



INTERNATIONAL VALUATION STANDARDS COUNCIL

Investment Property

Discussion Paper

Comments on this Discussion Paper are invited before 1 March 2013. All replies may be put on public record unless confidentiality is requested by the respondent. Comments may be sent as email attachments to:

CommentLetters@ivsc.org

or by post to IVSC, 41 Moorgate, LONDON EC2R 6PP, United Kingdom.

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Introduction to this Discussion Paper

At present IVS 233 *Investment Property under Construction* (IPUC) is an anomaly among the standards in the 200 series. The other “Asset Standards” all deal with generic asset classes. IVS 233 deals not only with a specific subset of an asset class but is limited to one type of valuation which is only likely to occur at the beginning of the asset’s life. The reason for this was that evidence was brought to the Board of inappropriate techniques being promulgated following the International Accounting Standards Board (IASB) amending IAS 40 in 2008 to require IPUC to be reported at fair value rather than cost provided fair value can be reliably determined. Some have argued that IVS 230 *Real Property Interests* obviates the need for a separate IVS on investment property, but the European Public Real Estate Association (EPRA) argues that it “cannot deal with some of the unique issues that cause inconsistency in the valuation practices for investment property” and therefore a separate standard is needed.

A good case can be made for IVS to include a standard dedicated to investment property on account of the size of the market, its role as an important investment class that is widely used directly and indirectly by the public and the fact that the IASB has a dedicated accounting standard – IAS 40 (and the FASB is considering introducing one).

This case has been highlighted by recent representations to the IVSC made by EPRA for the development of a specific standard for investment property. This has also been supported by the British Property Federation and also the Asian Public Real Estate Association. Discussions with National Association of Real Estate Investment Trusts, the trade association for real estate investment trusts in the USA, and major auditing and consulting firms have also revealed interest in a global standard for investment property.

EPRA’s request to the IVSC to consider an IVS for investment property is based on the belief that such an IVS would “play a crucial role in improving the consistency of valuation practices across countries as well as help to maintain or enhance the quality of valuations globally.”

The increasing reliance on fair value reporting for investment property, and the growing regulatory requirement for more frequent real estate valuations, are the key trends that argue for an examination of investment property valuations.

EPRA highlights a number of areas where their members have experienced diversity in the approaches taken to the valuation of investment property. These are included in the list of issues in the following section. EPRA believes that the benefits to be derived from a new IVS or guidance on the valuation of investment properties would include:

- Consistency of approach and greater transparency
- Clarity on contentious issues (eg, transaction taxes and hope value or redevelopment potential)
- Improvement in the balance of IVS that currently gives too much weight to IPUC
- Compliance with IFRS 13 and the US equivalent
- Demonstration of support for adoption of the fair value model for investment property

The IVSC Standards Board therefore agreed to set up a dedicated project on investment property and set up a Working Group comprising twenty experts from Europe, North America and Asia-Pacific, comprising valuers, investors, users and academics. The project is tasked with determining whether a dedicated IVS for investment property is required and if so to develop it and to consider the need for and develop any associated technical guidance to support the standard.

This Discussion Paper is the first stage of the project. It sets out a number of issues that the Board has identified and invites responses from all those with an interest in valuation of investment property, including developers, valuation consultants, investor groups, financiers and those with a regulatory role that is impacted by valuation.

Notes for respondents:

In order for us to analyse and give due weight to your comments, please observe the following:

1. Responses should be made in letter format, where appropriate on the organisation's letter heading.
2. Comments should not be submitted on an edited version of the Exposure Draft.
3. Unless anonymity is requested, all comments received may be displayed on the IVSC website.
4. Comments letters should be sent as an email attachment in either MS Word or an unlocked PDF format and no larger than 1mb. All documents will be converted to secured PDF files before being placed on the web site.
5. The email should be sent to commentletters@ivsc.org no later than 1 March 2013

DISCUSSION PAPER

THE VALUATION OF INVESTMENT PROPERTY

1. Project Scope

1.1. Definition of investment property

1.1.1. IVS 233 defines investment property as “property that is a land or building, or part of a building, or both, held by the owner to earn rentals or for capital appreciation or both, rather than for:

- a) use in the production or supply of goods or services or for administrative purposes, or
- b) sale in the ordinary course of business.”

1.1.2. This definition is the same as that in IAS 40 and reflects the origins of the IVS as a response to the need to address a valuation issue specific to that accounting standard.

1.1.3. However, while there are benefits in the IVS using a consistent definition to that in IAS 40 there is some concern that the definition may not be optimal for non-financial reporting purposes such as transactions or asset management, the exclusions may not be appropriate. For instance, 1.1.1.a) makes sense in the context of the accounting standards as it relates to the use of the property by the entity preparing the financial statements, but a valuation standard is addressing the type of asset, not how it is used by a particular entity. Investment property is normally used for one of the excluded purposes by the occupier and therefore the exclusion is potentially confusing for purposes outside of financial reporting. Likewise, 1.1.1.b) excludes property for sale in the ordinary course of business but this would appear to exclude some types of property generally recognised as being held for investment purposes, eg land held for future development or sale (“development land”).

1.1.4. Others argue that the IAS 40 definition is inadequate to cover all possible investments by REITs and funds, such as healthcare facilities, trade-related properties, cell towers, etc.

1.1.5. The tentative view of the Board is that while the first part of the current definition may be adequate and appropriate, the exclusions in a) and b) may be too specific to accounting and may need to be amended or removed for valuation purposes.

Questions:

- 1 Do you think that the current definition should be retained in full or that an amendment to the definition in IVS 233 is required?**
- 2 If you believe it should be retained in full, what guidance should be given to valuers when valuing for the non-financial reporting purposes referred to above?**
- 3 If you believe an alternative definition is warranted, please give reasons and suggest appropriate wording.**

1.2. Assets to be included

- 1.2.1. Apart from the principal real estate elements of buildings and land together with their fixtures and fittings, there is debate on how certain items attached to or associated with the property should be reflected in valuations of investment property. While many would concur that items such as goodwill, intangibles and inventories should either be excluded or valued separately from the property interest, some have argued that inclusion is also possible (and, in some cases, necessary – eg, where rights to such assets are included in leases of property), provided it is made clear exactly what has been included and what value has been ascribed to those elements.
- 1.2.2. By way of example, an investor may lease a hotel to an operating company and the lease includes the rights to use a particular title or brand. The lessor may also provide certain services, eg a central booking facility and a customer list that are reflected in the lease payments. Is the income derived from these rights part of the income of the investment property and therefore valued as part of the real property interest or should the intangible assets and services be treated as separate assets and separately valued as required?

Questions:

- 4 Have you encountered valuations that explicitly refer to intangible assets associated with either the property interest or the business in occupation? If so, were these separately valued or not? For what purpose was the valuation required?**
- 5 Have you encountered valuations of investment property where you believe that the value of an intangible asset has been included in the value of the property interest but has not been expressly identified?**
- 6 Do you consider that the IVSC needs to provide guidance on this issue?**

1.3. Format of IVSC output

- 1.3.1. The IVSC currently publishes both the International Valuation Standards (IVSs) and Technical Information Papers (TIPs). The IVSs set high level principles for the process of setting up, undertaking and reporting a valuation and are written in imperative language that makes them capable of mandatory application by those adopting the standards.
- 1.3.2. Technical Information Papers (TIPs) are designed to support the standards by providing guidance on their application to different situations. They are written using advisory rather than imperative language and do not give instructions on how to value.
- 1.3.3. At present, *IVS 230 Real Property Interests* and *IVS 233 Investment Property Under Construction* are particularly relevant to investment property. As indicated in the Introduction to

this Discussion Paper, IVS 233 is seen by many as an anomaly among the other standards because of its focus on one type of situation affecting one type of asset. Some have also pointed out that much of IVS 233 is equally applicable to the valuation of any property in the course of construction, not just investment property. The options being considered by the Board include amending IVS 230 and 233, producing a new standard on investment property which may incorporate IVS 233, producing a new standard for property under construction that would incorporate IVS 233, or making no or limited changes to IVS 230 and IVS 233 but producing a new Technical Information Paper providing guidance on the relevant issues.:

Question:

- 7 Which of these options do you favour or is there another option that you would suggest?**

2. Valuation Methods and Inputs

2.1. Sufficiency of current provisions

- 2.1.1. The Board considers the current provisions in IVS 230 and IVS 233 in relation to valuation methods to be adequate. Some consider that the standard should specifically encourage the use of more demonstrably market based methods. However, when it was suggested in the Exposure Draft of the current IVS Framework that there should be a hierarchy of valuation methods there was strong opposition to this from many respondents.
- 2.1.2. There is a view that guidance more should be provided on how to apply the highest and best use concept. For instance, if low interest rates lead to a short-term trend to transform residential rental apartments into condominiums for sale, is it reasonable for the valuer to value based on the residential rental market? The IVS Framework and IFRS 13 both refer to the need to take into account only uses that are possible, legally permissible and financially feasible, but some are uncertain as how to apply these criteria in practice.

Questions:

- 8 Do you consider the provisions of IVS 230 and IVS 233 in relation to valuation methods to be sufficient?**
- 9 If not, what specific aspects of valuation methodology for investment property do you think should be addressed in any future TIP?**
- 10 Do you consider that the additional guidance to that provided in the IVS Framework (paras 33 – 35) is needed to apply the highest and best use concept to investment property?**

2.2. Choice of method

2.2.1. Neither an IVS nor a TIP can be prescriptive about the valuation method to be used or on the selection of inputs. Some argue, however, that IVSC should be providing more guidance in relation to investment property in order to rebuild confidence in valuations in the wake of the global financial crisis.

2.2.2. Some specific topics that have been raised as potentially requiring development in the valuation methodology for investment property include:

- a) where there are either no or limited sale transactions of a particular type of investment property in a particular region;
- b) where an investment property has not been leased since its completion;
- c) where, due to specific legal or practical issues, the property cannot be sold as a separate asset;
- d) where an investment property comprises property to be developed, defining what constitutes "completion"; and
- e) how discount rates should and should not be constructed.

Questions:

11 Please indicate which of the above most frequently presents a problem in the valuations that you encounter and the most common methods you see being used to address the issue.

12 If you are a valuation provider, please indicate why you prefer these methods. If you are a valuation user, please indicate if you are confident in the result obtained by these methods.

2.3. Taxes and Costs

2.3.1. For many types of asset, including investment property, there is widespread concern that local variations in practice in relation to the treatment of taxes and costs create ambiguity and frustrate like for like comparisons. A particular issue for investment property arises in jurisdictions where there are high transaction taxes but these can be avoided by certain types of buyer or by arranging the sale through a special purpose company. Some consider that the IVSC should attempt to address this problem by identifying specific assumptions that valuers should adopt and requiring any deviation to be disclosed.

2.3.2. The IVS Framework states that the market in which the valuation is deemed to be taking place is the market in which the asset being valued is normally transacted and to which most market participants, including the current owner have access. Consequently it follows that the valuation inputs should reflect the realities of that market. Other IVSs and TIPs indicate that the inputs to a valuation should be consistent, eg if pre-tax income is used in a discounted cash flow then the discount rate should also be derived on a pre-tax basis. However, some believe that IVSC should set benchmarks for certain inputs and assumptions in order to achieve cross border consistency in valuation, with deviations only allowed if required by local law or regulation.

Questions:

- 13 Have you encountered material inconsistency in the approach adapted to the treatment of costs or tax in valuations of investment property? If so please indicate the nature of the inconsistency and its consequences.**
- 14 Do you consider that the IVSC should attempt to set benchmarks that indicate whether inputs and valuations should include or exclude different types of tax or other costs? If so, which specific benchmarks would you consider appropriate?**

3. Disclosures

3.1.1. IVS 103 *Reporting* requires all assumptions or special assumptions and the methods, approaches and reasoning used to support the valuation to be disclosed in the report. IVS 300 *Valuations for Financial Reporting* additionally requires that reports contain any information that the reporting entity is required to disclose by the relevant financial reporting standards. IFRS 13 *Fair Value Reporting* requires entities to indicate whether the inputs used in the valuation fall within either Level 1, 2 or 3. The guidance to IVS 300 suggests that the valuation report should contain sufficient information on the inputs used to enable the reporting entity to correctly categorise the assets within the IFRS 13 hierarchy.

3.1.2. Some suggest that the valuation report should go further and state which level of the hierarchy the valuation of an investment property be placed. If the inputs fall within Level 3 then the sensitivity analysis required by IFRS 13 should also be provided. However, others consider that this is not the valuer's responsibility and it is the responsibility of the reporting entity to make the decision on the hierarchy classification.

Questions:

- 15 Do you consider that an opinion on where the inputs used in a valuation of investment property fall within the input hierarchy under IFRS (or any other accounting standard that contains a similar hierarchy of inputs) should be provided as part of the valuation report?**
- 16 If so what guidance should the IVSC be providing to enable valuers to comply with the requirements of IFRS 13 in relation to disclosures on inputs?**

4. Reliable Determination

- 4.1. Under IAS 40 paragraph 53, investment property is required to be fair valued only if such fair value can be reliably determined. The Board is of the view that the value of completed investment property can be normally reliably determined by virtue of the fact that it will have an actual or anticipated income stream or identifiable potential for capital appreciation. However, there may be cases where value cannot be reliably determined.
- 4.2. Some factors that could indicate that a valuation cannot be reliably determined include:
- a) Where the prospect of future income is highly speculative because of uncertainty as to whether a specific type or size of building could be constructed.
 - b) Where there is uncertainty as the time at which a possible future development will become legally permissible or financially feasible.
 - c) Where a current or proposed building provides specialised accommodation for which there is no active market and no basis for establishing either a reliable rent or yield.
- 4.3. It has been suggested that the IVSC provides guidance on when it might not be possible to reliably determine the value of an investment property.

Question 4:

- 17 Do you agree that not all investment property is capable of reliable valuation? If so please give any additional examples to those above.**
- 18 Please indicate the nature of guidance that you believe IVSC could usefully provide to help determine when a valuation cannot be reliably provided.**