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International Valuation Professional Board
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Dear International Valuation Professional Board Members,

International Valuation Standards Board has recently published Exposure Draft of Technical Information Paper 1 named "The Discounted Cash Flow (DCF) Method - Real Property and Business Valuations" with an open invitation to submit comments. I have studied the Exposure Draft carefully and would like to make a comment on some of the thought stated herein.

My answers to Questions for Respondents are following:

1. Yes, DCF method, if properly applied, can be used as a method to arrive at market value. I understand that DCF method is a way, a kind of procedure, to transform the explicit cash flow into a final figure - a value. If market assumptions are inserted into DCF methodology market value might be received. Valuers are obliged to reflect market evidence into specific assumptions which probability of occurring is the higher no matter if they are doing a valuation of real property or business. The judgment of a sets of assumptions is done on the valuation date when DCF method is applied. Valuers cannot be blamed if explicit cash flow assumptions are not realized in the future because (i) firstly they do not control it and some differences might result from poor management, (ii) secondly the risk is reflected in discount rate and (iii) thirdly the set of assumptions are only valid on the valuation date. But on the other hand if a 10-year DCF model and an explicit cash flow are applied valuers should reflect negative market trends in property cycles (ie. dropping rents) and they are usually not.
2. Yes, DCF method described in Exposure Draft applies to the valuation of real property and businesses. The different sets of items has to be analyzed in both cases.
3. Yes, I agree that the discount rate should be determined based on the risk associated with the cash flows no meter if DCF model is used to determine a



market value or an investment value. The higher quality of projected cash flow the lower the risk attached to it thus means that there should be an awareness of different discount rate to be applied. If projected cash flow in valuation of real property is detailed and final cash flow includes the certain sets of assumptions for example voids, fit-out costs, agents fees those risks should be somehow excluded means different discount rate should be applied.

One of the risk associated with the cash flows is the risk of getting regular payment of rent from the tenant. Even this risk is linked with real property or business. Assuming that there are two identical lease agreements signed by the same tenant the risk associated with the cash flows is each case might be different.

If the risk is a probability of receiving a result different than expected I might add one theoretical thought that for zero or negative cash flow the risk allocated to such cash flows is very low because receiving positive figure is very unlikely and the discount rate applied to such zero or negative cash flow stream should be lower than discount rate applied to positive cash flow stream.

4. I agree that the most commonly adopted terminal value calculation a end of the explicit forecast period is the Gordon growth model. It involves summing the infinite series of cash flows which gives the value and only there the misleading assumption might be made. When terminal value in real property or business valuation is concerned the valuer must have consider the future length of such stream if it is truly close to infinite. If the growth is zero we end up with simple capitalization. Comparing simple capitalization with discounted cash flow stream we might observe that first 30 years are crucial. Another words id the expected series are lower than 30 years it might be difficult to reasonable explain summing the infinite series of cash flows. Depending of the discount rate applied (in this case 4%) but DCF of first 30 years of cash flow provides approximately 70% (or more for higher discount rates) of the value received using the Gordon growth model and zero growth assumption.
5. I 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. The only comment is that if you add additional assumptions which might not occur for example anticipated inflation you provide to you model with additional risk which must be compensated in higher discount rate. There should not be any influence for the final valuation result.
6. I share the view of the Board that no examples of DCF is needed. There might be only useful that the scale of accuracy of the cash flow is to be decided by valuer. There might be calculations which reflect perfectly the cash flow having in mind also a daily periods and for some calculation monthly, quarterly or annually streams might be sufficient and all of them should results in the same values.

Best Regards,

Lukasz Heciel