28 February 2013

Our Ref: BE/AA/Val.corr

IVSC
41 Moorgate
London
EC2R 6PP

Dear Sirs

Re: RICS OBSERVATIONS ON THE EXPOSURE DRAFT ON VALUATIONS OF SPECIALISED PUBLIC SERVICE ASSETS

Overall whilst the RICS notes the stated objectives, it believes the proposed guidance is in places more concerned with practical valuation issues than directly with international valuation standards interpretation. It would invite the Professional Board - and IVSC - to consider whether the level of detail is entirely appropriate, but nevertheless focuses this response solely on the Exposure Draft as published.

Questions

1. Some of the challenges that arise in valuing specialised public service assets result from similar assets being cash-generating when owned by a for-profit entity and non-cash-generating when owned by a not-for-profit or public benefit entity. The Board’s initial view is that it is the characteristics of an asset and the service it provides that are relevant to its valuation. Others argue that the status of the owner can be a significant factor that impacts on the value of an asset as in many cases there is circularity between the for-profit or not-for-profit status of the owning entity and the cash-generating status of the assets.

Which of these views do you support?

This is an extremely wide field and one needs to be cautious about generalizing, when there is already so much variation in public service providers across different jurisdictions, which is likely only to increase in the future. For example, in the UK the Localism Act has introduced the Community Right to Challenge, whereby a third sector organisation might provide a local government service with use of council premises for its delivery.

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1 The ‘third sector’ is the term used in the UK to describe the range of organisations that are neither public sector nor private sector. It includes voluntary and community organisations (both registered charities and other organisations such as associations, self-help groups and community groups), social enterprises, mutuals and co-operatives.
Specialised assets being those for which there is no ready market, the DRC approach is generally adopted, and the economic theory of substitution applies. This means that the building element is a cost based valuation to provide a ‘benchmark’ for the valuation of the actual asset, allowing for all forms of obsolescence and optimisation. This approach should not be affected by the nature of the owner as it is the characteristic of the asset from which value is derived. As the public body will be competing with the market for the land for the Modern Equivalent Asset (MEA), again we do not consider that the characteristic of the owner has any relevance to value.

Therefore the RICS agree with the Board’s initial view that it must be the characteristics of the asset and the service it provides that are relevant to its valuation, not the status of the owner. Sources of funding for, and revenue from, the asset (or liability) may however form a key part of that overall picture.

2. The draft contrasts the concepts of market value and investment value (as defined in the IVS Framework and this draft). Market value should give the same result as fair value as defined in IFRS 13 as the differences between the two do not affect specialised public service assets. It is therefore frequently used as a basis when specialised public service assets are valued for financial reporting. Investment value is specific to the owner and can reflect criteria that would either not be relevant or available to market participants, such as measures relating to the public benefit created by or accruing to the asset.

Do you consider that these distinctions are clearly explained?

No. RICS does not consider that these distinctions are clearly explained. Again taking for convenience a UK example, the CIPFA Code of Practice on Local Authority Accounting for financial statements adopts the IFRS concept of Fair Value, with a local amendment that where an asset is ‘operational’ then the value to the entity model is used, i.e., Fair Value (Existing Use). HM Treasury’s Financial Reporting Manual (FRoM) applies a similar interpretation of Fair Value to the UK’s central government operational properties. Only Investment Property and Assets Held for Sale will be valued to Market Value. This enables the valuer to adjust market evidence to reflect what the entity would pay for an asset, given its use to the business. This is of course the concept adopted through the use of the Modern Equivalent Asset (MEA) in DRC valuations. We also caution that public benefit may not relate to specific ownership – linking back to the point made above.

3. The proposed guidance makes a distinction between measuring the value of the asset and measuring the social value, i.e. the impact of that asset on either other assets or the wider community. It excludes the latter from the scope of the proposed TIP on the grounds that social value of an asset is not directly correlated with the value of the owner’s interest in that asset.

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2 Chartered Institute of Public Finance and Accountancy
a) Have you had experience of the impact that a specialised public service asset has on the value of other assets or the wider community being used as a measure of the value of that asset?

Whilst we have none that we can directly point to, in general no asset can be valued in a vacuum. Any valuation of any asset may, to a greater or lesser extent, reflect the value of other assets in the vicinity of the asset being valued. This could derive from social value or economic value. We see no argument for amending valuation guidance on this point.

b) If so, please explain the purpose for which the valuation was required.

N/A.

4. Many specialised public service assets such as roads, town squares, footpaths, public parks and gardens, informal recreational areas, etc are assets for which public users make no direct payment for access or use. Some regard such “assets” as being incapable of reliable measurement because:
i) neither the historic nor the current cost normally has any relevance or correlation to a measurable benefit to the owner and
ii) there are no actual or implied revenues, such as a reliable proxy or cost saving, that can be attributed the asset.

a) Do you consider that all specialised are capable of reliable valuation, or that some such assets should be declared as incapable or unsuitable for valuation?

RICS considers that some specialised public service assets should be treated according to an appropriate convention – whilst this may be akin to declaring them as incapable or unsuitable for conventional valuation, it more accurately recognizes circumstances where a value (positive or negative as appropriate) nevertheless needs to be ascribed. In the UK this point is covered in the CIPFA Code by including a class of assets as “Community” where the value is historic cost or nil. But generally, the RICS questions the merits of seeking to place a value on adopted roads and dedicated public parks except where there is part unrestricted value (e.g. parks may include licences or franchises for seasonal occupation of distinct structures or areas).

b) If you have experience of valuing assets such as those identified in this question, please describe the type of asset valued and briefly describe the method or methods used.

This really depends on individual facts and circumstances. Assets such as publicly adopted roads (i.e. those to be maintained at central or local government expense) and dedicated public parks (except where there is part unrestricted value) generally have no special value and indeed they could even be said to be a liability to the local authorities that are responsible for them.
In the UK, under the CIPFA Code, some assets are classified as “community assets” or “infrastructure assets” and are therefore held at cost rather than current value. This applies to assets such as highway infrastructure, parks and open spaces. And under the UK Government’s Whole of Government Accounts all assets are required to be valued - for the past three years highway infrastructure assets have been valued by UK local authorities on a DRC basis, with the condition of components within the network being used as a proxy for difference between GRC and DRC. CIPFA consulted in 2012 on adopting this concept for local authority financial statements and it is currently considering the consultation responses.

5. It is proposed that the current Annex to IVS 230 Historic Property be included in this TIP and deleted from the IVS. The rationale is that many historic and heritage properties are used for providing a public service. The historic features are a form of specialism as they can often limit or constrain the use of these properties. As a consequence it is felt that many of the valuation considerations that apply to specialised public service assets also apply to historic and heritage properties and that it is more appropriate to present the guidance here than as an adjunct to IVS 230.

Do you agree with this position?

RICS do not see any advantages to incorporating Historic Property in this TIP. Many historic and heritage properties are neither publicly owned nor used to provide a public service.

However where a historic or heritage property is being used for providing a public service and the asset is of a specialised nature then, in the UK, DRC will be adopted as the approach to valuation by local authorities. Guidance from CIPFA and RICS is clear in that, given the Modern Equivalent Asset (MEA) approach required to be adopted for DRC based valuations, reflecting the historic or heritage nature of the construction will in the main be ignored by the valuer as a modern form of construction will be assumed - the only exception to this being where the historic or heritage nature of the asset is intrinsic to its use.

6. Paragraph 36 of the draft proposes that four principal categories of specialised public service assets can be identified, and provides examples of types of asset that fall within each of these categories.

a) Do you agree with the categorisation proposed?

RICS do not see the need to categorise assets, where in any event a different view may be taken across different jurisdictions. For example, in the UK the CIPFA Code of Practice is the overriding guidance on asset categorization for local authorities.

b) Do you find the categorisation and examples to be helpful?

Whilst RICS can see that a list of the major categories of specialised asset can provide a point of reference it is difficult to see that this could ever be comprehensive from an international perspective. And while transport and utilities infrastructures can possibly be distinguished from
the remainder of the built environment and other infrastructures, RICS cannot see any advantage per se in distinguishing between organizations.

c) Do you consider that there are either any significant omissions or asset types that should be excluded?

Inter alia, RICS is concerned that leisure centres are excluded, in particular, the detailed justification in para 49. Public sector leisure centres are not like other fitness suites, etc, even where the latter have swimming pools. In the UK, many Local Authorities have leased their facilities to leisure trusts, but normally at nil or very concessionary rents. Therefore we cannot see how, therefore, leisure centres can be valued at anything other than DRC.

In respect of the detailed content of the Exposure Draft, RICS would make the following comments corresponding to the numbered paragraphs reproduced below in italics:

13. Valuations of public service assets may be undertaken as an input to or for a range of purposes including:

- Inter-departmental transfer
- Privatisation
- Monopoly pricing
- Cost-benefit or economic analyses, (to determine whether a public service asset is being used and managed efficiently)
- Financial reporting

- RICS would favour “Strategic asset management and option appraisal” being added to this ‘range of purposes’ list.

23. An additional factor that needs to be considered when considering the highest and best use in the context of a public service asset is that most entities providing public services are mandated or directed by government or other legal requirements to continue to provide the services for which the asset is required. This means that there is often a stronger presumption that the public service use of the land will continue to the exclusion of potentially higher value uses than would be the case with a private use.

- RICS think that this presumption is too broad brush as it does not apply to local authority assets. For example, in the UK none of the cultural, sports and recreational infrastructure listed are mandatory services (except National Parks) – neither are cemeteries.

29. All three principal valuation approaches identified in the IVSC Framework may be applied to value specialised public service assets. However, the specialised character and public service use often create difficulties in applying the market approach. Specialised public service assets are rarely traded, except by way of internal transfer between government bodies, or as part of a privatisation project. The specialised features, whether they be the design, specification or location of the asset mean that reliable comparisons can rarely be made with the prices of similar assets in the market.
➢ In principle this is correct, though one must always look to the individual facts and circumstances. As noted above, RICS would argue that leisure centres fit into this description, particularly if they include a large swimming pool.

Yours faithfully

[Signature]

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