GLOBAL VALUATION ISSUES

IVSC

MESSAGE FROM THE CHAIRMAN

It scarcely seems 12 months since we were launching the 2000 edition of International Valuation Standards – IVS 2000.

IVS 2000 was the first publication arising from the ambitious three year IVSC Standards Project which aims to have a comprehensive and robust set of international standards in place by 2002.

The 2001 edition of IVS is to be launched at the First World Congress of the International Real Estate Society in Alaska in late July. This edition develops and expands IVS 2000 in response to market changes and needs.

IVSC supports the development of a set of mutually reinforcing international financial sector standards of which valuation standards are an important component. We continue to strengthen the relationship with our sister organisation – the International Accounting Standards Board – and we are developing important links with others. The Public Sector Expert Group met with representatives of the International Federation of Accountant's Public Sector Group (PSC) in Melbourne in February. IVSC will be making a presentation to the full PSC later in the year. IVSC representatives also met with representatives of the Basel Committee on Banking Supervision (BCBS). Included in the BCBS consultation package on a new Capital Accord was, for the first time, some detailed proposals relating to the valuation of commercial real estate. Further details on the work of these two organisations plus an update on acceptance of international accounting standards appears in this Newsletter.

The IVSC business plan that launched the Standards Project concludes at the end of 2002. A new business plan will be presented to the IVSC AGM in Thailand on 1 October 2001. Buoyed by positive market reaction to its Standards Project and the enormous success of IVS 2000, the IVSC Board will be proposing a confident and ambitious route march towards the goal of globally accepted valuation standards.

GREG McNAMARA
LFAPI, A.I.Arb
IVSC Chairman

IVSC 2001

IN THIS EDITION

IVSC NEWS

2001 EDITION OF INTERNATIONAL VALUATION STANDARDS

The 2001 edition of the International Valuation Standards is to be launched at the First World Congress of the International Real Estate Society being held in Alaska from 25 to 28 July.

The 2001 edition represents a development of IVS 2000. New Guidance Notes on Valuation Reporting and Discounted Cash Flow Analysis will be published as Exposure Drafts. A definition of 'Mortgage Lending Value' is to be included in International Valuation Standard 2, Valuation Bases Other Than Market Value. International Valuation Application 1 (IVA 1) Valuation for Financial Reporting,and Guidance Note 8 Depreciated Replacement Cost,both of which appeared as Exposure Drafts in IVS 2000, have been extensively reorganised and revised.The new versions of IVA 1 and GN 8 are being published as Exposure Drafts for a further six months.Final versions will be available early in 2002. Guidance Note 5 Going Concern Concept of Valuation, has been withdrawn. It has been superseded by a discussion of the premise of going concern in Guidance Note 6, Business Valuation. A Commentary on the related subject of Specialised Trading Properties is currently in development.

In October 2000, the Committee approved the formation of several expert consultative groups to review IVS 2000 and make recommendations in areas such as 1) valuation in emerging markets, 2) valuation for lending purposes, and 3) valuation of public sector assets. Three new Commentaries have resulted from the work of these expert groups: Valuation in Emerging Markets, An Examination of the Possible Impact of Standards and Statements Issued by the Basel Committee on Banking Supervision (BCBS) on Valuation for Loan Purposes, and Public Sector Asset Valuation. The Investment Property Commentary that appeared in IVS 2000 has been retired and all relevant sections have been incorporated into IVA 1.

At its April meeting in Venezuela, the IVSC Management Board reconsidered the substantive issue of Market Value for Existing Use (MVEU) of land in regard to Depreciated Replacement Cost (DRC), and agreed that MVEU of land represents an essential component of DRC methodology. This issue is addressed in IVS 2001 in IVS 2, IVA 1, GN 8, and the Public Sector Asset Valuation Commentary.

The Glossary has incorporated approximately 60 new definitions and cross-references to terms from the materials that were developed for IVS 2001. Differences in the usage of terminology by Valuers in English-speaking communities of the Commonwealth and North America have also been identified.

The Index is a new feature in IVS 2001.

Copies of IVS 2001 will be available from the end of July. An order form is enclosed with this Newsletter and is also available on the IVSC web site – www.ivsc.org

IVSC WORK PROGRAMME

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

- Expert Group to be established to develop guidance on the valuation of personal property to be chaired by Richard Raymond Alsako (US).

- Raymond Trotz (Germany) is to chair the Expert Group looking at securitisation. Prior research is to be undertaken to identify the valuation issues before coming together with investors/rating agencies/securities commissions.

- Donald Boltje (The Netherlands) to chair an Expert Group considering Valuation for Insurance Purposes.

- An Issues Paper to be developed examining ways to mitigate risk associated with bank lending to property.

- Mass Appraisal – The IVSC has met with huge demand to develop standards/guidance for mass appraisal. The US Appraisal Foundation is developing guidance on this topic and has provided drafts to the IVSC. These will be developed to meet the needs of the international community.

- Guidance on Specialised Trading Properties is being developed.

- Discussions with International Accounting Standards Board on Valuation of Owner-Occupied Properties to be concluded.

- Guidance on the valuer/auditor relationship to be developed with International Federation of Accountants.

- The scope of a possible project on Financial Interests to be defined.

- Guidance on Agricultural Valuation to be drafted to take into account IAS 41, Agriculture which becomes operative on 1 January 2003. The UN Food and Agriculture Organisation has expressed particular interest in this project.

- A Commentary on Retrospective and Prospective Valuations to be developed.

One of the objectives of the IVSC is to achieve convergence between national and international valuation standards. To assist, the IVSC has developed a comparative matrix. The matrix will facilitate the correlation of areas of coverage in IVS with other principal standards documents around the world, i.e.,

- RICS Appraisal and Valuation Manual (commonly known as the "Red Book"),

- USPAP (the US Uniform Standards of Professional Appraisal Practice),

- the Appraisal Institute of Canada's Canadian Uniform Standards of Professional Appraisal Practice,

- the Australian Property Institute's Professional Practice 2000, and

- TEGoVA's Approved European Property Standards (the "Blue Book"),

The matrix is currently being reviewed by the other standard setting bodies but will be made available on the IVSC web site shortly.

INTERNATIONAL ACCOUNTING STANDARDS – AN UPDATE

INTERNATIONAL ACCOUNTING STANDARDS - TO BECOME THE EUROPEAN STANDARD

Activity is intensifying in Europe as some 7,000 listed companies start preparations to switch from the use of national to International Accounting Standards (IAS). On 13 February 2001,the European Commission published its long awaited proposals which would require all EU listed companies to use IAS for their consolidated accounts by 2005 at the latest. The new financial reporting requirements also apply to banks and insurance companies,and national authorities have the option of extending them to unlisted companies and to individual accounts. The most recent IAS/UK GAAP Comparison, written by the Financial Reporting Group of Ernst & Young[(i)], includes a statement that "the UK regulatory authorities will probably take advantage of the option to extend the requirement to apply IAS to all companies, in both consolidated and individual financial statements." The European Federation of Accountants (FEE) has also said that it expects that governments will introduce IAS for a wider range of enterprises than listed companies.

Despite the efforts of the European Commission and despite the adoption of the euro, European financial markets remain fragmented. The introduction of a single set of financial reporting standards is a key element of the Financial Services Action Plan that aims to create a single European Capital Market by 2005.The European Commission decided against producing a distinct body of regional accounting standards saying "This would miss the trend towards globalisation of financial markets and weaken the ability to raise capital by EU companies on third country markets."
The Commission's proposal takes the form of a Regulation, a very powerful legal instrument. A Regulation has direct effect within a member state. By contrast, a European Directive has to be transposed into national law before it becomes effective.
This approach was considered necessary in order to achieve full legal certainty and consistent application of IAS by all listed EU companies and to avoid undue delays in transposition of the new requirements into national law.

The adoption of International Accounting Standards within the EU will obviously also have an impact in other European countries seeking EU membership. Poland, for example, has anticipated the EU decision by issuing revised accounting standards that conform to many IAS requirements to come into force on 1 January 2002.

The Financial Reporting Group of Ernst & Young considers that by adopting IAS,Europe is "embracing a vision for financial reporting that is not necessarily that widely known or understood. It is a vision that consider fair value measurement to be paramount, and rejects historical costs, accruals and the realisation principle as irrelevant. A vision that regards the determination of taxable income or realised profits ass having no place in financial reporting."

2005 may sound a few years off but ….. 2005 accounts need comparative figures for 2004, and to get 2004's profit right, the closing 2003 position must be correctly stated.And that is only eighteen months away.

AND THE STANDARD FOR SINGAPORE

The Committee on Disclosure and Accounting Standards Committee (DASC), a private sector led body formed to review disclosure and accounting standards in

[(i)] *Ernst & Young, 'IAS/UK GAAP Comparison', 2001*

Singapore, has recommended that Singapore should adopt IAS as the accounting standards for Singapore. This would help preserve and strengthen Singapore's position as a major international financial centre. National Singaporean accounting standards would no longer be set.

Public consultation on the proposal began in December last year. Dr Richard Hu, Singapore Minister of Finance launched a second round of consultation prior to finalising the report to Government, on 21 May 2001.

Dr Hu said, "*Meeting high international standards of corporate governance helps us attract foreign capital and assure investor confidence. It would also help Singapore companies continually push themselves to meet the intense demands of the global economy. It is not simply a matter of Singapore companies being stronger in their expansion overseas. It is also very much a matter of domestic-bound Singapore companies being able to withstand better the foreign competitors setting up shop in Singapore. Shielding Singapore companies from competition is not the sustainable route to prosperity. It is high standards and superior capabilities that give the maximum chances of future success.*

The ongoing reviews to align us with global standards, and the initiatives to streamline our rules and procedures, are important steps towards building a world-class business and financial centre. The 1997 Financial Crisis highlighted the importance of good corporate governance and strong regulatory frameworks. Singapore companies managed to escape relatively unscathed because investors and multi-national businesses had confidence in our workers, our companies and the Government. We need to continue strengthening our foundations so that our companies have the resilience to ride the fluctuation sin the economic cycle and the wherewithal to win in the global economy."

BUT WHAT WILL HAPPEN IN THE US?

There is still no formal announcement from the US Securities and Exchange Commission (SEC) following the close of the consultation period on the Concept Release issued in February 2000.

Whether, or the extent to which,the US SEC will accept IAS is of great interest to many European companies in particular. Around 300 EU listed companies currently use US GAAP (Generally Accepted Accounting Principles) as compared to the 275 who use IAS for financial reporting. In most cases, EU companies have chosen the US GAAP to prepare their flotation on US securities markets or to attract foreign of US capital and investors. However, beyond 2005 they too will have to prepare their consolidated accounts in line with IAS under the European Commission's recent proposal.The European Commission acknowledges that this may cause difficulties but has said that it "hopes and expects that SEC will accept in the near future financial statements prepared by EU issuers without requiring a reconciliation to US GAAP". Whether the European Commission has 'inside knowledge' is a matter for conjecture.

The US SEC received around 100 responses to the Concept Release. Perhaps not surprisingly, on the issue of whether or not IAS are now of sufficiently high quality and whether the SEC should accept IAS without reconciliation to U.S. GAAP, most Europeans say "yes, definitely" while most U.S. respondents say "not yet."

Recent speeches by SEC staff give the best indication as to the possible route the SEC may take.The SEC currently accepts IAS with reconciliation to US GAAP. Reconciliation looks set to stay as an interim measure whilst efforts are made to bring IAS and US GAAP closer together. With convergence, fewer reconciling items will exist over time, and at a future date, reconciliation will become unnecessary

Speaking at the Third European FASB-SEC Financial Reporting Conference held in Germany in April 2001, Lynn E. Turner, SEC Chief Accountant, said: "I firmly believe that national standard-setters, auditing firms, and regulators from around the world should support and contribute to the work of the IASB. By bringing the brightest minds together, we can create convergence to a "best of breed" set of global standards that promote and sustain investor confidence. In this way, I believe we can see the elimination of the need for reconciliations in the future."

SEC Commissioner Isaac C. Hunt, Jr. speaking at the same conference echoed these words:" I can think of no greater gift to the investing public then establishing a set of world wide accounting standards. You should also know that I do not hold the view that the American accounting standards are the best in all cases. There is plenty of room for improvement by all. In fact, I hope someday to vote in favor of a set of international accounting standards, where reconciliation with U.S. GAAP would not be needed. I encourage all accounting standard setters, regulators and auditing firms to support and contribute to the important work of the International Accounting Standards Board…….In fact, we believe that the best way to deal with the reconciling items we commonly see today, is for the IASC to set an initial agenda in co-operation with the national standards setting bodies, which would result in all of the standard setters converging on the highest possible standard. That would in and of itself eliminate some of the items requiring reconciliation today. The SEC will continue to take a keen interest in monitoring and supporting this work."

The US House of Representatives Committee on Financial Services has new jurisdiction over accounting issues. On 7 June, a hearing was held on 'Promotion of International Capital Flows through Accounting Standards'. What is striking was that the hearing appeared to accept that there was no longer any debate that one set of international accounting standards was inevitable. Paul Volker, former chairman of the US Federal Reserve Bank and now chairman of the IASC Trustees summed up the situation facing the US; "More directly, the United States and U.S. based corporations have an incentive to remain at the table in the upcoming debates on the international treatment of accounting. The European Union is ready to approve legislation mandating that all consolidated statements of publicly traded E.U. companies conform to international standards as developed by the IASB by 2005. Other major trading partners –– Japan, Canada, and Australia – are also strongly supporting this initiative. I believe they will work toward convergence of their standards with those issued by the IASB. Having competing regional sets of rules does not make sense if we want globalized markets and to protect U.S. interests. Such a result would be unnecessarily costly to investors trying to understand the differences".

THE NEW INTERNATIONAL ACCOUNTING STANDARDS BOARD

The International Accounting Standards Board assumed its responsibilities on 1 April 2001, succeeding the International Accounting Standards Committee. Sir David Tweedie, chairman of the IASB has acknowledged that the key role for the IASB is the convergence of national and international accounting standards towards accounting standards that represent the best possible accounting solution. The medium-term aim is to achieve convergence of national and international accounting standards to ensure that a transaction occurring in Sydney, Stuttgart or Singapore is accounted for in an identical manner. What is required is what the U.S. Securities and Exchange Commission has termed "best of breed" standards. The aim of IASB is to lead a partnership between the IASB and the national accounting standard setters. IASB includes members with specific responsibility for formal liaison with national accounting standard setters in Australia and New Zealand, Canada, France, Germany, Japan, the United Kingdom and the United States. Ideally, national standard setters and IASB would issue similar, preferably identical pronouncements on any given subject.

The IASB met with the chairs of eight leading national standard setting boards for the first time on Thursday 24 May 2001.The meeting was an initial step in reaching agreement on a common work programme for standard setting.Reports of the meeting that appeared in 'The Times' suggest that there was "a genuine buzz of enthusiasm, and a tangible desire to make it all work." The new head of the French body was said to be 'enormously' enthusiastic about emphasising the international context. The head of the German body proclaimed himself to be "fighting for one set of standards world-wide".

THE IMPLICATIONS FOR THE IVSC

Both the US SEC and the European Commission agree on one issue – the need for a strong enforcement infrastructure. International Accounting Standards must be rigorously interpreted and applied. It is acknowledged that companies which currently apply IAS do not always fully comply with the standards.

The auditing profession is under strong pressure to ensure that financial statements have been properly prepared. External securities supervisors will have a critical role. The Forum of European Securities Commissions (FESCO), for example, plans to set up a permanent sub-committee that will work on enforcement issues, notably, "enforceability" of standards within the EU.

The importance of International Valuation Standards to the rigorous interpretation and application of International Accounting Standards is receiving increasing recognition. Sales of IVS 2000 have been particularly strong amongst the auditing profession world-wide.The two sets of standards are, of course, now linked in IAS 40, Investment Property, which acknowledges that the guidance on fair value was developed with the assistance of the IVSC and that the guidance is in substance (and largely in wording as well) identical with guidance in International Valuation Standards.

Two recent reports have highlighted the importance of property valuation and the need for international standards.

(i)*GAAP 2000*

The seven largest firms of auditors have been involved in the publication of an overview of the state of financial reporting rules in 53 countries in relation to IAS. A selection was made of some 60 accounting measures in IAS so the survey did not aim to record all areas of difference. Partners in the large accountancy firms were asked to benchmark their local written rules against those measures, focusing on standards (both IAS and national) in force for the financial reporting period ending 31 December 2000. One of the measures chosen was the revaluation of fixed assets.

From the 53 countries surveyed, 26 (just about 50%) highlighted inconsistencies between national accounting standards and IAS relating to the valuation of fixed assets. The question of revaluation of assets, and in particular the fact that there was no requirement to keep those valuations up to date received much criticism.

(ii) *'International Accounting Standards Survey 2000'*

This survey, the second to be published, assesses the use of IASs in the latest financial statements of 165 listed companies world-wide. It describes the level of compliance with IAS, and how their auditors report on compliance with IASs.
One company surveyed was Hong Kong Land, Hong Kong Land states in its Annual Report that "the financial statements have been prepared under the historical cost convention as modified by the revaluation of certain non-current assets, and comply with International Accounting Standards". The Annual Report includes a copy of the letter from its valuers stating that the valuation has been carried out in accordance with standards issued by the Hong Kong Institute

(i) *International Forum on Accountancy Developments, 'A Survey of National Accounting Rules in 53 Countries' available on IFAD web site www.ifad.net*

(ii) *'International Accounting Standards Survey 2000' David Cairns (www.cairns.co.uk)* of Surveyors,and for properties in Vietnam,in accordance with the UK national valuation standards.The reviewer comments that this is not in accordance with IAS and notes that the valuations were not carried out in accordance with IVS. This is an important comment. It is the view of the author of the report, a highly respected past Secretary-General of IASC, that valuations carried out under national standards, however well respected those standards may be, do not satisfy the requirements of IAS.

Throughout the EU a number of comparison studies are under way, highlighting differences between national and international accounting standards. The UK Comparison Project, for example, states the although IAS 16 and the equivalent UK financial accounting reporting standards are similar in terms of scope and general measurement requirements and options, for those enterprises that choose to revalue their assets, the revaluation methods and the treatment of revaluation losses differ between IAS and UK rules. In other words, once again, compliance with national valuation standards does not necessarily satisfy the requirements of IAS.

The European Commission has said that one of its keys actions is the development of an enforcement infrastructure to ensure rigorous application of IAS by EU listed companies. One focus will be on disseminating implementation guidance, and the IVSC is to open a dialogue with the European Commission seeking its support to wide promotion of the use of International Valuation Standards by EU companies reporting under IAS.

IVSC PARTICIPATES IN DEBATE ON ACCOUNTING BY MINING, OIL AND GAS COMPANIES

The IVSC brought together a grouping of 'experts' to assist in drafting its response to the IASC issues paper on financial reporting by enterprises in the extractive industries. Trevor Ellis, President, American Institute of Minerals Appraisers, took the lead role in drafting the IVSC response with Ray Westwood (Australia), one of the team of IVSC technical writers. Trevor and Ray were assisted by

Michael Lawrence, 1999 President of Australasia Institute of Mining and Metallurgy (AusIMM) who headed the development of the AusIMM's Valmin Code
Bill Roscoe, co-chairman, Canadian Institute of Mining, Metallurgy and Petroleum's committee on Valuation of Mineral Properties
Roger Sawyers, consultant, UK

A copy of the IVSC response will be available on the IVSC web site.

INTERNATIONAL FEDERATION OF ACCOUNTANTS

In February, the IVSC Expert Group on Public Sector Valuation met with representatives of the IFAC Public Sector Committee in Melbourne. The IFAC Exposure Draft 14, Property, Plant and Equipment, was discussed in particular cost based valuation methodology (Depreciated Replacement Cost) and the issues which arise following the removal of existing use as a basis for valuation.

Submissions received by IFAC on ED 14 reflected a high level of support for the propositions included in the ED. The most contentious issue was whether heritage and cultural assets should be recognised and could be measured reliably. At its recent meeting, the Public Sector Committee (PSC) agreed that, in principle, all property, plant and equipment (including military, infrastructure, heritage and cultural assets) should be recognised. However, the PSC has not completed its deliberations on the basis of measurement appropriate for heritage and cultural assets.

The IFAC Exposure Draft 19, Investment Property was issued 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 recognised.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
- permits measurement subsequent to initial recognition at either fair value or cost. However, like IAS 40, if the cost model is chosen, the fair value of the investment property should also be disclosed.

The IVSC has responded to ED 19 and will be meeting with the full Public Sector Committee in Washington in November to discuss both the response and the relationship between the International Public Sector Accounting Standards and International Valuation Standards.

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. In 1995, AIMR recognised the need for one globally accepted set of standards and sponsored and funded the Global Investment Performance Standards (GIPS) Committee to develop and publish one global standard by which firms calculate and present performance to clients and prospective clients. An international committee, representing countries in Europe and Asia, as well as the US developed the rules for GIPS. A global investment performance standard gives investors confidence that a firm's record is an accurate and complete picture of hits 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 principal goal of the IPC is to have all countries adopt the GIPS standards as the Standard for investment firms seeking to present historical investment performance. As of April 2001, approximately 25 countries around the world have adopted or are in the process of adopting the GIPS standards or of establishing a local investment performance standard.

On May 20,2001, the AIMR Board of Governors approved the redrafted AIMR-PPS standards, officially titled "AIMR-PPSTM Standards, the U.S. and Canadian version of GIPS™". GIPS (Ireland) comes into effect on 1 July 2001.

GIPS do not yet address real estate. The Real Estate Subcommittee of the IPC was created in March 2000 to develop new provisions for the GIPS standards to address the calculation and presentation of real estate investment returns. In conducting the research on local market practice, the Subcommittee assessed the treatment of real estate assets in various countries such as the US, UK, Japan, the Netherlands, Australia, Germany and Sweden.The proposed revisions have now been released for public comment.

The proposed Real Estate Section of the GIPS™ Standards applies to all private equity investments where returns are primarily from the holding, trading, development, or management of real estate assets. Real estate includes land, buildings under development, completed buildings,and other structures or improvements held for investment purposes.The rules apply irrespective of whether a real estate asset or investment is producing revenue and also apply to real estate investments with leverage or gearing.

Among the significant issues addressed are:

Valuation Review of Real Estate Assets

When reviewing current practices in several countries, the Subcommittee discovered the valuation review frequency for real estate assets ranges from quarterly to annually. In an effort to standardise valuation practice, the Subcommittee proposes that the GIPS Real Estate provisions initially require firms to value real estate investments at market value at least once every twelve months and by January 1,2005,upgrade the frequency to quarterly.The provisions also recommend firms implement the quarterly valuation before January 1, 2005

This provision addresses frequency of valuation but permits the firm to develop its own valuation procedures. It puts the industry on notice that in the future, valuations must be conducted more frequently than annually. This upgrade in part addresses the GIPS provision that indicates a likely increase in the frequency of portfolio valuation to occur on the date of any external cash flow in 2010.The Real Estate Subcommittee does not think that valuation on the date of any external cash flow is practical for real estate assets, but the Subcommittee believes that it is feasible for the industry to increase the frequency of valuation and improve the accuracy of performance returns.

Independent Appraisals for Real Estate Assets

The Subcommittee also found that many countries also require periodic, independent appraisals to determine real estate values for direct investments; however, the required frequency ranges from annual to every five years.The Subcommittee is proposing to initially require direct real estate investments to be valued by an independent, professionally designated property valuer or appraiser at least once every thirty-six months. Further, the Subcommittee proposes that the frequency is increased to every twenty-four months by January 1, 2005. The provisions also recommend firms implement the twenty-four month independent appraisal before2005.

The proposal defines what is considered an "independent valuation" and what constitutes a "professionally designated,certified or licensed valuer/appraiser". It also provides dispensation in markets where neither professionally designated nor sanctioned valuers/appraisers are available, indicating the firm should take the necessary steps to ensure that only well-qualified property valuers are utilized.

The Real Estate Subcommittee has previously stated that whilst it was confident in its ability to submit a comprehensive proposal of minimum GIPS real estate provisions,it was 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 will be discussing with members of the Subcommittee the proposal that those minimum expectations be based on the IVSC Standards.Without such a requirement,the IVSC contends that "apples to apples" comparisons would not be possible.

BANKING

BANKERS SEEK TO MINIMISE RISK ASSOCIATED WITH PROPERTY LENDING

Since January 2001, the Basel Committee on Banking Supervision has been consulting on its proposals for a New Basel Capital Accord.The common theme behind the proposals is greater risk sensitivity. Risk insensitive capital requirements have contributed to a number of real-world problems. David Clementi, Deputy Governor of the Bank of England, speaking in April wondered whether "if over-investment in highly-speculative real estate development, a common precursor to a number of banking crises, would have been quite so prevalent if capital requirements had better reflected the often-volatile nature of such lending."

Certainly it appears as if the Basel Committee does not think much of commercial real estate as a loan security, assigning it the highest possible risk weighting of 100%. However, the proposed Accord does admit an 'exceptional treatment' for commercial real estate lending, allowing in some limited circumstances, a lower risk weighting of 50%. In so doing, the Committee introduces for the first time in international banking regulations the concept of 'Mortgage Lending Value'.

For a full description of the New Basel Capital Accord and its importance to real estate, readers are referred to the IVSC publication 'Property Valuation and Capital Adequacy in International Banks – A Review of the Proposed New Basel Capital Accord' which is available on the web site – www.ivsc.org.This article focuses on the issue of Mortgage Lending Value.
Mortgage Lending Value (MLV) is a technique with a long tradition in certain European countries, notably Germany. As a valuation methodology it is an emotive issue among valuers. Professionals in some countries praise its characteristics of prudence and longevity. Others who question the whole concept of a "fundamental value" and regard the methodology as wholly subjective match them with an equal passion.

The subject was on the agenda at the October 2000 annual meeting of central bank economists hosted by the Bank for International Settlements.

A theme that pervaded the meeting was the recurrence of financial cycles.These cycles are often characterised by rapid increases in credit and asset prices,and often end with some form of financial system stress.The factors driving these cycles were discussed. In a paper entitled 'Procyclicality of the financial system and financial stability: issues and policy options'.Authors Claudio Borio, Craig Furfine and Philip Lowe contended that the interaction between practices concerning the valuation of collateral and loan-to-value ratios has potentially major implications for the procyclicality of bank lending. "Valuation methodologies that deliver collateral values that move closely with the cycle are likely to generate greater procyclicality. The combination of inflated property markets and market valuation of collateral is particularly problematic."

The authors continue, "Approaches to the valuation of collateral have been classified into two broad and stylised categories: the open market value and the mortgage lending value. The first approach focuses on the value of the asset if exchanged between a willing buyer and seller in an arm's length transaction after a period of proper marketing.The second approach,while still based on an arm's length transaction,is designed to arrive at an estimate of the realisable value of the property that is sustainable in the longer term.

BANKING

Other things being equal, approaches to valuation that are very sensitive to market values or which extrapolate cash flows and other parameters on the basis of short-term horizons would tend to be more procyclical. On this basis, the open market concept would arguably induce a higher procyclicality in valuations than the mortgage lending methodology. The former places comparatively more emphasis on the current transaction value of property, short-term financing conditions and capital gains; the latter is based on an analysis of long-term market trends and discount factors and is designed to produce more stable valuations. The counterargument is that long-term valuations can be used to avoid recognition of losses, with the effect of ultimately prolonging a recession by delaying the resolution of asset quality problems on banks' balance sheets.

Historically, restrictions on loan-to-value ratios and conservative valuation methods have probably helped to mitigate the amplitude of credit-asset price cycles or at least protected banking systems from their disruptive effects. Arguably, it is no coincidence that banking problems in real estate lending have been less evident in some of the countries using conservative approaches. Even so, attractive as the case may be on conceptual grounds, little systematic research has been done on these issues, not least owing to serious data limitations. More definite conclusions about the economic significance of these factors will require further empirical work.

Looking forward, one key issue is the impact of an increasingly deregulated and competitive environment on the viability and ultimate effectiveness of restrictions such on loan-to-value ratios. In particular, in such an environment it becomes easier for borrowers to avoid regulations by obtaining top-up loans from other institutions. Since higher overall ratios increase the sensitivity of the availability of lending to collateral values and reduce the safety cushion of lenders,they heighten the need for reliance on proper valuation methodologies.As in the case of provisioning, methodologies should take due account of the evolution of systematic risk over time, and hence of the losses that could arise from sharp reversals in asset prices associated with the financial and business cycles."

Central banks and supervisory authorities who gathered in Basel for the annual general meeting of the Bank for International Settlements in early June again addressed the problem created by financial cycles. Movements in property prices, in particular those of commercial property, they noted,have been central to the most pronounced financial cycles, reflecting the important role that property plays as a source of collateral for bank loans. One suggestion, proposed in the BIS Annual Report, is that rules regarding collateral valuation could act as a form of built-in stabiliser. The report states that "Countries that have used long-term valuation concepts in valuing collateral, and that have enforced strict loan-to-value ratios for mortgage lending, appear to have had less procyclical financial systems, although the exact role of these factors is difficult to disentangle from other factors."

Mortgage Lending Value (MLV) is a central plank to the exceptional treatment proposed for commercial real estate lending in the new Basel Capital Accord. However, it is rarely recognised or used by valuers outside Europe. As one of a number of risk assessment or "value at risk" techniques it would not ordinarily qualify for inclusion in International Valuation Standards although given its derivation from Market Value indicators,the preparation of a MLV assessment would properly fall into the skill range of valuers. The IVSC does have concerns, particularly with the unclear definition given to MLV in the draft Accord, that there could be a lack of uniformity in approach by valuers in countries outside its origins should it become a service requirement of the global banking community. If it does become a requirement, the IVSC will respond by developing appropriate standards drawing on the long-term experience of its European members.

XML, XBRL - THE NEW BUSINESS LANGUAGE

At its meeting in April, the IVSC Management Board agreed to a request from the Data Consortium to allow the use of the terms from the IVS glossary as part of an initiative to create a commercial real estate vocabulary in Extensible Markup Language (XML). The significance of that decision could be enormous. It will assist in a real estate industry initiative to codify standards to enable the exchange of data. Certainly of equal importance is that it ensures the valuation profession a stake in the current global development to develop a protocol for the electronic exchange of business information being undertaken by a sister organisation to Data Consortium called XBRL.

The Data Consortium is a not-for-profit organisation for the creation, maintenance and promulgation of universal communication protocols for the commercial real estate industry throughout the world. The XBRL Consortium is working towards the development of a protocol for the electronic exchange of business information, including stock exchange filings, audit reports and annual accounts.

Extensible Markup Language (XML)

Both the Data Consortium and XBRL are using the new generation of markup languages,called Extensible Markup Language (XML). Information is currently usually exchanged over the Web using HTML (Hypertext Markup Language) but HTML was designed primarily for the static representation of data. In contrast, the XML language allows for dynamic documents. Documents in XML format include identifiable information attributes that can readily be used and reused by a wide variety of applications. XML tells the browser how to display text and graphics as HTML does, but it also provides the ability to represent data relationships.While HTML has a defined set of possible tag values to describe the appearance of data, XML is extensible (as its name suggests).That means users can define their own set of tags and values that can convey information about data to software agents and to humans.

However, empowering users to define their own tags can also create problems. Two XML documents may use the same tag to describe different items.For example, one document may use the term "value" to describe the appraised value of a property while another may use the term to describe the sale price of a property.An XML application has no way of determining how to process a value element unless it has additional information external to the document

As organisations embrace new technology, in particular " e-commerce" or "B2B" (business-to-business), problems of information interchange become more critical. XML-based standards tend to be industry specific. So various industry groupings are getting together to develop standards to ensure that their particular industry doesn't get left behind in the new world of e-business.

Extensible Business Reporting Language – XBRL

There has been a rapid adoption of the Internet and the Web for business reporting and a growing number of companies are placing financial data on their sites. However, most Web-based reports are merely an electronic version of traditional paper reports. The business reporting environment is still in an early stage of evolving from a paper-based to a digitally based environment.

It is widely believed that an XML- based specification will revolutionise the way financial information is communicated, accessed and used. It will allow potentially limitless access to data stored by companies. Financial reporting is likely to become continuous rather than periodic so making notions of annual and interim reporting out of date. Analysts and others will be able to more easily use the information for further analysis and for comparison with the performance of other businesses around the globe. Banks are expected to insist that companies applying for a loan make their financial information available in XBRL.That financial information will automatically be imported into the bank's loan analysis software.

In August 1999, the American Institute of Certified Public Accountants (AICPA) together with six IT companies and the five largest accounting and professional services firms, announced that it was to develop an XML-based specification for the preparation and exchange of financial reports and data.The initial goal of this consortium called XBRL was to provide an XML-based framework that the global business information supply chain will use to create, exchange, and analyse financial reporting information

Over 100 companies are now part of the XBRL consortium.The XBRL Specification and its first taxonomy for financial reporting of commercial and industrial companies under US GAAP were published in July 2000. A draft taxonomy to provide a uniform structure for the presentation of IAS-based financial statements on company websites has been published for comment and work continues on developing 13 additional taxonomies for other national systems.

On February 27, 2001, (less than 18 months after the formation of the XBRL consortium, Morgan Stanley) filed its 2000 annual financial statements to the US Securities and Exchange Commission in a draft form of XBRL.

The Data Consortium

In 1993 the National Council of Real Estate Investment Fiduciaries (NCREIF),the Pension Real estate Association (PREA), and the National Association of Real Estate Investment Managers (NAREIM) joined forces to establish a set of real estate information standards for the institutional real estate investment industry in the US. The purpose of the information standardisation project was rooted in the perception of the real estate investment field relative to larger and more established institutional investment segments, such as stocks and bonds. The stock and bond segments are primarily public in nature, and have had many years of scrutiny and guidance by regulatory bodes.

Real estate, on the other hand,has been primarily a private market activity, with regulation and information exchange perceived as being less than complete. If private and public real estate markets are to become more acceptable as an institutional investment vehicle, increased standardization of information and its disclosure is critical.

The Real Estate Information Standards (REIS) is a written document produced and accepted as an authoritative source of definitions and applications of terms used in the institutional equity real estate investment business.

If text-based methods of information exchange were all that were required to communicate information and data about real estate, the REIS would suffice. Adoption of Internet-based technologies has begun to have a significant impact on the way all aspects of the real estate business are conducted. Current computer-based applications have difficulty communicating with one another due in large measure to the lack of standardised,industry-specific protocols. As more applications are created or desired within the real estate industry, the problems of communication are likely to get worse rather than better unless concerted action is taken by affected parties.

Data Consortium wishes to foster a community of commercial real estate investors, owners, agents,and service providers who want a cost-effective way to leverage the capabilities of the Internet in their day-to-day business activities, e.g.identifying purchase or leasing opportunities, exchanging purchase or lease contracts, valuing assets, performing due diligence activities, reporting to industry-related organisations. Over 150 people, including representatives from accounting and consulting firms, software vendors, "dot-coms", and real estate advisory firms are now members of the consortium.

To turn words into documents to serve the membership of the Consortium, RREEF has underwritten production of an initial 'enabling standard' for electronically exchanging real estate over the Internet, called the Data Consortium Namespace (DCN) written in the Extensible Markup Language. Because of the need for interfaces to other XML namespaces in order to take advantage of having a single data stream that can serve multiple needs,the DCN and XBRL formats are compatible.

The Data Consortium is to create and post for review and use a series of templates showing real-world applications of the DCN in enough detail to allow software developers to extend the templates into commercial products and services.Among the most commonly requested model applications are:

Property for Sale or Lease – finding a simple and efficient means to post information about property for sale or lease on a wide array of Web-based listing services is a high priority.

Due Diligence Transaction Processing – the process of transacting commercial real estate is complicated and time-consuming and lends itself to the XML standards

Property/Fund Reporting Server – the focus of the project is to identify all the information commonly used to report property and fund performance

Valuation/Cash Flow Forecasting –a model application will be created that captures the information typically required to perform valuations and develop the means for extracting that information from legacy systems for transmittal via the Internet to service providers and applications that can process the data.

Conclusion

Neither the Data Consortium nor the XBRL initiatives are about establishing new valuation or accounting standards but rather enhance the usability of current standards through the digital language of business. But at some time in the future there may be more profound implications for the IVSC and national standard setters. By an early involvement in the initiative, the IVSC is well placed to monitor and advice on these possible implications.

For further information visit the following web site – www.dataconsortium.org

FORTHCOMING MEETINGS AND SEMINARS

13 July 2001	First World Congress of the International Real Estate Society, Anchorage, Alaska details from eworzala@lamar.colostate.edu
1 October 2001	IVSC 2001 AGM, Bangkok, Thailand
2-4 October 2001	'Asset Valuations in Globalised Markets'. International Valuation Forum co-hosted by Thai Valuers Association and Chulalongkorn University, Bangkok (see page 18)

EVENTS

INTERNATIONAL VALUATION FORUM 'ASSET VALUATIONS IN GLOBALISED MARKETS'

The Forum will feature keynote addresses by the Secretary General of the Thai Securities and Exchange Commission, the President of the Stock Exchange of Thailand as well as the IVSC Chairman. Plenary sessions will be headed by prominent speakers from UK, USA,Australia, Singapore and Thailand, who will give their talks on select topics and participate in discussion groups.

Topics for plenary sessions are:

1. Role of Valuation in International Economies

1.1 Valuations and Development of the Real Estate Capital Markets
1.2 Valuations and Real Estate Institutional Investments in Globalized Markets
1.3 Valuations and Property Trusts/Funds
1.4 Bank Lending Valuations
1.5 The Globalization of Real Estate Valuation

2. Critical Interfaces between Valuation and Other professions

2.1 Convergence and Divergence of Valuation and Accounting Standards
2.2 Stock Market versus Property Market Valuations for Listed Property Trusts/REITs
2.3 Machinery and Equipment Valuation for Accounting Purposes
2.4 Valuation Expert Witnesses

3. Future of Valuation in the Changing Real Estate Industry

3.1 Education and Professional Development of Valuers of the Future
3.2 Are Valuers and Property Specialists in the Future Synonymous?
3.3 Impact of Information Technology on Present and Future of Valuation

For furthur information and to register, visit www.ivfb2001.org

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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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