The Appraisal Institute (AI) appreciates the opportunity to provide comments on the Governmental Accounting Standards Board’s (GASB) “Preliminary Views of the Governmental Accounting Standards Board on major issues related to Fair Value Measurement and Application”.

The Appraisal Institute is a global association of real estate appraisers with nearly 23,000 valuation professionals in almost 60 countries throughout the world. Its mission is to advance professionalism and ethics, global standards, methodologies, and practices through the professional development of property economics worldwide. Appraisal Institute professionals benefit from an array of education and advocacy programs, and may hold the prestigious MAI, SRPA and SRA designations.

As the largest professional organization of real estate valuers in the United States, we are strongly committed to improving the relevance and usefulness of financial reporting as it relates to real estate assets. We commend and support the GASB’s efforts to develop standards of state and local government account that result in useful information for users of financial reports, and guide and educate the public, including issuers, auditors, and users of those financial reports.

General Comments

1. We are very supportive of GASB’s efforts to modify accounting standards for state and local governmental entities to require the use of a fair value model for the reporting of investments, including investments by governmental entities in real estate assets. We believe that the fair value model provides the most relevant information about the composition, value, and recent changes in the value of the real estate investment assets held by state and local governmental bodies. Reporting land and other real estate held as investments at fair value enhances users’ ability to meaningfully evaluate a state or local governmental body’s investment decisions and performance, as well as to evaluate other real estate assets owned by the governmental body.

2. As it relates to the application of the fair value model, we think that real estate as an asset class should be treated separately, and differently, than assets in other tangible and intangible asset classes that are held for investment purposes by governmental bodies.
3. At a minimum, we would encourage GASB to provide additional guidance on the application of the fair value model to investment property that is held by state and local governmental bodies within any Fair Value Standard. Preferably, GASB would develop an entirely separate Investment Property Standard that is similar in scope to International Public Sector Accounting Standard #16.\(^1\) We would encourage GASB to incorporate the definition of “investment property” that is contained in IAS 16 as part of either the Fair Value Standard or as a separate Investment Property Standard, as we believe that it captures many more properties that have characteristics of being investment property. We would also note that the Financial Accounting Standards Board is likely to once again undertake a project related to investment property in the near future. GASB has also already adopted real estate specific standards for endowments and pension plans, specifically Statement 52, “Land and Other Real Estate Held as Investment by Endowments”, and Statement 67, “Financial Reporting for Pension Plans”. We strongly support the standards contained in Statements 52 and 67, and believe that similar guidance should also be provided to state and local governmental entities as it relates to real estate investment assets. Real estate as an asset class is much different than other types of investments, and it should be considered separately.

4. We are cognizant of the fact that most of the real estate assets held by state and local governmental entities, including those held by public benefit corporations/authorities, public utilities, hospitals/health care providers, and colleges/universities are not investment assets, but are instead used exclusively as part of on-going operations. For these types of assets in use, we agree that it is not appropriate, nor necessary, to utilize a fair value model to determine the value of the real property for purposes of the governmental entity’s balance sheet.

5. However, we believe that the application of the fair value model should go beyond the balance sheet and income statement, and beyond those real estate assets of a governmental entity that are being held “primarily for the purpose of income or profit”.

We believe that the users of the financial statements of a governmental entity, including taxpayers, legislators, bond issuers, ratings agencies, and the general public would benefit from knowing the fair value of real estate assets held by a governmental entity beyond those that are held primarily for income or capital appreciation. Specifically, our position is that governmental bodies should be required to disclose the fair value of any real estate asset held by the entity that is either: 1) currently being used to generate income in addition to being used in continuing operations (i.e., a county office building in which some space is leased to private tenants); or 2) could be converted from its current use into another use, and either used to generate income or sold for capital appreciation. The definition of an “investment”, as it relates to real estate, appears to limit the application of the fair value model only to those assets where a strong majority, or all, of the real estate is used to generate income or for capital appreciation. There are, however, situations in which a state or local governmental body owns property to generate income or capital appreciation, but is also used in operations. The users of financial statements should be able to weigh the “in-use” value of a real estate asset versus the value at its highest and best use, when making financial and policy related decisions.

For example, an operating, government-owned hospital will have a much lower “in-use” value than if it were sold and converted to its highest and best use (residential condominiums, for example) by a private owner. Based upon the value at its highest and best use, the governmental entity may decide that the value of selling the property outweighs the value of continued operations as a hospital, and may convert it to an investment property intended for sale or lease. Another example would be a shopping center that is used by a public university to house the campus bookstore. The shopping center may have a much higher value to the university if it were converted to its highest and best use, and leased out to private tenants, rather than being used to house the campus bookstore. Lastly, a school that is nearing the end of its useful life could be turned into residential apartments or office condominiums that are leased or sold to generate cash.

Clearly, the determination of the value of a parcel at its highest and best use is not appropriate for all real estate assets owned by a governmental entity, such as a city hall, a road, a tunnel, or a sewer system. But, disclosure of fair value may be appropriate for those real estate assets that are easily converted from their current use into another use which would generate income or capital appreciation for the governmental body.

We strongly encourage GASB to continue to require the application of the fair value model for real property that is held primarily for investment purposes, but to also adopt a fair value disclosure model for real estate assets held by governmental entities that could be reasonably expected to be sold and converted to their highest and best use. To accomplish this, we suggest an approach that is similar to that contained in International Accounting Standard (IAS) 40, “Investment Property”. IAS 40 allows for the issuers of financial statements to utilize a cost model on the balance sheet and income statement, but also requires the disclosure of the fair value of the investment property and the extent to which the fair value of the investment property is based on a valuation by a qualified independent valuer.

6. We also request that GASB provide some additional examples of types of real estate that meet the definition of an investment, and those that don’t. For instance, is property that is owned by a quasi-governmental economic development corporation (EDC), from which the EDC earns lease income, an investment? Or, is that property considered to be used in operations because it is leased in support of the EDC’s mission of fostering business development? We believe that this type of real estate is being held for both lease income and capital appreciation, and should be considered to be investment real estate.

7. As it relates to the measurement of fair value, while we generally agree with the application of the “Valuation Techniques” contained in the Preliminary Views document, we think that it would be appropriate for GASB to distinguish between the application of these valuation techniques to real estate investment assets, as opposed to other investment assets such as stocks, bonds, mutual funds, derivatives, etc. In addition, we think that it would be appropriate for GASB to highlight that only an appropriately trained real estate appraiser can accurately and reliably apply the sales comparison (referred to in the Preliminary Views document as the market approach), cost, and income approaches to determine the fair value of a parcel of real estate. The application of the
“Valuation Techniques” to real estate requires an entirely different skill set than it does to apply the same techniques to other asset classes. While an accountant or a financial analyst may be able to readily determine the value of a financial asset, only an appropriately trained real estate appraiser is able to accurately and reliably determine the value of a parcel of real estate.

8. We strongly disagree with the characterization in Paragraph 10 of the “Survey of Financial Statement Preparers” that appraisals are produced by “pricing services”. Professional real estate appraisers, who are licensed or certified by a state licensing authority, and may hold designations from organizations such as the Appraisal Institute, develop opinions of the value of real estate, and are very often called upon to provide an opinion of the fair value for financial reporting. They do not determine prices. There is a fundamental difference between “price” and “fair value”. According to The Dictionary of Real Estate Appraisal, “Price” is defined as:

“The amount asked, offered or paid for a property. Once stated, price is a fact, whether it is publicly disclosed or retained in private. Because of the financial capabilities, motivations, or special interests of a given buyer or seller, the price paid for a property may or may not have any relation to the value that might be ascribed by others.” Professional real estate appraisers utilize complex valuation techniques such as the sales comparison, cost, and income approaches to determine the value of a parcel of real estate. The performance of an appraisal by a professional real estate appraisal is not a “pricing service”.

On the other hand, “value” expresses an economic concept, and is an opinion of the worth of a property at a give time in accordance with a specific definition of value. In the case of “fair value”, it is “The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.” Price is a fact, while value is an opinion. And these two numbers may be drastically different.

9. We also are concerned about the notion contained in Paragraph 11 of the “Survey of Financial Statement Preparers” that “Several respondents indicated difficulties in determining fair value for real estate, including lands”. These financial statement preparers may have faced this difficulty because they do not have the training and experience that is necessary to determine an accurate and reliable opinion of the value of real estate. These respondents would not have faced this difficulty had they sought out the assistance of a professional real estate appraiser with the appropriate training and experience necessary to complete the assignment. An abundance of such qualified practitioners exists in throughout the United States, as does a robust body of knowledge in this area of valuation practice. Here, we suggest that GASB include additional guidance in any Fair Value Standard that highlights the need for financial statement preparers to engage the assistance of independent, third-party experts when faced with “hard to value” investment assets such as real estate.

10. We would suggest that GASB include references to the use of professional real estate appraisers in any Fair Value Standard. The language of this guidance would be similar to that contained on page 14 of the Preliminary Views document under heading of “Using Quoted Prices by Third Parties”. We would suggest language similar to the following:
The Board is aware that some governments use independent, third-party real estate appraisers to obtain fair value measurements for real estate. The Board believes that the opinions of value determined by professional real estate appraisers are acceptable ways to measure fair value, as long as the government has determined that those values have been developed in accordance with the guidance in this Preliminary Views document.

As state previously, real estate assets are much different than other type of assets, and should be discussed separately in any Fair Value Standard.

11. We believe that there should be some reference and caution provided by GASB to the preparers of financial statements in any Fair Value Standard about the preparation of opinions of the fair value of real estate by persons who are not appropriately state licensed or certified real estate appraisers. In at least thirty-six states, any person who develops an opinion of the value of a parcel of real estate, including a fair value as defined in the Preliminary Views document, must hold a state issued real estate appraiser credential. Some, but not all, of these states provide an exemption for licensed accountants. We think that GASB should caution financial statement preparers to carefully examine their state’s real estate valuation laws, and the laws of the state where any real estate is located, to determine whether or not they can legally prepare an opinion of the value of real estate, including for financial reporting purposes, or whether this must be performed by a licensed or certified real estate appraiser.

Comments on Relevant “Questions for Respondents”

Issue 1—Definition of Fair Value

Yes, we agree with the definition of fair value contained in the Preliminary Views document. However, we would encourage GASB to include some guidance regarding the need for financial statement preparers to clarify the definition of fair value to be utilized when they engage independent, third parties real estate appraisers to determine the fair value for real estate assets. The purposes for which the real estate is being valued (i.e., financial reporting) need to be clear to the appraiser performing the assignment.

Issue 3—Definition of an Investment

We are generally supportive of the definition of investment contained in the Preliminary Views document. However, as stated above, we believe that the application of the fair value model should be extended to those real estate assets that could be easily converted into investment properties by a state and local government entity, and subsequently used to generate income or sold for profit. We also again request that GASB provide some additional guidance as to real estate that generates income, is being held for capital appreciation, but simultaneously is used in operations or to further the mission and purpose of the governmental entity.
Issue 4—Measurement of Investments

Yes, we are strongly agree that investments, particularly real estate investment assets, held by state and local government bodies should be measured at fair value on a recurring basis. We believe that the fair value model provides the most relevant information about the composition, value, and recent changes in the value of the real estate investment assets held by state and local governmental bodies. Reporting land and other real estate held as investments using the fair value model enhances users’ ability to meaningfully evaluate a state or local governmental body’s investment decisions and performance. We also believe that value of other real estate assets held by a state and local government body should also be included within the requirements for the use of the fair value model, specifically those real estate assets that can be easily converted into another use.

Issue 5—Disclosures

We are strongly supportive of the disclosure requirements contained in the Preliminary Views document. In addition to the disclosure requirements contained in the Preliminary Views document, we suggest that GASB include a requirement that, as it relates to real estate assets, a governmental body be required to disclose the extent to which the fair value of the real estate was based on a valuation by a qualified independent valuer. If there has been no such valuation by an independent, third-party, that fact must also be disclosed. This type of disclosure would be consistent with what is required in IAS 40. We agree with the Board’s preliminary view that the disclosure of fair value should be organized by type or class of asset or liability. For the real estate asset class, we would also suggest that the types of real estate be broken down further into the type of real estate, such as leisure (hotels, public houses, sports facilities, etc.), retail, office, industrial, healthcare, or multifamily housing.

We appreciate the opportunity to provide comments on the FASB and IASB lease accounting Exposure Drafts. If you should have any questions, please do not hesitate to contact Bill Garber, Director of Government and External Relations at (202) 298-5586 or bgarber@appraisalinstitute.org, or Scott DiBiasio, Manager of State and Industry Affairs at (202) 298-5593, or sdibiasio@appraisalinstitute.org.

Sincerely,

Appraisal Institute