International Valuation Standards Council (IVSC)

Discussion paper

The Valuation of Trade Related Property

Response of the
Royal Institution of Chartered Surveyors (RICS)

Contact:
Lorraine Howells MRICS
RICS Associate Director Valuation Professional Group
lhowells@rics.org

Jeremy Blackburn
RICS Head of UK Policy
jblackburn@rics.org
Introduction

The Royal Institution of Chartered Surveyors (RICS) has noted the publication of the Discussion Paper – The Valuation of Trade Related Property – produced by the International Valuation Standards Council (IVSC) in August 2012 and welcomes the opportunity to comment.

About RICS

RICS is the global leading organisation for professionals in real estate, land, construction and related environmental issues as well as working in the personal property and business assets sectors.

Over 120,000 RICS members, who are Chartered Surveyors, exist globally and operate out of 146 countries, supported by an extensive network of regional offices located in every continent. RICS Headquarters is based in London and our international work is supported by a network of regional offices and national associations.

RICS members play a vital role throughout the entire asset life cycle – from initial inspection and measurement, development through to investment in, and the use of physical structures and other assets, as well as financial and business interests. We also provide impartial advice to governments, policymakers and non-Government organisations.

RICS is an independent professional body, which was established in 1868 and has a UK Royal Charter. It is committed to setting and upholding the highest standards of excellence and integrity, providing impartial and authoritative advice on key land and asset issues affecting businesses and society.

RICS is a regulator of both its individual members and firms enabling it to maintain the highest standards and providing the basis for unparalleled client confidence in the sector.

The general ethical principles for all RICS regulated members and firms are set out in our professional and ethical standards to which the following is an extract:

Act with integrity – Be honest and straightforward in all that you do

Always provide a high standard of service - Always ensure your client, or others to whom you have a professional responsibility, receive the best possible advice, support or performance of the terms of engagement you have agreed.

Act in a way that promotes trust in the profession - Act in a manner, both in your professional life and private life, to promote you, your firm or the organisation you work for in a professional and positive way.

Treat others with respect - Treat everyone with courtesy, politeness and respect and consider cultural sensitivities and business practices.

Take responsibility - Be accountable for all your actions - don’t blame others if things go wrong, and if you suspect something isn’t right, be prepared to take action.
RICS and Valuation Standards

A significant proportion of our members are involved in valuation practice on all manner of assets. The first RICS Valuation Standards was produced in 1976 and the current standards are the “RICS Valuation – Professional Standards” effective from 30th March 2012. The standards are commonly known as “the Red Book” and contain mandatory rules and best practice guidance for valuations of real estate and other assets.

RICS adopts the International Valuation Standards (IVS) 2011. Those reports that comply with the Red Book are deemed to comply with IVS. This is particularly relevant where valuations are provided for inclusion in financial statements that comply with International Financial Reporting Standards (IFRS). The adoption of IVS in the Red book provides an implementation and practice framework for the application of IVS globally, ensuring that RICS members follow consistent methodologies throughout the world.

The Red Book is mandatory for all RICS members and regulated firms worldwide when carrying out Red Book specific valuations. It is also widely referred to by non-RICS valuers, Members who carry out Red Book valuations in the UK are also required to register with RICS as a “RICS Registered Valuer”. They are then subject to compliance monitoring.

The global section of the Red Book comprises a broad ethical framework which can be applied to valuations of any asset type in any jurisdiction, in harmony with national legislation. They comprise a framework for the following:

- Compliance, competence, independence and ethical requirements;
- Terms of engagement;
- Valuation bases (global);
- Valuation applications;
- Investigations, inspections and verification of information; and
- Valuation reports.

More specifically the standards relating to application, competence, independence and objectivity are set out in Valuation Standards VS1.2-1.9.

The global standards are accompanied by detailed national standards.

For more information please visit http://www.ricsvaluation.org/
Detailed response to the Discussion Paper

You have requested that responses to this consultation paper are set out as answers to specifically posed questions.

Question 1

a) Are you familiar with the former GN12?

RICS is familiar with the former GN12

b) Is GN 12 used in the valuations that you provide or receive?

GN12 is not specifically referred to in valuations provided by RICS members, who have regard to the principles and concepts set out in RICS Guidance Note (GN)2.

c) If you have answered yes to either of the above, what are the elements of GN 12 that you find useful in either reporting or interpreting valuations

GN12 acknowledges the fact that trade related property is normally valued using the profits method of valuation, unlike most other forms of property asset.

In general, GN12 is a good document which explains the overall position. However, it has given rise to confusion with regard to goodwill, for which the definition in IVS 2011 - and further explanation in the Commentary C10-13 to IVS 210 - is in point.

As C16 of IVS 230 recognises, and RICS GN2 explains in greater detail, the valuation of the (tangible) asset reflects the property’s (inherent) trading potential. Such properties may be bought and sold on their own or – more commonly – as part of a business. Where the latter is the case, great care is required on the part of the valuer to identify clearly the assets – both tangible and intangible – involved, and to avoid any duplication in the valuation process. As GN2 underlines, matters personal to the current operator of the business will generally need to be excluded.

Question 2

Do you consider that it is a) practical and b) necessary to define a distinct category of real property for valuation purposes based on the degree to which the buildings or any other structures are specialised?

The key issues with regard to trade related property are firstly, that the property asset has been specifically built or substantially adapted for a specific use, and secondly, that such properties are usually bought and sold in the marketplace based upon trading potential – often, but not invariably, being transferred from one owner or operator to another as an integral part of a business.
It is relevant for guidance to acknowledge that such properties are valued adopting the profits method of valuation. We do not consider it necessary to go further in defining the category, which in any event does not necessarily have fixed boundaries (see answer to question 4 below). Nor do we consider that a separate, self-contained IVSC standard for trade related property is justified. A small section on the profits method of valuation is already incorporated in IVS 230 ‘Real Property Interests’ – this could be modestly expanded if further explanation were felt to be needed, but the focus should remain on high level principles rather than detailed practice.

**Question 3**

If you have answered yes to Question 2, do you consider that the term “Trade Related Property” adequately conveys the particular characteristics that may lead a valuer to adopt a different valuation method as compared to other types of property?

We consider that the term ‘Trade Related Property’ should continue to be adopted as it adequately conveys the particular characteristics that may lead a valuer to adopt a different valuation method as compared to other types of property. It is a matter of fact and degree in each instance, and the valuer must adopt the valuation method or approach most appropriate to the circumstances found.

**Question 4**

If you have answered yes to Question 2, please also indicate the types of real property that should be included in distinct category.

We believe that the current guidance which gives examples, i.e. hotels, theatres and fuel stations, is adequate. There can be no rigid categorisation eg some, but not all, self-storage facilities are valued on this basis.

**Question 5**

If you have answered no to Question 2, are there any other characteristics other than the specialisation of the buildings or structures that you believe may require Trade Related Property to be separately categorised from other real property for valuation purposes?

Yes – as well as the buildings being specially built or adapted for a specific use, the other key attribute of trade related property is that such properties are usually bought and sold in the market based upon trading potential.

**Question 6**

Are you familiar with the “profits method” as outlined above to value TRP? If so please indicate the types of real property where you are familiar with its application.

RICS members specialising in the valuation of trade related property are familiar with the profits method as outlined in paragraphs 8 – 12 of the discussion paper. The main types of property that are valued by the profits method include hotels, theatres, cinemas, public houses, restaurants, petrol filling stations, care homes, tourist attractions and leisure assets. This is not an exhaustive list. Other assets, such as self storage facilities, are now also commonly valued on this basis.
Question 7

What methods do you normally use to allocate value to the real property interest? Do you apply the same method regardless of the type of real property involved?

In general, trade related property valuers will only apportion an overall valuation between constituent assets on an informal basis, unless there is a specific need to do so and/or specific market evidence is available. No two cases are the same. The valuer uses experience and such market evidence, direct or indirect, as there may be to support any apportionment, depending on the particular circumstances.

Question 8

In your experience what sources of data are available to support the use of either the profits method or an allocation to the real property from the value of the business in occupation? How reliable are these?

RICS is not aware of general and consistently reliable sources of data to assist allocation to the real property interest from the value of the interest in the business, which may of course extend across more than one property. Any informal allocation is done on a case by case basis. The aim of RICS GN2, if correctly applied, is to arrive at a value of the relevant interest in the real property which reflects its inherent trading potential – this should not include the (additional or separate) value of the actual business in occupation.

Question 9

Do you consider that the general provisions in the IVSs concerning identification of the asset to be valued and clarification of the assumptions made about complementary or associated assets are sufficiently clear for application to TRP or do you believe that the IVSs should provide more specific guidance? If you believe that more specific guidance is required, please indicate the types of TRP where you believe that this is needed.

Yes, the general provisions are sufficiently clear.

Question 10

Please indicate any techniques with which you are familiar for ensuring that the value of the real property interest excludes any value attributable to other assets.

As mentioned in Question 7 above, valuers will normally only apportion an overall valuation between the constituent parts (or, more strictly, assets) on an informal basis, unless there is an express requirement and/or specific market evidence is available. No two cases are the same. The valuer uses experience and market evidence to support any apportionment depending on the particular circumstances, and must make very clear to what assets those apportioned figures relate.
Question 11

Please indicate for what purposes you consider that a valuation of a TRP should be made on the assumption that it is part of a going concern and for what purposes it should be made on the assumption that there is no business in occupation.

As mentioned in paragraph 10 of the discussion paper, the profits method uses a hypothetical business to replicate a market participant’s likely view of the inherent trading potential of an interest in the real property rather than a valuation of the business actually in occupation, thus it can be applied to unoccupied or proposed new buildings, as well as to those that are fully operational.

Individual trade related properties are not valued as “going-concerns”, they are valued as either fully operational or available for occupation for trade related use.

Question 12

Do you agree that the value of the real property interest is affected by whether or not there is a business in occupation?

Yes, subject to the facts and circumstances of individual cases. The basic hypothesis for a profits method valuation is “fully operational”. Where a property to be valued is actually unfitted, unlicensed and/or in disrepair, or the business has ceased trading, the valuer will reflect the actual circumstances depending on the state of the market. This will usually be addressed with detailed explanation.

Question 13

If you are a user of valuation reports, in your experience, is the distinction between the business and the property interest normally clear from the reports that you receive?

No comment

Question 14

If you are a provider of TRP valuations, what steps do you take to distinguish the business from the real property interest?

It is common in today’s market for secured lending specialists to require the valuer to provide the:

1. Market Value of the property on a fully operational basis; and
2. the Market Value subject to assumptions: that the business has ceased trading; that no accounts would be available to a prospective purchaser; and that the trade fixtures and fittings have been removed.

The report should clearly set out the asset(s) included in the valuation. The valuation is usually reported as an inclusive sum.
Where it is necessary to distinguish between the business and the real property interest, as with an allocation of a going-concern price which may reflect other business assets and liabilities, it is done by informal allocation of the constituent parts of the valuation.

**Content of IVS 232**

Paragraph 18 of the discussion paper specifically asks if the respondee is supportive or otherwise of the content of the former GN12 and the draft of IVS 232 that was not approved.

RICS does not consider it necessary for there to be a “Standard” on the valuation of trade related property in so much that the difference between this sector and other real property sectors relates to the method of valuation. If there is a specific standard for trade related property then one might question why there is not for other real property sectors.

This is underlined by the original draft of IVS 232, which – so far as the standards material as such is concerned, namely paras 2-5 - really only reinforces points that are already made elsewhere in IVS 2011. If it was felt beneficial to make them, then a modest expansion of the relevant part of IVS 230 might be the simplest way to encompass them.

Whilst RICS otherwise has no comments to make on the draft Standard ie IVS 232 itself, it would like to offer some comment on the Commentary (paragraphs C1-C9).

**C1 –**

a. “A trade related property is any type of real property designed for a specific type of business where the property value reflects the trading potential for that business.”

RICS considers whether this would cause confusion as to whether this is an identified business or a hypothetical operational unit. To avoid this, it would read better as:

“A trade related property is any type of real property designed for a specific type of business where the property value reflects the trading potential.”

b. “It can be contrasted with generic real property that can be occupied by a wide range of different business types, such as standard office, industrial or retail”.

This would read better without the term “standard”.

c. “referred to in this standard as the “operational unit”

Is there, or rather should there be, a definition of operational unit?
C3 –

We believe the inclusion of the reference to “goodwill” in this section may cause confusion. It would be better if greater emphasis – and clarity – were placed on the nature of the valuation task ie whether one is looking to establish the value of a business (see IVS 200) and/or of an intangible asset (see IVS 210) and/or a real property interest (see IVS 230).

We are also concerned that confusion may arise between the phrase “operational unit” in C1 and “entire operational unit” in the last paragraph of C3. The last sentence would read better as:

“If the valuation required is of the business and business interests, reference should be made to IVS 200 Businesses and Business Interests”.

C5 –

This paragraph is useful but would read better if the last sentence was removed:

“the market approach may therefore be a less reliable indicator of value than the income approach but can be a useful check on the income approach”.

C7 –

Including examples in a list often leads the reader to believe that these are the only things to consider whilst in fact this is not an exhaustive list. Re-phrasing the point as

“Examples of adjustments may include”

- would prevent this.

**Conclusion**

RICS would welcome the opportunity to provide further input to IVSC’s deliberations drawing on the practical experience of its members worldwide if that might assist.