Associazione Società di Valutazioni Immobiliari per le Banche

Response to public consultation

Exposure draft
Technical Information Paper 1

The Discounted Cash Flow (DCF) Method

Real Property and Business Valuations

April 28th, 2011

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Soci Fondatori:

ASSOVIB is the association of the biggest Italian Valuation Companies which provide valuation services to banks who grant mortgages based on real estate collateral. The purposes of the Association are promoting professional valuation culture within the context of mortgage granting and elevating the quality of services offered to Banks by establishing a code of conduct and carrying out, alongside government bodies and other stakeholders, initiatives focused on scientific and technical issues within the valuation field.

As representatives of ASSOVIB (the Italian "Association of Property Valuation Companies for Banks") we appreciate the opportunity to respond to the questions concerning the Technical Information Paper 1 relating to DCF Method, Real Property and Business Valuations.

In our valuation field we regularly encounter the need for financial methods of valuation, therefore we consider the inclusion of the DCF method in a specific Technical Information Paper as a safeguard of transparency and proper application. Please find below a brief response to several of the questions proposed by the IVPB.

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, we agree.

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?**

We believe that in principle the method as described is equally applicable to the valuation of real property and businesses and we appreciate the distinction between different forecast periods according to the object of valuation (contractual or estimated cash flows for real property assets and "operation cycles" for businesses). It is important to keep this distinction in the final version.

3 This Exposure Draft states that the discount rate should be determined based on the risk associated with the cash flows (paragraph 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 but would also welcome, as an example, discounts related to land and building components or mortgage and equity (band of investment)

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. We have some questions as to why you would use a DCF in the first place to value a business or a real property asset which will likely never be sold at the end of the period

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 believe that a more detailed discussion regarding the types of inputs that may be used in different situations and the inclusion of examples would help illustrate the correct application of the discounted cash flow model. This approach fosters the development of best practices, especially in countries which do not have an abundance of industry specific sources. It would be useful to have examples and further details of the applied methodologies in different countries and the data sources used to carry out said methodologies.