Dear Mr. Sherman:

Thank you for the opportunity to comment on the Exposure Draft “The Valuation of Forests” dated November 16, 2012.

**Question 1:**

The scope of this TIP is confined to the valuation forests held for the commercial production of timber and other forest products. It is intended to be applicable to valuations for a range of commercial and regulatory purposes but excludes valuations that are subject to national laws (eg taxation) or private contract (eg insurance).

Do you consider that the principles discussed in this TIP could have wider application beyond the indicated scope? If so, please indicate the additional purposes to which the TIP could be applied.

**Response:**

We believe the scope of the TIP is appropriate as presented.

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Mr. Steven J. Sherman, Chairman  
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Question 2:

In para 15 it is indicated that discussion of techniques for the measurement and sampling of the tree crop (forest inventory) are outside the scope of this TIP but that there may be standards or guidance applicable in specific markets. The Board wishes to know if there is a predominant measurement and sampling approach that IVSC could reference as an example in this TIP, while recognising that variations may be applicable in certain jurisdictions or for certain species.

i) Please indicate your experience of different standards or techniques that are applied in preparing forest inventory, and the markets in which these are applied.

Response:
We believe these topics would be beyond the scope of this TIP.

ii) Do you believe that it would reduce diversity of valuation practice if the IVSC gave more information on common sampling and measurement techniques?

Response:
It would undoubtedly be helpful to those who are not familiar with basic statistics and the principles of timber cruising, but as noted above these issues require an entirely separate review—one that is totally independent of the principles of real estate valuation.

Question 3:

The proposed guidance indicates at para 28 that all three approaches described in the IVS Framework are applicable to the valuation of forests. The discussion that follows indicates some of the strengths and weaknesses of methods under each approach in the context of valuing forestry interests.

Please indicate which of the methods discussed you most commonly encounter in the valuation of forestry interests. If you encounter more than one on a regular basis please indicate whether there is clear tendency to use different methods under different circumstances, eg:

i) the stage of maturity of the tree crop
ii) whether the valuation is of a single stand or multiple stands

Response:
For properties that are dominated by plantations of relatively young trees, normally the sales comparison (market) approach provides the best indicator of value, assuming adequate data are available. The cost approach is also appropriate under these circumstances so long as no deduction for entrepreneurial profit is included. For smaller properties with older trees, the sales comparison approach usually provides the best results. The cost approach and the income approach (DCF analysis) would not normally
apply. For larger properties with older trees, the sales comparison approach and the income approach are usually useful; the cost approach would not be appropriate.

**Question 4:**
*The draft discusses the use of the market approach, income approach, and cost approach.*

Are there any other valuation approaches or methods used for valuing interests in forestry with which you are familiar? If so, please describe the method and the circumstances under which it is applied.

**Response:**
Some valuers use a variation of the sales comparison approach that essentially adjusts for differences in timber resources in two steps rather than the more traditional procedure wherein a single adjustment is applied in a total property analysis. This variation involves the development of the contributory value of the harvestable timber and the development of the contributory value of the so-called land component that includes the land and the remaining trees, such as the pre-merchantable material and larger trees that cannot be harvested for various reasons, e.g., physical restrictions and regulatory restrictions along streams and other watercourses. This appraisal technique is especially useful when a substantial volume of loggable timber is involved, or when the available comparable sales primarily involve heavily cutover properties, among other differences. The temporary apportionment of the tract into components is utilized to facilitate the appraisal process. In the final analysis, the entire property is appraised as a single entity.

**Question 5:**
*The Board is aware of some significant diversity in the length of the explicit forecast period that is used when using a discounted cash flow model to value a forestry interest. The proposed guidance has avoided giving specific guidance on the length of the period.*

i) In your experience what is a typical range of forecast period for valuing forestry interests, and what criteria are used to determine how long this should be on a case by case basis?

**Response:**
Normally 10 years; sometimes 15 years.
ii) Do you consider that it would be helpful for the IVSC to provide specific guidance on the length of the forecast period?

Response:
This type of guidance might be helpful to novice valuers.

Question 6:
The discount rate to be used in a discounted cash flow is discussed in paras 45-49. This supplements the more detailed discussion of the DCF method in TIP 1. The Board has received evidence that in some parts of the world inappropriate reliance is being based on models such as the Capital Asset Pricing Model or the Weighted Average Cost of Capital where there is insufficient data to provide reliable evidence of either the risk premium or cost of equity that would be typical for a market participant. In order to address this issue the proposed guidance emphasises the need to give greatest weight to market based inputs.

Do you agree with this guidance? If you have experience of how appropriate discount rates can be derived for use in a DCF of a forestry interest please indicate if this differs from the proposed guidance.

Response:
Build-up methods may be necessary if reliable data for current market transactions are difficult to obtain, but generally, these methods are not used as market-based rates are preferred. Interviews with knowledgeable market participants are also helpful in selecting the appropriate rates.

Question 7:
The proposed guidance in para 52 is that the cost approach is mostly applicable to recently planted forests because the physical and possible economic changes that occur as a forest matures mean that other methods become more reliable. The Board is aware that some argue that the cost approach cannot be applied to commercial forests under any circumstances and others argue that it can be reliably applied to mature forests.

Please indicate if you agree with the proposed guidance on the applicability of the cost approach. If not please explain why by reference to practice in the markets with which you are familiar.

Response:
We agree.
**Question 8:**

It has been reported to the Board that some valuations of forestry are being presented in financial statements prepared for statutory purposes that show significant changes from those previously submitted solely due to the adopted valuation method changing. The Board considers that this is contrary to the IVSs, in particular the definition and conceptual framework for market value, or where prepared under IAS 41, the requirements of IFRS 13 Fair Value Measurements. The method adopted should be that appropriate to achieve the required basis of value, it should not dictate or change the basis of value. The draft ED recommends in paras 55 – 58 the need to consider the use of more than one approach and the reconciliation of the results as means of avoiding a misrepresentation of the value by over reliance on a single approach, and the appearance that value can change simply because a different method is used.

i) Please indicate if you have encountered a similar problem to that described and, if so, any reason or justification given for the change in value?

**Response:**

Our members did not report encountering this issue. However, we generally believe that all valuation methods should give the same results, more or less.

ii) Do you consider that the guidance provided on the need to consider an alternative method in the Exposure Draft addresses this issue?

**Response:**

Yes, we believe the TIP adequately addresses this point.

**Question 9:**

An interest in a forest can consist of the rights to the land, the tree crop and all other improvements to the land or it can be in only some of these components, eg the land only or the tree crop only. For most valuation purposes the benefits attaching to the subject interest, eg the right to receive certain cash flows can be readily identified. For valuations for financial reporting under the IFRSs a value has to be attributed to the “biological asset”, ie the tree crop, regardless of whether the crop and the land are held in the same ownership. This can create difficulties where there is no direct evidence of the value of the tree crop only. The proposed guidance in para 71 refers to the suggested approach in IAS 41 which is that the value of the “raw land” be deducted from the value of the combined asset, with the residual representing the value of the biological asset. However, it is argued by some that this is over simplistic as the value of “raw land” is not the same as the value of land supporting a mature forest and the evidence the price of bare land ready for planting is of limited relevance. Proponents of this view argue that the interdependence of the tree crop and the land mean that the land makes a significant contribution to the value of the tree crop, and therefore deducting only the value of the bare land from the value of the whole forest overstates the value of the biological asset.
Please indicate if you have experience of a separate value being ascribed to the “biological asset” in a forest for financial reporting purposes and, if so, the method or methods that you are most familiar with to arrive at this value.

Response:

Any guidance developed needs to distinguish between “allocation” and “separate valuation” of the different components (e.g., land, biological asset.) The questions “what is the value (as in value in exchange) of this item?” and “how much does this item contribute to the value of the whole?” are two very different questions.

If the objective is a separate valuation, then type of value (or standard of value) becomes an important consideration. If the standard of value is a market-based value, then highest and best use is a critical part of the analysis. The estimation of a market-based value of land as though vacant (i.e., “by itself”) is premised upon its highest and best use. Accepted practice is to value land as though vacant and available to be put to its highest and best use. While the highest and best use might be for growing timber, any existing timber does not impact the value of the land as though vacant. To consider that it does is to violate the principle of consistent use.

If the objective is not separate valuation but rather an allocation of the value of the “whole” among the components, there must be some logical basis for the allocation, depending on the intended use of the report. A generally accepted method is to deduct the value of the land as though vacant and available to be put to its HBU from the value of the whole forest; the remainder is attributed to the biological asset, and as such is not overstated.

Question 10:

Para 71 refers to the guidance in IAS 41 that the value of the biological asset, in the case of forests the living trees, may be derived at by deducting the value of the land from the value of the combined asset. It also points out the difficulty that arises if the land were worth more for an alternative use. The proposed TIP indicates that while this might suggest that the biological asset has a negative or zero value, if the trees will generate income to the entity when it is harvested then the biological asset will have a positive value and should be recognised as an asset regardless of the value of the land. Some disagree and argue that if the trees are preventing a more valuable alternative use then they can have no value.

In the context of the requirement to ascribe a fair value to the biological asset as required by IAS 41, which of these views do you support?

Response:

We see several flaws in the arguments presented. First, if the standard of value is a market-based value, an asset cannot have a negative value. An asset can have no value
in the marketplace – i.e., it will not transact at any price – but it will not transact at a price that effectively results in the seller paying the buyer. Second, if the present value of the income stream from the harvesting of the trees plus the value of the land as though vacant and available to be put to its HBU once the trees have been harvested is greater than the present value of the land as though vacant less costs to remove trees, then the property’s HBU is to continue the operation until the trees have been harvested. At issue is the timing of the use, which is one of the key considerations in HBU analysis.

**Question 11:**

The Illustrative Examples included with this draft are intended to illustrate the application of some of the principles discussed in this draft and in other IVSC pronouncements. They are deliberately simplified and are not designed to be applied to real life situations without modification to reflect the facts and circumstances.

i) Do you consider that these examples will be helpful in reducing diversity in practice?

**Response:**

They may be helpful to less experienced valuers.

ii) Are there any other subjects that you consider would benefit from an illustrative example?

**Response:**

We do not have other suggestions.

**Question 12:**

The objectives of the TIP are set out at the beginning of the Exposure Draft.

i) Please indicate whether you believe that the draft meets these objectives. If you disagree please indicate why and how the guidance could be improved.

**Response:**

Except as noted in our responses above, we believe the TIP adequately meets its objectives. It is well written and informative.
ii) Are there any additional matters that you believe should be addressed? If so please indicate what these are.

Response:

We do not have other suggestions.

We trust that you will find our comments helpful. Please do not hesitate to contact me if you have any questions regarding these comments.

Sincerely,

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