# IVSC Investment Property Project

## Project Brief

The International Valuation Standards Council (IVSC) is an independent, not-for-profit, private sector organisation that has a remit to serve the public interest. The IVSC's objective is to build confidence and public trust in the valuation process by creating a framework for the delivery of credible valuation opinions by suitably trained valuation professionals acting in an ethical manner.

The IVSC achieves this objective by:

(a) creating and maintaining the International Valuation Standards (IVSs);

(b) issuing technical guidance for professional valuers; and

(c) promoting the development of the valuation profession and ethical practices globally.

The IVSC Standards Board has agreed to undertake a project to examine the valuation of investment property, to consider the need for a new IVS or guidance on the topic and then to develop the necessary documents following the IVSC Due Process procedures. The project will also review the status of IVS 233 *Investment Property under Constructio*n, which may require revision or withdrawal depending on the project's conclusions.

This paper describes the background to the project and identifies matters that Board believes need to be addressed.

The IVSC wishes to form a volunteer working group to progress the project. This will ideally include individuals with different perspectives on the valuation of investment properties, for example:

- expertise in preparing valuations of investment properties,
- preparers and auditors of financial statements that include valuations,
- users of valuations, eg property fund managers, property companies,
- those with a regulatory or oversight interest in valuations in this sector.

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Nominations for membership of the working group are invited no later than 28 February 2012. An application form and further details can be obtained from the IVSC Technical Director, Chris Thorne by email cthorne@ivsc.org.

## BACKGROUND

At present IVS 233 *Investment Property under Construction* (IPUC) is an anomaly among the standards in the 200 series. The other “Asset Standards” all deal with generic asset glasses. IVS 233 deals not only with a specific subset of an asset class but is limited to one type of valuation which is only likely to occur at the beginning of the asset’s life. The reason for this was that evidence was brought to the Board of inappropriate techniques being promulgated following the IASB amending IAS 40 in 2008 to require IPUC to be reported at fair value rather than cost.

Some have argued that IVS 230 *Real Property Interests* obviates the need for a separate IVS on investment property as, but EPRA (see below) argues that it “cannot deal with some of the unique issues that cause inconsistency in the valuation practices for investment property” and therefore a separate standard is needed.

A good case can be made for IVS to include a standard dedicated to investment property on account of the size of the market, its role as an important investment class that is widely used directly and indirectly by the public and the fact that the IASB have a dedicated accounting standard – IAS 40 - (and the FASB are to introduce one).

## SUBMISSION BY EPRA

This case has been highlighted by recent representations to IVSC made by the European Public Real Estate Association (EPRA) for the development of a specific standard for investment property. This has also been supported by the British Property Federation and also the Asian Public Real Estate Association. Discussions with NAREIT, the trade association for real estate investment trusts in the USA, and major auditing and consulting firms have also revealed interest in a global standard for investment property.

EPRA’s request to the IVSC to consider an IVS for investment property is based on the belief that such an IVS would “play a crucial role in improving the consistency of valuation practices across countries as well as help to maintain or enhance the quality of valuations globally.”

The increasing reliance on fair value reporting for investment property, and the growing regulatory requirement for more frequent real estate valuations, are the key trends that argue for an examination of investment property valuations.

EPRA highlights a number of areas where their members have experienced diversity in the approaches taken to the valuation of investment property. These are included in the list of issues in the following section.

EPRA believes that the benefits to be derived from a new IVS or guidance on the valuation of investment properties would include:

- Consistency of approach and greater transparency
- Elimination of certain judgements inherent in the current valuation process

- Clarity on contentious issues (eg, transfer tax and hope value)
- Improvement in the balance of IVS that currently gives too much weight to IPUC
- Compliance with IFRS 13 and the US equivalent
- Demonstration of support for adoption of the fair value model for investment property

**THE IVSC PROJECT**

The IVSC Standards Board has identified the following issues that it considers will need to be addressed by the project, although the working group is encouraged to make recommendations to amend or extend this list.

- Definition of investment property. IVS 233 defines investment property as “a class of property that is held to earn rentals, realise capital appreciation or both”. The working group should consider whether this definition is sufficient or is in need of amendment or elaboration.
- Overview of principal methods. This should not provide a detailed critique of any method but should consider the use of different methods for different types of investment property. However, consideration needs to be given to possible diversity in constructing discount rates and property yields.
- Treatment of valuation inputs: Consideration needs to be given to how a valuation should treat the deduction of purchaser costs, particularly transfer taxes in jurisdictions where it is possible to effect a transaction in such a way as to avoid such taxes, lease incentives and initial direct costs, redevelopment potential (“hope value”), land tenure (leasehold versus freehold), among others.
- Apportioning value. For instance, the allocation of value to items such as, plant and equipment.
- Disclosure. The extent to which the valuation report should provide sufficient information, particularly on methods and significant assumptions, to assist preparers of financial statements make required disclosures, such as those required under IAS 40 and IFRS 13, including those relating the fair value hierarchy required in IFRS 13.
- Reliable determination. Discussion of the requirements of IAS 40 paragraph 53 which requires investment property, including IPUC, to be fair valued only if such fair value can be reliably determined.

The overall brief of the project is to:

**1. To develop a IVS for investment property.**

The standard would be similar in structure the existing IVS 200 series and consists of a standard and a commentary. The standard would set out requirements that either modify or augment the IVS General Standards as well as IVS 230 Real Property Interests and include illustrations of how the principles in the General Standards are generally applied to investment property. The commentary would provide additional background information on the characteristics of investment property that influences value and identify common valuation inputs, approaches and methods.

2. **Consider the need for and develop any associated guidance to support the standard and publish as a Technical Information Paper (TIP).**

   An IVSC TIP provides authoritative but non-mandatory guidance designed to be of assistance to valuation professionals and informed users of valuations alike. It can examine methods identified in a Standard in greater depth and illustrate their application. A TIP guides rather than instructs. It does this by providing information that is helpful to practitioners in exercising the judgements they are required to make during the valuation process, but should avoid anything that would restrict the proper exercise of that judgement by the imposition of inappropriate rules. A TIP should not direct or require the use of a particular method in specific circumstances but can include discussion of factors that should be considered when deciding which method it is appropriate to use. A TIP should also focus on practical issues rather than underlying theory and as such is not intended to provide comprehensive education or training.

   It is suggested that the first stage of the project should involve the Working Group considering the following:

- Identifying characteristics of investment property that create the need for specific valuation considerations, enquires or techniques.
- Whether there is consensus on acceptable valuation assumptions and input data verification procedures for different valuation purposes.
- The need to create a standard supplementary to the current IVS to reflect the particular factors that require consideration when valuing investment property.
- If a new standard is considered necessary, consideration needs to be given to IVS 233 and whether that should remain as a separate standard, become part of the new standard, be reconfigured as a TIP or some combination of the above.
- Identifying valuation methods used in to value investment property, developing guidance on those methods and matters that need to be considered in their application.
- Identifying any known valuation practices that are considered inappropriate.
- Developing a skeleton of a possible new IVS Standard and a possible new TIP for referral to the IVSC Standards Board.

The first task of the Working Group will be to review this proposed scope and make any recommendations for significant changes considered appropriate to the Board.