



## **Commercial property valuations: Accounting and valuation standards show the way through COVID-19**

Accurate property valuations during the current pandemic are shaping as a major challenge given the economic impacts from COVID-19 and the Commonwealth Commercial Leading Code on valuing, owning, managing and administering commercial real estate.

The only credible way through the COVID-19/Commercial Leasing Code conundrum is for the commercial property industry to defer to the recognized accounting and valuation standards.

Valuations will be put under more scrutiny by lenders, regulators, auditors and investors during this period.

Uniformity around property valuation methodology benefits the commercial property industry, including fund managers and investors. Deferring to the recognized standards is critical during a period with little to no comparable transactional evidence available, and an uncertain future.

These robust standards were developed in the aftermath of the Global Financial Crisis (GFC), and cover much of what we are dealing with today.

The relevant accounting standards for Australian commercial property include the following from the **Australian Accounting Standards Board (AASB)**:

- **AASB 13 - Fair Value Measurement:** applies when other standards require or permit an assessment of Fair Value. The standard notes that Fair Value is the price that would be received to sell an asset in an orderly transaction in the principal or most advantageous market under current market conditions, regardless of whether the price is directly observable or estimated using another valuation technique.

The standard covers the comparison approach, the cost approach and the income approach. In applying the approaches, the fair value hierarchy gives highest priority to quoted prices unadjusted in active markets for identical assets (Level 1 Inputs), and the lowest priority to unobservable inputs (Level 3 Inputs).

Appendix B to the standard gives guidance to valuation approaches along with fair value assessment where there is risk and uncertainty, and particularly where the amount and timing of cash flows is uncertain (see B-15 to B-17 inclusive). It also discusses discount rate adjustment techniques which may be relevant (see B-18 to B-22 inclusive).





- **AASB 116 - Property, Plant and Equipment:** relates to valuing assets generally. At paragraph 34, the standard refers to the frequency of revaluations noting that when the fair value of a revalued asset differs from its carrying amount, a further revaluation may be required. The cost model in AASB 116 may be applied when there is an inability to measure the fair value reliably under AASB 140.
- **AASB 140 - Investment Property:** defines investment property as property held to earn rentals or for capital appreciation or both. It covers various issues around measuring the fair value of an investment property.

For example, paragraph 40 requires that when measuring the fair value of an investment property in accordance with AASB 13 an entity shall ensure the fair value reflects, among other things, rental income from current leases and other assumptions that market participants would use when pricing the investment property under current market conditions.

This will be important in considering rental cash flows in the context of the Code.

Paragraphs 53 to 55 are also relevant, referring to an inability to measure fair value reliably because of market circumstances.

Paragraph 53 covers circumstances where the fair value of an investment property is not reliably measurable on a continuing basis. This arises when, and only when, the market for comparative properties is inactive (for example, if there are few recent transactions). If an entity determines the fair value of an investment property is not reliably measurable on a continuing basis the entity shall measure that investment property using the cost model in AASB 116 for owned investment property.

In Australia both the Australian Property Institute (API) and the Royal Institution of Chartered Surveyors (RICS) have adopted the **International Valuation Standards Council's (IVSC's) valuation standards**.

The IVSC republished its valuation standards effective 31 January 2020. It has also recently released a paper on valuation uncertainty relating to COVID-19.

The IVSC refers to the application of the market approach, income approach and cost approach in the same way as the AASB.





In its recent paper on uncertainty and COVID-19, the IVSC says it is critical that valuation reports properly consider observable valuation inputs, and where these inputs are not observable to ensure the assumptions are 'well-applied and articulated'.

When measuring valuation uncertainty, the paper notes any quantitative valuation measures should always have an accompanying narrative describing the cause and nature of the uncertainty.

The property funds industry suffered during the GFC and the lack of uniform guidance for the industry arguably made things worse.

As we negotiate the rapid change and valuation uncertainty brought about by the COVID-19 pandemic, deferring to the recognized accounting and valuation standards becomes vital.

*The standards, along with other COVID-19-related valuation issues are discussed in further detail in the issues paper [Dealing with Valuation Uncertainty – Investment Real Estate](#) by [Property Funds Association](#) together with [Preston Rowe Paterson](#).*

