

The Valuation of Specialised Government Property

Preliminary Project Brief

The IVSC Professional Board has approved a project to consider the development of standards and or guidance for the valuation of specialised property and infrastructure assets held in the public sector. It wishes to form a working group of suitably experienced individuals to assist in the development of the project.

BACKGROUND

The need for public sector assets to be valued is increasing around the world. Increasingly governments are requiring public sector entities to produce accounts in accordance with IFRS or IPSAS, and this includes a requirement to carry certain assets at their current value. Valuations are required for purposes other than financial reporting; including privatisation of government operations and for computing inter-departmental payments in lieu of taxation.

Although many assets held by public sector entities are similar to those held in the private sector and are exchanged sufficiently frequently to create readily available evidence of current values, the public sector also owns many specialised assets which are rarely, if ever, exchanged in the market. Also, such specialised assets are frequently held for the provision of a public service that does not generate income or any other directly tangible benefit.

Evidence has been provided to IVSC of considerable diversity in practice and also of disputes between different government entities as to how such specialised assets are to be valued.

The International Valuation Standards (IVS) contain principles that apply generally to the valuation of all asset types, including those in the public sector. The current standards contain two annexes which are of specific relevance to public sector assets. There are:

Annexe to IVS 230 *Real Property Interests – Historic Property*

Although historic properties may be publicly or privately owned, the restrictions and obligations that are frequently associated with the use of such property are similar to those affecting specialised government properties.

Annexe to IVS 300 *Valuations for Financial Reporting - Property, Plant and Equipment in the Public Sector*

This annexe provides a brief overview of the problems associated with the valuation of public sector property, plant and equipment and gives guidance on the provisions in IPSAS 17 and 21 on how some of these issues may be addressed in financial reporting.

The IPSAS Board is currently undertaking the Public Sector Financial Reporting Conceptual Framework Project which includes a review of the way in which public sector assets and liabilities should be measured. The advantages and disadvantages of different measurement bases are being considered as part of this review and the consultation papers issued to date recognises that there are difficulties in valuing specialised assets that may affect the credibility or relevance of this as a measurement basis. The IPSAS Board is interested in the IVSC project as the outcome could help inform its own deliberations.

TOPICS FOR EXAMINATION

Valuations of specialised public sector properties present some unique challenges when compared with other asset classes. These will include, but be not limited to:

Economic value v community or social value

Most common valuation situations call for the determination of market value (an economic value concept). Some argue that traditional economic value concepts fail to properly recognise the value of many government owned assets to the community. Measurement bases that are considered in this context include socio-economic value and social value.

Various socio-economic value models have been developed by economists and planners. These valuation models generally include all internal and external economies such as job markets, income generation, spin-off multipliers, etc. They tend to focus on justifying investments in terms of the wider economy and not on the economic value of the investment per se.

Although the larger socio-economic valuation models provide a good overview of the economic effects of cash flow plus intrinsic values, some argue that they do not assist the best practice of valuing the underlying asset because the modelling is too wide-ranging. The value of the underlying asset is not separable from the total economic impact.

Community or social value is created when resources, inputs, processes or policies are combined to generate improvements in the lives of individuals or society as a whole. Most governments operate in this area. However measuring community or social value is problematic because it reflects non-monetary concepts.

It is possible therefore that some guidance may be required to help practitioners and asset owners determine the most appropriate measurement basis having regard to the purpose for which the valuation is intended.

Highest and best use v economic use

A related issue that arises when valuing land owned by government entities is that the restricted use to which the government entity puts that land may be a sub-optimal economic use. By way of example, in the case of wilderness areas in national parks, the use of that land for say, the forestry industry or mining, may reflect the optimal economic use of that land. This issue arises for many other restricted use land such as cemeteries, land under roads, rail corridors, parks and gardens, etc.

According to some, the value of restricted use land should be set in the context of its value under those other competing uses. When the lands are acquired they are taken out of economic production. Taking them out of such production will require the buyer to pay at least the going rate for that particular type of land. Alternatively there is an argument that restricted use land has a low value due to the use restrictions placed on that land.

Does the cost to acquire land to remove it from its optimal economic use equal value once restrictions on its use are imposed on or by the acquiring entity (effectively removing the possibility of the optimal economic use)? Or put another way, should restricted use land be valued on the basis of its existing use or some alternative optimal economic use?

Reproduction cost v replacement cost

The depreciated replacement cost method (DRC) is commonly used in to value specialised assets. Fundamental to the DRC method is the assumption that the starting point for the calculation should be the lower of reproduction cost and replacement cost. However in the case of historic properties, the question arises as whether adoption of replacement cost adequately reflects value where part of the historical value of the property lies in its original design and construction. This point is addressed in para 47 of IPSAS 17 (referenced in the Annexe to IVS 300).

Economic obsolescence v service potential

When using the DRC method in the private sector, the need to adjust for the replacement cost for any economic obsolescence suffered by the subject asset can usually be determined by financial metrics. In the public sector this is rarely possible and therefore an equivalent adjustment is to consider the “service potential” of the asset, ie its capacity to continue to provide the goods or services in accordance with the entity’s objectives.

Cash generating v non-cash generating

Some government entities are for-profit entities and some are not-for-profit entities. This situation gives rise to a number of questions.

Firstly, does the status of a government entity as either a for-profit entity or a not-for-profit entity have an impact on the value of that entity’s assets? By way of example, rail infrastructure owned by a for-profit government business enterprise may be valued using the DRC method including economic obsolescence. However rail infrastructure owned by a not-for-profit government entity may be valued using the DRC method excluding economic obsolescence.

Whilst the underlying assets may be identical, the funding model under which each entity operates can have a significant impact on their value. It is not uncommon for this situation to exist within a single country. This fundamental difference in the measurement basis can give rise to significant differences in reported values.

The same anomalous situation can arise where a public service (such as public transport, prisons, healthcare, etc.) is partially privatised. For example a correctional centre owned and operated by a private sector entity will logically generate positive cash flows whereas an identical facility in government ownership will likely be funded to operate at break-even. If both assets were valued using the income approach the valuation outcomes would likely be quite different.

THE IVSC PROJECT

The overall objective of the project is to:

1. review and update as necessary the current Annexes to IVS 230 and IVS 300,
2. produce a new Technical Information Paper (TIP) or Papers providing guidance on the valuation of Specialised Government Property.

The working group shall follow the IVSC Due Process in developing this project.

An IVSC TIP provides authoritative but non-mandatory guidance designed to be of assistance to valuation professionals and informed users of valuations alike. It can examine methods identified in a Standard in greater depth and illustrate their application. A TIP guides rather than instructs. It does this by providing information that is helpful to practitioners in exercising the judgements they are required to make during the valuation process, but should avoid anything that would restrict the proper exercise of that judgement by the imposition of inappropriate rules. A TIP should not direct or require the use of a particular method in specific circumstances but can include discussion of factors that should be considered when deciding which method it is appropriate to use. A TIP should also focus on practical issues rather than underlying theory and as such is not intended to provide comprehensive training or be an educational document.

The project can be divided into three stages. The suggested tasks for each stage are:

Stage 1

- a. Consider the relevance of the Annexes to IVS 230 and IVS 300 to the valuation of Specialised Government Property and make recommendations for any modifications, including whether it is better to remove the annexes from IVS and include the matters addressed in Technical Information Papers. (TIPs)
- b. Research into the extent to which publicly owned specialized assets¹ are currently valued in different parts of the worlds and for what purposes.
- c. Identify the bases of value used for different purposes.
- d. Identify the extent of divergence of existing practice.
- e. Identify any significant existing guidance produced on valuing this type of asset.
- f. Consider whether separate guidance is required for valuations for financial reporting and other purposes such as tax assessment.
- g. Report with recommendations to the IVSC Professional Board.

Stage 2

- h. To prepare Exposure Draft for consultation. This may include presenting alternative approaches identified and inviting respondents to comment on these.
- i. Present the above to the IVSC Professional Board for approval.

Stage 3

- j. To review comments received on the Exposure Draft and produce analysis for IVSC Professional Board.
- k. To provide any assistance requested in preparing document for final approval and publication.

¹ Specialised assets for the purpose of this project are land, buildings, structures or equipment that are owned by government or other public sector bodies for either the delivery of a public service or for the public benefit and that are not similar to assets that are bought or sold between private sector bodies in an open market.