The Finnish Association for Real Estate Valuation appreciates the opportunity to comment the IVSC’s exposure draft The Valuation of Forests.

The comments are attached.

Sincerely,

prof. Kauko Viitanen  
Chairman  
The Finnish Association for Real Estate Valuation  
kauko.viitanen@tkk.fi

dr. Juhana Hiironen  
General Secretary  
The Finnish Association for Real Estate Valuation  
juhana.hiironen@nls.fi
The response of the Finnish Association of Real Estate Valuation

QUESTIONS

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.

Answer: As the regulatory purposes may include a different types of valuation situations (eg expropriation, compulsory acquisition, partition) the intended purposes are appropriate.

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.

Answer: -

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

Answer: As common sampling and measurement techniques vary from country to country depending on the "know-how", the available techniques and equipment, the value of the forest/stand and on the purpose of valuation, sampling and measurement techniques do not need to be addressed in a more detail manner in "the standard level".

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

Answer: There is clear tendency to use different methods under different circumstances and especially under different valuation purposes. However sales comparison approach is typically just "supporting approach" as the Finnish sale price register does not include information about trees (eg quantity, quality, species). Also cost approach is typically difficult to use since the land itself can not be sold without the trees in any circumstances due to regulatory requirements.

   II. whether the valuation is of a single stand or multiple stands

Answer: Income approach supported by other approaches is applied both to a single stand and to multiple stands.
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.

Answer: No.

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?

Answer: In Finland forecast period includes typically two “live cycle” of tree, which is typically around 80-150 years (and a terminal value which is in most cases close to zero).

II. Do you consider that it would be helpful for the IVSC to provide specific guidance on the length of the forecast period?

Answer: No. Different species in a different location have such a big differences in their growing pace that guidance on the forecast period might be either useless because of the large variation or misleading because of different circumstances.

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.

Answer: Yes. However, in the TIP it could be explained in a more detail manner how the discount rate should be derived from the market, as there is some inconsistency in Finland regarding this matter. Also the build up method should be explained since it remained unclear in this context. In para 44 it is stated that “The risk associated with a newly planted forest is often highest in the early years up until the first commercial thinning. Each subsequent thinning ameliorates the risk as the number of trees per hectare reduces over the rotation and as the tree size increases.” In Finland the discount rate seems to be highest for the oldest stands. This observation seems to be controversial to para 44.

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.

Answer: Agree.

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?

Answer: Since almost every market participant use income approach when valuing forests, this problem is not a major concern in Finland. However there are two different applications of income approach, which are commonly used in Finland. In these applications discount rate is derived with different principals and this causes variations between valuations. This is why it would be useful for Finnish valuers to have more “standards” on how to derive discount rate(s).

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

Answer: No.

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, e.g., the land only or the tree crop only. For most valuation purposes the benefits attaching to the subject interest, e.g., 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”, i.e., 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.

Answer: -

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?

Answer: Whether or not the biological asset have value depends if and when it can be realized. If harvesting is possible for the seller or for the buyer before the land is used for a more profitable manner then this option might have an effect to the market value of the “forest”. However in most cases market participants don’t but a much weight to the trees if the land has more profitable use. And if market participants does but value to the trees, nor should the valuer.

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
The accuracy of the valuation should be addressed in a more detail manner since the valuation of forests includes additional type of valuation risk when compared to the valuation of other assets. There is a separate risk concerning the forest inventory, which makes it impossible to valuate the asset precisely. More on this matter in a dissertation from Aalto university (Holopainen 2011), see http://lib.tkk.fi/Diss/2011/isbn9789526040134/.