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By email

30 January 2015

Dear Sirs

Consultation Paper - Draft Regulatory Technical Standards on valuation under Directive 2014/59/EU

We thank you for the opportunity to comment on the proposals in the above Consultation Paper.

The IVSC is an independent, not-for-profit, private sector organisation formed with the objective of strengthening worldwide valuation practice in the public interest. It achieves this objective by:

- Developing high quality international standards and supporting their adoption and use;
- Facilitating collaboration and cooperation among its member organisations;
- Collaborating and cooperating with other international organisations; and
- Serving as the international voice for the valuation profession

The membership of IVSC comprises over sixty professional valuation bodies from more than fifty countries. The IVSC also receives financial and logistical support from a number of the global valuation firms and banks.

The IVSC has a current project to develop global principles for the valuations that are required to support the recovery and resolution of financial institutions. This project is supported by a working group formed from representatives of a number of global banks and prudential regulators from different jurisdictions. This project has informed our comments on the Consultation Paper.

We believe that a number of improvements are required to the proposals in order that they may better reflect established valuation practice and be operationally effective. In summary these involve the following:

- The need to better articulate the differences between valuations prepared for financial reporting or capital adequacy and those required for recovery and resolution.
- The use of definitions and other terms that are not consistent with internationally recognised terms used in valuation.
- An inappropriate identification of the cause of valuation uncertainty, and linked to this an inappropriate emphasis on certain assets.
- Excessive or inappropriate prescription of valuation methods.

In the attached paper we have made detailed comments on different sections of the Consultation Paper, and indicated where we believe the draft can be improved. We have also answered the various questions included within Consultation Paper as they arise through the text.

We trust that you will find our comments helpful. If you would like to discuss any aspect of our comments in greater detail, please do not hesitate to contact us.

Yours faithfully

CG Thorne
Technical Director

IVSC Response to EBA Consultation Paper

Draft Regulatory Technical Standards on valuation under Directive 2014/59/EU

The comments in this response follow the order of the sections and proposed Articles in the Consultation Paper. As in the Consultation Paper, the responses to specific questions are highlighted in the text.

Contents of this Response

Background and Rationale

1. There is potential for confusion as to the relevance of valuations undertaken for accounting or capital adequacy to the value of the business.

We appreciate the need for the RTS to define as clearly as possible the valuation criteria for establishing whether resolution action is triggered. However, we consider that too much emphasis is placed on need for consistency with valuations for accounting and prudential regulation and insufficient emphasis on the reasons why the recovery and resolution value may be different.

On page 5 it states that Valuation 1 "requires considering the value of the relevant entity". This suggests the required valuations are of the whole or part of the entity or business. However, under "Approach to Measurement Assumptions", page 6, it suggests Valuation 1 must be "closely linked to accounting principles and to prudential regulations relevant to the calculation of the entity's capital requirements."

These two statements could be seen as contradictory. The value of an entity or business is rarely revealed by its balance sheet. Only certain assets and liabilities have to be carried on the balance sheet at current value and some items that contribute to the overall earnings of a business are excluded, eg most intangible assets. Many items will be on the balance sheet at depreciated cost, which accords with the relevant accounting requirements but which bears no relation to the price that might be paid for them in the market. The balance sheet is NOT therefore a reliable indicator of the value of a business, or of all its component parts.

Additionally, unless the most recent accounts are qualified, they will have been prepared on the assumption that the entity is a going concern, ie that the entity can continue in operation for the foreseeable future. In the circumstances of a recovery and resolution scenario this assumption would not be appropriate. If an entity is failing or likely to fail the valuations appearing on the balance sheet may no longer be appropriate.

Elsewhere the proposed RTS do mention the need for the balance sheet figures to be challenged and adjusted as necessary, for example where assets are being carried at figures in excess of their current value, but these statements are outweighed by those asserting that the valuations must be consistent with accounting valuations. We believe this is the wrong emphasis. While the valuations prepared for accounting (or capital adequacy) form a starting point and useful data for the "ex ante" valuations in recovery and resolution, the appropriate assumptions and what should be included for the latter will always be different

We recommend the wording be revised to make it clear that while the processes that a firm has in place for producing values for financial reporting or capital adequacy will assist in providing the valuations required to support resolution action, not all relevant assets will be covered by these processes. Additionally, some of the criteria and assumptions required where resolution action is contemplated will frequently be different from those required for other purposes. While we agree that any material differences between the values of assets on the most recent balance sheet and those of the same assets in an ex-ante valuation should be disclosed and justified, it is potentially confusing to suggest that the two valuations should be normally consistent.

2. Valuation Uncertainty

The Criteria for Valuations 1+2 on page 7 state that the valuer shall focus on areas subject to significant "valuation uncertainty" and provides loans, loan portfolios or repossessed assets as examples.

We disagree that the focus should be on assets that are subject to significant valuation uncertainty. In establishing the value of a business, or part of a business, in a potential recovery scenario the focus should not be on the value of individual assets or asset types but on the contribution that these make to the overall cash flows. It follows that the focus should be on the most significant assets of the business. The number of assets that might be deemed as being "subject to material uncertainty" could be immaterial in the context of the overall business and it would be inappropriate to concentrate on these. Our recommendation is that the focus should be on how different types of asset may be most effectively combined to minimise the loss to creditors and not on assets that happen to be subject to material valuation uncertainty.

The risk of inappropriate emphasis being placed on assets subject to uncertainty is compounded by listing examples of specific asset types that are always assumed to be subject to uncertainty, such as in the proposed Article 8. The degree of uncertainty attaching to any valuation of the types of asset listed, or any other type of asset, is dependent on the market conditions on the valuation date rather than the nature of the asset.

The International Valuation Standards (IVSs) require uncertainty to be disclosed when it is material. The IVSs provide guidance[1] on identifying both the causes of uncertainty and when it is material. The IVSs define valuation uncertainty as:

> *"The possibility that the estimated value may differ from the price that could be obtained in a transfer of the subject asset or liability taking place on the valuation date on the same terms and in the same market."*

An element of uncertainty is present in all valuations. In considering whether uncertainty is material and therefore requiring particular consideration and disclosure, regard has to be had to the purpose and context of the valuation

For some complex and illiquid instruments valuation uncertainty can be an inherent feature of the product. However, valuation uncertainty is more frequently caused by market conditions at the valuation date, and can affect even the most liquid of assets for which reliable price data is normally available. Attempting to identify uncertainty by asset type could therefore lead to material uncertainty being overlooked.

[1] IVS TIP 4 Valuation Uncertainty, IBSN 978-0-9569313-8

Draft RTS for Purposes of Resolution

3. Confusion between accounting and recovery and resolution requirements

Preamble (3) Page 10. The second sentence states that the valuations are not meant to replace accounting principles or to introduce greater prescription into accounting standards. While this may have been intended as a clarification, it actually introduces potential confusion. As indicated in Comment 1, accounting requirements have no relevance to the valuations required. Furthermore accounting standards only apply to the preparation of financial statements, not for any other purpose. For example, IFRS 13 *Fair Value Measurements* clearly states that it is not intended to establish valuation standards or affect valuation practices outside financial reporting. The current sentence implies that valuation requirements for accounting or prudential regulation are relevant. We recommend that it is either omitted or replaced with a clear statement that the requirements for valuations under accounting standards or prudential regulation are not applicable.

Paragraph 8 on page 11 states that a valuation for recovery and resolution needs to be consistent with applicable accounting and prudential regulatory frameworks, although the following sentence recognises that different management assumptions may be required. However, it is not only management assumptions that may be different but also other assumptions and conditions. What may be valued, how it is valued and the assumptions required by accounting standards are all different from those that are appropriate under resolution and recovery. It would be preferable to clearly explain that a valuation for recovery and resolution will normally require the inclusion of assets or liabilities that are not included in valuations for either the entity's financial statements or regulatory capital, and that different assumptions may also be required.

4. Imprecise use of valuation terms

Paragraph (12) of the Preamble uses the term "economic value". This is not a term that is defined in the draft RTS, or one that has a generally recognised meaning in business valuation generally. Likewise the term "franchise value" is introduced in (13). Although this term is defined in the draft, the term franchise value is also one that has no generally recognised meaning among valuation professionals.

The draft explains that "economic value" is based on the present value of cash flows that the entity can reasonably expect, and "franchise value" is the present value of cash flows that can reasonably be expected to result from business opportunities, including those stemming from the different resolution actions that are assessed. Since both economic value and franchise value are concepts that are intended to help establish which resolution action should be taken and both are based on cash flows that can reasonably expected, the distinction, if any, between these terms is far from clear.

Calculating the present value of expected cash flows (or the "income approach") is the most common method of valuing any business and also can be used to indicate many different types of value depending on the inputs and assumptions used. The method used to arrive at a particular type of value does not assist in defining what that value is supposed to represent.

The International Valuation Standards recognise that there are three main types of value; value to a specific party with no exchange involved, value in an exchange between two specific parties and value in an exchange after exposure to the market. Within each of these three basic types there are many different definitions, or “bases of value”, that provide different nuances under the basic premise. In most cases the principle that no creditor should be worse off as a result of resolution means that a value in exchange after exposure to the market is the most appropriate type of value to use. Unless there are special circumstances market value will reflect the best price reasonably achievable.

“Fair value” does assume an exchange in a market but is mainly associated with financial reporting where its application is precisely defined. In order to meet accounting objectives its application in some situations departs from how a price would be determined between market participants. Examples include the need to ignore controlling interests for certain categories of financial instrument and in the treatment of certain liabilities. Our recommendation would be to use the definition of “market value” as it appears in the International Valuation Standards. Not only is this definition widely recognised and used, but it is supported by a detailed conceptual framework that aids interpretation and consistent application. A copy of this definition and the conceptual framework is at Appendix 1.

If the conditions under which a resolution occurred precluded all the conditions in the IVS “market value” being met, for example there was a constraint that prevented “proper marketing” then a value taking into account that constraint could be provided. Although this would not be the market value, the almost limitless range of circumstances that could preclude proper marketing or the parties acting reasonably etc mean that this is not a type of value to which a single definition can be applied. We attach an extract from the IVS Framework that explains the approach to “forced sales” as Appendix 2.

Paragraph (14) refers to liabilities that are measured at fair value. For clarity we recommend that the words “for accounting purposes” are added after “fair value”. This will avoid readers believing that fair value is another type of value that is required in recovery and resolution.

5. Article 1 paragraph 4 and 5:

While the wording of (4) provides greater clarity on the distinction between valuations required under the BRRD and those required for accounting and prudential valuation (see Comment 3 above), the words “…are not meant to replace accounting standards…” still imply that under certain circumstances they could replace them. It would be better to make an unequivocal statement, eg “…and do not replace accounting standards…”

We generally support (5) which correctly indicates that the information gained in the recovery and resolution valuation may be useful in preparing an updated balance sheet under Article 36(6) of the BRRD. However, preparation of the balance sheet is not a valuation but an accounting function, and while the valuer can provide inputs to the preparer of the balance sheet, responsibility for the balance sheet should remain with either the entity or the resolution authority as the case may be.

6. Article 2 Definitions

(g) We discourage the use of the term "exit value" for a number of reasons:

- Firstly, IFRS describes Fair Value as an "exit price" at the measurement date from the perspective of a market participant that holds the asset or owes the liability. The similarity in the terms could be source of confusion.
- Secondly, as defined in the draft, the concept envisages a sale or transfer and therefore the seller's exit price will be the buyer's entry price, so describing only one perspective of the transaction could distort the value. In a resolution scenario the price that a buyer is willing to offer is at least as relevant as the price the seller expects to receive.
- Thirdly, reference is made to a "given disposal period". It is not explained how this disposal period is determined, or what assumption shall be made about market conditions in this period, however long it might be.
- Finally, the word "exit" may imply to some that all positions are exited, even where it is possible to hold to maturity and this would result in the greater value and recovery for creditors.

(h) We have commented on the inappropriateness of the term "franchise value" in Comment 4 above.

(i) Equity value is defined in the IVSs as "the value of a business to all its shareholders". The definition in the draft is not consistent with this. We recommend that the IVS definition be used as it is the most widely recognised definition used by professional business valuers. If the requirement is for an "assessed market price" the conventional way of describing this would be "market value", so compounding the two definitions would provide "market value of the equity". The final part of the definition in the draft is redundant. A definition of a type of value should not include reference to its calculation. If the use of generally accepted methods is required, and we believe this is sensible, words to this effect should be included in Article 7.

Question 1

Would you suggest any changes to the definitions of valuation approaches (letters e-i)?

Yes – see 6 above

In particular, are there specific valuation methodologies which the definition of equity value should refer to?

No. Definitions of value should not mention methods – 6 see above

(j) Measurement base. We cannot understand the definition as written. A "measurement basis" is sometimes used to describe the type or basis of value required, ie what the valuation represents. For example, this is the context in which the word is used in IFRS 13 *Fair Value Measurements.* However, the reference to a "process for determining monetary amounts" in the proposed definition and its usage in paragraphs 2 and 3 of Article 12 suggest that the words are being used to describe the valuation method adopted. A basis of value and a valuation method are very different things and should not be confused. As already explained (See Comment 4), the same methods can be used to estimate a variety of different bases of value.

The basis of value required is determined by the purpose of the valuation and the basis determines the inputs and assumptions that are appropriate when applying the selected method or methods. Without understanding what the purpose of this defined term is intended to mean we cannot propose an alternative, but we strongly recommend that this proposed term be changed or deleted.

7. **Article 3 (4)**

The classification of creditors is not a valuation role and should not be part of the valuation task. Correct classification is a legal matter and should be undertaken by appropriately qualified legal experts. If provided with a classification the valuer can then allocate value to each class depending on the assets over which they have claims.

The reference to "normal insolvency proceedings" needs clarification. The implication is that the alternative to the chosen resolution tool would be liquidation, but in many jurisdictions there are alternatives to liquidation under "normal insolvency proceedings". We note that the FSB's *Key Attributes* specifically refers to liquidation as the alternative to resolution and we believe that the clarity of the RTS would be improved by also referring to "liquidation" rather than "normal insolvency proceedings".

8. **Article 4**

While it is appreciated that this is a non-exclusive list and that it correctly states that the valuation shall be based on any information the valuer deems relevant, we recommend that the preparation of a comprehensive list of the entity's assets and liabilities should be near the top of the list. As explained in Comment 1, the financial statement will not necessarily include all relevant assets and liabilities that contribute, or potentially contribute, to the cash flows of the business. We note that this is actually a requirement in the proposed RTS for the no creditor worse off valuation and see no reason why it should not be paralleled here.

We also refer to a point made in our response to the draft RTS on Independent Valuer on 10 October. The independent valuer will be heavily reliant on facts and data supplied by the entity, especially given the probable scale of the valuation task in relation to a very limited time scale for its completion. It may be worth making this point here. The use of facts and information provided by the entity does not prohibit a valuer from reaching an independent conclusion.

9. **Article 7 (3)**

Again there is an inappropriate statement that valuations should be consistent with applicable accounting and prudential valuation framework. See Comments 1 and 3

Question 2:

Should specific types of information be required on deviations from management assumptions, for example on differences in expected cash flows and/or the discount rates?

To comply with the IVSs a valuation report must include the principal reasons for the conclusions reached, so in principle we agree with this type of disclosure. However, there could be practical difficulties in highlighting any difference from previous valuations undertaken by or for management if these were not supported with sufficient detail.

10. Article 8

We disagree with the proposed requirement to focus on "areas" of significant uncertainty, especially where this is defined by asset type. See Comment 2 above.

> **Question 3**:
>
> Would you add, amend, or remove any areas which are likely to be subject to significant valuation uncertainty?
>
> **Yes. We would recommend amending this list, and removing most of it as it incorrectly links uncertainty with asset types rather than market factors. See comment 2 above. Significant (or material) uncertainty must be disclosed under the IVSs and therefore we would support identifying and disclosing this in the RTS. We recommend the IVSC's guidance on identifying and disclosing Valuation Uncertainty.**

11. Article 9

We note that the BRRD requires a "buffer" to be provided where a valuation is provisional. However, we question whether such a buffer can realistically be expressed quantitatively, and therefore whether it can provide useful information. By definition a provisional valuation will be provisional because the valuer knows that there are unknown losses, but because they are unknown they cannot be quantified.

We submit that the buffer should be a separate exercise from the valuation and determined between the valuer and the supervisory authority, and may be a qualitative explanation of what is known and unknown to enable an informed decision to be made on the potential for the provisional valuation change once the full facts become known.

We note that Article 14 suggests that a buffer may be estimated by extrapolating losses from the entity's peers, but even this very approximate approach still requires some knowledge of the "unknowns" to judge whether these are comparable with the peers. This information may not always be available.

> **Question 4**:
>
> Should the buffer instead always be greater than zero? If yes, how should the buffer be determined?
>
> **If a provisional valuation is prepared it will require a buffer under the BRRD and therefore it must be more than zero – although we question the practicality and usefulness of any buffer expressed numerically when it is based on unknown facts.**

12. Article 11

> **Question 5**:
>
> Do you agree that a valuation of post-conversion equity is necessary to inform decision on the terms of write-down or conversion?
>
> **Yes.**

Question 6:
Do you agree with the definition of equity value for this purpose in Article 2 (i)? If not, what changes should be made to the definition? Should the definition be more closely linked to the net asset value determined on the basis of the remainder of valuation 2 adjusted for goodwill/'badwill', and if so how should that adjustment be estimated ?

We have already commented on the definition of equity value (see Comment 4). We are not sure what is meant by the "remainder of Valuation 2". Equity Value can exceed NAV because of goodwill (among other things) but goodwill is the residual amount when NAV is deducted from Equity Value. You cannot compute equity value by adding goodwill to NAV.

13. Article 12

We have already commented on the inappropriateness of the term "measurement base", see Comment 6. We note that in (4) there is a requirement for the valuer to use "hold value" as the appropriate measurement base. Hold value is not defined but is assumed to be the value to if held within the entity. This usage of "measurement base" suggests that it may be intended to be the type of value required rather than the method used to calculate it but it underlines the confusion between these distinct elements of the valuation process in parts of the draft. The lack of clarity about what "measurement base" is intended to mean makes the purpose of this whole Article difficult to understand. It is a disjointed series of statements that largely are made elsewhere in the draft.

14. Article 13

We have already commented on the proposed definitions of "exit value" and "franchise value" and their use here does not improve comprehension of those terms. It appears that "franchise value" is being used in situations where the entity is likely to hold an asset and "exit value" where a sale is deemed necessary. Whether the most appropriate action is to hold or sell will be determined by which results in the higher value, ie the value informs the decision to hold or sell. The discussion here seems to reverse this and suggest that the valuation objectives and approach will be determined by the decision to hold or sell.

A market valuation assumes a transaction even if none is intended. Whether an asset is held or sold will generally make no difference to the way in which cash flows are estimated. The exception is if the asset in question is subject to some contractual restriction that would prevent a sale or impose a penalty in the event of a sale.

Under either a sale or hold scenario the objective has to be to determine the market value, as this will reflect the best return to creditors unless an above market bid is forthcoming. If assets are to be disposed of separately the relevant measure is the market value of the individual assets. If certain assets are held within the business, the relevant measure is the market value of the business. The measurement objective is the same; the difference is in what is included in the value.

The draft confuses the difference between the required measurement basis, ie what the value represents, and the method of realising that value, and therefore the guidance in this proposed Article will be far from clear to many valuers.

Draft RTS to determine difference in treatment following resolution

15. Article 1

The second sentence of (2) is unnecessary and the discussion of discounted and undiscounted amounts is potentially a source of confusion. Having established that the valuation date is the resolution date there is no need to say more.

Question 7:
As an alternative, should the use of information that becomes available after the resolution date be more restricted, and in particular permitted only if it refers to facts and circumstances existing at the resolution date which could reasonably have been known at that date?

Yes, although we do not see this as being "more restricted". It is important that only facts that would have been reasonably known or anticipated by market participants on the valuation date are taken into account. The current wording of the draft restricts the valuation to facts and circumstances existing at the valuation date, which would preclude matters that could have been reasonably anticipated by market participants but not actually confirmed until after the valuation date. This could lead to relevant matters being artificially excluded and a misleading valuation.

Question 8:
Should the use of information available after the resolution date be further limited, for example by requiring that such information is only used if it results in a significant change in the values of the entity's assets or liabilities?

We see no reason for such a restriction. As a matter of course a valuer is only going to be concerned about events after the valuation date if they potentially have a significant impact. However, writing this into the RTS would create grounds for challenge and dispute as to whether the RTS had been followed, ie whether a post valuation date event results in a significant change or not.

16. Article 2

"Relevant Discount Rates" is not a term that needs defining in the context of these regulations. It introduces an element of prescription into the valuation process which is inappropriate. An independent valuer is required. That independent valuer will also be required to have the requisite skills, knowledge and experience. Prescribing the valuation method in the RTS conflicts with the principle of independence.

17. Article 3

(1) is a prerequisite for any valuation. Why is this specifically required under the draft RTS for Valuation 3 but not under that for Valuations 1 and 2?

(2) is inappropriate. The classification and determination of the rights and priorities of creditors is a legal matter and should be undertaken by an appropriately qualified lawyer based on information provided by the resolution authority or supervisory authority. These details should then be provided to the independent valuer.

18. Article 4

The purpose of the valuation is clearly set out in (a), (b) and (c) and accords with the BRRD. However, the opening sentence is inappropriate. The role of the independent valuer is to prepare the valuation in order for others to determine the points in (a) , (b) and (c), not to make that determination themselves. We suggest this be amended to:

"The purpose of the valuation shall be to establish whether shareholders and creditors would have received better treatment if the institution under resolution had entered into liquidation This requires consideration of:"

The reference to "mechanics" in the title is also inappropriate. Mechanics suggest a process and none is discussed in this Article.

19. Article 5

While most valuations of a business or its assets, including one that is facing insolvency, will be valued using a method under the income approach, it is wholly inappropriate for the draft RTS to limit the method used for this valuation to a discounted cash flow. We have previously made the point (see Comment 16) that prescribing the methods that may be used conflicts with the principle of independence. There is also an internal inconsistency with paragraphs 5 and 6 which place an emphasis on observed prices. We strongly recommend that 1 and 2 be deleted.

Question 9:
Should these technical standards provide further detail on the characteristics of appropriate discount rates?

No – Technical valuation standards can include the valuation purpose, what the reported value should represent, any sources of information that should be considered, any assumption that would be permissible (or not permissible) and any disclosures required when reporting the valuation. They should <u>not</u> attempt to limit the valuer's independence or the exercise of proper professional judgement by prescribing the method to be used, or any input to a method, such as a discount rate.

We have no comment on paragraphs 3 – 9 of the proposed Article.

20. Article 6

If the word "market" is inserted between "overall" and "value" in the penultimate line of paragraph 2, paragraph 3 becomes redundant and can be deleted. This will provide a better explanation of what the required valuation should represent.

Question 10:
Are there any changes you would suggest to the methodology for determining actual treatment of shareholders and creditors in resolution? In particular, should the methodology for valuing equity be further specified and, if so, what should be included in that specification (whether additional detail on the current approach, or a different approach, linked for

example to net asset values adjusted for goodwill / badwill)?

No. Paragraphs 1, 2 and 4 simply state matters that the valuer shall identify and/or consider. This is all relevant material for the RTS. As previously indicated the RTS should not be prescribing or limiting the valuation methods that are available to the independent valuer.

21. Article 7

Question 11
Should the valuer be required to accompany the comparison envisaged in Article 7 of this Regulation with additional relevant disclosures? If yes, what should those be (for example, documentation of any differences between the valuation of actual treatment and the market price that would be observed for those same claims were they traded in an active market)?

We believe that each valuation should be properly reported in its own right and in accordance with the IVSs, subject to any requirement under national insolvency law or regulation. This will allow those relying on the valuations to understand the key assumptions and rationale behind each valuation and for the key differences to be recognised. Only then and the process of comparison be carried out, both of the overall entity and of individual creditors and shareholders positions. The reports of the comparison between the valuations under Article 5 and Article 6 can be quite simple if there are robust background documents.

A requirement that the valuation should be produced in accordance with in accordance with the International Valuation Standards would also provide additional guidance for the valuer on what constitutes a satisfactory valuation and a higher level of assurance for those relying on the valuation.

Market Value – extract from IVS Framework

Market Value

29. *Market value* is the estimated amount for which an asset or liability should exchange on the *valuation date* between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

30. The definition of *market value* shall be applied in accordance with the following conceptual framework:

(a) "the estimated amount" refers to a price expressed in terms of money payable for the asset in an arm's length market transaction. *Market value* is the most probable price reasonably obtainable in the market on the *valuation date* in keeping with the *market value* definition. It is the best price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer. This estimate specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, special considerations or concessions granted by anyone associated with the sale, or any element of *special value*;

(b) "an asset should exchange" refers to the fact that the value of an asset is an estimated amount rather than a predetermined amount or actual sale price. It is the price in a transaction that meets all the elements of the market value definition at the *valuation date*;

(c) "on the *valuation date*" requires that the value is time-specific as of a given date. Because markets and market conditions may change, the estimated value may be incorrect or inappropriate at another time. The valuation amount will reflect the market state and circumstances as at the *valuation date*, not those at any other date;

(d) "between a willing buyer" refers to one who is motivated, but not compelled to buy. This buyer is neither over eager nor determined to buy at any price. This buyer is also one who purchases in accordance with the realities of the current market and with current market expectations, rather than in relation to an imaginary or hypothetical market that cannot be demonstrated or anticipated to exist. The assumed buyer would not pay a higher price than the market requires. The present owner is included among those who constitute "the market";

(e) "and a willing seller" is neither an over eager nor a forced seller prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in the current market. The willing seller is motivated to sell the asset at market terms for the best price attainable in the open market after proper marketing, whatever that price may be. The factual circumstances of the actual owner are not a part of this consideration because the willing seller is a hypothetical owner;

(f) "in an arm's length transaction" is one between parties who do not have a particular or special relationship, eg parent and subsidiary companies or landlord and tenant, that may make the price level uncharacteristic of the market or inflated because of an element of s*pecial value*. The *market value* transaction is presumed to be between unrelated parties, each acting independently;

(g) "after proper marketing" means that the asset would be exposed to the market in the most appropriate manner to effect its disposal at the best price reasonably obtainable in accordance with the *market value* definition. The method of sale is deemed to be that most appropriate to obtain the best price in the market to which the seller has access. The length of exposure time is not a fixed period but will vary according to the type of asset and market conditions. The only criterion is that there must have been sufficient time to allow the asset to be brought to the attention of an adequate number of market participants. The exposure period occurs prior to the *valuation date*;

(h) "where the parties had each acted knowledgeably, prudently" presumes that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the asset, its actual and potential uses and the state of the market as of the *valuation date*. Each is further presumed to use that knowledge prudently to seek the price that is most favourable for their respective positions in the transaction. Prudence is assessed by referring to the state of the market at the *valuation date*, not with benefit of hindsight at some later date. For example, it is not necessarily imprudent for a seller to sell assets in a market with falling prices at a price that is lower than previous market levels. In such cases, as is true for other exchanges in markets with changing prices, the prudent buyer or seller will act in accordance with the best market information available at the time;

(i) "and without compulsion" establishes that each party is motivated to undertake the transaction, but neither is forced or unduly coerced to complete it.

31. The concept of *market value* presumes a price negotiated in an open and competitive market where the participants are acting freely. The market for an asset could be an international market or a local market. The market could consist of numerous buyers and sellers, or could be one characterised by a limited number of market participants. The market in which the asset is exposed for sale is the one in which the asset being exchanged is normally exchanged (see paras 15 to 19 above).

32. The *market value* of an asset will reflect its highest and best use. The highest and best use is the use of an asset that maximises its potential and that is possible, legally permissible and financially feasible. The highest and best use may be for continuation of an asset's existing use or for some alternative use. This is determined by the use that a market participant would have in mind for the asset when formulating the price that it would be willing to bid.

33. The highest and best use of an asset valued on a stand-alone basis may be different from its *highest and best use* as part of a group, when its contribution to the overall value of the group must be considered.

34. The determination of the highest and best use involves consideration of the following:

(a) to establish whether a use is possible, regard will be had to what would be considered reasonable by market participants,

(b) to reflect the requirement to be legally permissible, any legal restrictions on the use of the asset, eg zoning designations, need to be taken into account,

(c) the requirement that the use be financially feasible takes into account whether an alternative use that is physically possible and legally permissible will generate sufficient return to a typical market participant, after taking into account the costs of conversion to that use, over and above the return on the existing use.

Transaction Costs

35. *Market value* is the estimated exchange price of an asset without regard to the seller's costs of sale or the buyer's costs of purchase and without adjustment for any taxes payable by either party as a direct result of the transaction.

Forced Sales - Extract from IVS Framework

Forced Sales

52. The term "forced sale" is often used in circumstances where a seller is under compulsion to sell and that, as consequence, a proper marketing period is not possible. The price that could be obtained in these circumstances will depend upon the nature of the pressure on the seller and the reasons why proper marketing cannot be undertaken. It may also reflect the consequences for the seller of failing to sell within the period available. Unless the nature of and the reason for the constraints on the seller are known, the price obtainable in a forced sale cannot be realistically estimated. The price that a seller will accept in a forced sale will reflect its particular circumstances rather than those of the hypothetical willing seller in the *market value* definition. The price obtainable in a forced sale has only a coincidental relationship to *market value* or any of the other bases defined in this standard. A "forced sale" is a description of the situation under which the exchange takes place, not a distinct *basis of value*.

53. If an indication of the price obtainable under forced sale circumstances is required, it will be necessary to clearly identify the reasons for the constraint on the seller including the consequences of failing to sell in the specified period by setting out appropriate assumptions. If these circumstances do not exist at the *valuation date*, these must be clearly identified as *special assumptions*.

54. Sales in an inactive or falling market are not automatically "forced sales" simply because a seller might hope for a better price if conditions improved. Unless the seller is compelled to sell by a deadline that prevents proper marketing, the seller will be a willing seller within the definition of *market value* (see paras 17 and 30(e)) above).