Comments on IVSC Illustrative Examples

Chapter 1 – Bases of Value

Exposure Draft

The Commentator:

The commentator has recently retired from Lincoln University’s property research and teaching staff. He is currently completing his PhD research into investment valuation methods.


Question 1

No.

(a) Trying to make this a generic chapter on the IVS bases of value, and then illustrating it with "examples" primarily applicable only to businesses/special cases/financial assets is the wrong emphasis.

It is not clear what audience the readers of this chapter are intended to be, whether valuers generally of both real property and personal property (business entities), their clients, students of valuation, or members of the public with an interest in what the asset valuation standards are intended to be about.

These illustrative examples in the Chapter 1 exposure draft are quite confusing, particularly to real estate valuers and to students of property valuation.

The valuation of real property and businesses entities are quite different, employing different methodologies and approaches that need to be distinguished and separately illustrated.

The interpretation in paragraph 6 refers to "IVS bases of value applied to the entity as a whole (business enterprise) rather than interests in that entity".

It is not clear what type of assets the examples apply to and the examples are not focused on fixed assets but more focused on business value.

Much of the language, use of undefined terms and examples are at a complex level including quite a lot of gobbledygook in terminology used. Even to the writer of 50 years plus experience as an academic, valuation textbook author and consultant valuer, much is strange and most unusual. For example, "incremental market participants synergies", "incremental buyer-specific synergies", "core building block in the value continuum", "differences in tax rates and tax
attributes of the owner vis-a-vis market participant financial buyers", "specific acquirer synergistic value", "IVS basis of value and related nuances", "general and administrative (G&A) savings due to the consolidation of operations ...", "MP synergies" (Member of Parliament?), "standalone valuation of target", "standalone valuation of acquirer" (surely it is the asset not the target or the acquirer that is being valued?).

The bulk of the examples, particularly paragraphs 26 to 41, pages 10 to 22 that relate to synergistic and special value show rare situations that typical real estate or property valuers do not deal with, and some of the examples are complex or unique, e.g. valuing an adjoining owner’s beach.\(^1\)

The chapter has a dearth of examples illustrating common property valuations that could and should be illustrated.

One would expect these would include a description of the different type of properties, assumptions, simple valuation calculation by one or two appropriate valuation approaches, a conclusion, and a comparison table for each of the different bases of value illustrated. This should include the reasons for any material value differentials.

(b) Forging a dichotomy between market value and investment value, as well as mixing in fair value, simply confuses readers as valuation should be primarily assessing market value.

The writer(s) of this draft chapter should take note of the concerns and advice expressed by Drs Whipple, Kumerow and Fraser in their response to the post Australian property crash in the early 1990s and the Report of the Property Economic Task Force in Australia that suggested making and using market/investment value distinctions, ... "We are, as explained above, a bit less sanguine about the valuers ability to outguess markets. A valuer who could predict the difference between market value and investment value ought to be investing not valuing." (Emphasis added)


**Question 2**

The primary issue this commentator has with some of the illustrations, particularly the diagrams, is that they suggest there is a hierarchical validity in the overlap between the resulting valuations under the three different bases of value.

Whilst the diagram in paragraph 7 is useful and explanatory; Figure 1 in para 11 is specified as illustrating "price" where Market Value/IFRS 13 Fair Value is at the lowest level of the hierarchy and that IVS Fair Value encompasses this including "an amount above the price". Also, Investment Value supersedes these, encompassing both of the foregoing and far exceeds market value. This may not be the intention, but it is certainly the consequence of any reasonable interpretation.

This criticism applies also to Figure 2 that reverses the hierarchy and equates Market Value (MV) with IFRS 13 Fair Value (FV) that exceeds and encompasses Investment Value (IV). This is nonsense because the minimum value that an asset has is its MV, as a buyer/seller must be

\(^1\) In New Zealand all foreshores, to the sea, rivers, lakes, and streams over a 9m width are by legislation owned exclusively by the Crown. Some old titles have riparian rights to mean high water line, but on subdivision or development are required to cede to the Crown a foreshore reserve to give public access to the foreshore.
assumed prudent and informed and not under duress (forced sale or other special circumstance). IV is a subjective (not objective) price or “worth” estimate to an individual or business entity and must be greater than or equal to MV (an objective market based assessment). It would be illogical for an existing owner to sell or transfer an asset to another user or new owner at less than the market value that could be obtained for it. See additional comments re para 21-25, where a special purchaser may be prepared to pay marginally over the normal MV to acquire an asset.

IVS valuation standards must be for the "real world" and not for subjective "fairyland" or "theoryland" concepts of IV to a particular owner/investor/buyer who may apply unrealistic personal investment analysis assumptions where IV assessments result in above- or below-market values. However, such resulting IVs have no substance in the "real world" as an asset purchased at higher than MV cannot be "worth" more than that purchaser could resell it for and turn it into cash or other equivalent assets. Vice-versa, if the asset is acquired at less than MV, it provides a potential profit arising where the purchaser could then sell it and realise that profit by selling it at market value (being the minimum value to the new owner). A valuer steps into a "fool's paradise" if assessing subjective IVs that have no foundation in the market place. The valuer’s role is to provide the objective MVs against which a price for an asset can be measured, i.e. against the IVS "standards" to decide if asset is over- or under-valued. Assessing IVs is investment analysis not valuation.

Figures 3 and 5 suffer from a similar criticism, particularly where shown in a vertical continuum representing "valuation increments" and might be less objectionable if the lower arrows were deleted and the vertical axes labelled "not to scale" and/or "conceptual marginal value increments". The "standalone" business value shown as IV to an owner may well be the greatest value exceeding that which could be obtained from other market participants, despite the synergies they may bring to the property. These two illustrations are quite hypothetical, highly subjective, especially when a valuer departs from the default IVS MV standard as shown indicating that MV could be as much as 200% of IV and that buyer’s subject of investment value maybe 300% of IV value to the owner. This is highly illogical for the very reasons explained in the above paragraphs where market value must logically in the real world set a minimum, and any special value must be only marginally different.

Figure 4, apart from the terminology of calling it a "Building Block" that should be replaced as an ideas "Flow Chart" diagram, and the words "a particular" should be replaced with "the" in the bottom box.

**Question 3**

Except for the issue of the requirement in certain cases under the IFRS 13 for the deduction of transaction costs, MV and FV should be the same or reconcilable, except for special cases under paragraph 20.

The terminology of synergistic value is simply what is more commonly known as "marriage" value (UK) "amalgamation" or "plotlage value" (US and NZ). It should be pointed out that synergistic value is only one of a number of different types of special value. Synergistic value can be negative as well as positive, for example in valuing in globo "block value" of subdivided sections (plots or lots of surveyed serviced land) compared to the sum of the individual values

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as separate lots in the market (that derives gross realisation in a residual approach)\(^3\).

**Question 4**
No, the IVS framework adequately defines this.

**Question 5**
No, in general they confuse readers for the reasons set out above particularly under Question 2.

**Question 6**
The second bullet point should be market value
The writer’s perceived numbered priorities of this list are as follows:
- 3. Market participants.
- 4. Proper marketing.
- 6. Forced sales.
- 7. Assumptions and special assumptions.
- 8. Aggregation and unit of account.
- 5. Transaction costs.
- 1. Valuation date.

**Further comments:**
Para 21: A prudent buyer, even with a potentially special use/value for the asset need not pay an excess for it, and needs only has to marginally outbid the next highest market participant for it.

Para 22: Acknowledges the above in part, but the example does not reflect this.

Para 24: The synergies will not be capable of being realised by all normal market participants – but at best only a few purchasers who possess the necessary knowledge and ability to exploit that potential synergistic value.

Para 25: Acknowledges the above in part, but an exchange of ownership is essential to achieve it. It cannot be a hypothetical value existing outside a transaction.

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**Synergistic or special value** (to a purchaser/owner) has a limited and temporal value during the purchaser’s term of ownership. If the acquired asset becomes surplus to requirements, due to changes in the synergies, its value is only realisable at its disposable value and will revert to its market value.

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\(^3\) Supra, Vol. I p. 10-34, and Chapter 10 where a "block deduction" measures the difference between gross realisation of the lots and the in globo single holding value as a "block" of properties.