DUFF & PHELPS

IVSC

March 1, 2013

Response to IVSC Exposure Draft Valuations of Specialized Public Service Assets

Responses to Specific Questions

Question 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?

Duff & Phelps response: We agree with the view that it is the characteristics of the asset that are relevant for the valuation. However, we believe that the current service the asset provides could be misleading in a valuation analysis (similar to the distinction between the for-profit vs. not-for-profit standing of the asset owner). If an income approach is to be applied, then the historical income, off of which projections are developed, might be incorporated into the analysis without due adjustment to reflect the asset's potential income rather than its current use.

For example, a non-for profit owner may be realizing cash flows from operating the asset, but these cash flows may not be representative of the full income generating potential of the asset. Likewise, a for-profit owner may be operating the asset sub-optimally. In either situation, it may be possible to develop pro-forma projections that a buyer could reasonably expect to generate. *The common thread in these situations is identifying the highest and best use of the asset*, which will form the basis for the pro-forma projections.

Our recommendation is therefore, that in addition to taking the asset perspective, the Board should emphasize that the highest and best use of the asset would govern the valuation, regardless of its specialized present purpose. This will guide the choice of valuation method and assumptions used in estimating the value of specialized public service assets.

Question 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?

Duff & Phelps response: While we agree with the statements above, we think that the ED is limited in that it only focuses on market value and investment value. It does not recognize the fact that valuations of specialized public service assets may be performed for other purposes as well (for example, for insurance), in which case a different basis of value may be required.

Further, the ED should acknowledge that jurisdictional requirements may exist which would call for the use of prescribed inputs and calculations, such that the result is something other than investment value or fair value.

Question 3

The proposed guidance makes a distinction between measuring the value of the asset and measuring the social value, ie 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.

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?

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

Duff & Phelps response: We have not encountered situations in which the social value of the asset needs to be measured. As noted in the ED, such value does not accrue to the asset or its owner.

Question 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 measureable 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 public service assets are capable of reliable valuation, or that some such assets should be declared as incapable or unsuitable for valuation?

Duff & Phelps response: We believe that all specialized public service assets are capable of reliable valuation. In particular, in the examples provided above whereby the Cost Approach or Income Approaches could not be applied as stipulated, one might consider a Market Approach. In concept, the valuation task may be no different than when valuing an easement and considering the contiguous uses of the area.

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.

In general, all valuation approaches would be considered. While a Cost Approach may be used traditionally for these types of assets, it would be supplemented with a Market Approach based on the highest and best use of the asset, and a pro-forma Income Approach, where possible.

In other words, the specialized use of the asset does not eliminate the consideration of its highest and best use, which may be different than the asset’s current use.

Question 5

It is proposed that the current Annexe 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 proposal?

Duff & Phelps response: We have no objections to including the guidance on historic property in this TIP. As we stated earlier, the starting point in the asset's valuation should be its highest and best use, regardless of the asset's specialized current use. However, the distinguishing point with historic property is that an alternative use may not be legally permissible. This may also impact the approaches that could be applied in valuing the asset.

Question 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?

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

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

Duff & Phelps response: We have no objections to the categories provided and the examples of assets therein.