohamed.abdelrahim@epra.com.

Yours sincerely,

Gareth Lewis
Finance Director
T +32 (0)2739 1014
gareth.lewis@epra.com

Appendix: Responses to Questions in the Discussion Paper

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?**
   We believe that the current IFRS based IVSC definition should be retained and that the link between IVS and IAS should not be lost or blurred. It is important to maintain clarity in valuations for financial reporting purposes. This is what regulators, auditors, oversight bodies, users of the accounts etc should aim for. Taking out part of the definition does not make sense as (a) and (b) are there to clarify. If you delete them the definition becomes less clear.

   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, but with an explanation that the principles in the paper may be applied to other properties to the extent that valuers consider it appropriate.

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?**
   As above, the current accounting definition should be used, but explanation should be given that the principles may be applied to other properties as valuers consider appropriate. We would anticipate that the guidance will principally be used for financial reporting purposes and, therefore, if there is a valuation for non-financial reporting purposes the other IVS will principally apply.

3. **If you believe an alternative definition is warranted, please give reasons and suggest appropriate wording.**
   N/a

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?**
   Yes, there are occasions where a valuation refers to intangible assets – a good example is rental guarantees. However, these are normally considered separate assets that arise from separate rights and agreements and in our view should be valued separately (although in practice this may not always be the case).

   An obvious exception to the above is ‘in-place leases’ which we note could be considered an intangible (in a valuation context) and which, of course, must be included in the valuation.

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?**

   No

6. **Do you consider that the IVSC needs to provide guidance on this issue?**

   Yes, to avoid uncertainty and given the subjectivity involved we believe it would be helpful to have guidance on leasehold land (in line with IFRS) and other common intangibles that should be separated.

   What is important is to provide clarity and ensure that there is no double counting of intangible assets, which under IFRS are reported separately. Such guidance should reflect the guidance in accounting literature, which is quite comprehensive.

   This could include the following items:
   - If the intangible asset is linked to the nature of the seller (for example they deliver a central reservation service that a regular real estate investor would not be able to provide), than the intangible should be valued separately.
   - If the intangible is independent from the nature of the seller (i.e. any other owner would benefit from the asset), or can be transferred with the asset, than the intangible should not be separated from the asset.

<u>Format of the IVSC output</u>

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

   We would be in favour of producing one standard that merges the two existing ones (IVS 230 and 233) and produce TIPs on the integrated paper. This would simplify things, especially on the interface between IPUC and standing property; the treatment of intangibles and interface with other IVS to be reviewed. We would urge that the standard also addresses:
   - the rotation of valuers; and
   - the content/format of the valuation report to reduce inconsistencies of approach

Sufficiency of current provisions

8. **Do you consider the provisions of IVS 230 and IVS 233 in relation to valuation methods to be sufficient?**

   We believe that more guidance on valuation methods through TIPs would be helpful. As a general comment, we note that IFRS 13 recommends maximising the use of observable inputs so any IVS should be consistent with this approach.

   Some of our members have encountered situations where valuers use widely diverging methods, with very different results and volatility (i.e. sensitivity to parameters differ). Providing guidance on how to address these situations could be helpful.

9. **If not, what specific aspects of valuation methodology for investment property do you think should be addressed in any future TIP?**

   Specific cases that may need addressing further in technical guidance include:
   a. Intangibles (see questions 4 -6)
   b. Guidance on 'highest and best use' and 'hope value' (see question 10)
   c. Purchasers costs and taxes (see question 13)
   d. Encouraging the use of multi-criteria approach to valuations (see questions 17-18)

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?**

    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. Companies rely on the professional input of the valuer to achieve a reasonable valuation based on a set of assumptions and we would clearly not want the IVSC to prescribe, for example, how a discount rate should be constructed.

    Nevertheless, there may be a risk of "valuing the dream" with too little substance behind this. We have had feedback that the highest and best use should not be taken into account unless there is strong evidence that market participants would be willing to pay for this; or, better yet, if the company is committed to execution of the plan.

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.**
    EPRA's view is that companies rely on the professional expertise and judgment of valuers to address different scenarios and we are wary of following a path which is too prescriptive, since it may be difficult to know where to draw a line on guidance. For example, we do note that a market with few transactions does pose a challenge, however the valuer should be equipped to deal with such scenarios.

    The construction of the discount rate can be challenging e.g. in the multi-criteria approach with exit cap rate and risk embedded in the cash flow. One way that a company may address this is to take the position to be more prescriptive on discount rates and embed the risk in the cash flows.

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.**
    We have received feedback from some members that they prefer a multi-criteria approach which could provide confidence in cases where different valuations methods and firms produce different valuations - for example, using a DCF approach or price per square meter to back up a market valuation. The overriding view, however, is that first and foremost, market evidence should be the dominant influence.

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.**
    Yes, there is some inconsistency in approaches. For example, in Belgium where valuations assume that the transfer tax is not the nominal amount, but that because of structuring the tax can be reduced.

    We strongly believe the valuer should not avoid the issue of whether it is appropriate or not to deduct purchaser costs from valuations. The standard should make it clear that disclosure of detailed methodology and assumptions is desirable but disclosure does not relieve a valuer from having to estimate fair value in accordance with the standard and IFRS 13. Certainly we do not believe that a valuer should present two values and invite their client to choose. A prudent approach may be that purchaser costs are deducted unless (1) market practice is dominantly such that those costs are avoided and (2) the asset is already structured to do so - in which case they should be explicit that this is their view - and present just one value accordingly. The valuer must make this assessment with reference to his/her knowledge of the market.

In markets where market participants are able to reduce transfer tax and that method of reducing transfer tax is available to, and widely used by the majority of the market, then that will have an impact on the prices of properties. Consider the following example assuming a market with 15% transfer tax. A property with an exit value of 100 (IAS 40) will result in paying 15 in tax when sold i.e. a buyer is prepared to pay 115 for the property. Let us assume that now market participants have found a way to reduce the tax to 3%. There is a gain of 12. This gain will, depending on the strengths of market participants be shared between buyers and sellers. So this could lead to a net (IAS 40) value of 106 and a total price to be paid of 106 * 1,03% = 109,2. So, in a market like this the prices will rise. The valuers should reflect that in the values they determine.

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 affect value, such as a latent capital gains tax, other liabilities, etc. Otherwise the valuer is only presenting a partial picture. We believe that the question in the DP should be posed in this context as it hints at a wider question as to what it is that is being valued - and this wider question should also be addressed.

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 benchmarks would you consider appropriate?**
As above, clearer guidance would be beneficial. IFRS requires valuations to be based strictly on the sale of an asset and generally speaking structuring should not be taken into account. However, when there are markets where it is possible for all market participants to reduce taxes, and this is widely utilised, this should be reflected in the valuation.

The guidance could indicate for example that, where a range of possibilities exist within a market, the highest transaction costs should be assumed. Reduced costs should only be assumed where it is the dominant market practice, in the jurisdiction, for transactions to be structured on a reduced cost basis. In the latter case, a strong assumption should be that in principle this will de facto be taken into account in the valuation for the reasons outlined in Question 13.

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?**
    We believe that a valuer should not be required to give an opinion on the fair value hierarchy under IFRS 13 but should provide sufficient information on the inputs used to enable the reporting entity to categorise the assets within the IFRS and U.S. GAAP fair value hierarchy.

    We believe that alongside management, a valuer may be the principal party with sufficient knowledge to advise on assumptions, sensitivities and the extent of unobservable inputs. The valuation report and the company's interaction with the valuer should therefore be geared towards providing the right information to support the decisions and disclosures by management required under IFRS 13.

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?**
    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.**
    We envisage that a reliable valuation can be difficult in some instances, particularly for some investment property under construction in difficult markets with very few transactions occurring - although management is normally expected to have a reasonable estimate of expected cash flows, yields, etc.

18. **Please indicate the nature of guidance that you believe IVSC could usefully provide to help determine when a valuation cannot be reliably provided.**
    The IVSC could provide examples of when such circumstances arise to minimise inconsistent interpretation.