IVSC Standards Board
1 King Street
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By email to: commentletters@ivsc.org

12 July 2016

Dear Sirs

Response to Exposure Draft

IVS 2017: IVS 400 Real Property Interests

Please find attached our comments on the above exposure draft.

The directors of Valuology have considerable experience of valuation standard setting generally and knowledge of the existing IVSs and their evolution.

If you would like any additional information in relation to our responses or comments, please do not hesitate to contact us

Yours faithfully,

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Comments on Exposure Draft of IVS 2017

IVS 400 Real Property Interests

Answers to Questions in ED

(a) In IVS 2013, all substantive portions of IVS 230 *Real Property Interests* were labelled as "commentary" (except for scope and effective date). This label seems to have created some confusion amongst stakeholders as to whether the standard was mandatory. The Board's position is that all aspects of IVS 2017 should be mandatory and this Exposure Draft has removed the "commentary" label for clarity. Do you agree with the removal of the commentary label?

We agree with changing the "Commentary" title. This was proposed in the 2015 ED[1] in response to earlier consultations. We do NOT agree that all aspects of the standards should be, or are capable of being, mandatory. We do not therefore agree with a format that makes no distinction between the mandatory Requirements and the supporting guidance. For further detail see our general comments below.

(b) Do you agree with Section 20.5, which states it is the valuers responsibility to state the extent of the investigation and source of the information to be relied on? If not, why not?

In principle, yes. However, if it is a mandatory requirement it should be identified as such, as it is in the current standards. You should also be aware that respondents to the Exposure Draft of the changes proposed as part of the project to improve the coverage of issues commonly encountered in the valuation of Investment and Development property[2] pointed out certain ambiguities in the current wording of IVS 230. 3. The Board accepted some minor changes to this list recommended by the expert Working Group and included these in the 2015 ED. We strongly recommend that these be carried forward into the new standard.

(c) The Board believes that the standard presented in this Exposure Draft can be applied in the valuation of real property interests regardless of the purpose of the valuation (secured lending, sales of plant and equipment, taxation, litigation, insolvency proceedings and financial reporting etc.). Do you agree? If not, for what purpose(s) do you believe this standard cannot be applied? Why?

We agree. However there some specific requirements when valuing for certain purposes that valuers need to be aware of. The proposal to remove application guidance for financial reporting and secured lending means that the IVSs will be less helpful in these two significant areas.

(d) Are there any further topics that you feel the Board should add or remove from IVS 400 Real Property Interests? If so, what are they and what is your rationale?

Yes. Important provisions recommended by the expert Working Group appointed to review and replace IVS 233 that were accepted by the Board in 2014 and included in the 2015 ED should be included. Details are provided below.

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[1] Proposed Amendments to the International Valuation Standards issued 19 March 2015

[2] Development Property and Investment Property Projects 2011 – 2014 – see www.ivsc.org/standards/international-valuation-standards/archive-consultations

General Comments

The current IVS 230 consists of two sections, Requirements and Commentary. As indicated above, while we support a change in the title of the Commentary, to "Application Guidance" or something similar, we do not support the position that everything in the standards can be deemed mandatory. Mandatory Requirements need to be clearly identified and distinguished from material that provides useful background information, explanatory narrative and discussion on how the Requirements may be met, not have to be met. The very nature of this supporting narrative means it is incapable of being made mandatory as there is no compulsion to take a specific action and there is no definitive way in which compliance can be measured. The existing commentaries in this and the other "Asset Standards" consist almost entirely of this type of material.

We note that in this draft, matters that do require specified actions to be taken under identified circumstances and which are accordingly identified as Requirements in the current standard have been mixed with paragraphs that appear in the current commentary. Examples include Requirement IVS 230.2 now appearing as 20.4 and IVS 230.3 appearing as 20.5.

If the distinction between the requirements and supporting guidance is not clearly made it will mean that the Board is ignoring not only the findings of the independent Critical Review Group that reported on the composition of the standards in 2008, which provided the basis for the comprehensive rewrite that culminated in the 2011 Standards, but also the vast majority of representations received on exposure drafts since that time. Making this distinction is also an essential pre-requisite to implementation of the 2014 Adopt or Comply MoU[3].

As a result of the review of the coverage of valuation issues arising in the valuation of investment property and development property that took place between 2011 and 2014, the Board agreed the following at its meeting in October 2014.

1. To retire the current IVS 233.
2. To introduce Application Guidance on the valuation of real property in the course of development or for which development was proposed (Development Property).
3. To make consequential amendments to IVS 230 *Real Property Interests* to cover issues that commonly arose in the valuation of investment property on which the standards are currently silent.
4. To introduce guidance on the valuation requirements for investment property, including investment property under construction to IVS 300 *Valuations for Financial Reporting*.

The Application Guidance for Development Property had been subject to full due process and was approved for publication in October 2014, along with the announcement that IVS 233 was retired. The Board agreed with the consequential changes to the current IVS 230 and IVS 300 recommended by the expert working group but since a fully amended version of these standards had not been exposed for public comment, included these in the 2015 ED.

We note that none of the changes to the existing standard recommended by the expert working group and included in the 2015 ED have been included in this current draft. Omitting these means that there are some significant gaps in the existing standards that the Board has previously identified

[3] Memorandum between IVSC and over twenty Valuation Professional Organisations – first signings 23 October 2014.

but is now declining to rectify. We strongly recommend that the changes in the 2015 ED are incorporated.

Subject to this overriding comment we make the following specific comments:

Specific Comments

10.1 This refers to “principles” rather than “Requirements” in the General Standards and to additional requirements in this standard, although the latter are not identified.

20.4 This is currently Requirement 2 in IVS 230. A third element was proposed by the Board in the 2015 ED to cover situations where property is held by way of a special purpose corporate entity, which is very common around the world for higher value investment property. We recommend that this be included as a number of respondents had identified the lack of recognition of this type of ownership interest and the special considerations required in the current standards.

30 Bases of Value. This is a new section that has been introduced. We cannot see that it serves any useful purpose as bases of value are covered elsewhere in the standards (but see our comments on the draft for IVS 104). We recommend the whole of this section be removed.

30.1 The requirement to use the appropriate basis is already covered in the first paragraph of this standard.

30.2 This discussion concerns how separable interests or assets are aggregated for valuation purposes. It has nothing to do with the basis of valuation. The principle also applies to the valuation of all types of asset and in the current standards is covered in the Framework. The need to consider the nature of the interest or interests involved is already covered in 20.4.

30.2 This paragraph is incorrect. There are many basis of value required for real property that do not require consideration of HABU. Additionally, the concept of HABU is not solely related to real property. We recommend this be removed.

40.2 This paragraph alters the current standard by introducing compulsion to use certain methods. We consider this wholly inappropriate for the reasons explained in our comments on the proposed IVS 105.

50.4 Some minor amendments were agreed by the Board and included in the 2015 ED which have not been reflected in this paragraph.

60.3 The rewording of the current IVS 230 C16 has omitted one important proviso, ie it is only appropriate to value a real estate interest using the actual or potential cash flows of a business in occupation when the building or property is only suitable for that type of business, ie all potential buyers would be operating the same type of business. In other words, it must have special features that would make it unsuitable for any other type of use without significant alterations. As worded it implies that it would be acceptable to value any type of commercial property by reference to the cash flows of the business in occupation.

This paragraph also highlights the impracticality of the Board’s position that all elements of the standards should be mandatory. The standards on business interests and intangibles may provide useful guidance when valuing property interests of this type, and highlight matters that should be taken into account when analysing the cash flows to determine the value attributable to the property interest. However, if the valuation is of a property interest, not of a business or of an intangible, it is absurd to suggest that every provision of these other standards be complied with. Not only will some be mutually exclusive, but others will result in extraneous and irrelevant information being included in the report that will compromise the requirement in IVS 103 to provide the recipient with a clear understanding of the valuation.

60.5 The income capitalisation method and the profits method are totally different methods and not synonymous as implied here. Neither does IVS 105 describe them as such.

70.1 As we pointed out in our comments on the draft of IVS 105, the description therein of the Cost Approach is full of errors and is at odds with not only the current standards but all other authoritative literature on this topic. The summary in this section is correct. If the Board is now minded to bring detailed discussion of methods into the standards, which is not something we support and certainly not if it is to be somehow deemed mandatory, it should incorporate the guidance in the current TIP 2 The Cost Approach for Tangible Assets.

80 This heading and section is superfluous – it would only be warranted if the following sections are intended to have a different status from those that preceded it, which does not appear to be intended. The whole of this standard is surely addressing “special considerations for real property interests”?

90 Hierarchy of Interests. Although this section has been taken verbatim from the current standard, it has been repositioned in way that decreases its apparent relevance. In the current standard it follows on from the description of the different types of interest, which now appears in 20.1 to 20.3 of this draft. All guidance on different types of interest and their relevance to valuation are better kept together. Since identification of what is to be valued is the first step of the process, this logically should come after 20.3.

100 Market Rent is a basis of value but one that is specific to real property, which is why it is defined in the current IVS 230. To remove the two paragraphs containing the definition and the explanation of the basis from the place where they are relevant to a generic standard is hardly helpful to a user of the standards. Since rent is an input that needs to be determined before any approaches and methods are selected, it would be more logical to move this section to come before the latter are discussed.