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IVSC Standards Board
International Valuation Standards Council
41 Moorgate
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Dear Sirs,

Exposure Draft – Amendments to the International Valuation Standards

On 1 February 2013 the IVSC announced the release of an Exposure Draft dealing with amendments to IVS 2011.

The document was issued seeking a response from interested parties by 30 April 2013.

The Australian Valuation Standards Board in general supports the amendments, however, where it believes further guidance is required, has provided the following for consideration.

1. **Definitions:**

Proposed Change

Valuation Date: The date on which the opinion of value applies. When and where applicable, the valuation date shall also include the time on which it applies if the value of the type of asset can be observed as changing materially in the course of a single day.

The Australian Property Institute has added the words "where and when applicable" to further clarify what is meant.

2. **Definitions:**

(a) The eighth edition of the International Valuation Standards included the following definition:

Highest & Best Use

The most probable use of a property which is physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value of the property being valued.

The IVSC International Valuation Glossary now defines Highest & Best Use as:

The use of an asset that maximises its value and that is physically possible, legally permissible and financially feasible.

As the concept of highest and best use is critical to the determination of market value the Australian Property Institute is of the opinion it should also form part of the definitions in the revision of IVS 2011.

However, before such inclusion the question as to whether it should more accurately read" "The use of an asset or liability...." rather than "The use of an asset.." needs to be resolved. Does a liability have a HABU?

It is also noted that the Accounting Standards define Highest & Best Use as:

> *The use of a non-financial asset by market participants that would maximise the value of the asset or the* group of assets and liabilities (eg a business) within which the asset would be used.

An alternative definition for consideration by IVSC is:

> *The most probable use of a non-financial asset that maximises its value and that is physically possible, legally permissible and financially feasible.*

We are talking about the HABU of real estate, plant and equipment etc. Because of the circumstances surrounding some zoning laws the use cannot always be absolutely determined as is implied in the current wording. The existing wording has the real potential to leave valuers exposed to legal challenge.

(b) The eighth edition of the International Valuation Standards included the following definition:

> Market Rent
>
> *The estimated amount for which a property, or a space within a property, should lease on the date of valuation between a willing lessor and a willing lessee on appropriate lease term's in an arm's-length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.*
>
> *Wherever market rent is provided, the "appropriate lease terms" which it reflects should also be stated.*

IVS 2011 and the IVSC International Valuation Glossary now define Market Rent as:

> The estimated amount for which a property would be leased on the valuation date between a willing lessor and a willing lessee on appropriate lease terms in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

However, the issue is whether:

- the word " property" should be replaced by "asset" or "asset or liability".
- the words "and where" should be replaced by "wherein" to ensure consistency with the recommended wording of market value.
- The word "would" to be replaced by "should" in line with the definition of market value

(c) The eighth edition of the International Valuation Standards included the following definition:

> Market Value
>
> *The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.*

IVS 2011 now defines Market Value as:

The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's-length transaction after proper marketing and where the parties had each acted knowledgeably, prudently, and without compulsion.

The IVSC International Valuation Glossary now defines Market Value as:

The estimated amount for which an asset or liability should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.

The Australian Property Institute would prefer that the Glossary definition appear in the revised version of IVS and all TIPs.

Currently the documents / definitions refer to "'Property", "Asset" or "Asset or Liability". Irrespective of the decision of the IVSC, the terms used need to be consistent in all documents.

It would also be appropriate for guidance to be provided on whether the IVSC believes the words 'asset' or 'asset or liability' interchangeable as an accepted definition of market value. Some members believe the word 'liability' is at odds with fee simple and could be taken to include mortgage debt in use of the market value definition / terminology 'asset or liability'.

3. **IVS Framework – 3 and 4.**

Proposed Change:

Independence and Objectivity

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~~Many states have laws or regulations that only allow certain persons to value particular classes of assets for various purposes. Additionally, many professional bodies and valuation providers have ethical codes that require the identification and disclosure of potential conflicts of interest. The purpose of these standards is to set internationally recognised principles and definitions for the preparation and reporting of valuations. They do not include regulations on the relationship between those commissioning valuations and those undertaking them, as~~

Whilst the Exposure Draft proposes to delete the above, the Institute believes there is merit in retaining the wording as it is an important statement that warns those who may otherwise see an internationally endorsed Standard as overriding state/national laws.

6. **IVS Framework: 30**

Proposed Change:

30 *Market value* is the estimated amount for which an asset or liability should exchange on the *valuation date* between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

Reason: consistency with approved definition. (note: this was a publishing error in the printed version on IVS 2011 only)

As stated earlier there is a need to ensure consistency of definitions in all documents i.e. IVS, TIPs and the International Valuation Glossary. Whilst the wording would be consistent with the current definition of IVS 2011 it would not be consistent with the wording in the IVS International Valuation Glossary or recent Exposure Drafts / Discussion Papers. The Institute would prefer the Glossary definition, however, consistency is paramount.

7. **IVS Framework: 31 (c)**

Proposed Change:

(c) "the date of valuation" requires that the value is date specific, and when and where applicable is time-specific as of a given date. Because markets and market conditions may change, the estimated value may be incorrect or inappropriate at another time. The valuation amount will reflect the actual market state and circumstances as of the effective *valuation date*, not as of either a past or future date. ~~The definition also assumes simultaneous exchange and completion of the contract for sale without any variation in price that might otherwise be made;~~

This is a reflection that prices and therefore values of certain asset classes such as equities, debt instruments and derivatives change during the course of the day. For asset classes such as real property, plant and equipment it is not necessary to record a time applying to the valuation.

Reason: The references to "exchange" and "completion" are specific to certain countries' systems of contract law and are therefore potentially confusing to readers unfamiliar with these terms. The definition of market value refers to an exchange on the valuation date, meaning that the agreed price is fixed and the asset transferred on that date. Under certain legal systems a contract is said to be "exchanged" when the contract becomes binding and "completed" when the transfer of the asset actually takes place, which may be on a later date.
This alternative meaning of "exchange" in the conceptual framework for market value potentially causes confusion. And in any event, the price is fixed when a legally binding contract is entered into (legal exchange), not at any later physical exchange of the assets subject to that contract (legal completion), so the point being made by this sentence is redundant as price does not vary between exchange and completion

The suggested additional amendments are in line with the Institutes recommended wording to the amended definition of ***Valuation Date*** as well as attempting to provide further clarity.

It should also be noted that 31 (b), 33 and 34 if applicable need to be amended if we are talking about assets and liabilities. They currently refer to assets only.

22. **IVS 230 Annexe – Historic Property**

Proposed Change

Remove the annexe from the IVSs.

Reason: The Board does not consider that there are sufficient unique requirements or considerations when valuing historic (real) property that warrant the inclusion of this annexe in the standards. It also provides only guidance, which under current IVSC protocols should be included in a TIP. The guidance provided is similar to that in the proposed TIP on Specialised Public Sector Assets that was issued in late 2012. One proposal is to remove this annexe to this future TIP, or it may be issued as a standalone paper providing information and guidance on some of the valuation criteria to be considered.

The eighth edition of the International Valuation Standards included GN 15 Valuation of Historic Property. This was subsequently carried forward into IVS 2011 as an annexe to IVS 230 Real Property Interests. If the IVSC is now to delete the annexe from IVS the Institute believes it would be appropriate for the IVSC to produce a separate TIP on this matter. It should be noted that not all historic property resides in the hands of government. The alternative would be for individual professional bodies to develop their own TIP dealing with historic (real) property.

23. **IVS 233 Investment Property Under Construction C10 and C11**

Proposed Change

C10

C11 The exact valuation inputs used will vary with the valuation model being used but will normally include those listed in this section. The inputs will also vary depending on whether a ~~growth-implicit or growth-explicit model is~~ nominal or real cash flow inputs are being used, see para C10 above. Typical inputs include:

(a) Completed property

~~If a growth-implicit model is used, this will reflect the value of the *investment property* as if complete, ie~~ The value of the completed property may be based on current values on the *special assumption* ~~its value on the assumption~~ that on the *valuation date* it had already been completed in accordance with the current specification or ~~. If a growth-explicit model is used, this will reflect~~ the projected value of the property upon completion, ie the expected value of the property on the date when it is anticipated to be complete. The choice will depend upon the availability of data to support either current or projected values and should also be consistent with the other cash flows reflected in the model. Care must also be taken to ensure that the discount rate used is commensurate with the valuation of the completed property, ie regardless of whether the completed value is based on current values or projected values the discount rate must also be derived on the same basis.

Reason: The terms “growth implicit” and growth explicit” were used in the Exposure Draft of TIP 1 on DCF. However, it was clear from the responses to that ED that these terms are not widely understood. Also, the existing text made no reference to “nominal” and “real” DCF models which are discussed in the published TIP1. Some confused the concept of growth explicit and implicit inputs with real and nominal inputs although this is incorrect as growth is not synonymous with inflation. The original consultation on the 2010 Guidance Note upon which IVS 233 is based revealed that in some markets the practice is to use current values and costs as inputs into the calculation of the value of IPUC and in others projected values and costs are the norm. From a standards’ perspective either is acceptable providing there is consistency across all inputs in the model. Given that TIP 1 has now been developed and published the Board believes that there is no need to label different types of input beyond the broadly understood categories of nominal and real and is proposing the changes to bring consistency with the published TIP 1. It should also be noted that IVS 233 is under review as part of the on-going Investment Property Project. These currently proposed changes deal only with inconsistencies with TIP1.

The API is of the opinion that valuation of investment real estate under construction is a complex area of valuation as it requires the consideration of development and investment cash flow logic.

If it is the intention of the Standard to require an entity holding investment real estate under construction to value the investment under construction at the financial reporting date the API is of the view that additional guidance is needed to explain the practical issues of such valuation.

This is needed as such property does not usually transact in an open market willingly. Sales evidence is usually the subject of a forced or distressed sale situation i.e. not a transaction that satisfies the market value test.

Another complexity is the fact the valuation methodologies, and analysis software models differ for a development when compared to an investment. It is rare to consider a valuation methodology that spans a development and sell period as well as an investment holding period following completion of the development in Australia.

Most development and investment software models (including off the shelf models and proprietary models are based on discounted cash flow logic, implicit in which is the expectation that growth in cash outflows and cash inflows should be included. The adoption of growth in such a model also assumes that the discount rate applied is mindful of the growth in cash outflows and cash inflows.

For this reason the API is of the opinion that there is merit in retaining the reference to growth and the nature of the model.

Notwithstanding the inclusion of growth in any valuation model for an investment or a development the API is of the opinion that Valuations must be reported in Current Value terms as at the date of valuation which is one in the same at the date of inspection.

This has been the position of the corporate regulator in Australia (Australian Securities and Investments Commission (ASIC) in a number of its regulatory guides relating to raising debt and equity for AREITS and unregulated capital raisings. In particular ASIC requires values to be determined at the current (Date of Valuation and Inspection terms) “As is” and “As If Complete”.

The “As Is” and “As if complete” logic would be a beneficial addition to the IVSC’s Standard on Valuation of Investment Property Under Construction as it differentiates between the property at the entities balance date/ valuation date and upon completion.

Should this Standard continue to support either option, it will be up to bodies like the Australian Property Institute to advise its membership of the need to value in accordance with legislative and Institute requirements. However, it does beg the question as to when the IVSC considers the “future value” option as acceptable and how such a position is treated by regulators, mortgage lenders and those in the professional indemnity insurance markets in other world regimes.

Yours faithfully,

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