March 31, 2011

Sent by email to: CommentLetters@ivsc.org

International Valuation Professional Board
41 Moorgate
London EC2R 6PP
United Kingdom

SUBJECT : Comments on the Exposure Draft of Technical Information Paper 1
The Discounted Cash Flow (DCF) Method – Real Property and Business Valuations

Dear Sirs:

The Japan Real Estate Institute (JREI) is pleased to comment on the above noted Exposure Draft. In terms of the following six questions raised in the draft, we would like to respond with positive answers to all of them. The reasons are explained below.

1. This Exposure Draft states that the DCF method should not be judged on the basis of whether or not the explicit cash flow assumptions are ultimately realized but rather on the degree of market support for the assumptions at the time they were made.
Do you agree that the DCF method, if properly applied, can be used as a method to arrive at market value?

Yes. The DCF method is based on the forecast of typical market participants at the effective date of value for an assignment. In that sense, the method is an appropriate tool for estimating market value although it does not guarantee that forecast cash flows will transpire in the future.

2. The IVPB has concluded that although there may be distinct terms and types of analyses that apply respectively to real property valuations and business valuations, the underlying DCF method is identical in each case.
Do you agree that the underlying DCF method described in this paper applies equally to the valuation of real property and businesses? If not, please explain the differences that you believe exist?

Yes, we agree with the opinion of the IVPB that real property valuations and business valuations share the basic idea of the DCF method regardless of some differences in

terminologies and analyzing processes of cash flows between them.

3. This Exposure Draft states that the discount rate should be determined based on the risk associated with the cash flows (para 10), whether the DCF model is being used to determine a market value or investment value.
   Do you agree, or do you consider that other matters should be taken into account in determining the appropriate discount rate?

   We agree with the statement in the Exposure Draft. Usually, different discount rates are used for estimating a market value and investment value. However, a discount rate is selected based on the risk that was not considered in the cash flows in both cases. For determining a market value, the discount rate must reflect the expected return for typical market participants. We could enhance its reliability by interviewing investors and by utilizing real estate investment indexes.

4. A number of different methods are identified which can be applied to the calculation of the terminal value at the end of the cash flow period (growth, fading growth, net asset value, salvage value, etc). For long-life real property assets or going concern businesses the Board believes a constant growth model is the most commonly used method, coupled with a cross check for the reasonableness of the figure, eg by reference to the implied exit multiple.
   Do you agree that the most commonly adopted terminal value calculation at the end of the explicit forecast period is the 'constant growth' model, cross-checked for sensibility to an implied capitalisation rate or exit multiple? If not please identify what other method you most commonly use?

   We agree that the most common method is the constant growth model. The terminal value is calculated by capitalizing the net operating income in either the last year of the analysis period or the following year. The terminal capitalization rate is usually chosen based on the going-in cap rate.

5. The Exposure Draft explains that cash flows can be developed on the basis of alternative financial assumptions, eg inclusive or exclusive of anticipated inflation, inclusive or exclusive of tax etc. Providing the discount rate used is consistent with the financial assumptions in the cash flows the valuation result should not be affected by the alternative used.
   Do you agree that providing a discount rate is used that is consistent with the financial assumptions made in calculating the cash flows that the choice of using explicit or implicit

financial assumptions in the cash flows should not affect the valuation result?

Yes. In the DCF method, cash flows are forecast based on a certain real estate operation scenario. A discount rate reflects the risk associated with the cash flows. As long as both the cash flows and discount rate utilize the same financial assumptions, an identical result should be derived.

6. This Exposure Draft is intended to identify best practice in the creation and application of discounted cash flow models. The Board has made the decision not to explain in detail the types of inputs that may be used in different situations or the investigations that may be appropriate. Neither are illustrative examples provided. The preliminary view of the Board is that detailed discussion of inputs or a limited range of examples is inappropriate because it could be misleading if it led readers to believe that these models were endorsed by IVSC or conversely, variations of these models in different situations were not appropriate. There are many industry specific sources for those who require training in the development and use of relevant DCF models.
   Do you agree that more detailed discussion and examples of the valuation inputs into a discounted cash flow model are inappropriate? If not how much additional information do you think should be included in best practice guidance?

   We agree with the decision of the Board. We understand that the purpose of this Exposure Draft is to identify best practice in the creation and application of discounted cash flow models. Line items in the DCF analysis vary among countries. Illustrative examples and detailed explanation are widely available in books and seminars (both classrooms and online).

Sincerely,
JAPAN REAL ESTATE INSTITUTE

Nobuo Kobayashi
Managing Director