Our ref: DR/MP/Corr.

20 April 2011

International Valuation Professional Board
41 Moorgate
London
EC2R 6PP

[By email: CommentLetters@ivsc.org]

Dear Sirs

Exposure draft - Technical Information Paper 1
The Discounted cash flow (DCF) method of real property and business valuations

RICS has noted with interest the publication of the draft TIP on DCF and welcomes the opportunity to comment.

Overall this is considered to be a very useful paper and we have relatively few comments to make. Dealing firstly with the questions put:

1. Agreed
2. Agreed
3. In isolation this comment is not unreservedly agreed but it has a link with question 5 and as a consequence we broadly agree.
4. Although we agree with the first sentence of this question we do not agree with the comment in the second sentence. The stated 'check' is just one approach and not necessarily the most commonly used method. For property assets the terminal value should be compared with a forecast of market value determined using whatever method is commonly used in that market. For instance an all risks yield.
5. Agreed
6. We agree with the conclusion that to include detailed examples are inappropriate for the reasons given.

With regard to the draft itself we would make the following comments:

1. In the definitions the term 'discount rate' is specifically limited to a market return. This may not be correct in the case of an investor who is looking at a personal target rate of return. We suggest this distinction should be made.

2. The definitions of GPV and NPV are agreed. However it is our experience that NPV may often be referred to colloquially to mean the gross discounted cash flow before deduction of the purchase price and possibly this could be mentioned.

3. In paragraph 8 the sentence beginning 'The duration of the forecast period' is too simplistic. By way of explanation our own guidance makes the following comments:

   > 'The characteristics of the specific asset should be taken into account when fixing the time horizon. An appropriate exit date may be influenced by material events in relation to the property itself, such as break clauses or lease expiries, which can lead to substantial refurbishment expenditure or voids. However, care should be exercised if the assessment of investment value for different properties is used to compare the advantage of buying one particular property over another. Internal rates of return (IRR) used over different time periods do not always make it possible to determine automatically which is the superior investment from the prospective owner's point of view.
   >
   > For an assessment of investment value, the time horizon adopted should reflect the investor's anticipated investment holding period (which will normally be determined having regard to the factors mentioned earlier).'

4. In paragraph 16 e) the comment is made that 'Expenses may be placed at the accounting point in time rather than the point of time at which they are incurred.' We do not agree with this comment. As the method is a cash flow process the expenses should be recognised at the point in time at which they may be expected to occur.

We trust that these comments are helpful but should you require any further clarification I will be pleased to hear from you.

Yours faithfully

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Our ref: DR/MP/Valuation corr.

3 May 2011

Chris Thorne
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[By email: cthorne@ivsc.org]

Dear Chris

Re: Exposure Draft – Technical Information Paper 1
The Discounted Cash Flow (DCF) Method – Real Property and Business Valuations

You will be aware that RICS has an active presence in the Americas. There has been a little delay in establishing links for responding to such exposures as the recent DCF TIP and one consequence is that the Americas' comments on this Draft were delayed. We trust that the following observations, offered as a supplement to my letter of 20 April 2011, with which we agree, can be included in your deliberations.

We note that the objective of the TIP is to offer guidance for both real property and business valuation practitioners. These supplemental comments are offered to specifically address business valuation practice aspects or offer alternative perspectives.

With regard to the draft itself, we offer the following additional comments and suggestions, as supplements to the 20 April 2011 letter:

Definitions Section:

Discounted Cash Flow (DCF): The beginning could be clarified to read "…is a method**, under the income approach,** utilizing…"

Free Cash Flow: The second line could be clarified to read "…from income the expenses and capital ***investment*** related items…"

Free Cash Flow to the Firm: It is unclear in the definition what "external debt" means – It would be helpful to elaborate or offer a synonym; for example, "interest bearing debt" is commonly used to differentiate what we understand as "external debt" from other liabilities.

Free Cash Flow to Equity: The definition should include "(net of additional borrowing)" after the phrase "debt repayment".

Gross Present Value: The beginning of the definition could clarify "…is the summation of the discounted ***cash*** inflows and outflows…"

Weighted Average Cost of Capital: It would be helpful if the definition included further explanation of "a business's capital structure." If determining investment value, it might be the capital structure of an actual business, whereas if determining market value, the capital structure would be that of a market participant.

The DCF Method – Overview

While we agree with the clarifying comments on Paragraph 8 of the TIP, they are specific to real property and might be better placed as a paragraph under the "Real Property Assets" subheading. Paragraph 8 is in the Overview section .We note that paragraph 16 (h) (under the Businesses subheading) provides more detail about the duration of the forecast period in business valuation - so it could make sense to include a sort of mirror paragraph with more detail about the duration of the forecast period in real property under the "Real Property Assets" subheading.

Paragraph 11: The text there indicates that AAA rated bonds are considered risk free. In business valuation, it is common to use (although there are definitely exceptions) a government bond as a proxy for the risk-free rate. We suggest a note be included that in some countries, the risk free rate is more likely associated with securities backed by the government.

Paragraph 22: For clarity, we suggest simply stating at the end of the first sentence "If inflation is excluded from the forecasted cash flows, then it should be excluded from the discount rate".
As a general comment, it appears that the word "liability" is sometimes used to indicate negative or outgoing cash flows. We note that the term "Liability" is a term that applies to items on a balance sheet. To avoid confusion with the accounting context of the term, we suggest using explicit text (outgoing cash flow or negative cash flow) rather than liability.

In appreciation for your efforts and with hope that these comments are helpful.

Yours sincerely

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