May 30, 2011

Jean-Florent Rerolle
Chairman
International Valuation Professional Board
41 Moorgate
London EC2R 6PP
United Kingdom

Dear Mr. Rerolle:

I am writing on behalf of the Appraisal Institute of Canada in response to your request for comments on the exposure draft, Technical Information Paper 2, Depreciated Replacement Cost

As you may be aware, the Appraisal Institute of Canada (AIC) is the leading professional real property valuation organization and standards setter in Canada. The Institute is a founding member of the International Valuation Standards Committee and a long-time supporter of the IVSC. The AIC publishes the Canadian Uniform Standards of Professional Appraisal Practice (CUSPAP) and confers its professional designations on members that fulfill its educational and professional requirements.

The comments provided are from a real estate and tangible valuation perspective.

With respect to question 1, we are in agreement with the statement that the cost approach, if properly applied, can be used as a method to arrive at market value for a variety of purposes other than financial reporting.

With respect to question 2, we support the view that that depreciated replacement cost is the most common method of valuation under the cost approach to value.

With respect to question 3, as related to the cost approach to value and one of the 3 forms of measurable depreciation, we are of the view that External depreciation best describes this generally incurable and negative influence outside the site. External depreciation can be caused by numerous factors such as location within a community, industrial area, transportation infrastructure; local market conditions and declines in neighbourhood, legislation etc. External/Economic obsolescence, as a title, may cover all concerns.

Regarding question 4, we are in agreement.

Highest and Best Use (HABU)

Highest and Best use is fundamental to real property value and its inclusion and analysis within all three approaches to value, including the Depreciated Replacement Cost (DRC) is seen as essential to measuring the property’s market value.

When the purpose of an appraisal is to estimate market value, the highest and best use analysis identifies the most profitable, competitive use to which the property can be put. Therefore, highest and best use is a market-driven concept. (i)
Under “Bases of Value” bullet point 56, this exposure draft; it is respectfully submitted that the words (it shall) replace (it may).

“When a market basis of value is required it shall also be necessary to consider the highest and best use of the subject asset is for the existing or an alternative use.”

Should an alternative use be identified, then a re-examination of the best approach to utilize for valuation may also be appropriate.

For reference: Excerpts from Canadian Uniform Standards of Professional Appraisal Practice (CUSPAP)

12.34 Highest and Best Use [see 6.2.14]
12.34.1 May be defined as:
"That reasonably probable and legal use of vacant land or an improved property which is physically possible, appropriately supported, financially feasible, and that results in the highest value."
12.34.2 The highest and best use of a property is an economic concept that measures the interaction of four criteria: legal permissibility, physical possibility, financial feasibility, and maximum profitability.
12.34.3 Estimating the highest and best use of a property is a critical appraisal component that provides the valuation context within which market participants and appraisers select comparable market information.
12.34.4 An appraiser considers highest and best use of the property as if vacant separately from the highest and best use of the property as improved. This is because the highest and best use of the site as if vacant and available for development determines the value of the land, even if the property’s existing improvement does not represent the highest and best use of the site.
12.34.5 Highest and Best use of land or a site is the use among all reasonable alternative uses that yields the highest present land value, after payment for labour, capital and co-ordination. The conclusion assumes that the parcel of land is vacant or can be made vacant by demolishing any improvements. 12 Practice Notes Canadian Uniform Standards of Professional Appraisal Practice Effective 01/01/2010 64
12.34.6 If for valid reason, as explained in the report (e.g. rent review, value in use, insurance coverage,) a highest and best use is irrelevant; no Extraordinary Limiting Condition is required.

Sincerely,

Paul Olscamp, AACI, Fellow
Past President and IVSC Representative