Global Standards for a Global Profession: Developing Understanding for 'Value in Use'

Dr. Sarah SAYCE, Owen CONNELLAN and Dr. Frances PLIMMER, **United Kingdom**

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ABSTRACT

This paper develops work carried out by the authors in the field of asset valuations for financial statements. Their research has concentrated on the treatment of owner-occupied properties in the balance sheet, where a policy of re-valuation is pursued. This paper develops this theme within the context of emergent global standards. It also explores the issue of a hierarchy of standards.

To be meaningful, valuations should meet the tests set by Lind (1998) yet research indicates that this is often not achieved. Much of the debate turns on the *basis* of valuation adopted. In a previous paper (Sayce and Connellan, 2001[b]) the authors called for a universal abandonment of the concept of *Existing Use Value* (EUV), which is, in any case, now excluded from International Valuations Standing Committee (IVSC) guidance. Instead, they advocated the preparation of *Market Value* (MV) and *Value in Use* (VU) calculations to satisfy the generic concept of '*Fair Value*'. The difficulty is that, whilst MV is a well-recognised concept, there is no common understanding of how a VU could be arrived at for owner-occupied property. Since that time the Royal Institution of Chartered Surveyors (RICS) has announced that it is considering the abandonment of EUV, except in a local context (RICS, 2001[c]).

This paper examines some of the possible effects of such abandonment. It concludes that it may lead to an increased need for valuers to regain skills in relation to the determination of *Value in Use.* A refined model based on *Going Concern Value* is put forward for debate.

CONTACT

Sarah Sayce, Owen Connellan and Frances Plimmer
Kingston University
School of Surveying
Knights Park,
Kingston-upon Thames, Surrey, KT1 2QJ
UNITED KINGDOM
Tel. + 44 20 8547 7070
Fax + 44 20 8547.7087
E-mail: s.sayce@kingston.ac.uk, oconnellan@aol.com, fplimmer@hotmail.com
Web site: www.kingston.ac.uk/surveying

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Dr. Sarah SAYCE, Owen CONNELLAN and Dr. Frances PLIMMER, **United Kingdom**

1. INTRODUCTION

The issue of valuation standards is not a new one. What is an issue is how far standards should be a matter of national concern and how far one that is supra-national. Within the UK, the valuer is presented with standards written within national, European and global contexts. This is not a unique situation. Many countries publish standards (Gelbtuch, 1997), as do the European Group of Valuers' Associations (TEGoVA) for the European arena (TEGoVA, 2000) and global standards are supplied by the International Valuation Standards Committee (IVSC) in their International Standards (IVSC, 2000[a], 2001[a]).

The ambition of these publications is the promotion of consistent valuation practice using appropriate bases of valuation designed to supply to the client base figures that are relevant, measurable and clearly defined (Lind, 1998). They also are concerned with the conduct of valuers better to ensure that clients' needs are met. To achieve these ambitions it is important that standards are widely accepted, workable and capable of enforcement. The question that arises is how best this can be achieved: by global, regional or national guidance or a combination thereof.

The paper considers this question generically and then looks in more detail at the implications for valuers that arise from the conflicts that now exist between the treatment of one specific set of properties (corporate owner-occupied assets without a ready market) valued for one specific purpose (the balance sheet). This group of assets is important in terms of analysis of company performance (Krumm, 2000). In so doing it builds on the authors' previous work (Sayce and Connellan, 2000[a] and [b]; 2001[a] and [b]). By examining this group of assets for balance sheet it considers the position of '*Value in Use'* in relation to *'Existing Use Value'* [EUV] and the relationship of both to the accounting concept of '*Fair Value'*.

2. AIMS OF THE PAPER

The paper aims to explore:

- The extant hierarchy of standards and consider whether a two-tier system, based on global and national standards or a three tier system also containing supra-national guidance best meets client needs.
- In the light of the extant and proposed publications, the implications of moves to abandon the basis of Existing Use Value (EUV), particularly in relation to properties that are seldom, if ever, traded and for which the Depreciated Replacement Cost (DRC) approach has normally been adopted, and also taking into consideration the relevance of the concept of 'Value in Use'.

3. GLOBAL STANDARDS: A TWO-TIER OR THREE TIER SYSTEM

The convergence of valuation standards and practice is accepted to be an ambition amongst professional bodies (Adair *et al.*, 1996). Sayce and Connellan (2000[a] [b], 2001[a] [b]), in debating the issue, have argued that asset valuations were the most likely vehicle for convergence. This is because valuations for financial statements had been observed to be the original driver behind the development of valuation standards in both the UK and the wider European context. It is accepted that asset valuations are not an issue in countries in which policies of re-valuation are not employed; nonetheless where they are, they are important.

From a UK perspective there are currently three tiers of valuation standards: global, European and national. This 'three-level' situation is not restricted to the UK and at the national level various bodies publish standards. This presents the question: does each tier have a continuing role – or is it one tier too many?

International Valuation Standards were first published in 1985 (TIASVC, 1985). The latest edition is 2001 (IVSC, 2001[a]). These have as their primary objective the production of "*truly international standards and reporting that meet the needs of financial reporting, international property markets and the international business community…*". Currently (IVSC, 2001) there are only two standards and two applications statements. One of these concerns asset valuations and the other is an exposure draft on valuations for bank lending. In addition, ten Guidance Notes have been produced.

At the European level, the European Group of Valuers' Associations (TEGoVA) publish standards. It is claimed that these adhere, where practicable, to the International Standards but basically their aim is to be more explicit. In some areas the advice to valuers does not comply with International Standards. One such area relates to asset valuations of owner-occupied properties for the balance sheet.

Within the UK, the Royal Institution of Chartered Surveyors (RICS) first published standards in 1976, following concerns about financial accounting and the lack of consistency in valuers' approach to valuations prepared for the balance sheet (RICS, 1976). The first publication addressed asset valuations. It was only in 1995 that the RICS issued *mandatory* standards (RICS, 1995) with wider application.[1] The extant standards, contained within what is colloquially called the Red Book, are primarily UK focused. In the case of assets outside the UK, their use is optional, except where other (national) guidance is silent.

Mandatory Practice Statements (PSs) cover most purposes of valuation and some nine bases of valuation are recognised including Market Value (MV), Open Market Value (OMV), Existing Use Value (EUV) and Depreciated Replacement Cost (DRC). The latter two are used only for asset valuations of owner-occupied properties and DRC is further restricted to specialised (or non-market) properties.

[1] Prior to this the RICS issued guidance to valuers on other types of valuation (RICS, 1980) but this was not as well known amongst members or their client base (Mallinson, 1994)

The Red Book is now in the process of fundamental review (RICS, 2001[2][a], [b] and [c], occasioned, in part, by the recent re-branding of the RICS as a *global* professional body. The initial consultation papers suggest a move to:

- International Practice Statements (IPSs) which will bind the RICS member in relation to valuations carried out regardless of location and which address matters of conduct and *process;* and
- National Practice Statements (NPSs) which will bind the member in relation to valuations carried out in the UK and which address the bases and, in some instances, the method of valuation.

At no time to date, have the consultation papers addressed the interface with the European Standards. So, it is perhaps relevant to examine why there is a perceived need for both global and more local guidance and standards.

3.1 A Matter of Client Protection and Enforceability

If valuers are to serve their clients it is important that there is both consistency and rigour in the processes adopted (Mallinson, 1994). To achieve this at a global level is simply not realistic, given the wide variety of customs and legal frameworks prevailing. Additionally, the IVSC is not a body with enforcement powers; it was set up to be and remains a loose-knit organisation with wide professional body membership but no *individual* membership. As constituted it is not able to produce other than guidance for its member organisations to apply at a national level. The same has been the case with TEGoVA up until now.[3]

The RICS concluded that the only way enforcement can be assured, in the absence of government regulation, is through mandatory compliance with published practice statements by members. In some countries, the degree of professional body membership is insufficiently developed to allow of such a system whilst in others state regulation renders such an approach unnecessary. So, the current thinking of the RICS is to produce a series of IPSs that reflect, but amplify, the principles enshrined in the global standards. This has the advantage that a power of enforcement is structured in to RICS members. They have no applicability to valuers who are not RICS members. NPSs will replace the current practice statements relating to the basis of valuation (as opposed to the process). However, for European countries for which no such structure prevails, if TEGoVA can develop such an enforcement role, it might be very influential in delivering the global objectives. Whether it is relevant to promote the development of similar regional bodies elsewhere to undertake the quality assurance of valuation process is an issue requiring discussion at a global level.

3.2 Valuations: a Matter of Culture and Context

Another barrier to the introduction of a single-tier of valuation standards rests in the cultural and socio-economic context within which they are prepared. Any meaningful valuation must

[2]

[3] Although this is currently the case there are indications that TEGoVA may, through the development of educational accreditation systems be in a position to introduce enforceability in the future.

recognise the wider legal and socio-economic context within which it is prepared; a one-size-fits-all approach is neither practicable nor in the best interests of clients. This would point to the development over time of practice statements for each country. In this the current moves by the RICS are to be welcomed. However, within the UK there is long established professional body structure for both property valuation and for accounting, which has enabled a fruitful, if times difficult, dialogue to develop. In the UK, therefore, European standards may not be required. Such a situation is not replicated in all countries and until this happens the development of regional level standards capable of mandatory application, for groups of countries that share socio-economic characteristics, could have a role.

At the moment however, the situation is confused, without clear linkages between the national, intermediary and global standards, leading to potentially conflicting bases of valuation being adopted. This will be demonstrated through an examination of the treatment of specialised properties within the balance sheet.

4. THE POSITION OF EUV IN VALUATION STANDARD

At the crux of the valuation standards debate for owner occupied properties lies the issue of Existing Use Value (EUV). With the exception of statutory purposes, EUV is only ever used for the valuation of *owner-occupied* assets for inclusion in the balance sheet. Even in this context it is not universally recognised.

The RICS (RICS, 1995 PS 3) defines Existing Use Value in relation to Open Market Value[4] from which it differs only in that it has two additional assumptions. These are that the property can be used for the foreseeable future only for the existing use; and that vacant possession is provided on completion of the sale of all parts of the property occupied by the business.

The definition of EUV as given in the European standards is similar. TEGoVA are very clear that EUV relates to deprival value - or the replacement cost in the event of deprival. However, under International Standards EUV is no longer recognised (IVSC, 2000[a]: 344).

4.1 Historical Background of EUV

EUV was first defined in the 1970s for use in asset valuation (RICS, 1976). European guidance and the first International Standards later followed this. An examination of leading textbooks on valuation practice that pre-date the issue of formal professional body guidance in the UK, reveals no reference of EUV, other than within a statutory context (e.g. compulsory acquisition). US literature contains no reference to EUV as it never has been a basis that has had relevance to American practice. Instead, in the UK, the valuer instructed to prepare valuations for the balance sheet was instructed to prepare a *'valuation on the basis of a going concern'* (see for example Lawrence *et al.*, 1949:217). As recently as 1971 (Lawrence *et al.*, 1971: 244) *'going concern'* was deemed to be an appropriate basis of

[4] The term Open Market Value (OMV) is defined within the Red Book as being synonymous with Market Value (MV).

balance sheet valuation for owner-occupiers. Importantly, such a basis was deemed to be within the remit of the valuer, which point is developed later in this paper.

4.2 How to Establish EUV

In extant professional practice, to establish EUV does not require the valuer to have any knowledge of the business in occupation, other that the baseline knowledge required for the preparation of any market valuation[5]. Instead it requires the valuer to ignore any bids that might arise for the property from any potential purchaser or class of purchaser who might use the asset for a different use. It is therefore fundamentally different from a valuation for 'highest and best use' (HABU) although in reality the existing use may well represent the highest and best use.

For assets for which there is a ready market, the most usual situation is that EUV will equate to Market Value; in this case, arguably, EUV serves little, if any purpose. However, if a property is not being deployed to its 'highest or best use' as it is being under-exploited in economic terms (for example where development value exists) it may well be less than Market Value. Conversely, in some circumstances EUV may be higher than OMV. This may be the effect, for example, of restricted alienation in headleases, planning consents that are personal to the present occupier, or known contamination that does not affect the existing use of the non-specialised property.

However, not all properties do have a ready market. For these assets EUV is interpreted as being the Depreciated Replacement Cost, albeit that where such a value is reported, the Directors will make a decision as to whether or not such figure will be the 'carrying amount.' Therefore, if there is no ready market, EUV will be, at best, a hypothetical figure unrelated to value in transfer. In this it fails to fulfil the tests set out by Lind (1998).

4.3 EUV : Has it Outlived the Reason for its Introduction?

According to the IVSC the concept of EUV *"was developed specifically for financial accounting"* (IVSC, 2000:345) and indeed this remains the case.

Where EUV is reported, if this differs materially from OMV the valuer must report both in order that the client may, within the accounts, reveal the value gap (RICS, 1995: PS 7.4.5)

The justification of this process, from a client perspective, is that the business should not bear in its published accounts, property values that are unreflective of the ability of the business to support that value. So, for example, a company occupying a property with very great development value which can only be realised on vacation of the building (and possibly cessation of the business) will be aware of the issue but the accounts will only formally show the asset at EUV. The debate must be whether this information, which is at best an artificial

[5] It is accepted that to value any property the economic and business context is a vital element. However, due to the fundamental principle of comparative valuations, it is comparable sales data, rather than business factors that drive valuations. Notwithstanding for types of assets (for example, hotels, nursing homes etc.) the value of the trade is very closely connected with the price achievable in the market place.

construct and open to various interpretations, is *consistent* with the concept of 'Fair Value', as envisaged in International Standards (see following Section)

So, EUV can only claim a role if it is seen to be a defensible measure by which an owner-occupied asset can be valued for financial accounts and this means that it must be consistent with the principles enshrined by the accounting standards. The concept of EUV has long had its opponents (Dunckley, 2000) and empirical work carried out by the authors (Sayce and Connellan, 2001) found little sympathy for its retention. The RICS (RICS 2001[b]) conclude that if EUV is to be retained it requires much clearer guidance. However, they accept that convergence of standards is likely to lead to its demise.

So, why does it continue to be recognised within the new European Standards and continue to have the approval of UK bodies? The only conclusion that can logically be drawn is that the continued recognition is an interim position and that unless a change of direction is realised it will go by 2005. It could be argued that EUV is the product of time-specific circumstances and it is now anachronistic. It is neither appropriate as a Market Value nor useful as a measure of 'Value in Use' and therefore if falls short of compliance with the 'Fair Value' principle enshrined in International Accounting Standards. This is now explored further.

5. IMPLICATIONS FOR VALUERS – AND THE CONCEPT OF FAIR VALUE

5.1 Fair Value

If EUV disappears as a valuation and accounting basis there is a need to re-examine the concept of Fair Value. This is a generic term defined in International and other Accounting Standards. It is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction (IAS 16).

In one sense, Fair Value is Market Value [MV]. However, it is generally regarded as being wider than MV. From an accounting perspective "*the Fair Value of real estate included among the assets of a corporate enterprise may consider the contribution of the real estate to the enterprise (its **Value in Use***)" (IVSC, 2000[a]:41). The second 'head' of the definition is important. Under this "*Fair Value is seen to represent the value of the service potential of an asset to an entity, i.e., the future economic benefits embodied in the asset in terms of its potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity.*" (IVSC, 2000[a]:140).

Therefore Fair Value may be viewed in terms of a Market Value (value in exchange) or in terms of a personal 'worth' to the owner (Value in Use). The implication is that the latter calculation is within the control of the property owner, not the valuer.

An examination of the European Standards interpretation of IAS 16 (TEGoVA, 2000) reveals a remarkable similarity to that contained in the International Standards. However, Standard 5, which deals with valuations prepared for the purpose of financial reporting states that "*Fair*

*Value defined**, only in this context**[6], as Existing Use Value – for properties occupied for the purpose of the business*" (TEGoVA, 2000:56).

The RICS supports the UK's Accounting Standards Board (ASB) in rejecting 'Fair Value' in favour of the 'value to the business' model. Under this, the concept of valuing owner-occupied property has three heads. These are:

- The recoverable amount, defined as EUV or DRC (Depreciated Replacement Cost) in the case of non-market assets;
- The net realisable value, in essence Market Value; and
- Value in Use.

The last two heads are consistent with the IAS's definitions of Fair Value; the first is not, except insofar as the IVSC accept DRC as a surrogate for MV for non-market properties.

To summarise, Fair Value is an imprecise term designed to give flexibility to accountants and their corporate clients. This may conflict with the needs of valuers who require specificity in order to give consistent advice. This dichotomy is not yet resolved. The remainder of the paper is written on the premise that Fair Value will continue to be the International Accounting Standards (IAS) principle. This principle, which is to be embraced by Europe, is also due to be adopted by the UK, as it is currently proposed that by 2005 all EU members will be required to conform to IAS.

If it is and EUV is abandoned the need to produce a Value in Use to run alongside MV may increase where a decision to revalue has been taken. The questions are, how and by whom?

5.2 Value in Use: Definition

Value in Use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. It relates to a *specific asset* with a *specific* use and to a *specific* user. It is, therefore, non-market related. It is an estimate of *worth* to the enterprise. This is the interpretation of both the IVSC (IVSC, 2000: 106) and TEGoVA (TEGoVA, 2000:319). However, under the RICS interpretation (see RICS, 1995:PS 12[re-written, 2000]) Value in Use is a part of the 'value to the business model'. Under this, value to the business is the *lower* of replacement cost (taken as EUV) and MV or Value in Use. In relation to the latter, the RICS is quite unequivocal when it states that Value in Use is not necessarily a figure which a valuer is competent to determine (RICS, 1995:PS 12[re-written, 2000])

The definitions under the International and European guidance are quite clear. Value in Use is a DCF based calculation based on the service potential of the asset. They accept that Value in Use is a *value*, whereas the RICS clearly does not, as the RICS works on the presumption that it is not normally possible to estimate the Value in Use of an individual fixed asset. So, does - or should - the valuer have a role in establishing Value in Use?

[6] Authors' bolding.

5.3 The Role of the Valuer in Establishing Value in Use

An examination of the treatment of Value in Use in the Red (RICS), Blue (TEGoVA) and White (IVSC) Books and within accounting standards reveals contrasting views. Generally, the IVSC is not specific as to the valuer's role in relation to Value in Use. However, establishing the carrying amount of impaired assets, IAS 36.27 makes it clear that ordinarily the financial managers of an enterprise would undertake the estimation using data specific to the enterprise and the asset, such as appropriate discount rates. Despite this, valuers might be consulted on certain aspects such as the likely value at the end of the asset's useful life. (IVSC 2000: 133).

TEGoVA, on the other hand, by implication considers it falls within a valuer's remit whereas, by contrast, the RICS, on the other hand, is unequivocal. Value in Use is not a value and it is not necessarily within the valuer's competence (RICS, 1995:PS12).

Prior to the introduction of EUV, the valuer would have seen this as part of his (or her) professional expertise[7] and a calculation would have been prepared, albeit that the methods used varied. In conducting research for this paper, the view was expressed to the authors that the valuer *should* have the skills necessary to perform such a calculation. Indeed, if a consideration of the traditional approaches to the valuation of trading properties[8] is taken, the interpretation of business data is a valuer concern. In essence this is in line with requiring the valuer to have a full appreciation of the underlying economic theory of land pricing and value, without which it could be argued that the valuer is little more than a brokerage expert.

The methodology to establish Value in Use is essentially subjective. But does this take it outside the realm of professional expertise? Presumably not, given that the Calculation of Investment Worth[9] is now fully established as being part of the valuation function.

The authors argue that the valuer *should* have a role within the calculation of a Value in Use. However, it is recognized that, unless they have a specialised knowledge of a particular business, valuers are currently unlikely to be involved in such determinations. Furthermore, if more reliance is to be made on Value in Use as a balance sheet solution, then convergence of accounting precepts will provide a challenge to valuers: accept that their only remit is in relation to MV or re-skill themselves within this area.

6. CALCULATING 'VALUE IN USE' WITHIN THE CONCEPT OF 'FAIR VALUE'

Adopting Market Value usually satisfies the concept of Fair Value as an International Accounting Standard (IAS). However, under this Standard, either DRC (with non-market

[7] By the carrying out of a 'going concern valuation'
[8] Properties such as hotels, leisure properties, nursing homes etc. have traditionally been valued by reference to profitability in the hands of an efficient operator. This requires the valuer to have a deep understanding of the particularities of the industry and business practices as well as an ability to work with consulting accountants.
[9] The performance of a Calculation of Worth relies on the imputing of data from the client and involves careful discussion with the client. However the actual execution of it and advice regarding such calculations are deemed to be within the reasonable competence of the investment valuer.

assets) or Value in Use (estimating the *worth* of assets to the enterprise) can be adopted as more appropriate valuation bases.

Both International and European standards point to Value in Use being a DCF based calculation. Although worded slightly differently both require the calculation of the present value of estimated future cash flow at a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the property (TEGoVA, 2000:44 and IAS 36).

7. A METHODOLOGY TO ENCOMPASS BOTH DRC AND VALUE IN USE WITHIN THE CONCEPT OF FAIR VALUE

The derivation of EUV from former 'Going Concern Valuations' has already been described. The principle that EUV includes DRC is also recognised in the current Red and Blue Books. With any disappearance of EUV, valuers need to consider a methodology to encompass both DRC and Value in Use within the concept of Fair Value. In so doing, it is important to recall that under extant practice in both valuation approaches, the proprietors of an enterprise can influence the level of asset value to be adopted in financial statements.

One alternative approach is to re-consider the method for going concern valuations. This approach has the benefit of simplicity but *does* require the valuer to have detailed industry knowledge – or the establishment of benchmarks to which the valuer can refer. In order to carry out a going concern valuation, the advice to the UK valuer, was that value would be established by *"a combination of either a valuation by comparison or by the contractors' method and the profits method"* (Lawrance *et al.*, 1971:245). Clearly both were expected to lie within the competence of the valuer. This calculation then resulted in a 'ceiling value'. The next step was to establish a *"reasonable amount of trading profits from such a concern"* and estimate this as a percentage return on the ceiling value and estimated working capital. The resultant percentage figure was then compared to a benchmark (fair rate of return) for the industry to establish whether the business could stand the full value – or whether it should be reduced to produce a 'fair' figure.

The example valuation reproduced in the **Appendix** is of a purpose-built property asset, for which little or no ready market exists. The method has been adapted and updated from the original example. An examination of the valuation raises a number of issues, which point to a requirement for valuers to develop new skills (or re-skill?) if such an integrated valuation model is to be adopted.

Step 1: estimate Market Value (or by using DRC as the nearest surrogate). This lies clearly within the scope of current valuer expertise. But, for the RICS model of normal competency, this also marks the limit of the expertise. The valuer is there to interpret the market place and if required by the instruction, to supply an appraisal of the context within which the estimate of value has been produced.

Step 2: provides the watershed. It requires the valuer to both calculate the working capital required and estimate an appropriate level of trading profit from the concern. Valuers working in the field of trading properties (such as leisure units and nursing homes) would not consider such calculations to fall outside the sphere of their expertise. However, in the wider context of commercial property there has been a shift. The client's *accountant* would now be expected to undertake such calculations- if deemed relevant. However, inevitably, this calculation will be undertaken from the stance of the *actual* business - not the hypothetical one - yet this latter source is what is required. The ability to stand outside the business and to work with benchmarks of performance is the 'added value' that the professional valuer should be in a position to provide in the context of the appropriate sub-market.

It is an easy response to say that a valuer has no means of knowing the profitability per square metre any property should yield but, given that every business has to undertake such an exercise when committing themselves to either purchase or lease premises, it should not be beyond the skill of the profession to develop appropriate benchmarks, even for offices and warehouses.

The **final step** is reconciliation. This requires one further input: the fair annual percentage rate of profit for a typical enterprise. Once more there is the issue of whether this is a matter for the client or the valuer or for negotiation. As with the setting of an IRR when undertaking a Calculation of Worth for investment decisions, it is suggested that it could well be developed in the same way, taking into account appropriate benchmarks when developed.

In an earlier paper (Connellan and Sayce, 1996) the suggestion was raised that going concern as a basis of valuation could usefully be re-examined. The current position and the stance adopted by both IVSC and TEGoVA in relation to the adoption and interpretation of Value in Use lend weight to this suggestion.

8. CONCLUSIONS AND IMPLICATIONS

This paper has examined two issues in relation to the emergence, or otherwise, of global valuation practice standards. First it explored the issue of hierarchy of standards and guidance; second it looked at the issues consequent on a potential abandonment of EUV.

In relation to the first issue, a tension exists. The development of international standards has progressed a long way. Many countries are involved with the work of the IVSC and the standards are gaining in acceptance, judging by the stance adopted in the European Standards and the recent views of the RICS. However, it is clear that they alone are insufficient to meet practice needs. They lack enforceability and the necessity to accommodate a wide range of different legal and cultural contexts precludes a 'one size fits all' solution. Furthermore, they are still incomplete; even the application for valuations for financial statements is still only an exposure draft. There remains, therefore, the need to address both enforceability and legal and socio-economic context.

Within Europe there are two-tiers below the International Standards. The EVS advise valuers to comply with international standards insofar as these do not contravene national standards, but they go far further in respect of both scope and conduct. However they do not have enforceability. At the UK national level the RICS practice statements are both detailed and mandatory. As currently written there are a number of conflicts in both content and approach with the international standards, but some of these are being addressed in the current revision process. The initial RICS review process makes no mention of the EVS; it appears to be predicated on a two-tier system.

Such a simple two-tier system has attractions. The national can deal with the matters of local custom and legal framework; the international with the broad picture. Arguably an intermediary layer is not required. On the other hand, at least within Europe it can be argued that such an intermediary tier *is* appropriate. There is much shared business, legal and socio-economic infrastructure in both the 'Europe of the fifteen' and the wider Europe. To provide guidance that can be applicable *across* borders at a level of greater detail than, realistically, can ever be achieved globally, has attractiveness. To perpetuate a system such as currently exists, in which there is ambiguity between tiers, is not in the best interests of promoting global standards.

Taking one example of the conflicts that can arise, the paper addressed the case study of EUV. It is clear that EUV, as a concept, is being abandoned, except in specific country applications, such as the UK, where it is fits the local accounting model. Even here, its life would appear short. If and when it goes, this leaves MV as the only allowable basis. The consequences of this are two-fold.

First, there is an issue of how to treat specialised properties that under EUV would be valued to DRC. In the market place such properties would normally sell for alternative use. Therefore to follow the principle of adopting a land value linked to EUV is untenable. But even if the land element is to be 'Highest and Best Use' (HABU) with the depreciated cost of the buildings being added, then it is arguably doubtful whether the resultant figure really corresponds to the concept of Market Value. Such as approach however, whilst not representing an 'exit' figure' does perhaps provide a surrogate for an 'entry' cost.

Second, the adoption of MV in all cases may run counter to the concept of Fair Value and the resultant figure could be unacceptable as a carrying amount. Value in Use provides an appropriate alternative basis from which to derive Fair Value and by comparing the resultant figure with the Market Value give an indication of performance. This could be argued to be not the valuer's concern. It is for the client to establish in the light of the business operation. The current RICS assumption explicit within the valuer guidance is that Value in Use probably lies outside the remit of valuers. For TEGoVA and IVSC this assumption is less strong. There is a greater acceptance that the valuer may have a role - even if it only to be consulted on certain aspects such as the likely value at the end of the asset's useful life (IVSC 2000: 133).

It is concluded that valuers do, or should, have a very real role to play in establishing the Value in Use - just as they do for value in transfer. This is accepted within the remit of investment valuations, where the Calculation of Worth is now part of the valuer's armoury. The authors argue that in the past Value in Use *was* considered to be within a valuer's remit. With the replacement of going concern by EUV the skill base was narrowed – but the removal of EUV leads to *either* an acceptance of a further reduction in the skill base *or* the need to re-skill. The key to developing a model relies on the establishment of property performance measures as ‘benchmarks’. For some types of property this is comparatively easy – for example trading properties. It is more difficult to establish Value in Use for properties that do not, *per se*, generate a cash flow and for non-market properties.

For the latter (i.e. non-market properties) the interpretation of Value in Use is also problematic. It is suggested that one approach would be to use a cost approach where the building is fairly new – as the very fact of construction provides evidence of value to the owner. If however, the building is old, then the cost approach is not necessarily an appropriate measure of value.

Therefore, the call is made to abandon EUV, even at national level. It serves no useful purpose. Instead to supply clients with valuations which better fulfil Lind’s criteria (1998), a MV with an accompanying estimate of Calculation of Value in Use is argued to provide a sounder basis for informing both clients and their stakeholders. In so doing, the profession should accept that the adoption of Value in Use has serious implications for the future skill base of valuers.

APPENDIX:

THE VALUATION OF A PURPOSE-BUILT PROPERTY ASSET FOR ‘VALUE IN USE’ AND BASED ON A 'GOING CONCERN APPROACH

Step 1: Estimate Capital Value of Asset

Inputs For Outline DRC Valuation
Purpose-Built Property Asset:
Gross floor area: 20,000 sq.m   Construction period: 2 years
Construction cost: £400 p.sq.m   Short term finance: 8.25%
Professional fees: 10.00%   Contingencies: 5.00%
Site Value (4 Ha site): £1,000,000

Calculations *[please note : the following figures are for illustrative purposes only and have no intrinsic significance]*
Replacement Process (DRC)
Building Costs
Building: 20,000 sq.m @£400 p.sq.m   £8,000,000
Prof. fees: @ 10%   £800,000
Contingency: @5%   £440,000
Total Construction: £9,240,000
Interim Finance Costs
Construction Costs: £9,240,000
1 year (av).@ 8.25%   0.0825
£762,300
GRC (Gross Replacement Cost)   £10,002,300
Allow: Depreciation/Obsolescence: say 30%   £3,000,690
NRC (Net Replacement Cost)   £7,001,610

Add: Site Value £1,000,000
DRC (Ceiling Figure) (say) £8,000,000

Alternative Replacement Process (Investment Equivalent)
ERV (net area) 16,000 sq.m. @ £40.p.sq.m £640,000
YP in perp @ 8.00% 12.50
Capital Value (Ceiling Figure) £8,000,000

Step 2: Calculate Return on Capital

The valuer should then decide on a reasonable amount of trading profit from such a concern, say £625,000, and on the total amount of working capital, say £1,500,000. Then £625,000 must then be expressed as a percentage of the 'ceiling figure' plus the amount of working capital:-

$$\frac{£625{,}000 \times 100}{£1{,}500{,}000+£8{,}000{,}000}$$

= 6.58%

Step 3: Reconcile

If 6.58% is equal to or greater than the 'fair annual percentage rate of profit, then the valuation can go in at the ceiling figure of £8,000,000, but if it is less than the real rate, the ceiling figure must be reduced . Supposing that a fair rate in this instance were to be 8%, then the amount of working capital plus the value of land, buildings, plus any plant and machinery, must total:-

$$\frac{£625{,}000 \times 100}{8}$$

= (say) £7,800,000

The amount of working capital must be deducted from this sum, thus leaving an adjusted value of the land, buildings and any plant and machinery at:

£6,300,000 (i.e. £7,800,000 - £1,500,000)

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BIOGRAPHICAL NOTES

Sarah Sayce BSc PhD FRICS is a Chartered Surveyor and Valuer. She heads the School of Surveying at Kingston University (UK), a position she has held for some ten years. She has written and lectured widely on real estate issues in both the UK and Europe. Her primarly specialisation relates to leisure property and she is the Editor of *Journal of Leisure Property*, an international refereed journal. Her research interests also embrace valuation methodology generally and the emergent field of sustainable property. She is also active in RICS matters and currently is a member of the National Council for England and Wales.

Owen Connellan BSc FRICS Rating Dip. is a Chartered Surveyor and Valuer who has written and lectured widely on real property matters in Britain and abroad. He is also a member of the International Association of Assessing Officers (USA) and a Faculty Associate of the Lincoln Institute of Land Policy (USA). He has specialised in rating and property taxation matters and his present research interests include valuation methodology and the application of information technology to asset appraisal and property taxation. Currently he is a Senior Research Fellow of Kingston University in England, where he was formerly Head of School of Surveying.

Frances Plimmer Dip Est Man MPhil PhD FRICS IRRV is a Chartered Surveyor and former Reader who has written books and presented papers at many international conferences on the subject of land taxation. She is a member of the International Association of Assessing Officers (USA) and a member of the Institute of Continuing Professional Development. She is the RICS's delegate to Commission 2 and has been the official secretary to the FIG Task Force on Mutual Recognition of Professional Qualifications for the past four years. She is the editor of *Property Management* and is currently part-time Senior Research Officer with the College of Estate Management and part-time Senior Researcher with Kingston University, both in England.