

# Valuation - what are the current issues?

An update from the NZIF Forest Valuation Working Party

The goals of the NZIF Forest Valuation Working Party are to:

- Continue to develop, and promote the implementation of NZIF Forest Valuation Standards.
- Maintain the leadership role of the NZIF in this area.
- Support members who are practitioners (this includes helping to make transaction information publicly available).

The NZIF Forest Valuation Working Party (consisting of Alan Barnes, Peter Berg, Peter Gorman, Bill Liley, Bruce Manley, Karen Musham, Brian Rawley, Steve Croskery, Theo Vos) continues to meet regularly to review the NZIF Forest Valuation Standards and develop additional material to guide practitioners. Current thinking was presented at the Forest Valuation Workshop in Rotorua last November. Another workshop will be held in Christchurch on 22/23 August.

So what are the big issues that we are actively working on?

## Transaction database

The NZIF Forest Valuation Standards require that "*The market value of a crop of trees shall be derived from transaction evidence where this is available and suitable for the purpose in terms of reliability, comparability and volume of transactions.*" However in New Zealand the "reliability, comparability, and volume of transactions" limit the extent to which transaction evidence can be used to directly estimate market value.

The Working Party is currently considering whether the NZIF should facilitate the development of a transaction database in order to make more transaction information available? Issues here are:

- What information is already available either in the public domain or via subscription (e.g. Quotable Value)?
- What additional information is potentially available?
- Would holders of this additional information make it available? There are matters of confidentiality here. Often the transaction data is subject to a confidentiality agreement between the parties. The information also has commercial value to the gatherer of it; i.e. it is the "stock-in-trade" of the larger forestry consulting companies.

The initial step will be that, as part of the 2005 Discount Rate Survey, forest valuers will be asked to provide more detail about transaction information that they are aware of. In previous surveys valuers have been asked to provide the discount rate implied by recent transactions. This year, valuers will be asked to provide \$/ha for transactions together with key forest characteristics such as maturity, distance to market, species composition, terrain, site productivity, past silviculture and land tenure.

## Valuation of young stands

Situations can arise when the crop value calculated using the expectation (discounted cashflow) approach is negative, particularly for young stands. This has led a number of forest valuers to use a cost compounding approach to value these stands.

What should valuers do in this situation? Apart from exceptional circumstances, the minimum estimate of the market value for a tree crop should be zero. The absence of sufficient transaction evidence would indicate that the value for the tree crop lies somewhere between 0 and the accumulated costs (with or without compound interest and taking account of taxation benefits).

Any cost-based assessment of value must nevertheless be benchmarked against actual transactions. The Working Party is seeking to help practitioners who are valuing young stands narrow down this value range through making more transaction information available.

## Land cost

In determining the value of the tree crop the question arises as to what is the opportunity cost of the land on which the crop is growing; i.e. should a land rental be charged based on the Land Market Value (LMV) or on the Land Expectation Value (LEV).

The general rule is that land rental should be based on LEV if ongoing forestry is the "highest and best" land use or compatible with some other "highest and best" land use (e.g. lifestyle, investment, potential capital gain). Otherwise land rental should be based on LMV.

We are working on a Guidance Note to help practitioners recognise the different situations.

## Accounting Standard

With the adoption of IAS 41 Agriculture by the FRSB (Financial Reporting Standards Board), New Zealand now has a financial reporting standard that encompasses all agricultural activities and assets which show natural value increase, including forestry. Application of the standard will be to annual accounting periods beginning on or after 1 January 2007 (or, in the case of entities choosing to adopt it early, annual accounting periods beginning on or after 1 January 2005).

The Working Party met the FRSB in Wellington last August to discuss the interface between IAS 41 and the NZIF Forest Valuation Standards. It was a useful discussion and confirmed that what we regard as "market value" is synonymous with what the FRSB refers to as "fair value". In valuing a crop we are estimating the "number written on the cheque"; i.e. the amount that the seller receives in a transaction before paying tax on the proceeds – rather than value in ongoing use to the current owner.

We are working with the FRSB to prepare a Practice Note that clarifies forest valuation issues associated with the accounting standard.