

DECEMBER 2000 NEWSLETTER

# GLOBAL



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## VALUATION ISSUES

IVSC



INTERNATIONAL VALUATION STANDARDS COMMITTEE



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# IVSC 2000

## IVSC WORK PROGRAMME

The current IVSC work programme as confirmed by the Management Board at its October meeting is as follows:

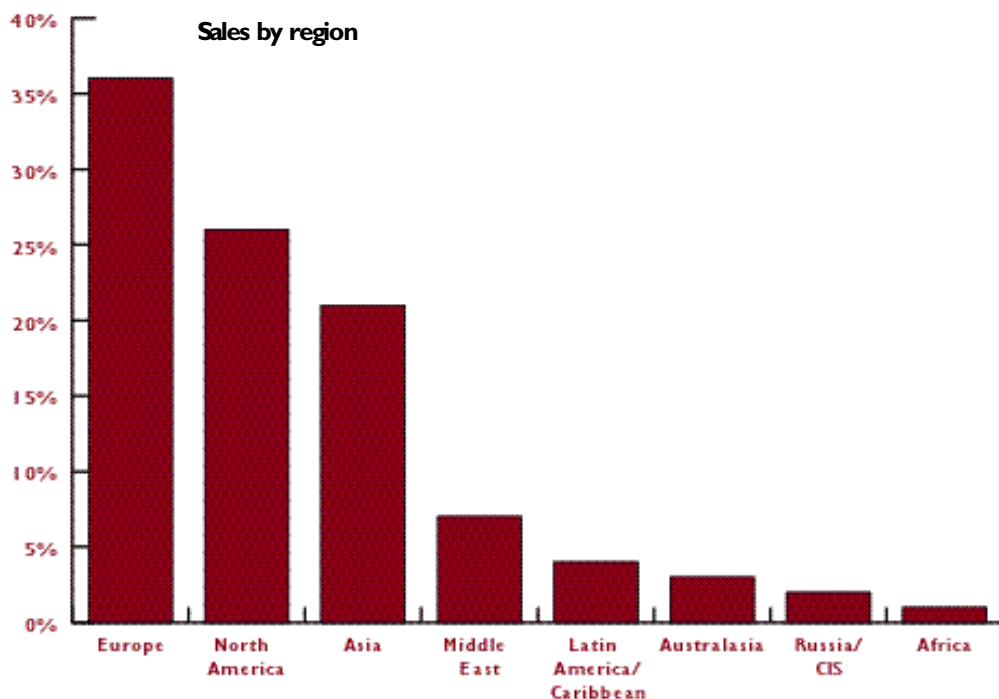
- Expert Groups established to produce guidance in four areas:

Valuation for Public Sector  
 Valuation for Lending Purposes  
 Valuation in Emerging Markets  
 Valuation for Securities Commissions' purposes

- Expert Group to be established to develop guidance on the valuation of personal property
- Mass Appraisal – The US Appraisal Foundation is developing guidance on this topic and has agreed to provide drafts to the IVSC that can be developed to meet the needs of the international community.
- Going Concern – paper to be produced by a small working group, discussing the relationship between the current 3 guidance notes – Intangible Assets, Going Concern, and Business Valuation – and proposed guidance on Specialised Trading Properties.

- The Valuation Report – guidance to be developed
- Discounted Cash Flow – research to be undertaken on current national guidance on this issue and discussion paper prepared
- Matrix highlighting differences between IVS, USPAP (plus Canadian edition), the RICS Red Book, Australian/New Zealand standards to be developed
- Paper on Valuation of Owner-Occupied Properties to be drafted for discussion with International Accounting Standards Committee
- Guidance on the valuer/auditor relationship to be developed with International Federation of Accountants

Among the issues the IVSC Management Board is developing for future inclusion in the IVSC work programme are the valuation of financial interests; valuation of agricultural land and property; valuation for insurance purposes; valuation of renewable assets; retrospective and prospective reports; reviews and desktop valuations.



## THE IVSC EXPERT GROUPS

International Valuation Standards are gaining increasing importance and acceptance around the world. As a result, the IVSC Management Board has acted so that the due process for establishing those standards ensures that they are of the highest quality and are acceptable to both users and preparers of valuation reports. The Board has adopted the use of 'Expert Groups' to develop guidance on a number of issues.

The Expert Group, as its name suggests, consists of experts in the subject under discussion. Experts are chosen for technical expertise and to ensure geographical representation. They may or may not be valuers. Indeed, the Management Board actively seeks members from related industries/professions to join appropriate Groups.

The role of the Group will be to research and consider existing guidance (if any) on the issue under consideration. It then produces the first draft of a Commentary for the Board, identifying the issues and recommending action. The Commentary may be issued by the Board for wider consultation. Following discussion of the Commentary, the Board may then instruct the Group to produce draft guidance/standard, or proposed additions to the current IVS. Once approved by the Board, these drafts will be subject to a six month exposure period. The final task of the Expert Group will be to produce any final documents for Board approval prior to publication.

The following four Expert Groups have been established:

### Valuation in Emerging Markets

Chairman:	Elvin Fernandez, Malaysian delegate to IVSC Management Board
Group Technical Advisor:	Mike Milgrim
Members:	Gheorghe Badescu, Romania Simon Landy, Cushman & Wakefield, Thailand Annop Sangprasit, Richard Ellis, Thailand Professor Haisu Wang, Zhongnan University of Finance, Economics and Law, China

This group will address the specific issues of valuation in emerging markets. Emerging markets is an extremely broad category, which covers a diverse spectrum of economic and governmental circumstances. Nevertheless, it is possible to identify certain characteristics these markets have in common. Among the main issues that the Group will consider are the following:

- Poor or inadequate legal framework that does not allow for the proper functioning of the property market;
- Lack of published information or difficulty in obtaining information regarding market transactions as well as other data requisite for proper valuations;
- Lack of an adequate framework for land use planning. This is particularly required by valuers to undertake highest and best use analyses that are the foundation for forming an opinion of market value;
- Greater volatility of property markets in emerging countries, a reason for which could be the poor dissemination of information about the market;
- Inadequately trained professionals to support the market by providing good analyses.

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The concept of Market Value is the keystone of the International Valuation Standards. Fundamental to this concept is the understanding that in market transactions, buyers and sellers are acting in a willing, independent, knowledgeable, and prudent manner and that their activity is not subject to undue restriction. The functioning of a free market with a ready availability of pricing information is, therefore, implicit in the concept of Market Value. At present, the International Valuation Standards do not specifically address the special circumstances of emerging markets other than to call for disclosure of the conditions and assumptions of valuations undertaken in markets with characteristics that diverge from the above model.

#### **Valuation for Securities Commissions' Purposes**

Membership: TO BE CONFIRMED

The work of this group will constitute the basis for a commentary that will address the specific issues involved in the valuation of securitized real estate assets. Real estate securities may require valuation for three reasons: for purposes of stock market prospectuses, toward fulfillment of the disclosure requirements of securities and exchange commissions that apply to securities in general, and for use in compiling real estate benchmarking indices. It is important, therefore, that valuations of securitized real estate and properties assembled in investment portfolios be performed in a manner consistent with best practice or the Generally Accepted Valuation Principles, reflected in the International Valuation Standards (IVS).

In response to different informational requirements, the focus of assignments involving real estate securities is shifting away from the value of the individual properties that constitute portfolios to the value of the partial interests in portfolios and to portfolio cash flow and debt-equity ratios. The expert

group will develop this issue, which represents a "paradigm shift" away from the traditional focus of real property valuation.

#### **Valuation for Lending Purposes**

Chairman: Andrew Cherry, Healey & Baker, UK

Group Technical Advisor: John Rich

Members: Daiva Albertaviciene, Vilnius Bankas, Lithuania  
Philip Cropper, CB Hillier Parker, London  
Chiu Kam Kuen, DTZ Debenham Tie Leung Ltd, Hong Kong  
Alex Hesterberg, Deutsche Bank, New York  
Raymond Trotz, Association of German Mortgage Banks

Current guidance on Valuation for Lending Purposes in IVS 2000 is to be developed to reflect current and proposed regulations to be issued by the Basel Committee on Banking Supervision.

The Basel Committee has been compiling recommendations on best practices in banking supervision since 1982. More than half of these positions have been issued since 1995, reflecting the increasing importance of its recommendations as markets diversify and globalise.

The BCBS does not have any formal international supervisory authority but generally seeks convergence towards common standards and approaches to supervision by formulating broad supervisory standards and statements of best practice. The Core Principles for Effective Banking Supervision address several key areas including policies, practices and procedures for evaluating asset quality and the adequacy of loan loss provisions and reserves.

The IMF is carrying out assessments of the Core Principles with the aim of judging the adequacy of the rules for banking supervision and supervisors' ability to monitor and limit major risks run by banks. The IMF has stated that defects in many of the necessary preconditions for effective bank supervision such as loan valuation procedures are a major source of weakness and has called for rapid progress to provide guidance or standards on asset valuation. The IMF has made the same point to the Basel Committee in its comments on proposals for a new Capital Adequacy Framework. Without proper rules on asset valuation any capital adequacy assessment based on the Accord's methodology is bound to be misleading.

A major discussion paper covering valuation is to be released by the BCBS in January 2001,

#### **Valuations for the Public Sector**

Chairman: Graeme Horsley, Ernst & Young, New Zealand  
Group Technical Advisor: Mike Milgrim  
Members: Peter Clark, Manager Real Property Valuation and Chief Appraiser, Pacific Region, Public Works and Government Services, Canada  
Mark Gerold, Weatherall Green & Smith, UK  
Leung Yew Kwong, Chief Valuer, Inland Revenue, Singapore

Valuation of public sector assets is undertaken for purposes of financial reporting, often required for cost-benefit analyses and government program budgeting. Recently, the Public Sector Committee of the International Federation of Accountants (IFAC) released exposure drafts (EDs) of two proposed standards (IPSASs) involving fixed

assets in the public sector. One ED relates to the valuation of property, plant and equipment in public sector infrastructure and heritage assets; the other addresses the treatment of finance leases and operating leases in the financial statements of public sector lessees and lessors. IFAC has also circulated the draft of a paper by its Public Sector Committee on procedures for measuring impairment in assets held with the objective of generating net cash flows as well as in assets held without net cash flow as the objective. It is essential that valuations of public sector assets be performed in a manner consistent with best practice or the Generally Accepted Valuation Principles as reflected in the International Valuation Standards (IVS), and the International Valuation Standards Committee is strongly committed to ensuring that the IVSC and IFAC Standards complement and reinforce one another.

IVS 2000, the current edition of the Standards, contains no specific guidance to practitioners involved in the valuation of public sector assets. A number of public sector assets exhibit characteristics similar to assets held in the private sector. Because comparable market data exists for these assets, it is possible to estimate their Market Value. However, for many public sector assets, market data is simply not available. The principal issue involving such assets is that their Fair Value can often be determined only by applications of the cost approach. Cost is considered an acceptable surrogate for Fair Value, when the asset provides a utility or service commensurate with its cost and when the use to which the asset is put represents the asset's highest and best use. Cost estimates may be made on two bases. Reproduction cost is generally used for heritage assets, and an optimised depreciated replacement cost (DRC) is used with infrastructure and other specialized assets. The only mention in the IVS 2000 of public sector assets is found in Guidance Note 8, (Depreciated Replacement Cost).

# IVSC NEWS



## NEW IVSC MEMBERS

### GERMANY JOINS IVSC MANAGEMENT BOARD

The growing influence of international standards on German financial and business markets led to the application by Bundesverband ö.b.u.v sowie qualifizierter Sachverständiger e.V (BVS) and Verband deutscher Hypothekenbanken (VdH) to represent Germany on the Management Board of the International Valuation Standards Committee. The application was unanimously endorsed by the IVSC Annual General Meeting held in London in October.

BVS representative to the IVSC, Günter Schäffler, said, "The influence of international standard setting in Germany has been most marked in the field of accounting standards. In May 1998, legislation was passed creating the German Accounting Standards Committee (GASC) to develop accounting standards for consolidated financial statements and to represent Germany on the international stage. Earlier this year, the BVS created the German Valuation Standards Committee (GVSC) whose goal is to integrate national and mainland European standards into the international valuation standards."

On the same day as the German Accounting Standards Committee was created, legislation was passed allowing German companies to prepare their consolidated financial statements in accordance with International Accounting Standards or US standards in preference to domestic accounting requirements. This is a transitional situation until 2004. The European Commission announced recently that it intends to mandate the use of International Accounting Standards by all EU listed companies by 2005 at the latest. According to Günter Schäffler it is crucial that the valuation profession in Germany contributes to the development of international valuation standards that complement international accounting standards.

It is an IVSC objective that valuation standards are produced that support the international regulatory frameworks being developed by related organisations such as the International Accounting Standards Committee and the Basel Committee on Banking Supervision, among others.

Raymond Trotz, who will represent VdH on the IVSC Board, welcomed the IVSC work with the Basel Committee. Trotz, who chairs the VdH Committee for Valuation Issues, said, "Supervisors have become more and more aware of the importance of consistent valuation practices for a bank's risk profile. In a recent study on asset prices and banking stability, the European Central Bank pointed out that consistent valuation is a core criteria for prudent mortgage lending and stable real estate markets. An earlier World Bank study on the 1985-1994 Global Real Estate Cycle had stressed the importance of valuation to prevent careless lending by financial institutions and to reduce sharp volatilities in real estate prices. The debate on international valuation standards will strongly influence the Basel Committee's work on a new capital adequacy framework for banks as well as the future discussions on real estate rating."

### VENEZUELA AND GEORGIA BECOME MEMBERS

As the countries of Latin America develop and restructure their financial markets, in many instances using international standards as benchmarks, so there has been increasing interest in the IVSC. The Sociedad de Ingenieria de Tasacion de Venezuela, whose president is currently also president of the Union of Pan-American Valuers (UPAV) was admitted as a Full Member of the IVSC representing Venezuela at the October AGM. Applications are anticipated from a number of other countries within Latin America during 2001.



Georgia, represented by the Georgian Federation of Professional Assets Valuers was admitted as an Observer Member at that same meeting. The situation in Georgia demonstrates how the introduction of International Accounting Standards leads to the need for International Valuation Standards. In his letter accompanying the application by the GFPVAV, George

Tkeshelashvili, chairman, said, "In our country economic reform is a great success. Last year IAS was adopted as national standards by Georgia and the process of implementation of international practice has started throughout the country. We hope that the adoption of the IVS will fill the current vacuum in this sphere and complete the economic reform in the country."

#### **APPRAISAL INSTITUTE AND IVSC OFFER PROGRAM ON INTERNATIONAL VALUATION STANDARDS**

The Appraisal Institute is currently working with the International Valuations Standards Committee to develop a modular education program that will examine the context of a global property market and the need for common global standards. This program will provide participants with an overview of the history of the IVSC and the development of the standards and explain the general valuation concepts and principles used to derive the standards.

The program can be presented over a one or two day time period. The first day will cover the core content of Standards 1 and 2 (market value basis and valuation bases other than market value.) During the second, optional day modules on different property types and applications can be presented.

This program will assist valuers worldwide in developing a common understanding of International Valuation Standards. The target date for course availability is May 2001.

Any institute or organisation interested in running one of these programs should contact either the IVSC Executive Director – [mtissier@ivsc.org](mailto:mtissier@ivsc.org) - or Bill Endsley at the Appraisal Institute – [bendsley@appraisalinstitute.org](mailto:bendsley@appraisalinstitute.org)

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## INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE – AN UPDATE

### INTERNATIONAL ACCOUNTING STANDARDS

One of the key drivers towards widespread adoption of International Valuation Standards is market acceptance of International Accounting Standards (IAS). In view of this, 'Global Valuation Issues' reports regularly on the growing acceptance of International Accounting Standards.

A number of major announcements during 2000 have confirmed the International Accounting Standards promulgated by the International Accounting Standards Committee (IASC) as the world standard, and mean that the IAS versus US GAAP debate is at an end.

The Basel Committee on Banking Supervision completed a comprehensive review of IAS in April 2000 and, based on that review, expressed its support for the IASC Standards

The International Organization of Securities Commissions in May recommended that IOSCO members permit incoming multinational issued to use the IASC 2000 standards to prepare their financial statements for cross-border offerings and listing, as supplemented where necessary to address outstanding substantive issues at a national or regional level. In an obscure comment, IOSCO said that 'specialized reporting practices for different industries (e.g., banking, insurance extractive industries, real estate, etc) are outside the scope of the core standards work program', although IAS 16, *Property Plant and Equipment* was part of the program.

The European Commission took many by surprise when it announced in June that all EU companies listed on a regulated market (including banks and other financial institutes) should be required to prepare consolidated accounting in accordance with

IAS by 2005 at the latest. It is intended also that within two years the requirement will be extended to all companies preparing a public offer prospectus in accordance with the EU's Listing Particulars Directive. The Commission is proposing also that Member States be permitted either to require or allow unlisted companies to publish financial statements in accordance with the same set of standards as those for listed companies.

The Commission is also proposing to introduce an endorsement mechanism by which IAS will be monitored and approved by political and technical processes. This has caused concern in that it could compromise the move towards true harmonisation. However, Karel van Hulle, head of Financial Reporting and Company Law, European Commission, speaking to TEGoVA in Brussels recognised this concern. Van Hulle said, "People have argued that the endorsement mechanism would inevitably lead to the creation of 'euro-IAS' or to a 'pick-and-choose' IAS. In its Communication the Commission puts the emphasis on the pro-active role of the endorsement mechanism. In a global context, it is essential that the EU takes an active part in the elaboration and formulation of the accounting standards rather than changing, them once issued.....The intention is not to set up a new body which will undo the work delivered at the technical level. If the experts (from the private sector) deliver high quality work, the chance that a standard would be found unacceptable diminishes considerably".

EU companies are already talking about the amount a company reporting under a single accounting framework could save is huge. Hoffman La Roche calculated that it could save Sfr 10m a year; Dutch financial services group ING, which operates in heavily regulated areas in 100 countries, has recently assessed it could save 0.25 bn euro annually.

PricewaterhouseCoopers has conducted a



survey of chief financial officers from 717 listed companies throughout Europe. The overwhelming majority – 79% - supported the introduction of compulsory reporting using international standards. Only 19% of the companies surveyed currently use IAS; 68% use only their national accounting standards. A notable feature of the survey is that in Europe as a whole, three in five respondents said that international standards were preferable to their own national standards. The figure dropped to 1 in 5 for the UK – the lowest of any country. Finally, the advice from 64% of companies that have already converted to IAS is: start planning by 2002 to meet the 2005 deadline.

Market pressure is growing on countries world-wide to adopt IAS. All eyes are now on the US Securities and Exchange Commission. Following the release in February of its Concept Release on the use of IAS in the US, its conclusions are expected shortly. However, the American authorities' commitment to the IASC's new structure seems so complete as to indicate that US GAAP and IASs look likely to converge in a relatively short timescale. It is certainly unlikely that major accounting standards will be issued by either IASC or US authorities that are not agreed by both.

## **NEW INTERNATIONAL ACCOUNTING STANDARD, AGRICULTURE**

IAS 41, Agriculture, was approved by the IASC Board at its December meeting. It becomes effective for financial years beginning on or after 1 January 2003. The Standard does not establish any new principles for land related to agricultural activity. Instead, an enterprise follows IAS 16, Property, Plant and Equipment, or IAS 40, Investment Property, depending on which standard is appropriate in the circumstances. Biological assets that are physically attached to the land are recognised and measured at their fair value less estimated point-of-sale costs separately from the land.

## **IASC INVITES COMMENTS ON ACCOUNTING BY MINING, OIL AND GAS COMPANIES**

An issues paper on financial reporting by enterprises in the extractive industries has been published by IASC. Among the critical issues on which IASC invites comments are:

- The extent to which the costs of finding, acquiring, and developing reserves should be capitalised;
- The methods of depreciating (amortising) capitalised costs;
- The degree to which quantities and values of reserves, rather than costs, should affect recognition, measurement and disclosure; and
- The definition and measurement of reserves.

To obtain IASC publications, please contact Publications Dept, International Accounting Standards Committee, 166 Fleet Street, London EC4A 2DY, UK.

Tel: +44 (171) 427-5927, Fax: +44 (171) 353-0562, <http://www.iasc.co.uk>



## INTERNATIONAL FEDERATION OF ACCOUNTANTS

The International Federation of Accountants (IFAC) Public Sector Committee has released for comment exposure drafts (ED) and an invitation to comment (ITC). The exposure drafts and ITC are another key step in the PSC's efforts to develop a comprehensive body of international accounting standards for governments around the world. The drafts are

- ED14 Property, Plant and Equipment proposes the accounting treatment for property, plant and equipment, including the timing of their initial recognition, and the determination of their ongoing carrying amounts and related depreciation.
- ED 15 proposes requirements for the accounting treatment of leasing transactions.
- Invitation to Comment (ITC) on Impairment of Assets. The purpose of the ITC is to seek comments on the

appropriate accounting treatment for the impairment of assets. It reflects the tentative position that an impairment test should be applied to all assets.

"The ultimate goal of the public sector accounting standards issued by the Public Sector Committee is to improve the financial reporting of governments and their agencies. It is our firm belief that by developing and promoting the use of a comprehensive set of public sector accounting standards, IFAC can contribute to financial management in the public sector, enhance the accountability of governments, and support social and economic reforms, particularly in countries that lack structured public sector accounting systems," comments Ian Ball outgoing Chairman of the IFAC Public Sector Committee.

### PROPOSED PUBLIC SECTOR ACCOUNTING STANDARD, PROPERTY PLANT AND EQUIPMENT

Among the key points for discussion in this Exposure Draft are:

- The Standard requires all items of property, plant and equipment to be recognised where they meet the asset definition and recognition criteria. Accordingly, items of property, plant and equipment such as infrastructure assets, military assets and heritage assets would be recognised in the financial statements where they meet the proposed asset definition and recognition criteria.
- An alternative approach would be for some or all of these categories of property, plant and equipment to be specifically exempted from the scope of the Standard, pending the development of more detailed guidance and/or Standards on these assets. The Committee decided not to exempt infrastructure assets, military assets and heritage assets, on the grounds that, while these assets may have certain unique features, in the main they will meet the definition of property, plant and equipment and the recognition criteria in this Standard. The Committee decided instead to include commentary outlining the specific features of infrastructure and heritage assets.

- The Standard proposes a five-year transitional provision during which entities are not required to comply with the requirement to recognise as assets items of property, plant and equipment that satisfy the recognition criteria.
- On initial recognition of an item of property, plant and equipment, the Standard allows measurement either at cost, or where the item's cost cannot be determined reliably or is not relevant, at fair value as at the date of initial recognition.
- The Standard allows, for measurement subsequent to initial recognition, items of property, plant and equipment to be carried at cost, or as an alternative measurement basis, to be carried at a revalued amount, being its fair value at the date of the revaluation. It states that the fair value is usually market value determined by appraisal and that an appraisal of the value of an asset is normally undertaken by a member of the valuation profession.

#### **EXPOSURE DRAFT, INVESTMENT PROPERTY**

IFAC is to issue an Exposure Draft, *Investment Property* in January 2001. The ED is based on IAS 40, *Investment Property* and requires either a cost or fair value model to be adopted. The ED:

- makes it clear that property held to deliver a social service is not an investment property even though it may also generate some cash inflows. Such property is accounted for in accordance with ED 14 *Property, Plant and Equipment*;
- proposes that investment property initially be measured at cost or where the item's cost can not be determined reliably or is not relevant at its fair value as at the date it is first recognized. This differs from IAS 40 which requires investment property to be initially measured at cost – however, it reflects the requirements proposed in ED 14; and
- clarifies that on initial adoption of the accrual basis of accounting any change in the carrying value of an investment property arising on a move from the cost model to the fair value model be recognized in net assets/equity.

Copies of all IFAC exposure drafts are available on its web site – <http://www.ifac.org>



## THE GLOBAL INVESTMENT INDUSTRY

The importance of global valuation standards to the property investment industry is achieving greater recognition. The IVSC at its London meeting, received a presentation from Ian Cullen on Global Investment Performance Standards (GIPS). Ian is the UK member of the subcommittee developing GIPS to cover real estate.

The IVSC has also been invited to deliver a presentation to the Spring meeting of the National Council of Real Estate Fiduciaries. A brief look at both organisations follows:

### GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS)

The US Association of Investment Management and Research (AIMR) has long been committed to establishing one broadly accepted standard for calculating and presenting investment performance history. Over 13 years ago, the investment performance standards that have now become the AIMR Performance Presentation Standards™ (AIMR-PPS) were first introduced in North America, and were embraced as the industry practice for presenting investment performance. However, the rapid globalisation and growth of the investment industry heightened the need for consistent, globally accepted standards for the calculation and presentation of performance. Investment practices, regulation, performance measurement, and reporting of performance results vary considerably from country to country. Some countries have established performance calculation and presentation guidelines that are domestically accepted, while others have few or not standards.

In 1995, AIMR recognised the need for one globally accepted set of standards and sponsored and funded the Global Investment Performance Standards Committee to develop and publish one global standard by

which firms calculate and present performance to clients and prospective clients. The rules for GIPS were developed by an international committee, representing countries in Europe and Asia, as well as the US. On February 19, 1999, AIMR formally endorsed the GIPS. The GIPS standards have been crafted to meet the needs and capacity of a broad range of global markets. A global investment performance standard gives investors confidence that a firm's record is an accurate and complete picture of its historical performance achievement. Such a standard also facilitates competition in the global investment industry by allowing clients and potential clients to make an "apples to apples" comparison of investment advisory firms, regardless of their domicile.

To provide a practical and effective implementation structure for GIPS, AIMR established the Investment Performance Council (IPC). The IPC strongly encourages countries without an investment performance standard in place to accept GIPS as the local standard. Countries with an existing investment performance standard are encouraged to move the standard towards GIPS by first adapting to a Country Version of GIPS. The pressures to adopt GIPS will be subtle but powerful according to the London Financial Times. The AIMR, itself, is now seeking public comment as it takes an important next step in supporting the convergence to one world-wide performance standard by harmonising the provisions of the AIMR-PPS and GIPS.

GIPS do not yet address real estate. The IPC has formed a Real Estate Subcommittee to draft the Real Estate provisions to be incorporated in the GIPS.

The Subcommittee began its work by examining provisions for real estate contained in the Australian PPS, the VBA standards in the Netherlands, the US AIMR-PPS and in the UK real estate standards

While the RE Subcommittee is confident in its ability to submit a comprehensive proposal of minimum GIPS real estate provisions, it is also aware of significant issues that will continue to challenge the presentation of real estate performance now and in future years. Some of these persistent challenges include 1) real estate valuation practices, 2) the definition and comparability of real estate investment strategies in relation to composite construction and presentation, and 3) the suitability and relevance of real estate performance benchmarks.

As the Subcommittee has noted, valuation standards, methodologies, and prevailing practices vary widely between countries and guidance may be required to define the minimum expectations for an independent appraisal. The IVSC is discussing with members of the Subcommittee the proposal that those minimum expectations be based on the IVSC Standards.

## **NATIONAL COUNCIL FOR REAL ESTATE FIDUCIARIES (NCREIF)**

The US National Council of Real Estate Investment Fiduciaries (NCREIF) is an association of institutional real estate professional who share a common interest in their industry. Investment managers, plan sponsors, academicians, consultants, appraisers, CPA's and other service providers who have a significant involvement in pension fund real estate investments come together to address vital industry issues and to promote research.

Although June 17, 1982 marks the official beginning of NCREIF, the difficult task of uniting a highly competitive industry actually began in the late 1970's. Following several meetings, 14 investment managers agreed in principle to form a not-for-profit entity to foster research on the real estate asset class. This led to the development of a database

consisting of property operating information which used to be known as the Russell/NCREIF Property Index (the Frank Russell Company used to publish the Index). On January 1 1995, thirteen years after its inception, NCREIF assumed full responsibility for the Index, including its publication and distribution.

Produced quarterly the NCREIF Property Index (NPI), shows real estate performance returns using data submitted by its Data Contributing members. The NPI is used as an industry benchmark to compare an investor's own returns against the industry average. Each property's return is weighted by its market value and each property's market value is determined by real estate appraisal methodology, consistently applied.

In 1993, NCREIF, the Pension Real Estate Association (PREA) and the National Association of Real Estate Investment Managers (NAREIM) joined forces to create the Real Estate Information Standards, a text-based description of terms commonly used to report commercial real estate performance to institutional investors. NCREIF's Performance Measurement Committee works closely with AIMR to coordinate real estate performance standards in the AIMR standards with the Real Estate Information Standards that NCREIF produces. The Japanese have translated the Real Estate Information Standards into Japanese because it is expected that the Japanese real estate industry will adopt them as their own industry standards.

And as the AIMR moves to adopt the Global Investment Performance Standards, so NCREIF takes an interest in international valuation standards and hence the invitation to the IVSC to address the Winter 2001 Conference.

For further information, visit the following web sites: <http://www.aimr.org> and <http://www.ncreif.org>

# FAIR VALUE

## FAIR VALUE – THE DEBATE CONTINUES

Slowly, but inexorably, the movement towards adoption of fair value accounting around the world continues as the following evidence shows:

- First, a reminder that IAS 40, *Investment Property*, becomes effective for annual financial statements covering periods beginning on or after 1 January 2001. The Standard permits enterprises to choose either a fair value model or a cost model. However, an enterprise that chooses the cost model should also disclose the fair value of its investment property. This is the first time that IASC has introduced a fair value accounting model for non-financial assets. An enterprise is encouraged, but not required, to determine the fair value of investment property on the basis of a valuation by an independent valuer who holds a recognised and relevant professional qualification and who has recent experience in the location and category of the investment property being valued.

- Arthur Levitt, Chairman, U.S. Securities & Exchange Commission to the Fall Council of the American Institute of Certified Public Accountants (AICPA), October 24, 2000

*“I would like to see you develop valuation models that result in consistent, comparable and fair values of assets and liabilities.”*

- Swiftly followed by Lynn E Turner, Chief Accountant, U.S. Securities & Exchange Commission, in an address in Ohio, November 10, 2000

*“There is **no question** that Fair Value can also provide useful information and I am a staunch believer we need to move toward greater use of Fair Values in Financial Statements. .... We are looking to the AICPA for leadership in developing models that will result in comparable, consistent Fair Value reporting. The AICPA should bring together the appropriate constituents to focus on*

*providing similar guidance on valuation models and methodologies. Those constituents should include valuation experts, accounting standard setters, auditors, preparers and regulators..... I have heard analysts say, as we move toward Fair Value, that the first step should not be a total desertion of historical cost financial statements... Perhaps consideration should be given to a process whereby historical cost and Fair Value numbers are reported side by side, at least for some period of time.”* (Editor’s note: sounds like the solution adopted for IAS 40).

- Former IASC Secretary-General, David Cairns, in his response to the US SEC Concept Release on International Accounting Standards stated that the use of fair values for the measurement of property, plant and equipment *“is more relevant to users than historical cost information and the fair value information is reliable provided that it is determined in accordance with IAS 16 and the appropriate International Valuation Standards”*.

## **DOWNWARD MOVEMENT IN THE REAL ESTATE MARKET PRESENTS A GREATER RISK TO BANKS THAN A STOCK PRICE**

That is the main finding of a report published in April 2000 by the European Central Bank entitled 'Asset Prices and Banking Stability'.

The ECB's Banking Supervision Commission carried out an assessment of possible implications for the EU banking sector in the event of asset prices falling significantly. This was considered appropriate in the light of the observation that historically many banking problems have been caused by a sharp fall in asset prices.

The report investigated the relationship between the structure of the balance sheet of banks and the prices of various assets. The report identifies the main channels through which banks would be affected by a fall in these asset prices: credit risk, market risk, reduction in commission income, re-capitalisation of subsidiaries and the "second round" effects deriving from the impact on the macroeconomic environment and banks' funding conditions.

The main finding was that a downward movement in the real estate market presents a greater risk to banks than a stock price fall. EU supervisory authorities have not, however, identified a major threat to financial stability.

Even the hypothetical situation of a sudden and large stock price correction would probably have limited direct effects on banks' profitability and solvency, since banks have very limited equity investments themselves and the overall incidence of the activity of the subsidiaries specialised in stock markets is limited. Banks' credit exposure through the direct financing of stock investments does not appear very relevant. However, owing to the lack of a comprehensive analysis of the second round effects, one should not rule out the relevance of banks' stock market exposures.

Banks' real estate exposures are more significant, since property is the basic form of collateral accepted by banks and real estate lending constitutes the bulk of lending by banks and other credit institutions (62% of total lending to households and 32% of total lending in the euro area at end-June 1999). Banks' risks associated with a real estate price fall vary significantly across countries, not only due to differences in price developments, but also to differences in property valuation and other lending practices. The use of market value when determining the value of the collateral, accompanied by a high LTV, could constitute a very high risk to mortgage lenders in the face of a downward trend in prices.

Banks' lending margins have narrowed in many countries and rising loan-to-value ratios are reported for a number of countries, while there is no apparent slackening of other credit standards. A factor alleviating the concerns of the supervisory authorities is that the burden of debt servicing has not risen in general, together with the increased borrowing to finance real estate investments, on account of the low interest rate level. However, the financial position of the most recent entrants into the real estate markets could be quite vulnerable.

The ECB report, 'Asset Prices and Banking Stability' April 2000, is available on the ECB website <http://www.ecb.int>

# BANKING

# SPONSORS

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## **FORTHCOMING MEETINGS AND SEMINARS**

- |                    |   |
|--------------------|---|
| April 2001         | IVSC Management Board, Venezuela  |
| 26 - 29 April 2001 | World Valuation Congress, Singapore<br><a href="http://www.worldvaluationcongress.org">www.worldvaluationcongress.org</a>   |
| 13 July 2001       | First World Congress of the International Real Estate Society, Anchorage, Alaska<br>details from <a href="mailto:eworzala@lamar.colostate.edu">eworzala@lamar.colostate.edu</a> |
| 1 October 2001     | IVSC 2001 AGM, Bangkok, Thailand  |
| 2-3 October 2001   | 'Asset Valuations in Globalised Markets'. Conference<br>co-hosted by Thai Valuers Association and<br>Chulalongkorn University, Bangkok  |

# STREETS

**IVSC**



*This Newsletter is produced on behalf of The International Valuation Standards Committee (IVSC) twice a year. The views expressed are not necessarily those of the IVSC Board or of the members of IVSC.  
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