

May 31, 2011

Mr. Jean-Florent Rérolle, Chairman  
Professional Board  
International Valuation Standards Council  
41 Moorgate  
London EC2R 6PP  
United Kingdom

RE: Comments on the Exposure Draft of Proposed Technical Information Paper 2: *Depreciated Replacement Cost*

Dear Mr. Rérolle,

On behalf of the Appraisal Institute, the Appraisal Standards Committee ("ASC") submits these responses to the following questions posted in the Exposure Draft of Proposed Technical Information Paper 2: *Depreciated Replacement Cost*.

Please see below our comments to the Questions for Respondents of the draft.

- 1. It is proposed that this Exposure Draft will replace the current GN8 "The Cost Approach for Financial Reporting - (DRC)". As the name suggests GN8 only covers the use of the cost approach for financial reporting purposes. This exposure draft proposes that a properly applied cost approach can be applied in a wide variety of circumstances.**

**Do you agree with the argument that the cost approach, if properly applied, can be used as a method to arrive at market value for a variety of purposes other than financial reporting?**

Yes, we agree with this statement. The cost approach if properly applied can be used as a method to arrive at market value for a variety of purposes other than financial reporting.

- 2. This Exposure Draft identifies depreciated replacement cost as the most common method of valuation under the Cost Approach. An alternative view is that this is the only method of applying the cost approach.**

**Which of these views do you support? If you believe that there are other valuation methods that fall under the Cost Approach, please describe them.**

Replacement cost new less depreciation may be the most common methodology under the Cost Approach but reproduction cost new less depreciation may also be appropriate and necessary to some assignments. If the market and physical condition of the property allow the comparison of an exact replica, then the reproduction cost is another viable valuation method. More information on this can be found in the Appraisal Institute text *The Appraisal of Real Estate, 13<sup>th</sup> Edition*.

- 3. GN8 in the 2007 edition of IVS identifies the three main types of deduction for obsolescence as physical deterioration, functional obsolescence and external**

**obsolescence. In this Exposure Draft external obsolescence has been replaced with economic obsolescence. Supporters of the proposed change argue that the term economic obsolescence is most commonly used to describe this form of obsolescence. Those who support the existing definition argue that the term external obsolescence more clearly requires all factors that arise from changes to the environment in which the asset operates to be considered, regardless of whether they have a direct economic impact.**

**Which of these views do you support?**

Some appraisal literature recognizes a distinction between economic obsolescence and external obsolescence, while others do not. We believe there is a strong case to be made for separate distinctions between the two definitions.

External obsolescence may derive from location of a property proximate to a negative feature such as a sewage disposal plant. This is a distinctly different source of obsolescence from economic obsolescence due to market conditions. Both are generally incurable by the property owner, but it is important to note they are both handled the same way within the cost approach.

- 4. The exposure draft provides that where the purpose of the valuation is governed by regulations that preclude adjustment for all forms of obsolescence, for example valuations for tariff setting purposes of regulated monopoly assets, the outcome does not represent market value and should not be described as such.**

**Do you agree that a cost approach valuation that does not identify and quantify all forms of obsolescence is not a measure of market value?**

We agree that this scenario does not result in market value.

We submit these additional comments on certain sections of the Exposure Draft of Proposed Technical Information Paper 2: *Depreciated Replacement Cost*.

Paragraph 25 in the “Physical deterioration” section discusses physical life and later the paper refers to expected total life. The concepts of “useful life” and “economic life” are closely related to physical life and may be more appropriate for some assets. Inclusion of these two terms might be helpful.

From *The Dictionary of Real Estate Appraisal, 5<sup>th</sup> Edition*:

Useful life: The period of time over which a structure or a component of a property may reasonably be expected to perform the function for which it was designed.

Economic life: The period over which improvements to real property contribute to property value.

We suggest some additional language be added to the “Economic obsolescence” section of the paper. It would benefit real property valuers to include a short paragraph more specifically related to real property.

We have also included a bibliography for additional more information on the items discussed in this letter. Please let us know if full copy texts of the materials would be helpful for a more thorough review and proper citation.

We trust that you will find our comments and resources helpful. Please contact Christina Austin at 312-335-4287 or [caustin@appraisalinstitute.org](mailto:caustin@appraisalinstitute.org) if you have questions or would like more information.

Sincerely,

Sincerely,

A handwritten signature in blue ink that reads "Bonnie Roerig". The signature is written in a cursive style.

Bonnie Roerig, MAI  
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## Bibliography

### AI Publications

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Ratterman, Mark R., [\*Student Handbook to the Appraisal of Real Estate, 13<sup>th</sup> Edition\*](#), Appraisal Institute, 2009.

Slade, Barrett A., [\*The Valuation of Office Properties\*](#), Appraisal Institute, 2009.

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[\*The Dictionary of Real Estate Appraisal, 5<sup>th</sup> Edition\*](#), Appraisal Institute, 2010.

### AI Education

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[\*Residential Site Valuation and Cost Approach\*](#)

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Ramsett, David. ["The Cost Approach: An Alternative View."](#) The Appraisal Journal (April 1998): 172-180.

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