International Valuation Standards Council (IVSC)
Exposure Draft
Illustrative Examples: Chapter 1 - Bases of Value
Response of the Royal Institution of Chartered Surveyors (RICS)

Contact:
Alexander Aronsohn FRICS
RICS Director of Technical International Standards
aaronsohn@rics.org

Ben Elder FRICS
RICS Global Head of Valuation
belder@rics.org
Introduction

The Royal Institution of Chartered Surveyors (RICS) has noted the publication of the Exposure Draft – Illustrative Examples: Chapter 1 - Bases of Value – produced by the International Valuation Standards Council (IVSC) in January 2014 and welcomes the opportunity to comment.

About RICS

RICS is the global leading organisation for professionals in real estate, land, construction and related environmental issues as well as working in the personal property and business assets sectors.

Over 120,000 RICS members, who are Chartered Surveyors, exist globally and operate out of 146 countries, supported by an extensive network of regional offices (detailed on our website) located in every continent. RICS Headquarters is based in London and our international work is supported by a network of regional offices and national associations.

RICS members play a vital role throughout the entire asset life cycle – from initial inspection and measurement, development through to investment in, and the use of physical structures and other assets, as well as financial and business interests. In the valuation field our members’ expertise covers a very wide range of disciplines, including business valuation. We also provide impartial advice to governments, policymakers and non-Government organisations.

RICS is an independent professional body, which was established in 1868 and has a UK Royal Charter. It is committed to setting and upholding the highest standards of excellence and integrity, providing impartial and authoritative advice on key land and asset issues affecting businesses and society.

RICS is a regulator of both its individual members and firms enabling it to maintain the highest standards and providing the basis for unparalleled client confidence in the sector. This regulation includes a specific focus on valuation via Valuer Registration.

As well as technical standards there are also rules of conduct for members and rules for the conduct of business for firms. These rules are coupled with ethical standards for all members.

RICS and Valuation Standards

A significant proportion of our members are involved in valuation practice on all manner of assets. The first RICS Valuation Standards publication was produced in 1976 and the current standards are the “RICS Valuation – Professional Standards” effective from 1st January 2014. The standards are commonly known as “the Red Book” and contain mandatory rules and best practice guidance for valuations of real estate and other assets.

RICS adopts the International Valuation Standards (IVS) 2013. The adoption of IVS in the Red book provides an implementation and practice framework for the application of IVS globally, ensuring that RICS members follow consistent methodologies throughout the world.
The Red Book is mandatory for all RICS members and regulated firms worldwide when carrying out Red Book specific valuations. It is also widely referred to by non-RICS valuers.

The global section of the Red Book comprises a broad ethical framework which can be applied to valuations of any asset type in any jurisdiction, in harmony with national legislation. They comprise a framework for the following:

- VPS1 – Minimum terms of engagement;
- VPS2 – Inspections and investigations;
- VPS3 – Valuation reports;
- VPS4 – Bases of value, assumptions and special assumptions.

More specifically the standards relating to compliance with standards and practice statements where a written valuation is provided and ethics, competency, objectivity and disclosures are set out in Professional Standards PS1 and PS2.

The global standards are accompanied by detailed national standards.

For more information please visit http://www.ricsvaluation.org/
31 March 2014

Our Ref: BE/AA/EDR2

International Valuation Professional Board
41 Moorgate
London
EC2R 6PP

Dear Sirs

Re: RICS OBSERVATIONS ON THE EXPOSURE DRAFT ON ILLUSTRATIVE EXAMPLES: CHAPTER 1 - BASES OF VALUE

The RICS note the stated objectives for the Illustrative Examples. RICS however are of the opinion that the area of ‘Illustrative Examples’ is not an appropriate area of activity for a standard setting organization such as the IVSC. There are more appropriate bodies to fill any actual or perceived gaps in information at this level and IVSC’s activities in this space undermine its critical role as a standard setter.

However the RICS response solely on the Exposure Draft as published is as follows;

Question 1. Do you consider the differences among the IVS bases of value have been adequately illustrated? If not, what additional illustrations might be helpful?

Overall, it is not clear to which audience this paper is addressed – is it primarily to valuation practitioners or to valuation users or to both? Clarity on this point would help determine the level at which the information might best be presented.

Turning to the detail, paragraph 6 causes uncertainty as to the exact scope - is this Exposure Draft focussing only on the valuation of “business” property? If so, this should be incorporated in the title, and it should perhaps be more specifically linked to IVS 300. Or is it genuinely focussing on bases of value in general, but taking only commercial examples for the purpose of the detailed illustrations? The second sentence of paragraph 6 says that the focus of the illustrations is on an “entity as a whole” i.e. at a business enterprise level rather than at a constituent asset level. This seems to imply a focus on enterprise value (as defined in IVS 200 C1 (a)), which impression is reinforced by the reference to “no debt assumed for simplicity”. But the third sentence of paragraph 6 leaves one wondering what the significance is of the reference to “asset” being interchangeable with “business” yet with the proviso “depending on the context”. This calls for some clarification.
Moving on to paragraph 7, caution needs to be exercised in relation to how the bases of value are described and presented. The IVS Framework makes clear (at paragraphs 27 and 28) that whilst there are three principal categories into which a basis of valuation may fall, there are in fact a large number of different bases in use around the world. Although the IVS Framework focuses on market value, investment value and fair value at paragraph 27, it does not refer to fair value under IFRS 13 – this is probably one of the most important of the “other categories” covered by paragraph 28 (and then by IVS 300). In the circumstances, the “graphic” on page 3 of the Exposure Draft (following paragraph 7 and its associated text box) is over-simplified.

Paragraph 11 might benefit if it was emphasised that the basis of value to be adopted and followed depends on the individual circumstances – or context - of the case. It may be a requirement of jurisdiction, legislation, regulation, client request or client requirement etc. (again reference can usefully be made to paragraph 28 of the IVS Framework). It is rarely a matter to be determined by “which basis of value yields the highest or lowest amount”. Once the basis is established, it is the valuation method adopted, the evidence and other inputs used, and the skill, knowledge and judgements applied that influence the detail of the valuation output.

In Figure 1 the assumed equivalence of Market Value and IFRS 13 Value is introduced without explanation, whereas paragraph 26 (discussed below) makes clear that it is not a case of precise “equivalence” but of general consistency. A similar criticism could be made of Figure 2.

Paragraph 12 is directed to the investigation, research and analysis that might be undertaken by a valuer in an individual case, where “potential bases of value embedded in the projections” may or may not be a relevant matter. The last sentence “Fundamentally the distinctions between the different bases of value reflect different expectations regarding cash flows and risk” makes an assumption that expectations will differ, which clearly is not universally the case, and also implies that cash flows and risks are the only factors material to valuation, which is clearly not the case, even though they may be major factors where the asset being valued is a business.

Regarding Figure 3, there appears to be no justification for supposing that the IVS Fair Value could be as low as zero. Furthermore it does not automatically follow that Investment Value will always be different for buyer and seller (“owner” in the text) or that they will automatically differ from Market Value (in fairness, Figure 3 does attempt to recognise this, as does paragraph 15, but the point could be made more directly). The reference to “a subset thereof” in the first sentence of paragraph 14 is not understood – the market is made up of all participants (see paragraph 18 of the IVS Framework).

Paragraphs 14-18 are confusing in their treatment of “synergistic” value, which is an addition to value not a basis of value in itself. In fact reference is being made in these paragraphs, and in Figures 3 and 5, both to synergistic value and to special value – paragraph 47 of the IVS Framework. Whilst these are picked up at paragraph 20 onwards (albeit with considerable compression at paragraph 24 which does not properly capture the point in the second sentence of paragraph 47 of the IVS Framework), a better link could be forged. And the second part of the last sentence of paragraph 19 could be better worded. It is not that bases of value themselves “overlap” – it is that the valuation outputs/outcomes from the use of different bases (and valuation methods) may have some commonality.
Figure 4 is over-simplified, and of doubtful benefit. The valuation of a business involves rather more than this.

Moving on to paragraph 32 and the Application Examples, the reference to “related nuances” might usefully be reworded to clarify what is being covered.

In Example 1 it is not immediately clear what asset is involved – referring to “hotel property”, and the words that follow, suggest this may be referring to a business asset i.e. the real estate rather than an asset which is a (hotel) business. It also begins to cause some confusion between synergistic value and how far it may properly be reflected in market value. The special value example involving the beach lacks clarity as to how additional value arises, is assessed and is then apportioned between the relevant interest in the beach and the ownership of (hotel) business.

In paragraph 33, the basis of value should be determined by its purpose (paragraph 26 of the IVS Framework). It is not determined by the synergies that may or may not exist. Nor is it clear what is meant by “bridging” the various IVS bases of value. Example 3 is very long, and confusing as to the asset(s) involved - we can see no benefit in it being included. Example 4 does nothing to improve the clarity – there are too many provisos in what, presumably, is intended to cast a clear light on the issues.

Turning to paragraph 35, it is not clear why price, cost and value need to be introduced into a paper on bases of value. Nor is Example 5 well written – the basic points could be made more simply.

In paragraph 36, cost and price may be related, but not invariably so. Nor is cost factual until it has actually been incurred. Paragraphs 37 to 41 appear redundant given the main focus of the paper – see also paragraph 8 of this same Exposure Draft.

Question 2. Do you perceive any issues or unintended consequences arising from any of the illustrations? If you do, please explain what these are.

Yes – as set out in the answer to Question 1 above. An additional observation would be that greater clarity could be brought to bear on the distinction between basis of value, assumption(s) (or in some markets, premises) and method(s)).

Question 3. Do you consider that there are any other differences between Market Value and IFRS 13 Fair Value that should be discussed and illustrated?

A prior question concerns the differences that are discussed and illustrated. In particular paragraph 29 makes reference to “blockage factors” and “defensive value”. Particularly on the first, it would be helpful to comment on, and illustrate, its significance in terms of valuing (as in this case) a business in accordance with IVS 300.

Question 4. Does the term “arm’s length” in the Market Value definition need explanation?
“Arm’s length” is a term that shares some characteristics with “Chinese Wall”. It is widely used and widely understood in many markets. But there are some where it will be less clear because of the way that the market operates or the way that transactions are executed. However it is difficult to see that, at a global level, more needs to be said than is already contained in paragraph 30(f) of the IVS Framework.

Question 5. Do you find the graphics in the document helpful in understanding the relationships between the bases of value and other pertinent concepts?

Whilst graphics may be useful in some instances, there are a number of examples in the Exposure Draft where they are unsatisfactory and/or potentially misleading. Specific instances are mentioned in our responses to the other questions.

Question 6. Below are examples of other topics within the scope of the Illustrative Examples project which the Board is planning to cover in future chapters:

- Market participants
- Market
- Proper marketing
- Forced sales
- Assumptions and Special Assumptions
- Aggregation and Unit of Account
- Highest and Best Use
- Transaction Costs
- Valuation Date

Please indicate the perceived priorities from this list and if there are any additional concepts or issues within the IVS Framework that you believe it would be helpful to address.

RICS are of the opinion that illustrative examples are not an area that should be addressed by the IVSC and therefore are of the opinion that none of these topics should be covered in future chapters.

Yours faithfully

Ben Elder BA BSc FRICS ACIarb
Global Director of Valuation
RICS Professional Groups

T +44 (0) 20 7695 1695
F +44 (0) 20 7334 3712
E belder@rics.org
www.rics.org