

**Asset Valuation
Valuation of Land & Buildings
for Public Listing**

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Qualifications

- Bachelor of Science (Estate Management)
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ASSET VALUATION

VALUATION OF LAND & BUILDINGS FOR PUBLIC LISTING

The establishment of valuation standards was initiated by The Royal Institution of Chartered Surveyors (RICS) in the mid 70s during a period when banks were extremely eager to extend loans for property purchasers and increasingly unrealistic bases of valuations were adopted for the Stock Exchange and for mortgage valuation. Some companies were alleged to have floated their shares to the public based on valuations of property assets incorporating goodwill, unrealistic assumptions and bullish projections of market trends. As a result, the Assets Valuation Standards Committee was set up by the RICS in an attempt to establish and regulate standards in valuations for financial statements. The Statements of Asset Valuation Practice and Guidance Notes, commonly known as 'The Red Book', first published in 1976, was the product of this Committee.

With the growth of multi-national companies expanding their activities across national boundaries and having property interests worldwide, there is an ever increasing need for international valuation standards to be established. This led to the establishment of The International Assets Valuation Standards Committee (TIAVSC) of which the Singapore Institute of Surveyors and Valuers (SISV) is a member. TIAVSC had its first meeting in Melbourne in 1981 during the 11th Pan Pacific Congress of Real Estate Valuers, Appraisers and Counsellors. The objective of TIAVSC is to formulate and publish, in the public interest, valuation standards and procedural guidance in the valuation of assets for use in financial statements and to promote their worldwide acceptance and observance. Eligibility to become members of TIAVSC is confined to societies or institutions one of whose objective concerns the valuation of fixed assets for financial statements and which has a substantial number of its members practising as asset valuers.

This paper highlights some of the requirements and salient features of asset valuation in the context of Singapore and the relevant standards and guidelines adopted. To achieve this, it will briefly discuss the fundamental and important aspects of asset valuation such as what asset valuation is, the features that distinguish asset valuation from other types of valuations, the purposes of asset valuations, how land and buildings are classified for asset valuations, the appropriate basis of valuation to adopt and the contents of the valuation certificate. Some of the precautionary measures asset valuers should take and problem areas that may be encountered in asset valuations are also briefly covered.

1.0 Definition of Asset Valuation

Asset valuation refers to the valuation of land and buildings of all kinds and plant and machinery, which are held by a company as fixed assets or current assets, for inclusion or reference in any public or published document.

2.0 Distinguishing Features of Asset Valuations

What makes asset valuation different from other forms of valuations since the latter are also concerned with property assets ?

The following are some features which distinguish asset valuations from valuations for other purposes :

- (1) The main difference is that asset valuations are often published or referred to in a public document such as Company Accounts and other financial statements, stock exchange prospectuses and circulars.
- (2) Such valuations may thus be relied upon by parties other than to whom the valuation is addressed
- (3) As such valuations may be relied upon by parties other than the clients who commissioned the valuations, standards and guidelines thus need to be established to protect the public who rely on information contained in the documents.

3.0 Some Purpose of Asset Valuations

Valuers may be required to undertake asset valuations for the following purposes :

- (1) incorporation in company accounts and other financial statements subject to audit;
- (2) incorporation in Stock Exchange prospectuses and other circulars;
- (3) takeovers and mergers; and
- (4) security for loans, debenture issues and mortgages.

4.0 Land and Buildings Held as Fixed or Current Assets

Land and buildings may be held as fixed assets by companies for the following reasons :

- (1) for owner-occupation by the business;
- (2) as an investment for leasing the property to earn a rental income or for future occupation by the business or for future sale to earn a profit; and
- (3) as a result of the property becoming "surplus to requirements" of the business.

Land and buildings which are held as trading stock do not fall into the category of fixed assets and are deemed current assets.

5.0 Classification of Land and Buildings held as Fixed Assets

Land and Buildings held as fixed assets may be classified as :

- (1) Non-specialised properties; and
- (2) Specialised properties

5.1 Non-specialised Properties

Non-specialised properties are those for which there is a general demand, with or without adaptation, by a variety of business or trades and which are generally bought, sold or leased in the open market for their existing or similar use, generally on a vacant possession basis for owner-occupation or for investment. Examples of such properties are residential properties, offices, shops, flatted/standard factories and warehouses.

5.2 Specialised Properties

Specialised properties are those which are rarely (if ever) sold except by way of a sale of the business in occupation due to the specialised nature of the buildings. Their specialised nature may be due to the construction, arrangement, size, location of the property or a combination of these factors or the nature of the plant and machinery and equipment which the buildings are designed to house. Examples of such properties are oil refineries, chemical works, food processing plants, shipyards, brickworks and cold stores.

6.0 Basis of Valuation

The appropriate basis of valuation that is to be adopted depends on the classification of and the purpose for which the properties are held by the undertaking. It is thus important to establish the class under which the property falls. The valuer could give advice, but it is ultimately the responsibility of the directors of the undertaking to decide the class to which the property or group of properties belong.

Owner-occupied properties may be classified as non-specialised or specialised properties while properties held as investments or are surplus to the requirements of the business will always be treated as non-specialised properties.

7.0 Basic Principle of Asset Valuation

The basic principle of asset valuation is that it must reflect the fact that the assets are in continuing use by the undertaking for the purpose of its current activities. The valuation figure arrived at is thus not necessarily the same amount as that which the assets might expect to realise if sold on the open market separately from the undertaking which owns and uses the assets. The value of a fixed asset may thus be expressed as deprival value i.e. cost to owner of acquiring the particular asset as if ownership had been lost.

8.0 Applicable Basis of Valuation

The following are the major applicable basis of valuation :

- (1) Open market value;
- (2) Open market value for existing use;
- (3) Open market value for alternative use, and
- (4) Depreciated replacement cost.

As stated previously, the appropriate basis of valuation depends on the classification of the fixed asset and the purpose for which it is held.

9.0 Methods of Valuation

Having established the appropriate basis of valuation, the value of the property is to be ascertained using the suitable valuation technique(s). The choice of the appropriate valuation technique is dependent on the type of property to be valued. The five main methods of valuation available for asset valuations as well as valuations for other purposes are the :

- (1) sales comparison method;
- (2) investment method;
- (3) replacement cost method;
- (4) profits method; and
- (5) residual method.

In Singapore, the most common method used is the sales comparison approach. Other methods are often used as checks. For investment properties, the investment method may be more appropriate whilst for specialised properties for which there is a dearth of transactions the more appropriate method to use is the replacement cost approach.

10.0 The Valuation Certificate or Appraisal Report

The form of certificate depends on the nature of the client's instructions and the use of the valuations as well as the requirement for any special format by the relevant legislation and/or any self regulatory bodies. For inclusion in prospectuses, the valuation is usually in the form of a letter addressed to the Board of Directors.

The valuation certificate must be carefully and clearly worded so as not to give rise to ambiguity. Merchant bankers handling the public listing of an undertaking may get solicitors to word the valuation certificate based on drafts proposed/furnished by the valuer.

11.0 Precautionary Measures for Asset Valuations

As asset valuations are almost invariably published in documents which are available to the public, the liability of a valuer might be extended to third parties where it is reasonably foreseeable that the valuation might be relied upon. Hence, while the valuer should exercise the highest standard of care and skill and professional integrity in all valuation work, this is especially pertinent in the area of asset valuation.

Asset valuers should take note of the following to reduce the risk that their work would be taken out of context or misinterpreted and they be found liable for professional negligence to third parties who rely on the valuations :

- (1) Valuers should be familiar with and have up-to-date copies of the principal legislation, standards and guidelines for asset valuations. In Singapore these would include the Statement of Accounting Standards published by Institute of Certified Public Accountants of Singapore, The Companies Act, Code of Takeovers and Mergers, the Stock Exchange Listing Manual and the standards and guidance notes published by TIAVSC and the RICS.
- (2) Asset valuers should have a good understanding of the ways in which real estate valuations can be used and shown in financial statements by accountants and merchant bankers so that they can better communicate with them and ensure that their valuations are undertaken on the appropriate basis.

For instance, it should be noted that the treatment of property assets owned by property companies generally depends upon whether the company is classified as a dealer or an investor. In dealing companies it is assumed that the property is bought or built with the intention of turning the property, either in the short or medium term; the property is thus treated as a development property under current assets. In investment companies, the property asset will be shown as an investment property under tangible fixed assets. There are separate guidelines for the valuation of these two categories of property assets.

- (3) Valuers must maintain the highest standards of accuracy, disclosure and fair presentation in the valuation certificate/report. For instance, any special assumptions used must be clearly stated and disclosed.
- (4) The valuer must be objective and use realistic assumptions where assumptions are necessary. Market trends must be objectively and realistically presented. For instance, if the property is encumbered, the valuer should not value it on the assumption of vacant possession even if instructed by the client.
- (5) The valuer should keep detailed notes of the valuation process, the comparables used etc. This is because he may be required at times to produce explanations or working papers relating to the valuation.
- (6) The valuer, as in all valuations, must maintain a high standard of professional conduct and ethics and should not be subjected to client advocacy valuation.

12.0 Problem Areas in Asset Valuations

12.1 Leasehold interest

Basic accounting concepts require the valuation of leasehold land and buildings which are occupied by an undertaking being valued for financial statements to be based on net current replacement cost on the assumption of an on-going business. In most cases, this will be on the basis of open market value for existing use. This implies that if there are any onerous lease covenants, such as restriction on users or restriction to a particular trade or type of business, which would adversely affect the saleability but not the value of the property to the business, they should be ignored.

Where these circumstances apply, it would be prudent for the valuer to draw attention to the fact that the value to the business is not necessarily obtainable on a sale of the property in the open market. In Singapore, the valuation of factories leased from the Jurong Town Corporation (JTC) and the Housing & Development Board (HDB) on long leases of 30 years or 60 years fall into this category. Such leases often contain covenants which restrict the use or type of business that can be conducted on the premises as well as the requirement of an increase in rent upon assignment of the lease. The value to the present owners, in this case, may, depending on market conditions, be higher than the price obtainable in the open market. For such cases, a separate valuation report would be required for mortgage purposes.

Lease covenants which give rise to a significant difference between open market value and the value of the property to the undertaking, be it to its advantage or disadvantage, should be noted by the valuer and disclosed, even though basic accounting concepts require the valuation to be at net current replacement cost.

13.0 Conclusion

Asset valuation require strict compliance to standards and guidelines as well as full disclosure due to the likelihood of their being used by parties other than the client. A high degree of expertise, skill and care on the part of the asset valuer is thus required. In addition, as in all other valuations, the valuer must exercise a high standard of integrity, professionalism and ethics so as to minimise the risk that the valuation will be taken out of context or misinterpreted. The valuer should also keep himself abreast of developments and changes in the various guidelines and statutory requirements regarding asset valuations and the applicable valuation concepts and techniques.