

The Globalization of Real Estate Valuation

John A. EDGE, Chairman-Elect of IVSC, United Kingdom

Key words: Globalisation Valuation Accounting Standards.

ABSTRACT

The paper discusses the development of valuation standards and the commercial and regulatory pressures that created them using as examples the development of standards in the UK and USA, and the International Valuation Standards developed by the International Valuation Standards Committee (IVSC). Initiatives at a European and Asian level are discussed.

The IVSC standards - the most recent edition being “IVSC 2001” - are currently being widely promoted. Valuation rules are no longer national standards existing in isolation. The standards of various countries have to harmonize with each other, and to do that there must be a strong, single benchmark of common standards to which all our states can relate. This is the role that the IVSC fulfills.

Pressure for international standards is coming from a number of different sources, including:

1. The requirement of governments for valuations of publicly owned assets for the purpose of accountability, measurement of performance, and financial transparency—to this end, the IVSC is in close contact with the International Federation of Accountants (IFAC), and has contributed to International Public Sector Accounting Standard on “Property, Plant, and Machinery,” with particular reference to those troublesome categories of property—heritage assets, infrastructure, and military facilities.
2. The trend towards the privatization of government enterprises—there is no reason to make any differentiation between property assets in the public and private sectors, although the concept of “public interest value,” community value, or social value is one that currently defies the sort of measurement that auditors would consider adequately reliable for accounting purposes.
3. The development of international accounting standards—the IVSC had advised the International Accounting Standards Board, advising in particular on IAS 16 “Property, Plant, and Machinery,” IAS 17 “Leases,” and IAS 40 “Investment Property.” Emerging economies with no established skill or depth in real estate appraisal
4. The Basle Committee on bank lending—the IVSC has responded to draft position papers on lending collateral in relation to property lending.

5. The GATT agreements, designed to balance world trade practices, which led to establishment of the World Trade Organization in 1995—the IVSC recognizes that the agreed valuation standards should reflect the role of real estate across global markets.
6. The move towards a fair value accounting model, for investment property and for owner-occupied property—this model will increasingly demand the services of external or independent valuers who can satisfy those accounting requirements by assessing the market value of property assets.
7. The United Nations Conference on Trade and Development (UNCTAD), which is working towards the harmonization of accounting and other professional practices.
8. The need for performance measurement of both real estate investments and owner-occupied property to measure property, portfolio, and company management performance. Common indices of pooled property data exist in some countries, and the prospects for similar databases elsewhere establish the need for common performance measures based on common standards.

All these challenges offer a real opportunity for more work for valuers and appraisers. When individual national institutions align behind a common international document that has the quality and content to earn universal recognition, the profile of the entire profession and all those associated with it is raised.

The paper provides working examples of how the valuation business operates elsewhere, and how the prospects for globalization of real appraisal are coming about. The principal areas of globalization in this field are:

- The development of common valuation standards
- Valuation concepts (based on accounting concepts)
- The development of global property consultancy firms servicing the needs of global businesses
- The trend towards the fair value convention, and the consequent benefits to the appraisal profession

CONTACT

John A. Edge, FRICS, Chairman-Elect and UK representative to IVSC
Knight Frank
20 Hanover Square
London W1R 0AH
UNITED KINGDOM
E-mail: john.edge@knightfrank.com

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1. INTRODUCTION

Capitalism and Capital Markets need the operation of a free, transparent and liquid market, and are dependent upon the existence of the “rule of law” to allow them to work.

Real estate is a key component of wealth, but is only tradeable as an asset if there exists a legal framework for property ownership and exchange.

Real estate can only be reliably borrowed against as collateral if that legal framework is in place, if there is an identifiable market for the property and if there is a trusted valuation profession to provide an informed and objective opinion of value.

So, what relevance are global standards in real estate valuation to the appraiser or valuer in Bangkok, in Brunei or in Bangalore? Quite a lot, as I hope now to illustrate!

This paper will discuss the development of valuation standards and the commercial and regulatory pressures that created them.

2. THE DEVELOPMENT OF VALUATION STANDARDS

Property is one of the basic factors of production and land and buildings are the most tangible (touchable) assets of property. Valuation is the skill of putting a price on property. Accuracy, consistency, and transparency—the three cornerstones of reliable asset pricing—are needed to assess the value of property for owner occupation, investment, capital markets, or loan security. This is a recurrent theme, whether in countries where high-quality, comprehensive standards are already in place, or in emerging nations finding their way in the capitalist system.

It is important to identify the difference between “standards” and valuation “methodology.” Standards should be constant, a benchmark of “good practice.” Methodologies are dynamic, changing with need, fashion, demand, and analytical techniques borrowed from other fields. Methodology belongs to the textbooks, on an academic level, and in the valuer’s toolbox, on a practical level. Essentially, however, methods are derived from the marketplace. Valuers analyze transactions and apply the data to the appraisal of a property. The techniques applied reflect those used by the market.

Standards, on the other hand, are rules imposed by personal conscience, by national professional institutions, or by law. These rules cover conduct, ethics, and competency issues such as:

- The basis of valuation
- The stated purpose of the valuation
- Competency tests (i.e., relevant experience for that type of property in that location)
- The valuer’s responsibilities
- The extent of due diligence and inquiries
- Disclosure when accepting instructions
- Disclosure in the body of the report
- The reasonableness of limitations and stated assumptions
- Explicit coverage of the valuation process and rationale.

3. UK HISTORY

The Royal Institution of Chartered Surveyors (now known simply as “RICS”) initiated the development of an improved set of standards in the U.K. following the 1974 property crash, which followed two boom years. The oversupply of development, fueled by cheap money, coincided with the disappearance of occupier demand and created a free fall in property prices. The property market froze for nine months and banks, investment trusts, property companies, and speculators lost a lot of money. This precipitated a loss of credibility for the valuation profession.

The RICS commissioned a new set of rules, which was published in 1976 under the title “Guidance Notes on the Valuation of Assets.” This document became known as the “red book” and was endorsed by the Bank of England, the London Stock Exchange, the City Panel on Takeovers and Mergers, banking others. The red book was taken up by the Commonwealth countries, particularly in Africa and the Far East, and served as a template for national standards for many countries on those continents.

However, complacency set in and some failed to realize that standards need to be enforceable and to adapt to meet user expectations. A reprise of the 1970s boom-and-bust scenario unfolded in the late 1980s and the first half of the 1990s. Once again, valuers took the brunt of criticism for banking losses and some high-profile litigation ensued. One of the most heavily publicized disputes about valuation occurred with respect to the Queens Moat Hotels portfolio, which was valued in the early 1990s by one firm at about £2 billion and, a year later under similar market conditions, at about £800 million. A Department of Trade & Industry enquiry followed. The RICS, aware that the red book was either deficient or that valuers were not adhering to its rules, commissioned the Mallinson Report. That report was commended by the Bank of England as the best report produced on any profession’s standards in modern times. The report cited 43 key points, which might be summarized as follows:

1. Understand the client and his needs.
2. Precise, written instructions are necessary.
3. Clarity of valuation bases are required.
4. Explicit methodologies are needed.
5. The valuation needs to be explained.

6. Any uncertainty or other concerns should be stated.

In response to the Mallinson Report, the red book was rewritten, supplemented, amplified, and republished in 1995. The practice statements are now mandatory for member valuers, while the guidance notes are advisory only. The new red book is an impressive tome but is now so large as to be unwieldy. A new revision is now planned.

4. EUROPEAN HISTORY

The red book, which is UK-centric, serves the needs of U.K. valuers very adequately, but it has become less relevant to users in other countries, including those in continental Europe. Europe is clearly problematic due to its variety of languages, cultures, histories, currencies, legal frameworks, economic development, and general fragmentation. In 1981 The European Group of Valuers Associations (TEGOVA) developed its own valuation standards and guidance, known as the “guide bleu” or the “blue book.” Originally based almost word-for-word on the RICS red book, the blue book is now an amalgam of trans-European influences designed primarily to comply with EC rules and regulations.

5. USA HISTORY

The USA has a long history of regulation of appraisal standards, but the lead standard-setting role was taken over by the government-supported Appraisal Foundation, following the Savings and Loans debacle in the 1980s. The Appraisal Foundation has the support of the principal appraisal bodies, such as The Appraisal Institute who contribute to the discussion, and produces the Uniform Standards of Professional Appraisal Practice (known as USPAP).

USPAP is highly regulatory and there has been some criticism within the profession that it is too restrictive to the extent that it hinders effective reporting.

6. ASIAN HISTORY

The Asean Valuers Association, some of whose national members are also members of the IVSC, have made a positive and worthwhile contribution to the discussion and development of standards in the region, and are liaising with IVSC, through its common membership, to achieve consistency in application and an influential voice on the world stage.

A new commentary, in “IVSC 2001”, on “Valuation In Emerging Markets”, was initiated by the AVA member for Malaysia, Mr Elvin Fernandez, who chaired the IVSC committee into that subject.

7. INTERNATIONAL HISTORY

Estimates of foreign direct investment (FDI) vary, but the annual figure may be in excess of \$1 trillion (U.S.). The U.K. Economist Intelligence Unit estimates that the property component, including both direct and indirect investment in real estate, might comprise up to as much as 20% of total FDI. Thus, real estate is a significant factor in global business. It is

often used as collateral in bank lending, and the occasional volatility of property markets in recent years has contributed to the economic turbulence of stock markets around the world.

At about the same time that European standards were being developed, international standards were also initiated and first published in 1985. Again, these standards were based closely on the U.K. red book concepts and definitions. A complete redraft of international standards was published in 1994 by the International Valuations Standards Committee (IVSC). This draft reflected the needs and requirements of the broad membership of member states, with particular emphasis on North America. These standards have been further extended and developed to form a single benchmark that meets the needs of users, capital markets, regulators, national valuation and appraisal institutes, and individual members throughout the world.

The IVSC standards - the most recent edition being "IVSC 2001" - are currently being widely promoted. Both the IVSC and the leading institutes of more than 50 member nations appreciate the opportunity given by this forum for examination, scrutiny, comment, and, hopefully, approval.

The IVSC will continue to upgrade and add to the standards over the coming months, adhering to the existing framework and format and maintaining a single, concise writing style. The IVSC Web site is www.ivsc.org. Appraisers are encouraged to review the standards and pass

Comments about the relevance of property asset valuation illustrated the need for uniform international standards:

"Interviews with large institutional investors... reveal the following areas where international disclosure practices are considered most wanting: ...methods of asset valuation..." *Professor Frederic Choi, "Accounting and Business.*

"I note there is broad support for the development of standards of best practice for other financial sectors, comparable to those the BIS has established for international banking ...but we need new or strengthened standards for ...asset valuation" - *Peter Sutherland, Chairman of Goldman Sachs, 1998 Per Jacobsson Lecture.*

"...Widely accepted norms have not been developed for asset valuation despite its importance for financial stability". - *G10 Working Party Report on Financial Stability in Emerging Market Economies, 1997.*

What investors, regulators, and users of valuation require is consistency, clarity, reliability, and transparency in valuation reporting worldwide. The evolution and creation of a set of standards for any field is far from straightforward. A single international standard has to encompass or recognize property laws, tenures, accepted rules of conduct, languages, concepts, and "best practice" benchmarks. Trying to accommodate all views and perspectives could result in a bland, multi-optional conglomeration lacking definition, incisiveness, or adequate direction. The "view from 60,000 feet" may be all-encompassing, but is of limited relevance to the valuer with "his feet on the ground".

The development of international standards is both a bottom-up and a top-down process. The best national standards can contribute to a single global standard which, in turn, can be adopted and assimilated by those nations with a less-established standard-setting model. Inevitably, a hierarchy will emerge that places international standards at the top of the pile, and, below that, local standards. “Local” can mean national or bloc – such as the European Union, where common regulations may make the interpretation and application of variations from international standards mandatory. In addition, regional interests in common – such as are represented by the Asean Valuers Association (AVA) or the Union of Pan American Valuers (UPAV) – may provide a stronger voice in making submissions to and influencing the continuing process of standards setting by the IVSC.

When the three-year Standards project is concluded this year, “IVSC 2002” will be a culmination of the efforts of the IVSC’s Board, its Executive Director, and its co-opted writers, led by Michael Milgrim of the U.S. with support from both Europe and Australia. The standards will continue to be a living document, subject to continuing adjustment, updating, and correction. The stated objectives of the IVSC are:

1. To develop truly international standards of valuation and reporting that meet the needs of international property markets and of the international business community;
2. To develop truly international standards of valuation and reporting that meet the needs of the developing and newly industrialized countries and to assist the introduction of those standards; and
3. To identify instances where local and regional standards differ, and work towards greater compatibility and harmony between local or regional requirements, and international valuation standards.
4. To illustrate the developing relationship between national and international standards, note, for example, that in certain circumstances the red book permits U.K. valuers to be directed by a client to follow other guidance, such as “IVSC 2001”, rather than the RICS red book.

Pressure for international standards is coming from a number of different sources, including:

1. The requirement of governments for valuations of publicly owned assets for the purpose of accountability, measurement of performance, and financial transparency—to this end, the IVSC is in close contact with the International Federation of Accountants (IFAC), and has contributed to International Public Sector Accounting Standard on “Property, Plant, and Machinery,” with particular reference to those troublesome categories of property—heritage assets, infrastructure, and military facilities.
2. The trend towards the privatization of government enterprises—there is no reason to make any differentiation between property assets in the public and private sectors, although the concept of “public interest value,” community value, or social value is one

that currently defies the sort of measurement that auditors would consider adequately reliable for accounting purposes.

3. The development of international accounting standards—the IVSC had advised the International Accounting Standards Board, advising in particular on IAS 16 “Property, Plant, and Machinery,” IAS 17 “Leases,” and IAS 40 “Investment Property.” The International Accounting Standards Board is gaining increasing acceptance from national standard setters.
4. Emerging economies with no established skill or depth in real estate appraisal—it is worth noting, in this context, that recent new members of IVSC include Lithuania, Romania, The Peoples Republic of China and Tanzania.
5. The Basle Committee on bank lending—the IVSC has responded to draft position papers on lending collateral in relation to property lending.
6. The GATT agreements, designed to balance world trade practices, which led to establishment of the World Trade Organization in 1995—the IVSC recognizes that the agreed valuation standards should reflect the role of real estate across global markets.
7. The move towards a fair value accounting model, for investment property and for owner-occupied property—this model will increasingly demand the services of external or independent valuers who can satisfy those accounting requirements by assessing the market value of property assets.
8. The United Nations Conference on Trade and Development (UNCTAD), which is working towards the harmonization of accounting and other professional practices—the IVSC is represented at the Geneva conference.
9. The need for performance measurement of both real estate investments and owner-occupied property to measure property, portfolio, and company management performance. Common indices of pooled property data exist in some countries, and the prospects for similar databases elsewhere establish the need for common performance measures based on common standards.

All these challenges offer a real opportunity for more work for valuers and appraisers. When individual national institutions align behind a common international document that has the quality and content to earn universal recognition, the profile of the entire profession and all those associated with it is raised.

8. RELATIONSHIP TO ACCOUNTING STANDARDS

The accountancy profession and the valuation profession are developing a mutual understanding and appreciation for each other’s expertise. This communication will improve further when valuers better understand the accounting concepts behind accounting rules and accountants understand the bases on which valuations are made.

My personal experience of the interaction between accountants and valuers has been focused on the two main areas of property valuation—appraisal of owner-occupied property and of investor property. I sat on a steering committee relating to owner-occupied property in the U.K. and on an IASB working party (one valuer and 11 accountants) studying the proposed standard on investment property (now IAS 40).

9. GLOBAL MARKET

As mentioned previously, valuation rules are no longer national standards existing in isolation. The standards of various countries have to harmonize with each other, and to do that there must be a strong, single benchmark of common standards to which all our states can relate. This is the role that the IVSC fulfills.

One common set of standards is also emerging in the accounting world, spearheaded by the IASB. Since property valuations for financial reporting purposes must be based on accounting requirements and rules, it is essential that the two interrelate smoothly and effectively.

Property is an essential element of many businesses. It is often used as collateral for borrowing by the owners and is one of the key “factors of production” in most businesses. Its correct accounting treatment is important. The need for agreement and consistent standards in both the accounting and asset valuation spheres is well recognized.

The IVSC has sought a closer relationship with the IASB to align its own standards for valuations for the purposes of financial reporting with common accounting concepts.

10. UNITED KINGDOM

Communication between the professions in the UK has been generally good. The Accounting Standards Board (ASB) liaises with the RICS and its Appraisal and Valuation Standards Board, which monitors the red book, and with the Reporting for Financial Statements Group in particular.

One of the most important and fundamental differences between the United States and many other countries is that upward revaluation for accounting purposes is not permitted in the United States, while it is an optional requirement in, for example, the U.K. for owner-occupied property.

Value may either be recorded at historic cost (benchmark treatment) or at fair value (allowable alternative treatment) which means, to all intents and purposes, market value.

Market value can, as we all know, move upward or downward and the implications on property values are recorded on the balance sheets of U.K. companies. If they follow an allowable alternative treatment, these companies tend to revalue their properties at least once

every five years (or on a rolling programme of 20% of properties per annum) or, more commonly, once every three years. This leads to a lot more work for valuers.

For example, my firm values the assets of a well-known retail stores group on the basis of 25% of their assets each year. We also allocate the values between the land element, the building element, and the fixtures and fittings for depreciation purposes. Similarly, each year we value one third of the assets of the largest health care group in the U.K. with some 50 private hospitals and 250 nursing homes. We value these on the basis of their market value as trade-related properties, i.e., inclusive of fixtures, fittings, and equipment. These assets are valued by applying a multiple to operating profits and/or using a discounted cash flow analysis of the operating entity.

For all investment properties, particularly those held by listed property investment companies, stock exchange rules require a valuation each year, but not necessarily by external or independent valuers. In practice, all the main property companies quoted on the London Stock Exchange will have all their property assets revalued by external valuers at least annually, to coincide with their reporting and accounts. The trend now is to have these property portfolios valued also at the half year, to coincide with the companies' interim reports. For example, my firm values the assets of Land Securities PLC, the largest U.K. property company with assets of approximately \$12 billion (U.S.) contained in some 500 properties across the U.K.

My understanding is that the United States may be moving towards a fair value or mark-to-market system. If this comes about, the implications for the American valuation profession could be profound. Equally, if IASB requirements firm towards revaluation of assets in company accounts, then the resources of the valuation profession world-wide will be tested!

11. FAIR VALUE

Fair value is defined in IAS 16 as "The amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction." Fair value is also used as a generic term. In relation to owner-occupied property, it can encompass market value or its surrogate (in the absence of an identified market), depreciated replacement cost (DRC).

The recent IASB background paper on investment property went beyond the usual boundaries established for market value by defining how fair value can be assessed by other, less direct indicators. An extract from that paper follows:

The valuation profession will have an important role in implementing the Standard. Accordingly, in developing its guidance on the fair value of investment property, the Board considered not only similar guidance in other IASB literature, but also International Valuation Standards (IVS). The Board understands that IVSC intends to review, and perhaps revise, its Standards in the near future.

The Board believes that IASB's concept of fair value is similar to the IVSC concept of market value. IVSC defines market value as "the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion." The Board believes that the guidance in paragraphs 28–29 and 31–37 of the current draft is, in substance (and largely in wording as well) identical with guidance in IVS1.

Paragraphs 30 and 38–45 of IAS 40 have no direct counterpart in the IVSC literature. The Board developed much of this material in response to commentators on E64, who asked for more detailed guidance on determining the fair value of investment property. In developing this material, the Board considered guidance on fair value in other IASC Standards and Exposure Drafts, particular to those on financial instruments (IAS 32 and IAS 39), intangible assets (IAS 38) and agriculture (E 65).

Paragraph 39 states "In the absence of current prices in an active market, an enterprise considers information from a variety of sources, including:

- a) Current prices in an active market for properties of different nature, condition or location (or subject to different lease or other contacts), adjusted to reflect those differences;*
- b) Recent prices in less active markets, with adjustments to reflect any changes in economic conditions since the date that occurred at those prices; and,*
- c) Discounted cash flow projections based on reliable estimates of future cash flows, supported (where possible) by the terms of the existing lease and other contracts and by external evidence such as current market rents for similar properties in the same location and condition, and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows."*

The standard goes on to say that, in some cases, the various sources listed in the previous paragraph may suggest different conclusions as to the fair value of an investment property. An enterprise considers the reasons for those differences in order to arrive at the most reliable estimate of fair value within a relatively narrow range. The range of reasonable fair value estimates would be so great and the probabilities on the various outcomes will be so difficult to assess that the usefulness of a single estimate of fair value is negated. This may indicate that the fair value of the property will not be determined reliably on a continuing basis.

12. MARKET VALUE

One of the key successes of the IVSC has been developing a common definition of market value accepted in most of the world. For example, the blue book quotes this definition and concurs with it. The RICS red book states that there is no effective difference between the international definition of market value and the U.K. definition of open market value. The latter will probably be dropped in favor of the former.

Market value is defined in the IVS as:

“The estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.”

Explanatory notes amplifying this definition can be found on the IVSC Web site.

13. OPEN MARKET VALUE

The U.K. definition is included here to illustrate what we will give up when we finally move to the international definition. Open market value (OMV) is more fully defined in the red book and, while it is dangerous to summarize, key points of the definition are set forth below: Best price for cash consideration, assuming:

- a) A willing seller
- b) Reasonable period for marketing
- c) Exchange date/valuation date
- d) No special purchaser
- e) Knowledgeably, prudently and without compulsion.

The RICS used to have a strong reluctance to incorporate the words “willing buyer” into any approved definition, fearing abuse. Now the RICS appears to concede that this is no longer a material concern.

14. PROPERTY TYPES

A comparison of the different accounting, and therefore valuation, approaches reflected in the U.K. and by the IASC is summarized in Exhibit 1. Exhibit 1 illustrates the difference in valuation approaches between the U.K. and the IVSC, as dictated by the different accounting rules in these two jurisdictions. Valuers in the U.K. follow their own Accounting Standards Board, which favors the existing use concept. (See the discussion of the value to the business on the next page.) The International Accounting Standards Board used to recognize the existing use concept but abandoned it two years ago. Although the IVSC directs members to follow the IASB ruling, the committee remains sceptical about that decision. IVSC continues to favor the intellectual purity of existing use. The concept is explained in more detail in a subsequent section.

15. DEPRECIATED REPLACEMENT COST

Depreciated replacement cost (DRC) is a surrogate figure, not a market-based valuation, used in the absence of a provable value. It is based on land value plus modern equivalent replacement cost, suitably discounted for obsolescence. Obsolescence provides the first problem for the valuer. There are two types: physical obsolescence and, more problematic, functional or economic obsolescence. The determination of functional or economic obsolescence is often based on fairly subjective criteria. It is often difficult to separate how the owner uses and occupies the property from how a hypothetical owner might use it.

A second element of uncertainty lies in the qualification that all valuers have to apply to a DRC valuation —i.e., that it is “subject to adequate profitability of the business.” In this case it is up to the directors, who may “write down” the valuer’s figure, to make this judgment. At this point, the DRC valuation moves away from being a surrogate for a market-based assessment and toward a value in use concept, which may be problematic.

16. EXHIBIT 1

Property Type	U.K.	IVSC
Owner-occupied by the business	Existing use value (EUV)*†	MV*
Surplus property	OMV *	MV*
Investment property	OMV	MV

*If specialised, depreciated replacement cost (DRC) is used.

† Advise also on open market value (OMV) if materially different.

17. VALUE TO THE BUSINESS

The IASB view of the “value to the business” of property assets is quoted below and illustrated in Exhibit 2.

The recoverable amount is the higher of value in use and net realisable value. Value in use is essentially the “worth” of the property to the business. Net realisable value is, in effect, the same as market value, which would be the equivalent of the contract price in the sale document, but less costs of disposal.

In international accounting, therefore, the impairment test, under IAS 36, works out whether the market value of the property exceeds its worth (in which case the business should sell the property) or vis-à-vis (in which case it should retain the property). There is no reference to market value for the existing use.

In the U.K., the value to the business rule adds another layer, as shown in Exhibit 3, and decrees that it should be the lower of the recoverable amount (as defined above) and replacement cost. Replacement cost is the lowest cost or deprival value of an asset and is normally equated with existing use value (plus costs).

18. VALUE IN USE

The IASB defines value in use as, “The present value of estimated cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life” (IAS 35). The IVSC, however, defines the term as “An apportionment of the business value of an overall enterprise as allocated between individual assets contributing to that enterprise” (IAS APG 1).

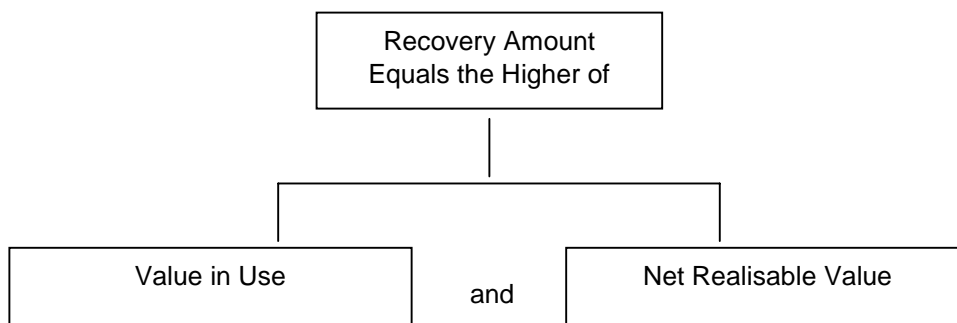
Value in use is entity-specific and is a non-market assessment. As such, it is a “worth” calculation that must be assessed subjectively and therefore its reliability is in question. Is a

valuer competent to comment on value in use? It would seem that a valuer can, at best, assist in the calculation of value in use. Any “impairment test” that consistently settles on a value in use figure that is significantly greater than net realisable value (NRV) would, presumably, be scrutinized very closely by the company’s auditor.

19. EXHIBIT 2

IASB Approach

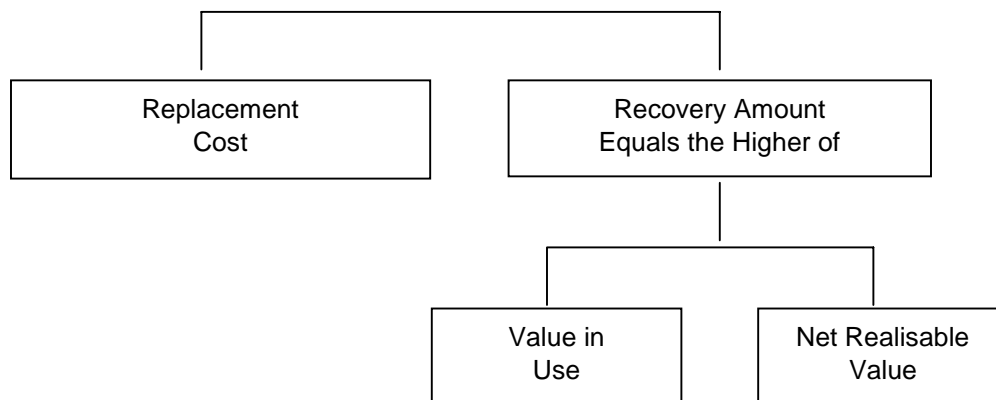
Value to Business



20. EXHIBIT 3

UK’s ASB Approach

Value to Business Equals the Lower of



21. EXISTING USE VALUE

To arrive at existing use value (EUV), the definition of open market value is further qualified as follows:

- f) Only for the existing use
- g) Assuming vacant possession

As the going concern concept assumes that the business will continue in perpetuity, any higher alternative use value is therefore to be disregarded. However, the property's development potential within the existing use for surplus land or upgrading through refurbishment can be reflected as long as it does not disrupt the existing business being conducted on the premises.

EUV is a market-based assessment and assumes a *hypothetical* occupier, not the actual occupier. Therefore, any special reason for occupation, over and above that which would be recognized in the marketplace, must be disregarded.

Nonetheless, the valuer can ignore restrictions that would only affect a sale of the property, which the going-concern assumption precludes. Such restrictions might include restricted alienation rights, planning consents that are granted with conditions specific to that particular company, and contamination clean-up costs.

Most importantly, the definition of EUV assumes *vacant possession*, i.e., the price that would have to be paid in the marketplace for empty premises. This contrasts with the interpretation in certain states, where EUV is treated more like a value in use concept. There, valuers have to assume a hypothetical lease to the occupier and set out the terms in the report, which is then capitalized to provide the EUV. This is akin to a sale and leaseback transaction, which can produce an inflated figure. For example, an occupier could buy an empty building on Monday for \$700,000, revalue it on the books on Tuesday at \$1 million, and decide to sell it again on Wednesday for, presumably, \$700,000. That seems a flawed basis to me.

22. HISTORIC COST

Occupiers in the U.K. are able to opt for (or return to) depreciated historic cost which, on the face of it, appears a retrograde step. The benefits to a company would appear to be:

- •A disguising of the true value of the assets of the company
- •Avoidance of volatile movements in capital value, especially for trade-related properties
- •The avoidance of heavy impairment write-down
- •A reduction in the depreciation charged, based on a lower valuation amount.

23. PUBLIC SECTOR

In the U.K. heritage assets and infrastructure are generally recognized at historic cost due to the difficulty of applying any other valuation approach, the questionable benefit given the likely cost involved, and the questionable reliability of the valuation produced. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued clear and useful guidance for valuers and accountants on the subject.

Overseas, particularly in New Zealand and Australia, the question of how to identify asset values, accountability, asset performance, etc., has led to animated discussion between accounting and valuation professionals. The matter has not yet been properly resolved.

24. INVESTMENT PROPERTY

Investment property, the second principal category of property ownership, is attracting particular interest on the international front. Investment properties are owned by investors and leased out to earn rental income.

The valuation of investment properties is generally less contentious than valuation of owner-occupied properties because most types of investment property are well represented in the marketplace. The playing field is pretty level in terms of information sources and computer valuation software systems. The key to accurate valuation is access to first-hand market information and market sentiment. To have that in the U.K., the valuer must be part of a large, multi-disciplinary practice with strong agency and investment market exposure.

In addition to the core markets for office, retail, and industrial space, certain investors have moved into the markets for properties such as nursing homes, serviced offices, factory outlets, marinas, and turnover space. In these markets the more traditional basis of valuation, the all risks yield approach, is usually less applicable and more explicit DCF analysis is required. In my experience, accountants feel more comfortable with valuations based on specific assumptions rather than on the implicit all risks yield, even though the traditional approach can be applied if the market is well analyzed. With the all risks yield method, a single capitalization rate is applied to the rental income streams of the individual property.

25. PROPERTIES IN THE COURSE OF DEVELOPMENT

Properties in the course of development cause more controversy than most. First, some investment companies choose to value these properties at market value in their existing state, while others choose to value them at cost until completion or until significant space has been let. Second, it is inevitable that these properties are more volatile during the development period. Many variables contribute to a relatively low residual value in the early stages of development. These variables include the need to estimate the completed and let value, outstanding development costs, the remaining development period, and the time delay before rental income commences; uncertainty as to the quality of the likely tenant; a required discount for the risk/profit margin; and the risk of changes in finance costs over the remaining period. However, volatility does not necessarily indicate a lack of reliability. Some properties can be relatively stable in the course of development due to pre-lettings and/or fixed price contracts.

The IASB Working Party on “Investment Property,” upon whose conclusions the exposure draft was based, decided that properties in development should be appraised on the basis of their market value (fair value), but the Board of IASB overturned that and directed that they be booked at cost until completion.

When assessing the market value of a property in the course of development in its existing state, the valuer should consider the following:

- Estimated completed and let value

- Outstanding costs to complete
- Finance/interest costs
- Profit/risk allowance
- Rent-free/void allowances.

26. LIMITED PARTNERSHIPS

In the U.K., limited partnerships are an interesting development in the ownership of large lot properties. Rather than create a series of horizontal slice leasehold interests to accommodate a number of ownerships, a limited partnership is created. Although this practice is increasingly popular, the valuation issues are not entirely resolved. Valuers are usually instructed to value 100% of the property. The company then apportions that value according to the ratio of its own partnership interest. Until the market identifies a premium or a discount for such an interest in property, it is difficult to identify whether any variation from a straight apportionment of the 100% valuation is needed. That evidence should emerge in due course.

The difficulty with limited partnerships really begins when there is cash in the business or a central partnership loan arrangement. In these circumstances, each partner will need to be able to identify a net asset value (NAV) reflecting an individual share of gross rents, cash, loan interest, etc. Those valuers with corporate finance associates should be able to make such an assessment, although the conclusion will not be market value but rather net asset value.

27. APPRAISAL COMPANIES

The last two or three years have seen the creation, through mergers and takeovers, of some very large international property consultancy and outsourcing businesses. These are would-be global players. Much of the initiative, and the money, has come from American firms looking to consolidate in the United States and then to provide their American-based clients with assured, seamless service overseas. The principal business lines are:

- Brokerage services
- Tenant representation
- Outsourcing management
- Facilities management
- Investment asset management.

A key area that comes with the overseas business package, but which is generally not particularly sought out by USA practices, is global valuation services.

The overseas businesses that these property consultancies have taken over or allied with are generally U.K. firms that have developed an international network. These firms are all multi-disciplinary, which means that they cover investment acquisition and disposal, investment asset management, property management, building survey services, project management, leasing, CRE consultancy, tenant representation, planning consultancy, property research,

property tax advice, financial services, residential agency, and other services. They also have large valuation practices, which operate close to their investment and leasing colleagues to stay current about market information and market sentiment for the valuation of client properties.

The presence of an appraisal business within a wider property services business is not viewed as a conflict. A clear conflict would arise, however, if a company performed the investment asset management role for a client as well as undertaking the valuations. This would not be accepted in the marketplace. However, it is not considered to be a material conflict for a valuer to value the property portfolio of a particular client while, at the same time, the valuer's agency colleagues are trying to lease one of the client's buildings. Generally, the benefits of using a valuer whose colleague connections help him operate effectively in the marketplace is perceived to outweigh the concern that the valuer be completely independent in all respects. Valuation fees would have to rise significantly to compensate the company for the potential loss of other business.

In conclusion, there are two reasons for U.S.- based property consultancies that are seeking overseas representation to be interested in the prospect and potential of global valuation services:

1. Most overseas businesses, being multi-disciplinary, already include a significant valuation business.
2. The potential for the expansion of the valuation business is generally good, if accounting trends towards a fair value basis continue.

28. CONCLUSION

This paper provides working examples of how the valuation business operates elsewhere, and how the prospects for globalization of real appraisal are coming about. The principal areas of globalization in this field are:

- The development of common valuation standards
- Valuation concepts (based on accounting concepts)
- The development of global property consultancy firms servicing the needs of global businesses
- The trend towards the fair value convention, and the consequent benefits to the appraisal profession

Finally, the impact of these developments on the local appraiser will take time to arrive, but change will occur. Neglecting what is happening on the international stage and allowing other organizations to take the lead would most definitely impact the appraiser on the street—to his detriment—and sooner than he might think!