

EUROPEAN VALUATION STANDARDS

2016

EIGHTH EDITION



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Preface



In the four years since the last edition of EVS, Europeans have confronted economic and financial crisis together, through Banking Union, Capital Markets Union, consolidation of the Internal Market and EU Economic Governance. A key aspect for the valuation profession was the property valuation article of the Mortgage Credit Directive. It is this Article and its relevant Recital that introduce European Valuation Standards into European law as internationally recognised valuation standards containing high level principles serving as a template for valuation standards in the member states. This was done in recognition of the importance of valuation both for the security of financial and property markets and for consumer protection.

The single most crucial event has been the European Central Bank's action to shore up banks and avoid systemic meltdown. Key to this in 2014 was the ECB's Asset Quality Review enabling it to gauge the solidity of the Eurozone's banks. Its tool for achieving this was the AQR Manual, Section 5 of which focused on Collateral and Real Estate Valuation and gave EVS primacy over all other standards for the updating of banks' real estate collateral values in the AQR exercise.

The European authorities want reliable valuation standards throughout the Union giving TEGoVA a special responsibility to adapt EVS to the rapid EU mutations in banking supervision. Mortgage Lending Value is a case in point: EVS 2016 continues to provide the authoritative guidance on the assessment of MLV and enhances it with detailed analysis and explanation of the key issues and approaches to be followed. Other systemically key updates are the guidance on Property Valuation for Securitisation Purposes and Property and Market Rating.

It is my pleasure to preface this new edition of standards which are now an important tool for the reforms needed to put financial and real estate markets on a solid footing going forward.

A handwritten signature in blue ink, appearing to read 'Krzysztof Grzesik', written over a light blue horizontal line.

Krzysztof Grzesik REV
Chairman of the Board of TEGoVA

Introduction

The framework and content of EVS 2016, the eighth edition of European Valuation Standards, has been determined by recognition, extensive consultation and feedback.

Feedback from a wide variety of stakeholders has confirmed that EVS should remain clearly focused on real estate, provide additional guidance and technical information to meet the diverse needs of the 63 TEGoVA Member Associations (TMA's) and continue to concentrate on high level principles.

In meeting these objectives this publication follows the direction of previous editions, being informed by existing and emerging European regulation, acknowledging that EU law is the origin of an increasing amount of the local property law underpinning valuation. However, Union regulation can presume outcomes that are not always evident in the market. Energy efficiency is an example in point. EVS helps raise the valuer's consciousness of energy efficiency issues and EU instruments such as the energy performance certificate and its recommendations for improvements, but at the same time upholds the scientific and professional obligation on the valuer to value energy efficiency on the basis that values set must reflect verifiable market reality.

EVS 2016 provides harmonised European standards, guidance and technical information for use by all sectors of the European valuation profession. Corporate governance and ethical considerations are embedded within the standards, confirming, for instance, that a valuation produced in accordance with these standards is signed by a qualified professional whose experience, qualification, diligence and ethical behaviour are appropriate to the instruction.

Part 1: European Valuation Standards and Guidance Notes

EVS continues to provide five Standards. They have all been refined and reinforced beyond those published in 2012. By way of example:

- EVS 1, Market Value, is expanded to include a definition of Market Rent, derived from and consistent with its definition of Market Value.
- EVS 2, Valuation Bases Other than Market Value, extends the commentary relating to Mortgage Lending Value (MLV), explaining the conceptual value-at-risk approach to manage the risk exposure of credit institutions taking into account special safety requirements.
- EVS 3, The Qualified Valuer, expands the requirements that determine that the

valuer be, and be seen to be, not only competent to act, but also independent, and without any undisclosed potential conflicts of interest which are actual or possible and which can be foreseen at the time when the instructions are accepted.

- EVS 4, The Valuation Process, incorporates and amends guidance published in May 2013 relating to terms of engagement.
- EVS 5, Reporting the Valuation, cites the European Union's Capital Requirements Regulation 575/2013 which defines both Market Value and Mortgage Lending Value, in line with the definitions set out in EVS and also provides commentary on situations where opinions of "value in the longer term" are requested.

Guidance Notes (previously referred to as Applications) follow on from the Standards. They have been reinforced to provide detailed analysis and explanation of key issues and approaches to be followed. For example, EVGN 4, Assessment of Insurable Value and Damages has been expanded and incorporates an updated Information Paper relating to insured damage published in May 2013.

There are two new topic areas covered by the Guidance:

- EVGN 9, EMF and TEGoVA Commercial Loan Specification - This specification was initially published in October 2014, designed to be used by valuers providing valuations for secured lending to lenders that are members of the European Mortgage Federation (EMF).
- EVGN 10, Valuations: Compliance with EVS - This GN provides clarification on those valuations that will be compliant, and explains the main reasons that a valuation would not need to comply or would depart from TEGoVA requirements.

Part 2: European Codes

Two updated and extended codes are provided, namely the European Valuers' Code of Conduct and Ethics, and the European Code of Measurement.

Part 3: European Union Legislation and Property Valuation

Introduced in the 2012 edition, a complete section is devoted to the body of EU law impacting real estate and valuation with many updates to take account of the EU real estate policy advances over recent years. Based on comments received since 2012, this section is of particular value to academics, researchers, civil servants and advisers involved in the real estate aspects of EU policy.

Part 4: Technical Documents

Eight Information Papers (inter alia) are included within Part 4. New topic areas include Valuations for Recurrent Property Tax Purposes, Automated Valuation Models (AVM) and Valuation Methodology. The remainder papers have been updated and refreshed.

In Conclusion

EVS provides minimum standards that TEGoVA Member Associations (TMAs) must adopt in their own standards, supplementing such additional requirements as are deemed necessary by legislation, regulation or generally accepted practice within a specific state. National exposure to EVS has enabled standards published by TMAs to increasingly mirror EVS.

References within this publication to a valuer (singular) also apply to valuers (plural) and to valuation firms. Reference to him or his is intended to be gender neutral, so should be considered to be the same as her or hers.

EVS 2016 is effective from 1 June 2016.

Publication has been made possible thanks to the considerable support, time and expertise of highly respected individuals working in many countries across Europe. I am indebted to many, but in particular to the members of the European Valuation Standards Board for their two-year devotion to duty in the pursuit of excellence, the TEGoVA board members and the TEGoVA secretariat.



JoÚ Hockey
Editor
May 2016.

PART 1

EUROPEAN VALUATION STANDARDS AND GUIDANCE NOTES

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PART 1A

European Valuation Standards

EVS 1 Market Value

Valuers should use the following definition of Market Value unless otherwise directed by legislation:

“The estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion.”

Valuers should use the following definition of Market Rent unless otherwise directed by legislation:

“The estimated amount of rent at which the property should be leased on the date of valuation between a willing lessor and a willing lessee on the terms of the actual or assumed tenancy agreement in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion.”

EVS 2 Valuation Bases Other than Market Value

The valuer should establish the purpose for which the valuation is required before using any basis of value other than Market Value.

Save as required by European and national law and regulation in any particular case, the valuer should only use recognised bases of valuation that are compatible with the purpose of the valuation and, in doing so, honour the principles of transparency, coherence and consistency.

Such other bases of value may need to be used as required by law, circumstances or a client’s instructions where the assumptions underpinning Market Value are not appropriate or cannot be met. The result will not be a Market Value.

EVS 3 The Qualified Valuer

Each valuation carried out in accordance with these Standards must be carried out by, or under the strict supervision of, a Qualified Valuer.

Valuers will at all times maintain the highest standards of honesty and integrity and conduct their activities in a manner not detrimental to their clients, the public, their profession, or their respective national professional valuation body.

The valuer must be able to show professional skill, knowledge, diligence and ethical behaviour appropriate to the type and scale of valuation and must disclose any factor which could compromise an objective assessment. Each valuation must provide an informed and independent opinion of value supported by a recognised basis or bases of valuation.

All Qualified Valuers and their representative professional or technical organisations are required to adhere to the TEGoVA European Valuers' Code of Ethics and Conduct.

EVS 4 The Valuation Process

The terms of engagement and the basis on which the valuation will be undertaken must be set out in writing and agreed before the valuation is reported.

The valuation must be researched, prepared and presented in writing to a professional standard. The work undertaken must be sufficient to support the opinion of value reported.

Data retained following the submission of a valuation must be sufficient to enable verification that the analysis and evaluation undertaken in the approach, or approaches, to providing the opinion of value reported were sufficient for the type and scale of valuation.

EVS 5 Reporting the Valuation

The valuation must be presented in clear written form to a professional standard, transparent as to the instruction, purpose, approaches, bases, methods and conclusions of the valuation, as well as to the use to which it is to be put, as shown in the agreed terms of engagement.

EVS 1

Market Value

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EUROPEAN VALUATION STANDARD 1

Market Value and Market Rent

Valuers should use the following definition of Market Value unless otherwise directed by legislation:

“The estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion.”

Valuers should use the following definition of Market Rent unless otherwise directed by legislation:

“The estimated amount of rent at which the property should be leased on the date of valuation between a willing lessor and a willing lessee on the terms of the actual or assumed tenancy agreement in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion.”

1. Introduction

1.1 Market Value is a key concept in establishing an informed expectation as to the price for something, one that is neutral as between buyer and seller. The nature of the market in which that value is determined will differ according to the subject of the transaction while market conditions will vary with the changing balance of supply and demand, changing knowledge, fashion, rules, expectations, credit conditions, hopes of profit and other circumstances. “Value” does not mean the actual sum that may prove to be paid in a given transaction between specific parties. At an individual level, the value of an asset, such as a property, to a person will reflect its usefulness to him when judged against his resources and opportunities. In the context of a market with competing parties, it is rather an estimate of the amount that could reasonably be expected to be paid, the most probable price in market conditions at the date of valuation. While the property in question may have different values for different individuals who may be in the market, its Market Value is the estimate of the price in the present market on assumptions that are deliberately neutral to achieve a standard basis of assessment for both buyers and sellers. These assumptions are explored in Section 4 below.

1.2 The ultimate test for Market Value, however determined, is whether parties in the market place could really be expected in practice to pay a price at the level of the value that has been assessed. That emphasises the importance of soundly analysing good quality comparable evidence where it can be obtained. Any valuation arrived at with a purely theoretical approach must face this final test. This is particularly applicable to valuations of real property, given the usual individual nature of the properties and the markets concerned, especially at times of flux.

1.3 EVS 1 considers Market Value in the context of real estate, including interests and rights in land and buildings.

2. Scope

2.1 EU legislation makes a number of references to “market value”. Most refer to financial instruments or the aggregate capitalisation of businesses. These are generally based on transaction prices or values reported from official exchanges and other markets for generally homogenous, interchangeable and widely traded assets which can often be sold immediately at a price.

2.2 EVS 1 specifically considers the application of Market Value to:

- *real estate and related property rights* which are less homogenous as an asset class and for which such instant, liquid and reported market conditions rarely exist but for which market values often need to be identified;
- *that are marketable*, that is to say legally and physically saleable;

- it does so for assessing both the value that would be expected to be paid for ownership of a property and the rent that might be paid to take the property on a lease.

2.3 In marked distinction to many financial instruments, real property is commonly more individual in both its legal and physical nature, less frequently traded, has buyers and sellers with varied motives, faces higher transaction costs, takes longer to market and buy and is more difficult to aggregate or disaggregate. These features make the valuation of real property an art requiring care, experience of the specific market, research and the use of market evidence, objectivity, and an appreciation of the assumptions required and judgement – in short, professional skills.

2.4 The definitions of Market Value and Market Rent approved by TEGoVA at paragraphs 3.1 and 3.4 rely on the range of assumptions explored in Section 5.

3. European Valuation Standard 1 - Definitions of Market Value and Market Rent

3.1 The TEGoVA Approved Definition of Market Value

Unless otherwise directed by legislation (see below), “Market Value” means:

“The estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion.”

3.2 TEGoVA’s definition of Market Value, identical to that in Regulation 575/2013/EU (the Capital Requirements Regulation), is to be used as the basic definition and interpreted in accordance with the commentary in Section 5 below, save where legislation specifically requires otherwise.

3.3 Market Rent - The market for property is one in which property is not only bought and sold but also leased. Market Value is appropriate for valuing the ownership of property while Market Rent is appropriate for the value that may be expected to be paid as rent for a property.

3.4 The TEGoVA Approved Definition of “Market Rent”

“The estimated amount of rent at which the property should be leased on the date of valuation between a willing lessor and a willing lessee on the terms of the actual or assumed tenancy agreement in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion.”

3.5 Market Rent is usually to be expressed as an annual figure.

3.6 TEGoVA’s definition of Market Rent, derived from and consistent with its definition of Market Value, is to be used as the basic definition and interpreted in accordance with the commentary in Section 5 below, save where legislation specifically requires otherwise.

3.7 Unless specifically required by legislation, obliged by the terms of a contract or instructed by a client, valuers are to use Market Value (or, as appropriate, Market Rent) as the basis of value rather than the alternative bases reviewed in EVS 2.

4. Definitions of Market Value in EU and EEA Legislation

4.1 There are several definitions of Market Value within EU legislation, each provided for a specific purpose – EU law does not provide a general definition. After analysis and consideration of the legal cases and other rulings arising under these provisions, especially the 1997 State Aid rules (see 4.3.1 below) as the relevant regulation that has been most closely analysed in practical situations by EU and EEA institutions) these definitions are perceived to be entirely consistent in practice with that set out in EVS 1.

4.2 The Capital Requirements Regulation Definition

4.2.1 European Union legislation has defined Market Value for the purposes of assessing the value of real estate as collateral for a lending institution, in essence as part of implementing the Basel Agreements. *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (Text with EEA relevance)* defines “market value” for “immovable property” (but not apparently in other contexts such as for financial collateral) for the purposes of the Regulation at Article 4.1(76) as:

“the estimated amount for which the property should exchange on the date

of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion."

This is unchanged from the definition in the previous Capital Requirements Directive 2006/48 at its paragraph 63 in 1.5.1(a) of part 3 of Annex VIII, Credit Risk Mitigation. As an EU Regulation, the new text is, where the Regulation applies, directly binding in member states.

4.2.2 The Regulation's Title II, *Capital Requirements for Credit Risk*, sets out the EU's legal framework for the Approaches that may be used to calculate an institution's "risk weighted exposure amount" that it has to match with a minimum level of its own funds. Chapter 2 provides for the Standardised Approach and Chapter 3 for the Internal Ratings Based (IRB) Approach. Under both approaches, real estate collateral is recognised as a risk mitigation tool. Thus, where a credit institution lends on the basis of property, these rules are of significant importance both to the amount of capital it needs to hold in its balance sheet and for its management of credit risk.

4.2.3 Specifically, within the Regulation's Chapter 4 Section 4, *Calculating the Effects of Credit Risk Mitigation*, Article 229(1) relies on an independent valuer's assessment of market value for immoveable property when applying the IRB approach. "Independent" is seen to mean independent of "undue influence" (Article 144(1)(c)), "that does not directly benefit from decisions to extend the credit" (Article 173(1)(a)) and specifically for a valuer of property "independent from the credit decision process" (Article 208(3)(b)). The rules for the IRB Approach are then applied by Articles 125(5)(c) and 126(2)(c) to the Standardised Approach. The lending institution concerned is to require the valuer to document this in a "transparent and clear manner", seen as a procedural requirement for the purposes of the Regulation rather than a factor helping determine the market value of any property and is thus addressed below in EVS 5.

4.2.4 The Regulation's definition of market value for immoveable property is also relevant to Article 199 regarding additional eligibility for collateral, Article 210 on requirements for other physical collateral and Article 211 on treating lease exposure as collateralised.

4.2.5 Article 229(3) also provides for these purposes a shorter definition of market value for physical property other than immoveable property:

"the estimated amount for which the property would exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction"

omitting the final phrases about marketing and the parties acting knowledgeably, prudently and freely.

4.3 The State Aid Communication and the Insurance Accounts Directive Definition

4.3.1 The definition used in both in the *State Aid Communication* and the *Insurance Accounts Directive* - This second definition is used in the EU legislation governing:

- the rules for assessing whether a sale of property by a public authority in the European Economic Area to a business and which might distort competition should be investigated as a potentially illegal state aid. These are set out in *Commission Communication on State aid elements in sales of land and buildings by public authorities (OJ C 209, 10/07/1997, p0003-0005 – 31997Y0710(01))* and extended to EFTA countries by *EFTA Surveillance Authority Decision No 275/99/ COL of 17 November 1999 introducing guidelines on State aid elements in sales of land and buildings by public authorities and amending for the 20th time the Procedural and Substantive Rules in the field of State aid*;
- accounting for insurance undertakings requiring the market value for “land and buildings” as provided in *Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings*.

and states that for these purposes:

“Market value shall mean the price at which land and buildings could be sold under private contract between a willing seller and an arm’s length buyer on the date of valuation, it being assumed that the property is publicly exposed to the market, that market conditions permit orderly disposal and that a normal period, having regard to the nature of the property, is available for the negotiation of the sale.”

State Aid Communication II.2.(a) (last paragraph) and Directive 91/674/EEC, Article 49(2)

4.3.2 Until 2006, this definition was also used for the assessment of property as collateral for secured lending by credit institutions, being replaced in 2006 for this purpose by the definition now adopted above as the TEGoVA definition of Market Value.

4.3.3 In the State Aid Communication, where a value in question was achieved by a “Sale on Unconditional Bidding” this is to be after:

“a sufficiently well-publicized, open and unconditional bidding procedure, comparable to an auction, accepting the best or only bid is by definition at market value”.

4.4 Solvency II Definition - A third definition of market value is given for the valuations of assets required for the solvency capital requirement for these institutions under the Solvency II Directive (2009/138/EC):

“the amount for which they could be exchanged between knowledgeable willing parties in an arm’s length transaction”. (Article 75(1))

The background for and development of this is set out in Section A3 of Part 3 below showing the expectation that valuations will conform with international accounting standards save where this would be in conflict with Article 75. When compared to the simpler definition of market value for physical property at Article 229(3) of the Capital Requirements Regulation (see 4.2.5 above), this:

- omits a date of valuation;
- requires that the parties be knowledgeable.

4.5 The VAT Definition - A fourth definition is provided for VAT purposes. VAT can apply to real estate under Articles 135 and 137 of *Council Directive of 28 November 2006 on the common system of value added tax (2006/112/EC)* (sometimes called the Seventh Directive) which consolidated VAT law including the Sixth VAT Directive (77/338/EEC) with its Articles 13A and 13B. Its Article 72 (being Chapter 1 (Definition) of Title VII (Taxable Amount)) provides a general definition of open market value for the VAT system.

“For the purposes of this Directive, ‘open market value’ shall mean the full amount that, in order to obtain the goods or services in question at that time, a customer at the same marketing stage at which the supply of goods or services takes place, would have to pay, under conditions of fair competition, to a supplier at arm’s length within the territory of the Member State in which the supply is subject to tax.”

As this definition is provided for all VAT purposes and so applies to any goods or services, it is not drafted with specific reference to real property. However, it is seen to cover the main points of an assumed transaction between arm’s length, competitive, hypothetical parties for an actual subject property.

4.6 The EU Accounting Definition - A further provision is made for the EU’s own internal accounting when assessing tangible fixed assets (specifically including land and buildings) for the accounts of an EU institution. Any asset acquired free of charge is to be assessed at its market value which is defined as:

“The price which a buyer would be prepared to pay for it, having due regard to its condition and location and on the assumption that it could continue to be used”

at Article 19(2) of *Commission Regulation (EC) No 2909/2000 of 29 December 2000 on the accounting management of the European Communities' non-financial fixed assets*.

5. Commentary

5.1 General

5.1.1 The definition in EVS 1:

- carries forward the definition used in both EVS 2009 and 2012;
- uses the definition given for immoveable property in the Capital Requirements Regulation;
- is consistent with most definitions of market value in European countries, and
- can be taken as setting a basic definition of Market Value that is available for general application.

5.1.2 The same points essentially apply to the TEGoVA approved definition of "Market Rent" in 3.4 above. As these concern the rent for a leasehold interest, EVS 1 refers to a "property".

5.1.3 The advantage of the definition of Market Value used in EVS 1 over other available EU definitions is that it more clearly sets out the key concepts involved, namely:

- the result;
- the real property being valued;
- the transaction;
- the date of valuation;
- the nature of the hypothetical parties as willing and competitive;
- the necessary marketing;
- the consideration by the parties;
- other matters.

This commentary takes each phrase of the definition in turn and explores its meaning in seeking the Market Value of real property. In this, it is noted that the definition of market value used in the Capital Requirements Regulation (see 4.2.1 above) specifically applies the assumptions as to marketing (5.7 below) and the knowledgeable, prudent and free actions of the parties (5.8 below) which are not given in its expectations for the market value of other physical property.

5.2 The Result

5.2.1 *"The estimated amount ..."* - This refers to a price expressed in terms of money (normally in the local currency), payable for the property in an arm's-length market transaction. Market Value is measured as the most probable price reasonably obtainable

in the market at the date of valuation on the assumptions of the Market Value definition. It is the best price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer.

5.2.2 This estimate specifically excludes an estimated price inflated or deflated by any special terms or circumstances such as financing which are not typical, sale and leaseback arrangements, special considerations or concessions granted by anyone associated with the sale, or any elements of Special Value.

5.2.3 Market Rent is measured as the most probable rent reasonably obtainable in the market at the date of valuation on the assumptions of the Market Rent definition. It is the best rent reasonably obtainable by the lessor and the most advantageous rent reasonably obtainable by the intending tenant.

5.2.4 Special Value is considered with related issues under EVS 2 – ‘Valuation Bases Other Than Market Value’.

5.2.5 The application in practice of the 1997 Communication on land sales for the EU State Aid rules may potentially have regard to special value, whether specific marriage value or otherwise.

5.3 The Real Property Being Valued

5.3.1 “... a property...” - This is where the property itself, which can be any legal interest in real estate, with its legal, physical, economic and other attributes is to be analysed with all its actual opportunities and difficulties.

5.3.2 When considering a Market Rent, as defined at 3.4, the terms of the actual or proposed tenancy agreement, subject to any further relevant statutory provisions, define the legal nature of the property with its duration, opportunities, restrictions and liabilities and so, in combination with the physical property, form the asset to be valued. If the valuation of the Market Rent is made before a lease is in place, the valuer should state the material terms of the lease as assumptions, typically following conventional practice for that type of property in its market. He should ordinarily assume that the terms of the lease would not require a premium, be restrictive or contain clauses that would not suit average market participants. If any of those points arise they would require an adjustment to the rental value.

5.3.3 Valuers must take due regard where the purchase price of any property includes items additional to the property itself, whether fittings, personal goods, incentives for the transaction or other matters.

5.3.4 The Market Value of a property reflects the full potential of that property so far as it is recognised by the market place. It may thus take account of the possible uses of the property that may be unlocked by changes affecting it, whether new development control permissions, relevant infrastructure, market developments or other possibilities. Thus, the Market Value of a property may reflect any “hope value” that the market may place on such prospects and, as such, should be distinguished from an assessment of market value limited by the “highest and best use” assumption.

5.3.5 Hope value is used to describe an uplift in value which the market is willing to pay in the hope of a higher value use or development opportunity being achievable than is currently permitted under development control, existing infrastructure constraints or other limitations currently in place. It is an element within the Market Value of the property being considered. (In some countries the phrase “future value” is used to describe the value achievable now for the potential of such future opportunities for a property.) It will reflect an appraisal of the probability that the market places on that higher value use or development being achieved, the costs likely to be incurred in doing so, the time scale and any other associated factors in bringing it about. Fundamentally, it will allow for the possibility that the envisaged use may not be achieved. While descriptive of that uplift, it does not exist as a separate value but helps explain the Market Value of the property which must be judged from the available evidence just as much as any other part of the valuation. Hope value is not a special value as it represents the market place’s reasonable expectations as to the opportunities offered by the property.

5.3.6 As a factor reflected in Market Value, hope value does not include any element of special value that may be available from particular purchasers.

5.3.7 The concept of “**highest and best use**” is met in a number of countries and some valuers in Europe may be asked to value a property on the assumption of its highest and best use. In essence, that is the use that is actually permitted as at the date of valuation that offers the highest value. On analysis of the limitations intended to be imposed by its more formal definitions below, that excludes the hope value that the market might place on a property’s potential opportunities that are not currently available. While finding the “highest and best use” of a property is an assessment of the property as it is on the date of valuation, it is not an assessment of the best use that the market might at that date reasonably envisage could be possible for it. This approach is thus Market Value limited by an assumption and not a simple Market Value or an element within Market Value.

5.3.8 Highest and best use has been more formally defined in several formulations, including:

“the reasonably probable use of a property, that is physically possible, legally permissible, financially feasible and maximally productive, and that results

in the highest value.” (Canadian Uniform Standards of Professional Appraisal Practice 2014 - The Appraisal Institute of Canada)

and

“the reasonably probable and legal use of vacant land or an improved property that is physically possible, appropriately supported, financially feasible and that results in the highest value.” (The Dictionary of Real Estate Appraisal, Fifth Edition, Appraisal Institute).

5.3.9 It should be noted that there may be specific definitions of highest and best use applying under statute or practice in individual countries.

5.3.10 Key components of the usual definitions for the concept of highest and best use, to be assessed as at the date of valuation, are:

- it is the most reasonably probable use – so disregarding the specialist uses that might occur to an individual bidder;
- legal – this is perhaps the critical point with regard to Market Value. While a common definition requires the use to be “legally permissible”, the commentaries make it clear that this is only within existing zoning or permissions and so disregards any hope value or future value that the market might pay for the practical possibility of achieving new permissions. While most discussion is in terms of currently permitted development, the same legal constraint applies where the property is let but the market might perceive that possible future re-lettings or new uses offer a potential hope value that is excluded by the constraints of the highest and best use assumption;
- physically possible – again this appears to assess the property’s physical circumstances as at the date of valuation and not take account of possible developments (such as a new road or a flood alleviation scheme) which might occur and of itself offer prospects for which some bidders would pay extra value;
- supported by evidence;
- financially feasible;
- that offers the highest value for the property.

This final point is sometimes discussed in terms of the use that offers the highest net return, as where the benefit of a higher value is offset by higher costs when a lower value use may support a higher bid.

5.3.11 That use will depend on the specific nature of the property in question and so might change where the property is aggregated with others for the valuation. Where practitioners apply the highest and best use assumption, that use gives guidance as to which properties may offer the best comparable evidence to support their valuation and may affect the choice of valuation method.

5.3.12 Unless instructed otherwise, it is the valuer's task to determine the Market Value of the land or property in accordance with the full analysis of Market Value in EVS 1. The hypothetical seller will accept no less for his property and the hypothetical buyer will not want to offer more than he would pay for an equivalent property of similar usefulness to him. As each point of the definition of highest and best use (except the requirement for evidence) places some constraint on the definition of Market Value, the highest and best use assumption will not necessarily be the same as Market Value, albeit that it might be higher than existing use value for which no alternative use could be considered. The most obvious common point of difference lies in the exclusion of potential permissions or other future opportunities for which the market might express hope value and in doing so judge the prospects, risks and costs of that future opportunity.

5.3.13 If particular conditions are imposed on the sale, the State Aid rules will only regard the offer as 'unconditional' if all potential buyers would have to, and be able to, meet that obligation, irrespective of whether or not they run a business or of the nature of their business.

5.3.14 The 1997 State Aid rules for an unconditional offer are:

"... when any buyer, irrespective of whether or not he runs a business or of the nature of his business, is generally free to acquire the land and buildings and to use it for his own purposes, Restrictions may be imposed for the prevention of public nuisance, for reasons of environmental protection or to avoid purely speculative bids. Urban and regional planning restrictions imposed on the owner pursuant to domestic law on the use of the land and buildings do not affect the unconditional nature of an offer."

State Aid Communication II.1.(b)

5.4 The Transaction

5.4.1 "... should exchange ..." - It is an estimated amount rather than a predetermined or actual sale price. It is the price at which the market expects a transaction to be completed on the date of valuation and that meets all the other elements of the Market Value definition.

5.4.2 For a Market Rent, it is again an estimated amount rather than a predetermined or actual rent. It is the rent at which the market expects to be paid for the lease if taken on the date of valuation and that meets all the other elements of the Market Rent definition. The actual rent would anyway be expected to be different if there were a capital cost such as a premium associated with taking the lease.

5.4.3 The use of “should” conveys that sense of reasonable expectation. The valuer must not make unrealistic assumptions about market conditions or assume a level of Market Value above that which is reasonably obtainable.

5.4.4 Under the definition used in the State Aid rules the price is to be that at which the land and buildings “*could be sold under private contract*”. The use of “could” reflects the hypothetical nature of the transaction. This is not assumed to mean the best possible price that could be imagined but rather the reasonable expectation of the price that would be agreed.

5.4.5 The hypothetical sale is by “private contract” and so is the subject of negotiation.

5.4.6 In considering the Market Rent for a property, it would be conventional to assess it on the basis that no premium was also being paid in respect of lease by any party so that it is simply the rental value that is being determined. Where a premium, positive or negative, is expected under the terms of the lease that should be clearly stated to avoid all ambiguity.

5.5 The Date of Valuation

5.5.1 “... on the date of valuation ...” - This requires that the estimated Market Value or Market Rent be time-specific to a given date; a value is a judgment as at a particular point in time. This is normally the date on which the hypothetical sale is deemed to take place and is usually, therefore, different from the date the valuation is actually prepared. As markets and market conditions may change, the estimated value may be incorrect or inappropriate at another time. The valuation amount will reflect the actual market state and circumstances at the required date of valuation, not at a past or future date. The date of valuation and the date of the valuation report may differ, but the latter cannot precede the former. The definition also assumes simultaneous binding agreement of terms and completion of the contract for sale without any variation in price that might otherwise be made in a Market Value transaction at the date of valuation.

5.5.2 Market Value is quite expressly not an assessment of value over the longer term but only at the time of the hypothetical transaction.

5.5.3 The phrase “date of valuation” (and also “valuation date”) are used to refer to the date as at which the valuation is assessed or determined (and for which the evidence supporting it is to be relevant) rather than the, usually later, date when the valuation is prepared and considered, with the valuation report then being completed for the client. The completion of the valuation report will never be earlier than the date of valuation, as it would then be contemplating circumstances that have not happened and may not and for which important evidence may yet be found. The report should record both the date of valuation and the date on which the report was completed.

5.5.4 The date of valuation will not be later than the date of the Valuation Report. By providing that the hypothetical binding agreement of the terms of the transaction is deemed to take place on the date of valuation, this ensures that the valuation is informed by those factors that would have been in the expectations of the parties as to value at that point in time. However, national regulation might require that, in specific circumstances, the date of valuation may coincide with a later reference date for the purposes of assessing the quality and situation of the property (for example, statutory compensation schemes on compulsory purchase).

5.6 The Parties – Hypothetical, Willing and Competitive

5.6.1 “... *between a willing buyer* ...” - This assumes a hypothetical buyer, not the actual purchaser. That person is motivated, but not compelled, to buy. This person is neither over-eager to buy nor determined to do so at any price.

5.6.2 The same provisions apply to Market Rent, presuming a hypothetical would-be tenant who is willing to take the tenancy, but not at any price.

5.6.3 This willing buyer or would-be tenant is also one who would undertake the transaction in accordance with the realities of the current market and with current market expectations, rather than on an imaginary or hypothetical market, which cannot be demonstrated or anticipated to exist. This person would not pay a higher price than that which the market requires him to pay. The present owner (or, as appropriate, tenant) of the property is included among those who constitute the market.

5.6.4 Equally, the motivated bidder cannot be presumed to be reluctant or unwilling. He is attending to this as a practical man of business.

5.6.5 The State Aid rules refer to an “arm’s length buyer” unconnected with and independent of the seller.

5.6.6 “... *and a willing seller* ...” - Again, this is a hypothetical seller, rather than the actual owner and is to be assumed to be neither an over-eager nor a forced seller who is 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 property at market terms for the best price obtainable in the open market after proper marketing, whatever that price might be. The factual circumstances of the actual owner are not part of this consideration because the ‘willing seller’ is a hypothetical owner. The property is on the market.

5.6.7 Again, for Market Rent, the lessor is a hypothetical one, not the actual owner. He is willing to lease but is neither compelled to lease the property out nor to hold out for a price not considered reasonable in the current market.

5.6.8 Thus, while the property to be valued as it is in the real world, the assumed buyer and seller (or landlord and tenant) are hypothetical parties, albeit acting in current market conditions. The requirement that they both be willing to make the transaction creates the tension between them in which Market Value (or Market Rent) can be assessed.

5.6.9 Market Value and Market Rent are thus independent of and uninfluenced by the objectives of the client instructing the valuation.

5.6.10 *“... in an arm’s-length transaction ...”* - An arm’s-length transaction is one between parties who do not have a particular or special relationship (as might be the case, for example, with parent and subsidiary companies, landlord and tenant or family members) which may make the price level uncharacteristic of the market or inflated by any element of special value. For the purposes of Market Value and Market Rent the transaction is presumed to be between unrelated parties, each acting independently.

5.7 The Marketing

5.7.1 *“... after proper marketing ...”* - The property would be exposed to the market in the most appropriate manner to effect its disposal at the best price reasonably achievable in accordance with the Market Value definition. The length of exposure may vary with market conditions, but must be sufficient to allow the property to be brought to the attention of an adequate number of potential purchasers. The marketing period is assumed to have been before the date of valuation.

5.7.2 If the Market Rent is to be assessed for a property, then it again assumed that it would be exposed to the market in the most appropriate manner to effect its disposal at the best rent reasonably achievable in accordance with the Market Rent definition. The length of exposure may vary with market conditions, but must be sufficient to allow the property to be brought to the attention of an adequate number of potential tenants.

5.7.3 Under the guidance for applying the EU State Aid rules, the property is to have been:

“repeatedly advertised over a reasonably long period (two months or more) in the national press, estate gazettes or other appropriate publications and through real-estate agents addressing a broad range of potential buyers, so that it can come to the notice of all potential buyers.”

II.1.(a), 1st paragraph

As the EU and EEA rules are intended to ensure that transactions are at market value, they are also concerned that, where the sale might attract international bidders, it should be advertised accordingly and

“such offers should also be made known through agents addressing clients on a Europe-wide or international scale”.

II.1.(a), 2nd paragraph

5.7.4 The State Aid rules are specific in expecting the sale to be one in conditions that allow “*orderly disposal*” – no undue haste is imposed that could limit the proper testing of the market or compel the owner to sell precipitately. The rules refer to a “*normal period*” for the negotiation of the sale which is to be judged by the “*nature of the property*”.

5.7.5 These factors, testing the general range of bidders that may come forward, should (subject to the market conditions that anyway frame the market value) bring out the qualities required of the hypothetical buyer.

5.8 The Parties’ Consideration of the Matter

5.8.1 “... *wherein the parties had each acted knowledgeably...*” - This presumes that both the willing buyer and willing seller are reasonably well informed about the nature and characteristics of the property, its actual and potential uses, and the state of the market at the date of valuation. The same assumption applies to the willing lessor and the willing tenant for Market Rent.

5.8.2 The parties will thus appraise what might reasonably be foreseen as at that date. In particular, the hypothetical buyer may be better informed for this assessment than some or all of the real bidders. This involves knowledge not just of the property but also of the market and therefore the evidence (including such comparables as may be available) on which to judge the value of the property.

5.8.3 “... *prudently...*” - Each party is presumed to act in their own self-interest with that knowledge, and prudently to seek the best price for their respective positions in the transaction. Prudence is assessed by referring to the state of the market at the date of valuation, not with the benefit of hindsight at some later date. It is not necessarily imprudent for a seller to sell property in a market with falling prices which are lower than previous market levels. In such cases, as for other transactions in markets with changing prices, the prudent person will act in accordance with the best market information available at the time.

5.8.4 “... *and without being under compulsion...*” – This establishes that each party is motivated to undertake the transaction, but is neither forced nor unduly coerced to complete it. Each freely enters into and completes the business.

5.9 Assumptions

5.9.1 The valuation instruction may require the valuer to make an assumption, as, for example, on the time allowed for marketing in the context of a forced sale valuation (see 5.10.4 below). The valuer may have to make certain assumptions in order to complete the valuation effectively, often in the absence of particular information. In either case those assumptions should be clearly stated.

5.9.2 The valuer makes an assumption where he assumes (or is instructed to assume) something on a matter of fact which he does not or cannot know or reasonably ascertain.

5.9.3 The valuer must undertake inspections and investigations to the extent necessary to produce a professional valuation for the purpose instructed. Where the information provided or available is limited or restricted, the valuer may need to make assumptions to enable an opinion of value to be reported in the absence of full data or knowledge. Assumptions may relate to facts, conditions or situations affecting the valuation and, as they are in the absence of full information, be those considered most likely to be correct. For matters such as, for example, title or asbestos that may be beyond the valuer's ability to check independently, the assumption may be accompanied by a recommendation that the client have the facts established by those with the appropriate specialist skills. Where assumptions made are subsequently found to be incorrect, the valuer may need to review and amend the figures reported and refer to that possibility in the report.

5.9.4 The following is an indicative, but not exhaustive, list of matters that may be reported as matters where assumptions have been made in arriving at an opinion of value:

- A detailed report on title that sets out any encumbrances, restrictions or liabilities that may affect the value of the property may not be available. In such a case, the valuer would have to assume the position he considers most likely, also stating that he accepts no responsibility or liability for the true interpretation of the legal title.
- The extent of the inspection should be clearly set out in the report, consistent with the nature of the instruction and the type of property. It may be necessary to make the assumption that, while any obvious defects have been noted; other defects may exist which could require a more detailed survey or the appointment of specific experts. That might be followed by a comment that the opinion of value stated is based on the condition as reported and so that any additional defects that exist may require the figures to be amended.
- Assumptions may be needed with regard to the necessary statutory consents for the current buildings and use together with reference to any policies or proposals by statutory bodies that could impact positively or adversely on the value.

- The competence of the valuer to report on any potential risk of contamination or the presence of hazardous substances will need to be considered. It may be necessary to make assumptions in providing an opinion of value that either no such risks exist or that the valuer will rely on information prepared by specialist consultants.
- The valuer may, on occasion, need to assume that all mains services provided are operational and sufficient for the intended use.
- It may be necessary to make an assumption as to whether the property has not, or will not be expected to flood or whether other environmental matters may bear on the opinion of value.
- Where the property is let and to be valued as such, it may be necessary to assume that detailed enquiries about the financial status of tenants would not reveal matters that might affect the valuation.
- The valuer may need to assume that there are no planning or highway proposals that might involve the use of any statutory powers or otherwise directly affect the property.
- The valuer may assume that items of plant and equipment normally considered to be part of the service installations to a building would pass with the property.

The assumptions required where a valuation without an inspection is required are considered in EVS 4 at 6.4.

5.10 Special Assumptions, Including Alternative Use Value and Forced Sale Value

5.10.1 In distinction to an assumption that the valuer has to make to undertake his task, the valuer may make a special assumption when he assumes, usually on instruction, a fact or circumstance that is different from those that are verifiable at the date of valuation. The result will be a Market Value on that special assumption.

5.10.2 This may often be to inform the client about the effect of changed circumstances on the valuation. Examples of this include where the valuer is instructed to make special assumptions as to the value of the property:

- were it vacant when in fact the property is let;
- were planning permission to be obtained for a particular use.

5.10.3 Two particular examples are considered below:

- alternative use value (at 5.10.6);
- forced sale value (at 5.10.7).

5.10.4 Specific, usually national, statute law may require special assumptions to be made, as perhaps for valuations for certain taxation or compulsory purchase purposes.

5.10.5 Where special assumptions are to be made they should be recorded in the terms of engagement and in the valuation report (see also EVS 4 at 5.8).

5.10.6 Alternative Use Value

5.10.6.1 Definition - This means the Market Value of the property without presuming the continuation of its present use.

5.10.6.2 Commentary - While Market Value identifies the best available value for a property however used, some valuations may be required only to assume the present use; for example, a business is being assessed as a going concern. If it is material to consider alternative uses of the property which may not involve continuing the present business, then that would be its alternative use value, a market value. That value would not reflect any costs of ceasing the business.

5.10.6.3 This basis may also be relevant where a depreciated replacement cost valuation has been undertaken as the client may wish to have an indication of the value of a specialist property for other uses.

5.10.7 Forced Sale Value

5.10.7.1 Definition - A sum that could be obtained for the property where, for whatever reason, the seller is under constraints that require the disposal of the property in conditions that do not conform with the definition of Market Value.

5.10.7.2 Commentary - Forced sale value is not a basis of value but an example of a Market Value on a special assumption as to the conditions for marketing. The need for a valuation may arise where the seller is under compulsion to sell, is desperate to sell or a strict time limit is otherwise imposed. This might most obviously arise where the period in which the property is to be sold is too short to allow the proper marketing needed to be confident of the best bids. More generally, potential buyers may be aware that the seller is under constraint and so moderate their bids from those they may otherwise have offered. The nature of these specific constraints determines the situation in which the hypothetical transfer takes place – without those constraints, it would simply be Market Value.

5.10.7.3 Further specific issues have been found in some markets with repossessed properties in the financial circumstances after 2008. The lender, now in possession, may either wish to dispose of the property promptly or be under some pressure to do so. Where the property is vacated by the former owner in good order, it might be that there are no further factors. Where it has been left in poor order, even without most fixtures and fittings, that will be evident on inspection and potentially relevant to the valuation. In either case, the valuer may be asked for the Market Value of the property subject to a special assumption about the period for marketing.

5.10.7.4 There may be cases where the previous owner is disputing the repossession. However, if the lender is in possession the valuer may well not know of any dispute and be in no position to judge its outcome. The opinion of value might then usually be stated to be on the assumption of the lender's right to possession.

5.10.7.5 Forced Sale Value is not a basis of valuation. Once all the relevant constraints are identified it may be seen as a Market Value assessment on the Special Assumption of a stated but limited period for marketing the property. Thus, the valuer should not undertake a valuation on a forced sale basis but rather on a Market Value basis on stated specific special assumptions relevant to the case in hand.

5.10.7.6 The valuer needs to know and state the time allowed and the relevant constraints on the seller. As the value will reflect those very specific circumstances of the assumption that is imposed, they should be stated in the terms of engagement and in the Valuation Report. The result will not be a Market Value as it is not based on a hypothetical willing seller but a seller under actual constraints.

5.11 Other Matters

5.11.1 *Documentation* - While Market Value and Market Rent exist independently of documentation, a professional valuation under this standard should be properly recorded in writing in a way that is transparent and clear to the client in accordance with EVS 4 and to anyone else who might reasonably seek to rely on it or appraise it.

5.11.2 The definition of Market Value (or, if appropriate Market Rent) should be recorded in both the terms of engagement and the valuation report.

5.11.3 *Transaction costs and taxes* - Market Value is to be the estimated value of a property and so excludes the additional costs that may be associated with sale or purchase as well as any taxation on the transaction. Market Value will reflect the effect of all the factors that bear on participants in the market and so reflect such influences as transactions costs and taxes may have but, if they need to be recognised, this should be as a sum in addition to the Market Value. These factors may influence the value but are not part of it.

5.11.4 In particular, Market Value will be the value before any taxes which may apply to any real transaction in the property being valued. The fact of transaction taxes or Value Added Tax as they may affect some or all potential parties will be part of the wider framework of the market and so, along with all other factors, influence value, but the specific taxation due on a transaction is over and above its Market Value.

5.11.5 However, the position on this may vary (perhaps especially for accounting purposes) with different national legislation. In certain circumstances EU law also takes

a different approach. Article 49(5) of *Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings* states that:

“Where on the date on which the accounts are drawn up and land and buildings have been sold or are to be sold within the short term, the value arrived at ... shall be reduced by the actual or estimated realisation costs.”

5.11.6 In such cases, the valuer may choose to state the Market Value both before and after these costs of disposal. In either case, he should make it clear whether such costs have been deducted and, if so, specify how much has been deducted for each identified cost.

EVS 2

Valuation Bases Other than Market Value

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- 2. Scope**
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EUROPEAN VALUATION STANDARD 2

The valuer should establish the purpose for which the valuation is required before using any basis of value other than Market Value.

Save as required by European and national law and regulation in any particular case, the valuer should only use recognised bases of valuation that are compatible with the purpose of the valuation and, in doing so, honour the principles of transparency, coherence and consistency.

Such other bases of value may need to be used as required by law, circumstances or a client's instructions where the assumptions underpinning Market Value are not appropriate or cannot be met. The result will not be a Market Value.

1. Introduction

Although the majority of professional valuations will be on the basis of Market Value, there are circumstances where alternative bases may be required, or may be more appropriate. It is essential that both the valuer and the users of valuations clearly understand the distinction between Market Value and other bases of valuation, together with the effects that differences between these concepts may create in the valuer's approach to the valuation and in the resulting reported value.

2. Scope

This Standard defines, explains and distinguishes bases of value other than Market Value.

3. Basis of Value

3.1 Definition - A statement of the fundamental assumptions for assessing a valuation for a defined purpose.

3.2 Commentary

3.2.1 A basis of value as a statement should be distinguished from the methods or techniques used to implement a chosen basis. Established terms and methods used in the valuation should be defined in the valuation report.

3.2.2 In the event that none of the bases in EVS 2016 are suitable for the completion of an instruction, a clear and transparent definition of the basis used must be expressly stated, and the valuer should explain the reason for deviating from a recognised basis. If the resultant valuation does not reflect a sum that would equate to a valuation prepared on the basis of Market Value, this should be stated. Any assumptions or special assumptions used should be set out in the valuation report.

4. Fair Value

4.1 Definition - The term Fair Value is used in two particular but distinct contexts, giving it differing applications:

- **A General Definition** - Fair Value may generally be used as a basis of valuation for real estate as between specific, identified participants in an actual or potential transaction, rather than assuming the wider market place of possible

bidders. As such, it may often result in a different value to the Market Value of a property. For this purpose it is defined as:

“The price that would be received to sell a property or paid to transfer a liability in an orderly transaction between identified willing market participants possessing full knowledge of all the relevant facts, making their decision in accordance with their respective objectives.”

The same concept can be applied to the determination of a Fair Rent between two specific, identified parties. In this context Fair Rent is defined as:

“The rent that would be received on the letting of a property in an orderly rental transaction between identified willing market participants possessing full knowledge of all the relevant facts, making their decision in accordance with their respective objectives”.

When the Fair Rent is reported, the valuer should state the assumptions adopted as regards the main terms of the lease, as these may have an impact on the level of the rent.

In some jurisdictions the expression “fair rent” may have other meanings, determined by legislation or regulations.

- **For Accounting Purposes** - Fair Value is specifically adopted as a term under International Financial Reporting Standards for which, albeit with slightly less detailed assumptions than the full definition of Market Value, it may often give the same result as Market Value. This is more closely reviewed in EVGN 1. For this purpose, it is defined as:

“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” (International Accounting Standards Board (IASB), International Financial Reporting Standards (IFRS) 13, par. 1).

This definition was introduced by IFRS 13 Fair Value Measurement and came into force from 1 January 2013.

The Fair Value of a non-financial asset like real estate takes into account a market participant’s ability to generate economic benefits by using the property in its highest and best use, that is, the most valuable use of the property that is physically possible, legally permissible and financially feasible at the date of valuation. In this non-financial context, Fair Value may differ from a valuation prepared in accordance with the definition of Market Value (see EVS 1 for Market

Value and EVGN 1, 6.6 for a discussion of possible differences between Market Value and Fair Value).

4.2 Commentary - Fair Value in its General Definition

4.2.1 Fair Value, in the sense used in 4.1 above, is the amount that represents a fair price to be paid between two known parties, taking account of their respective interests and the advantages and disadvantages to the buyer of acquiring the property. This can give a different value from the assumptions used to determine Market Value, which is an amount to be paid by an unknown, hypothetical buyer to a hypothetical seller. In some instances, the two identified parties may possess characteristics that would be excluded by the definition of Market Value (for example, the proposed deal may not actually be an arm's-length transaction).

4.2.2 Fair Value is particularly pertinent in situations where, for whatever reason, it could be envisaged that the real buyer might pay a different price than the Market Value. Examples of this might include:

- the tenant under a ground lease buying out the freehold;
- the owner of an area of potentially developable land buying the only strip that gives road access to his site, etc.

4.2.3 Fair Value therefore allows recognition of the individual value a property may have to one particular bidder. This is considered in the concept of Special Value in section 5, below.

4.3 Commentary - Fair Value for Financial Reporting

4.3.1 In respect of financial reporting under IFRS13 (see EVGN 1), Fair Value is a required basis of valuation, defined as in 4.1 above. While the definition differs from that of Market Value, being less detailed in its assumptions about prior exposure to the market, the value reported will frequently be indistinguishable from Market Value. However, there may be cases, particularly involving future development potential and hope value, where the two values are not the same.

4.3.2 The determination of Fair Value is discussed in greater detail in EVGN 1, Valuation for the Purposes of Financial Reporting. It should be noted that, since the publication of IFRS 13, it is now clear that Fair Value is intended to be an estimate of the sale price (or "exit price") that could be achieved. Fair Value must be estimated from the point of view of actors in the market. Any special value to the existing owner is to be disregarded if actors in the market would not be expected to bid for that extra value.

4.3.3 Fair Value will generally be determined on the basis of the property's highest and best use, that is, the most valuable use of the property that is physically possible, legally permissible and financially feasible at the date of valuation.

5. Special Value

5.1 Definitions

5.1.1 Special Value is defined as an opinion of value that incorporates consideration of characteristics that have a particular value to a Special Purchaser.

5.1.2 A **Special Purchaser** is a purchaser who can optimise the usefulness of a property compared to other market participants and whose opinion of price equates to a Special Value.

5.2 Commentary

5.2.1 Where particular qualities or characteristics of a property have a value for one acquiring party that is higher than Market Value, that party may be described as a Special Purchaser and any figures reported that equate to a sum representing that purchaser's opinion of value would represent a Special Value. For example, one particular telecommunications operator might be prepared to pay an above-market price to site an aerial in a particular location if this was the last one he needed in order to complete his network.

5.2.2 Special Value could be associated with elements of Going Concern Value. The valuer must ensure that such criteria are distinguished from Market Value, making clear any special assumptions made.

5.3 Synergistic Value (known in some countries as Marriage Value)

5.3.1 This is a particular class of Special Value that valuers will commonly meet.

5.3.2 It is a higher value, created when the total value of several properties (or of several legal interests in the same property) combined is greater than the value of the sum of their parts.

5.3.3 Commentary - If a Special Value arises where a combination of interests results in a greater value than the total of those interests valued separately, this value is often described as a Synergistic Value. Terms of Engagement and Valuation Reports should clearly specify where such values are required or will be provided and Market Value should also be reported, so as to identify the differential between the two bases.

5.3.4 This might often be found where the acquisition of a property, often a neighbouring one, unlocks extra value for the purchaser. It may be relevant to transactions between landlord and tenant. However, where a property offers the same synergistic value opportunities to several potential bidders (as by offering any of them a

greater scale of operation) then this value should be considered to be the Market Value of the property.

6. Investment Value

6.1 Definition – “Investment Value is the value of a property to a particular identified party for investment, owner-occupation or operational purposes.”

6.2 Commentary

6.2.1 This subjective concept relates a specific property to a specific investor, group of investors, or entity with identifiable investment objectives and/or criteria. As valuations prepared on this basis assess what an individual buyer may be prepared to bid, they are not a measure of the overall judgment of the market on the property. Thus, they would not be expected to be consistent with or equivalent to valuations prepared on any other basis, including Market Value. Such valuations:

- are to determine the value of a property for a specific individual investor with his own actual concerns, rather than a hypothetical party;
- do not assume an exchange of property between parties.

6.2.2 The application of this definition is discussed in EVGN 5.

7. Mortgage Lending Value

7.1 Definition - The value of immovable property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property.

7.2 Commentary

7.2.1 The above definition was for the first time incorporated in Directive 2006/48/EC (the Capital Requirements Directive) at Annex VIII, paragraph 64 in the context of real estate collateral for the capital requirement and credit risk management of credit institutions. This Directive was subsequently replaced in 2013 by the Regulation (EU) N° 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms transposing the Basel III Accord into European law (Capital Requirements Regulation (CRR), OJ L321, 30.11.2013, p.6). The Mortgage Lending Value definition is included in its Article 4 par. 74.

7.2.2 Mortgage Lending Value is recognised by the CRR as a valuation basis for the calculation of the risk-weighted exposures of credit institutions secured by mortgages on immovable property. More precisely, the CRR recognises real estate as a security or as risk-mitigating collateral inducing a lower risk weight, i.e. lower capital requirements to be allocated by credit institutions. The Regulation stipulates in its Article 229 par.1 that:

“for immovable property collateral, the collateral shall be valued by an independent valuer at or at less than the market value.

In those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions, the immovable property may instead be valued by an independent valuer at or at less than the mortgage lending value”.

7.2.3. The concept of Mortgage Lending Value (MLV) is of particular value in some European countries in the context of long term lending programmes. It is a value-at-risk approach to manage the risk exposure of credit institutions taking into account special safety requirements. It especially applies to the valuation of real estate for funding purposes, i.e. valuation of eligible cover pool assets securing the issuance of covered bonds. MLV is understood by banking supervisors as a risk management tool where only long-term sustainable aspects of the property and no speculative elements shall be taken into account. Art. 229 par. 1 CRR explicitly stipulates that:

“institutions shall require the independent valuer not to take into account speculative elements in the assessment of the mortgage lending value and to document that value in a transparent and clear manner.”

In contrast, the concept of Market Value is universally understood as representing a spot value, a market assessment of value at a given point in time (see EVS 1 and EVGN 3).

8. Insurable Value

8.1 The ‘Insurable Value’ of a property means the sum stated in the insurance contract applying to that property as the liability of the insurer should damage and financial loss be caused to the insured by a risk specified in the insurance contract occurring to that property. When instructed to provide an insurable value, the valuer is to determine the figure that will provide appropriate insurance cover for the property.

8.2 Commentary - If the insurable value proves to have been less than the damage and financial loss suffered when a risk occurs, then the insured has an unrecoverable loss.

8.3 The application and assessment of this basis of valuation is discussed in EVGN 4, Assessment of Insurable Value and Damages.

9. Value for Local and National Taxation Purposes

In many countries real estate assets are used as a basis for raising local or national taxes. Taxes can be levied on one-off events (such as sales or purchases of the property, or on death of the owner) or can be levied on a recurring basis, typically annually. As the basis of value to be adopted for taxation purposes will generally be defined in the relevant national or local legislation or regulations, it is inappropriate to go into further details in this EVS.

10 Values for Compulsory Purchase and/or Compensation

Where national or local government bodies acquire property compulsorily in order to carry out public interest schemes it is usual for the owner (and the occupiers, if any) to receive appropriate compensation payments. While compensation for loss of property is often based on Market Value, this principle may be modified by national or local law and legal precedent. As such, it is inappropriate to seek to treat this subject further in this EVS.

EVS 3

The Qualified Valuer

1. Introduction
2. Scope
3. General
4. The Qualified Valuer
5. Commentary

EUROPEAN VALUATION STANDARD 3

Each valuation carried out in accordance with these Standards must be carried out by, or under the strict supervision of, a Qualified Valuer.

Valuers will at all times maintain the highest standards of honesty and integrity and conduct their activities in a manner not detrimental to their clients, the public, their profession, or their respective national professional valuation body.

The valuer must be able to show professional skill, knowledge, diligence and ethical behaviour appropriate to the type and scale of valuation and must disclose any factor which could compromise an objective assessment. Each valuation must provide an informed and independent opinion of value supported by a recognised basis or bases of valuation.

1. Introduction

For a client to be able to rely on a valuation, it must be professionally prepared by a suitably skilled, competent, experienced and objective valuer.

2. Scope

This Standard considers who should take responsibility for a valuation, requiring that the Valuation Report must be approved by a Qualified Valuer who bears responsibility for it. All valuers contributing to a report must have sufficient expertise and work to professional standards and, where considering valuation issues, should meet the expectations of this standard.

3. General

3.1 A valuation should be prepared by a qualified valuer and meet the requirements of a professional service. Such a person will commonly be an individual but, on occasions and in some countries, a valuation may be made by a company with a legal personality. In either situation the relevant work should be undertaken by suitably qualified individuals delivering the professional skills, knowledge, competence and independence consistent with the requirements of both EVS and the European Valuers' Code of Ethics and Conduct. Professional service determines that the skill, knowledge and competence of the valuer must be appropriate to the type and scale of valuation, with any factor which could compromise an objective assessment being disclosed.

3.2 The terms and conditions for the valuer's instruction should be agreed before undertaking the valuation and set out clearly in writing before the valuation is reported. Valuations which are to be in the public domain or which will be relied on by third parties are frequently subject to statute or regulation. There are often specific requirements that a valuer must meet in order to be deemed suitable to provide a truly objective and independent view. However, there are no specific statutory or regulatory criteria for most valuations and it will therefore be for the valuer to satisfy himself that he possesses the requisite skills; knowledge, competence and independence for each instruction undertaken (see EVS 4 for further guidance).

3.3 In all cases the onus is on the valuer to ensure that he is aware of potential conflicts of interest and ensure that he can meet the requirement of independence.

4. The Qualified Valuer

4.1 Definition - A Qualified Valuer (including valuers working for valuation companies) who is responsible for preparing and supervising valuations, bearing liability for them as included in financial statements and for other authorised purposes, shall be a person of good reputation, who can demonstrate:

- (i) either:
 - a university degree, post graduate diploma;
 - or other recognised academic or vocational certification relevant to property valuation that meets TEGoVA's Minimum Educational Requirements (MER); and having at least two years' professional experience in property valuation; or
 - long term relevant professional experience.

4.2 Competence. A qualified valuer is competent when he can demonstrate:

- (i) sufficient experience in valuing real property in the location and category of the subject property or, having disclosed the insufficiency to the client before accepting the assignment, that he has obtained suitable assistance from competent and knowledgeable person(s);
- (ii) where required by home country national legislation or regulations, any required licence to practise as a valuer or membership of a professional association;
- (iii) compliance with all legal, regulatory, ethical and contractual requirements related to the valuation;
- (iv) that he will at all times maintain the highest standards of honesty and integrity and conduct his activities in a manner not detrimental to clients, the public, the profession, or his respective national professional valuation body. It is mandatory for all Qualified Valuers and their representative professional or technical organisations to adhere to an ethical code that is as stringent as the TEGoVA European Valuers' Code of Ethics and Conduct;
- (v) that he holds professional indemnity insurance appropriate to the valuation work undertaken (unless the Member Association does not require it);
- (vi) he has maintained and enhanced his professional knowledge through a relevant programme of continuing education.

4.3 Enhanced Competence: A qualified valuer reaches this level when he can demonstrate enhanced skills by:

- satisfying the requirements of TEGoVA's Recognised European Valuer (REV) programme; or
- satisfying the requirements of the TEGoVA Residential Valuer (TRV) programme.

See Part 4 of these Standards and the TEGoVA website.

4.4 Accredited ISO certification Several European states have specific certification systems in place to qualify valuers under national legislation or regulation.

European Standard EN45013, the European Standard for Bodies operating Certification of Personnel, was issued in 1990 and became in 2006 a world standard, ISO/IEC 17024. The system is managed by national certification bodies which in turn must be accredited by a national accreditation body.

For a qualification to be approved under this standard, applicants have to comply with admission requirements as defined by the certification body. The standard requires training, a written and oral examination as well as periodic re-certification in line with the certification curriculum produced by the certification body. During the validity period of the certificate, valuers have to comply with professional ethics and are subject to monitoring of compliance and to a continuing professional development (CPD). Addressing the usually diverging national qualification levels of valuers, ISO 17024 provides transparency on the basis of internationally uniform requirements.

4.5 Recognised European Valuer (REV) - TEGoVA has developed the Recognised European Valuer (REV) programme to enable individual valuers, through their professional associations, to have an enhanced status, over and above TEGoVA's Minimum Educational Requirements, to assure clients, especially from other countries, of their valuation expertise. The REV programme is summarised in the Information Paper in Part 4 and its more detailed requirements are set out on the TEGoVA website, www.tegova.org.

4.6 TEGoVA Residential Valuer (TRV) -The TEGoVA Residential Valuer programme enables recognition of qualification, knowledge and professional experience for individual valuers undertaking residential valuations. Attainment of this recognition can assist in ensuring that "internal and external appraisers conducting property valuations are professionally competent and sufficiently independent from the credit underwriting process so that they can provide an impartial and objective valuation ..." Directive 2014/17/EU, Art. 19(2). The TRV programme is summarised in the Information Paper in Part 4 and its more detailed requirements are set out on the TEGoVA website, www.tegova.org.

4.7 TEGoVA's Minimum Educational Requirements (MER)

As part of its education strategy of supporting standards of professional competence, TEGoVA sets Minimum Educational Requirements (MER) for its Member Associations to require of their qualified members so that they apply to every valuer elected to practice after 1 January 2003. TEGoVA's Minimum Education Requirements are summarised in the Information Paper in Part 4 and set out in detail on the TEGoVA website, www.tegova.org.

4.8 Continuing Professional Development - The qualified valuer must maintain his expertise by keeping up to date with all relevant developments, whether legislative, technical or otherwise, affecting instructions to be undertaken so that he continues to have the commercial and professional expertise for the preparation and provision of valuations.

5. Commentary

5.1 General

5.1.1 Valuers must ensure that they meet the requirements of the instruction with professional standards of knowledge, competence and independence. It follows that a valuer who is asked to undertake an instruction must make initial enquiries of the client as to the nature of the instruction and purpose of the valuation. Confirmation of the detail of the instruction will be required in writing through the provision and acceptance of Terms of Engagement (see EVS 4). The valuer must be able to meet both the requirements of the client and the rules, legislation and codes of conduct relevant to the task.

5.1.2 EU Definition

5.1.2.1 The Commission's 1997 Communication on the application of EU State Aid rules to real property provide a definition of an "asset valuer" for the purposes of such valuations (Commission Communication on State Aid elements in sales of land and buildings by public authorities (OJ C 209, 10/07/1997, p0003-0005 – 31997Y0710 and extended to EFTA countries by EFTA Surveillance Authority Decision No 275/99/COL of 17 November 1999 introducing guidelines on State Aid elements in sales of land and buildings by public authorities and amending for the 20th time the Procedural and Substantive Rules in the field of State Aid). Cases concerning the application of these rules have been considered by the Court of Justice of the European Union.

5.1.2.2 Under these rules, the valuer is to be "a person of good repute who:

- has obtained an appropriate degree at a recognised centre of learning or an equivalent academic qualification;
- has suitable experience and is competent in valuing land and buildings in the location and of the category of the asset."

5.1.2.3 In the absence of the Member State having appropriate established academic qualifications, the asset valuer should be

"a member of a recognised professional body concerned with the valuation of land and buildings and either:

- be appointed by the courts or an authority of equivalent status;
- have as a minimum a recognized certificate of secondary education and sufficient level of training with at least three years' post-qualification practical experience in, and with knowledge of, valuing land and buildings in that particular locality."

5.2 Conflicts of Interest

5.2.1 The requirements of the valuer in terms of professional objectivity mean that he must be aware of anything that could be perceived as a conflict of interest. In his initial enquiries he should ask the client to identify any other interested or connected parties so as to establish whether there is a possible conflict of interest for the valuer, the valuer's partners, co-directors or close family.

5.2.2 If such a conflict exists, then this should be disclosed in writing to the client who may then choose whether or not to confirm the appointment, subject to a clear statement of the circumstances in any Certificate or Report that is produced by the valuer.

5.2.3 There may be circumstances where the valuer, despite the client's wishes, will still decline to accept the instructions.

5.3 Independence of the Valuer

5.3.1 There are various circumstances where the relationship with the client or another party makes it imperative that the valuer be, and be seen to be, not only competent to act, but also independent, and without any undisclosed potential conflicts of interest which are actual or possible and which can be foreseen at the time when the instructions are accepted. Any connection, other potential conflict of interest or other threat to the valuer's independence and objectivity, should be disclosed in writing to the client and recorded in the valuation report. The opinion of value reported must be that of the valuer and no other party, notwithstanding that a valuation company may take responsibility.

5.3.2 Where joint valuers are appointed they are subject to the same requirements individually and severally as regards independence and objectivity, as set out above.

5.3.3 Where a country has national rules on objectivity and independence, they must also be complied with and referred to in the Report.

5.3.4 EU Definitions

5.3.4.1 The Commission State Aid rules noted above at 5.1.2 require that:

"The valuer should be independent in the carrying out of his tasks, i.e. public authorities should not be entitled to issue orders as regards the results of the valuation. State valuation offices and public officers or employees are to be regarded as independent provided that undue influence on their findings is effectively excluded." *State Aid Communication II.2 (a)*

5.3.4.2 The Capital Requirements Regulation (CRR) states in Art. 208 (3b) that:

“a valuer should be independent when he possesses the necessary qualifications, ability and experience to execute a valuation and when he is independent from the credit decision process”.

5.3.4.3 Art. 229(1) requires that where immovable property is collateral, it is to be valued by an independent valuer. The European Banking Authority stated on 3 October 2014 (Question ID 2014_1056):

“In accordance with Article 208(3)(b) of Regulation (EU) No 575/2013 (CRR), the review of an immovable property collateral has to be carried out by a valuer who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process. As long as an employee of the bank meets all the aforementioned conditions, he/she can be considered as an independent valuer for the purposes of Article 229(1).”

5.3.4.4 Bank Recovery and Resolution Directive 2014/59/EU (BRRD) defines an independent valuer as:

“a person independent from any public authority, including the resolution authority and the financial institutions subject to the Directive”. [Article 36(1)]. For the BRRD, the European Banking Authority EBA provides further details in Article 2 of its Draft Regulatory Technical Standard (RTS) on the independence of valuers published on 6 July 2015 and confirms that the person concerned must have “the qualifications, experience, ability, knowledge and resources to ensure that he can perform the valuation without depending on support from third parties, in particular the relevant public authorities, including the resolution authority, and the relevant entity”.

5.3.4.5 The Mortgage Credit Directive 2014/17/EU (MCD) states in Article 19 that

“Member States shall ensure that internal and external appraisers conducting property valuations are professionally competent and sufficiently independent from the credit underwriting process so that they can provide an impartial and objective valuation, which shall be documented in a durable medium and of which a record shall be kept by the creditor”.

5.3.4.6 The 1997 State Aid rules provide that

“The valuer should be independent in the carrying out of his tasks” (for the full text see 4.2.2 above).

5.4 The Valuer's Liability

5.4.1 The valuer has been instructed to undertake a professional task, advising as to the value of property, or a legal interest/s in that property on which the client can expect to rely in taking decisions. Thus, the valuer's role is one that carries liability and deficiencies may result in loss to the client and legal action against the valuer.

5.4.2 According to the circumstances and the national legal system, that liability may arise where loss follows a failure to apply skill and care, breach of contract or otherwise.

5.4.3 The extent of that liability may be defined by the written instructions and the terms of engagement as well as by the drafting of and qualifications in the valuation report.

5.4.4 The valuer may seek to limit his liability in the terms of his contract with the client. Unless it is clear that a third party needs to have access to the report (for example, if the property is to be used as security), its use could be limited to the client and liability to third parties expressly excluded.

5.4.5 However, in a number of countries there are strict limits, statutory or otherwise, to the limitation of liability and, before attempting to draft clauses which are intended to do this, valuers are advised to take legal advice as to the likely effect of any limiting clauses.

5.4.6 As a professional, the valuer's fundamental duty is to his client. Any limitations on his liability should not be at the expense of the professionalism of the valuation.

5.4.7 The valuer should undertake tasks within his competence and fulfil them professionally within his instructions, appraising the property and seeking out all relevant evidence before determining the value, maintaining sound records while doing so, and reporting in a professional way.

5.4.8 *Recognising Limits on Expertise* - The valuer should not accept instructions outside his expertise. In more complex cases, the valuer may, on occasion, lack specific necessary specialist expertise for the proper completion of the instruction. This may, for example, concern geology, environmental issues, minerals, accountancy or a legal point. In these circumstances, the valuer must advise the client and seek specialist professional assistance to complete the assignment. To avoid confusion as to responsibilities and potential issues of contractual liability, valuers are advised that the client should, wherever possible, instruct the expert directly, rather than the valuer instructing the expert.

5.4.9 *Professional Indemnity Insurance* – As the level of liability for the valuer that could arise out of a valuation (together with any costs of associated legal action or interest accruing over the period of a dispute) may often be greater than the valuer's personal or corporate assets, professional indemnity insurance is available in many countries. Recognising that such cover is an assurance to the client, many professional associations make the maintenance of appropriate cover a condition of qualified membership. However, it is not universally available or required in all countries in which it is available.

EVS 4

The Valuation Process

1. **Introduction**
2. **Scope**
3. **Terms of Engagement**
4. **Liaison with Client's Advisers, Auditors and Others**
5. **Commentary**
6. **Supporting the Valuation**
7. **Valuation Reviews**

EUROPEAN VALUATION STANDARD 4

The terms of engagement and the basis on which the valuation will be undertaken must be set out in writing and agreed before the valuation is reported.

The valuation must be researched, prepared and presented in writing to a professional standard. The work undertaken must be sufficient to support the opinion of value reported.

Data retained following the submission of a valuation must be sufficient to enable verification that the analysis and evaluation undertaken in the approach, or approaches, to providing the opinion of value reported were sufficient for the type and scale of valuation.

1. Introduction

A valuation must be professionally prepared with the property appraised and all available evidence considered so that the result can be sustained under challenge.

2. Scope

This Standard considers the procedural steps followed in preparing the Valuation Report. Starting with terms of engagement, it continues with the appraisal and inspection of the property and then reviews the Valuation Report and retention of data. Finally, it discusses what may be considered when a valuer is instructed to review an existing valuation.

3. Terms of Engagement

3.1 Terms of Engagement are the specific terms of the contract between the valuer and the client. These terms are submitted to the client or prospective client once verbal or written instructions are received to provide a valuation service. Specific terms are prepared for each instruction; clearly and accurately reflecting the nature and purpose of the valuation and the extent of investigation to be undertaken to justify the subsequent opinion of value reported.

3.2 Detailed terms of engagement should be agreed in writing. In respect of lending, other financial or receivership instructions, terms must be agreed in writing before the valuation is submitted to the instructing client.

3.3 The main agreed terms or Instructions should be referred to in the report.

3.4 Terms of engagement as agreed may require subsequent amendment, and any variations must be recorded in writing to avoid misunderstanding and consequential dispute.

3.5 Terms as set out in 3.9 below should be regarded as minimum terms. Valuers are expected to revise and augment terms as appropriate or necessary to reflect local custom, requirements of the TEGoVA Member Association (TMA), national legislation or regulation.

3.6 Terms of engagement must be regularly evaluated to recognise client feedback or amended client requirements; recent legislation, regulation, TMA requirements and any update or new edition of EVS.

3.7 Failure to issue written terms will result in non-compliance with EVS 2016 and the requirements of TEGoVA's European Valuers' Code of Ethics and Conduct. This may

also result in an inadequate defence to any legal action relating to fees, negligence or performance.

3.8 Where valuations of a similar nature, such as lending valuations, are regularly provided to the same client and the valuer has previously provided terms of engagement, the valuer should confirm in writing that these terms continue to apply unless otherwise agreed with the client. The client should be notified in writing of any subsequent variations as soon as they come into force.

3.9 The minimum terms to be submitted and agreed are as follows:

- the client's identity;
- the purpose of the valuation;
- the precise extent of the property/interest being valued;
- the basis or bases of value;
- a specific date of valuation;
- confirmation that no potential conflict exists. Declaration of any previous involvement with the property or the parties involved;
- the identity and status of the valuer;
- assumptions, special assumptions and departures;
- the scope and extent of investigations;
- reliance placed on information provided by the client;
- any restriction placed on publication;
- the extent to which a duty of care will be provided;
- compliance with European Valuation Standards;
- the basis of fee to be charged.

See table under 5.10

3.10 Additional terms will be determined by the nature of the instruction; legislation or regulation, or TMA membership requirements. Any monitoring of valuations undertaken by the TMA should be referred to, including reference to the purpose of the monitoring.

4. Liaison with Client's Advisers, Auditors and Others

4.1 The valuer may need to liaise with the client's other advisers to secure necessary information. Where the valuation is required for inclusion in financial statements, it will be important to liaise closely with the auditors to ensure that the work undertaken is what is required, and to ensure consistency and the use of appropriate bases of value.

4.2 The professional judgement of the valuer will determine whether he relies on information provided or disclosed. Terms of engagement agreed must explicitly state what, if any, reliance is placed on information provided by the client, the client's representatives or third parties.

5. Commentary

5.1 Valuers have an absolute responsibility to ensure that they are, and can be seen to be, competent, qualified and not debarred by reason of any actual, potential or perceived conflicts of interest or have otherwise declared, and taken steps to remedy any real or apparent deficiency so that they may carry out the proposed assignment.

5.2 Unexpected events such as legal disputes may occur many years after the original valuation instructions have been completed. The historic context and reasoning behind any special terms and conditions may then be difficult to recall unless they were contemporaneously recorded in writing. Such a record will also show if the valuation has been used for purposes other than that for which it was prepared.

5.3 Apart from the benefits to the valuer of a clear and concise record which has been prepared and agreed in advance of the assignment, it also ensures that the client and the client's professional advisers know what to expect and are able to judge whether what they receive is what they wanted and expected.

5.4 Sub-contracted Valuations - Prior approval must be obtained from the client where work is sub-contracted to other specialist valuers or where substantial third party professional assistance is necessary. This approval must be recorded in writing from the client and disclosed in the Valuation Report.

5.5 Valuations Passed to a Third Party - There is a risk that valuations prepared for one purpose may be passed to a third party and used for another unrelated purpose. The terms of engagement must therefore exclude liability of the valuer vis-à-vis third parties and must specify the restricted nature of the valuation which is for the sole purpose of the client.

5.6 Valuations which do not comply with EVS - Where a valuer is asked to carry out a valuation on a basis that is inconsistent with, or in contravention of, these Standards, the valuer must advise the client at the beginning of the assignment that the Report will be qualified to reflect the departure from EVS. See EVGN 10.

5.7 Valuations carried out with limited information or where special assumptions are necessary - A situation may arise where there is limited information, inadequate inspection opportunities, or restricted time available to the valuer. For example, in some cases the Report may be required for the internal purposes of the management, in others the Report may be required in relation to a takeover or merger where time is of the essence. In such cases, the valuer must ensure that the terms of engagement agreed confirm that the Report will be for the client's use only and that it will not be published.

5.8 A valuer may need to make **special assumptions** or be required to value on the basis of special assumptions by the client. Such situations could include:

- assuming vacant possession when the property is tenanted;
- valuing on the basis of an assumed planning consent which differs from the actual consent;
- assumptions to provide a basis for the valuation of fire-damaged property;
- special assumptions when valuing trading property.

In such circumstances it is essential that the terms of engagement state clearly that the Valuation Report, and any publication based on it, will set out in clear terms the instructions relating to the valuation, the purpose and context of the valuation, the extent to which enquiries have been restricted, the assumptions that have been made, the dependence that has been placed on the accuracy of the sources of information used, the opinion that the valuation represents and the extent of non-compliance with these Standards.

5.9 Exceptionally, it may be appropriate and expedient to issue **valuations containing appropriate qualifications** in instances where the limited circumstances set out below apply:

- the valuer has already inspected the subject property and is familiar with it and with the market and the locality; or
- the valuer has received sufficient detailed supplementary information from management and/or Internal Valuers to the undertaking, to make up for the deficiency in the valuer's own enquiries.

5.10 Comment on Minimum Terms of Engagement

Terms	Comment
The client's identity	The valuer must ensure that the client is specified. In the event that instructions are provided by a director of a company, it is probably the company that is the client, not the director. Where the valuation is for lending purposes, instructions may be received from and invoices paid by the lender's customer, though the client will usually be the lender.

<p>The purpose of the valuation</p>	<p>As the specific purpose of the valuation will determine the basis or bases of value to be adopted, it is important that clarity be provided. It is prudent to state that the valuation will only relate to the specific purpose identified.</p>
<p>The precise extent of the property/interest being valued</p>	<p>The following should be considered:</p> <ul style="list-style-type: none"> - where the boundaries of the property being valued are undefined, reference to a plan or other fixed object may be required; - where the property is part of a block (e.g. a flat), the precise address should be stated; - more than one legal interest or legal estate may exist, specify which is/are being valued; - where fixtures, fittings, plant or machinery are present in a property, specify what will be assumed to remain with the property; - where a property is being valued subject to a tenancy it is possible that improvements undertaken by tenants will be disregarded upon renewal or review of a lease. This may have an impact on value.
<p>The basis or bases of value</p>	<p>The basis or bases of value that will be reported must be specified. Where the basis of value is Fair Value, as the term is used in two particular but distinct contexts, giving it differing applications, the correct definition must be provided as set out in EVS 2, paragraph 4.1. A basis of value recognised in EVS should be used. This may be determined by the client, the professional body, legislation or regulation.</p>
<p>A specific date of valuation</p>	<p>The date of valuation must be a specific date, as agreed with the client. It is not acceptable to state that the valuation will be dated at the date of the report.</p>

<p>Confirmation that no potential conflict of interest exists. Declaration of any previous involvement with the property or the parties involved</p>	<p>In general, valuers will be able to state that no potential conflict of interest exists that might prevent them acting independently. In cases where a potential conflict exists, the valuer should give details of the situation and state what actions he proposes in order to ensure he can act independently.</p> <p>A statement is required as to whether the valuer has had previous dealings with the property or the parties, irrespective of whether there have been any previous dealings or not.</p>
<p>The identity and status of the valuer</p>	<p>Clarify whether the valuer is acting in an external and independent capacity, specifying a corporate or personal persona, or as an independent internal valuer. Compliance with the valuer's professional associations and with TEGOVA's European Code of Conduct and Ethics should be confirmed.</p> <p>The qualifications and designations of the valuer should be set out, including REV or TRV, if awarded. In some circumstances it is appropriate to state the experience of the valuer in respect of undertaking similar valuations in the same location.</p> <p>Such a statement may be limited to a confirmation that the valuer has sufficient knowledge of the particular market, and the skills and understanding to undertake the valuation competently.</p>
<p>Assumptions, special assumptions and departures</p>	<p>All assumptions and special assumptions that will be made in preparing the valuation or valuation report must be specified, irrespective of whether they are identical to those stated in previous instructions. Reference must be made to any departures from EVS, setting out the reasoning and justification for departure. See EVS 1.</p>

<p>The scope and extent of investigations</p>	<p>The scope and extent of the investigation to be undertaken by the valuer should be clearly set out. The following must be included:</p> <ul style="list-style-type: none"> - the extent of the inspection (internal and external); - any reliance on desk-top research, including where appropriate, data concerning whether the property is within an area identified as having a flood risk; - any reliance on information provided by the client or third parties; - any information requested but not available at the time of reporting; - the energy performance rating, and other sustainability factors that might impact on value, with comment as appropriate; - any reports provided in respect of asbestos or other contaminative materials, or the absence of such reports; - any requirements determined by insurers and/or other third parties; and - confirmation that the extent of investigation will be sufficient to enable a fully justified opinion of value to be reported (or a statement where this is not the case).
<p>Reliance placed on information provided by the client</p>	<p>If the client has supplied information relating to the property or if the valuer is advised by the client to obtain information from a specified third party, then the terms should state that the valuer will rely upon this information and will not seek to verify the accuracy of the information provided.</p>
<p>Any restriction placed on publication</p>	<p>The valuer should state that prior consent in writing will be required for any reproduction or public reference to the valuation or report. In some cases, it will be appropriate to state that the content of the valuation or report is only provided to those to whom a duty of care is owed by the valuer.</p>

The extent to which a duty of care will be provided	The specific identity of the parties to whom a duty of care is owed should be set out. It may be appropriate to specify that no responsibility or duty of care will be offered to any other parties.
Compliance with European Valuation Standards	Where the valuation has complied with the requirements of EVS, reference should be given with the title European Valuation Standards 2016. If the valuation has to comply with other standards, a statement should be made to that effect.
The basis of fee to be charged	All relevant costs and charges to be borne by the client should be specified. If expenses are to be charged, the basis of that charge should be included. Figures quoted should state where they are exclusive of VAT or other taxes. Where the client is not registered for VAT (such as a private individual) the total fee including VAT should be stated. Where fees are determined by third parties or prescribed by statute, the actual amount to be charged should be provided.

6. Supporting the Valuation

6.1 A professional valuation relies on the valuer appraising the subject property in its context, researching and verifying all matters with a bearing on the value of the property. The quality of the valuation will, in part, rely on the quality of the information used to prepare it and so the valuer will need to verify any sources and the date of that information. Market conditions relevant to the subject property should also be reviewed as, where soundly appraised, these form part of the basis on which decisions may be made. Data retained following the submission of a valuation must be sufficient to enable verification that the analysis and evaluation undertaken in the approach, or approaches, to providing the opinion of value reported were sufficient for the type and scale of valuation.

6.2 Property Inspection - As part of obtaining personal knowledge of the subject property, the valuer should make his own visual inspection of it. This will usually include

the interior of the buildings, the locality and the environment to record all matters which appear relevant to the value of the property. Exceptionally, if instructed or agreed by the client, there may be a more limited inspection or the valuer may be authorised to rely on an inspection report prepared by a third party but, in each case, this should then be recorded in the valuation report. A valuation relying on a third party inspection carries risks as to the quality of that inspection and the interpretation that the valuer has made of it. The valuer should draw attention to the fact that his conclusion may have been different if he had made a personal and proper inspection.

6.3 The nature of the on-site inspection will depend upon the property and national legislation, custom and practice, but the valuer should record the main characteristics of the property and the location that affect the value.

6.4 The nature and scale of the property inspection(s) will depend on the purpose of the valuation and the basis agreed with the client. There may be circumstances, such as the provision of a portfolio valuation, where it is appropriate to restrict the inspection(s), for example, to the exterior and locality only or a desk valuation. If an inspection has not been made, or it was not carried out in a proper way to gather all necessary information, this fact and the reason for the restriction must be recorded in the valuation report or certificate as factors which could significantly affect the property's value may not have been identified.

6.5 Desktop Valuations - A first valuation of a property on a "desktop" basis, i.e. with no inspection, inside or out, will not be EVS compliant. Repeat valuations can be EVS compliant on a desktop basis as long as the valuer is satisfied that there have been no changes to the surrounding area since his last inspection that would have a material impact on value and as long as he has obtained the client's written confirmation that there have been no material changes to the property itself since the last inspection was carried out.

6.6 Consideration should be given to establishing relevant financial, legal and regulatory points regarding the property.

6.7 Having inspected the property, valuers should seek out and consider available comparables (for sale or for rent as appropriate) and analyse them comprehensively on a common basis as to evidence of prices and/or yields.

6.8 Valuations for secured lending purposes require an objective assessment of property specific risk factors linked to the structure and the duration of the proposed loan facility. See EVGN 2.

6.9 Figures reported should be supported, not just stated. The valuation is the culmination of the valuer's investigations and research that demonstrates his skill in

being able to bring together data from various sources, use that information efficiently and provide a considered opinion.

6.10 The contents of a valuation report will be determined by the purpose and agreed Terms. EVS 5 deals with valuation reporting.

6.11 Where the valuer is aware of market uncertainty, volatility or other issues putting the value at risk, these should be considered and reported in the assessment. EVIP 2 provides support with regard to valuation certainty and market risk.

7. Valuation Reviews

7.1 A valuer may be asked to review a valuation prepared by another valuer for a variety of reasons which may concern potential litigation or relate to other sensitive issues. In some instances, these may be retrospective valuations. As a result, the valuer will need to exercise special care before agreeing to undertake a review of another valuer's work. There are circumstances where such a review can give added confidence in a valuation or remove or reduce doubt about it.

7.2 Circumstances where the valuer may be involved in review include:

- where the valuation is to support a valuation carried out internally;
- where the valuer is seeking to co-ordinate the work of teams of independent valuers; and
- where a representative sample of properties provides a check as to the overall accuracy of the valuation.

7.3 The instructions to the reviewing valuer may vary from a need for general comments on methodology and compliance with standards to a specific and thorough review of an individual valuation.

7.4 On occasion, a valuer may be required to review a valuation carried out by management, a valuation internal to the client or another party, or to carry out a revaluation of properties already known to the valuer. In such cases, the valuer must set out in writing, in advance and by mutual agreement, the conditions of engagement, the limitations imposed and the resulting nature of the qualification to the Valuation Report. It is normally advisable for the valuer to discuss the case with the original valuer though this may sometimes not be possible, for example, in litigation. The reviewing valuer should clarify with the client, in the conditions of engagement, whether or not he may do so. It must be made clear in the Report whether or not discussions with the original valuer have taken place.

7.5 A Valuation Report for such a review may sometimes be limited to comments on the appropriateness of the basis adopted or, following a sample valuation of a representative cross section, to a more general statement as to the overall accuracy of the aggregate valuation or whether European Valuation Standards have been observed.

7.6 The reviewing valuer should be in possession of (at least) all the facts and information relevant to the date of valuation on which the first valuer relied. As with an initial valuation, it will be more robustly supported if he has carried out a personal inspection and made all proper inquiries. If he does not have this information then, while his views may be of use to the client, any such limitation should be noted and the resulting views should not be disseminated further (unless required by a dispute resolution process). Critical comments that are not properly justified could be defamatory.

EVS 5

Reporting the Valuation

1. **Introduction**
2. **Scope**
3. **Valuation Reporting - Definitions**
4. **The Valuation Report or Certificate**
5. **Commentary on the Valuation**

EUROPEAN VALUATION STANDARD 5

The valuation must be presented in clear written form to a professional standard, transparent as to the instruction, purpose, approaches, bases, methods and conclusions of the valuation, as well as to the use to which it is to be put, as shown in the agreed terms of engagement.

1. Introduction

The valuation, as determined by the valuer, must be clearly and effectively conveyed to the client. The Valuation Report will be the document on which the client will rely in taking decisions. It is therefore important that it be exact, both as to what it says and as to any caveats and reservations expressed therein.

2. Scope

This Standard deals with the Valuation Report in which the valuer informs the client of the value determined.

3. Valuation Reporting - Definitions

3.1 The European Union's Capital Requirements Regulation 575/2013 defines both Market Value and Mortgage Lending Value, in line with the definitions set out in EVS. It then goes on to say in Article 229 that:

"An institution shall require the independent valuer to document the market value in a transparent and clear manner."

and

"Institutions shall require the independent valuer... to document [the mortgage lending value] in a transparent and clear manner".

This is just one example of a regulatory requirement for transparent and clear reporting, in this case as regards valuations for European banks and financial institutions in the context of secured lending.

3.2 Documenting the Market Value (or the Mortgage Lending Value) is dealt with in the Valuation Report.

3.3 **A Valuation Report** means a document detailing the scope, key assumptions, valuation methods, and conclusions of an assignment. The report provides a professional opinion of value supported by a recognised basis or bases of valuation within the framework of European Valuation Standards.

3.4 The terms 'valuation certificate', 'certificate of value' and 'statement of value' have specific meanings in certain States in designating statutory documents. One common factor is that those documents require a simple confirmation of value, without any requirement to describe the context, fundamental assumptions or analytical processes behind the figure provided.

4. The Valuation Report or Certificate

4.1 General

4.1.1 A Valuation Report must be in writing, prepared and presented in a reliable and comprehensible manner for the users and clients. This is appropriate for a report providing a Market Value and also for reports concerning all other bases of valuation, as it gives certainty between valuer and client.

4.1.2 The Valuation Report should record the instructions for the assignment, the basis and purpose of the valuation and the results of the analysis that led to the opinion of value, including, where appropriate, details of comparables used. It may also explain the analytical processes undertaken in carrying out the valuation, and present the supporting information.

4.1.3 The Valuation Report must provide a clear and unequivocal opinion as to value, as at the date of valuation with sufficient detail to ensure that all matters agreed with the client in the terms and conditions of engagement and all other key areas are covered and that no misunderstanding of the real situation of the property can be construed.

4.1.4 The Report must not be ambiguous, must not mislead the reader in any way nor create a false impression. For these and other reasons it needs to be written in terms which a person with no knowledge of the property or of valuations can understand.

4.1.5 The Report must be objective. Decisions may be made and finances committed or withdrawn on the strength of it. If the valuer has strong opinions about the merits or weaknesses of the property, these should be expressed in a reasoned and objective way that will enable the reader to understand the conclusions reached.

4.1.6 Where the valuer has been instructed despite a potential conflict of interest, that potential conflict should be stated with a record that it was notified to the client and with details of the measures taken to ensure that the potential conflict did not adversely affect the valuer's objectivity.

4.2 Contents of a Valuation Report

4.2.1 The form and detail of the Report will be a matter for the valuer's discretion but must meet the specific instructions from the client to the valuer and have regard to the purpose of the valuation and the use that the client proposes to make of the valuation.

4.2.2 A Valuation Report must adequately report all matters set out within the terms of engagement (see EVS 4, section 3).

4.2.3 Valuations are provided to a variety of different clients, for a variety of different reasons, on a variety of different occasions. In some cases, the client will be very familiar with the property, whereas in others he may be discovering it when he reads the valuer's report. In some cases, the report will be used as part of the decision-making process for a major investment or disinvestment, whereas in others the client merely seeks to keep himself informed of the current value of his portfolio. In some cases, the report will be passed on to third parties, whereas in others the client will be the sole reader.

4.2.4 In view of all this, the contents, length and detail of the Valuation Report will therefore necessarily depend on the purpose of the valuation and the profile and needs of the client. The form and content of the report should therefore be agreed with the client at the start of the instruction and confirmed in writing in the terms of engagement.

4.2.5 Valuation Reports can generally be considered as falling into one of two categories: "full" valuations and those where more concise reporting is acceptable. The length and degree of detail of full valuation reports will nevertheless also vary according to the purpose of the valuation and the client's needs.

4.2.6 A **full Valuation Report** will generally cover the following topics, not necessarily presented in the same way or order:

a. The basis of the instruction and the valuation

- The client and the instruction - the client's name, details of how the valuer was instructed (it is recommended to include a copy of the terms of engagement as an annex);
- Third party reliance - where it has been agreed that certain identified third parties will be able to rely on the report, those third parties should be named;
- The property - name (if any) and address of the property;
- The legal interest of the property that is being valued (freehold, leasehold, etc.);
- The purpose of the valuation;
- Basis of the valuation (e.g. Market Value) and reference to the appropriate EVS or to the law or regulation that defines the basis of valuation;
- Special assumptions - state if any special assumptions are to be made (in the sense of EVS 1);
- The date of valuation;
- The date of the report;
- The status of the valuer (external or internal and whether or not he is considered to be independent). Confirmation that the valuer has the experience and market knowledge necessary to value the subject property;
- Use of specialist valuers or advisers - where the signing valuer has used the services of third party specialists, they should be identified;
- Confirmation that there are no potential conflicts of interest. Where potential conflicts existed, the report should state that these were brought to the client's

attention and detail the measures taken to ensure the valuer's objectivity was not affected.

b. Investigations carried out

- The inspection - date of inspection, name of the person who inspected, extent of the premises inspected. If the inspection has been less complete than usually required for this type of valuation, this should be highlighted;
- Floor areas - clearly state the type of area adopted (e.g. net lettable, gross lettable, etc.), state the source of the areas adopted;
- Documents received and studied - the valuer will state the documents received and will also state, where appropriate, which important documents were not made available to him;
- Reliance on information obtained from the client and from third parties - a statement should be included if such information has been relied on;
- Assumptions - the valuer should state any important assumptions made as regards documents or information that were not available to him, or about information that he was not able to verify;
- Investigations not carried out - for the avoidance of doubt it is recommended that the report state any investigations that were not carried out, the results of which might have an impact on value. Typical examples are environment and contamination investigations, tests of technical equipment, etc. Where appropriate, the valuer should indicate how the reported value might be affected if such investigations yielded unfavourable conclusions;
- Caveats - the valuer will typically caveat a number of these items. It is recommended that caveats should not be used indiscriminately. The valuer should ensure that any caveats used are pertinent to the property and the valuation.

c. The property

- Location;
- Description;
- State of repair;
- Environmental aspects of the property (contamination, etc.), including energy performance ratings;
- Technical equipment - where there is a significant amount of plant and equipment, the valuer should make it clear which items are included in the valuation of the property and which are excluded;
- Where appropriate the valuer will state whether the valuation includes goodwill or intangible property (e.g. for hotel valuations).

d. The legal situation

- Tenure - including comment on any covenants, restrictions or obligations that could have an effect on value;

- Tenancies - with names of any tenants, information on the main lease terms, the amounts of current rents and any provisions for them to vary during the remaining life of the lease;
- Town planning and development control - information about the current zoning in the relevant development plan(s), allowed uses, etc.

e. The market

- Identification of the market within which the property falls;
- Sufficient information about the market to allow the client to understand how the property relates to it;
- Comparables - information on transactions involving comparable properties would normally be provided as part of a full Valuation Report.

f. The valuation

- Methodology - which approaches and which methods have been used;
- Key assumptions - as regards capital values, rental values and yields adopted. It is recommended that the choice of these key inputs be explained with reference to the comparables listed;
- Additional assumptions - if the characteristics of the property require particular additional assumptions (such as re-letting of currently vacant space), details of the assumptions adopted;
- Where a recent transaction has occurred involving the subject property or a provisionally agreed price has been disclosed to the valuer for its sale, the report should state the extent to which that information has been accepted as evidence of value;
- Valuation uncertainty - in those cases where there is an high level of uncertainty about the level of values, rents or yields, the valuer should comment on it here;
- Special assumptions - if a special assumption is being made, details of how the valuer has treated that case as regards the inputs adopted.

g. Conclusion

- The reported value should be clearly and unambiguously stated, together with confirmation that sufficient investigation has been undertaken to justify the opinion of value reported;
- A clear statement as to whether transaction costs such as VAT, fees, etc. are or are not included in the reported value;
- Currency - the reported value should clearly indicate the currency that has been used for the valuation. If the value is reported in a currency other than the currency of the country in which the property is situated, the report should state whether the value was determined in the local currency and then converted into the second currency, in which case the value in the local currency and the conversion rate used should also be stated, or whether the value was determined directly in the second currency. In the second case, the

valuer should indicate whether changes in the exchange rate between the local currency and the second currency would affect the reported value;

- Limitations on investigations and information - where investigations, the inspection or information have been less complete than the valuer would normally wish and where fuller information could potentially lead to a revision in value, this should be emphasised in the conclusion of the Report;
- Limitations on the report - at this point, or elsewhere in the Report, the valuer may wish to state any limitations on the use of the Report as regards publication, third party reliance, etc.;
- The valuation report should be signed by a suitably qualified valuer and dated.

4.2.7 Valuations for certain purposes, such as commercial secured lending or acquisition may need to deal with additional or alternative requirements of the client such as reference to the suitability of the subject property for an intended loan. Where the terms of the loan have not been disclosed, the valuer should provide an opinion based on normal lending terms, having regard, as appropriate, to the profile for risk-related criteria for valuations published by the European Mortgage Federation (see Appendix C of EVGN 9).

4.2.8 Additional items - in some cases it may be necessary to refer to the following points, which would usually have been recorded within the terms of engagement:

- development properties or potential development properties - the existing permitted use, any planning permission or potential planning consent for an alternative use, including any potential or actual impact on value at the specified date of valuation;
- any special or synergistic (or “marriage”) value that may exist and whether such value is available only to the current owner or whether it would pass to a new owner on transfer of the property;
- any unusual market conditions at the specified date of valuation and whether any valuation uncertainty relating to low volumes of reliable comparable evidence, marked volatility or other specified factors had been taken into account or ignored in reaching an opinion of value (see also EVIP 2 Valuation Certainty and Market Risk); and
- any recent or proposed changes to the property, the immediate or local environment or legislation that might have an impact on value, and where such an impact is reported, the extent of that impact. Matters that might be included within this category include potential or actual contamination, deleterious materials or title.

4.2.9 The Report will need to include additional relevant material where the property is, or is to be, held as an investment, fully equipped as a trading entity or the subject or potential for actual development, refurbishment or retro-fitting.

4.2.10 The valuer should confirm whether in undertaking the valuation he has become aware of matters that could affect the figures reported. Such matters might include potential contamination on or near the subject property, the presence of deleterious materials or issues over title.

4.2.11 Where the market for the property being valued is affected by unusual uncertainty and this is relevant to the valuation, the valuer should proceed with caution, comment on the issue to the client and make appropriate statements in his report (see EVIP 2 Valuation Certainty and Market Risk).

4.2.12 Length of validity of the reported value - generally speaking, valuations are prepared with reference to a specific date of valuation. As such, strictly speaking the value may not be the same the day after the date of valuation. Nevertheless, clients will generally expect to be able to rely on a valuation for a certain period following the date of valuation. In certain circumstances, the valuer may wish to consider and state a period after which the valuation should no longer be relied on. This may be particularly important in times when values are volatile. This may be specified by national legislation in some countries or by the requirements of the contract.

4.2.13 All Valuation Reports should include a statement to the effect that the Qualified Valuer responsible for the valuation to the client has conformed to the requirements of these European Valuation Standards. The valuer should state the extent of, and reasons for any departure from the standards or state why any key part of the valuation process has been omitted.

4.3 Shorter Reporting Formats

4.3.1 There are many instances where it may be appropriate for a shorter reporting format to be adopted. A common example is an update of a previous valuation report. Nevertheless, before agreeing to a shorter format, the valuer should always satisfy himself that shorter reporting will not be misleading or inappropriate, given the nature of the property, the purpose of the valuation, the type of people who are likely to rely on the report and the use that they are likely to make of it.

4.3.2 In particular, despite the use of a shorter reporting format, the valuer should seek to ensure that due prominence is given to any particular factors that have had a significant impact on his assessment of value, such as:

- any unusual features of the property that have a material effect on value, such as particular aspects of its location, its condition, or its legal situation;
- any important limitations on his investigations and any recommendations as to further investigations that he recommends;
- any special assumptions adopted and their effect on value;
- any important caveats that have implications for the reported value.

4.4 The Summary Report or “Valuation Certificate”

4.4.1 The term “Valuation Certificate” has come to have a number of different meanings in different countries. These include:

- a short format report, designed to deal with the essential points in a concise way;
- an introductory summary document to a report concerning a portfolio of properties, dealing with points common to the valuation of all the properties;
- a brief, formal confirmation of value, required by law or regulations in certain countries.

Depending on the nationality of the reader, seeing the term “Valuation Certificate” could lead him to believe that the document in front of him has a legal weight that was perhaps not intended. As valuation reports are increasingly read by people in other countries, valuers may wish to avoid terms like “valuation certificate” if there is a possibility that this term may lead to confusion for some potential readers.

4.4.2 If the valuer is asked to issue a summary of his conclusions as to the value of the property as at the date of valuation, he may do so in a separate document or one that is incorporated within the valuation report, of which it may be a summary. His document should refer to the valuation report and state that for a full understanding of the reported value the reader of the summary should refer to the original report.

4.4.3 In countries where legislation or practice determines that a valuer must certify the amount of the valuation of the property, that will usually be done by way of a short letter, the contents of which will include:

- the client’s name and address;
- details of the property (address and a brief description, including its use(s));
- the date of valuation;
- the purpose of the instruction;
- the date of the Certificate;
- any assumptions upon which the valuation is based;
- any particularly unusual aspects of the property or the valuation that have had a material impact on the reported value should be referred to if to omit them could potentially mislead readers;
- the name, address and qualifications of the valuer.

4.4.4 The same basic requirements apply to that certificate or letter as to a valuation report. It must be objective, unambiguous and clearly written in terms that a person with no knowledge of the property or of valuations can understand. It must not mislead or create a false impression. It must meet the client’s instructions. It should state and have regard to the purpose of the valuation and the use that the client proposes to make of the valuation.

4.5 Desktop Valuation Reports

4.5.1 For the avoidance of doubt, a first valuation of a property on a “desktop” basis, i.e. with no inspection, inside or out, will **not** be EVS compliant.

4.5.2 Repeat valuations (i.e. second or subsequent valuations of a property already valued a first time with inspection) can be EVS compliant on a desktop basis as long as the valuer is satisfied that there have been no changes to the surrounding area since his last inspection that would have a material impact on value and as long as he has obtained the client’s written confirmation that there have been no material changes to the property itself since the last inspection was carried out.

4.5.3 In a report for a repeat desktop valuation, the valuer should therefore:

- state clearly that he has not carried out an inspection, internal or external, of the property; and
- state that this is because, to his knowledge there has been no change to the surrounding area since the last inspection that would have a material effect on value; and
- state that to his knowledge (or as informed by the client) there has been no change to the property itself since the last inspection that would have a material effect on value.

4.6 Draft Reports

4.6.1 There may be circumstances where it is appropriate to provide an advance draft of a valuation in an abbreviated form that does not comply with this European Valuation Standard. In such cases the existence of, and reference to, a future detailed report or an earlier comprehensive certificate must be made and it should be made clear that the draft report is not the final document and should not be relied upon by the client or any third party.

4.6.2 In any case the valuer should resist any pressure to provide a draft or preliminary value or report before he has been able to inspect the property and review and properly consider all the information that is relevant to the valuation. If values are reported too early there is a danger that this will subsequently place the valuer under pressure to meet expectations that may have been created by his announcement of the draft value and this could create problems in situations where newly received information would normally lead him to make a downward adjustment of the draft value.

4.7 Value Added Tax

4.7.1 Where relevant, the valuation should identify the rate of VAT, if any, which applies to the property as at the date of valuation. It should state that any VAT that may be due on any transaction in the property will be in addition to the valuation reported.

5. Commentary on the Valuation

5.1 This EVS has advised at several points that the valuer and client may find it useful for the valuation report to provide some commentary on issues or to bring perspective to the valuation to assist the client's understanding or enable the valuer to make points considered important.

5.2 This may be particularly important where the client is or may become anxious to understand opinions as to the certainty or the prospects for the value of the property. Some aspects of this are discussed in Part 4 in the context of valuation certainty. Others arise with the developing discussion of "long term value".

5.3 A Value in the Longer Term?

5.3.1 While the valuer cannot give reliable opinions of the value at any future date with its unknown circumstances, it may assist some clients if his commentary on the valuation in the Valuation Report might record where present market circumstances significantly diverge from long-run trends, looking over decades. For let commercial properties, that might refer to the long-run average yield for the relevant class of property. Other data might be relevant for the housing market, such as prices as a multiple of incomes.

5.3.2 The underlying insight is that markets tend over time to revert to the mean. If a relationship between values, such as yield, has diverged markedly from that average, it may well, all other things being equal, revert to that long run yield at some point in the future. That observation of overall markets then needs to be tempered by the circumstances of the individual property, whose type or location may be improving or weakening in the overall market as the economy changes.

5.3.3 This approach may also assist with the situations discussed in EVIP 2, Valuation Certainty and Market Risk. Nonetheless, while such an approach may be useful for some clients as commentary, it will not be a measure of Market Value which is specific to its point in time. Long run value is not a basis of value, though a client may instruct the use of one of the versions of Mortgage Lending Value (see EVS 2 and EVGN 2) as a basis for some form of sustainable value.

PART 1B

European Valuation Guidance Notes

- EVGN 1 Valuation for the Purpose of Financial Reporting**
- EVGN 2 Valuation for Lending Purposes**
- EVGN 3 Property Valuation for Securitisation Purposes**
- EVGN 4 Assessment of Insurable Value and Damages**
- EVGN 5 Assessment of Investment Value**
- EVGN 6 Cross-border Valuation**
- EVGN 7 Property Valuation in the Context of the Alternative Fund Managers Directive**
- EVGN 8 Property Valuation and Energy Efficiency**
- EVGN 9 EMF and TEGoVA Commercial Loan Specification**
- EVGN 10 Valuations: Compliance with EVS**

EVGN 1

Valuation for the Purpose of Financial Reporting

- 1. Introduction**
- 2. Scope**
- 3. The Conceptual Framework for Financial Reporting**
- 4. Classification of Assets**
- 5. The Selection of Consistent Bases of Valuation**
- 6. Fair Value**
- 7. Apportionment between Land and Buildings**
- 8. Valuation Reports for Financial Statements**

1. Introduction

1.1 European Union legislation has since 1978 prescribed a developing set of accounting rules to assist the consistency and comparability of financial reporting. The current rules on annual financial statements, consolidated financial statements and related reports of certain types of undertakings are contained in Directive 2013/34/EU of 26 June 2013.

1.2 Regulation (EC) 1606/2002 requires publicly quoted companies governed by the law of a Member State to prepare their consolidated accounts for each financial year starting on or after 1 January 2005 in conformity with the International Accounting Standards as adopted by the European Commission. International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) were developed by the International Accounting Standards Committee (IASC) until April 2001 and the International Accounting Standards Board (IASB) since April 2001 in the public interest to provide a single set of high quality, consistent and uniform accounting standards.

1.3 Most of the International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) have been adopted into European law by subsequent Commission Regulations, in particular Regulation 1255/2012 which adopted IFRS 13 Fair Value Reporting.

1.4 IAS/IFRS applicable to property or property related assets are:

- IAS 2: Inventories;
- IAS 11: Construction Contracts;
- IAS 16: Property, Plant and Equipment;
- IAS 17: Leases;
- IAS 40: Investment Property;
- IAS 41: Agriculture;
- IFRS 5: Non-current Assets Held for Sale and Discounted Operations;
- IFRS 6: Exploration for and Evaluation of Mineral Resources;
- IFRS 13: Fair Value Measurement.

1.5 The EU has not sought to provide separate European Accounting Standards for the valuation of real estate, preferring instead to support the adoption of, or consistency with, International Accounting Standards or International Financial Reporting Standards.

1.6 Valuers undertaking valuations prepared for the purpose of financial statements must, in consultation with the directors and the auditor of the client company, take account of EU Directives, national law and regulation, national and international accounting standards, the strategy of the undertaking, and the operational purpose and resultant classification of the subject property.

1.7 It should be noted that only publicly-quoted Member State companies are obliged to adopt IFRS accounting. Non-quoted entities may or may not choose to adopt IFRS accounting – where such entities have chosen not to adopt IFRS, valuers dealing with the assets of those entities should liaise with the client's accountants and follow the relevant national standards, legislation or regulations.

2. Scope

2.1 This Guidance Note applies to the valuation of properties and interests in property for the purpose of financial reporting under IFRS accounting. It sets out the principles underlying the preparation of financial statements, the bases of valuation and provides guidance on the valuation of real estate on a fair value basis.

2.2 This Guidance Note cannot replace knowledge of the applicable IAS/IFRS. Valuers undertaking a valuation for financial reporting purposes should understand the 'Conceptual Framework' as adopted by the IASB in April 2001 and revised in September 2010 outlining the principles that underlie the preparation of financial statements.

2.3 This Guidance Note does not seek to cover valuations under standards, legislation or regulations other than IFRS, as they may vary from IFRS requirements and also from country to country. Nevertheless, some of the following may also be relevant to non-IFRS valuation work.

3. The Conceptual Framework for Financial Reporting (extracts from the document of the same name published by the IASB in September 2010)

3.1 The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit. Financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future.

3.2 Qualitative characteristics of useful financial information - If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

3.3 Recognition and measurement of assets. The elements directly related to the *measurement* of a financial position are assets, liabilities and equity.

- (i) An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
- (ii) A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
- (iii) Equity is the residual interest in the assets of the entity after deducting all its liabilities.
- (iv) Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the balance sheet and income statement. This involves the selection of the particular base of measurement.

4. Classification of Assets

4.1 The classification of assets affects both the basis of valuation and the presentation of valuation reports. Land and buildings are normally classified for the purpose of financial statements into one of five categories:

- owner-occupied for the purpose of the business, whether specialised or general;
- investment for the purpose of generating income or capital gain;
- surplus to the requirements of the business;
- trading stock, designated as current assets; and
- leases.

4.2 Property, Plant and Equipment - IAS 16 defines these as “tangible items that are held for use in the production or supply of goods or services, for rental to others or for administrative purposes and are expected to be used during more than one period”. IAS 16 applies to **owner-occupied properties** which are defined by the commentary to IAS 40 as property held (by the owner or by the lessee under a finance lease - see 4.7) for use in the production or supply of goods or services or for administrative purposes.

4.3 Investment Properties - IAS 40 defines these as “Property (land or buildings, or part of a building, or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation, or both, rather than for:

- use in the production or supply of goods or services or for administrative purposes; or
- sale in the ordinary course of business;”

Investment property shall be recognised as an asset when:

- it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and
- the cost of the investment property can be measured reliably.

4.4 Property Surplus to Operational Requirements - This is land with or without buildings that is surplus to the foreseeable future operational uses of the undertaking, and will normally be held for sale.

4.5 Trading Stock - Certain property may have been purchased for trading purposes and be classified not as fixed assets, but as current assets for balance sheet purposes.

4.6 Leases - The objective of IAS 17 is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures to apply in relation to leases. IAS 17 will apply up till the end of 2018, then IFRS 16 will be applicable for accounts prepared from 1st January 2019 onwards (although the reporting entity is free to decide on earlier adoption of IFRS 16 if it so wishes).

4.7 Under IAS 17, a lease is classified as a finance lease if it transfers substantially all the risks and rewards relevant to ownership. All other leases are classified as operating leases. A lease must be classified at its inception (IAS 17.4, 17.13). Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the lease. Where, for example, the lease contract transfers the ownership of the property to the lessee by the end of the lease term or stipulates a purchase option in favour of the lessee at a price which is expected to be lower than fair value at the date the option becomes exercisable, this would normally lead to a lease being classified as a finance lease.

4.8 In a lease of land and buildings, the classification of each element as a finance or an operating lease has to be assessed separately. In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life (IAS 17.15A).

4.9 Whenever necessary in order to classify and account for a lease of land and buildings, the minimum lease payments are allocated between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in both elements at the inception of the lease (IAS 17.16).

4.10 IFRS 16 makes a number of changes to the way leases are accounted for, particularly for lessees (tenants). Whereas for lessors (landlords) the distinction between finance leases and operating leases will be maintained, from 1st January 2019 onwards there will be no more distinction between the two types of leases for lessees – all their leases will be treated as finance leases. Leases will therefore be brought onto the balance sheet for companies that rent properties (except for leases of less than 12 months).

5. The Selection of Consistent Bases of Valuation

5.1 International Accounting Standards currently adopt two models for the recognition of property assets in the balance sheet:

- the **Cost Model**: after recognition as an asset, “an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses” (IAS 16.30); and
- the **Fair Value Model**: relying on 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 (IAS 16.31 and IFRS 13 Fair Value Measurement). (see below paragraph 6.1 Fair Value Measurement).

5.2 The four most relevant International Accounting Standards applicable to property valuation for accounting purposes are IAS 16 (owner occupied property, plant and equipment), IAS 17 (leases) – to be replaced by IFRS 16 (leases), IAS 40 (investment property) and IAS 41 (agriculture). The following commentary will focus on these four Standards. Detailed reference is made in section 6 below to IFRS 13, Fair Value Measurement, which has particular importance for real estate valuers.

5.3 IAS 16 - Property, Plant and Equipment

5.3.1 *Measurement at recognition* - An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost. This cost is the cash price of the item equivalent at the recognition date and includes its purchase price,

import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

5.3.2 *Measurement after recognition* - An entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property, plant and equipment.

5.3.3 The revaluation model specifies that “any item of property, plant and equipment whose fair value can be measured reliably shall be carried at a re-valued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent impairment losses. Revaluation shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date” (IAS 16.31).

5.3.4 *Application* – For practical purposes, valuers will find that IAS 16 generally concerns property owned by the entity and occupied for its own operational purposes (for example, a factory owned by a manufacturing company).

5.4 IAS 17 and IFRS 16 - Leases

5.4.1 Up until the end of 2018, IAS17 applies to the accounting for leases (unless the reporting entity decides on early adoption of IFRS 16). Under IAS 17, at the start of the lease term, lessees shall recognise finance leases as assets and liabilities at the lower of the fair value of the asset and the present value of the minimum lease payments (IAS 17.20). The depreciation policy for assets held under finance leases should be consistent with that of owned assets. If there is no reasonable certainty that the lessee will obtain ownership at the end of the lease, the asset should be depreciated over the shorter of the lease term or the life of the asset (IAS 17.27).

5.4.2 For operating leases, the lease payments should be recognised as an expense in the income statement over the lease term on a straight-line basis, unless another systematic basis is more representative of the time pattern of the user's benefit (IAS 17.33).

5.4.3 From 1st January 2019 onwards, different regimes apply to lessors and to lessees. Whereas lessors will continue to distinguish between finance leases and operating leases, lessees will be obliged to treat all leases with a term of more than 12 months as finance leases.

5.4.4 Lessees will be required to capitalise the present value of lease payments and either show them as lease assets (for “right-of-use” assets) or show them together with property, plant and equipment. Where payments (such as rent) are paid over time, a company will also have to recognise a financial liability representing its obligation to

make future payments. Balance sheets will therefore show increased amounts for lease assets and for financial liabilities.

5.4.5 As regards the profit and loss account, instead of showing rent as an expense, lessees will have to show two lines: a depreciation charge for lease assets and an interest expense on lease liabilities. The former will be included in "depreciation" and the latter in "finance costs" in the accounts.

5.4.6 Valuers will note that there does not appear to be any requirement to determine the Fair Value of a lessee's leasehold interests. While companies will have to determine an appropriate discount rate and capitalise future rental payments in order to recognise a lease as a lease asset, it appears likely that this will be a financial discount rate rather than one derived from property market transactions. As such it would appear that the role for property valuers to assist lessees under IFRS 16 will be limited.

5.5 IAS 40 - Investment Property

5.5.1 IAS 40 applies to land or buildings held to earn rentals, for capital appreciation or both. Investment property is initially held at cost. Transaction costs shall be included in the initial measurement. After recognition, investment property is carried either at cost or Fair Value. This choice of model applies to all the entity's investment property. Where an entity chooses the cost model, it should nevertheless disclose the Fair Value of its investment property.

5.5.2 A property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property, if the property would otherwise meet the definition of an investment property and the lessee uses the fair value model (IAS 40.6).

5.6 IAS 41 - Agriculture - Many farm businesses will be below the thresholds at which the use of IAS is mandatory or will not be carried out by companies quoted on EU stock exchanges, in which case they may well not have chosen to prepare their accounts in line with IFRS accounting standards. It will therefore be quite rare for valuers in EU states to have to value agricultural assets under IAS41.

5.7 Where IAS 41 does apply, it does not introduce any new principles for the valuation of land used for agriculture, horticulture, floriculture, aquaculture or forestry. Thus, IAS 16 or IAS 40 should be followed as required by the circumstances. It does, however, affect the accounting treatment of growing plants that are physically attached to the land and are managed for their produce or for transformation into further plants. Whether they are annual crops such as wheat or potatoes, multi-annual crops such as fruit bushes, orchards and vines or long term crops such as forestry, they are classed (with breeding livestock) as biological assets and are to be assessed at their fair value

reduced by the estimated costs of selling them separately from the land. This is thus different from the ordinary treatment of stocks on a cost basis under IAS 2.

IAS 41 recognises that this may be a difficult task and commends various options to tackle this including an income basis or apportionment of the prices achieved for land sold with growing crops. Where fair value cannot be measured reliably, a cost basis may be used. Where, for example, with amenity woodland, growing plants are not managed for their biological potential, they are not taken into account.

6. Fair Value

6.1 IFRS 13 Fair Value Measurement

6.1.1 Up till the end of 2012 Fair Value was defined in IAS 40, but questions of its measurement were dealt with in a number of the IFRS standards. A new standard, IFRS 13 “Fair Value Measurement”, was introduced in May 2011 and applies to all accounts concerning periods starting 1st January 2013 or later. Both IAS 16 and IAS 40 now refer to IFRS 13 concerning the definition and measurement of Fair Value.

6.1.2 The Standard provides a clarifying definition of fair value and further guidance for measuring fair value. It also improves transparency by enhancing detailed disclosures about fair value measurement derived using models. It must be clear that this standard provides an answer only to the question ‘how to measure?’ and not to the question ‘what to measure?’. This latter question is dealt with by the appropriate IAS (typically IAS 16 or IAS 40 for real estate assets).

6.1.3 IFRS 13 applies to the determination of fair value for a very wide variety of financial and non-financial assets. As such, some aspects of the standard are not easy to apply to property assets. In cases of doubt valuers may wish to consult with their client and his auditors to ensure that their interpretation is in line with the appropriate accounting rules.

6.2 Definition of Fair Value - IFRS 13 defines Fair Value as:

“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”.

IFRS 13 adds the following explanations to help understand the definition:

6.2.1 *The unit of account* - the measurement of value can concern either an individual asset or a group of assets. The decision as to whether an asset is to be valued individually

or as part of a group of assets will depend on the rules for identifying the “unit of account” in the appropriate IAS.

6.2.2 *The hypothetical transaction* - the Fair Value is to represent the sale price in a hypothetical transaction. That sale is to be considered as taking place either in the principal market for the asset type in question, or, in the absence of a principal market, in the most advantageous one for the asset.

6.2.3 *Market participants* - Fair Value is to be measured using the assumptions that market participants would use when pricing the asset, assuming that market participants act in their own best economic interest.

6.2.4 *The price* - Fair Value is intended to be the price received to sell the asset at the measurement date. IFRS 13 specifically states that it is to be an “exit price”, i.e. the net price receivable by the seller, not the gross price paid by the buyer. Transaction costs are therefore not included in Fair Value. If necessary, they are accounted for elsewhere under the rules of the appropriate IAS.

6.3 Highest and Best Use

6.3.1 In case of non-financial assets, such as property, a fair value measurement takes into account a market participant’s ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use (IFRS 13.27).

6.3.2 Highest and best use is the use that is at the same time physically possible, legally permissible, and financially feasible and that gives the best value for the property. Highest and best use is determined from the perspective of market participants, even if the entity envisages a different use for the property. However, the current use is presumed to be the highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the property (IFRS 13, 29).

6.3.3 IFRS 13 requires the reporting entity (who will generally be the valuer’s client) to confirm that the property has been valued on the basis of its highest and best use. For the reporting entity to be able to make this statement, it will be necessary for the valuer to have stated in his report that he has valued the property on the basis of its highest and best use. In most cases this is unlikely to pose any difficulties for the valuer, as many properties are already clearly in their highest and best use, particularly investment properties. In other cases it may be possible to envisage uses that could give a higher value, but if none of those other uses pass the triple economic, physical and legal test referred to above then the property can also be considered to be in its highest and best use. If the valuer has not valued the property on the basis of its highest and best use he

should state this and should give the reasons why he did not do so. The reporting entity will then in turn be able to include this information in its report.

6.3.4 The triple test - “physically possible, legally permissible, and financially feasible”: The valuer may have to decide whether a potential alternative use passes this triple test.

“Physically possible”: to pass this test, the proposed use must be possible with regard to the physical attributes and limitations of the property. Thus for a potential redevelopment the valuer will consider the size and dimensions of the plot, the adequacy of road and other accesses, the availability of services, etc. For a potential change of use he will consider the size and arrangement of the floor plates, floor-to-ceiling heights of the current building, the degree of natural light available, the adequacy of fire escapes, etc.

“Legally permissible”: this concerns any legal restrictions that would influence market participants in their pricing at the date of valuation. Zoning in town planning documents are the most obvious examples, but in many cases a change of use may not be possible in the short to medium term because of the existence of occupational leases. As another example, fire or health and safety regulations may also make certain changes of use of existing buildings impossible as they currently stand.

“Financially feasible”: if the proposed use is physically possible and legally permissible, yet does not yield an acceptable financial return in the eyes of market participants, it does not pass this test.

6.4 Valuation Methods

6.4.1 IFRS 13 talks in terms of “valuation techniques”, whereas valuers are more used to “valuation methods”. The entity is to use methods that are “appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of observable inputs and minimizing the use of unobservable inputs”.

6.4.2 Observable inputs are “Inputs that are developed using market data, such as publicly available information about actual transactions..., that reflect the assumptions that market participants would use...” Unobservable inputs are “Inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use”.

6.4.3 IFRS 13 sets out three valuation techniques: market approach, cost approach and income approach (IFRS 13.62). The entity is to use methods consistent with one or more of these approaches.

6.5 Fair Value Hierarchy

6.5.1 IFRS 13 provides a 'fair value hierarchy', categorising the inputs used in valuation techniques into three levels. The purpose of this notion is to allow readers of financial reports to understand the extent to which the reported value is based on readily observable evidence or, on the other hand, derived from other methods.

6.5.2 It is important to note that the concept of Fair Value hierarchy in IFRS 13 applies to the **inputs** used or adopted in valuations, not to valuation methods. This is a change from the previous situation, where IAS 40 defined a hierarchy based on valuation techniques. The inputs are categorised in one of levels 1, 2 or 3, as follows:

- **Level 1** inputs are unadjusted quoted prices in active markets for items identical to the asset being measured;
- **Level 2** inputs are inputs, other than quoted prices in active markets included within Level 1, that are directly or indirectly observable;
- **Level 3** inputs are unobservable inputs. A reporting entity develops unobservable inputs using the best information available in the circumstances, which might include the entity's own data, taking into account all information about market participant assumptions that is reasonably available.

6.5.3 Adjustment to inputs - The standard states that an adjustment to a significant Level 2 input might result in categorisation of that input as Level 3 if the adjustment uses significant unobservable inputs. This concept is particularly relevant to the valuation of real property assets, as will be seen below. Valuers should therefore pay particular attention to the concept of adjustments to observable inputs in deciding on the hierarchy level to be ascribed to an input.

6.5.4 Once the inputs have been categorised, the Fair Value measurement (i.e. the valuation) will finally be classified as level 1, 2 or 3 according to the classification of the inputs adopted, not on the basis of the method used. It should not be thought that the use of one method or another automatically leads to the valuation being categorised as level 1, 2 or 3 – the final classification will depend on the nature of the inputs used in each case. If inputs are of different levels, the whole Fair Value measurement will be categorised at the lowest level input that is significant (3 is lowest). Thus a valuation that contains a significant input that is at level 3 will be classified as level 3.

6.5.5 It is important to understand that the classification of a value measurement as Level 3, rather than Level 2, for example, is not intended to suggest that the valuation on which it is based is of a lower or poorer quality. The distinction between Level 2 and Level 3 is intended to inform readers of financial reports about the nature of the inputs used, rather than being in some way a measure of the quality of the valuation. In a similar way, classification of a fair value measurement in Level 3 is not intended to imply that the property is less liquid than others.

6.5.6 IFRS 13 strengthens disclosure requirements for the characteristics and risks of the asset class, valuation techniques, the level of the fair value hierarchy and the inputs used. Specific disclosures are required for fair value measurements using significant unobservable Level 3 inputs (IFRS 13.91). Reconciliation of opening to closing balances as well as an extensive description of valuation process in place are new requirements to be complied with.

6.6 Fair Value Compared with Market Value

6.6.1 TEGoVA considers that the fair value requirement is, in principle, met by the valuer adopting Market Value (EVS 1), but Fair Value and Market Value are not synonymous, particularly in circumstances where Market Value is not readily identifiable or where specific characteristics of a property translate into a special value for the party involved.

6.6.2 Valuers should pay particular attention to cases where Market Value may contain an element of hope value, i.e. where market participants may be prepared to pay a higher than normal price because, for example, they consider that planning permission may be obtainable at some time in the future for a more valuable use of the property. While the definition of Market Value in EVS 1 allows such hope value to be taken into account, in the absence of planning permission or suitable zoning, the potential future use may not pass the “legally permissible” test inherent in IFRS 13’s definition of highest and best use. In that case the Fair Value would be lower than the Market Value.

6.6.3 In any case where the valuer chooses to report a Fair Value significantly lower than the Market Value, he is strongly recommended to highlight this fact to his client and to explain the reason for the difference.

6.7 Disclosure Requirements

6.7.1 Regardless of the hierarchy of the value measurements, a company has to include in its report a description of the valuation techniques adopted and the inputs used, as well as information regarding the changes made in valuation techniques and the reasons for making those changes. However, if a measurement is classified as level 3, the report must cover a number of additional points, including:

- quantitative information about the significant unobservable inputs used in the fair value measurement if reasonably available;
- description of valuation processes, policies and procedures;
- narrative description of the sensitivity of the fair value measurement to significant changes in unobservable inputs.

6.7.2 It remains the responsibility of the reporting entity to state in its financial report whether fair value measurements are at level 1, 2 or 3. Nevertheless, the valuer

may be asked to provide the information needed to enable his client to comply with these requirements. While much of this information is already given in EVS-compliant valuation reports, valuers may be asked to identify the significant valuation inputs in their reports and to comment on their level in the IFRS 13 hierarchy.

7. Apportionment between Land and Buildings

7.1 An apportionment of value between the land and the buildings that stand on it may be required to allow a proper accounting to be made for depreciation, and thus for the purpose of the preparation of financial statements. This technical task should be distinguished from valuation. EU Directives and international and national accounting standards all require an apportionment for depreciation purposes. National rules might prevail in certain circumstances, but never in contradiction to EU law. Further guidance on this is given in EVIP 3 in section 3 of these Standards.

7.2 In cases where an entity has opted for the Cost Model of accounting, valuers may be asked to assist in the apportionment of the part of the value attributed to the buildings between the various components of the buildings. Once again, this is considered to be a technical task and not a valuation exercise as such and regard should be had to any appropriate accounting standards and to IAS16 in the case of apportionments between components under IAS16. Further reference is made to this in EVIP 3 Apportionment of Value between Land and Buildings.

8. Valuation Reports for Financial Statements

8.1 Valuations for the purpose of financial statements must be clearly presented and contain at least the following information:

- the instructions, date and purpose of the valuation;
- the basis of the valuation, including type and definition of value;
- tenure of the property and its classification as an asset;
- identification of the property and its location;
- date and extent of the inspection;
- regulatory framework;
- any special assumptions and limiting conditions;
- plant, machinery and equipment;
- compliance statement with European Valuation Standards (not required by IAS/ IFRS);
- valuation methods employed;
- the reported values; and
- other matters relevant to the valuation.

More detail on the contents of the Valuation Report is contained in EVS 5.

EVGN 2

Valuation for Lending Purposes

- 1. Introduction**
- 2. Scope**
- 3. Commentary on Land and Property Categories**
- 4. Usual Bases of Value**
- 5. Application of Mortgage Lending Value**
- 6. Forced Sales and Liquidation Sales**

1. Introduction

1.1 Lending institutions rely on sound valuations not simply for obvious reasons of commercial prudence in lending but also under the rules following the Basel III agreement governing their credit structures as applied to credit institutions in the EU by the Capital Requirements Directive 2013/36 and the Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.

1.2 Furthermore, from a consumer protection perspective, European Union law recognised the importance of sound property valuation provisions with Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property. Its Article 19 stipulates that Member States shall ensure that reliable standards for the valuation of residential immovable property for mortgage lending purposes are developed within their territory. Recital 29 of the Directive specifies that, in order to be considered reliable, valuation standards should take into account internationally recognised valuation standards, with express reference to those developed by the European Group of Valuers' Associations (TEGoVA).

1.3 All this means that the valuation of property for lending purposes carries a high degree of fiduciary responsibility. It must take account of, among other factors:

- the purpose of the valuation;
- the basis required by the client;
- the objective assessment of property-specific risk factors linked to the structure and the duration of the proposed loan facility;

- potential future market demand for the subject property and be clear in its reporting of the date of valuation, the market context and net cash flows.

1.4 Where financing arrangements are secured on specific property, valuers are typically asked to prepare the valuation on the basis of Market Value (see EVS 1). In some countries an assessment of Mortgage Lending Value (see EVS 2) may be required.

1.5 This European practice is also reflected by Regulation 575/2013. In its Article 229 par. 1, it is stated that collateral shall be valued by an independent valuer at or at less than the market value. In those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions the property may instead be valued by an independent valuer at or less than the mortgage lending value.

2. Scope

2.1 EVGN 2 applies to all circumstances in which valuers are required to advise or report to institutions and others lending money on the basis of property valuations and where the objective of the valuation relates to loans, mortgages or debentures.

2.2 EVGN 2 applies to valuations prepared prior to, and in contemplation of, a new loan, a renewal or an additional loan. It also applies in analogous cases where a secured lender is considering whether to repossess or appoint a receiver in case of default and/or instructions on disposal of a property are being formulated.

2.3 The valuer must be competent to undertake a valuation for the specific purposes of lending business. Besides the determination of the value itself, the valuer must give advice on property and sector-related risks if this is required. It is generally the role of the lender to assess risk as it relates to the financial status of the borrower or in the context of the overall geographical, sector, and client bias. The valuer in contrast may be consulted on all risk aspects related to the property to be valued.

2.4 These matters relate to, and depend on, the type of property on which the loan is to be secured, the property's geographical or sector context, client orientation and, particularly, on the effects of liquidation procedures in the country in which the property is located. More detail about the qualification of the valuer is contained in EVS 3.

3. Commentary on Land and Property Categories

3.1 Property can be classified in the following five categories:

- investment properties;

- owner occupied properties;
- development properties;
- properties normally valued on the basis of trading potential;
- wasting assets - mineral assets, etc.

Specialised properties are not normally suitable as security for loans other than on a basis that takes account of alternative uses of the property.

3.2 Investment Properties

3.2.1 Revenue-producing investment properties are valued individually on the basis of the Market Value or Mortgage Lending Value taking into account the future income of the property and the yield.

3.2.2 In the case of a portfolio, the valuation can additionally be carried out and reported as an assessment of the current value of the subject property if it were to be sold as part of an investment portfolio to reflect the market discount or premium applicable. The distinction between the two values must be clearly explained. In stressed market situations, portfolio sales and/or market premiums might not be achievable.

3.3 Owner Occupied Properties - These should be valued on the basis of the Market Value or Mortgage Lending Value, as if empty and to let or for sale, irrespective of potential costs of marketing or renting of the property. However, the latter assumptions generally do not apply to single family houses which are assumed to be available for occupation on transfer.

3.4 Development Properties

3.4.1 Where advice is to be given in respect of development land or land and buildings in the course of development, the valuation will depend on whether the lender will advance funds only when planning permission has been obtained and whether the lender intends to finance the site purchase and/or subsequent development. In the latter case, the current estimated value of the development, as proposed to be completed, will be required.

3.4.2 The valuation of development properties requires a high number of assumptions especially with regard to the development of rents, yields, cost and timing. Reliance on a feasibility analysis is advised. The volatility of development values following changes in any of the underlying assumptions must be explained to the lender as part of the risk assessment. It is advisable to make the methods of valuation explicit, and to ensure that cash flow, discounted cash flow, residual valuations, and assessment by comparison are all, as relevant, shown clearly with appropriate explanatory notes.

3.5 Properties Normally Valued on the Basis of Their Trading Potential

3.5.1 Properties normally valued on the basis of their trading potential are notably hotels, public houses and bars, private healthcare facilities, and most types of leisure facilities. They are normally valued on the basis of a careful assessment of the sustainable level of net income derived from accounting data or projections. This will exclude any special goodwill derived from an operator with above average management skills. In such cases, the lender must be made aware of the significant difference in value that will arise between an operating business unit and one where, for example, licences/certificates, franchise agreements or permits are removed or are in jeopardy or where other circumstances may impair future financial performance.

3.5.2 The valuer should advise on potential future fluctuations in the status of the property as security, and any vulnerability to change of occupier, fashion and regulatory framework and to cultural shifts.

3.5.3 Lenders expect valuers to assess the marketability of the property and/or its suitability for third party use. In certain cases, an assessment on the basis of Alternative Use Value or Market Value under Special Assumptions as regards time constraints on a sale may be required. Third party use and marketability are particularly important aspects for properties with trade potential.

3.5.4 Where such operational properties are being developed or redeveloped with borrowed money, the time to obtain all necessary permits and licences and to build up a sustainable level of trade and commercial risks must be assessed, and the lender advised of the dynamics of the industry.

3.6 Wasting Assets - Mineral Assets

3.6.1 In some jurisdictions, wasting assets may not be used as security for loans.

3.6.2 Where this asset class is permitted as security, valuation has to reflect the very special aspects of this category. Where a loan is proposed, particular attention needs to be drawn to the duration and financial profile of the loan, including interest and capital repayment dates, as they relate to the life of the wasting asset and the planned programme for its extraction or productive use. As such analysis requires several assumptions with the need to consider developments which are difficult to anticipate, mineral producing properties and other wasting assets are not an asset class favoured by lenders.

3.7 Leasehold interests

3.7.1 In many jurisdictions it is unlikely that banks will accept normal occupational

leases as security for a loan, as they can generally be considered as wasting assets – the value of a lease, if indeed it has any value, tends to fall off as the end of the lease term approaches. However, there may be some exceptions to this, such as some leases of prime retail properties, particularly in states where rents are held artificially low by law or regulation.

3.7.2 However very long leases, such as ground leases or building leases, are generally granted for much longer terms and are more suitable as security for loans. Typically, such leases are granted for 50 years or more, often to allow the leaseholder to erect one or more buildings on the land, usually with a view to then letting them out to occupational tenants. Some long leasehold properties can be highly sought-after, such as city centre shopping centres. The comments below apply mainly to these long leaseholds.

3.7.3 The initial length of a lease is usually fixed such that its value will not be significantly eroded by the passage of time over the first few years of the term. Nevertheless, as time passes the length of the unexpired term inevitably decreases and eventually the point is reached where this starts to have an impact on value. Once the unexpired term passes below a certain threshold, value can be expected to start to fall more quickly.

3.7.4 The appetite of market players for such properties can vary significantly according to the current position in the property cycle, because many buyers prefer not to purchase leaseholds: in a buyers' market there are generally more freehold properties to choose from, so demand for leaseholds can be reduced (and hence values of them fall), whereas in a sellers' market leaseholds attract interest from buyers who are unable to find freeholds that meet their return targets. Values of leaseholds can therefore be more volatile than those of freeholds.

3.7.5 Unlike a freeholder, a leaseholder will generally have to pay a rent (a "ground rent") to the freeholder, unless he paid a substantial premium when the lease was originally granted. In modern leases the amount of any such ground rent will probably vary over time, according to local market practice, laws and regulations. The valuer's calculations therefore need to take account of and model any such future variations. In addition, the liability to pay ground rent often doesn't cease if sub-tenants leave and the property becomes vacant – it may be appropriate to comment on this aspect.

3.7.6 Finally, some ground leases contain onerous repairing, demolition or re-building clauses at lease end. These may be of little concern in the early years, but can start to have financial implications as the lease term reduces.

In view of all this, the bank will be particularly keen to have the valuer's opinion on the present and future liquidity of the property in the event that it has to be sold. Valuers should therefore pay particular attention in their reports to the following points:

- The potential buying public for such leasehold properties – what sorts of buyers are currently active? Is this typical of general market conditions, or affected by cyclical patterns? Is the value of this leasehold likely to be more volatile than that of a freehold equivalent?
- The length of the unexpired term of the lease at the valuation date – is this likely to have a significant impact on the liquidity of the property in the event of a sale? Will this change as the length of the term reduces over the life of the loan?
- Current and future ground rent liabilities – these should be detailed and if the amount of ground rent is likely to increase during the life of the loan the bank's attention should be drawn to this, as it may affect their client's ability to service the loan.
- What are the provisions of the lease as regards the obligations of the respective parties at lease end? Could these be onerous for the bank's client and might this have an impact on value during the life of the loan?

4. Usual Bases of Value

4.1 Market Value, as the paramount basis of value, has been considered in detail in EVS 1 with the definition adopted by TEGoVA and other definitions where provided in EU legislation.

4.2 Mortgage Lending Value as defined in EU legislation has been considered with a brief commentary in EVS 2. It should be noted that, as stated in EVS 2, such valuations do not meet the definition of Market Value.

4.3 The concept of Mortgage Lending Value is defined by legislation both by the EU and, in some countries, by national law and rules. Article 124 par. 4 of Capital Requirements Regulation (EU) 575/2013 (CRR) stipulates that the European Banking Authority shall develop draft regulatory technical standards (RTS) to specify the rigorous criteria for the assessment of the mortgage lending value referred to in the CRR provisions.

Until the RTS on Mortgage Lending Value is published, it is recommended that the application of Mortgage Lending Value follow the Guidance provided in more detail hereunder (par. 5).

4.4 In any circumstances where a valuer is requested to provide valuations on a basis other than Market Value, the valuer should proceed only if that valuation is not in breach of local laws or regulations and will not otherwise be misleading.

4.5 As the basis of value might differ from country to country, it is advised to consult the country chapters on the TEGoVA website.

5. Application of Mortgage Lending Value

5.1 Mortgage Lending Value has a particular relevance as an approved basis for assessing the collateral value of real property for credit institutions. It should provide an assessment of the *long term sustainable* value of the security, i.e. a basis for assessing whether a mortgaged property provides sufficient collateral to secure a loan over a long period.

5.2 Hence, Mortgage Lending Value can be used by banks as a risk management measure in a number of ways in the context of:

- lending secured by real estate;
- capital requirements for credit institutions as detailed in the EU supervisory framework;
- funding of mortgage loans through covered bonds secured by real estate as the cover assets;
- the development of capital market products converting real estate and real estate collateral into tradable assets (e.g. mortgage-backed securities as discussed in EVGN 3).

5.3 Mortgage Lending Value is distinguished from Market Value as it is intended to be an estimate of the value of the property for a long period of time. Market Value is an assessment only as at the valuation date.

5.4 There are thus important differences between Market Value and Mortgage Lending Value. Market Value is internationally recognised for the assessment of the value of a property at a given moment in time. It estimates the price that could be obtained for a property at the date of valuation, notwithstanding that this value could alter over time, sometimes very rapidly. In contrast, the intended purpose of Mortgage Lending Value is to provide a long-term, sustainable value as a stable basis for judging the suitability of a property as a security for a mortgage which will continue through potential market fluctuations. As a matter of prudence and recognising the potential for short term market fluctuations, Mortgage Lending Value is likely, in most market conditions, to be below Market Value but offers a guide to expected underlying long-term trends in the market.

5.5 In very stable markets, Mortgage Lending Value may be indistinguishable from Market Value. However, where and when markets are more volatile, a marked differential between Market Value and Mortgage Lending Value may be expected to emerge but there will be no simple, standard or enduring ratio between the two bases.

5.6 The assessment of the Mortgage Lending Value can be based on one or more appropriate valuation approaches:

- Income Approach

- Cost Approach
- Comparison Approach

It is recommended to choose the most suitable of these approaches to assess Mortgage Lending Value depending on the type of the property and the available data. If more than one approach is applied, due consideration must be given to substantial deviations in the respective results by concluding on the final value.

5.7 Mortgage Lending Value is derived from the long term observations of markets and market data at the time of valuation, on the basis of durable characteristics of the property and its environment, and reflects a price which should be achieved in normal property transactions over a long period in the future. This exclusion of purely temporary factors, including short term market disruptions, and factors specific to certain parties is to ensure that the valuation reflects a long term stable equilibrium and appropriate alternative uses. For this purpose, when estimating the Mortgage Lending Value, the valuer will disregard any influences on value that are either of a temporary nature or related only to specific parties and not to the market at large. The valuer should address the following key issues when determining the Mortgage Lending Value of a property:

- The future marketability and saleability of the property has to be assessed carefully and prudently. The underlying time perspective goes beyond the short-term market and covers a long-term period.
- As a principle, the long-term sustainable aspects of the property such as the quality of the location, construction and layout have to be considered.
- The Mortgage Lending Value is generally based on the current use of the property. It should only be calculated on the basis of a better alternative use under certain circumstances, such as where there is a proven intention to renovate or change the use of the property. Essentially speculative or transient uses are excluded.
- All identified circumstances which affect the value, in particular any restrictions to use, duties to tolerate, preemptive rights, environmental risks and natural hazards, building encumbrances and all other restrictions and encumbrances must be assessed. The valuer should comment on the potential impact on value and/or marketability of the property.
- The property to be valued must be inspected as part of the valuation procedure
- Any factors that have a negative impact on value but that can, by their nature, be considered as merely temporary (e.g. a maintenance backlog, a temporary vacancy, a reduction in income for a specific term, a charge or easement with a specified term etc.) have to be assessed separately.

5.7.1 Income Approach

- The determination of the Mortgage Lending Value shall be assessed on an assumed stable occupancy level at a sustainable income of the property. This is the income that the property is capable of producing for any responsibly efficient owner on a sustained basis assuming proper management and permitted use.
- The actual tenancy situation will be disregarded in favour of an assumed occupancy at income levels achievable in the long term by any reasonably efficient owner. The income stream of the property used in this valuation should be no more than the sustainable net rental income that the type of property which is the subject of the valuation usually produces over time in the specific local market, excluding any actual over-rented element and other additional unusual or extraordinary cash flows. This means assessing the sustainable yield on the basis of a judgment of past and current market situation as well as future market trends and not taking any uncertain elements into account, e.g. possible future income growth.
- The case of trade related properties such as hotels, parking facilities, healthcare properties where comparable rents are not available: the sustainable income may be based on an appropriate share of the profit that any reasonably efficient operator can achieve in the long term from operating the property. When estimating the profit, due consideration must be given to a prudent assessment of the long term sustainable factors impacting net revenue and costs to ensure the sustainability of the trading capacity of the property. The Mortgage Lending Value of trade related properties has to be assessed without considering fixtures, furniture and equipment (FF&E) and small operating equipment (SOE).
- The sustainable income of the property must be reduced by those costs to be borne in the long term by any reasonably efficient owner and include also adequate reserves which are necessary in the long term to ensure the income producing capability of the property.
- The non-recoverable operating costs are not those actually to be borne by the current owner, but those arising in the long term to any owner on the assumption that the property is adequately managed. The valuer must fully deduct administration costs and allow for obsolescence, reinvestment, annual maintenance, the risk of vacancies, tenants not meeting their obligations and other risks to the rent.
- The capitalisation rate has to be prudently assessed, taking into account long term market data and trends and excluding all short-term expectations regarding the return on investment. The sustainable income-producing capacity of the property, multi-purpose or appropriate alternative uses as well as the future marketability of the property should be considered.
- The capitalisation rate has to be determined on the basis of the remaining useful life of the property. Contrary to the physical useful life, the remaining useful

life covers the period in which the building can still be operated economically assuming proper maintenance and operation. The remaining useful life of the building has to be considered within the income approach in a transparent manner taking into account national/local market practice.

5.7.2 Cost Approach

- The cost approach consists of an estimation of the land value plus the replacement cost of the building in relation to a comparable property.
- The land value is to be derived either directly from appropriate long term market data or from other approaches based on sustainable input parameters.
- Replacement cost represents the estimated costs to construct, at current prices as of the effective valuation date, a building with utilities equivalent to the building being valued, using modern materials and current standards, design and layout.
- Replacement cost includes those costs that are usually to be borne by a reasonably efficient developer owning the unbuilt site rather than those that have effectively been spent or budgeted, e.g.
 - construction cost
 - utilities, outdoor installations, gardening
 - ancillary costs such as professional, management and consent fees, opportunity costs
- The replacement costs have to be reduced in consideration of the age, state of maintenance and functional and economic obsolescence of the building.

5.7.3 Comparison Approach

- When applying the comparison approach, long term parameters and trends prevail against current prices of properties.
- To determine the comparative value, prices of properties are to be referred to which sufficiently correspond to the property to be valued in terms of the sustainable features that have a major effect on its value, in particular location, interiors and possible types of use. The comparable prices may be extracted from reliable market data/database providers.
- The comparable prices shall be assessed with respect to their sustainability and be adjusted, where appropriate.

5.7.4 Further Requirements

- Further requirements, for example, with respect to compliance with national standards, transparency, content and comprehensibility of the valuation, complement the legal framework for the calculation of Mortgage Lending Value.

- The valuer shall not be involved in the lender's mortgage acquisition, loan processing, loan decision and credit underwriting process. He must neither be involved in the brokering, sale or letting of the property, nor have an actual or potential, current or prospective interest in the result of the valuation.
- The valuer must possess the appropriate technical skills and professional experience to carry out mortgage lending valuations. This particularly applies to the type of property and the subject property market.

Some of these principles require further commentary:

- *Future marketability* - The valuer has to identify situations where current values reflect short term demand due to market inefficiencies such as may arise in the development cycle (shortage of supply of a property type followed by over-supply) or where identifiable factors such as consumer taste distort a market so that future marketability is at risk.
- *Normal and local market conditions* - For some properties, the valuer may need to examine the potential impact of wider economic and social factors. Examples of these might be an analysis of demographics, patterns of wealth, income ratios, employment and socio-cultural spending habits within the catchment area, public transport infrastructure, legal and political risk, as well as the cost of finance and the inter-relationship with capital markets, currency fluctuations and estimates of economic growth. There will be a responsibility on valuers to develop or acquire, maintain and use authoritative relevant information as to local trends and sustainable values to underpin their valuations, only discounting that data where exceptionally warranted by the circumstances of the case. If such information is not available, the valuer has nevertheless to demonstrate that the valuation is based on market data.
- *Current use* - As it is not uncommon for property to have a higher value in an alternative use, lenders should be made aware of any potential to improve value. However, Mortgage Lending Value is primarily based on the existing use of the property, unless there are special circumstances, such as imminent redevelopment, which may make a valuation on the basis of an alternative use more realistic.
- *Elimination of speculative elements* - The valuer is required to identify explicitly any current market phenomena which are not sustainable, such as where a rising or falling trend no longer supported by fundamentals is magnified at the end of a cycle.
- *Clear and transparent documentation* - The lender needs to have confidence in the valuation. Thus, transparent and clearly stated valuation methods should be both adopted and expressed clearly in the valuer's report. Only well-recognised valuation methodologies should be used, most commonly the income capitalisation approach (investment method) or the comparative approach. A cost-based approach is frequently used in some jurisdictions (as for single

or two family houses), or when limited market information is available. While of assistance to valuers operating in stable markets in which owner-occupiers predominate, this is more appropriately employed as a cross-check rather than a prime valuation method. The need to use a cost approach could indicate a specialist property of a type that is not normally bought and sold and so, potentially, a property which would not be considered suitable for loan (or securitisation) purposes.

5.8 The valuer instructed to give the Mortgage Lending Value of a property should also report on its Market Value, and explain carefully the difference in value, if any, that exists. As is clear from the commentary on preparing Mortgage Lending Value, there is no reason to assume that there will be any standard ratio between the two bases – a simple percentage adjustment to derive one from the other will not be appropriate.

6. Forced Sales and Liquidation Sales

6.1 Valuers may be requested by lenders to provide valuation advice where the property has not been properly exposed to the open market, or where a reduced hypothetical marketing period has to be reflected in figures reported.

6.2 In a falling or depressed market, owners may not be willing sellers and may be obliged to accept a price considered to be less than Market Value (see EVS 1) due to constraints imposed upon them. Such constraints may reflect the characteristics of the property or circumstances of the owner and must be clearly indicated in the report.

6.3 Figures reported should be stated to be subject to specific special assumptions which should be agreed in writing and included within the terms of engagement (see EVS 4). The result should be a Market Value, but on the basis of the special assumptions cited. The figures reported will only be valid as at the valuation date due to potential changes in market conditions.

6.4 Forced sale value is not a basis of valuation and should not be used. If requested to give a value on the basis of a shorter than usual marketing period, the value should be reported as “the Market Value on the Special Assumption that the sale of the property must be completed within (x) months of the property being placed on the market”.

EVGN 3

Property Valuation for Securitisation Purposes

- 1. Introduction**
- 2. Scope**
- 3. Definitions**
- 4. Guidance**
- 5. Commentary**

1. Introduction

1.1 The securitisation of property has become an important source of financial instruments in capital markets and a means for lending institutions and others involved in property to fund themselves. Property securitisation can be defined as the process of converting property-related assets into tradable paper securities by pooling debt or equity interests in real property (such as mortgage loans) into a form that can be sold with the income stream from those interests then assigned to investors. The creator of the asset (typically a lending institution) transfers the interests to a special purpose vehicle (SPV) which then issues securities into the capital markets where they will usually be purchased by financial institutions (such as investment funds, insurance companies, pension funds or credit institutions).

1.2 The creator of the securities benefits from the removal of property-related assets from its balance sheet. This helps to improve its financial ratios, enhance its return on capital and achieve compliance with risk-based capital standards (such as the Basel Accords, the Capital Requirements Directive (CRD), the Capital Requirements Regulation (CRR) and national regulations).

1.3 These securities offer their purchasers a chance to diversify their funding and achieve a better match between the duration of their loans and that of their funding.

1.4 Where property-based securities have been created from mortgages (or use them as collateral), investors are principally exposed to changes in:

- the underlying value of properties securing the mortgages; and
- the income from those mortgages.

Investors, therefore, usually rely on externally awarded credit ratings to assess the credit quality, structural integrity and other attributes of a particular security.

1.5 As every investment decision is based on the ability of a property to produce revenue over the long term up to the maturity of the security, property valuation is of fundamental importance to property securitisation.

1.6 It is also important to bear in mind that valuations of properties that are securitised or that are the collateral for credits that end up securitised might, in some jurisdictions, imply responsibility for the valuer towards investors who were neither present nor even identifiable at the time when the valuation was agreed and performed.

2. Scope

2.1 This Guidance Note applies to property valuation for the purpose of valuing these securities, whether for those creating them or those who might buy them. It does not address the valuation of the securities themselves. Its prime application is in the context of those securities created on the basis of mortgages, but the same principles generally apply to other forms of property securitisation. The identification of market and property related risks is crucial. This EVGN also applies to revaluations of such properties and to the regular control (monitoring) of the collateral that helps to identify relevant changes in value.

2.2 The valuations relevant to REITs, property trusts and property unit trusts are considered in EVGN 1, Valuation for the Purpose of Financial Reporting, and EVGN 5 Property Valuation for Individual Investing Purposes.

2.3 The assessment of other risks relating to the assets, such as debt service coverage and credit quality of the borrower, are not the subject of a valuer's work and are therefore not considered by this EVGN.

3. Definitions

3.1 Property Securitisation is the procedure of creating and marketing financial assets assembled from debt and equity interests in real property that are managed by financial professionals and quoted in the securities markets.

3.2 Property-related Asset-backed Securities (PRABS) are investment instruments backed by pools of cash flow-generating assets and sold to a bankruptcy-remote special purpose vehicle (SPV). Such instruments may be either mortgage-backed securities (MBS) or property-backed securities where the asset is the property itself. Some instruments will combine the two, such as PRABS based on receipts from a property project. There are generally two types of MBS, largely reflecting a division between retail and wholesale portfolios:

- Residential mortgage-backed securities (RMBS), based on retail mortgage loans;
- Commercial mortgage-backed securities (CMBS), based on commercial mortgage loans.

3.3 A **Special Purpose Vehicle (SPV)** is an entity expressly created to acquire and finance specific assets. It is usually established by the institution holding the underlying properties. It may often have a specially designed legal status to make its obligations secure even if the parent company goes bankrupt – where this is done it may be called a “bankruptcy-remote” entity.

3.4 Net Asset Value is a measure of the aggregate current value of assets, less all liabilities.

3.5 A **Sustainable Net Asset Value** or **Sustainable Asset Value** is sometimes estimated. This represents the sustainable value that an asset may be expected to achieve or maintain over the long term. This concept is used by those creating such securities, rating agencies, investors, and portfolio insurers. It is estimated either by reference to Mortgage Lending Value or by making adjustments to Market Value, depending on the phase in the market cycle and potentially destabilising factors such as market volatility and speculative activity. The estimate should reflect the expected course of the cycle and expectations of volatility and speculation specific to the subject market. As a concept, sustainable net asset value is similar to Mortgage Lending Value.

3.6 Market Value is defined in EVS 1.

3.7 Mortgage Lending Value is defined in EVS 2.

3.8 A **risk profile**, in this context, is a detailed summary of the risks associated with a property or group of properties being issued as collateral. The main categories of risk can be identified as follows:

- market risks;
- property related risks, including those relevant to its location and any proposed development;
- fiscal and legal risks;
- financial risks.

The valuer’s role will usually only require consideration of the first two risks – those relating to the market and to the property.

4. Guidance

4.1 Where the valuation will be used to secure a loan on a property or a portfolio of properties intended to back a securitised instrument, this will normally be on the basis of the Market Value of the property. In some jurisdictions, the Mortgage Lending Value may also be used.

4.2 When undertaking a valuation for securitisation purposes, valuers should focus on the market and property-related risks relevant to the property or properties being mortgaged so that interested parties can understand:

- the Market Value (and/or the Mortgage Lending Value) of the individual properties;
- the net asset or sustainable asset values for a portfolio;
- the associated market and property risks, so facilitating the development of mortgage loan portfolios, portfolio ratings and investor decisions.

4.3 It is essential that the client and the valuer agree before the start of the valuation on the extent of the valuer's instructions – is he simply to determine the Market Value of the property at the valuation date, or is he also required to prepare a property risk profile? In some cases he may also be asked to play a role in determining the sustainable asset value. The written terms of engagement should clearly set out the extent of the valuer's instructions.

4.4 It will be assumed for this paper that the valuer is asked both to determine the Market Value and prepare a property risk profile. In this case, TEGoVA recommends valuers to undertake their task in two stages: first, the conventional valuation of the property, then an assessment of the specific property risk profile. Where a portfolio of properties is being assessed, the valuation and risk assessment should relate to the whole portfolio.

5. Commentary

5.1 The first step is to consider the individual underlying properties. The valuer should determine the Market Value (and/or the Mortgage Lending Value) at the point when the mortgage is granted on the individual property, following EVS 1/EVS 2 and EVGN 2. If such an assessment was not carried out when that initial mortgage was agreed, this must be done for each property at the point when the mortgage loans are being sold to the special purpose vehicle. Individual credit rating agencies may impose special conditions, which must be factored into the valuation and the advice provided.

5.2 For further guidance on such valuation types, see EVGN 9 TEGoVA Commercial Loan Specification.

5.3 The valuer should prepare a structured risk assessment (considering both market and property risks) for each property in mortgage loan portfolios at the moment when the relevant mortgages were granted. If this assessment was not carried out at the time when the individual properties were financed, this must be done for the first time at the point when the mortgage loans are being sold to the special purpose vehicle.

5.4 For further reading on risk assessment, see EVIP 7, "European Property and Market Rating: A Valuer's Guide".

5.5 Valuations and risk assessments are carried out within the context of the market. Hence, any unusual volatility in the value of the subject properties or in the market for comparable properties should be stated in the valuation report. In some jurisdictions, identifying such volatility may require the value to be reduced.

5.6 The second step, where a portfolio of properties is being considered, is to assess the entire portfolio, determining its net asset value and/or the sustainable asset value.

5.7 Valuation of portfolios of mortgages on residential properties held by private investors should be undertaken by analysing groups of properties with a similar nature ("cluster analysis") on the basis of the age of the properties, similar income streams, location or other features. The values of the individual properties within a cluster can be examined by a simplified method (such as a desk-top valuation), taking into account those factors most likely to influence values. If there has not been a previous valuation of the properties, they should be valued at this stage. Ideally all properties should be inspected internally, although if a large number of standard properties are concerned an external inspection may suffice. The valuations of the individual properties are then summarised as the value of the cluster, for which a risk assessment is also completed. Finally, the values of the individual clusters are used to derive the net asset value for the entire portfolio, which will also be risk-assessed.

5.8 For further reading, see EVIP 6, Automated Valuation Models (AVM), in Part 4.

5.9 When valuing portfolios of mortgages on residential properties and commercial or mixed-use properties held by commercial or institutional investors, the validity of the Market Value of the individual properties should be verified on the basis of the initial valuation. If necessary, this may be adjusted to reflect the current market situation and any foreseeable long-term market changes. If Market Values have not been calculated before, they will have to be estimated at this stage. A risk assessment of the individual properties is also necessary. The net asset value and the risk profile for the entire portfolio are derived from the individual property values.

5.10 The same procedures can be used to estimate the sustainable net asset value and the Mortgage Lending Value, where applicable.

5.11 A lender may require a new valuation if information indicates that the value of the property may have declined materially relative to general market prices.

5.12 Valuations or revaluations of real estate serving as collateral for securitised interests are regulated in some jurisdictions. In case of doubt or conflict, national law prevails over this Guidance Note.

EVGN 4

Assessment of Insurable Value and Damages

- 1. Introduction**
- 2. Scope**
- 3. Definitions**
- 4. Recommendations**
- 5. The Assessment**
- 6. Reporting**
- 7. Other Issues**
- 8. Special Provisions and Recommendations for Damage Assessment**

Attention

Parts of this Note consider the assessment of the value of buildings for insurance cover against damage or destruction and apply where this is the primary purpose of the value to be provided under the instruction (see paragraph 1.7). They do not consider other insurance that may be needed against other risks arising from that damage or destruction. Nor do they consider the associated disruption of business or other insurance commonly handled by those managing property.

It is pointed out that some properties might not be insurable due to special circumstances or unpredictably high risks. The Insurer or the Insured must be aware that this might be the case. The property might have a location where usage is restricted or under conversion, the building might have been erected in conflict with legislation, there might be environmental issues limiting future usage and there might have been recurrent historic events of a specific type of damage i.e. flooding, earthquakes, and volcanic activity etc.

1. Introduction

1.1 This Guidance Note is intended to be a general guideline in assessing the insurable value and the cost of damage to, or losses on, real properties. This document does not take into account detailed legal or country-specific regulations or special conditions set out by the insurance company.

1.2 An insurance contract is a business contract. As such, it is a legally binding agreement between the parties, with the insurer being paid premiums to indemnify the

insured against losses up to a defined amount or amounts arising out of a specified risk or risks. The basis of cover rests on the terms of contract.

1.3 An insurance contract is a contract of utmost good faith (*uberrimae fidei*). Any factors likely to affect the risk/s must be disclosed (whether or not such information is requested). Failure to reveal details which could influence an insurer's decision to provide cover may allow it to repudiate the contract.

1.4 The valuer will assess the cost of repairing damaged or destroyed buildings or properties as a basis for determining the amount the insured shall be compensated in case of damage or destruction. Unless the insurance contract explicitly removes the maximum liability of an insurer through full value coverage, the limitation of the compensation will be the sum insured, even though this may not represent a full indemnity. In the event of a total loss the insurers would only pay out, as a maximum, the amount insured. It is thus important to consider that amount carefully and regularly. It is, however, not a part of the valuer's assignment to consider contractual limitations on the coverage.

1.5 In the event of a partial loss (i.e. where only part of a building is destroyed), insurers will usually only pay out, as a maximum, a percentage of the amount of the sum insured as stated in the insurance policy. The valuer will assess the cost of reconstruction and thus contribute to determining the relative portion of the insurable value.

1.6 It is generally prudent for cover (and so premiums) to be based on full reinstatement costs, though first loss policies may occasionally be issued where both parties know and accept that the sum insured represents less than the total value at risk.

1.7 A prospective lender may require an assessment of insurable value as part of a report on the suitability of the property as security for a loan, so that the lender can require that the pledged security be adequately insured. Where the instruction includes a request for an indication of rebuilding costs, supplementary to the primary purpose of the valuation for security, the client should be advised that such a figure is for general guidance only (unless it has been prepared fully in accordance with this EVGN) so that if a full insurable valuation is required it can be specifically instructed.

1.8 An assessment may also be required in connection with loss adjustment following a claim on an existing policy and also of any damages associated with the cause of the claim. The reinstatement criteria may be defined in the insurance contract. While the framework of this paragraph is generally relevant to loss adjustment and calculation of damages, the requirements set out in EVS 3 The Qualified Valuer regarding appropriate expertise including documented qualifications specific to insurance contracts and calculations, apply to this specialist work.

On many occasions the valuer must also assess the market rental value of comparable premises for temporary use by the insured. Notwithstanding any limitations to

compensation, the compensation will, under given circumstances, also be assessed on the basis of market value. This will occasionally occur when rebuilding is not permitted by law or special public regulations or for other reasons beyond the control of either of the two parties.

In some cases, the valuer must be assisted by persons having a detailed knowledge of the value of special items (See 3.24), and complicated structures and installations.

The general rule is that “the valuer must gather all appropriate information and administer all inspections he considers necessary”, obviously within limits and in agreement with the insurance company. This implies that the valuer must consider acquiring/gathering supplementary information as necessary where his specialised knowledge is limited. Examples could be expertise within the fields of static calculations, special technical installations, geotechnical surveys, historical buildings, artworks, special architectural features, etc. The recommendations in EVS 3 The Qualified Valuer 5.4.8 apply.

1.9 Where the basis of cover is to be full reinstatement, the valuer should assess the full extent of any prospective loss, normally by reference to reinstatement of the damaged property – essentially an assessment of cost rather than of the value of the property. As such a loss will usually concern damage to buildings, the valuer must have a proficient knowledge of buildings and construction techniques, constraints and costs alongside appropriate valuation skills in order to make an accurate assessment of the cost of reinstatement.

1.10 An assessment of insurable value is described in certain countries as a “Valuation for Insurance Purposes”.

1.11 In the case of **Natural Disasters** there seems to be a growing tendency that such damages occur more frequently and have a much greater extent than previously. This effect can be related to climate changes and therefore preventive measures should be given priority wherever they may be possible to implement.

Local planning authorities should consider the possibility of future natural disasters:

- when planning new developments;
- when damaged properties are to be rebuilt. Consideration must be given to rebuilding in other locations;
- when preventive measures are considered in the form installations to protect properties considered to be in a danger zone.

However, in this respect the valuer’s assessment must be based on existing national and local government policy and regulations, and shall normally not take into account the possibility of future preventive measures being implemented.

1.12 In many countries the assessment of Insured Value and Insured Damage is not necessarily carried out by professional valuers. In Serbia, Iceland and other countries the assessment of Insured Damage in the case of disasters, is traditionally carried out by persons with an engineering background having no form of valuation qualification. In such cases the essence of the guidelines in 1.8 should be made applicable.

2. Scope

2.1 This Guidance Note considers the assessment by a valuer of the insurable value of buildings for the purposes of the liability of an insurer of buildings should they be damaged or destroyed. It does not consider the other insurances that may be needed against other risks arising from that damage or destruction or the associated disruption of business or those other insurances commonly handled by those managing property.

2.2 The Note also considers the assessment by a valuer of the evaluation of damages which are objects of compensation, usually the cost of repairing damages on insured buildings or properties as the basis of assessing the liability of an insurer of the buildings or the properties or the compensation if the buildings or properties have been destroyed.

2.3 Depending on the coverage, the valuer will in some cases also consider the incurred cost covered under other insurances that may be needed, for instance the risks arising from the damage or destruction or the associated disruption of business or those other insurances commonly handled by those managing property.

3. Definitions

3.1 The **insurable value** of a property means the sum stated in the insurance contract applying to that property as the liability of the insurer should damage and financial loss be caused to the insured by a risk specified in the insurance contract occurring to that property. When instructed to provide an insurable value, the valuer is to determine the figure that will provide appropriate insurance cover for the property. This is a matter which may not only be relevant to the insured and the insurer but also to others such as someone with a loan secured on the property. Insurable Value will take account of the total cost of rebuilding together with additional factors as appropriate. For insurance cover restricted to buildings ('buildings only'), the figure should exclude all items of plant and machinery, trade fixtures and other materials that do not form an integral part of the structure but will usually be covered by other insurances held by the occupier or other relevant person.

3.2 Damage means physical damage to, loss of or destruction or damage or loss of use of tangible property, including conversion, trespass, nuisance or wrongful interference with the enjoyment of rights over property.

3.3 Where **reinstatement** is the basis of the assessment, the principle is to replace what might be damaged or destroyed as it was before the event. It is not to cover improvements or extensions, save where such changes are required at the time by law or regulation.

Reinstatement where property is destroyed means the rebuilding of the property in a condition equal to, but not better or more extensive than, its condition when new.

Reinstatement where property is damaged means the repair of damage and the restoration of the damaged portion of the property to a condition substantially the same as at the date of the damage, but not better or more extensive than its condition when new.

3.4 Rebuilding, repair and restoration within the context of reinstatement means replacement by methods or with materials that satisfy current building, fire and other regulations or legislation. It shall also include the cost of demolition, site clearance, shoring and propping-up, together with all professional and statutory fees that will be incurred in the reconstruction.

3.5 Property means land and buildings on, below or above the surface including pipes, cables and other installations that connect to the property.

3.6 Replacement cost is defined as the cost to replace the damaged property with materials of like kind and quality, without any deduction for depreciation. If the valuer is instructed to use Depreciated Replacement Cost or if it is appropriate to do so, then the valuer should assess the new replacement cost and then deduct an allowance for ageing and wear and tear of the structure. This cover equates to the replacement of the building as it is, not to its replacement with a new building.

3.7 Major renovations, as defined by Directive 2010/31/EU - Energy Performance of Buildings: "major renovation" means the renovation of a building where:

- (a) the total cost of the renovation relating to the building envelope or the technical building systems is higher than 25 % of the value of the building, excluding the value of the land upon which the building is situated; or
- (b) more than 25% of the surface of the building envelope undergoes renovation

Member States may choose to apply option (a) or (b)."

3.8 Natural disasters. Damage resulting from:

- floods;
- storms;
- landslides and avalanches;
- storm surges;
- earthquakes;
- volcanic eruption.

Such disasters are acts of God. The effect of climate change must not be underestimated and can certainly affect the occurrence, magnitude and frequency of floods, storms, landslides and avalanches and storm surges.

The insurance payment can be reduced or even fall away if the extent of the damage, fully or in part, is due to:

- weak construction, considering the conditions that the building or component could have been expected to be subjected to;
- the lack of maintenance;
- the lack of supervision;
- the insured being answerable for not taking steps to minimise the extent of the damage (the insured's competence in this respect must be considered).

In considering whether the damages are to be classified as "Natural Disasters", consideration must be given to the following points:

- The damages must not have been caused by man-made structures or installations;
- Have the weather conditions been extraordinary as defined for each of the types of damage?
- Has the damaged property been built in accordance with land use regulations and building permits?
- Have similar damages occurred previously and has it been possible to foresee recurrences of damages due to extraordinary conditions?
- Have recommended measures regarding damage prevention been carried out?

3.9 Other hazards

- fire;
- water;
- biological including insects and rodents etc.;
- theft and malicious damage;
- acts of terrorism;
- other damages e.g. blasting, hit and run, mechanical damage, overloading etc. Normally special insurances must be entered into.

3.10 Flood damage - Flooding occurs when streams, rivers and lakes overflow their banks i.e. their natural limits, and thus cause damage.

Generally two types of damage occur:

- damage to buildings. This type of damage is often accompanied by damage to land, communications, power supplies, etc. resulting in many community interests being affected;
- erosion of river banks leading to landslides or the formation of new river directions often causing considerable damage to built-up areas.

3.11 Storm damage - The general limit for insurance coverage is normally 20,8 m/sec, 41 knots or 75km/hour. In accordance with international understandings, wind speeds should where possible be measured 10 meters above ground level as the mean value over approximately 10 minutes. Gusts of wind can have a far greater strength than the average information obtained from meteorological weather stations in the vicinity. Similarly, consideration must be given to the topographical conditions that could lead to a sharp increase in wind speed. For example, a narrow fjord, high mountains and steep valley slopes, fall winds etc. The wind force can be measured in m/sec, knots or km/hour.

3.12 Damage from landslides or avalanches - The sudden occurrence of natural deposits of large or smaller masses of rock, soil, mud or snow moving out of control. Damage from landslides (not avalanches) is not defined as a Natural Disaster if the landfill is manmade and has been established within the last 30 years.

3.13 Damage from storm surges - During periods of low air pressure and in some instances combined with high winds from a direction that leads to the accumulation of water, the water level can become abnormally high. If this coincides with an annually high tidal cycle, this extremely high water level is termed a storm surge. Damage from storm surges is not defined as a Natural Disaster if the water level does not exceed a 5-year cycle of return. This type of damage occurs as a result of a combination between astronomical (e.g. phases of the moon) and meteorological high tides resulting from low atmospheric pressures. Water overflows land. The damage is primarily due to water damaging properties. Damage due to high waves would also normally be covered in this case. It is also worth noting that storm surges are not necessarily accompanied by high winds. High water levels may occur in conjunction with flat and calm seas due to extreme weather conditions taking place elsewhere off shore.

3.14 Damage from earthquakes - Earthquakes vibrate the ground surface caused by a sudden release of tension/energy in the earth's crust. When an earthquake occurs on the ocean floor this can cause tsunamis. In some countries there is a limitation in the insurance coverage in that the quake must have a magnitude exceeding 3.7 on the Richter Scale.

3.15 Damage due to **volcanic activity** - A volcano is a rupture on the crust of the Earth, which allows hot lava, volcanic ash, and gases to escape from a magma chamber below the surface.

3.16 **Fire damage** - Fire, i.e. flames out of control, sudden and unforeseen sooting, explosion, lightning, (the item has been hit directly by the lightning and is clearly marked by it), short circuit or other electrical phenomena or other similar damage, aircraft or falling parts of or from aircraft hitting items.

3.17 **Water damage** - including other fluid, gas or powder. Damage resulting from a sudden and unforeseen outflow from pipelines including attached equipment in a building. That is damage associated with cracks, leaks or overflow systems, seepage of water or other fluids from external pipelines, seepage of water through openings or other leaks. Damage to structures in a building due to the above. Damage in a building directly from the ground due to rainfall, melting of snow or ice, insofar as it results in water rising above the lowest floor level, leaks from an approved fire extinguisher system and the supply line from the main stop valve of the extinguisher system within the building.

3.18 **Theft and malicious damage** - limited to items in a building The valuer must describe the actual incident and must be familiar with the specifications and limitations in the insurance policy. Relevant deviations and person responsible must be reported. Special care should be taken regarding access doors, windows and other openings leading to the premises. The valuer must make sure that if the incident has been reported to the police, the premises may not be entered before authorization has been granted. The reporting is to be carried out as for regular damages.

3.19 Full rebuilding value - Full replacement cost - Guaranteed replacement cost - Full coverage

3.19.1 Full rebuilding value is a type of insurance of buildings which covers the buildings with an amount corresponding to the reconstruction value. The insurable value is based on and fixed by the Insurer or his professional valuer and should be stipulated in the insurance policy. Any extension or alteration affecting the value of the building must be notified to the Insurer to be covered by the insurance. If the Insurer is not notified thereof, indemnity will be provided for that part of the damage which corresponds to the ratio between the reconstruction value as it would be excluding and including the alteration. Where the insurance also covers buildings without specification in the insurance policy, the same applies to new buildings which have not been notified to the Insurer.

3.19.2 Full replacement cost is the payable amount limited to the insured value as stated in the insurance policy. If the insured property is destroyed, the insurance

company is obligated to fully replace or rebuild the property without any deduction for depreciation. To obtain a full replacement cost for the property, over and above the insured value, the insurance company will normally charge an annual fee of about 10 to 20 percent more than for the actual-cash-value coverage.

3.19.3 Guaranteed replacement cost is the payable amount limited to the insured value as stated in the insurance policy, but if the damage exceeds the limits on the policy, the insurance company is obligated to fully replace or rebuild it without any deduction for depreciation. Guaranteed replacement policies aren't exactly what one might imagine. Insurers limit the amount that they pay out to replace or rebuild the property to usually no more than 20 percent above the amount for which the property is insured. If the property appreciates beyond the level of coverage, the policy will not cover that amount - even though the insured might be under the impression that a guaranteed replacement coverage is in effect.

3.19.4 Full coverage Any form of insurance that provides for payment in full (e.g., without a deductible or coinsurance limitation) of all losses caused by the perils insured against.

NOTE

The terms above appear to have differing definitions in different countries. For the sake of this document the above definitions are used as typical examples. If the Insurance Policy does not include settlement over and above the Insured Value as stated in the Policy, it is imperative that the Insured Value be re-considered on a regular basis, so as to avoid the risk of under-insurance.

3.20 First loss insurance is a type of insurance of property and interests which covers damage within the stated sum insured. Under-insurance will not be claimed.

3.21 Fixed sum - The sum insured is fixed by the Insured and is stipulated in the insurance policy. The sum insured as a minimum must correspond to the reacquisition value in order to avoid under-insurance.

3.22 Reacquisition value is understood to mean the costs of reacquiring corresponding insured items at the date of the damage. Where the sum insured is lower than the reacquisition value, indemnity will be provided for that part of the damage which corresponds to the ratio between the sum insured and the reacquisition value (under-insurance).

3.23 Reconstruction value is understood as the cost of reconstructing a corresponding or essentially corresponding building at the place of the damage at the date of the damage. Additional expenses in connection with building methods and equipment which are inappropriate according to the current building methods etc. are not to be included when fixing the reconstruction value.

3.24 Special items such as historical buildings, artworks, special architectural features etc. etc. In such cases the valuer must consider being assisted by persons having detailed knowledge of the value of such items.

4. Recommendations

4.1 The valuation process, the status of the valuer, clarifying whether acting in an external and independent capacity, specifying a corporate or personal identity, or as an internal valuer, should be clearly communicated to the parties involved as set out in EVS 4. When settling claims it is of the utmost importance that the insured be compensated fully for the amount he is entitled to according to the insurance policy.

4.2 It is imperative that the valuer, in addition to his qualifications as a valuer under the EVS, be conversant with the methods employed in this type of work and that he be in possession of the necessary expertise (knowledge and understanding) and have the experience needed to carry out such assignments. Minimum recommended qualifications are listed in the following, and the valuer is expected to possess a sound knowledge of the topics including:

- building costs and building constructions;
- local and national building regulations;
- local planning constraints;
- insurance contracts;
- insurance coverage and limitations;
- estimates of expected time for repairs;
- market values;
- rental rates.

4.3 In preparing an assessment of Insurable Value, the valuer should be aware of risks which may be excluded from insurance cover.

4.4 Exclusion from cover does not remove the responsibility to report any matters that might impact any decision of the insurer. There might well be matters excluded from cover (though still to be considered in any assessment) or for which cover may be specifically limited under the contract. Matters that have, entirely or partially, been excluded from cover, or been given limited cover or alternative cover, can, as far as appropriate, still be considered in a damage report and, in the report, explicitly excluded, or limited, when determining the compensation.

However, in some countries only items covered by the insurance policy are to be included in the damage report.

In the following, examples are given as to procedures adapted in some countries. Practice can vary from one country to another and the insurance policies will vary

from company to company. Some countries have legislation covering the minimum requirements in an insurance contract, whereas in other countries contents of insurance policies might not be regulated.

Examples of recommended control points to detect conditions that would imply that certain elements could be entirely, or partially, excluded from cover are given below. The list is not exhaustive:

- Asbestos and other deleterious materials (in some countries deleterious materials will, by law, always be included in the insurance policy);
- Damage from flooding, especially if the premises are situated within a flood plain and may have suffered flooding in the past;
- Potential storm damage to fencing;
- The condition of all roofing as insurers might exclude storm damage where the standard is poor, which in turn can lead to a reduction in the compensation;
- Fire damage may be excluded if the electrical system has not been certified or if there is insufficient fire protection (e.g. extinguishers). Usually such a limitation must be a part of the insurance contract and should be valued and be included in the valuers report;
- For premises with sprinkler systems, water damage could be excluded unless sprinkler leakage cover is purchased;
- In areas prone to subsidence problems, subsidence cover may be excluded; while normally secondary damages will be included in the policy;
- Earthquakes can be an excluded risk in some areas;
- Loss of rent, and costs for providing alternative accommodation and associated risks, are normally covered but must be verified by the valuer before being taking them into consideration;
- The valuer must assess whether building regulations change constructional details resulting in extra cost;
- Incorrect information by the insured and the financial implications of holding back information or giving erroneous information;
- Deceit and the possibility of losing all rights under the insurance policy.

4.5 Unless there is firm evidence to the contrary, or specific instructions have been issued to the valuer, it will be assumed that the nature of the building and the ground conditions of the site would not give rise to the need for any special construction techniques, such as raft foundations, piling, etc. and that there are no contaminated ground conditions that might add to the reinstatement costs. It is recommended that a statement to this effect be included within an assessment report.

4.6 Where VAT would be due on the reinstatement cost, it is good practice to show it as a separate figure, in addition to the reinstatement cost net of VAT. It is for the client to establish how far it may be able to recover that VAT.

4.7 In respect of apartment buildings, unit owners have a financial interest in the entire building, as well as the building elements within their unit. Whilst a unit owner should not need to insure the entire building, insurers of an individual unit require an adequate level of indemnity. Local regulation or tradition may determine the extent of cover required beyond the assessment of insurable value of the specified unit of accommodation. It is recommended that details of the insurance policy be reviewed to ensure that cover is provided in accordance with the requirements of the insurer. It is also recommended that valuers make enquires relating to any specific requirements of insurers where flooding of any block of property may impact on the individual unit, irrespective of whether the fabric of any unit is affected by flooding.

4.8 Where an entire property comprises more than one unit of occupation, it is usual for all units to be insured within one policy, including common areas and ancillary accommodation. Valuers should ensure that the insurable sum accurately reflects different values that may exist within the total area and the impact that perils such as flooding may have on any part of the property.

5. The Assessment

5.1 The conventional purpose of insurance cover is to make good the loss caused by damage. An assessment of the Insurable Value or the cost of reinstatement should be based on the full cost of replacement, rather than Market Value or any other basis, unless the valuer or the insurance contract specifically states otherwise. In such a case the damage report should make clear that the value given is not an assessment of the cost of reinstatement and the actual basis shall be stated.

5.2 The rebuilding cost will be influenced by a number of different factors including the type of property, the type of construction, the quality of construction and the location of the property, particularly in the context of the proximity of surrounding property and any restrictions relating to building activity within the boundaries.

5.3 The cost of construction in an insurance context will often be substantially higher than the actual cost of a recently completed building on a cleared site. A new build cost would reflect the fact that the site was clear of buildings and the contractor could employ efficient site construction methods. Where it is a case of rebuilding, the site may often be constrained by other buildings already on site and other surrounding buildings which have since been developed. Any building attached to another property may need to be supported temporarily and protected from the weather. In his damage report, the valuer shall include such additional costs in the cost of reinstatement.

5.4 The cause of a claim for total reinstatement may be a catastrophic fire or explosion. Provision therefore needs to be made for the cost of demolition of the

existing structure as well as any work needed to protect adjacent and adjoining buildings. Depending on the nature or extent of the damage, the demolition process may be more dangerous than might otherwise be the case and in extreme cases the foundations may also require removal.

5.5 Provision needs to be made for the cost of removing any rubble and other waste material from site prior to rebuilding. Costs associated with depositing in landfill or waste sites have increased substantially over recent years, particularly in respect of deleterious or contaminated materials. In his damage report the valuer must also take this into account.

5.6 Costs associated with improving the energy performance of a qualifying building require consideration. Energy Performance of Buildings Directive 2010/31/EU requires improved energy performance in the event of "major renovation". (See Definitions). The valuer must include such calculations in his damage report.

5.7 Fees for architects, surveyors, engineers and fees for other relevant service-providers all need to be taken into account in assessing the Insurable Value. Fees and costs associated with planning permission and building regulation approval must also be considered. This implies that the valuer must also take these factors into account when calculating the value of the claim in his damage report.

5.8 Building areas are of utmost importance in calculating Insurable Values and assessing the loss caused by damage. The valuer must ensure that the basis of measurement undertaken is consistent with the basis adopted by authors of any recognised cost guides and the practice adopted in the country concerned.

5.9 Insurance contracts have differing clauses regarding acceptance and limitations. The valuer must therefore be well informed and well conversant with the particular insurance contract relating to the property concerned. The report must take these factors into account in order to provide the insured with a correct insurance settlement.

6. Reporting

6.1 Recommended Procedures for reporting the Insurable Value and Insurable Damages. The valuer must undertake an assessment and provide an adequate description of the following:

6.1.1 General reporting

- the location and use of both the subject property and adjacent property; as well as the address of the beneficiary of the insurance contract;
- the accommodation/space, number of floors, services, and access;

- internal and external facilities including a record of construction details, dimensions, fittings and use, supported by a comprehensive photographic record. Specific regard should be made to materials or features not commonly found in similar property or where the replacement costs would be higher than normally incurred;
- relevant planning permissions, licenses and approvals;
- the condition and state of repair of the property, including an assessment of any deterioration arising from damage, age, defects or overdue repairs. In some cases such conditions will result in deductions in the insurance compensation;
- in cases where the insured is unable to recover input VAT charges the valuer must clarify whether it is possible under the insurance policy, or national law, to increase the assessed costs correspondingly.

6.1.2 Specific to Insurable value

- the specification of reconstruction costs together with necessary additional costs associated with reinstatement.

6.1.3 Specific to Damages

- the cause of the damage must be stated. However, fire and arson etc. is a criminal matter and must be considered by the police or other appropriate agents. The underlying causes of the damage need then not be reported, while the fact that this is under investigation by other agents must be included in the rapport;
- extent of the damage;
- repairs and cost of replacement and contractual conditions regarding market price for construction work necessary to repair the damage;
- the specification of reconstruction costs together with necessary additional costs associated with reinstatement. The cost of Improvements must explicitly be stated in the report or, alternatively, explicitly be excluded;
- breach of special provisions in the insurance contract, identification, causation and in some instances liability and regress;
- reservations and mandatory limitations.

7. Other Issues

7.1 In certain specialised cases, it may be necessary to envisage that, in the event of total loss, it would be unrealistic or perhaps unnecessary or uneconomic to rebuild the structure as it existed. This might arise where the insured property had been constructed using materials that would not now be used or by methods or to standards that are now outmoded. An example would be a building built with traditional materials and designed to accommodate outdated processes. In such instances, there may be no need to rebuild the structure as it was and it may be cheaper and more appropriate for

rebuilding to meet the current and foreseeable requirements at the time of assessment with contemporary methods, materials and standards. The valuer may be asked to provide a valuation based on the concept of Depreciated Replacement Cost. Frequently the insurance contract will also provide alternative provisions for calculating adequate alternatives for compensation.

7.2 The Cost Approach (or the Contractor's Method) is used to assess the new replacement cost and the depreciated replacement cost.

7.3 When determining the **Depreciated Replacement Cost**, allowance should only be made for the depreciation arising from physical deterioration, but not functional or economic obsolescence as the objective is to replace what may be physically lost. The assessment of depreciated replacement cost depends, inter alia, on the building's age, its expected remaining life, its construction, its use and maintenance.

7.4 Underlying land does not need to be valued unless it is subject to an identified risk covered by the insurance policy (for example, flooding, contamination or a mudslide). In some countries such damages are under separate coverage.

7.5 Any assessment of insurable value of listed or heritage buildings requires specialist knowledge of construction detail, appropriate replacement costs and requirements of a government agency or planning authority. Unless the valuer is recognised as a specialist in this area, no assessment should be completed without assistance from an expert in the type and design of the subject property. Where assistance is obtained, the client and the insurance company must be advised, and agree to the appointment

8. Special Provisions and Recommendations for Damage Assessment

8.1 A typical list of procedures is as follows:

- Acknowledge the assignment.
- The representative of the insured to be contacted without delay.
- Inspection is carried out with all involved parties present.
- The damaged property and the damage to it is recorded.
- The cause of the damage is established.
- If the insured is not in agreement with the valuer's conclusions, the opinion of the insured should be reported before the valuer's final conclusions are submitted.
- The underlying cause of the damage is described including reference to official regulations and other statutes.
- For Natural Disasters the following must be observed.
 - Records from the time of the incident regarding wind, wave height and recurrence, man-made structures etc.

- Evaluation of factors such as “What should the construction be able to withstand in accordance with regulatory building rules at the time of construction?”
- If not in compliance with building regulations is there a relationship with this point and the extent of the damage?
- Is the extent of the damage a result of a lack of maintenance and/or wrong construction design?
- Reasons for faulty designs and/or constructions shall be stated, and who was responsible,
- The report shall not place the blame, but only state factual observations.
- The extent of the damage is recorded.
- Consider and report the need for immediate measures to safeguard the property and to avoid further damage.
- The damage report should contain a description of repair work needed, followed by a calculation of the costs.
- In some cases the inspection and the report cannot be completed immediately and an interim report must be produced, to estimate budgetary figures for costs.
- In such cases the parties must agree on procedures for demolition to determine the exact cause and extent of the damage.
- Recommended method of repair is advised.
- The Final Report is produced.

8.2 Typical Consequences of Damages and Typical Check Points

The following lists are intended as examples and are not complete.

8.2.1 Flooding

- extensive long term damage to structural elements and fixtures;
- extensive and often substantial interference in- and replacement of major components of a building;
- long periods for “drying out”;
- often substantial exterior damage to terrain and site works;
- well-functioning early warning systems can prevent or diminish losses;
- in some cases, slow progress of water insurgence;
- in other cases, sudden influx of water, mud and rocks increasing the effect of the damage;
- preventive measures such as placing of sandbags, excavating river beds etc. can reduce the effects of the damage;
- official registers and maps can contain information about areas listed as unsafe.

8.2.2 Storms

- often some time lapse for warning;

- most commonly very few preventive measures can be implemented;
- often “old structures last longer”;
- modern buildings are often erected in exposed locations;
- the effect of climate change is increasing;
- under-dimensioned constructional details;
- lack of understanding for the implementing preventive measures.

8.2.3 Landslides and avalanches

- heavy rainfall is often accompanied by landslides;
- frequently landslides occur in places historically considered as safe areas;
- official registers and maps can contain information about areas listed as unsafe.

8.2.4 Storm surges

- tide water tables and records of historical data must be collected;
- official recording stations must be consulted;
- damage must be reported on secondary outbuildings near the sea shore;
- damage to land development such as landfills, breakwaters, harbours, quays and piers;
- climate change resulting in rising sea levels.

8.2.5 Earthquakes

- special areas are prone to this phenomenon, but seldom with a forewarning;
- special construction techniques are normally employed in exposed areas;
- care must be taken to determine the direct cause of the damage, often other causes show similar symptoms e.g.
 - hair cracks and cracks, tension cracks, cracks between different materials;
 - structural expansion;
 - heating;
 - damaged window panes;
 - earth pressure;
 - weakened structures;
 - shrinkage and drying of materials;
 - frost and ice;
 - foundations.

8.2.6 Volcanic activities

- fallout of ash;
- fire;
- time for evacuation;
- substantial damage to buildings, earth, air and water;
- long term effect.

8.2.7 Fire

- fire, i.e. flames out of control;
- sudden and unforeseen sooting;
- sparks;
- explosion;
- lightning, i.e. the item has been hit directly by lightning and is clearly marked by it;
- short circuits or other electrical phenomena or other similar damage;
- ignition from work requiring warming e.g. welding, arch cutting;
- chimney fires, resulting in damages to the chimney structure, can also be a result of intensive heat from extensive use of the fire place. Discovered only after professional inspection of the chimney.

8.2.8 Water, and other fluids, gas or powder - sudden and unforeseen occurrences

- escape from the pipelines of a building and attached equipment in connection with cracks, leaks or flooding;
- seepage of water or other fluids from external pipelines, drainage tanks, septic tanks oil tanks, aquariums;
- seepage of water through openings or leaks;
- seepage of water in building directly from the ground due to rainfall, melting of snow or icing, insofar as it results in water above the lowest floor level;
- leak of extinguisher from an approved extinguisher system and the supply line from the main stop valve of the extinguisher system within the building;
- damage from frost, underprovided heating and incomplete insulation;
- wrongly dimensioned drains or sediments in drains;
- backlash from municipal sewerage;
- damage to underground surface water drainage systems;
- responsibility and regress.

8.2.9 Theft and malicious damage

- only in relation to items in the building.

8.2.10 Biological damage including damage from insects and rodents etc.

- fungi, rot and decay: Analysis must be carried out to determine the nature and type of the occurrence and thereby to consider the elimination of the growth environment, constructional, aesthetic and health consequences;
- rodents: look for access points and resulting damage (disturbed insulation, gnaw marks on electrical wiring, excrement and smell/stench);
- insects: analyse nature and type. Repair damages;
- damages caused by household pets are normally not covered by normal insurance policies;
- check against registers of "listed animals" such as bats, certain bird species etc.;
- counselling to prevent recurrence is normally covered.

8.2.11 Other sudden and unforeseen damage to the buildings

- internal frost;
- wind which is weaker than storm,;
- snow impact or snow load;
- snow sliding onto or from roof;
- broken glass in windows and doors and other building glass which is fixed on its permanent place;
- damage which results from gradual or considerable impairment caused by rust, corrosion, other corrosive attack or wear and tear;
- damage which consists in wastage, crevices and cracks, spots, scratches and spalling;
- damage caused by animals, insects, bacteria, fungi or rot;
- damage which only affects mechanical or electrical devices;
- damage which affects a building part which has not been fixed at its permanent location;
- damage to glass, devices, equipment and sanitary equipment which have been fixed specifically by or for the tenant;
- damage to glass with the effect that the frame of the double glazing has become draughty
- aircraft or falling parts of or from aircraft hitting items.

EVGN 5

Assessment of Investment Value

- 1. Introduction**
- 2. Scope**
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1. Introduction

Real estate investment is a very significant industry in Europe, since it allocates several hundred billion euros each year. Despite concerns over weak fundamentals and economic conditions, investors in European properties are always actively looking for profitability and diversifying investments into a mix of strong and active as well as recovery markets, both in terms of location and property type.

Therefore, it is important to be able to establish a way to assess the value that the property to be acquired has for the specific investors.

From a quantitative perspective, investing in real estate is similar to investing in the capital markets: in order to make successful real estate investments, investors will assess the value of the properties they buy by making educated guesses about how much profit those investments will generate, whether through property appreciation, rental income or a combination of both. Hence, the investor's assumptions about the asset's profitability and capability of capital gain, combined with the expected hold period and the specific requirements on investment return, will be key for determining the investment value of an asset

2. Scope

This Guidance Note considers the basis of value and analysis methods used to assess the investment value (or worth) of a property for a known individual investor. This process should be distinguished from the determination of Market Value: whereas Market Value is the best price that would be reasonably expected in the open market, taking account of all the various types of likely bidders, investment value is the maximum price that a known individual bidder would offer, according to his specific investment requirements.

EVGN 5 is of application where an investor needs to assess the maximum price to pay to purchase a property, taking account of the benefits to be received by holding that asset.

3. Definitions

3.1 All bases of value contained in EVGN 5 are defined in EVS 2 (Valuation Bases other than Market Value).

3.2 Useful Life of a Property. In the context of this Guidance Note, the useful life is the period during which the property will be capable of being effectively used for its purpose. Note that this definition is different from the useful life of an asset for IFRS accounting purposes, which is concerned more with the period for which the owning entity will have use for the asset, rather than the period for which the asset could be used by any owner or occupier.

4. Guidance

4.1 Categories of Investment Property

4.1.1 Investment properties can be divided into four main categories:

- properties held as investments because of their capacity to generate income and/or capital gains;
- properties which are in the course of development;
- properties held for future development;
- investment property for owner occupation.

4.1.2 Properties held as investments will normally include those where construction work has been completed and which are owned for the purpose of letting, producing a rental income which is negotiated at arm's length with third parties.

4.1.3 Properties in the course of development will include properties that have been acquired with vacant possession, with the intention of seeking an early arm's-length letting to a third party irrespective of whether works of repair or improvement are required. Apart from properties where work is actually in progress, this category will also include any property where the start of work is imminent, all the appropriate consents and permits have been obtained and a building contract agreed.

4.1.4 Properties held for future development will include those acquired for redevelopment purposes at some future date (with or without any other properties

which have not yet been acquired) and which are not in any of the other three categories above.

4.1.5 Properties to be purchased for owner-occupation – valuers may also be asked to advise purchasers as to the price they should pay to acquire properties that they will subsequently occupy themselves. This would include the purchase of leisure properties such as hotels, leisure parks, etc. While they would not be considered as investment properties for accounting purposes, such instructions can be considered to fall within this Guidance Note.

4.2 Basis of Value

These valuations must be made under the basis of Investment Value (see EVS 2), i.e. the value of a property to a particular identified party for investment, owner-occupation or operational purposes.

4.3 Information to be Gathered

In order to perform a proper valuation for investment purposes, the valuer will normally need the following information from the investor:

- land register and cadastral documents;
- site plan with boundaries;
- any permits or licenses relevant to the property;
- schedule of floor areas, existing or proposed;
- tenancy schedule / lease contracts in place and/or likely to be closed;
- if multi-let, details of service charge costs and, in particular, any shortfall due to vacancies;
- expected budgets;
- any specific characteristics of the investor's business or investment portfolio that might have an influence on the future cash flows generated by the subject property;
- the investor's investment criteria (such as a target rate of return or the hold period).

And also, usually from other sources, information as to:

- market data related to the property;
- interest rates and expected changes;
- potential for disposal of the property;
- legal and development control issues affecting the property, including, where relevant, HMO (houses in multiple occupation) licences, condition surveys and/or environmental reports;
- current and prospective inflation.

4.4 Valuation Methods

To assess Investment Value, the valuer will usually use the Discounted Cash Flow method or equivalent techniques. On occasions, the residual method may be appropriate.

4.5 Reporting

The valuation report, prepared in accordance with EVS 5, must state that the basis of value adopted is Investment Value and **not** Market Value. The report should stress that the Market Value may be different from the Investment Value that has been reported. It should make clear that it is prepared only for the particular investor to whom it is addressed, that it contains specific requirements and assumptions relating solely to that investor and that it is not to be relied on by any third parties.

5. Commentary

5.1 Cash flows are to be estimated over the period that the investor is expected to hold the property, taking into account all factors that could affect them. Having assessed the in and outflows together with the risks attached to each during the hold period, the final item in the cash flow will be the expected Investment Value at the date of the future sale less selling costs.

5.2 Where a property is being or will be developed, the valuer will have to form a view as to the dates when permissions will be obtained, construction completed, the property let and the first rents achieved.

5.3 The discount rate applied to future income and costs will be the one chosen by the investor, reflecting his specific investment requirements.

5.4 For further information on the DCF and residual methods, please refer to EVIP 5, Valuation Methodology.

5.5 Finally, valuers need to be able to distinguish between Investment Value and Market Value under specific special assumptions.

5.5.1 Investment Value is the maximum price that one known bidder would pay, taking account of his personal financial requirements, particularly as regards returns on investments.

5.5.2 In contrast, the **Market Value under a specific special assumption** aims to determine the best price that could be reasonably expected in the open market, in accordance with the definition of Market Value, but incorporating the

specific special assumption that has been agreed with the client. The special assumption will relate to the property and its physical, occupational, legal or town planning situation, rather than to the financial characteristics of any potential buyer.

EVGN 6

Cross-border Valuation

- 1. Introduction**
- 2. Scope**
- 3. Qualification of Valuers**
- 4. Professional Experience and Market Knowledge**
- 5. Terms of Engagement**
- 6. Compliance with Local Rules**
- 7. Insurance**
- 8. The Report**

1. Introduction

1.1 Clients are increasingly looking for property valuations across national borders. TEGoVA's Recognised European Valuer (REV) and TEGoVA Residential Valuer (TRV) Programmes assist clients and their valuers in identifying qualified practising valuers in other countries who can be instructed to do this work. Equally, valuers themselves may have experience in valuing in other countries and be instructed to do this, perhaps most often where specific property markets now cross national borders. The different market circumstances, legislation and practice of each country means that particular care should be taken when undertaking a valuation in another country.

1.2 Directive 2006/123/EC on services in the internal market (the Services Directive) seeks to eliminate the obstacles to the development of cross-border service activities. It enhances the Treaty right of service providers to develop their activities within the EU Internal Market either by establishing a practice in another Member State or by providing services there from the base of their home country. The legal framework provided by the Directive benefits a wide variety of services, including real estate services and property valuation.

1.3 Although the Directive ensures the right for valuers to undertake valuations outside their home countries, it does not cover the professional qualifications, skills and practices of valuers that are necessary to operate in other countries' markets.

1.4 EVGN 6 sets out the basic requirements with which valuers should comply if they intend to carry out property valuations in countries other than their own. These requirements are based on:

- qualification;
- professional experience;
- market knowledge;
- compliance with local rules;
- transparency;
- independence;
- avoidance of conflicts of interest.

TEGoVA considers that these principles are not only fundamental to valuations carried out by valuers in their home markets but also apply fully to cross border valuations.

2. Scope

This Guidance Note provides guidance to a valuer carrying out a valuation in a country (the host country) other than his own (the home country). The GN complements the Services Directive relevant to cross-border valuation services within the European Economic Area (EEA) – which enhances the freedom of valuers to operate cross-border without administrative obstacle – by covering the experience, competence and reporting requirements required when undertaking a cross-border valuation report.

3. Qualification of Valuers

3.1 Valuers must be professionally competent to undertake valuations in the country in question. A valuer should only undertake a valuation in another country when it is within the scope of his professional and personal qualifications. These qualifications should be set out in the valuation report.

3.2 Valuers could be required, where relevant, to have adequate knowledge of the language of the country where the property is located as documentation and other property specific information might only be available in the foreign language.

3.3 Though EU law relieves the valuer of any obligation to hold host country qualifications, holding specific relevant qualifications from recognised professional bodies and long term professional experience may further demonstrate these skills to clients.

4. Professional Experience and Market Knowledge

4.1 Valuers must demonstrate their ability to practice in the host country. They must possess:

- up-to-date information;
- sound knowledge of European Valuation Standards and of valuation practice of the host country;
- professional experience in the real estate market relevant to the property to be valued;
- knowledge of the host country property market and property law.

4.2 Valuers should have and maintain good and active knowledge and experience of the host country property markets, laws and practices relating to property valuation, at least as regards the sectors in which they accept instructions.

4.3 In cases in which the host country is not only the country of the property to be valued but also the country of the client, valuers must be able to communicate effectively with the client on the issues of local professional relevance. These include all value-relevant questions, as well as all professional issues regarding the exercise of the valuer's activities.

5. Terms of Engagement

5.1 When receiving instructions to carry out the valuation of properties which are situated outside the valuer's home country (and possibly outside the country where the client is based), the valuer is advised, prior to the assignment, to consult with the client (including the directors and officers if it is a company) and, where relevant, the client's professional advisers (including auditors) and agree terms of engagement in writing.

5.2 If the valuer does not have the necessary suitable experience or competence relevant to the location and type of property he must advise the client and, with the client's agreement, seek to remedy the insufficiency by working in conjunction with a properly qualified valuer or, if appropriate, with other professionals in the location of the subject property who are appointed by the client. The professional assistance provided must be declared expressly in the valuation report. To increase the assurance of quality local assistance, the valuer seeking host country assistance should seek the support of a competent local valuer, such as a Recognised European Valuer (REV) or TEGoVA Residential Valuer (TRV).

6. Compliance with Local Rules

6.1 Departures from EVS and/or special assumptions made in order to comply with the legal requirements, valuation standards or other valuation provisions of the host country must be clearly stated in the valuation report. If relevant, valuers shall follow the generally recognised principles in that country governing the form and content of valuation reports.

6.2 Where there are differences in accounting law and practice or where resultant valuation procedures differ materially from the practices of the country of the client, the rules applicable in the client's home jurisdiction will take precedence for the purposes of financial statements. The valuer, in reporting his findings, must highlight such differences.

7. Insurance

Valuers should be aware that they may need professional indemnity insurance when working in some European countries and that this insurance should provide sufficient cover for their potential liabilities to their clients and third parties with consideration given, as necessary, to legal costs and interest.

8. The Report

8.1 The less familiar the client is with the market in which the property is situated, the more important it is that the valuation report convey the data and statements in a clearly comprehensible and verifiable form, enabling the client to understand the development of the valuation report from the recording of value-relevant data, through the application of the appropriate methods to the assessment of the results.

8.2 Where the client is based in a third country, the valuation report must also contain clear reference to any material differences in law or custom that may exist between the country of the client and the country in which the subject property is located.

8.3 The report on a cross border valuation shall clearly record the data on which it relies. Valuers shall indicate the origins of the data so as to facilitate judgment of their quality and effects on the valuers' statements.

EVGN 7

Property Valuation in the Context of the Alternative Investment Fund Managers Directive

- 1. Introduction**
- 2. Scope**
- 3. Definitions**
- 4. Statement of the Guidance**
- 5. Commentary**

1. Introduction

1.1 As a consequence of the financial crisis emerging in 2007, the European Union adopted Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers providing regulation and oversight of entities engaged in the management and administration of alternative investment funds (AIFM).

1.2 The Directive establishes a harmonised EU framework for monitoring and supervising the risk that AIFM pose to their investors, counterparties, other financial market participants and to financial stability.

1.3 The provisions address a broad variety of risks like leverage risk, weak risk management systems, poor investor protection or trading inefficiencies. Large AIFM with high levels of leverage may have amplified market movements and thus contributed to the instability of financial markets across the EU.

1.4 In order to facilitate the development of the single market, an AIFM authorised in its home Member State is entitled to market its funds to professional investors in the territory of any Member State (European passport). This passport does not cover AIF marketing to retail investors, although Member States may allow AIF marketing to retail investors within their country.

1.5 The funds under the scope of the Directive are defined as all funds that are not regulated under the UCITS Directive: for example, hedge funds, private equity, commodity funds, infrastructure and real estate funds.

1.6 Article 19 of the Directive provides extensive rules on asset valuation. AIFMs are required to establish appropriate and consistent procedures ensuring a proper and independent valuation of assets. Fund managers have to calculate the net asset value per unit at least once a year in accordance with the applicable national legal provisions and the AIFM rules.

1.7 The Directive sets the principle of appropriate and consistent valuation procedures and provides a definition of 'external valuer', but it does not provide valuation standards or any kind of technical guidance, nor does it contain provisions about valuation methods to be applied to the funds' assets.

1.8 The European Commission adopted a Delegated Regulation (EU) N° 231/2013 of 19 December 2012 specifying the general operating conditions for AIFMs, including valuation principles. Articles 67 to 74 of the Delegated Regulation stipulate the rules to be applied by AIFMs for the valuation of their assets. AIFMs are required to:

- establish written policies and procedures that ensure a sound, transparent, comprehensive and appropriately documented valuation process;
- consistently apply the valuation policies and procedures;
- explain and justify the valuation models used;
- periodically review the policies, valuation methodologies as well as individual values of assets;
- ensure that the net asset value per unit is calculated on the occasion of each issue, subscription or redemption of units or shares, but at least once a year.

2. Scope

2.1 This Guidance Note applies to the valuation of real estate assets of AIFs under the AIFM Directive. AIFs investing in real estate assets can take the form of an open-ended or a closed-ended fund.

2.2 The subsequent Commentary is based on the Directive and the Delegated Regulation. Valuation rules and net asset value calculation procedures followed by AIFs are usually set out in AIF prospectuses or in their constitutional documents.

3. Definitions

3.1 Definitions 3.2 to 3.4 are drawn from the AIFM Directive.

3.2 "Alternative Investment Fund Manager" means a legal person whose regular business is managing one or more AIFs (Article 4(b)).

3.3 “Alternative Investment Funds” means collective investment undertakings which raise capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors (Article 4(a)).

3.4 “External Valuer” means a legal or natural person independent from the AIF, the AIFM and any other persons with close links to the AIF or the AIFM (Article 19(4)(a)).

3.5 “Net asset value” is defined in EVGN 3 at 3.4 as a measure of the aggregate current value of assets, less all liabilities.

4. Statement of the Guidance

4.1 The net asset value of an AIF is typically quoted per investment unit. In the case of real estate funds, it is generally calculated on the basis of the total value of the property portfolio net of disposal cost.

4.2 As AIFMs employ different methodologies and systems for valuing assets depending on the assets and markets in which they predominantly invest - the professional valuer must be aware of national and statutory AIF valuation rules. He shall consult the AIFM’s procedures and policies in order to identify his duties, the rules and valuation methods applicable.

4.3 Valuations of real estate assets should normally be carried out on the basis of the Market Value of each property. If a valuer is instructed to value a real estate portfolio, each single property of the portfolio should be valued individually. Except as otherwise provided by local provisions, the income approach applies. Departures from European Valuation Standards should be recognised in the valuation report.

5. Commentary

5.1 General

5.1.1 Neither the Directive nor the Commission’s Delegated Regulation provide general applicable procedures or valuation standards for the calculation of the value of an AIF’s assets. The rules applicable to the valuation of assets are laid down in the law of the country where the AIF is established and/or in the AIF rules or instruments of incorporation.

5.1.2 The AIFM itself is responsible for the proper valuation of the AIF’s assets. The Delegated Regulation therefore requires that an AIFM has to establish written policies and procedures outlining the role and duties of all parties involved in the valuation process, transparent and sound valuation procedures as well as applicable methods.

5.1.3 Because of the variety of AIF asset classes and diverging national traditions, the Directive provides a flexible regime as to the persons carrying out valuations. The valuation function may be performed either through external valuers or by the AIFM itself.

5.2 Internal or External Valuation

5.2.1 TEGoVA considers that AIFMs investing in real estate should always appoint an external valuer to perform the valuation function.

5.2.2 However, the AIFM can process the asset valuation itself if the valuation task is functionally independent from the portfolio management and the remuneration policy and other measures ensure that conflicts of interest are mitigated and that undue influence upon employees is prevented (see Article 19 par. 4 of the Directive).

5.2.3 As the valuation of the AIF's assets is considered to be a function of the AIFM, the valuation of assets by an external valuer is deemed to be a delegation of functions to a third party subject to strong additional requirements.

5.2.4 Where an external valuer (see definition at 3.4 above) performs the valuation function, he:

- (i) is subject to mandatory professional registration recognised by law or to legal or regulatory provisions or rules of professional conduct;
- (ii) is requested to provide sufficient professional guarantees to be able to perform effectively the valuation function;
- (iii) shall not delegate the valuation function to another party.

5.2.5 According to Article 73 of the Commission's Delegated Regulation, the professional guarantees to be furnished should contain evidence of the external valuer's qualification and capability to perform the valuation with:

- (i) sufficient personnel and technical resources;
- (ii) adequate procedures safeguarding proper and independent valuation;
- (iii) adequate knowledge and understanding;
- (iv) a sufficiently good reputation and sufficient experience with valuation.

5.2.6 The valuer's liability is enshrined in the Directive. Article 19(10) par. 2 which stipulates that the external valuer is liable to the AIFM for any losses suffered by the AIFM as a result of the external valuer's negligence or intentional failure to perform his tasks (see EVS 3 for further guidance). As this liability is conceived without limitation, external valuers are advised to provide sufficient insurance cover.

5.2.7 Valuers should be aware of the AIFM's obligation to notify their appointment to the competent authorities of their home Member State (Article 19(7) of the Directive). Member States can refuse the appointment and request the nomination of another valuer.

5.3 Valuation Frequency and Review of Individual Values

5.3.1 Although the Directive states the principle that non-financial assets have to be valued at least once a year (Art. 19(3), par. 2), it is specified that the valuation of such assets of open-ended funds shall also be carried out at a frequency which is both appropriate to the assets and to its issuance and redemption frequency (see Article 19(3), par. 3 of the Directive).

5.3.2 This enables open-ended real estate funds to apply tailor-made regimes and increase the valuation frequency if relevant. This applies when the last determined value is no longer fair and/or proper. It is the valuer's task to consult the AIFM's internal policy and procedures for this purpose.

5.3.3 By Delegated Regulation (EU) N° 694/2014 of 17 December 2013, the Commission provided the following definition of an open-ended fund: an Alternative Investment Fund shall be considered open-ended when its shares or units are, at the request of any of its shareholders or unit-holders, repurchased or redeemed directly or indirectly out of the assets of the Fund.

5.3.4 In the case of closed-ended funds, valuations shall also be carried out in case of an increase or decrease of the AIF's capital (Article 19(3), par. 4). In addition, individual asset values must be reviewed when evidence arises that they are no longer appropriate. This could be the case in volatile as well as in illiquid markets. The AIFM is required to hold systems suitable to process the validation of the AIF's asset values.

EVGN 8

Property Valuation and Energy Efficiency

1. **Introduction**
2. **Scope**
3. **Definitions**
4. **Statement of the Guidance**
5. **Commentary**

1. Introduction

1.1 Energy is often one of the more significant costs of occupying property. The requirements of heating, lighting and, increasingly, air conditioning combine with the demands of services, from cooking to lifts, and the energy needs of the processes for which the building is used. Potential purchasers and tenants are usually interested, at least as a matter of practicality, in the availability and cost of suitable energy for their needs. Some may wish to demonstrate particular levels of efficiency or that the energy comes from renewable sources.

1.2 More widely, buildings are held to account for about 40 per cent of CO₂ emissions from the EU and so energy concerns are now a major factor driving legislation affecting property. Both the EU and individual countries hope to influence property occupiers to change their behaviour, reduce consumption, improve efficiency and make greater use of renewable energy sources. In this, buildings distinctively have a much longer life cycle than equipment or systems. Many, especially houses, are more than a century old. The European Commission expects 75 to 90 per cent of current buildings to be in use in 2050 with an annual demolition rate of 0.1 per cent and a refurbishment rate of 1.2 per cent.

1.3 *Directive 2010/31/EU on the Energy Performance of Buildings* developed the approach of its predecessor 2002/91. Its Preamble notes that:

“The sector is expanding, which is bound to increase its energy consumption”

and so states that:

“reduction in energy consumption and the use of energy from renewable

sources in the buildings sector constitute important measures needed to reduce the Union's energy dependency and greenhouse gas emissions". (Para 3)

"It is necessary to lay down more concrete actions with a view to achieving the great unrealised potential for energy savings in buildings and reducing the large differences between Member States' results in this sector." (Para 7)

As a Directive its provisions are then implemented by legislation and administration in member states.

1.4 As part of the February 2015 EU Energy Union policy, the European Commission held a consultation on the experience and effectiveness of the Directive in 2015 with a view to its possible revision by the end of 2016. Such a review was envisaged by the Directive's Article 19. The Commission has said that it wishes to increase the number of deep renovations of property (giving savings of 60 per cent or more) and the refurbishment rate above 2 per cent per annum, recognising that the financing of this is a challenge (*Evaluation of the Energy Performance of Buildings Directive 2010/31/EU; June 2015*). Review is driven by the intention to achieve a 30 per cent reduction in greenhouse gases by 2030 from sectors, such as property, that are not covered by the Emissions Trading System.

1.5 *Directive 2012/27/EU on Energy Efficiency* requires, among many other measures:

- that central governments only purchase buildings that are energy efficient and make energy-efficient renovations to at least 3 per cent of the buildings they own and occupy;
- member states are to prepare long-term national building renovation strategies, including policies to stimulate the deep renovation of buildings, as part of their EU-supervised National Energy Efficiency Action Plans;
- the roll-out of individual or smart metering;
- member states to address the problems that can be posed for action on energy efficiency improvements by the separate interests of owners and tenant/occupiers, including national rules and measures to regulating decision-making processes in multi-owner properties.

Energy distributors are to be subject to national energy efficiency obligation schemes so that from 2014 to the end of 2020 they have achieved a cumulative energy saving equal to 1.5 per cent of the annual energy they sell to final customers. Encouraging energy saving in property may be one means by which they do this.

1.6 Attitudes in the market place may respond to this policy framework as it develops. The professional valuer is to report his opinion as to the value of the property under his instructions to the client on the basis of the evidence available to him. That will

include the evidence of values from the market place. That is essential to the concept of "Market Value". Energy costs and efficiency will be one part of this matrix and so one of many issues for the valuer to take into account.

2. Scope

This Guidance Note applies to consideration of energy efficiency issues in the valuation of property and particularly to the effect of the measures to be taken by EU member states under the Energy Performance of Buildings Directive. The Commentary here is based on that Directive. Valuers should be aware that while member states are bound to implement the Directive, they are free to set higher standards. Note also that the Directive itself is being reviewed and its provisions may be revised.

3. Definitions

3.1 The definitions cited here are, unless otherwise stated, drawn from the Energy Performance of Buildings Directive 2010/31/EU (referred to here as "the Directive").

3.2 "**Building**" means a roofed construction having walls, for which energy is used to condition the indoor climate;" (Article 2(1))

Note – This definition excludes from the energy performance standards and Energy Performance Certificate (EPC) regimes a number of structures that might normally be referred to as buildings, particularly those where no effort is made to heat or cool them.

3.3 "**Energy performance certificate**" means a certificate recognised by a Member State or by a legal person designated by it, which indicates the energy performance of a building or building unit, calculated according to a methodology adopted in accordance with Article 3" (Article 2(12))

3.4 "**Energy performance of a building**" means the calculated or measured amount of energy needed to meet the energy demand associated with a typical use of the building, which includes, inter alia, energy used for heating, cooling, ventilation, hot water and lighting;" (Article 2(4)).

3.5 "**Nearly zero-energy building**" means a building that has very high energy performance as determined in accordance with Annex 1. The nearly zero or very low amount of energy required should be covered to a very significant extent by energy from renewable sources, including energy from renewable sources produced on site or nearby" (Article 2(2)).

3.6 “**Technical building system**’ means technical equipment for the heating, cooling, ventilation, hot water, lighting or for a combination thereof, of a building or building unit;” (Article 2(3)).

4. Statement of the Guidance

4.1 The professional valuer is to report his opinion as to the value of the property under his instructions to the client on the basis of the evidence available to him. The energy efficiency of a building may be relevant to a property’s value, whether because it is appreciated in the market place or because of regulatory issues, as where a particular EPC rating may affect the current or future use of a property. Those issues, with the associated energy costs, will be only one factor in this assessment.

4.2 Where a valuation is being prepared in a context to which construction, sale, or lease to a new tenant is relevant, then the energy performance certificate (EPC) rating and any salient recommendations it may make should be reported and, as the valuer judges appropriate, taken into account in the valuation.

4.3 In particular:

- when considering a property with an EPC, the valuer will take account of the rating and recommendations so far as relevant, reflecting market circumstances, in providing his opinion as to the value of the property on a recognised basis of valuation;
- when asked to advise on or assist with the determination of whether works constitute a “major renovation” in a member state that has adopted the option based on cost and value, the valuer when so instructed should:
 - i. judge whether the renovation required by the building is sufficient to trigger any upgrading of the building’s required minimum energy performance as a consequence;
 - ii. according to the valuer’s skills and instructions, estimate, obtain a reputable estimate or advise the client to obtain an estimate for the cost of that upgrading so that the client may make an informed decision.

5. Commentary

5.1 General

5.1.1 Among its measures most relevant to valuations of property, the Directive requires member states to establish:

- integrated energy performance standards, based on both the thermal characteristics of each building and its renewable energy systems, to be:

- set by each member state for all buildings
- enforced not only for new buildings and but also for existing buildings subject to a “major renovation”, and
- energy performance certificates (EPCs). Existing EPCs, provided under the 2002 Directive, remain valid.

Alongside those, it requires that by 2021 all new buildings meet a “nearly zero-energy use” requirement and imposes a regime for the regular inspection of larger heating and air conditioning systems with resulting recommendations.

5.1.2 The valuer will need to understand the provisions applying in the member state where the property is situated.

5.2 New Buildings – Nearly Zero-Energy

5.2.1 “Member States shall ensure that:

- a. by 31 December 2020, all new buildings are nearly zero-energy buildings; and
- b. after 31 December 2018, new buildings occupied and owned by public authorities are nearly zero-energy buildings.”

Article 9(1)

5.2.2 This is a strict obligation although Article 9(6) allows member states not to apply it in “specific and justifiable” cases where the cost-benefit analysis over the economic cycle of the building in question is negative.

5.3 Existing Buildings and “Major Renovation”

5.3.1 While energy performance standards are to be set for existing buildings, the Directive does not require their enforcement save when this is triggered by a “major renovation”.

5.3.2 “Major renovations” - The Recitals point out that “Major renovations of existing buildings, regardless of their size, provide an opportunity to take cost-effective measures to enhance energy performance.” (Recital 16).

5.3.3 Article 7 of the Directive states: “Member States shall take the necessary measures to ensure that when buildings undergo major renovation, the energy performance of the building or the renovated part thereof is upgraded in order to meet minimum energy performance requirements ...”.

5.3.4 A valuer could be instructed by a client concerned as to whether proposed works amount to a “major renovation” with the consequent requirement under the Directive to meet current energy performance standards. The Directive sets out two

options from which each member state is to select its tests to determine whether works are a “major renovation”:

“major renovation” means the renovation of a building where:

- a. the total cost of the renovation relating to the building envelope or the technical building systems is higher than 25% of the value of the building, excluding the value of the land upon which the building is situated; or
 - b. more than 25% of the surface of the building envelope undergoes renovation.
- Member States may choose to apply option (a) or (b).” (Article 2(10))

5.3.5 Where a valuer is required to advise on this, he should know which option has been chosen in the relevant member state.

5.3.6 It may be a matter of interpretation in the light of the facts of any case whether an extension amounts to a renovation (which in the absence of any further definition, is assumed to be limited to its usual meaning of improving or putting into good condition by renewing and restoring).

5.3.7 For option (a), the Directive does not specify the basis on which “value” is to be assessed – by default, it is assumed to be Market Value assessed in accordance with EVS 1 unless there is good reason to adopt another basis (though paragraph 16 of the Directive’s Recitals do refer to both its “actuarial value” and the cost of reconstruction as possible bases). The tenure of the building does not seem to be relevant to this assessment. It is a comparison of the cost of the proposed work with the value of the building, having excluded the value of the land under the building. The test does not ask for an apportionment of value but the exclusion of the value of the land. That would mean that in most cases, this test appears to require two valuations for any building that would ordinarily be sold with its underlying land:

- one of the building as it would be sold with the land;
- another of the underlying land without the building (likely to be with the benefit of any development value).

The resulting net figure is then to be compared with the cost of the proposed works. As cost is a different concept from value, especially for the adaptation of buildings, this test may often require the upgrading of the energy performance of the building where the value added by the work is less than 25 per cent of the apportioned value of the building.

5.3.8 Option (b) requires an assessment of physical characteristics rather than values, namely:

- the total external area of the building, including its walls and roofs, and
- how much of that area would be subject to the renovation.

This might appear to mean that a purely internal renovation would not be caught by option (b) but could be caught by option (a).

5.3.9 If the renovation proves to be “major” under the test adopted by the member state, the Directive gives each member state the freedom to decide whether it is the whole building or just the renovated part of it that is to be upgraded to minimum energy performance standards. The valuer should be aware of the local rules on this point.

5.3.10 As option (a) turns on value, where this option is selected by the member state, the valuer when so instructed should:

- judge whether the renovation required by the building is sufficient to trigger any upgrading of the building’s required minimum energy performance as a consequence;
- according to the valuer’s skills and instructions, estimate, obtain a reputable estimate or advise the client to obtain an estimate for the cost of that upgrading so that the client may make an informed decision.

5.4 Energy Performance Certificates (EPCs)

5.4.1 An EPC is to record an assessment by an approved inspector of the energy efficiency of a building using a standard rating basis and making comparisons and advisory recommendations for its improvement. The rating will summarise in one letter or number the building’s thermal characteristics and the extent of the building’s reliance on energy from renewable sources, following the Energy from Renewable Sources Directive 2009. These ratings are based on standardised methodologies for assessing building construction and typical uses. They do not therefore necessarily reflect either the actual thermal characteristics of the building or any actual use of it made by any one occupier. An EPC cannot be valid for more than ten years. Certificates issued under the 2002 Directive remain valid within that period. The reported efficiency rating is now to be shown in advertisements marketing the property and the EPC is to be given to the prospective purchaser or tenant.

5.4.2 Having a valid EPC is a legal requirement for the construction, sale, or lease to a new tenant of most buildings and for all buildings occupied by public authorities with a useful floor area of over 250m². The energy performance certificate or a copy thereof is shown to the prospective new tenant or buyer and handed over to the buyer or new tenant.” (Article 12(2).

5.4.3 The policy purpose of the EPC in informing the property market is described in the Directive’s Recitals:

“The prospective buyer and tenant of a building or building unit should, in the energy performance certificate, be given correct information about the energy performance of the building and practical advice on improving such performance. The energy performance certificate should also provide information about the actual impact of heating and cooling on the energy needs of the building, on its primary energy consumption and on its carbon dioxide emissions.” (Recital 22)

5.4.4 Is an EPC Needed? - When considering a building as part of valuing a property, the valuer may usually wish to determine whether an EPC is required for it and, if so, check that a valid one has been obtained.

5.4.5 Subject to the exceptions noted below, an EPC is mandatory for:

- buildings that are:
 - constructed,
 - to be sold,
 - to be rented to a new tenant;
- buildings with a total “useful” floor area over 250m², occupied by a public authority and frequently visited by the public.

5.4.6 Unless so instructed, it is not the valuer’s responsibility to obtain the EPC or a report on any technical building systems.

5.4.7 Buildings Not Needing EPCs - As the Directive’s definition of a building for these purposes (see 3.2 above) only relates to roofed structures with walls “for which energy is used to condition the indoor climate”, an EPC is not required for buildings where no effort is made to alter the climate within the building. These are outside the EPC regime. These might include some storage and many agricultural buildings.

5.4.8 Member states are also free to exempt the following categories of buildings from the obligation to issue an EPC:

- a. buildings officially protected as part of a designated environment or because of their special architectural or historical merit, in so far as compliance with certain minimum energy performance requirements would unacceptably alter their character or appearance;
Note – This exclusion applies only as far as compliance would change the character or appearance of the building, as perhaps where a historic building’s appearance would be altered by double glazing or external insulation. Its application to such buildings may therefore be a matter of interpretation of the relevant national law implementing the Directive on this point.
- b. buildings used as places of worship and for religious activities;

Note – Buildings used for religious activities might include such places as monasteries and facilities for ritual purification. It would not appear to matter that such buildings may also have other uses.

- c. temporary buildings with a time of use of two years or less, industrial sites, workshops and non-residential agricultural buildings with low energy demand and non-residential agricultural buildings which are in use by a sector covered by a national sectoral agreement on energy performance;

Note – This exclusion appears to come in three parts:

- temporary buildings might include those used on construction sites and for specific events as well as those on temporary planning permissions;
- it appears that the “low energy demand” exclusion not only applies to non-residential agricultural buildings but also qualifies industrial sites and workshops. “Low energy demand” is not defined in the Directive. Some member states may choose to define the term;
- sectoral agreements on energy performance covering agricultural buildings are most likely to apply to buildings housing pigs, poultry and some horticultural enterprises.

- d. residential buildings which are used or intended to be used for either less than four months of the year or, alternatively, for a limited annual time of use and with an expected energy consumption of less than 25% of what would be the result of all-year use;

Note - This is most likely to cover seasonal housing, whether for holidays or work.

- e. stand-alone buildings with a total “useful” floor area of less than 50 m².

5.4.9 When valuing a building which might fall into one of these categories, the valuer should, where relevant, check whether it is exempted from the energy performance certification (and also the renovation requirements discussed above) in the jurisdiction in question.

5.4.10 Using an EPC - The Directive does not create a *common* format for the EPC throughout the EU. EPCs vary between member states, and sometimes within them. The Directive does instruct the European Commission to adopt a voluntary EU certification scheme for non-residential buildings (Article 11(9)). Valuers may thus see EPCs in different national formats as well as those under the voluntary common EU scheme.

5.4.11 Where a valuation is on the basis of Market Value (see EVS 1) or relevant for the purposes of sale or lease to a new tenant of a qualifying building, it should take account of a valid current EPC. These circumstances would usually include a valuation for secured lending as the mortgagee is also commonly interested in the disposal value of a property. The weight, if any, given to the EPC will be a matter for the professional skill of the valuer. It may be that in some countries there will, in time, be additional

requirements for or liabilities on the sale or letting of properties with a poor EPC rating.

5.4.12 The valuer should have access to the EPC (recording its supplier, registration reference, reported energy rating and expiry date) and establish that it is a current one for the purposes of the instructed valuation. The relevance of an EPC may be affected by any changes to the building since it was issued.

5.4.13 Where an EPC is required, the reported efficiency rating may have an impact on value. The valuer is to judge that from his knowledge of the market place, in which effects on value, if evident, may vary by type of property, region and other factors.

5.4.14 The valuer should advise the client where an EPC is not available or, if relevant, not a trustworthy indicator of the building's energy efficiency and should assess the situation for his report as seems appropriate in the circumstances and available knowledge.

5.4.15 The potential for buildings to have their energy efficiency upgraded by "retro-fitting" may be recognised in their Market Value. Equally, where that work would not be cost-effective, its potential cost may depress values. In such circumstances, the valuer may judge the significance and impact of the recommendations made by the EPC to improve the efficiency of the building.

5.4.16 It will be for the valuer's professional judgment to determine whether and how anything more than the existence and facts of the EPC is reported in the valuation.

5.4.17 Any significant recommendations in reports on technical building systems may also be taken into account where relevant.

5.4.18 The valuer may on occasion be instructed to advise the client on economic improvement of the property in the light of the EPC. The valuer should only do so if it is within his professional competence. If the valuer undertakes this task, his aim would be to use the analysis of the EPC and the actual circumstances of the property to help the client in forming a judgment on his possible approaches to the issues raised. Common key points in this may include:

- the energy rating reported for the building (on a scale either from A to G or 0 to 100);
- the annual energy demand;
- the cost of that annual energy use;
- comparison with current relevant standards;
- the condition of the technical systems in the building;
- energy efficiency improvement measures, including those recommended by the EPC, with their associated costs and returns; and
- any other value that may be achievable by a different rating if, according to any national rules, it makes it possible to sell or let a property more easily.

5.4.19 The valuer will take account of the rating and recommendations so far as relevant, reflecting market circumstances, in providing his opinion as to the value of the property on a recognised basis of valuation.

EVGN 9

EMF and TEGoVA Commercial Loan Specification

The document set out below was issued by the European Mortgage Federation in October 2014 after discussions between the Federation and TEGoVA.

EMF & TEGoVA Commercial Mortgage Valuation Specification

1. **Introduction**
2. **Scope**
3. **General Definitions**
4. **Commercial Loan Specification**
5. **Appendices**

1. Introduction

This Specification is intended to be used by valuers when providing valuation advice to lenders that are members of the EMF or members of the member associations of the EMF and where the purpose of the valuation is secured lending.

2. Scope

2.1 This specification applies to valuations prepared prior to, and in consideration of, a new loan, a replacement loan or an additional loan.

2.2 This specification does not apply to valuations where the subject property is for residential use, nor property that is adapted for use as a place to live.

2.3 This specification provides best practice principles; lenders and valuers will agree individual terms and requirements in accordance with national rules and/or legal frameworks.

3. General Definitions

3.1 Valuation Standards refer to the current edition of Standards published by those standard setters recognised by the EU, namely, the International Valuation Standards Council (IVSC), the European Group of Valuers' Associations (TEGoVA) and the Royal Institution of Chartered Surveyors (RICS).

3.2 Terms of Engagement are the specific terms of the contract between the valuer and the client. These Terms are submitted to the client or prospective client when instructions are received to provide a valuation service. To accord with the requirements of this specification, the client must be a named lender and not a third party.

3.3 Market Value is as currently defined by the standard setters as shown in 3.1 above.

3.4 Mortgage Lending Value is defined as - The value of the property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property. Speculative elements shall not be taken into account in the assessment of the Mortgage Lending Value.

3.5 A **Qualified Valuer** (including valuers working for valuation companies) is defined as the person who is responsible for preparing and supervising valuations and takes responsibility for them.

3.6 Commercial Property refers to non-residential property.

4. Commercial Loan Specification

4.1 Terms of Engagement

4.1.1 Terms must be agreed in writing before the valuation is submitted to the lender.

4.1.2 Where valuations of a similar nature are regularly provided to the same lender and the valuer or firm has previously provided terms of engagement that have been agreed, the valuer should confirm in writing that these terms continue to apply unless otherwise agreed with the client. The client should be notified in writing of any subsequent variations as soon as they come into force.

4.1.3 Explicit reference to the following must be included within the terms agreed:

- a. a declaration that no conflicts of interest exist in respect of the property or the

- lender's customer; or, in cases where a potential conflict has been identified, a statement that where a conflict may arise, that the lender has acknowledged disclosure and agreed that the valuer should proceed with the valuation;
- b. confirmation of the status of the valuer as being an external or an internal valuer, having the necessary experience, qualifications and expertise to undertake a valuation for lending purposes of the specific property;
 - c. confirmation that the named valuer is an independent valuer;
 - d. details of the fee payable, or the basis upon which the fee will be calculated, together with any other costs or charges including tax;
 - e. confirmation that the valuer has sufficient professional indemnity insurance for the property being valued;
 - f. If the parties have agreed a maximum limit on the valuer's potential liability, confirmation of the amount of that limit;
 - g. confirmation that all aspects of the instruction will be subject to non-disclosure;
 - h. a statement to confirm that the valuation will not be undertaken by a sub-contracted valuer; or if part or all of the instruction is sub-contracted, that written client agreement has been obtained.
 - i. confirmation of the date of the report;
 - j. confirmation that the valuation will be prepared in accordance with the requirements of this specification.
 - k. a statement as to whether the valuer is required to measure the property. If the valuer is not to measure, state that the report will contain a statement that the valuer reserves the right to alter their valuation if subsequent measurement of the building shows that the actual areas are significantly different from those adopted.

4.1.4 Valuers must demonstrate within the terms of engagement that they are competent to give advice on comparative property and sector-related risks. While it is the role of the lender to assess risk as it relates to the financial status of the borrower or the overall geographical, sector, and client bias, a valuer may be consulted on any of these matters because of their specialist knowledge.

4.1.5 Valuers are not expected to provide commentary or recommendations in respect of the mortgage term or the amount to be advanced. These decisions are solely the responsibility of the lender.

4.1.6 Where lenders have standard terms of engagement that refer to this specification the valuer must scrutinise those terms to ensure that all relevant requirements of the valuation standards set together with those provided in this specification are addressed.

4.1.7 Explicit reference to this specification within terms of engagement provided by either the valuer or the lender removes the requirement to include reference to the

following assumptions and special assumptions:

- a. vacant possession being provided upon completion of the purchase; or in the case of an investment property, that the occupational lease/s would continue;
- b. valid planning permissions and statutory approvals for the buildings and for their use had been obtained and complied with;
- c. that the valuer is not required to undertake a search of statutory notices;
- d. no deleterious or hazardous materials had, or were being used in the construction of the property or outbuildings;
- e. the land and buildings are not contaminated and are free from environmental hazards;
- f. an inspection of the title documents to the property would not reveal any unusual or especially onerous restrictions or encumbrances and that no unusual outgoing interests were required or provided for within the title documents;
- g. that the result of any inspection of notices and searches normally conducted as part of a pre-contract review would not indicate that the property and its condition, use or intended use were, or would be, unlawful;
- h. that the valuer reserves the right to revise the figures reported if they became aware of the existence of any defects that were not apparent during the limited inspection of the property.

4.1.8 In respect of a property to be developed or under construction, the valuer will, unless instructed otherwise, provide a valuation on a special assumption that the construction had been satisfactorily completed in accordance with planning permission/s granted and that it satisfies other statutory and building approval requirements.

4.1.9 Where a lender requires an indication of rebuilding costs, the lender should be advised that such a figure is for general guidance only, and could only be provided where the building has been constructed using modern materials and is not protected or classified as a heritage property. Provision of an assessment of insurable value in accordance with the requirements of the standard setters may require a separate instruction.

4.2 Inspection and Investigations

4.2.1 The property must be inspected both externally and internally by the named valuer.

4.2.2 The nature of the on-site inspection will depend upon the property, national legislation and practice, but the valuer should note the main characteristics of the property and all matters which will impact on the valuation or might affect any resale of the property.

4.2.3 The location, extent and condition of the property should be photographed, both internally and externally.

4.2.4 Where the inspection reveals matters that relate to any assumption or special assumption reported in the terms of engagement, or matters included within (a-h) in 4.1.7 above, these matters should be recorded and referred to the client.

4.2.5 Any use of the property that is likely to be outside the uses permitted by the local authority should be recorded and reported.

4.2.6 Any recent alterations or extensions to the property should be recorded and reported.

4.2.7 Where the inspection reveals the obvious use of deleterious or hazardous materials in the construction, this must be recorded, reported and further instructions requested.

4.2.8 Where the inspection reveals a suspicion of contamination or other environmental hazards, the valuer should record the suspicion and report to the client with a recommendation for further investigation by specialist consultants or contractors.

4.2.9 Where the inspection reveals a suspicion that hidden defects exist that could have a material effect on the value of the property; the valuer should record this suspicion and report to the client with a recommendation that a more detailed investigation is undertaken. In exceptional circumstances the valuer might recommend to the lender that the valuation report is withheld pending the results of those further investigations.

4.2.10 Where a lender requires an indication of rebuilding costs, the valuer should estimate the expense of demolishing and clearing away the existing structure, together with the cost of rebuilding it to its existing design in modern materials, using modern techniques, to a standard equal to the existing property and in accordance with current building regulations and other statutory requirements.

4.2.11 Where the lender determines the format of the report and the valuer records material matters during an inspection that might have an impact on value, these matters should be reported, irrespective of the limitations of the formatting.

4.2.12 Where the inspection reveals defects that need to be costed in order to estimate the value of the property in its current condition, the valuer should either provide the estimate, assuming that such estimation is within their ability, or seek specialist advice. Submission of the valuation should be deferred pending the results of the specialist advice being provided.

4.2.13 Guidance relating to the extent of inspection and investigation expected of the valuer is outlined at Appendix A.

4.3 The Valuation Report

4.3.1 The valuation report should be concise and reflect the extent of inspection and investigation undertaken. It is recommended that the valuer should have regard to the profile of risk criteria for valuations adopted by members of the EMF as part of the risk management process for lending, as set out at Appendix C.

4.3.2 The valuation report should record the instructions for the assignment, the basis and purpose of the valuation and the results of the analysis, including, where appropriate, details of comparable evidence used in the approach to justify an opinion of value. Rent and yields are included.

4.3.3 The Valuation Report must provide a clear and unequivocal opinion as to value, as at the valuation date with sufficient detail to ensure all matters agreed with the client in the terms of engagement and all other key areas are reported.

4.3.4 The opinion of value reported must not be influenced by pressure brought by the client or a third party to produce a particular result in terms of the valuation or any other associated advice. Where a valuer has reported the existence of a conflict of interest to the client and been instructed to proceed with the valuation, that conflict should be referenced in the report as well as the terms of engagement.

4.3.5 The valuation report must not be ambiguous, must not mislead the reader in any way nor create a false impression. The report should, as far as possible, avoid the use of technical terms that may not be understood by the client.

4.3.6 Where the market for the property being valued is affected by uncertainty and this is relevant to the valuation, the valuer should comment on the reasons and degree of uncertainty within the report.

4.3.7 Where the market for the specific type of property being valued is volatile or unstable the valuer may state the period after which the valuation will be deemed to have expired.

4.3.8 The valuer should include reference in the report to the use of this specification and, exceptionally, the extent and reasons for any departure or why any key part of the valuation process has been omitted.

4.3.9 Matters that are required to be included within a valuation report are listed at Appendix B.

5. Appendices

Appendix A - The Extent of Inspection and Investigation

Appendix B - Contents of a Valuation Report

Appendix C - EMF Profile of Risk Related Criteria for Valuations

APPENDIX A

The Extent of Inspection and Investigation

1. The extent of inspection and investigation undertaken must satisfy the provisions of this specification as set out in 4.2 above.
2. Inspection of any roof space, space above the eaves and areas above a suspended ceiling is not required.
3. Areas that are not available for inspection, such as telecommunications rooms, heating / cooling plant rooms, laboratories, and other secure areas must be noted and reported with additional comment provided if the valuer believes that the condition or presence of any such areas not inspected might impact on value or any risk associated with any loan, stating the rationale for the additional comment.
4. The valuer is not required to move any furniture, fittings, plant or machinery nor lift any floor covering or inspect areas such as pits or raised floor areas beneath the floor. The valuer is required to note and report any impact that might follow the removal of items in-situ both in terms of any potential change to the structural integrity of the building or where exposure to the elements may result.
5. Testing of mains services is not required, though comment will be expected as to the age, apparent capacity and condition of each service.
6. The main characteristics of the property should be noted and measured where practicable, including a note as to the basis of measurement. In countries where measuring properties is not normally undertaken by valuers, or in cases where the parties have agreed that the valuer is not to take measurements, the valuer should nevertheless be aware of the need to check visually that the size of the property inspected appears to correspond with the areas provided. Specific reference should be made to the following:
 - a. site description including reference to hard standing, car parking, circulation areas, recycling areas and external storage;
 - b. accessibility including any evidence of restricted access or easements;
 - c. site location and topography including comment relating to the proximity of streams, rivers or coastal waters;
 - d. orientation and shape;
 - e. potential damage or contamination;
 - f. description of all permanent buildings including materials used and

- finishing materials applied to the elevations, fenestration and roof; providing particular comment where non-standard materials have been utilised;
- g. current and potential lawful use of the buildings, with specific comment where he has reason to believe that this might be restricted as a result of legislation, regulation, lease terms or any legal action by third parties;
 - h. approximate year of construction;
 - i. date and scope of any refurbishments or alterations;
 - j. any completed/planned/required repairs or refurbishment noting any damage or obvious contamination;
 - k. duration of the remaining economic life of the main building together with comment where specific major expenditure might be expected beyond normal maintenance and refurbishment;
 - l. certified energy performance rating;
 - m. heating (type) and condition on the basis of a cursory inspection providing specific comment where unlawful or undesirable products (such as hydrochlorofluorocarbon 22 (R-22) gas) are suspected to be used in connection with air conditioning or refrigerant plants;
 - n. any special fixtures and fittings;
 - o. condition and state of repair with recommendations as to any required improvements are to be reported;
 - p. comment relating to areas not inspected;
 - q. comment relating to defects found either at the property or nearby that are known to exist at that location. Examples include flooding, mining settlement, subsidence, woodworm and invasive vegetation.
- 7.** Where the property forms part of a building or block, details relating to the following should be recorded and reported:
- a. common areas including recreational areas and dedicated parking provision;
 - b. lifts and stairwells including condition and state of repair;
 - c. areas for communal or individual storage, waste and recycling areas;
 - d. external plant including turbines, heating or other facilities;
 - e. fire safety and security areas.
- 8.** Where the property is to be built or being constructed, details relating to the following should be recorded and reported:
- a. total number of properties / units / total floor area following completion of the development;
 - b. likely timescale before development activities are completed;
 - c. roads and footpaths, including comment as to whether they are expected to be maintained at public expense;
 - d. foul and surface water drainage, including comment as to whether they

- are expected to be maintained at public expense;
- e. open space and recreation areas, including comment as to whether they are expected to be maintained at public expense;
- f. any obligations relating to planning conditions, including any outstanding conditions contained within legal or planning agreements; and
- g. any other matters that might impact on value, other legal interests or resale.

APPENDIX B

Contents of a Valuation Report

1. The report should include reference to all matters included within 4.2, inspection and investigation together with all matters referred to in 4.3, contents of a report.
2. The report should include a summary of the floor areas measured or adopted by the valuer, together with a statement as to whether these are areas as measured on site, or areas provided by a third party. In the latter case the third party source should be identified and the valuer should highlight anything that might lead them to believe that the floor areas provided need to be checked.
3. Physical factors to be reported include details of the location and situation of the property, including a description of the:
 - a. macro-location; and
 - b. micro-location including statements concerning the infrastructure and accessibility of the property by foot, cycle, car and public transport.
4. A concise description of the property including reference to the recognised market category as appropriate.
5. A summary of the legal context including reference to tenure, any tenancies held or given on all or part of the property, any mixed use of the property and conformity with permitted planning use and development control requirements.
6. A commentary on the market for the property including reference to:
 - a. factors that may have a material impact on value or resale;
 - b. factors linked to the structure and the duration of the proposed loan facility where known;
 - c. situations where current values may not be sustainable due to market volatility, short-term decreases in availability or increases in demand, locations that may not sustain value in differing economic cycles and any planned or actual developments that might create market distortion; and
 - d. the potential impact of wider economic and social factors such as employment and socio- cultural spending habits within the catchment area, public transport infrastructure, legal and political risk and estimates of economic growth.

- 7.** A summary of the condition and repair of the property providing comments that relate to any obvious evidence of serious disrepair, or potential hazard to the property, and any other matters likely to materially affect the value or resale. This should include:

 - a. reference to matters that are not serious at the date of inspection, but could become so without proper maintenance and repair;
 - b. other items of disrepair or poor design, or a lack of maintenance that may adversely affect the structural integrity of the property in the future;
 - c. suspicion of any serious structural defect that requires further examination by a specialist consultant or contractor
 - d. reference to recommendations that the lender retains part of the intended loan pending completion of necessary works
 - e. recommendations that a programme of active maintenance should be instigated to prevent any material effect to value or resale;
 - f. recommendations that further investigations are instigated where there is the likelihood that any deleterious materials such as high alumina cement or asbestos had been used in the construction of the property;
 - g. recommendations that an environmental assessment or a mining report should be obtained where appropriate.
- 8.** Specific details of building insurance contracts, where required by the client, providing comment where agreed in the terms of engagement on the reinstatement costs set and the adequacy of this sum.
- 9.** A description of the valuation methodology and analysis used, reporting the approach taken in reaching the opinion of value and setting out sufficient reliable market data to justify a clear and unequivocal opinion of value. Where the property has recently been sold or agreed to be sold in the open market and where the valuer is aware of the price agreed, commentary should be provided that explains the extent to which this knowledge has influenced the opinion of value reported.
- 10.** Clear reference should be made to any assumptions or special assumptions that have been made.
- 11.** Where the property is currently being refurbished, a value should be provided for the property in its current state, as well as a value for the property following refurbishment, commenting on the refurbishment cost and its adequacy.
- 12.** Commentary should be provided on the suitability of the property as security for the lender based on an assumption of normal lending and duration terms. State how long you would consider a reasonable period in which to negotiate a sale at your opinion of value, and comment on any difficulties likely to arise if realisation became necessary.

- 13.** The opinion of value to be reported on the agreed basis, followed by a written definition of that basis. The report must be signed and dated.
- 14.** Where practicable, attach a copy of any instruction letter and the terms of engagement to the report.
- 15.** Where the property is subject to the payment of service charges and where applicable, the valuer should report on the following:
 - a. costs of repairs and maintenance to the building and grounds and the basis of the current charges payable, with specific reference made to major impending or short term liabilities that would not be covered by existing service charge agreements;
 - b. the presence or otherwise of appropriate legal agreements that ensure an equitable and enforceable pro-rata division of costs, confirming whether or not the service charge provisions are adequate;
 - c. any apparent deficiencies in the management and/or maintenance arrangements which materially affect the value or resale of the property;
- 16.** Where the property is leasehold and where applicable, the valuer should report on the following:
 - a. specific details of tenure, reporting the unexpired term of any lease, including ground leases, together with a summary of the main lease terms including the ground rent payable and any mechanism that might increase that rent. If the lease has not been made available for inspection specific mention must be made in the report;
 - b. any capital sum paid by the landlord or tenant that determined that the current rent payable was not based on the market rent when agreed reporting on any potential or actual significant change in the rent payable when the rent is reviewed in accordance with the lease contract;
 - c. any lease provision that might result in early determination of the lease;
 - d. any evidence of breaches to the lease covenants together with any evidence of outstanding claims or litigation concerning the lease of the subject property or any others within the same development;
 - e. any unusual restrictions on assignment or subletting of the property;
 - f. any significant risk to health or safety as determined by legislation, regulation or lease covenant;
- 17.** Where the property is to be built or being constructed, details relating to the following should be reported:
 - a. any warranty or guarantee offered by or on behalf of the vendor or developer in respect of the buildings, fixtures and fittings
 - b. any anticipated discount from the opinion of value stated that the lender should anticipate where the property was sold following occupation;

- c. details of any incentives offered to the lender's customer as part of the sale agreement for the property, providing specific reference to incentives that would not pass to any subsequent purchaser or might have an impact on the price achieved in any subsequent resale.

APPENDIX C

European Mortgage Federation: Profile of Risk Related Criteria for Valuations

All Types of Property

A valuation of property for lending purposes should reflect the following riskcriteria:

1. Market Risks

- Timing (present market conditions);
- Market cycles;
- Market volatility / stability / liquidity;
- Demand and supply;
- Economic stability of the market;
- Market structures;
- Attractiveness of regional markets;
- Investor or owner occupier driven market;
- Behaviour of the market participants;
- Demographic trends;
- Labour supply;
- Other investment opportunities.

2. Location Risks

- Planning and development of the immediate neighbourhood and the greater surroundings (micro & macro);
- Development of the region, the city and the district;
- Competition: micro-trends of the local economy / other alternative investment opportunities at local level;
- Suitability of the location for investment, revenues and increases in values;
- Infrastructure;
- Public utilities / local supply;
- Attractiveness of the location for companies.

3. Construction-related Property Risks

- Physical / architectural issues / quality of the property (fitting out, age etc.);
- Maintenance requirements;
- Economic efficiency;
- Environmental efficiency;
- Marketability and appropriateness for third party users;
- Flexibility for other types of use;

- Contamination / polluted land;
- Reconstruction cost.

4. Tenants / Leases

- Strength of tenants;
- Reputation of tenants;
- Cash flow risks;
- Strength of investor.

5. Fiscal risks

- Current tax situation;
- Potential positive / negative changes;
- Local tax regime;
- Regional incentives.

6. Legal risks

- Ownership;
- Planning permission;
- Country specific lease structures;
- Subsidies;
- Efficiency of enforcement (repossession) and forced sale;
- Liability for contamination.

EVGN 10

Valuations: Compliance with EVS

- 1. Introduction**
- 2. Scope**
- 3. Valuations Compliant with EVS**
- 4. Valuations that Are Not Required to Comply with EVS**
- 5. Commentary**

1. Introduction

1.1 Valuation reports produced in accordance with the requirements of European Valuation Standards (EVS) published by TEGoVA represent best practice. The Report must be produced by a qualified professional whose experience, qualification, diligence and ethical behaviour are appropriate to the instruction. The Report will provide a professional and informed opinion of value supported by a recognised basis or bases of valuation.

1.2 For clients and other valuation users, EVS ensures consistency in approach, clarity with regard to terms of engagement, basis or bases of value and proper disclosure of matters pertinent to the valuation.

1.3 Not all valuation reports will or can be compliant with EVS.

2. Scope

2.1 This Guidance Note provides clarification on those valuations that will be compliant, explains the main reasons that a valuation would not need to comply or would depart from TEGoVA requirements and provides commentary to support any reference referred to in EVS 1 – EVS 5, Guidance Notes, Information Papers, or Codes. This paper also reiterates the importance of compliant Terms of Engagement and adherence to the TEGoVA European Valuers' Code of Conduct and Ethics.

2.2 Reference to a valuer means either an individual qualified valuer or a valuation firm.

3. Valuations Compliant with EVS

3.1 A valuation will be compliant with European Valuation Standards 2016 where it has been, or will be, prepared strictly in accordance with the requirements set out in EVS 1-5 which embrace compliant Terms of Engagement and professional conduct and ethical behaviour consistent with TEGoVA's European Valuers' Code of Conduct and Ethics.

3.2 Valuations carried out where limited information is available to the valuer, or where a valuation is subject to any Special Assumptions will be compliant with EVS subject to the valuer having confirmed the limitations or Special Assumptions in writing to the client within Terms of Engagement that are agreed.

3.3 Valuations provided in a format determined by the client will be compliant with EVS on the presumption that the valuer has written agreement of EVS-compliant Terms of Engagement and the requirements set out in EVS 1-5 as referred to in 3.1 above are met.

3.4 Where a valuer or valuation company has to depart from some of the requirements of EVS in producing a valuation, the resulting valuation report will comply with EVS if the specific areas that determine departure are justified, notified to and agreed by the client, explicitly referred to in the valuation report and otherwise comply with all other aspects of EVS.

4. Valuations That Are Not Required to Comply with EVS

4.1 Valuation advice provided purely for internal purposes where there is no liability upon the valuer or a valuation company, and the advice provided is neither published nor communicated to any third party.

4.2 Valuation advice provided for the sole purpose of agency or brokerage work in connection with actual or potential instructions to acquire or dispose of an interest in property by licence, lease or sale.

4.3 Valuation advice provided as part of a statutory function or duty, where the prescribed instructions determine a departure from EVS compliance.

4.4 Advice provided in relation to an assessment of insurable value except where the main purpose of the report is to provide an opinion of value of a property and that dominant part of the report is compliant with the requirements of EVS.

4.5 Valuation advice provided in respect of a property or a legal interest in a

property without undertaking a physical inspection; irrespective of whether the advice is supported by comparable evidence, data from property databases, or data derived from the use of an automated valuation model (AVM). This includes, but is not limited to, instructions described as a 'desk-top' or 'drive-by' valuation. Such advice would not satisfy the requirements of a valuation for secured lending.

5. Commentary

5.1 While EVS 2016 is effective from 1 June 2016, updates, additional guidance and information will be subsequently published online via the TEGoVA website. Accordingly, compliance with EVS means a valuation which accords with the latest published Standards.

5.2 The requirement for agreed written Terms of Engagement is recited in EVS 4. Failure to issue written Terms that are agreed by the client will result in non-compliance with EVS 2016. In addition to the scope of works, the Terms require (inter alia) confirmation of the independence of the valuer including a statement as to whether the valuer has had previous dealings with the property or the parties. A further statement requires confirmation that the valuer has sufficient knowledge of the particular market, and the skills and understanding to undertake the valuation competently. If a valuer or valuation company is unable to truthfully provide this confirmation, then the Terms are incomplete and the valuation will not comply with EVS.

5.3 EVS 4 states that to enable a considered opinion of value to be given, that opinion should be supported, not just stated. Failure to provide appropriate support would mean that the valuation did not comply with EVS unless it has been agreed with the client in the Terms that support is not required to be reported. In such cases analysis and evaluation used in the approach to the reported value must be recorded and retained in the office file.

5.4 TEGoVA requires every member association to set, monitor and enforce a code of ethics and conduct that is at least equivalent to and consistent with the requirements of the European Valuers' Code of Ethics and Conduct unless prohibited from complying with part of the Code by law or regulation. The core values embedded in the Code include fairness, a proper professional respect for others and for standards, responsibility and trustworthiness. Any deviation from the core requirements of the Code would result in non-compliance with the requirements of EVS in any valuation produced.

5.5 Valuations provided in a format determined by the client are often used in respect of secured lending valuations of residential property. The valuer should record and retain in the office file all material matters identified during an inspection and subsequent research and investigation. Those material matters that have an appreciable

impact on value should be reported, irrespective of the limitations of the formatting to ensure compliance with EVS.

5.6 Where valuation advice is provided for the sole purpose of agency or brokerage work the valuer should state in any correspondence or report that the nature of the advice falls outside the remit of EVS.

5.7 Valuation advice provided as part of a statutory function or duty could be compliant with EVS where the valuation formed part of documentation submitted to a tax authority.

5.8 The provision of preliminary advice, a draft report or a valuation in advance of its completion will not comply with the requirements of EVS as stated in 4.4 above. In these scenarios it is recommended that the client be advised that the final report will comply with the requirements of EVS whereas the advice or opinion initially provided is provisional and subject to completion of the final report, is provided for the client's internal purposes only and is on no account to be published or disclosed.

5.9 Desktop Valuations - A first valuation of a property on a "desktop" basis, i.e. with no inspection, inside or out, will **not** be EVS compliant. Repeat valuations can be EVS compliant on a desktop basis as long as the valuer is satisfied that there have been no changes to the surrounding area since his last inspection that would have a material impact on value and as long as he has obtained the client's written confirmation that there have been no material changes to the property itself since the last inspection was carried out.

5.10 Whereas valuation advice based on the premise that the figure reported represents a 'forced sale' value or price does not comply with the requirements of EVS, a compliant valuation can be produced where the valuer establishes the nature of the specific constraints determined by the client, recites those matters in the Terms agreed, then proceeds to provide an opinion of the Market Value on those stated specific special assumptions.

5.11 Advice provided in relation to an assessment of insurable value may be set out within a valuation report that is primarily related to an opinion of value of a property. In such cases the valuation can be EVS compliant. The assessment for insurance purposes should follow the opinion of value and signature of the valuer. An assessment of insurable value in itself is not EVS compliant.

PART 2

European Codes

EC 1 European Valuers' Code of Ethics and Conduct

EC 2 European Code of Measurement

EC 1

European Valuers' Code of Ethics and Conduct

1. **Code**
2. **Introduction**
3. **Scope**
4. **Definitions**
5. **Commentary**

1. **Code**

1.1 In accordance with the Charter of Fundamental Rights of the European Union, in particular its Article 8 on Protection of Personal Data, Article 17 on the Right to Property, Article 21 on Non-discrimination and Article 38 on Consumer Protection;

1.2 And in accordance with the European Convention on Human Rights, in particular its Article 14 on Prohibition of Discrimination;

1.3 European valuers must adhere to the following Code:

- A.** Valuers are required to comply with all relevant laws and regulations of the countries in which they operate provided that such laws and regulations are compatible with the EU freedom to provide services in any member state without obstacle.
- B.** Valuers must act with integrity at all times to safeguard the trust in which they are held by colleagues, employers, clients and anyone to whom a duty of care is owed.
- C.** Valuers must maintain a level of professional knowledge and technical skill consistent with the expectation and requirements of the national professional valuation body of the valuer in respect of all legal, regulatory, ethical and contractual requirements. Valuers should not accept instructions outside their expertise.
- D.** Valuers who have access to privileged or confidential information must not use or disclose that information to achieve personal gain for themselves or others.

- E.** Terms and conditions of every valuation instruction must be agreed and set out clearly in writing before the valuation is reported.
- F.** Valuers must not offer, promise, give, demand or accept an unethical advantage or bribe in order to obtain, retain or give business or other advantage.
- G.** A valuer shall not accept, directly or indirectly, any rebate, fee, commission, discount or other benefit, monetary or otherwise, which could reasonably be seen as a conflict with the interests of the client or employer.
- H.** A valuer has a duty to provide the national professional valuation body with any significant factual information that reasonably suggests that another member of that body may have violated its Code of Ethics and Conduct.

2. Introduction

2.1 Clients expect a valuation to be prepared by a professional, qualified valuer who:

- adheres to a prescribed code of conduct;
- behaves ethically;
- is transparent in handling all aspects of the instruction from its inception through to completion. Among other matters, this will include the provision of detailed terms of engagement that:
 - cover valuation assumptions;
 - confirm that no conflict of interest exists;
 - confirm that the valuation report will correspond to the client's needs as advised together with the requirements of statute, regulation and the valuer's fiduciary duty.

2.2 Clients also expect the valuer to conduct himself appropriately and ethically, so that he takes the correct actions, has the confidence to follow them through and deal with their consequences and outcomes, doing so with integrity in the production of a competent, professional valuation.

2.3 EVS 4 makes specific reference to the requirement for the detailed terms of the valuer's engagement, covering valuation assumptions, responsibilities of the valuer, and the fee basis, to be recorded in writing (at its section 3). That Standard also requires the valuer to report his status, clarifying whether he is acting in an external and independent capacity, specifying a corporate or personal personality; or as an internal valuer (para.3.9). EVS 5 stipulates the need for openness, stating that opinions of value must be set out in a transparent and clear manner (at 3.1); while EVS 3 states:

“A valuation should be prepared by a qualified valuer and meet the requirements of a professional service. Such a person will commonly be an individual but, on occasions and in some countries, a valuation may be made by a company with a legal personality. In either situation the relevant work should be undertaken by suitably qualified individuals delivering the professional skills, knowledge, competence and independence consistent with the requirements of both EVS and the European Valuers' Code of Ethics and Conduct. Professional service determines that the skill, knowledge and competence of the valuer must be appropriate to the type and scale of valuation, with any factor which could compromise an objective assessment being disclosed.”

3. Scope

3.1 This Code encompasses personal responsibility, corporate responsibility and responsibility to the profession. The core values embedded in the Code include fairness, a proper professional respect for others and for standards, responsibility and trustworthiness. Its core requirements include acting with integrity, recognising personal interests and maintaining competence. Such professional standards extend beyond the requirements of law, entailing a balance between transparency, openness, client confidentiality and external communication with clients, stakeholders and anyone to whom an established duty of care is owed. These principles reinforce the need for professionalism, accountability and client focus.

3.2 It is for the valuer's national professional body to outline and maintain these professional values through its rules, management, monitoring and accountability structures and as necessary, disciplinary procedures. It is that body that has responsibility to monitor and enforce compliance and determine what action is taken as a result of any known or perceived activity that is inconsistent with the requirements of a Qualified Valuer.

3.3 This Code is not intended to restrict legal and reasonable business competition, but compliance does require clarity in respect of the extent of services and the responsibilities provided by the valuer.

4. Definitions

4.1 A valuer may be an individual person, a practice, firm, other corporate body or a company with legal personality undertaking or assisting with a valuation.

4.2 A qualified valuer is a valuer who meets the standards of reputation, education and experience set out in EVS 3, particularly its paragraph 4.1.

4.3 A valuer may be a contributor to a valuation report. Responsibility for the report is to be borne by a qualified valuer.

5. Commentary

5.1 TEGoVA requires every member association to set, monitor and enforce requirements that are at least equivalent to and consistent with the requirements of this Code unless prohibited from complying with part of the Code by law or regulation.

5.2 To assist compliance, the member association should provide appropriate resources for training and ensure continual professional development.

EC 2

European Code of Measurement

- 1. Introduction**
- 2. Scope**
- 3. General Definitions**
- 4. Building Measurements in Practice**

1. Introduction

All European countries use similar bases for measuring floor areas in buildings, but the way these components are grouped and coded differs vastly between various countries. This means that comparisons between many types of areas are often highly misleading. Several countries have principles governing measuring practice laid out in country specific standards and legislation. They must be strictly adhered to. In such cases, if allegations of professional negligence are made against a surveyor a general reference to the use of other codes of measuring practice or recommendations will, most likely be rejected by the Court. This also applies to measurements and calculations conducted under the recommendations of this TEGoVA Code if they differ from local practice and regulations.

2. Scope

This Code does not define how different types of property are to be measured in detail as this will depend on local conditions, standards and regulations. Valuation reports should clearly state and explain the bases of measurements used and identify any unusual bases or deviations from this Code.

3. General Definitions

3.1 Measurements will usually be made and recorded using the metric system. However, individual countries and sectors may conventionally use imperial or local measurements commonly adopted in national practice or in keeping with market practice.

3.2 Subject to any legal provisions or instructions from the client, the choice of units and the number of decimal places used will be a practical matter for the valuer to determine in the circumstances of the property and the needs that a client may be expected to have.

3.3 Units

- Distances are measures of length in one dimension and should be expressed in metres (m).
- Areas are measures in two dimensions and should be expressed in square metres (m²).
- Larger areas, rural properties and older buildings commonly have irregular shapes. Care should be taken to measure such areas accurately, perhaps by a land survey, or the use of digital maps. The areas can be expressed in hectares.
- Volumes are measures in three dimensions and should be expressed in cubic metres (m³).

3.4 Distance

- Gross length is measured as the horizontal distance between either the outer faces of exterior walls or between the centres of interior walls. The choice of basis should be stated.
- Net length is measured as the horizontal distance between the inner faces of exterior walls, disregarding internal structural components such as pillars or buttresses that are not complete walls.
- Gross height is measured as the vertical distance between the top of a finished floor and:
 - the top of the finished floor of a room situated above it, or
 - the top of the roof structure above it.
- Net height is measured as the vertical distance between the top of a finished floor and the bottom of a ceiling, floor or roof situated above it, disregarding internal structural components that are not complete ceilings.
- Free height is measured as the vertical distance between the top of a finished floor and the underside of a suspended ceiling above it.

3.5 Areas and Volumes

- Gross areas are determined by using gross lengths.
- Net areas are determined by using net lengths.
- Gross volumes are determined by using gross lengths.
- Net volumes are determined by using net lengths.

3.6 Property Boundaries and Plot Areas

- **Plot area** is the area of the property within its boundaries. This may be referenced by government agencies (such as a Land Registry, Cadastral or Local authority) measured from a horizontal plan. Plot area can then as appropriate be divided into the built area and the un-built area.
- **Built area** is the part of the plot area which is covered by buildings in their finished state both above and below ground.
- **Unbuilt area** is the remaining part of the plot area which is not classified as built area.

3.7 Identifying External Boundaries - Valuers should be careful to establish that they have an accurate understanding of the boundaries of the property. It is important to establish whether and which boundary features belong to the property and so be certain of the line of the boundary with adjacent properties. This also applies to party walls between buildings.

3.8 The area of the property as documented for the valuer may not be the correct one. Older documentation may be obsolete.

3.9 Land may, for example, have been subject to compulsory purchase or subdivided. Property areas may also change when boundaries alter as a result of agreements between neighbouring parties who may not always formally register their agreement.

3.10 Boundaries such as woodland edges, tree lines, hedges and rivers may not prove to be precise descriptions and can change over the years. Fences and other markers may be incorrectly placed or have been moved and consequently the GPS measurements used in preparing digital maps may not represent the true position.

3.11 Where boundaries are not precisely recorded or are in dispute, there may be local practices and interpretations which may offer presumptions for identifying the boundary.

3.12 Measuring Boundaries - the methods for recording boundaries and measuring the areas within them have developed substantially from measuring distances and angles to global positioning and electronic mapping. In each case, the measurement will only be as good as the limitations of the method used – even the global positioning systems available for commercial use work to certain tolerances and may be affected by military or other considerations.

3.13 The internet now offers many opportunities to view property, whether from the air or the street. This can be a useful tool, perhaps especially for a preliminary or a general view. However, the pictures may be dated and the property could have changed since

they were taken. There are particular problems in taking measurements from such services and these should not be relied upon.

3.14 Where working from any form of records, as for desk top valuation, the data as to measurements will only be as at the date they were recorded and will be subject not only to changes that may have occurred since but to any omissions or errors in their collection.

3.15 The valuer should cite the source (and its date) for the property area reported in his valuation.

3.16 In some cases, the value of the land can be influenced by the topography of the land which may give it a greater or lesser usable area - sloping and undulating farmland may offer a larger croppable area than flat land.

3.17 Classification of Types of Plot Areas

a) Natural landscape:

- forests
- greens including individual plants
- planted areas
- agricultural land which may be further divided by its use, quality or other characteristics including its qualification under the specific rules of subsidy schemes
- natural expanses of water
- other natural landscapes (sand, rocks)
- land neighbouring or on the foreshore of tidal waters

b) Paved areas:

- paths for pedestrians or cyclists
- roads for light and heavy vehicles
- parking areas including internal roads
- sports fields and playgrounds including sport greens and swimming pools
- railways

c) Structural units:

- walls and other internal boundary features
- protection systems (against noise and light)
- ramps, stairs, steps
- bridges, catwalks
- canopies, shelters, pergolas
- water basins, fountains

d) Technical units:

- water supply

- waste water
- gas supply
- heating and cooling services
- earth heat exchanger
- other technical units

Specific Definitions of Building Areas

3.18 Site area is the part(s) of the plot area used for one or more buildings or intended for their construction.

3.19 The Building Envelope (BEA) is the plan of the part of the site area that is physically occupied by the building both above and below ground, using its maximum dimensions.

3.20 The Building Footprint (BFA) is the plan of the part of the site area that is physically occupied by the building above ground level, using its maximum dimensions.

3.21 Gross External Area (also called Gross Floor Area (GFA)) is the area within the outside of the exterior walls of the building envelope and so includes the thickness of the perimeter wall of the building (“extra muros”).

3.22 Exterior Construction Area (ECA) is the area of the perimeter walls themselves.

3.23 Gross Internal Area (also called Internal Floor Area (IFA)) is the Gross External Area after deducting the Exterior Construction Area (“intra muros”). Thus, $GLA = GFA - ECA$.

3.24 Interior Construction Area (ICA) is the area of the internal structural components of the building within the perimeter walls, so recording the area taken up by load bearing columns and supporting walls.

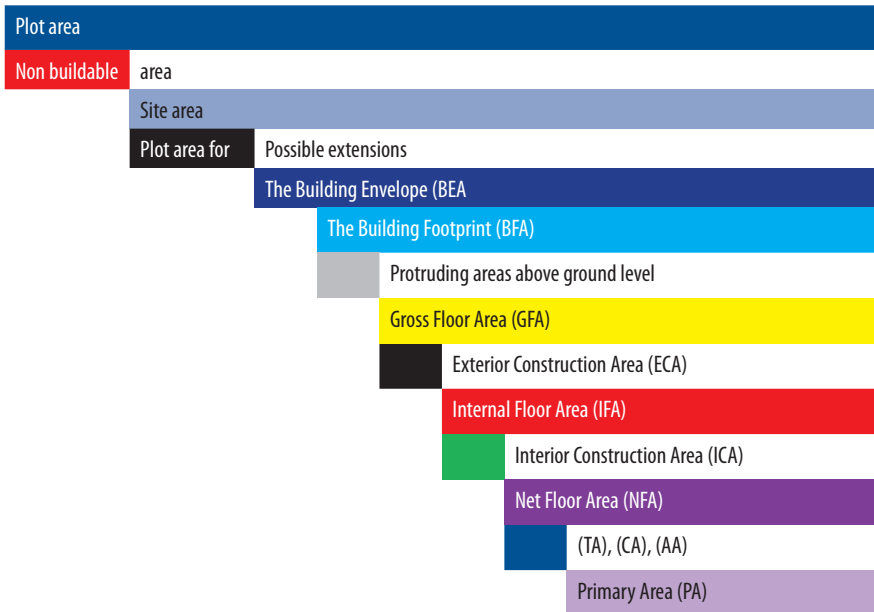
3.25 Net Floor Area (NFA) (also called the Effective Floor Area) is the Internal Floor Area (IFA) after deducting the Interior Construction Area (ICA). Thus, $NFA = IFA - ICA$.

3.26 GLA is defined as the total floor area designed for the occupancy and exclusive use of tenants, including basements and mezzanines. GLA for retail premises is typically calculated by measuring from the building line in the case of street frontages, and from the inner surfaces of the other outer building walls and from the inner surfaces of the corridor and other permanent partitions and to the centre of partitions that separate the premises from adjoining rentable areas. No deductions are made for vestibules inside the building line or for columns or projections necessary to the building. No additions are made for bay windows extending outside the building line.

3.27 Areas for Technical Services (TA), Circulation (CA), Amenities (AA) etc. are the areas common to all users, measured as net floor area.

3.28 Primary Area (PA) is the portion of the Net Floor Area (NFA) used for supporting the core business needs and work processes, for example TA - TecÚical Area, CA - Circulation Area, AA - Amenity Area.

Figure 1 – Illustration of the various types of areas and their relationships.



4. Building Measurements in Practice

4.1 These measurements will be of all available space in a building on each relevant storey meeting the definition in question.

4.2 Gross Floor Area (GFA)

- (a) Each floor should be measured to include the outside faces and projections of the enclosing wall. The full thickness of the building's perimeter wall is included in this measurement. Non-functional areas such as large open areas (without a floor) should not be included - if such areas are to be included their area must be specified.

(b) The measurement should include areas occupied by:

- internal walls, partitions, columns, stairwells, lifts, escalators, air (or other) vertical ducts;
- lift motor rooms, central heating or air-conditioning (ventilation) plant rooms, fuel tank rooms, electricity transformer and/or low tension rooms, corridors and other circulation areas, all sanitary areas;
- open-sided covered areas, ramps, enclosed parking areas, storage rooms, archive rooms (basement).

4.3 Internal Floor Area (IFA)

- a. The IFA of each floor should be calculated between the internal surfaces of external building walls. The IFA is the Gross Floor Area (GFA) after deducting the Exterior Construction Area (ECA).
- b. Measurements are to be taken at a specified height above the floor. Where ceilings are sloping the valuer should explain how he has measured the area.

4.4 Net Floor Area (NFA)

This is the usable area offered by all floors within a building on the following bases:

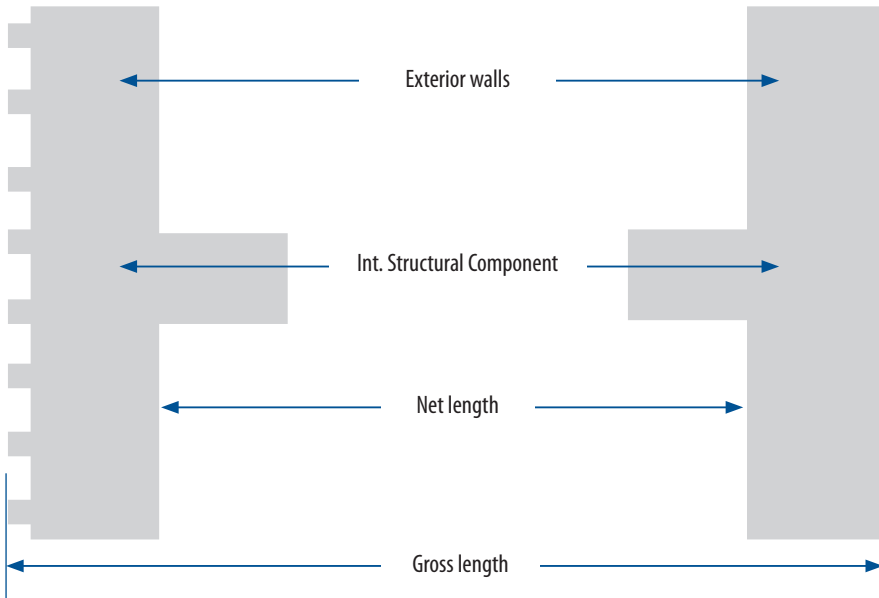
- a. Each floor should be measured at all levels between internal surfaces of external building walls. The NFA is the Internal Floor Area (IFA) after deducting the Interior Construction Area (ICA).
- b. Measurements are to be taken at a specified height above the floor. Where ceilings are sloping, the rules for measurement must be specified.
- c. The following areas of each floor are to be excluded from the calculation:
 - internal structural walls;
 - vertical ventilation, wiring or pipe ducts and structural columns (generally only excluding items larger than one square metre in area but there may be differing practices between countries);
 - staircases and lift wells;
 - lift motor rooms, tank rooms, (other than those used for processes), transformer rooms, high and low tension areas;
 - space occupied by permanent air-conditioning, heating or cooling apparatus and surface mounted ducting which makes the space unusable, having regard to the purpose for which it is said to be used. This does not apply to apparatus installed by or on behalf of the tenant or used in the building for special purposes, such as computer operation, processing or manufacturing.

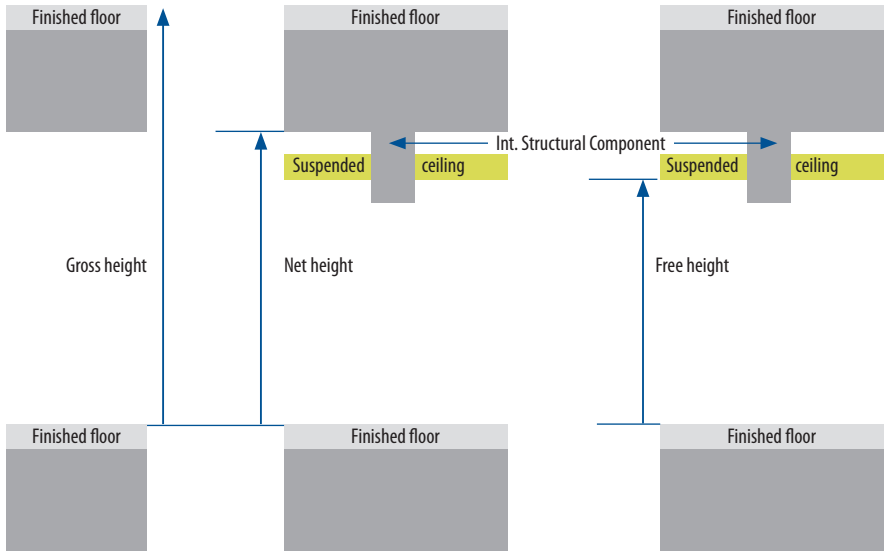
In calculating this area for office buildings, the following areas of each floor should be excluded:

- a. those areas set aside for the provision of facilities or services to the building not for the exclusive use of occupiers of the building;
- b. areas set aside as public space for thoroughfares and not used exclusively by

- occupiers of the building. (Note: additional common areas that may be created by the subdivision of a single floor to accommodate more than one tenant are to be included in the calculations);
- c. those parts of buildings such as entrance halls, landings and balconies which are used in common with other occupiers. In some cases, these parts may be apportioned between the building's occupiers.

Figure 2 – Illustration of Bases for Measuring Areas of Buildings





4.5 Zoning

4.5.1 For some properties, particularly in the retail sector, the area within stated depths from the building's frontage may be a significant factor for a valuation. Typically, the area nearest the frontage may be described as Zone A and have the highest value per unit of area – for retail, this may offer the greatest density of sales. The areas at increasing depths beyond that (Zones B, C and so on) will each have a value, usually given as a proportion of the Zone A figure and commonly reducing with growing distance from the frontage (depth). This offers both a means of appraising the commercial utility of the subject building and of analysing comparables.

4.5.2 Discussion of zoning may refer to the Built Depth, measuring the depth of the building back from its commercial frontage onto a thoroughfare within which the relevant zones are established.

4.5.3 It is important that the same zone depths be used in the analysis of comparable properties and in the valuation of the subject property. The depths used may vary between countries and by types of property but, for example, 6 metre depths are often used in the United Kingdom.

4.6 Special Provisions

4.6.1 Where relevant, the room height should be reported. The measurement procedures used for rooms with sloping ceilings should be reported.

4.6.2 Mezzanine areas, temporary or permanent, should be reported as well as the free height above and below them.

4.6.3 Areas for special purposes such as areas and heights designed for special sized pallets and likewise, should also be reported.

4.6.4 The height to a building's eaves or of the entrance doors is a key measurement for buildings used for vehicles or machinery in such sectors as transport, warehousing or agriculture.

4.7 Applications of Specific Measurement Bases

4.7.1 Gross Floor Area (GFA)

- Building costs (also for Insurance Valuation purposes),
- Site coverage
- Planning
- Zoning

4.7.2 Internal Floor Area (IFA)

- Building cost estimation
- Industrial building, shop and warehouse agency
- Valuation practice

4.7.3 Net Floor Area (NFA)

- Agency and valuation practice
- Service charge apportionment

4.7.4 Building Footprint

- Land usage

4.7.5 Building Envelope

- Land usage

PART 3

European Union Legislation and Property Valuation

1. **General Introduction**
2. **The EU Internal Market**
 - 2.1 **Internal Market - Provisions on the Valuation of Property**
 - 2.1.1 **Valuation of Property for Company Accounts**
 - 2.1.2 **Valuation of Property for Credit Institutions**
 - 2.1.3 **Valuation of Property for Insurance and Reinsurance Institutions**
 - 2.1.4 **Valuation of Property for Alternative Investment Funds**
 - 2.1.5 **Valuation of Property for State Aid Rules**
 - 2.2 **Internal Market - Taxation Legislation**
 - 2.2.1 **Value Added Tax (VAT) and Property**
 - 2.2.2 **VAT and the Supply of Land and Buildings**
 - 2.2.3 **VAT and Leases**
 - 2.2.4 **Payments Concerning Tenancies between Landlords, Tenants and Assignees**
 - 2.2.5 **Other VAT Issues Relevant to Property**
3. **Health and Safety**
4. **Energy**
5. **Environment**
 - 5.1 **General**
 - 5.2 **Environmental Impact Assessments and Strategic Environmental Assessments**
 - 5.3 **Water**
 - 5.4 **Environmental Liability and Contaminated Land**
 - 5.5 **Pollution**
 - 5.6 **Asbestos and Other Substances**
 - 5.7 **Bio-diversity and Conservation**
6. **The Common Agricultural Policy**

Caution – This text is prepared as a brief, general review of EU legislation as it may apply to property. It is intended to offer general assistance to valuers in their professional capacity – not in any other role, including the ownership of property – and is based on an understanding of the law as at February 2016.

It offers signposts for, not guidance on, what are often complex technical subjects and cannot be exhaustive or dwell on specialist areas. Where an issue is relevant to a valuation, the valuer should seek further specific information on appropriate points.

In particular, it is a review of EU legislation, mainly by Directive which means that Member States will generally have used their own legislation to implement it. Many EU regulations may also be implemented with supporting national legislation. It is thus likely that there will be local features of significance as well as interactions with other domestic law, including that for taxation.

1. General Introduction

1.1 European Union (EU) legislation has an increasingly important impact on the use, management, associated costs and development opportunities of property and so on its value. In some cases, it makes specific provisions for its valuation.

1.2 The Treaty on the Functioning of the European Union expressly states at Article 345 that:

“The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership.”

While the founding treaties of the EU do not therefore touch on property law or land tenure as a sensitive area left to member states, their general economic provisions have an impact on property. Thus, from a relatively early stage EU law on company accounting bore on the valuation of property for the financial accounts of relevant companies. This has been developed for lending institutions by successive Capital Requirements legislation.

1.3 Similarly, while real estate, being ‘immovable’, is not subject to EU law ensuring the free movement of goods within the European Union, the EU Treaty and legislation do ensure the free movement of capital and so the ability to buy or sell property anywhere in the EU.

1.4 Again, while housing policy is not covered, the EU is active in legislating in a growing number of policy areas that affect property markets and professions.

These include energy efficiency, renewable energy, environmental protection, discrimination by landlords, unfair contract terms, access to buildings by the disabled, regulation of retail services including shopping centre development, work site safety, construction products, construction and building-related cartels, state aid to social housing companies competing for middle-income tenants, mortgage credit, capital requirements for mortgage lending and insurance, financial market reform, reduced rates of VAT on renovation and repair of housing, and money laundering. Just some of these are reviewed in this chapter.

1.5 While taxation is also left to member states, EU directives provide a common framework for Value Added Tax. This has a specific regime for interests in property based on their exemption and the ability to waive it. This affects transactions and has consequences for those who cannot fully recover VAT. More generally, the non-discrimination provisions of EU law have forced changes in national taxation legislation.

1.6 The EU's State Aid rules have increasingly regulated public bodies in all manner of activities to limit distortions in the market place. These include rules for the valuation of property.

1.7 For more than three decades, two particular areas of EU policy have developed enormously in ways that affect property:

- the Internal Market programme;
- environmental policy.

Throughout this period the Common Agricultural Policy has had an effect on rural property.

1.8 The Internal Market programme for the free movement of goods and services, labour and capital throughout the European Economic Area (the EEA; that is, the EU with Iceland, Liechtenstein and Norway). Its legislation is supervised by the Court of Justice of the European Union (CJEU, previously the ECJ) and decided cases show how this programme can drive changes in areas of policy otherwise apparently outside the EU's formal competence – as, for example, the *Jäger* (C-256/06 [2008]) case has led to changes in the treatment of property for taxation by both Germany and the United Kingdom so that domestic tax legislation was no longer an impediment to the free movement of capital.

1.9 The Treaty of Rome had from the beginning sought to promote a single market in goods and services, labour and capital. This underlay the legislative emphasis on harmonisation of standards and rules to enable fair competition, less distorted by national action.

1.10 The concept was developed radically by the Internal Market programme under the Single European Act of 1987 giving a powerful stimulus to intra-Community trade and allowed new economic patterns to be created across national borders.

1.11 The substantive creation of the Single Market (now the Internal Market) has had an impact on property markets, both in terms of the demand for property and the availability of finance for property. In turn, this has affected matters relevant to valuations. Its spirit and rules also influence legislation bearing on property.

1.12 The substantial removal of borders between member states for the free movement of capital has reshaped patterns of demand for all real property, both commercial and residential.

1.13 Cross-border property investment has increased sharply from relatively insignificant levels in the mid-1990s and, even after the financial crisis and the accompanying general decline in investment, stood at €36.2 billion in 2010 (€21.4 billion intra-EU and a further €14.8 billion from outside the EU; Source: DTZ Research). It has now recovered to exceed pre-crisis levels. While initially the preserve of large, often listed, property investment companies and funds concentrating on prime assets in capital cities, this activity has developed to involve smaller property companies investing in niche markets as well, while many individuals have invested in residential property.

1.14 In implementing the Internal Market policy, the Services Directive (Directive 2006/123 on services in the internal market) was the formal instrument for opening the EU market for services. It acts to preclude any national measure which, albeit applicable without discrimination on grounds of nationality, impedes access to a market for service providers or undertakings from other Member States and so hinders trade within the EU. This includes valuation services.

1.15 However, most 'cross-border' valuation work is done by *local* valuers with their specialist knowledge servicing *foreign* investors, i.e. it is the foreign investor who provides the cross-border element, rather than the valuer. These investors operating often for the first time in an unfamiliar market are in particular need of local valuers qualified to a recognised European standard. In this context, TEGoVA's Recognised European Valuer (REV) and TEGoVA Residential Valuer (TRV) programmes also give a ready means for those who need valuation services in another country to identify qualified practising valuers to provide valuations in that other state.

1.16 The increasing importance of the EU in driving **environmental policy and the response to climate change** is affecting policy especially on energy issues but also on resource protection, water, pollution (including for example asbestos) and bio-diversity. Much of this affects property. Section 5 below reviews the main regimes as they may be relevant to property but there are provisions that will apply to individual sectors and arise from the control of particular chemicals or issues which may be pertinent to specific properties.

1.17 At first, this was driven by concerns to ensure a safe environment, stimulated by incidents such as the exposure in 1976 of the population of Seveso and neighbouring

settlements near Milan to dioxins following an incident at a chemical manufacturing plant. This concern was evidenced by, for example, drinking water legislation. Increasingly now, property is seen not only to pose key problems of consumption and inefficiency to be tackled in these areas but perhaps also to offer solutions in terms of land management, climate change mitigation and renewable energy as well as economic opportunities for the construction industry.

1.18 Policy on the protection of species of flora and fauna can affect both the potential for and costs of development. The classification of land for nature conservation and for subsidy purposes also has an influence on valuation of relevant property.

1.19 From almost the earliest days of the European Union, the **Common Agricultural Policy** has affected much rural property. At first, this influence was indirect through intervention in the market for produce, supporting prices, but it has since developed both as a support policy that has increasingly been available through a defined relationship with and use of specific land and with rural development policy.

1.20 Throughout, the impact of legislation on property is generally twofold:

- where it applies to activity on an area or site specific basis, creating opportunities or imposing limitations according to location; and
- where it applies to property or activities closely associated with its ownership, occupation or use.

1.21 The European Union's emerging role in economic policy may have a larger influence on the property market. The developing framework for EU/Eurozone Economic Governance involves procedures to co-ordinate national economic and budgetary policies, so influencing the wider macro-economic background. More specifically, Council country-specific Recommendations include liberalising rent controls, rationalising planning law and include increasing the taxation of property, especially higher value property, to ease the taxation of labour. Those in the Eurozone can be fined 0.1 per cent of GDP if they do not address them. The emphasis is on moving the taxation of housing from transactions to a recurrent basis, and reviewing the tax deductibility of mortgage interest payments. Volatility in house prices is seen as an issue for a number of member states.

The Nature of EU Legislation

1.22 Much of this common framework and increasing influence is not directly evident to many who are active in their local marketplaces.

1.23 Most of the EU legislation reviewed here has been made by Directives which require member states to implement them by their own legislation – as member

states have legislated for Energy Performance Certificates as required by the Energy Performance of Buildings Directive. Once a Directive is agreed it is, for member states, “binding as to the result to be achieved” within the time specified by the Directive. The force of this was shown in the CJEU decision in *Commission v UK (C-337/89 [1992])* finding that compliance with the Drinking Water Directive was an absolute obligation – it was not sufficient to take all practical steps. Where a Directive prescribes an outcome, such as a particular quality of water, that outcome has to be achieved (*Commission v UK (C-56/90 [1993])* on the Bathing Water Directive). The effect of a Directive will, thus, depend on how it is drafted. Determining whether a member state has complied with a more general “framework” Directive which does not specify outcomes so closely may turn more on the approach it has taken (see *Commission v Italy (C-365/97 [2003])* – the San Rocco Valley case).

1.24 Further, the CJEU ruled in *Marleasing SA v La Comercial Internacional de Alimentación (C-106/89 [1991])* that national legislation must be interpreted to suit the purpose of the directive:

“in applying national law, whether the provisions in question were adopted before or after the directive, the national court called upon to interpret it is required to do so, as far as possible, in the light of the wording and the purpose of the directive in order to achieve the result pursued by the latter.”

1.25 While EU Regulations apply directly in member states, they are frequently covered by domestic legislation. Sometimes this is for the purposes of effective implementation, supplying further operational matters.

1.26 In some cases, the European requirements will interact with other existing domestic regimes or be implemented alongside other domestic measures.

1.27 Although much EU legislation is applied through national laws, that does not detract from the key place of the EU as the source of much that affects the valuation of property. This role, one that has grown and seems likely to develop substantially, needs to be understood clearly.

1.28 Where an EU Directive or Regulation is relevant to the valuation of a property, the valuer will need to refer to and understand the appropriate national or local detailed provisions implementing the underlying EU legislation. With the range and scale of EU legislation, this text cannot be exhaustive in its review of the Directives and Regulations that may affect the valuation of specific properties but outlines the major areas that may more commonly be met.

2. The EU Internal Market

2.1 Internal Market - Provisions on the Valuation of Property

2.1.1 Valuation of Property for Company Accounts

2.1.1.1 The requirements of European legislation in valuing property for reporting in company accounts have been referred to in Part I at EVGN 1.

2.1.1.2 Directive 78/660 applying to the annual accounts of public companies (but not financial institutions and insurance companies) outlined the basic requirements for the recognition of assets. These were originally to be valued on the basis of the cost at which they were purchased or produced. The valuer is to report the method he has used. Any different approach driven by national law was to be disclosed.

2.1.1.3 That approach was:

- extended to consolidated accounts by Directive 83/349;
- applied to banks and other financial institutions by Directive 86/635;
- applied to insurance undertakings by Directive 91/674.

2.1.1.4 In the case of insurance undertakings, current value could under 91/674 be assessed on the basis of "market value" defined as:

"... the price at which land and buildings could be sold under private contract between a willing seller and an arm's length buyer on the valuation date, it being assumed that the property is publicly exposed to the market, that market conditions permit orderly disposal and that a normal period, having regard to the nature of property, is available for the negotiation of sale."

This is discussed at EVS 1 4.3 above.

2.1.1.5 These directives have since been amended a number of times (see Legislation section below) with the more significant changes being:

- Directive 2001/65 for public companies and banks allowing valuations to be at "fair value";
- Regulation 2909/2000 providing that for the accounting of non-financial fixed assets:
"The market value of an asset shall be the price which a buyer would be prepared to pay for it, having due regard to its condition and location and on the assumption that it could continue to be used";
- Regulations 1606/2002 and 1725/2003 provide that from 2005 all consolidated accounts of listed companies must be prepared in accordance with international accounting standards. These are not only International

Accounting Standards (IAS) but also International Financial Reporting Standards (IFRS) and Standing Interpretations of these;

- Directive 2003/51 amended the four main Directives above and allowed “fair value” generally as a basis of valuation.

2.1.1.6 The concept of “fair value” is reviewed at EVS 2. It can have a different meaning for accountants to that understood by valuers.

Legislation

Fourth Directive on the annual accounts of certain types of companies 78/660

Seventh Directive on consolidated accounts 83/349

- These Directives are amended by Directives for:
 - The exemptions for small and medium sized companies and publication of accounts in ecus 90/604
 - The extension of company types 90/605
 - Statutory audits of annual accounts and consolidated accounts 2006/43 amended by 2008/30.

Directive on the annual accounts and consolidated accounts of banks and other financial institutions 86/635.

- Amended by Commission Recommendation 2000/408 – Disclosure of information on financial instruments and other items.

Directive amending Directives 78/660, 83/349 and 86/335 with regard to the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions - 2001/65.

Directive on the annual accounts and consolidated accounts for insurance undertakings 91/674.

Directive amending Directives 78/660, 83/349, 86/335 and 91/674 with regard to the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions 2003/51.

Regulation 2000/2909 on the accounting management of non-financial fixed assets.

Regulation 2002/1606 on the application of international accounting standards.

Regulation 2003/1725 adopting certain accounting standards in accordance with 1606/2002.

2.1.2 Valuation of Property for Credit Institutions

2.1.2.1 Banking Capital Requirements and Regulation - The international Basel agreements seek to impose a prudent framework for banking and so set out a basis for calculating the amount of capital that a lending institution should hold against its liabilities. The regulators apply a ratio to the value of each class of available capital according to its nature to find the capital that the institution is required to hold. As one of the major asset classes involved, there are rules for the approach to assessing values for this purpose for property on which lending has been secured.

2.1.2.2 The EU has addressed these issues in successive legislation on capital requirements, most recently the Capital Requirements Regulation 575/2013, following the recast Directive 2013/36. This has been considered at EVS 1 4.2 in Part I above.

2.1.2.3 The Capital Requirements regime (now CRD IV) regulates credit institutions and so provides the framework for their operation in the EU's internal market. In doing this, it applies the requirements of the Basel agreements. With its reliance on the valuation of assets for this purpose:

- it provides the definitions of “market value” set out in EVS 1 at 4.2.1 and of “mortgage lending value” set out in EVS 2 at 7, both in Part I above;
- it defines an “independent valuer” – see EVS 3 5.3.5 in Part I above.

2.1.2.4 In some roles, valuers may find TEGoVA's Property and Market Rating to be a helpful tool (see Part 4 below).

2.1.2.5 The provisions for the regulation of banking, including the operation of these requirements, are to be developed and standardised by the European Banking Authority (EBA) in the Single Rulebook for common implementation of prudential regulation under Basel III across the EU. The EBA will develop this with Binding Technical Standards (BTS) which, once adopted by the Commission, will be legally binding and directly applicable as national law in member states (unless otherwise agreed). There is to be an accompanying Single Rulebook Question and Answer process on practical implementation.

2.1.2.6 As one of the reactions to the financial crisis, banks have had to screen the quality of their assets. The European Central Bank (ECB) instructed the major Eurozone banks in May 2014 that, in considering real estate for the required Asset Quality Review, European Valuation Standards were to prevail in the event of any conflict with other standards:

“5. Collateral and Real Estate Valuation

Real estate should be valued in line with European Standards EVS 2012 (Blue Book) and other international standards such as the Royal Institute of Chartered Surveyors (RICS) guidelines – where a conflict is seen EVS 2012 will apply (for the avoidance of doubt – this should be considered to apply throughout the document). For the avoidance of doubt a full e.g. RICS report is not required.”
(*Asset Quality Review*, p. 144)

2.1.2.7 Residential Mortgages - EU legislation has now also made general provision for the valuation of property for the purposes of lending to consumers, essentially residential mortgages. Among other matters, the Mortgage Credit Directive requires member states to ensure that:

- reliable valuation standards are used when assessing residential property for

mortgage purposes. The Directive's Recital 26 says that for standards to be reliable they should take into account internationally recognised valuation standards, specifically mentioning those developed by TEGoVA (European Valuation Standards). Creditors should "adopt appraisal standards and methods that lead to realistic and substantiated property appraisals in order to ensure that all appraisal reports are prepared with appropriate professional skill and diligence and that appraisers meet certain qualification requirements and to maintain adequate appraisal documentation for securities that is comprehensive and plausible";

- those doing property valuations are "professionally competent and sufficiently independent from the credit underwriting process so that they can provide an impartial and objective valuation which shall be documented in a durable medium and of which a record shall be kept by the creditor". (Article 19)

Legislation

Directive on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms 2013/36.

Capital Requirements Regulation on prudential requirements for credit institutions and investment firms 575/2013.

Mortgage Credit Directive 2014/17.

2.1.3 Valuation of Property for Insurance and Reinsurance Institutions

2.1.3.1 The EU has legislated for this sector since at least 1964. In a process akin to that imposed on banking by the Basel agreements, the insurance and reinsurance sector is now governed by the Solvency II regime under the framework Directive 2009/138/EC, which requires each institution's Solvency Capital Requirement to be calculated at least once a year. As regards property held by such businesses, the Directive's Article 75(1) requires member states to:

"ensure that, unless otherwise stated, insurance and reinsurance undertakings value assets ... at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction."

Recital (46) states that "valuation standards for supervisory purposes should be compatible with international accounting developments, to the extent possible, to limit the administrative burden"

2.1.3.2 Following the Lisbon Treaty and the creation of the European Insurance and Occupational Pensions Authority (EIOPA), Directive 2014/51 (Omnibus II) amended Solvency II in a number of ways. Its Article 2(22) provides that technical standards on matters such as valuation can be laid down by the EIOPA. Part 1 of the technical specifications was issued in October 2012 (EIOPA-DOC-12/362) adopted through

Commission Delegated Regulation (EU) 2015/35) including guidance on valuations (for which property will only be a part of the work) stressing conformity with Article 75 and international accounting standards. The provisions most relevant to property valuation are at Articles 7 to 10 of the Regulation and provide that, where necessary, Article 75 prevails over international accounting standards:

“Where the valuation methods included in international accounting standards adopted by the Commission in accordance with Regulation (EC) No 1606/2002 are not consistent either temporarily or permanently with the valuation approach set out in Article 75 of Directive 2009/138/EC, insurance and reinsurance undertakings shall use other valuation methods that are deemed to be consistent with Article 75 of Directive 2009/138/EC.” (Article 9(3))

2.1.3.3 The EIOPA technical standards now make no provision allowing the use of non-IFRS accounting values, even if they provided an economic valuation. It sets a five level hierarchy for valuation of assets (paragraph V5), including some greater allowance for adjusting the market prices of similar assets and “the maximum use of observable relevant inputs” (also Article 10(6) of the Regulation). It specifically notes in the table at V.1.4 that:

- for IAS 40 (investment property) and 16 (property, plant and equipment):
“Undertakings shall apply the fair value model and the revaluation model of IAS 40 and IAS 16 respectively when valuing property, including investment property, plant and equipment. The cost model permitted by IAS 40 or IAS 16, whereby investment property and property, plant and equipment is valued at cost less depreciation and impairment, shall not be applied.”;
- for IAS 17 (leases):
“Undertakings shall value assets and liabilities in a lease arrangement in accordance with IAS 17, applied as follows: undertakings which are lessees in a finance lease, shall value lease assets and liabilities at fair value. Undertakings shall not make subsequent adjustments to take account of the own credit standing of the undertaking.”;
- for IAS 41 (agriculture):
“Undertakings shall apply IAS 41 for biological assets if the estimated costs to sell are not material. If the estimated costs to sell are material, the undertaking shall adjust the value by including these costs.”

The Regulation’s Article 10(7) gives guidance on the use of the market, income and cost approaches to valuation.

Legislation

Directive 2009/138 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

Directive 2014/51 (Omnibus II).

Commission Delegated Regulation 2015/35.

2.1.4 Valuation of Property for Alternative Investment Funds

The Alternative Investment Fund Managers Directive introduced rules for the valuation of assets held by hedge funds (including real estate funds) and other similar institutions. These are to be assessed on a net asset value basis, discussed in EVGN 7 in Part 1 above.

Legislation

Alternative Investment Fund Managers Directive 2011/61.

2.1.5 Valuation of Property for State Aid Rules

2.1.5.1 With the EU's promotion of an open internal market, it has sought to regulate the extent to which governments and public bodies can use subsidy, both express and implied, as a protectionist tool, distorting the free operation of that market. The Treaty on the Functioning of the European Union provides at Article 107(1) that:

“Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.”

The EU's State Aid rules have been a major part of this policy, providing a legal framework in which such actions in member states can be regulated, approved or forbidden. Effective throughout the EEA, they have been used to regulate the valuation of property, the methods for disposing of property and the management of state owned or subsidised property.

2.1.5.2 These rules apply to state owned entities that are carrying out an economic activity when offering goods or services on a market (*T-319/99 Fenin*). This has been tested in such cases as:

- *Brighton West Pier (N560/01 and NN17/02)* in which a trust was found to be an undertaking as it was charged with the management and profitable use of space to generate funds for its purposes (though on the facts the national heritage funding was found not to be disqualifying state aid);
- *Irish Finance Housing Agency (N209/2001)* in which local authorities offering low cost housing were found to be performing an economic activity in competition with other housing market operators;
- *Irish hospitals (N543/2001)* in which hospitals offering both public and private services were undertakings.

2.1.5.3 Valuation of Public Property - Following a number of cases involving the sale of public land, the Commission issued its *Communication on State aid elements in sales of land and buildings by public authorities* (OJ C 209, 10/07/1997, p0003-0005 – 31997Y0710(01)). This provides a basis on which public property is to be valued for disposal so that no question of a state aid is seen to arise, whether by being sold at an undervalue or to favoured buyers.

2.1.5.4 These rules are discussed at EVS 1 at 4.3 and in its section 5 in Part I above. They require a sufficiently well-publicised, open and unconditional bidding procedure, comparable to an auction, accepting that the best (or only) bid is market value. If that process is not used, then an independent valuation is required.

2.1.5.5 The rules use the same definition of “Market Value” as Directive 91/674 (accounts for insurance undertakings):

“... the price at which land and buildings could be sold under private contract between a willing seller and an arm’s length buyer on the date of valuation, it being assumed that the property is publicly exposed to the market, that market conditions permit orderly disposal and that a normal period, having regard to the nature of property, is available for the negotiation of sale.”

2.1.5.6 They define the qualifications of an asset valuer suitable for this purpose – see EVS 3 5.1.2 in Part I above.

2.1.5.7 State Subsidy for Social or Municipal Housing - That last point is illustrated by the Commission’s intervention in both the Netherlands and Sweden to limit the ability of social or municipal housing providers to offer state subsidised properties for rent on the open market and so compete unfairly with the private sector for middle-income tenants.

2.1.5.8 Under the Commission Decision of 14th July 2005, the Dutch state may only subsidise housing bodies that cater for socially disadvantaged households and, as a result, the Dutch government set a €37,000 income cap on households entitled to social housing. As the Dutch social housing companies had also been using excess state capital to invest in commercial property, the Commission also decided that any commercial exploitation of public service activities must take place under market conditions.

2.1.5.9 In Sweden, under the ‘utility value’ system, private sector rents were effectively set at the levels of comparable municipal flats, yet only the municipal housing companies were receiving state aid and they were competing with the private sector for the same tenants. Informal action by the Commission under the State Aid rules brought the system to an end in 2011. (Source: European Property Federation)

2.1.5.10 In its 2005 Monti-Kroes package for state aid to services of general economic interest, the Commission clarified that only state aid to genuinely social housing could escape investigation for compatibility with EU law. This was confirmed by the Commission Decision of 20th December 2011, Recital 11 of which states that:

“... undertakings in charge of social services, including the provision of social housing for disadvantaged citizens or socially less advantaged groups, who due to solvency constraints are unable to obtain housing at market conditions, should also benefit from the exemption from notification provided for in this Decision ...”

Thus, state aid to housing not specifically reserved for disadvantaged citizens or socially less advantaged groups must be notified to the Commission so that it can consider its legality under EU law.

Legislation

Treaty on the Functioning of the European Union Article 107(1).

Commission Communication 97/C 209/03 on State Aid Elements in the sale of land and buildings by public authorities.

Commission Decision of 20.12.2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest C(2011) 9380 final.

2.2. Internal Market - Taxation Legislation

2.2.1 Value Added Tax (VAT) and Property

2.2.1.1 VAT, a tax on the value added in the supply of goods and services, is a fundamental aspect of the operation of the EU and its adoption is a key part of the accession process for any new member state. It is the one tax administered on a national basis by member states for which the EU expressly provides a common framework, albeit that it does not operate as an EU-wide tax. That framework of EU legislation provides a common underlying structure for the way VAT is applied, its exemptions and the rates, though the detail of its implementation within this framework varies between member states. Disputes over VAT are ultimately referred to the Court of Justice of the European Union whose decisions (alongside directives and regulations) govern what member states can do. CJEU decisions about the application of the exemption for the letting of property have created a body of EU case law as to the nature of a lease which is discussed below.

2.2.1.2 Property is often the second or third largest cost for a business; buying or selling a property may be the largest transaction a business makes. While salaries and finance are not subject to VAT, where VAT is levied on a transaction in property it can be

a significant factor in several ways:

- while most businesses can fully recover VAT on qualifying inputs, it is still a pressure on cash flow;
- where a party to a transaction is not registered for VAT it cannot recover it on inputs. Aside from consumers that is often also a factor for financial and other businesses whose outputs are deemed to be exempt;
- it is a complex area of legislation with much case law, making it important to understand how VAT will treat each transaction. As the volume of case law shows, this is not always possible, adding to the uncertainty and potential risk in some situations.

2.2.1.3 VAT was first instituted by directive in 1967 (Directive 67/227). The current EU legislation is the Seventh VAT Directive 2006/112 though many of the CJEU cases referred to here were decided under its predecessor, the Sixth Directive 77/388.

2.2.1.4 The Directive contains specific provisions as to the identification of value where this is needed (see EVS 1 4.4 in Part I above).

2.2.1.5 The VAT Directive makes specific provision for interests in property, through exemptions and reduced rates.

2.2.1.6 Exemptions - The exemption of sales, leases and other equivalent transactions in property from VAT is provided for by Article 135(1) at:

- “(j) the supply of a building or parts thereof, and of the land on which it stands, other than the supply referred to in point (a) of Article 12(1);
- (k) the supply of land which has not been built on other than the supply of building land as referred to in point (b) of Article 12(1);
- (l) the leasing or letting of immovable property.”

The equivalent provision of the Sixth Directive was at Article 13(B). While the references to Article 12 exclude new buildings from the exemption (making them taxable), Article 371 gives a “transitional” right to member states to retain exemption from VAT for new buildings and building land for the time being and Article 370 allows the retention of taxation of other buildings – position upheld by the ECJ in *Norbury Developments Ltd* (C-136/97).

2.2.1.7 Under Article 137, the exemptions given by Article 135(1)(j) to (k) can be waived if the member state provides for this and the taxpayer then makes the necessary election. Where that exemption is waived VAT will be chargeable on the supply of property by sale, lease or equivalent transactions, including the surrender and assignment of leases. Where a business makes both VATable and exempt supplies it falls under the partial exemption rules in calculating the VAT that it can recover on its inputs.

2.2.1.8 It may be difficult in some situations concerning property to assess whether the transaction involves a single supply or separate supplies (including one of property) with possibly different VAT treatments. Tests for determining this were laid down by the CJEU in *Card Protection Plan (C-349/96 [1999])*:

- is there a single service whose economic purpose would make it artificial to split?
- is the essential feature of transaction a single supply?
- are some elements ancillary to the main purpose of the supply? They will be ancillary if they do not constitute a separate purpose for the customer but rather a means of better enjoying the service supplied.

Where there is a single supply involving land and the land predominates, the whole transaction may be exempt but, if the sale or lease of land is found on these tests to be ancillary to a taxable supply, it may be treated in accordance with the VAT status of that supply.

2.2.1.9 Reduced Rates for Works to Property - Directive 2009/47/EC amended the Sixth VAT Directive to allow member states the freedom to adopt reduced VAT rates (as low as 5 per cent) on a small number of items, including “renovation and repair of private dwellings, excluding materials which account for a significant part of the value of the service supplied”. (Article 106 and Annex IV (2) of the Seventh Directive).

2.2.1.10 This is an option which each member state can take up or not. Valuers should be acquainted with the rate in the state in which they are carrying out the valuation.

2.2.1.11 As an exception to the formal architecture of the Sixth Directive, its Article 110 allows member states to retain those exemptions or reduced rates that they were applying on 1st January 1991. In at least some member states, these may relate to property or works on property while the Directive also makes a limited number of specific national exceptions.

2.2.1.12 Property Valuation and VAT - The valuer should understand or seek instruction on the VAT status of the property being valued where this is relevant. Is it exempt or has the exemption been waived? If it is subject to tax what rate of VAT would apply to transactions? With the significant rates of VAT applicable in many countries, failing to recognise the impact of VAT, especially in markets where some buyers are not able to recover it fully or at all, could prejudice the valuation.

2.2.2 VAT and the Supply of Land and Buildings

2.2.2.1 A supply naturally includes a clear disposal but Article 15(2) also allows member states to treat the following as a supply of goods:

- “(a) certain interests in immovable property;
- (b) rights in rem giving the holder thereof a right of use over immovable property;

(c) shares or the equivalent to shares giving the holder thereof de jure or de facto rights of ownership or possession over immovable property or part thereof.”

2.2.2.2 Meaning of “land” and “buildings” There are differences between member states as to whether buildings can be owned independently of the land under them. In this context, “land” is undefined but appears not to include buildings as they are given their own exemption. However, the exemption of Article 135(1)(k) for the supply of buildings does include the land on which they stand. Article 12(2) defines a “building” to be “any structure fixed to or in the ground”.

2.2.3 VAT and Leases

2.2.3.1 Article 135(1)(l) (previously 13(B)(b) of the Sixth Directive) requires member states to exempt the “leasing or letting of immovable property” under conditions that they are to determine. As this is an important distinction in tax treatment of property it has led to a number of CJEU cases.

2.2.3.2 What is a Letting for EU Law? Consistent with the *Marleasing* ruling, CJEU decisions are clear that this is a concept to be analysed under European Union law, not the varied national property legislation of member states. This can be particularly problematic in an area that is as individual between member states as land law.

2.2.3.3 Some light may be cast on the meaning of “leasing or letting” by the four exceptions in Article 135(2) to the exemption of Article 135(1)(l):

- “(a) the provision of hotel accommodation in the hotel sector and in sectors with a similar function including holiday camps and camping sites;
- (b) the letting of premises and sites for parking vehicles;
- (c) lettings of permanently installed equipment and machinery; and
- (d) hire of safes.”

These are liable to VAT. While they may not extend the exemption, member states are allowed to add further exclusions from it even to the point where the CJEU approved Spain making all leasing and letting taxable except for residential property (*Miguel Amengual Far v Juan Amengual Far* (C-12/98)). As these exceptions would, from their context, otherwise fall within the “leasing or letting of immoveable property” they have been found to offer assistance in interpreting that phrase, as discussed below.

2.2.3.4 The CJEU noted in *Stichting Goed Wonen* (C-326/99 [2001]) that the recital to the Sixth Directive stated the aim of collecting the Community’s resources in a uniform manner in all member states: “exemptions must constitute independent concepts of Community law”. The Advocate General’s Opinion in *Maierhofer v Finanz Augsburg-Land* (C-315/00 [2003]) was that these exemptions should “have their own meanings which must in principle be independent of the civil law concepts of individual member states”. In particular, he said that “the term used to specify the exemption in Article 13B(b) must be given a Community definition”.

2.2.3.5 In *Breitsohl* (C-400/98), the CJEU commented in passing that:

“the concept of ... land cannot be defined by reference to the national law applicable to the main proceedings, given the purpose of the Sixth Directive, which is aimed at determining the basis of VAT in a uniform manner according to Community rules. Such a concept which contributes to determining the persons who may be regarded by Member States as taxable persons by virtue of Article 4(3)(a) of the Directive, must therefore be interpreted in a uniform manner in all Member States.”

This case concluded that the exemption or option to tax would apply to land and the buildings on it together – they could not be treated separately.

2.2.3.6 Is the property immovable? In *Maierhofer* prefabricated buildings had been bolted onto a concreted area of land and then leased for use as temporary housing for asylum seekers. The buildings could be dismantled by eight persons in ten days and then re-erected elsewhere. The Advocate General held that these buildings were securely fixed to the ground and so their letting was a letting of immovable property. The final CJEU judgment itself said:

“The answer to the Question must therefore be that the letting of a building constructed from prefabricated components fixed to or in the ground in such a way that they cannot be either easily dismantled or easily moved constitutes a letting of immovable property for the purposes of Article 13B(b) of the Sixth Directive, even if the building is to be removed at the end of the lease and reused on another site.”

The terms of the lease were not decisive in this. *Maierhofer's* facts were distinguished from those of *EC Commission v France* C-60/96 [1999] where caravans, tents, mobile homes and light framed structures were held to be moveable. In the Dutch case, *Coffeeshop Siberie* (C-158/98), the Advocate General felt that the renting of a table in a coffee shop for the sale of narcotic drugs did not amount to the letting of immovable property.

2.2.3.7 A consequence of *Maierhofer* is that the leasing of fixtures, if held on the facts of the particular case to be a separate supply, may be exempt for VAT as a letting of immovable property.

2.2.3.8 What is a “Leasing or Letting”? In *EC Commission v United Kingdom* (C-359/97 [2000]), the CJEU noted that but for specific exclusions:

“... the wording of article 13B(b) ... does not shed any light on the scope of the terms ‘leasing or letting of immovable property’. The definition of ‘letting of immovable property’ under that provision is certainly wider in some respects than that enshrined in various national laws. For instance, the article lists, in

order to exclude it from the exemption, a contract for a hotel room ... which in view of the overriding importance of the services provided by the hotelier and the control he retains over the use of the premises by patrons, is not considered in some national laws, to be a contract to let."

2.2.3.9 The Advocate General's Opinion in *Lubbock Fine*, stated:

"In my view, a letting for the purposes of Community law includes a lease, a licence, 'un bail' or a 'convention d'occupation précaire'."

That is clearly not an exhaustive list and, in practice, case law continues to develop the concept as successive CJEU decisions have considered possible tests.

2.2.3.10 While the member state's land law is relevant in understanding what rights have been conferred, it is irrelevant to the interpretation of how the VAT system then applies to those rights. Also irrelevant are:

- any artificial presentation of the transaction – the issue is its essential purpose;
- the duration of the supply (length of the lease or letting);
- whether it includes the land on which the immoveable property stands (*Maierhofer*).

"Leasing or letting" must not be by a person to himself (*Seeling* (C-269/00)).

2.2.3.11 The interpretation of this exemption from the VAT system was closely considered by the CJEU in *EC Commission v United Kingdom* (C-359/97 [2000]) which, with the parallel case C-358/97 involving Ireland, concerned the VAT status of road tolls (illustrating the potential breadth of the topic). It affirmed that, especially as this concerned a potential exemption from taxation, the Directive was to be interpreted strictly.

2.2.3.12 It first observed that the duration of the supply does not matter in interpreting this exemption:

"transactions as short lived as the use of a hotel room for a single night or the letting of sites for parking vehicles fall *prima facie* within the definition of leasing or letting."

It further said that exclusive possession was not required:

"the terms 'leasing' and 'letting' ... do not imply a right of exclusive occupation or a fixed duration for the right to use the goods in question. Any other interpretation is incompatible with article 13B(b)(2) ... from which it is clear that the letting of sites for parking vehicles is *prima facie* leasing or letting within the meaning of that provision. A contract of that type does not imply exclusive use

of the car park or even of a particular space in the car park.”

In that case, a “leasing or letting” was understood to require an agreement on duration and that the duration should be reflected in the price charged.

2.2.3.13 The CJEU took a stronger line on exclusive possession in *Stichting Goed Wonen* and began to develop the test of “leasing or letting” as a passive activity not generating value added. However, if property is made available to a taxable person it is then within the economic system contributing to the production of goods and services whose cost is passed on in their price. The Dutch association had been right to charge VAT on the grant of a 10 year usufructuary right for a housing complex. The usufruct was accepted as:

“conferring on the person concerned, for an agreed period and for payment, the right to occupy property as if that person were the owner and to exclude any other person from enjoyment of such a right”.

In economic terms, it has common characteristics with letting and so member states could treat it as such, irrespective of its separate legal nature.

2.2.3.14 However, this approach was revised by the CJEU in *Belgian State v Temco Europe SA* (C-284/03 [2005]). Temco provided space to businesses sharing premises, with no set duration and rent partly linked to turnover and staff numbers. As in *Stockholm Lindopark* (C-150/99) (see below), the decision emphasised the criterion of passivity as “leasing or letting” agreements:

“have as their essential object the making available, in a passive manner, of premises or part of buildings in return for payment linked to the passage of time.”

The absence of exclusivity and of an agreed term was not fatal. In making this change of stance, it explained that:

- exclusivity could be shared and only need be available against “all other persons not permitted by law or by the contract to exercise a right over the property.”;
- previous decisions had considered duration in distinguishing letting from industrial and commercial activity which saw the provision of a service rather than “simply the making available of property” “an activity simply linked to the passage of time and not generating any significant added value”.

2.2.3.15 The CJEU has since followed this approach in *Fonden Marselisborg Lystbådehavn* (C-428/02) where agreements for mooring and storing boats were accepted as an exempt “leasing or letting” even though when the boat was away from the mooring for more than a day it was then offered to visitors without reimbursement, as “such occasional use does not cause harm to the lessee, it cannot be regarded as altering the relationship ...”.

2.2.3.16 What is the main character of the supply? For VAT law purposes, the issue was to establish the character of the main supply. For this, the CJEU distinguishes activities that are essentially the supply of services rather than simply making property available.

2.2.3.17 In *Mirror Group plc* (C-409/98 [2001]), the Advocate General said:

“In my view, this idea that the characteristics of the lease or let must predominate in a contract in order for it to come within the exemption is highly irrelevant for our purposes. It would exclude from the exemption contracts which, while sharing a number of features with contracts of leasing or letting, are primarily concerned with the supply of services incidental to the occupation of the property ... In order to identify the key features of a contract, however, we must go beyond an abstract or purely formal analysis. It is necessary to find the contract’s economic purpose, that is the precise way in which the performance satisfies the interests of the parties. In other words, we must identify the element which the legal traditions of various European countries term the cause of the contract and understand as the economic purpose, calculated to realise the parties’ respective interests, lying at the heart of the contract. In the case of a lease ... this consists in the transfer by one party to another of an exclusive right to enjoy immovable property for an agreed period.”

He concluded stressing the importance of the duration of the right to use the immovable property.

2.2.3.18 In *Stockholm Lindopark* a Swedish development company ran a golf course for the exclusive use of businesses which were able to offer staff and clients an opportunity to play golf. The CJEU decided that:

- the activity of running a golf course generally entails not only the passive activity of making the course available but also a number of commercial activities and continuing maintenance. Letting a golf course is unlikely to be the main service supplied on the facts;
- permission to use the course is likely to be restricted both as to purpose and period of use. The period of enjoyment of immovable property is an essential element of a lease.

2.2.3.19 In *Sinclair Collis* (C-275/01), the CJEU found that the commercial objective of installing cigarette machines in another person’s licensed premises was to sell cigarettes. While the agreement excluded competitors, it could not be the “leasing or letting” of immovable property, however much the machines were fixed to the premises, as only limited rights of possession or control were granted.

2.2.4 Payments Concerning Tenancies between Landlords, Tenants and Assignees

2.2.4.1 For a payment to be exempt it must be for an exempt supply. Where a tenant makes a payment to take a lease it will be exempt, whether it is of rent or a premium. Variations of a lease may usually be exempt.

2.2.4.2 Service charges will only be exempt if they are ancillary to an exempt supply of property and supplied by the landlord rather than a third party.

2.2.4.3 Reverse Payments - For a reverse payment to be exempt, it must not only be shown that it is for a supply but that the supply is of land. VAT is due on the supply of goods or services, not on a payment. If a supply is identified, it is then a question of analysis whether that supply falls within the exemptions of Article 135. The leading CJEU cases are *Mirror Group plc* and *Cantor Fitzgerald International* (C-108/99 [2001]) overturning an earlier decision in *Lubbock Fine* (C-63/92 [1994]).

2.2.4.4 Where:

- a landlord pays a tenant to take a tenancy, it may be that there is no supply by the tenant or it may be liable to VAT – see *Mirror Group plc*, as perhaps where the payment is for building works;
- the tenant pays the landlord to accept the surrender of a tenancy, that may be liable to VAT;
- an outgoing tenant pays the assignee for taking the tenancy, that may well be a VATable supply by the incoming tenant – see *Cantor Fitzgerald*.

2.2.5 Other VAT Issues Relevant to Property

2.2.5.1 Transfer of a Going Concern - Article 19 of the Directive allows that a member state can consider that the transfer of “a totality of assets” is not a supply of goods but that instead the new owner is simply treated as the successor of the transferor. This allows the purchase of a business to be effected without VAT applying.

2.2.5.2 Capital Goods Scheme - The Directive’s Articles 187 to 191 can apply to durable goods, such as buildings or substantial work on them, spreading the recovery of input tax over several years.

Legislation

Seventh VAT Directive 2006/112

Directive 2009/47 amending Directive 2006/112 as regards reduced rates of value added tax.

3. Health and Safety

3.1 The European Union legislates on health and safety at work under Article 153 of the Treaty for the Functioning of European Union, the main provision being the Framework Directive on Safety and Health at Work (Directive 89/391 on the introduction of measures to encourage improvements in the safety and health of workers at work), with more specific directives supplementing it, such as that on work places (Directive 89/654). The EU's current Strategic Framework on Health and Safety at Work 2014-2020 is set out in Commission Communication 2014/332. This body of legislation may have effects on the use of a property and so its value. Substantial limitations on use or development potential can be imposed by the legislation on hazardous activities.

3.2 Buildings and the Disabled - EU legislation makes a number of provisions concerning the accessibility of buildings to the disabled. In Directive 89/654, Paragraph 20 of Annex 1 and Paragraph 15 of Annex 2 of Directive 89/654/EEC requires that both new and existing workplaces "must be organized to take account of handicapped workers, if necessary. This provision applies in particular to the doors, passageways, staircases, showers, washbasins, lavatories and workstations used or occupied directly by handicapped persons." Directive 95/16 sets requirements for the accessibility of lifts to the disabled.

3.3 Directive 2000/78 establishing a general framework for equal treatment in employment and occupation strikes a balance between requiring reasonable accommodation of the needs of the disabled and the burden of adjustment. Its Article 5 reads:

"In order to guarantee compliance with the principle of equal treatment in relation to persons with disabilities, reasonable accommodation shall be provided. This means that employers shall take appropriate measures, where needed in a particular case, to enable a person with a disability to have access to, participate in, or advance in employment, or to undergo training, unless such measures would impose a disproportionate burden on the employer. This burden shall not be disproportionate when it is sufficiently remedied by measures existing within the framework of the disability policy of the Member State concerned."

Ensuring the accessibility of buildings for both employment and access to services is part of the European Disability Strategy (2010-2020) (A Renewed Commitment to a Barrier Free Europe). In that vein, works co-financed by EU Structural Funds are to consider accessibility for disabled persons.

Legislation

Directive 89/391 on the introduction of measures to encourage improvements in the safety and health of workers at work.

Directive 95/16 on the approximation of the laws of the Member States relating to lifts.
 Directive 2000/78 establishing a general framework for equal treatment in employment and occupation.

3.4 Hazardous Activities - Member states are required to adopt land use planning strategies around sites of hazardous activity under Council Directive 2012/18 on the control of major accident hazards. This is known as the Seveso III Directive from its origin as a response to the release of dioxins in an accident at a chemical plant near Seveso. This replaced Directive 96/82 on 1st June 2015 which had been amended in 1997 and then extended by Directive 2003/105 following industrial accidents at Toulouse, Baia Mare and Enschede. The aim is to “ensure that the objectives of preventing major accidents and limiting the consequences of such accidents are taken into account in their land-use policies and/or other relevant policies”. The measures which should be taken to achieve these objectives include controls on new developments in the vicinity of existing hazardous installations and on the siting of new hazardous installations. The 2003 extensions covered risks arising from storage and processing activities in mining, from pyrotechnic and explosive substances and from the storage of ammonium nitrate and ammonium nitrate based fertilisers. Activities covered by other legislation such as nuclear establishments and the transport of dangerous substances are excluded.

3.5 The principal changes introduced by Seveso III for this developing regime require further public access to information and increased standards for inspections.

3.6 The required land use planning strategies can restrict the use of land close to major industrial sites such as chemical plants and oil refineries, but their scope can extend much further. In the United Kingdom, for example, they can affect the land along the line of a high pressure gas pipeline. Such restrictions on development potential can affect value and may require valuations for compensation or mitigation.

Legislation

Directive on Major Accident Hazards of Certain Industrial Activities 2012/18 (Seveso III Directive).

4. Energy

4.1 Much of the EU's energy policy is now devoted to achieving a very substantial reduction in the emission of greenhouse gases from energy. The essential thrusts of the policy are that:

- energy should come from sources that do not make a net contribution to those gases and so a very strong emphasis on renewable sources of energy;
- energy for heat and transport should come increasingly from electricity;
- energy efficiency should be increased.

These are now being taken forward under the general structure of the EU's Energy Union.

4.2 This is being tackled by an array of instruments which will have both direct and indirect effects on property and its use, from the Energy Efficiency Directive and the Energy Performance of Buildings Directive to the Large Combustion Plant Directive, which will see parts of the EU lose more than a third of their existing generation capacity by 2020, aside from any ordinary obsolescence.

4.3 The current target set by the Directive on Energy from Renewable Sources (2009/28/EC) is for the EU to supply 20 per cent of its overall energy needs from renewable sources by 2020. Member states must require the use of minimum levels of energy from renewable sources in new buildings and in existing buildings that are subject to major renovation. There is a parallel target for greenhouse gas emissions to be reduced by 20 per cent from 1990 levels by 2020 – with the possibility of this increasing to 30 per cent if non-EU countries co-operate – supported by the Energy Efficiency Directive 2012. More recent targets have been set to reduce greenhouse gases by 40 per cent for 2030 and for renewables to meet 45 per cent of energy needs by 2030 (A policy framework for climate and energy in the period from 2020 to 2030 COM 2014/15).

4.4 The pressure imposed by these targets is shown by the November 2010 Commission Communication (COM(2010) 639): Energy 2020, A strategy for competitive, sustainable and secure energy. Its title reflects the goals set for energy policy by the Lisbon Treaty but the paper notes "Europe's energy systems are adapting too slowly, while the scale of the challenges grows" and expresses concern that the EU may not meet all its 2020 energy goals:

"Time is short. Thus, the Commission will present most of the proposals to achieve the 2020 goals in the coming 18 months. Discussion, adoption and implantation will be needed quickly. In this way, the EU will be better able to put in place the building blocks of the 2020 outcome – standards, rules, regulations, plans, projects, financial and human resources, technology markets, social expectations, etc. – and prepare Europe's citizens for the challenges ahead."

4.5 This will all have implications for property whether as the location for renewable generation or improving the efficiency of its use of energy. If the costs of property together with transport and other key factors change markedly, that may influence users' and investors' decisions as to the nature and location of property.

4.6 Energy Efficiency - There is a clear concern to improve the efficiency with which energy is used so that the greatest benefit is achieved for the least use of resources and so contain the likely increases in energy demand. Much of the general policy is provided for by the Energy Efficiency Directive. Both efficiency and greenhouse gas issues can be tackled by carbon pricing through mechanisms like the EU's Emissions

Trading System, making the use of fossil fuels to generate energy relatively more expensive. Equally, energy conservation has a key part to play and this is particularly significant for buildings.

4.7 The best known EU measure in this regard is the Energy Performance of Buildings Directive of 2010 (replacing that of 2002). It applies to buildings, with their technical systems, rather than the operations within them.

4.8 One of its prime objects is to improve market awareness of energy inefficiency and cost. Its predecessor set in place the system of Energy Performance Certificates (EPCs), giving each premises an energy efficiency rating on a relatively standard system. These are required for the sale or lease to a new tenant of a wide range of buildings, essentially almost all residential, commercial and public sector buildings and most other buildings unless they are “low energy demand”.

4.9 The Directive requires that advertisements marketing a property for sale or rent show the building’s energy rating and requires prominent display of the EPC in buildings over 250m² that are frequently visited by the public.

4.10 Under the Directive, new buildings must be “nearly zero energy” by 31 December 2020 (after 31 December 2018 for buildings occupied and owned by public authorities) – a demanding goal reinforcing other trends in policy to increase the energy efficiency requirements of national building standards. It does not enforce standards for existing buildings except where a renovation qualifies as a “major renovation”, in which case it requires compliance with energy performance standards. It imposes a regime of inspections for heating and air conditioning systems.

4.11 This Directive is discussed in more detail at EVGN 8.

Legislation

Energy from Renewable Sources Directive 2009/28

Energy Performance of Buildings Directive 2010/31

Energy Efficiency Directive 2012/27

5. Environment

5.1 General

5.1.1 Valuations and Environmental Issues - The professional valuation of a property can only reflect the actual market as it exists on the valuation date with its balance of supply and demand, hopes and concerns and the information the market thinks relevant reduced to a single figure. Legislation and policy relevant to the property

is part of that matrix of circumstance but cannot necessarily drive it. Valuations cannot get ahead of the market.

5.1.2 Environmental regulation can impose large costs on property and business owners and users, making it important to understand the potential for its impact in any particular situation and so its consequence for property values. These concerns will be shared by lenders. They also need to be considered in lettings.

5.1.3 Growth of Environmental Legislation by the European Union – The original Treaty of Rome of 1957 made no mention of the environment. As environmental issues became more significant in the early 1970s, the first official EU reference to them was a declaration made by the then six heads of state in October 1972. That heralded the first of six Action Programmes for the Environment, setting out broad policy objectives. The current, sixth, Programme covers the period 2002 to 2012 and has four “key environmental priorities”: climate change, nature and biodiversity, environment with health and quality of life, and natural resources and wastes.

5.1.4 Case law and then treaties have progressively extended the activity of the European Union in environmental policy on the basis that many issues see both causes and effects extending beyond the reach of individual countries. In the years from 1973 to 1986, EU environmental law steadily developed for water, waste and then air pollution before being given a further impetus by the Seveso incident. In particular, the EU’s role was confirmed by the Single European Act 1987 (as since amended) and applied by the CJEU in its constitutional interpretations, as in, for example, the *Titanium Dioxide* case (C-300/89 [1991]), tending to run ahead of formal constitutional change. In 1989 a separate Environment Directorate was created in the Commission and the creation of a European Environment Agency was agreed in 1990 which, operational from 1993, is to produce a report on the state of the European environment every three years. The EU not only agrees specific legislation but frames general environmental policies. A “Sustainable Development Strategy” was agreed in 2001.

5.1.5 This is a large, diverse, complex and developing area with considerable consequences for property. Each piece of EU legislation is likely to have a body of case law and, especially for Directives, is likely to be masked and sometimes extended by national implementing regulations. There will often be much associated subsequent amending and related EU legislation for each.

5.1.6 The first significant EU intervention for nature conservation was the Wild Birds Directive of 1979 setting an approach to conservation policy later broadened by the Habitats Directive. Those conservation interests were then applied more broadly through the Environmental Impact Assessment Directives since 1985, bearing first on major development proposals but now a significant issue for much development – see 5.2 below.

5.1.7 The Single European Act 1987 was the first formal confirmation of the EU's role in environmental policy, previously unclear. The CJEU decisions in *Titanium Dioxide* [1991] and *Wallonian Waste* (C-2/90 [1993]) elaborated this position which has since been consolidated and reinforced by the 1997 Treaty of Amsterdam at Articles 95 and 174 to 176. Article 174(2) simply states:

“Community policy on the environment shall aim at a high level of protection taking into account the diversity of situations in the various regions of the Community. It shall be based on the precautionary principle and on the principles that preventive action should be taken, that environmental damage should as priority be rectified at source and that the polluter should pay.”

Since the Treaty of Amsterdam, Article 6 of the Treaty states:

“Environmental protection requirements must be integrated into the definition and implementation of the Community policies and activities referred to in Article 3, in particular with a view to promoting sustainable development”.

The effect is that environmental protection is now an integral part of the framework of EU legislation and that, alongside the precautionary and the “polluter pays” principles, “sustainable development” has been affirmed as a core principle (and is also mentioned in the amended Article 2 of the Treaty on European Union). Articles 95 and 176 allow member states to impose more stringent requirements.

5.1.8 Environmental protection is not an overriding objective. The CJEU's Advocate General commented in *R v Secretary of State for the Environment Transport and the Regions, ex p First Corporate Shipping Limited* (C-371/98 [2000]) that the reference to “sustainable development” in the Preamble to the Treaty does not mean that;

“the interests of the environment must necessarily and systematically prevail over the interests defended in the context of the other policies pursued by the Community in accordance with Article 3 of the EC Treaty.”

It is a political matter of reconciling competing interests at the EU level. This was affirmed by the Advocate General in *Austria v Parliament/Council* (C161/04 [2006]):

“Although this provision is drafted in imperative terms ... it cannot be regarded as laying down a standard according to which in defining Community policies environmental protection must always be taken to be the prevalent interest. Such an interpretation would unacceptably restrict the discretionary powers of the Community institutions and the Community legislature. At most it is to be regarded as an obligation on the part of Community institutions to take due account of ecological interests in policy areas outside that of environmental

protection *stricto sensu*. It is only where ecological interests manifestly have not been taken into account or where they have been completely disregarded that Article 6 EC may serve as the standard for reviewing the validity of Community legislation."

5.1.9 Climate Change Measures - The European Union is increasingly focussing on measures to mitigate climate change. In part, this is through legislation on energy issues (see Section 4 above) but also more directly through limitations on greenhouse gas emissions. Buildings are said to be responsible for some 40 per cent of emissions while land management can either aggravate or ameliorate the issue. The Emissions Trading System and other measures may affect the economics of some businesses. More generally, many property owners and occupiers may find it important to consider the commercial issues arising from carbon reduction schemes when appraising property: does it offer easy opportunities to assist or is it expensive to adapt?

5.2 Environmental Impact Assessments and Strategic Environmental Assessments

5.2.1 In general, the EU has intervened relatively little in spatial planning policy but rather in ways that affect decisions on specific proposals. Its most general intervention in development control is through directives requiring environmental impact assessments (EIAs) for specified classes of development proposals. First enacted in 1985, amended in 1997, 2003 and 2009, these rules have been codified in the Environmental Impact Assessment Directive of 2011, as amended in 2014.

5.2.2 The object is to ensure a systematic account, an environmental impact assessment, of a development's likely effects on the environment and so consideration of measures that would avoid significant adverse effects. This relies on a structured approach using expert reports to assist those making development control decisions. Projects listed in the Directive's Annex I must have EIAs while member states are to decide whether an EIA is needed ("screening") for those listed in Annex II.

5.2.3 The CJEU decision *Commission v Ireland* (C-215/06) suggests that a member state is not entitled to grant a development consent retrospectively for a scheme for which no EIA had been submitted without a new EIA being provided. That could be a significant issue for the assessment of some properties.

5.2.4 In 2001, the Strategic Environmental Assessment Directive extended the need for environmental assessment to plans or programmes setting the framework for future development consents for agriculture, forestry, fisheries, energy, industry, transport, waste management, water management, telecommunications, tourism and development control. This applies to projects listed in Annex I or II of the 1985 EIA Directive and to any plan requiring an assessment under the 1992 Habitats Directive.

Legislation

Environmental Impact Assessment Directive 2011/92.

Directive 2014/52/EU amending Directive 2011/92 on the assessment of the effects of certain public and private projects on the environment.

Assessment of the Effects of Certain Plans and Programmes on the Environment Directive 2001/42 (commonly called the Strategic Environmental Assessment Directive).

5.3 Water

5.3.1 Most water issues naturally fall into three categories:

- water quality – pollution in various forms,
- water scarcity – shortage,
- water quantity – flooding risk.

EU policy has generally focused on water quality but the wide-reaching Water Framework Directive now implicitly touches on scarcity and the Floods Directive requires action on flooding risk. The ecological role of water bodies is recognised in nature conservation legislation, sometimes imposing a significant constraint on development.

5.3.2 The first EU legislation on water quality was the Surface Water for Drinking Directive of 1975 and it has steadily broadened since 1990. The most powerful piece of general legislation is the Water Framework Directive of 2000, due to have been fully implemented by 2015 with the prospect now of member states being fined for breaches of standards.

5.3.3 Water pollution issues can be divided into point source ones (as with a specific sewage pipe, factory outlet or local incident) and diffuse pollution arising from the background environment. General pollution legislation can be effective in limiting the potential for point source pollution and penalising incidents. The Water Framework Directive tackles the much harder problems of diffuse pollution from a background of contaminants which may be anything from soil, fertilisers, sprays for weeds or pests, animal wastes and urban run-off to naturally occurring chemicals and bacteria.

5.3.4 The Dangerous Substances Directive of 1976 required member states to control prescribed substances from entering sewers and has been reinforced by later directives on discharges into sewers. The terms of licences to discharge may add or limit the value of affected premises.

5.3.5 The first Groundwater Directive was introduced in 1980 to require member states to take measures to prevent the pollution of groundwater by a wide range of substances whose discharge is either to be prevented or controlled, subject to their toxicity. It was replaced by the Groundwater Directive 2006/118 of which parts are now under review.

5.3.6 The Nitrates Directive was introduced in 1991 to reduce water pollution arising

from nitrates from agricultural sources and preventing further such pollution. It requires member states to designate nitrate vulnerable zones within which “good agricultural practice” is to be imposed, limiting the application rates for nitrogenous fertilisers and requiring storage of manures and slurries. Surface waters and groundwater aquifers in the zones are to be monitored as is the eutrophic state of fresh surface waters, estuarial and coastal waters.

5.3.7 The Urban Waste Water Directive of 1991 requires that discharges of industrial waste water to sewage or treatment plants must be subject to prior regulation and so any necessary pre-treatment to reduce its pollution potential and use collecting systems designed and maintained in accordance with the “best technical knowledge not entailing excessive expenditure”. This applies to a plant measured by its “population equivalent” (pe), a measure of the organic biodegradable load imposed by the effluent. More stringent standards apply to “sensitive” areas.

5.3.8 The Water Framework Directive applies to surface waters (lakes, reservoirs, rivers, canals, estuaries and waters up to one nautical mile from the shore) and groundwater. Its aims are:

- to prevent further deterioration of waters, and to protect and enhance aquatic eco-systems;
- to promote sustainable water use based upon long-term protection of available water resources;
- to reduce discharges, emissions and losses of priority substances, and to cease or phase out discharges, emissions and losses of priority hazardous substances into the aquatic environment. Priority substances are governed by both the Directive and the Environmental Quality Standards Directive;
- to reduce and prevent groundwater pollution;
- to contribute to mitigating the effects of floods and droughts.

It requires strategic management plans for each river basin to show how the objectives for its water bodies are to be met, addressing both point source and diffuse pollution. Member states are to deliver good surface water status in terms of both chemical composition and ecology and ensure groundwater’s chemical status and quantity (so that it is not depleted by the long run rate of abstraction). These standards are not precisely defined but are now expected, especially in areas designated under other EU legislation, but can be delayed to 2021 or 2027.

5.3.9 As a framework directive, there are several “daughter” directives to assist its implementation. Those already enacted are:

- Dangerous Substances Directive 2006/11 – an interim measure;
- Groundwater Directive 2006/118;
- Environmental Quality Standards Directive 2008/105, listing and setting limits for priority substances and requiring an inventory of emissions, discharges and

- losses for each river basin;
- with others to follow.

5.3.10 The Floods Directive establishes a framework for the assessment and management of inland and coastal flooding risks. Member states are obliged to carry out an assessment for each river basin, prepare flood hazard and risk maps and set out flood management plans. The identification of a site as at risk from flooding will have consequences for affected property both from the practical fact of any actual flooding but also from the impact of that identification on the availability or cost of insurance. In some cases, flood control measures will require land to be flooded to protect other property by managing water flow – with effects on values.

Legislation

Surface Water for Drinking Directive 75/440.

Water Pollution by Discharges of Dangerous Substances Directive 76/464.

Directive on Urban Waste Water Treatment 91/271.

Nitrates from Agricultural Sources Directive 91/676.

Water Framework Directive 2000/60.

Dangerous Substances Directive 2006/11.

Groundwater Directive 2006/118.

Floods Directive 2007/60.

Environmental Quality Standards Directive 2008/105.

5.4 Environmental Liability and Contaminated Land

5.4.1 The 2004 Directive on Environmental Liability with regard to the prevention and remedying of “environmental damage” (as amended) will be relevant to property transactions where there is pollution or contamination that affects land, designated conservation sites and groundwater.

5.4.2 Applying the “polluter pays” principle entrenched by Article 191(2) of the Treaty on the Functioning of the European Union Article, a person may be liable under the Directive if considered an “operator”. The operator of an activity listed in the Directive’s Annex III is strictly liable for measures to prevent or remedy damage to land, groundwater, surface water, coastal waters, and protected species and natural habitats. The Annex invokes the Integrated Pollution Prevention and Control Directive and the Waste Framework Directive. For activities outside Annex III, the operator is liable for measures to prevent damage to protected species and natural habitats, provided he is negligent or at fault in this.

5.4.3 There is “environmental damage” to:

- land when there is a significant risk of human health being affected by

contamination due to the introduction of “substances, preparations, organisms or micro-organisms”. The operator who damaged the land must remove that significant risk;

- water if there is a significant adverse effect on the ecological, chemical or quantitative status of water or its ecological potential;
- protected species or natural habitats if there is significant adverse effect on reaching or maintaining a favourable conservation status.

5.4.4 For both water and protected species or habitats the operator who caused the damage is liable for:

- primary remediation, restoring the subject to its condition before being damaged;
- complementary remediation where this is not possible; and
- compensatory remediation by providing other improvements to compensate for interim losses between the damage and its restoration.

5.4.5 The Directive has since been amended with respect to extractive industries, the geological storage of carbon dioxide and offshore oil and gas operations.

5.4.6 Waste - Land contamination issues will also interact with the developing EU regimes governing waste, intended to drive both the reduction of waste and an increase in recycling. The main present legislation is the Waste Framework Directive 2008 which specifically excludes:

- “land (in situ) including unexcavated contaminated soil and buildings permanently connected with land” (Article 2(1)(b)); and
- “uncontaminated soil and other naturally occurring material excavated in the course of construction activities where it is certain that the material will be used for the purposes of construction in its natural state on the site from which it was excavated” (Article 2 (1)(c)).

Otherwise, waste is to be recovered or disposed of without endangering human health, without using processes or methods which would harm the environment and particularly without:

- risk to water, air, soil, plants or animals;
- causing nuisance through noise and odours;
- adversely affecting the countryside or places of special interest.

The policy is implemented by environmental permitting regulations, the preparation of development plans, and regimes for a duty of care. The Directive is supported by the Landfill Directive, the Waste Incineration Directive and Integrated Pollution Prevention and Control Directive.

Legislation

Environmental Liability Directive 2004/35.

Waste Legislation

Landfill Directive 99/31.

Waste Incineration Directive 2000/76.

Integrated Pollution Prevention and Control Directive 2008/1.

Waste Framework Directive 2008/98.

5.5 Pollution

5.5.1 The central directive for this subject is the Integrated Pollution Prevention and Control Directive applying to operations with significant potential for pollution.

5.5.2 Compliance with standards will be important for such businesses and so should be a major factor in their approach to property.

5.5.3 The water legislation reviewed above considered both point source and diffuse pollution of water.

5.5.4 Several directives bear directly on air pollution and so on emissions from various classes of industrial and other plants, all requiring member states to set controls on the air pollution from individual plants. These mean that a valuer addressing such a property needs to understand how far it is compliant and the practical consequences of any shortcomings as they may affect a valuation.

Legislation

Integrated Pollution Prevention and Control Directive 2008/1.

Air pollution legislation relevant to property

Framework Directive on Emissions from Industrial Plants 84/360.

Large Combustion Plants Directive 88/609.

Municipal Waste Incinerators Directive 89/369.

Ambient Air Quality Assessment and Management Directive 96/62.

Solvent Emissions Directive 1999/13.

Waste Incineration Directive 2000/76.

Large Combustion Plant Directive 2001/80.

5.6 Asbestos and Other Substances

5.6.1 The Control of Asbestos Directive has a significant impact on the management of many buildings constructed in the twentieth century when asbestos was a cheap and effective building material used in roofing sheets, as panels and in other ways. The Directive followed the association of some forms of asbestos with cancer and:

- requires a survey of the asbestos present in any building; and
- imposes standards for its removal and disposal.

This can add substantially to the costs of building work or demolition of a property or the remediation and development of a site, and so may affect its value.

5.6.2 Assessment will require specialist knowledge. It is normal for valuation reports to contain exclusions regarding asbestos, recommend the commissioning of a specialist report and otherwise assume that asbestos is present.

Legislation

Control of Asbestos Directive 87/217.

5.7 Bio-diversity and Conservation

5.7.1 Nature conservation was one of the first significant areas of EU activity in environmental policy, sometimes superimposed on earlier national provisions. It has now generated a structure to designate many sites to protect them for their value in this regard by stating what is not permitted on them. It can therefore impose significant hurdles for the development or change of use of property affected by conservation interests. However, there may be opportunities for grants or annual payments under management agreements, subject to state aid rules. As the conservation interests are likely to be site specific they will have a bearing on the value of the site. In addition to international and national schemes for designating sites, EU Directives require the designation of sites:

- The Directive on the Conservation of Natural Habitats and of Wild Flora and Fauna (the Habitats Directive) requires member states to designate Special Areas of Conservation (SACs - the network of these is called Natura 2000) to maintain or restore natural habitats and species of wild flora and fauna of Community interest. It also implements the 1979 Bern Convention on the Conservation of European Wildlife and Habitats as EU law.
- The Directive on Conservation of Wild Birds requires the designation of Special Protection Areas (SPAs) on the basis of the ornithological criteria in the Directive (*European Commission v Netherlands* C 3/96 [1999]) to ensure the survival and conservation of certain species.

There are also a number of sites of European Union importance designated by the Commission on the nomination of member states.

5.7.2 Member states are then to “take appropriate steps to avoid the deterioration of the sites and significant disturbance of the species for which the areas have been designated” (Article 6(2), Habitats Directive).

5.7.3 The CJEU has interpreted these directives strictly, both for initial designation of sites and their subsequent protection in decisions on such areas as Leybucht Dykes (*Commission v Germany* (C-57/89 [1991]), Santoña Marshes (*Commission v Spain* (C-355/90 [1993]), and Lappel Bank (*R v Secretary of State for the Environment, ex p Royal*

Society for the Protection of Birds (C-44/95 [1997]). Designation is an objective issue to which economic criteria are not relevant (*R v Secretary of State for the Environment Transport and the Regions, ex parte First Corporate Shipping Limited* C-371/98 [2001]). The CJEU has rejected considering the effect of the Common Agricultural Policy (*Commission v France* (C-96/98 [2000])) or the effect of an outstanding public consultation and state ownership (*Commission v France* (C-166/97 [1999])).

5.7.4 Once a site is designated, the Member State is then to protect it and the species for which it was designated. However, development proposals may be allowed after due consideration and where they will not adversely affect the integrity of the site. The Directive was amended after the Leybucht Dykes decisions so that where there is no alternative solution to damaging a designated site, it may be reduced in extent “for imperative reasons of public interest, including those of a social or economic nature”. However, the Member State must then take compensatory measures to ensure the overall coherence of Natura 2000, an objective that requires more than simple mitigation. That may mean:

- recreating a habitat on a new or enlarged site to be incorporated into Natura 2000;
- improving a habitat on part of the site or another Natura 2000 site proportional to the loss due to the project;
- proposing a new site;

with that new measure to be operational when the Natura 2000 site is damaged. As many Natura 2000 sites involve wetland, this can be a particular constraint on the development of, for example, coastal sites as may be desired by ports or power stations. The requirement for compensatory measures for lost tidal flats was a significant feature of the development of Cardiff Bay as part of the city.

5.7.5 Annexes II and IV of the Habitats Directive list several hundred species of animal and plants that are to be protected. Equivalent protection for bird species is provided under the Wild Birds Directive. This protection is frequently relevant to the potential development of property as it requires that the impact on these species be assessed which can take time and be expensive. Where that impact is significant, it that may be taken into account in decisions about whether consent for development should be granted and, if so, on what conditions. Following the effect of this requirement on a plan for a deep water berths at Dibden Bay near Southampton, a case in point was the project for the development of the port of Le Havre (Le Havre 2000). The presence of bird nests on islets in the Seine estuary caused major delays while the French authorities and the Commission negotiated adaptations to the project (*see Catherine Prudhomme-Deblanc, Un Ministère Français Face à l'Europe – le cas du Ministère de l'Équipement des Transports et du Logement, pp. 341-345*). Where relevant compensatory habits must be provided first while the presence of protected species can also influence the management of property.

Legislation

Wild Birds Directive 79/409.

Habitats Directive 92/43.

6. The Common Agricultural Policy

6.1 The Common Agricultural Policy (CAP) has been a major feature of the EU since 1963 and still accounts for towards 40 per cent of its budget, albeit declining to 2020, providing significant support to those who qualify for payment. With changing policy needs, budgetary constraints and the demands of world trade talks, it has slowly adapted from a regime based on support for product prices through intervention in the market – mainly for temperate products such as cereals, milk and beef – and so tending to support the sale and rental value of land naturally used for those products. Milk quotas (now abandoned) were introduced in 1984 to limit the cost of the dairy regime and major general reforms were agreed in 1992 (MacSharry Reforms) and 2003 (the Single Payment Scheme). Following minor changes to the 2003 reforms, especially in 2008 (the Health Check), a new Basic Payment regime adapting the Single Payment was implemented from 2015 to apply until 2020. Its basic structure and additional options have been implemented in widely varying ways by member states.

6.2 The long reform process has also seen the use of some of the CAP budget for “rural development” purposes, variously support for hard-pressed areas, agri-environment schemes and measures to strengthen or diversify the rural economy. Member states have taken differing approaches and emphases in implementing this while the allocation of funds to each country varies widely.

6.3 It is noteworthy that CAP legislation is by regulation, and not directive, though issues of national implementation usually still require additional domestic legislation.

6.4 The CAP is divided into two “pillars”:

6.5 Pillar 1 essentially comprises the annual direct payments to farmers (now the Basic Payment with allied schemes) and market management. The Basic Payment is a payment to qualifying farmers in respect of the area of qualifying agricultural land they have at their “disposal”. Meeting world trade commitments, the payment does not depend on the type or volume of current agricultural production – it is “decoupled” (though some member states have used limited powers to retain or develop limited production support schemes). The Basic Payment is then supplemented by a “greening” payment (largely affecting farms with arable land by requiring multiple crops and ecological focus areas) and other possible and optional payments.

6.6 The main form of the scheme uses a system of transferable entitlements (expressed in hectares), generally allocated on the basis of the eligible agricultural land declared in 2015, with payment rates based on previous claims history but being phased to or towards standard values in each payment region. The importance of the system will thus vary between countries according to their historic commitment to cereals, cattle and dairying. To yield the payment, entitlements must be matched each year against an equivalent area of qualifying land in the same payment area as the entitlements were created.

6.7 Those states that joined the EU more recently, especially in central Europe and having no such history of subsidy, have operated a Single Area Payment Scheme simply based on the qualifying land declared each year, which is carried forward with the option of switching to the Basic Payment Scheme. It is paid at standard rates, though these are being phased in for Croatia, as the most recent accession country, with its former direct payments being phased out.

6.8 The land at “disposal” test that qualifies land for a claim has been considered by the CJEU in *Landkreis Bad Dürkheim* (C61/09), finding that the claimant must be an autonomous farmer on the land and managing agricultural activity on the land (so at least substantially able to deliver the cross compliance requirements). With the varied property laws of member states, that was not expressed in land tenure terms.

6.9 Pillar 2 is the Rural Development Regulation. This offers support, often on a longer term or multi-annual basis, in wide variety of ways, of which those usually most relevant to the assessment of property are for:

- agri-environment schemes, usually commitments binding the land for periods of five years. The claimant should have management control of the land, understood to be different from having the land at his disposal;
- Less Favoured Areas (LFAs) which are defined as areas of usually difficult or adverse terrain seen as challenging to farm but often of social, cultural or landscape significance. These payments have variously been made on the basis of the numbers of qualifying animals, the area involved or, sometimes now, for agri-environment commitments. These payments, where still made, are being removed and member states who wish to provide some specific support will be able to do so in Pillar 1 for re-defined Areas of Natural Constraint.

6.10 Payments under both pillars are subject to penalties for breaches of cross-compliance rules which impose legal obligations and minimum land management requirements.

6.11 These schemes and their administration are not only important to those involved but are often complex for both the farmer and the official payment agencies and vary significantly between (and sometimes within) member states. Access to and

limitations on payments may be relevant to both capital values and rents of relevant property.

Legislation

Direct Payments Regulation 1307/2013.

Rural Development Regulation 1305/2013.

SCHEDULE OF EU LEGISLATION

Valuation of Property for Company Accounts

Fourth Directive on the annual accounts of certain types of companies 78/660.

Seventh Directive on consolidated accounts 83/349.

These Directives are amended by Directives for:

- the exemptions for small and medium sized companies and publication of accounts in ecus 90/604;
- the extension of company types 90/605;
- statutory audits of annual accounts and consolidated accounts 2006/43 amended by 2008/30.

Directive on the annual accounts and consolidated accounts of banks and other financial institutions 86/635. Amended by Commission Recommendation 2000/408 - Disclosure of information on financial instruments and other items.

Directive amending Directives 78/660, 83/349 and 86/335 with regard to the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions - 2001/65.

Directive on the annual accounts and consolidated accounts for insurance undertakings 91/674.

Directive amending Directives 78/660, 83/349, 86/335 and 91/674 with regard to the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions 2003/51.

Regulation 2000/2909 on the accounting management of non-financial fixed assets.

Regulation 2002/1606 on the application of international accounting standards.

Regulation 2003/1725 adopting certain accounting standards in accordance with 2002/1606.

Valuation of Property for Financial Institutions

Directive on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms 2013/36.

Capital Requirements Regulation on prudential requirements for credit institutions and investment firms 575/2013.

Mortgage Credit Directive 2014/17.

Directive 2009/138 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)

Directive 2014/51 (Omnibus II).

Commission Delegated Regulation 2015/35

Alternative Investment Fund Managers Directive 2011/61.

Valuation of Property for State Aid Rules

Treaty on the Functioning of the European Union Article 107(1).

Commission Communication 97/C 209/03 on State Aid Elements in the sale of land and buildings by public authorities.

Commission Decision of 20.12.2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest C(2011) 9380 final.

Value Added Tax and Property

Seventh VAT Directive 2006/112.

Directive 2009/47 amending Directive 2006/112 as regards reduced rates of value added tax.

Health and Safety

Directive 89/391 on the introduction of measures to encourage improvements in the safety and health of workers at work

Directive 95/16 on the approximation of the laws of the Member States relating to lifts.

Directive 2000/78 establishing a general framework for equal treatment in employment and occupation.

Directive on Major Accident Hazards of Certain Industrial Activities 2012/18 (Seveso III Directive).

Energy

Energy from Renewable Sources Directive 2009/28.

Energy Performance of Buildings Directive 2010/31.

Energy Efficiency Directive 2012/27.

Environmental Liability

Environmental Liability Directive 2004/35.

Environmental Impact Assessments and Strategic Impact Assessments

Environmental Impact Assessment Directive 2011/92.

Directive 2014/52/EU amending Directive 2011/92 on the assessment of the effects of certain public and private projects on the environment

Assessment of the Effects of Certain Plans and Programmes on the Environment 2001/42 (commonly called the Strategic Environmental Assessment Directive).

Water

Surface Water for Drinking Directive 75/440.

Water Pollution by Discharges of Dangerous Substances Directive 76/464.

Directive on Urban Waste Water Treatment 91/271.

Nitrates from Agricultural Sources Directive 91/676.

Water Framework Directive 2000/60.
Dangerous Substances Directive 2006/11.
Groundwater Directive 2006/118.
Floods Directive 2007/60.
Environmental Quality Standards Directive 2008/105.

Contaminated Land, Environmental Liability and Waste

Landfill Directive 99/31.
Waste Incineration Directive 2000/76.
Environmental Liability Directive 2004/35.
Integrated Pollution Prevention and Control Directive 2008/1.
Waste Framework Directive 2008/98.

Pollution

Integrated Pollution Prevention and Control Directive 2008/1.

Air Pollution

Framework Directive on Emissions from Industrial Plants 84/360.
Large Combustion Plants Directive 88/609.
Municipal Waste Incinerators Directive 89/369.
Ambient Air Quality Assessment and Management Directive 96/62.
Solvent Emissions Directive 1999/13.
Waste Incineration Directive 2000/76.
Large Combustion Plant Directive 2001/80.

Asbestos

The Control of Asbestos Directive 87/217.

Biodiversity and Conservation

Wild Birds Directive 79/409.
Habitats Directive 92/43.

Common Agricultural Policy

Direct Payments Regulation 1307/2013.
Rural Development Regulation 1305/2013.

PART 4

Technical Documents

European Valuation Information Papers:

EVIP 1 Sustainability and Valuation

EVIP 2 Valuation Certainty and Market Risk

EVIP 3 Apportionment of Value between Land and Buildings

EVIP 4 Valuation and Other Issues for Recurrent Property Tax Purposes

EVIP 5 Valuation Methodology

EVIP 6 Automated Valuation Models (AVM)

EVIP 7 European Property and Market Rating: A Valuer's Guide

EVIP 8 Fair Value Measurement under IFRS 13

Summary of Recognition of Qualifications: TEGoVA's Minimum Educational Requirements

Summary of TEGoVA's Recognised European Valuer (REV) and TEGoVA Residential Valuer (TRV)

Glossary

Members of the European Valuation Standards Board

Membership of TEGoVA

EVIP 1

Sustainability and Valuation

- 1. Introduction**
- 2. Sustainability and Property Users**
- 3. Developing “Green” Standards for Property**
- 4. Valuation and Sustainability**

1. Introduction

1.1 The twin pressures of economics and public policy have led to greater attention being paid to a range of natural resource issues, covered by the concept of sustainability. It can be expected that both regulation and market sentiment will make these issues of environmental performance and sustainability increasingly important to those concerned with property and buildings and so, where relevant, to valuation. Indeed, many larger corporate clients and those with ethical concerns look to meet rising standards with regard to sustainability and expect similar standards from those with whom they deal. They are likely to raise the matter when seeking valuation advice.

1.2 It is very clear that these issues are evolving, with new ones, such as those related to climate change, coming to the fore with the European Union placing an increasing emphasis on the role of buildings in its energy policy. The emphases between the issues involved will change as legislation and market sentiment develop. While they may often still be externalities in economic terms, not influencing values, regulation (including taxation) is likely to increase the impact of these issues, partly to address the problems posed for policies by externalities. Thus, while the market may often not have taken significant account of many of these issues to date, it seems increasingly likely that it will. As specific issues crystallise and become understood so they become part of standard practice. It may be inevitable that much discussion of sustainability as a concept focuses on those issues that have not yet crystallised including some that may not do so.

1.3 As an example, energy issues are becoming more salient, driven by cost, resource issues and now climate change concerns. The introduction of gradually strengthening regulation (such as the EU Energy Performance of Buildings Directive with its Energy Performance Certificates (EPCs) and other tools) for new and existing building stock will eventually lead to more sensitivity concerning a building's energy performance and efficiency. This means that labelling and certification systems using independent information will be used more often, regulations on energy codes will become stricter and subsidies and tax relief might be available when building energy efficient houses

- due to the internalisation of negative external effects. As and where such rules and any differences between more and less compliant properties come to matter to parties such as owners, buyers, tenants, lenders and others then the market will take that into account in capital and rental values, alongside all other factors. It may well be that concerns over water scarcity and quality or other matters will follow a similar path.

1.4 Many of the issues covered by sustainability involve a long term perspective, such as expectations as to energy prices or handling environmental risk, while the necessary specific information may often be uncertain and the analytical tools still developing. However, those limitations do not make the questions unimportant.

1.5 Valuers must act within the limits of their professional skills. This will usually mean that they will need to call on relevant expertise, certification and reports as to a property's sustainability rather than prepare them personally. This follows existing practice regarding environmental issues such as the assessment of contamination, asbestos, flood risk or soil erosion for which valuers need to be able to understand what the specialist reports might mean and judge what weight to give to them. Valuers can only value on the basis of the market as it is, not hypothesise about the future. This information paper is offered to assist valuers' awareness of and sensitivity to these issues and so their understanding of markets as they evolve.

1.6 Sustainability - At a general level, sustainability is the capacity to endure. While this paper focuses on the environmental aspects of sustainability, it also has economic and social dimensions and many of the issues of economic sustainability may already be material to valuations. Indeed, economic concepts such as sustainable rental income or sustainable cash flow long pre-date the current uses of the word.

1.7 As pressures on resources and natural systems have grown, so attention has focused on the extent to which this capacity can be protected by intervention and management. The focus on environmental constraints has led to one definition of sustainability as improving the quality of human life while living within the carrying capacity of supporting eco-systems.

1.8 Sustainable Development - That approach already implies the problems of reconciling sustainability with any action or change. The concept of "sustainable development" was promoted by the World Commission on Environment and Development (the Brundtland Commission) which reported in 1987. It has since been a key component in many policy discussions on economic, social and environmental issues. In its report, *Our Common Future*, the Brundtland Commission defined it as:

"development which meets the needs of current generations without compromising the ability of future generations to meet their own needs."

The Commission's proposals were approved by the United Nations Conference on Environment and Development at Rio de Janeiro in 1992 leading to both national and international attention, including the United Nations Commission for Sustainable Development.

1.9 It has proved to be a lasting, broad but vague, portmanteau concept. Its formulation does not arbitrate between economic, environmental and social objectives where they conflict. Indeed, as the emphasis between these objectives will vary between parties and situations as well as over time, this very fluidity may assist its general acceptability, if not its robustness. No more precise definition has emerged and it will have different practical connotations for different people, in different contexts and over time.

1.10 With the developing momentum of such policy discussions, sustainable development may be best understood as a process rather than a defined end, that process currently being increasingly influenced by concerns over climate change and resources.

1.11 A variety of tools and concepts have evolved to consider environmental issues for property, including Life Cycle Assessment, Cradle to Cradle, Ecological Footprint Analysis and green buildings. In varying ways, they consider the impact of development on the environment and ecological systems over time, with greater efficiency in the use of resources and less degradation of the environment, developing resilience and adaptability and with concerns about social equity. These are measured through a growing range of audits, procedures and indicators all trying to capture aspects of the larger concept and influence decisions and so increasingly bearing on the use and development of land, property and buildings. This is not only through public policy and regulation but also by market perceptions and the demands of investors, businesses and their customers.

1.12 One challenge in analysing this is to understand for each case whether addressing sustainability adds or subtracts value. It can be seen as a cost and a restriction. Equally, economic opportunities can be seen in green growth with its accompanying technical innovation, while meeting standards may protect or enhance value. Once a regulatory or market standard is seen as the norm, then failing to meet it may see the values of non-compliant properties penalised.

1.13 At the larger level, it has been conventional to see economic growth as a challenge to environmental concerns but there is evidence (sometimes summarised in the Environmental Kuznets Curve) that higher levels of economic development can see reduced environmental degradation, perhaps partly as resources are then available to tackle the issues that are then of increasing concern and also as the nature of economic activity and the technology used changes. This transition with rising economic activity

appears to reduce local externalities first, with more dispersed externalities being addressed at higher income levels. As techniques to reduce degradation are developed so it becomes easier for others to adopt them. Equally, the growing scale of economic activity represents a challenge. Increasing knowledge, sophistication and scientific advance open up new challenges – few would have been troubled by CO₂ emissions forty years ago.

1.14 As the concepts become clearer in practice and guidance develops so it is likely to create intangible assets which will themselves need valuation where they can be separated from the underlying asset.

1.15 The Vancouver Accord was established in 2007 as an international forum for discussing the valuation issues associated with the sustainability debate: “a commitment by valuation standards organizations globally to begin the process to embed sustainability into valuation and appraisals.” That initiative with subsequent and other developing discussions can help inform the valuation profession and its practice.

1.16 Eco-System Valuation - There is a growing body of work, particularly for economic and environmental policy, to put values on such resource and environmental issues as:

- pollution, energy and materials;
- environmental protection and resource management;
- natural resource assets;
- valuation of non-market flows and environmentally adjusted aggregates.

Others have adapted this for topics such as fishing, water and agriculture. The developing exploration of the concept of Payments for Eco-systems Services as a means for private transactions to place value, agreed between buyer and seller, on achieving environmental outcomes, as through the management of property, may begin to bring market mechanisms to this area and so potentially aid resolution of the many current externalities.

1.17 This approach, developed independently from an economics background, tends to identify values that can be on very different assumptions from those required by the valuation profession's standards. The resulting assessments, commonly reflecting externalities and often very sensitive to changes in assumptions, may or may not be useful for public policy, according to the realism of their assumptions and rigour of their analysis, but will not be either a Market Value or be a fair value. Conceivably, they could represent a measure of Investment Value or Worth (see EVS 2) applicable to the policy makers concerned but not of wider relevance. Understanding and perhaps reconciling the differences between the two approaches may be increasingly necessary as eco-system valuations develop. In practice, the more economics-based eco-system valuations may be of greater relevance in comparing options than in identifying absolute values while more specific valuations for transactions may influence individual behaviour.

2. Sustainability and Property Users

2.1 The sustainability movement is now increasingly driven by concern over climate change and so focuses on energy and carbon issues. This bears on all aspects of a firm's business including its property and buildings. This leads to the use of new terms such as "green building" and "sustainable building".

2.2 Owners and occupiers of property may have a variety of motives for considering sustainability in general or specific aspects of it, such as energy efficiency in particular. These may range from personal commitment to cost-cutting, from complying with regulation to seeing it as an advantage with customers.

2.3 With the increasing prominence of climate change as a source of policy concern, the association of buildings with some 40 per cent of energy consumption makes property a particular focus of attention and comment. Nonetheless, energy costs may only form some 1 per cent of some businesses' operating costs, while staff costs may account for as much as 85 per cent of the operating costs of an office tenant. Such ratios have limited the impact of energy issues on rents and values. It could equally suggest that the aspects of the building that influence the working environment may have a perhaps unrecognised importance. Where tenants are willing to pay higher rents for compliant properties then that will assist values, but they may only do so if they see benefits in occupying a green building. In practice, attitudes may vary over the economic cycle.

2.4 For those owners and businesses that make purely commercial judgements, the necessary investment has to show an acceptable return. It may be that investment in improving building equipment (such as heating, ventilation, air conditioning or for chilling) may not appear justified by the financial benefits of the improved energy efficiency or the market premium of that property. Green leases (see 3.3 below) are a means to try to reconcile the common imbalance of interests between landlords and tenants in these matters.

2.5 As businesses choose or are increasingly expected to operate in ways more sensitive to these issues, their owners and customers may tend to demand more relevant credentials to prove this. For larger businesses, such credentials might include:

- demonstrations of Corporate Social Responsibility (CSR)
- a Carbon Reduction Commitment (CRC)
- accreditation according with ISO 14001 - the international standard for environmental management systems or EMAS, the EU-wide Eco Management and Audit Scheme.

A tangible example of such commitment by either party may be the use of "green leases".

2.6 Corporate Social Responsibility (CSR) describes companies' voluntary choice to integrate the consideration of social and environmental issues into their daily business to demonstrate ethical behaviour and improve social conditions. This may include considering:

- inputs, such as raw materials, energy, water;
- processes, such as environmentally friendly production; and
- publicity, such as community relations.

The more developed policies will cover property occupation and investment and so may have an effect on both capital and rental values.

2.7 While voluntary, an increasing number of companies accept CSR as an element in business plans and annual company statements. In some cases, it may be seen as a proxy for quality and good, sensitive management. It may be that the largest companies will be legally required to report on these matters. In some countries, the law already regulates the presentation of non-financial performance indicators.

2.8 A CSR policy may be driven by a company's strategic plan, its corporate risk strategy, the needs for grants and funding or pressure from investors, customers and others. A clear statement of the company's rationale will be needed for any appraisal of its impact.

2.9 Some companies encompass the ecological, social and economic aspects of sustainability in the concept of the "Triple Bottom Line", analysing and reporting performance under each heading. This is, of necessity, a permanently evolving approach and indeed sustainability could be extended to consider technical and functional quality.

2.10 Responsible Property Investment (RPI) is a framework for investors to maximise the positive effects and minimise the negative effect of property ownership, management and development on society and the natural environment. The UNEP Finance Initiative has set out Principles for Responsible Investment to incorporate environmental, social and corporate governance (ESG) issues into company policies and practice, offering a series of toolkits for this. Its declaration requires companies to look to their "investment service providers (...) to integrate ESG factors into evolving research and analysis". Recognising the constraint of a tenant's legal possession, it sees the investor's role as particularly critical for construction, refurbishment, management of common space and the opportunities given by lease termination - at each point having more control over sustainability issues than when an investor in equities (including REITs). The responsible investor should engage with its tenants to manage the environmental and social impact of a property, albeit that few historic leases have many clauses relevant to sustainability issues.

2.11 When considering investment, properties might be screened for:

- the location – sustainability grounds might point to those with better public transport or on brownfield sites;
- physical characteristics – do the buildings meet environment standards such as BREEAM, LEED, Green Star or CASBEE (see 3.2 below)? This may limit the choice of investments, potentially constraining portfolio diversification and, by focusing demand on such properties, affecting their prices and so their returns;
- tenants – perhaps by their business activity.

The data to support such screening is often limited and partial, in some markets there may be almost no relevant data.

2.12 An alternative approach is to seek out properties that are best in their class. However, this will also rely on recognised certification and rating systems, such as BREEAM or EPCs. While this may help identify properties whose value is better protected for the future, it will tend to be available only for new properties. EPCs will be issued for most existing buildings where they are sold or rented out, but the outcome may also depend heavily on the assessment methodology used which may not accurately report the status of property types for which it was not designed.

2.13 Environmental Management Systems (EMS) offer tools for businesses to consider sustainability issues by seeking continuous improvement on the basis of the four stages of planning: what is to be done, do it, check that it was done, and act to make improvements, throughout considering the impact on the environment and the activity that causes that change. It may assist businesses in looking at cost savings, managing legal, financial and reputational risks (including the identification of prospective legal requirements), marketing opportunities and the expectations of stakeholders. It can start from reviewing the current position (as a baseline) which may show that much has already been done without having thought of it as “environmental” and then developing an environmental policy to drive the future process.

2.14 ISO 14001 sets standards for these by which businesses can then be audited. These cover five aspects or stages:

- environmental policy;
- planning of action;
- implementation and operation of project;
- checking and corrective action;
- management review.

2.15 The Eco Management and Audit Scheme (EMAS) offers a European standard that is voluntary but once adopted is subject to mandatory auditing (unlike ISO 14001). As some of its requirements are supported by legislation, it may be more demanding than ISO 14001 to which it is essentially similar. A business is to identify its direct and indirect environmental impacts and assess their significance. Internal audits must cover the management of the issue, performance in doing so and compliance and there is an external audit on a three year cycle.

2.16 Life Cycle Costs - A judgment on the sustainability of a property may focus on its whole life cycle together with its associated externalities. Where the valuation employs the income method, cost and income must be analysed and reduced to a present value. Life Cycle Cost Analysis (LCCA) calculates the present value of all costs for the whole remaining life of a building, including construction, operation, maintenance and end-of-life costs. Such approaches may not yet capture all the externalities that can be involved.

2.17 Some European countries have national standards and guidelines for carrying out LCCA while the international standard is ISO 15686-5 Buildings and constructed assets - Service life planning - Part 5: Maintenance and life cycle costing set the frame. However, ISO 15686-5, does not prescribe a common format for this analysis, allowing different approaches in practice.

3. Developing “Green” Standards for Property

3.1 “Green Buildings”

3.1.1 A “green” or “sustainable building” uses resources such as energy, water, materials and land more efficiently than buildings constructed to existing minimum standards, producing less waste and fewer emissions and potentially offering a better internal working environment, benefitting health comfort and usefulness. As the concept of sustainability expects that the needs of the present should not compromise the ability of future generations to meet their own needs, green buildings should also take social, ecological and environmental issues into account. That broader definition includes external effects and the impact across generations and so the property’s life cycle.

3.1.2 The American Society of Heating, Refrigerating and Air-Conditioning Engineers (ASHRAE), in conjunction with the Illuminating Engineering Society of North America (IES) and the US Green Building Council (USGBC) published a standard for the design of high-performance green buildings in February 2010. Standard 189.1, *Standard for the Design of High-Performance Green Buildings Except Low-Rise Residential Buildings*, states:

“a high performance green building is a building designed, constructed and capable of being operated in a manner that increases environmental performance and economic value over time, seeks to establish an indoor environmental performance that supports the health of occupants, and enhances satisfaction and productivity of occupants through integration of environmental-preferable building materials, and water-efficient and energy efficient systems.”

3.1.3 That definition shows that the concept of sustainability is far from precise when applied to buildings which themselves vary enormously in design, construction and use while different users will have their own concerns which may change over time.

3.1.4 The following may serve as a general checklist:

- location - where relevant, is it accessible by public transport as well as private means?
- the existing land use of a site for development – there may be such issues as contamination or water management;
- the risks to a building's location from such threats as flooding or earthquakes or those caused by its siting and design (as with flooding from hard surfaces);
- the design and layout of building, covering issues from its expected life to its energy management, including materials (source, recycling, type, life) and resource efficiency;
- its quality as a working environment and so its impact on occupiers' health and efficiency, which can include ventilation and lighting;
- energy efficiency and sourcing;
- water efficiency;
- waste management;
- how resilient is it to potentially rising costs of energy, water and waste management?

3.2 Certification of Buildings and Green Rating Tools

3.2.1 A number of approaches have been launched for rating buildings against defined environmental standards, some statutory and others voluntary, offering standardised assessment and certification for green and energy-efficient buildings. There are around 30 voluntary rating systems worldwide that try to meet the conceptual complexity of the term "sustainability". Perhaps inevitably, they are overwhelmingly focused on new or heavily renovated buildings.

3.2.2 Internationally recognised schemes offering a more useful common standard for international investors include:

- BREEAM (Building Research Establishment Environmental Assessment Method founded in 1990) which scores the performance of a building for ten criteria (materials, energy, transport, water, waste, pollution, land use, health and wellbeing, innovation and management) whose scores are then totalled and rated. It provides different regimes for different uses such as industrial, retail, or schools. A new building may be first assessed at the design stage (with an interim certificate) and after construction. It can also apply to renovations. There are five pass grades. BREEAM reports research that office developers typically invest up to 2 per cent more to achieve higher ratings, recovering that additional investment in two to five years through savings in their energy and water bills.

- LEED (Leadership in Energy and Environmental Design) set by the US Green Building Council (USGBC, founded in 1993) applies to new buildings and renovations. It has steadily developed to create a regime of inter-related standards covering design and construction, maintenance and operation of buildings. LEED v.4 fully replaces LEED 2009 for new projects from November 2016 with a greater focus on information about materials and environmental impact in developing the scoring system used by LEED 2009, with four final levels of certification. The main scheme's criteria for assessment are sustainable sites, water efficiency, energy and atmosphere, materials and resources, and indoor environmental quality together with scores for innovation in design and regional priority. The USGBC issued data in 2008 to show that buildings compliant with its then LEED standards showed:
 - 8-9 per cent lower operating costs
 - 3.5 per cent higher occupancy rates, more recently 4 per cent
 - 3 per cent higher rents
 - a 6.6 per cent higher return on investment
 - a 7.5 per cent increase in market valuebut as noted elsewhere there may be many factors influencing such findings.

3.2.3 Other standards noted internationally are DGNB in Germany, HQE in France, CASBEE in Japan, Green Star and NABERS in Australia. Individual countries may have their own domestic standards or codes. Each scheme varies in what and how it assesses and all are regularly revised. Their appraisal methods often tend to be prescriptive rather than applying underlying principles to form assessments.

3.2.4 There are few bases for assessing existing buildings. EPCs offer a prescriptive approach to energy ratings in the EU, while the US Building Owners and Managers Association has developed Go Green.

3.2.5 All approaches tend to be applied differently in different countries, so that even EPCs vary between EU member states, posing issues for international understanding and appraisal in comparing information. (Note - the Energy Performance of Buildings Directive of 2010 instructed the European Commission to adopt a voluntary EU certification scheme for non-residential buildings (Article 11(9) - see EVGN 8)).

Global Real Estate Sustainability Benchmark (GRES B) is anticipated to be a catalyst for individual sustainable developments since it provides investors with a method by which to judge the sustainability performance of property funds against each other. This will inevitably feed down and incentivize a green approach to more and more assets.

3.2.6 Policies and expectations for sustainability continue to change and develop. Thus, mandatory standards for new buildings imposed through development control or building regulations systems may well increasingly focus on ever more demanding low

energy or passive house standards and the use of renewables as well as more general sustainability criteria. In some areas, these regular requirements may either replace voluntary green building rating tools or encourage them to set still higher standards. The Energy Performance of Buildings Directive provides for new buildings to be to “near-zero energy” standards by 2018 (public buildings) and 2020 (private buildings) (see EVGN 8).

3.3 “Green Leases”

3.3.1 The initial discussion of the concept of “green leases” has now developed with their growing use in parts of some property markets and may again have an impact on the valuation of some properties. A concept as to intention, there is no precise definition of green leases that is widely accepted in the market.

3.3.2 Discussion of green leases has arisen in response to the common imbalance of interest between landlord and tenant in environmental issues. Capital investment, sometimes with long pay back periods, is often required to improve a property's performance. Landlords and investors may often be reluctant to incur that cost without an appropriate return while tenants can be cautious about investing in a property they do not own, indeed may only hold for the balance of a short lease. The green lease, which may in practice only be agreed between parties interested in the issues for their own commercial or personal reasons, endeavours to tackle identified sustainability concerns between them and meet rising legal standards.

3.3.3 In general, a green lease refers to a lease of a sustainable/energy-efficient property on terms that promote sustainability. Those terms, widely varying in practice, may often relate to green or energy-efficient standards, operational controlling and audit procedures related to energy performance measurements. Some landlords have granted green leases with just a few basic green obligations, such as co-operation on energy-saving initiatives, provision of information on energy, water and waste, the use of sustainable materials, and prohibitions on harming the building's energy performance – “Light Green Leases”. At the other end of the spectrum there may be provisions setting targets for the use of energy, waste and water, including separate metering, reports, rent review assumptions, alterations, and reinstatement – “Dark Green Leases” (often in practice limited to some high quality buildings in prime locations). They may cover such topics as waste disposal or the avoidance of volatile organic chemicals in cleaning materials. The leases may include incentive and penalty clauses based on agreed upon service and energy performance levels which may affect the rent or be considered as improvements or dilapidations on termination of the tenancy. They may also allow the flexibility for the lease to be revised in response to developing standards.

3.3.4 The concept appears to have been first developed in Australia where the Government published a series of model green lease schedules for different types of tenancy, requiring the tenant to operate the property efficiently and extract the greatest

environmental benefit from it in ways such as using the most efficient equipment, fittings, lights and heating systems with an Energy Management Plan and a framework for reporting and auditing subject to penalties. Precedents are now available in other jurisdictions, such as the United Kingdom. They may make provision for a range of subjects to be, addressed between the landlord and the tenant including:

- the landlord providing the tenant with a handbook to energy and environmental operation of the property;
- energy efficiency targets – maintaining and improving EPC ratings with any failure exposing the party responsible to financial penalties;
- if the landlord fails to meet agreed commitments to improve energy efficiency there may be rent rebates;
- the tenant is to ensure that energy consumption is efficient and provide the landlord with full data on energy and water use;
- the landlord and the tenant produce Energy and Sustainability Performance Reports;
- alterations which materially reduce the environmental performance of the property may be prohibited absolutely;
- as the tenant may be the best person to make alterations to improve the environmental efficiency of the property, there can be provisions allowing him to leave them at the end of the lease with the landlord waiving dilapidations on them;
- a reduction in the EPC rating may be considered a dilapidation;
- service charges – where a property has several tenants the landlord may reserve the power to weight and re-weight the service charge to reflect the tenants' relative environmental performance which can then be a comparable factor at a rent review;
- a property with several occupiers may have a management committee including the landlord.

3.3.5 Green leases are now more widely seen in Europe, especially in the United Kingdom, France and now Germany, though the way it is understood varies between states with terms that are generally contractual rather than statutory.

3.3.6 However, under the French Grenelle II law (which more generally integrated sustainability reporting into financial reporting and provided for the environmental performance rating of buildings), leases must now contain a separate environmental appendix where they are for premises with an area of more than 2,000 m² intended for office or commercial use. The content of that appendix has been defined by a ministerial order of 30th December 2011:

- a list, description and energy characteristics of the equipment in the building in which the leased premises are located, and of the equipment installed by the tenant in the leased premises, relating to waste treatment, heating, cooling, ventilation and lighting.

- an undertaking by the landlord and the tenant to assess the progress of the energy and environmental efficiency of the building and of the leased premises at agreed intervals, and to agree objectives to improve the energy and environmental efficiency of the building and the rented premises.
- an undertaking by the landlord and the tenant to inform each other of the annual consumption of water in the building and in the rented premises, and the quantity of waste generated from the building and the rented premises.
- consent by the tenant to allow the landlord to have access to the rented premises for the completion of works intended to improve the energy efficiency of the building.

3.3.7 More widely, the expression “green lease” can refer to several different types of document or clause. Relevant terms may often be found in a Memorandum of Understanding, attached to the lease, sometimes preceded by a statement of agreed purposes or working from the accepted definition of sustainability. It may provide for an environmental management plan which could make more detailed provision for such matters as energy source and use, appliances and lighting, water, cleaning materials, waste, and the management of the use of the building.

3.3.8 In states like the United Kingdom, Holland and Belgium, the issues are purely ones of contract. In Germany, with no framework of relevant legal definitions and concerns about reputational risk, DIFNI DE (which certifies for BREEAM) can award a “badge of recognition” to a lease in which the parties agree a minimum number of unaltered recommended clauses. In addition, a market standard for understanding “sustainability” now appears set by the third edition of the German Property Federation’s sustainability guidelines published in March 2013, seeing it to cover environmental friendliness, economic efficiency and social compatibility. In similar need of a clear definition, the Swedish Property Federation issued a standard green lease agreement appendix in June 2012 but this is not as yet considered customary practice.

3.3.9 In countries with less experience of green leases, tenant concerns about costs can be a factor for resistance.

3.3.10 Where considering a green lease, it is prudent to make a record of condition using an energy and environmental audit to establish a baseline from which to judge the issues and commitments of the lease.

4. Valuation and Sustainability

4.1 The valuer can only provide his opinion of value on the basis of evidence and so reflecting the experience of the marketplace. That opinion cannot state that something should have a value, just that it has a value assessed from a judgment of the available

data. That opinion is to be so supported and prepared so that, within the limits of the available evidence, the client can rely on it for the purpose for which the valuation was instructed.

4.2 There can be no general rule as to any typical pattern of premiums or discounts accounting for environmental issues. Even where such issues are significant in the marketplace, much will turn on factors such as the state of the market, transparency of information, location, sector, exposure to environmental risk in the region, and consumer awareness.

4.3 Markets may in time differentiate between the values of properties on environmental grounds. Thus, it may be that highly energy-efficient buildings with low energy consumption or properties with a recognised green certification may begin to attract an additional value in some markets. While this may apply for a while, it may then be that as the market begins to expect such standards or regulation requires them, that premium is replaced by a discount for other properties. Such changes will be phenomena of the market place and there cannot be any general rule for the impact of these issues on property values, rents and yields.

4.4 The issues on which the concept of sustainability focuses may or may not be relevant to that opinion, according to the nature of the asset, the relevant circumstances and the behaviour of prospective buyers. Thus, their relevance may turn on several factors including the extent to which the issues:

- are not externalities but relevant to the price someone will pay;
- are of interest as incentives or deterrents to buyers.

In essence, it is a question of how far the evidence shows that a willing, knowledgeable and prudent bidder will take them into account when considering the price or rent of a property. Corporate buyers of commercial property may view these issues in a different way from someone buying a house to live in.

4.5 This may also be influenced by market circumstances. Where there is a strong market with a limited supply of buildings, the market may not particularly distinguish between properties on sustainability grounds. However, as these issues come to matter to buyers and occupiers and as more properties meeting recognised sustainability criteria are available so the market may differentiate on this point, perhaps especially when market sentiment is weak.

4.6 There may be particular classes of bidders to whom sustainability issues may be more important. Most obviously these will include those for whom the ethical aspects matter more, whether out of personal conviction or under the rules of a specific investment fund. Some may be temperamentally interested in innovation – “early adopters”.

4.7 Others may see them as criteria relevant to potential future movements in values. They may think that properties meeting particular standards are more likely to rise in value or that properties failing to meet them are at greater risk of standing at a discount to a future market. Only the future will prove whether they were right or wrong, whether about the future reactions of markets or the specific criteria they have selected. Where such purchasers have chosen the right criteria and markets prove to move as they expect, then they may outperform the general market whether by buying advantageous properties or selling ones at greater risk from environmental factors. Markets may, of course, move in unforeseen directions or regard other factors as relevant.

4.8 One way of analysing this behaviour is to observe that those parties are approaching their decisions on the basis of Investment Value (also known as Worth – see EVS 2 and EVGN 5) in assessing the value of a property to them for their own objectives. Where the Worth of the property to them on their criteria is markedly greater than its Market Value, they may see an opportunity.

4.9 When considering properties that are to be let, sustainability issues will be more relevant if they encourage tenants to pay higher rents or the market to see them as more secure income streams. The former will depend on the usefulness of such properties to tenants, over and above other properties – tenants will rarely have an interest in the future capital value of the property. Such buildings may offer relevant differences in energy or other costs, more attractive working environments for staff or help the tenant project its favoured image to its own customers. Some of this will inevitably overlap with the likelihood that the most sustainability-compliant buildings will be those built most recently, so also meeting other contemporary standards and be less likely to need refurbishment in the near future. Less compliant properties may need to incur the greater costs of adaptation in “retro-fitting” to meet rising standards as and when this may be required, whether by market expectations or as legislation develops or stand at a discount to more compliant properties.

4.10 Should such an approach become more widely adopted by parties in the market place in respect of particular criteria then it would over time influence market values. However, if the criteria in question do not become more widely used, they would remain factors for only a limited number of individual players with less or no influence over market values.

4.11 These issues can become more difficult where a building is in several different occupations where the owner and occupiers may all have differing obligations, interests and objectives.

4.12 Where markets do move towards a greater appreciation of sustainability, whether just, say, for energy or a wider range of issues, then it will be relevant to the

assessment of Market Value. In practice, analysing this may often not be a matter of general sustainability, but of appraising the role of specific issues (such as energy) which may interact with operational costs or be currently salient issues in the market place.

4.13 Many may say they will pay a premium for meeting certain general standards such as BREEAM, but, as can often be seen in such matters, this may be less evident from actual behaviour. It can be hard to tell from market evidence of actual transactions where traditional factors may often appear to explain the outcome.

4.14 Conversely, as legislation, market sentiment and perhaps taxation increasingly enforce sustainability issues, so the costs of compliance and improvement for many existing properties or more complex development proposals (such as some urban regeneration schemes) may adversely affect their values.

4.15 **“Green Value”** - The concept of “green value” is sometimes invoked. Just as there are various green building definitions, there is no commonly accepted definition of “green value”. At one level, it can just mean that the “sustainable” qualities of buildings and properties may be reflected in their value.

4.16 More specifically, green value is the extra value a green building may have when compared with an ordinary building. However, while this may offer a useful shorthand, especially for comparison, such green value does not exist on its own but is one integral part of the property’s overall market value and is separate only as a theoretical construct.

4.17 **Approaches** - While ever greater attention is being focused on sustainability issues, it is often noted that they may often not be reflected in market values. As any one issue becomes of general concern to buyers, so it just becomes part of the general matrix of factors underlying market value. The effect may of course not be that of a premium over other properties, but that less compliant properties may be at a discount.

4.18 Sustainability, energy efficiency and green features can only be reflected in the valuation where this is supported by observable market evidence. There is no reason to assume that meeting or failing to meet any aspect of sustainability will generally see a premium or discount in the property’s value. The impact of a feature may vary over time, between different sectors, uses or regions.

4.19 All existing valuation methods – mainly income, direct value comparison and replacement cost – are suitable for the valuation of sustainable buildings. Comparable transactions are the best proof of the market’s willingness to pay for certain building features.

4.20 In some markets, the valuer may try to apply advanced statistical methods to identify green value as part of his analysis. This may depend on the quality, range

and relevance of available data and skill in its objective analysis. The use of multiple regression analysis may persuade more sophisticated clients. Contingent valuation, hedonic pricing or even cost-benefit analysis may offer approaches but these can risk producing results that are uncertain, unduly sensitive to changing assumptions, with large ranges and that are not obviously supported by the market place. The valuer may also draw of the analysis of very large data samples that is now possible. While that can illustrate even relatively subtle effects the statistical associations apparently demonstrated need objective testing.

4.21 Discounted Cash Flow (DCF) can be a way of taking into account and comparing differing profiles of operating and refurbishment costs.

4.22 One practical problem is that sustainability issues do not exist in isolation but, as noted above, will overlap with other factors. For example, energy efficiency may be a virtue, a cost saving, allow a higher quality of working environment and be an aspect of a modern building which, as such, has lower maintenance costs, less need of refurbishment and may be in a more attractive location. Taken on its own, energy efficiency might not be the decisive factor in value

4.23 As a practical profession, valuation turns on observation and appraisal. In present circumstances, considering sustainability issues in relation to a property requires careful analysis. It may only rarely be that sustainability issues as a generality will be relevant, but more often that specific issues and particularly, specific standards will be of concern. Standards, certification and rating regimes can summarise and encapsulate information on, say, energy in ways that the market may more easily take into account. It thus becomes more important to know how to:

- identify, describe and assess the relevant characteristics of properties;
- interpret and judge assessments of them;
- consider whether they are already taken into account so far as they are relevant to value;
- select the appropriate way to take any remaining points into account without double counting.

4.24 Once relevant factors are identified and appraised in this way they can, in principle, be taken into account for valuations in just the same way as any other specific factors. They do not require new valuation methods but rather calm, practical assessment under the terms of the valuation basis instructed. They will need to be covered in the valuation report to the extent and in the manner that is appropriate.

4.25 The extent to which the report refers to sustainability will be a matter of judgement in the circumstances. This will in part reflect the extent to which sustainability issues are relevant to the value and in part the interests of the client. These two points come together where a client interested in sustainability issues instructs a valuation on the basis of Investment Value.

4.26 Any recognised certification or rating awarded to the property should usually be reported.

4.27 Towards Checklists - Where sustainability issues are relevant to the valuation, the valuer will have to collect appropriate information, appraise it and take it into account in his report, either as aspects within the usual structure of his report or as separate sections, with or without appendices, according to the case. The diversity of properties and the developing nature of sustainability combine to mean that no general check list can be exhaustive but it may, according to the property, be relevant to consider some or all of the following non-exhaustive lists of points.

4.28 Alongside the usual description of the property, factors to consider might include:

- construction materials;
- any contamination of properties such as brownfield sites for development;
- risks of natural disasters such as flooding, earthquakes, or avalanches;
- compliance with relevant building standards;
- insulation and related features, its special features (such as heat bridges or type of windows) and continuity in terms of durability, regional and legislative building standards;
- nature and complexity of building services;
- age and quality (efficiency) of the equipment in the building for heating, cooling and other purposes and so the feasibility of maintaining or replacing specific building components (such as an oil-fired heating system compared with an alternative system that may reduce overall operating costs);
- energy efficiency, EPC ratings and recommended measures for improving it, energy sources (renewable?) and net energy demand;
- water efficiency, especially in locations with scarce water supplies, using grey water, recycling of water, rainwater harvesting, etc.;
- operating expenses;
- floor area in terms of usability, adaptability and cost effectiveness;
- impact on users' productivity and wellbeing;
- likely timing and cost of refurbishment;
- market attitudes towards sustainability and willingness to pay for green features;
- requirements of legislation;
- possible financial support;
- relevant certifications or ratings;
- terms of leases (green leases).

4.29 Reviewing the property more generally:

- Does it meet best practice?
- Can deficiencies be remedied economically?
- How does it compare to other buildings in the area of search?

- Do sustainability issues affect the demand from potential tenants? And the rents they will pay?
- Do they affect the yields that other investors will seek?
- What are its running costs and the likely timing and scale of any refurbishment costs?

4.30 While this paper has considered sustainability largely on the environmental terms that are salient in today's discussions, other practical issues of adaptability and flexibility of the property and the space and facilities it offers may also be aspects of its ability to remain useful without major change. Where larger areas of land are involved, as with agriculture or for development, other relevant issues may include bio-diversity and diffuse pollution. Where an Environmental Impact Assessment is required, that will require a review of many sustainability issues.

EVIP 2

Valuation Certainty and Market Risk

Summary Guidance

1. **Introduction**
2. **Scope**
3. **Definitions**
4. **Valuation Uncertainty**
5. **Property and Market Risk**
6. **Lessons Learnt from the Financial Crisis: The Irish Example**
7. **Conclusions**

Summary Guidance

S1. Valuation Certainty - The security of the valuation depends on the valuer's application of professional skills to clear instructions and good evidence, acting in accordance with valuation standards. The better the evidence and the more professional the appraisal, the more secure should be the valuation. The potential certainty of a valuation is challenged where markets are non-existent, dormant, thin or volatile. In such circumstances valuations are best accompanied by descriptive commentary on the issues to assist the client's understanding of the figure given or perhaps some form of sensitivity analysis.

S2. Future Risk - Events subsequent to the valuation and any decision taken on its basis may mean that the value of the property will change over time. These changes may offer gains or risk losses. Clients in general, and secured lenders in particular, may be more troubled by risks of loss. Such risks might arise from:

- changed market circumstances;
- physical changes affecting the property;
- regulatory changes; or
- developments in the wider economy.

Again, it may be possible for the valuer, as an informed observer of the market, to offer a view about potential changes in the value or marketability of the property in certain defined circumstances. That must, though, be firmly on the basis that these are observations about a future that cannot be known.

S3. Regarding both valuation uncertainty and future risk, the key is that there be an open and clear relationship between the client and the valuer with shared expectations of what is properly wanted from the valuer, what can properly be delivered by the valuer and how it may be understood and used so that the valuer's skills and experience can be employed to the best effect by the client. The valuer can be "eyes" of the client, inspecting and assessing the property in its context, informing the client in taking the decisions about risks and actions that only the client can make. An open understanding of those expectations and of the boundaries between the roles of valuer and client (often best defined in the terms of engagement) will enable each to do most effectively what is most appropriate to them – the valuer can alert the client to any unusual uncertainty in the valuation assisting the client's evaluation of future risk.

1. Introduction

1.1 Valuation, Certainty and Risk - The value of a property exists in the market place as the outcome of the interplay of supply and demand for the attributes, opportunities and deficiencies of that property in its contemporary circumstances, almost always in competition not only with other similar properties but often also with other assets and market places. As such, a value has no independent objective existence but is the summary of a property's circumstances and the market's evaluation of expectations into a single figure at a particular moment in time, captured by the concept of Market Value (see EVS 1).

1.2 While the instruction may impose specific further assumptions or the use of other bases, such as fair value (see EVS 2), this issue is best and most directly considered in the context of the fundamental concept of Market Value. In principle, that is the value that summarises, from the behaviours of actual and potential buyers and sellers, the market's view of an asset's value taking into account all the information known about it, including expectations as to the future. The leading definitions (such as EVS 1) generally define Market Value as an "estimated amount".

1.3 As with all exercises in judgment, the value of a property is subject to uncertainty, both as to the valuation and as to the value that may actually be realised, either on the valuation date or at any later date. Such uncertainty may arise from:

- the facts on which a valuation is based, whether at property itself or the market and any limitations on their volume, quantity or certainty; and
- the judgment applied to those facts.

1.4 Once assessed, that value is then subject to risks for the future. These are a natural part of the real world and inherently associated with the potential for profit and loss. They include:

- changes in market circumstances, including the balance between supply and demand for the property in question or the emergence of particular bidders;

- changes in the regulatory framework for the ownership or occupation of the property;
- changes in the future circumstances of the property.

1.5 Valuation Standards, TEGoVA and EVS - While the risks of the market place and the future are for those acting in the market place, the role of valuation standards is to ensure that valuations for those parties are soundly based, thoroughly prepared and reveal relevant issues of judgment on which opinions may legitimately differ.

1.6 TEGoVA has acted positively to support valuation certainty for the clients of valuers by:

- generally requiring and supporting its member associations in upholding professional standards and ethics – indeed, setting a European Code of Ethics and Conduct;
- specifically by preparing and regularly updating European Valuation Standards (EVS - the most recent, eighth, edition published in 2016);
- its Recognised European Valuer (REV) and TEGoVA Residential Valuer (TRV) programmes identifying qualified and active property valuers.

It expects valuations to be undertaken by an experienced professional whose report conforms to the requirements of EVS.

1.7 EVS 3 defines the qualified valuer and requires ethical behaviour, fiduciary duty, independence, appropriate qualification, experience and expertise. TEGoVA has set and revised Minimum Educational Requirements. All these steps support professional valuers in their skill, experience and objectivity.

1.8 EVS set out best practice to alleviate potential concerns relating to certainty. It is recognised that many clients expect a report to provide, not just an opinion of value, but a justification of that opinion. That can be offered with a section in the report that discusses the approach to value, providing suitable comparable evidence that is evaluated with the client informed of the characteristics of the chosen comparables that are considered in the report, and then comments on market circumstances. Building on the long history of EVS, TEGoVA's EVS 2016 provides the tools to do this.

1.9 In the Wake of the Financial Crisis - These supports for valuation certainty are consistent with the requests from financial authorities, following reviews of the financial turmoil from 2008, seeking more transparency in valuations. While much of this concerns the different world of complex financial instruments, it is also clearly relevant to real property.

1.10 As we have gained more perspective on the financial situation since 2008, discussion has moved to the issue of risk management. That requires the risks to be appreciated and understood. The Basel Committee's Supervisory Guidance on Assessing

Bank's Financial Instrument Fair Value Practice urged "the articulation and communication of valuation uncertainty both within a bank and to external stakeholders". The IASB has extended the valuation disclosures required by IFRS. While, again, obviously focussed on financial instruments, this can easily be read across to real property.

2. Scope

Every valuation report concludes by giving the valuer's opinion as to the value of what is being valued. The financial crisis has stimulated discussion of the certainty to be given to a valuation. The purpose of this paper is to provide:

- an understanding of both valuation certainty and market risk in the context of the challenges posed by sometimes non-existent, thin or volatile markets;
- ways forward for valuers and clients to understand each other more effectively, improving valuation certainty;
- an approach by which the valuer can, if instructed and within his expertise, offer the client a qualitative view of market risk to the value of the property.

3. Definitions

3.1 Market Value - "The estimated amount for which the property should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion." (EVS 1)

3.2 Valuation Uncertainty - The extent to which an assessment of the value of an asset as at the valuation date might not be exact. That uncertainty might arise from market circumstances, lack of evidence, deficiencies in the valuation or differences in professional opinion.

3.3 Market Risk - The possibility that the value of the asset might change after the valuation date for reasons that could include physical risks, macro-economic circumstances, changes in the market and regulatory change.

4. Valuation Uncertainty

4.1 While there are underlying principles for valuation, its practice and the issues will vary with:

- the nature of the asset;
- the nature of the available evidence; and
- the factors in the market for such assets.

This means that there is not a standard answer, particularly with the very varied nature of the assets, markets and parties for real property.

4.2 The essential proposition is that the Market Value of a property should be the value at which it would sell as at the valuation date between knowledgeable and willing parties after proper marketing (other bases of value cannot be so readily tested). It is the work of valuation standards to provide the framework and standard assumptions within and on which the skilled work and judgment of a professional valuer can identify that answer for a specific property on a specific date.

4.3 His ability to do that will depend not only on his skills and the framework for the valuation but on market circumstances and the quality of the evidence available to him. The more thorough the inspection of the property and the identification and analysis of comparables, the more likely it is that the valuation will be well and forensically founded. As a human judgment on a complex world it is accompanied by some uncertainty. Different valuers may legitimately come to differing opinions as to the value of the same asset at the same valuation date. That can reflect differing judgments as to the weight to be given to particular factors in the market or the appraisal of the subject property. It can also reflect differences in the evidence available to each valuer – and also where restrictions have been imposed on the inspection, inquiries or information available. While the latter could be reconciled by ensuring the same evidence is available to all, the former is a **difference of opinion**, inevitable in any human activity. The more that professional valuers experienced in the market in question are used, the more this issue will be reduced to genuine and legitimate differences of professional opinion.

4.4 There are larger reasons that may be inherent in the market place for **valuation uncertainty** beyond the different of professional opinion. These most obviously lie in the limitations on the available evidence or other market circumstances as at the valuation date.

4.5 Ultimately, all valuation is comparative – that is the nature of the trade that creates the market that expresses values. Actors in the market compare the asset with the other assets they possess or want and also with the resources they have or could obtain. That comparison is most reliable when the comparables used are closest to the subject property. They should be of a similar physical and legal nature. They should be in the same marketplace. The transactions concerned should be as close as possible to the valuation date. There should be as many comparables as possible.

4.6 Transactions in property are more individual than for many other assets and, even within classes of property, it is also much less homogenous than many other assets. At its most basic, property is distinguished by its location, not just by country but by locality and all the issues inherent in that, including possible special purchasers. Even in the same location, there will be differences of age, size and function, aside from

questions of its occupation or particular conditions applying to the transaction. This is the specificity that makes the valuation of property a challenge warranting professional consideration and judgment, closely informed by knowledge of the relevant market.

4.7 In turn, the specificity of real property makes the prevailing market conditions more critical in this. There may be ready markets for residential flats or conventional offices but not for more specialist properties and so comparison of prices or yields is easier for the former than for the latter. Critically, markets can be:

- thin, with little supply at the time of valuation;
- volatile, moving rapidly (and perhaps changing direction) and often associated with low trading volumes;
- non-existent or dormant.

4.8 As each of these circumstances creates problems over comparisons, each poses a challenge for valuation:

- In a thin market, the number of possible comparables may be limited and few if any may be directly comparable, especially for properties with individual features. Consideration and use of each potential comparable then has to be given to the adjustments to be made for differences between the properties in physical terms (e.g. location and facilities), in legal terms (e.g. title and tenure), financial terms (basis and reviewability of rents) and in the date of the transactions (how close they are to the valuation date). Each of these issues creates a link in the chain of comparison, each requiring judgment, each extra link adding a greater likelihood of variation in the final answer.
- A volatile market can make it hard to form a judgment when prices are moving rapidly around the valuation date, whether upwards or downwards or are simply unstable. Not only does this make it important that comparables are for transactions at times very close to the valuation date but such market conditions are often associated with low levels of activity which means there are fewer comparables than in a normal market. Alternatively, such markets may be associated with periods of high inflation and so be accompanied by other economic dislocation.
- In a non-existent market with no transactions occurring, there are no directly relevant comparables on which to draw yet it is usually clear that assets that could be traded do have a value.

4.9 A further challenge is where a sudden change in market circumstances makes transactions prior to the change less relevant as comparables.

4.10 Markets can be badly disrupted by sudden financial, political, legal, natural or other events. At one extreme, these may genuinely change (or suspend) market perceptions of value but, at the other extreme, may only suspend transactions for a short period with value remaining evident, if temporarily unrealisable. On occasions, it can be hard to tell at the time where an event lies in that spectrum. The valuer should report such circumstances as they may be of particular importance to understanding the security of the valuation.

4.11 In all these cases, the valuer can still make a judgment as to value but his report should express the uncertainty accompanying it, describing and commenting on it.

4.12 For some properties, perhaps most obviously some development properties, it may be possible to illustrate the issues with sensitivity analysis.

4.13 One option in such circumstances is to look for models to take the facts available for the subject property and generate a value. To an extent that is what the income method of valuation achieves, so far as it is being used to value the property rather than the income expected from it. Yield, judged against comparables, is a measure of risk. However, a model is simply an artificial means to represent the real (and often complex) world and is only as useful as its assumptions, being vulnerable to changes in market behaviour or problems over the data used to drive the model. Especially at very low yields, relatively slight changes in assumptions can lead to large changes in valuations so making the results sensitive to such choices. Apparent precision may thus not bring real accuracy and the results should be subject to judgment which may in turn lead to revisiting the assumptions of the model.

4.14 All valuations, on whatever method they have been prepared, should be subject to a cross-check as to market reality – would the actors in that market actually pay (or accept) the sum assessed? That becomes even more important where the valuation has been achieved through a hypothetical model.

4.15 The valuer can only report the Market Value at the time to the best of his ability and within the limits of the evidence available. The valuer can however include in his report a commentary on relevant conditions, perhaps by considering the European Mortgage Federation's risk criteria, reproduced as Appendix C of EVGN 9, which can at least alert the client lender. The lender, aware of the financial environment in which money might be lent, may judge the loan to value ratio or other terms appropriate to the case.

4.16 With the nature of the real property markets and at least some actors in them making long term decisions, this appraisal is likely to be best expressed descriptively with a qualitative view rather than attempt to quantify the risks in question as might perhaps be feasible for a financial instrument. The complex and interactive nature of real property markets suggests that a simple quantitative assessment is unlikely to be illuminating. On

occasions, an answer might be for the clients to instruct that an additional opinion be given on the basis of a specific assumption about market conditions.

4.17 More generally and given the complexities, a considered commentary may often offer more explanation than reporting a different figure predicated on a precise assumption that may prove to be irrelevant or misleading. It is stressed that such a commentary is about uncertainty as to the valuation as at the valuation date, not possible risks to value in the future, considered below under the heading of market risk. In undertaking such a view, the skilled valuer familiar with his market will be better equipped with the practical perspective that can be gained by having worked through at least a couple of full economic cycles.

4.18 However, it might on occasion be feasible, where required, to give an appreciation of legitimate valuation uncertainty by indicating a range of values with a commentary. This could be akin to the spread between the buying and selling prices of some financial instruments and is what could be expected of a valuer as an expert witness in litigation.

4.19 Where the valuer considers valuation uncertainty to be significant (more than might ordinarily be understood by a market participant), then explaining it is part of giving the client a clear understanding of the valuation. Whether the valuer places stress on the figures or on the commentary, such further information could convey a sense of the market conditions in which the valuer has arrived at his specific opinion. However, it is then still for the lender or other client to form their own views as to whether and how to act – those decisions should not be delegated to the valuer.

5. Property and Market Risk

5.1 A valuation gives a value as at the relevant date, taking account of the market's views of the opportunities and risks then involved with the property. The property is subsequently exposed to the uncertainties of the future as they unfold, often in ways not foreseen at the valuation date. So far as they were taken into account by the market at the time, they should be reflected in the valuation. However, the future may bring profit or loss and prudence may dictate attention to these risks.

5.2 Such risks may be classified in many ways but most may come under the following headings which are among the reasons why values and relative values change over time:

- physical risks – is the property at risk from earthquake, flood, coastal erosion, rising sea levels or equivalent risks? Is the building likely to need major repairs or updating?
- macro-economic circumstances – the period of time for which property is held

and the effort involved in property transactions make property vulnerable to changes in the economy or general financial conditions;

- changes in the market – commercial patterns may change, as, for example, a shift of retail from towns to regional centres, the changes that follow the move to interest trading, or changes in the customary agreed lengths of leases;
- regulatory change – not only might changing standards or new requirements add costs but changes in legislation or development control policy may create or remove opportunities for value.

5.3 These and other risks are all issues for the investor and lender (and indeed the seller or landlord) to consider as part of the risk management aspects of their decisions. Each participant in the market is fully entitled to arrive at an individual view; it is that diversity of views that makes a market. At the valuation date, all these potential prospects are hypothetical and so the valuer can only report on them to the extent to which the market has taken them into account. He cannot be expected to foresee changes in market attitudes or new information and is no more likely to succeed in foreseeing the unknown than anyone else. Indeed, when considering risk management in a market place, a key question is what is the level of risk that actors in a particular market commonly consider they have accepted by participating in that market.

5.4 Where real property is used as security for lending, the lender has a substantive interest in seeking to understand how far the property is likely to be useful as security for the life of the mortgage. Since a mortgage is a loan for a period of time of a value fixed in nominal terms, this question becomes more acute should relevant property prices fall or in periods of deflation or increased market volatility. Others making investment decisions or simply committing resources to property rather than another asset or to one property rather than another may have similar needs.

5.5 That practical question is, however and like all investment decisions, one about the future and so about things and events we cannot know but on which we all may take views. While changing circumstances may offer the opportunity for profit, there is understandably often greater concern about the potential for loss or damage from changes in the market place – of natural concern to a secured lender.

5.6 The attempt to judge that is an attempt to judge **market risk**. That risk will always be of the future variation in values. The value at each future date should encapsulate the balance of the views of actual and potential buyers and sellers at that future time in the circumstances then holding. The risk may also be of changes over time in the liquidity in the market for the asset as circumstances and tastes change. Minor changes in liquidity may be part of the normal process of price adjustment but more substantial changes or market shocks may mean the possibility of periods when an asset cannot then be sold. It may assist analysis and advice to distinguish between the probability of an event occurring (its risk) and the magnitude of its consequences for the person (his exposure).

5.7 Analytically, it may be helpful to distinguish between:

- the sense that economic activity and values move in cycles and so that each valuation date is at a given point in the cycle, whether on the upswing, the peak, the decline or the trough; and
- the knowledge that prices change relative to each other as part of the process of a freely functioning market giving signals to its participants from the aggregate of their own actions in response to new information so that regions, sectors and types of property move in and out of favour whatever the state of the cycle.

5.8 Some discussion since the financial crisis began in 2008 has focused on the role of market sentiment and the ways in which the behaviour of buyers, sellers, lenders and others can feed into and reinforce a trend or cycle, whether on the upswing or the decline, and lead to prices that overstate the prevailing view, whether positive or negative, until underlying fundamentals (or new information) result in a correction. Not only does every cycle have its characteristics but it will work itself through in different ways in different markets. However, this is about more than economic cycles and the possible illusion of predictability that analysis might be thought to offer. The normal process of continuing economic change is an important part of the wider issue of future uncertainty. It can be hard in practice to distinguish the upswing of a cycle or the effects of loose money from underlying growth. Equally, the bottom of the cycle can be hard to see at the time. Not only will the actual path of any cycle only be evident with hindsight but the economy itself always alters over a cycle. The course of a cycle can mask or enable more fundamental changes between sectors, classes of property or geographical areas. Some sectors may remain strong even in a downturn (especially if they are seen as safe in a time of risk), while other sectors may never recover to their former position and some (agricultural land can be an example) may tend in particular circumstances to move against the cycle. The market place will have changed between the equivalent points in successive cycles.

5.9 That analysis indicates that identifying a long-run sustainable value for a property as the alternative to judging market risk is challenging. A valuer's practical experience of previous cycles will support an awareness and understanding of changes in the behaviour and volatility of the property's price and its market but that is nonetheless inevitably subject to unknown future changes in markets and risks.

5.10 A Value in the Longer Term? – While the valuer cannot give reliable opinions of the value at any future date with its unknown circumstances, it may assist some clients if his commentary on the valuation in the Valuation Report (see EVS 5) might record where present market circumstances significantly diverge from long-run trends, looking over decades. For let commercial properties, that might refer to the long-run average yield for the relevant class of property. Other data might be relevant for the housing market, such as prices as a multiple of incomes. The underlying insight is that markets tend over time to revert to the mean. If a relationship between values, such as

yield, has diverged markedly from that average, it may well, all other things being equal, revert to that long run yield at some point in the future. That observation of overall markets then needs to be tempered by the circumstances of the individual property, whose type or location may be improving or weakening in the overall market as the economy changes. Nonetheless, while such an approach may be useful for some clients as commentary, it will not be a measure of market value which is specific to its point in time. Long run value is not a basis of value though a client may instruct the use of one of the versions of Mortgage Lending Value (see EVS 2 and EVGN 2) as a basis for some form of sustainable value.

5.11 Furthermore, individual investors and lenders may, as a risk management strategy, seek to form a view on their own criteria as to a long run value or a minimum secure value that may exist in all but cataclysmic conditions. If given clear instructions as to the desired assumptions, a valuer may be able to assist with those judgments.

5.12 These considerations do not remove the point of drawing on experience of previous market cycles. They are rather to observe that each valuation is at a given point in the economy at which there are prevailing trends and prospects (not necessarily limited to the cycle) which may be vulnerable to change. It is right that, where appropriate, the valuer comments on this as he might were he an expert witness in a court.

5.13 Beyond issues of the cycle, most recent concerns have arisen from unforeseen market circumstances. Property may be affected by changes in legislation and taxation. Recent discussion of shocked markets perhaps started with the Al Qaeda attack on the World Trade Centre. Since then parts of Japan have seen the effects of major physical disasters and many western economies have seen significant but diverse financial crises. Each of these may have been outside the risks that market participants may have thought they were accepting in entering the markets in question and in some cases may have exposed markets that could anyway have been unsustainable.

6. Lessons Learnt from the Financial Crisis: The Irish Example

6.1 Each country in Europe experienced the recent financial turmoil in different ways but property (and finance lent on property) was distinctively at the heart of the problems in Ireland. As an acutely concerned regulator, the Central Bank of Ireland understandably considered these in its report "Valuation Processes in the Banking Crisis – Lessons Learnt – Guiding the Future" (Final Version, 18th December 2012).

6.2 Of the three over-riding areas of weakness identified by the report primarily addressed to lenders regulated by the Bank, one concerned valuation uncertainty: "inadequate valuation processes and standards or a disregard for adherence to such processes".

6.3 Of the seven “primary weaknesses” which the report identified in lenders’ valuation processes, two relate most clearly to valuers:

- *Weaknesses in instructions given to valuers* - “... Valuations based on vague instructions provided inaccurate values and therefore inaccurate assessments of risk at the time of underwriting.”;
- *Conflicts of interest are unacceptable* - This is reported as a phenomenon of the “volume led transaction phase of the property development boom”. Where there is a conflict of interest it may be more likely that the valuation provided “is neither robust nor reliable” as it will not be independent. The valuer’s duty of care is to the lender as the client who should require that the valuer disclose any previous involvement with the property. No valuer involved in the purchase, sale or letting of the property should be used. All instructions should come from the lender, fees should only be paid by the lender and the valuation report should be specifically addressed to the lender.

6.4 In reviewing this, there is an important distinction between the role of the client, instructing and using the report, and the role of the valuer, preparing the report. Each has his own responsibilities but their mutual engagement, recognising those different roles, can maximise the value of the work.

6.5 It is for the experienced, skilled, independent professional valuer to provide a clear and informative report as to value and, as instructed, related issues within the valuer’s expertise as explanation. The report opens with the Bank expressing itself as content with valuation standards as appropriate practice, protecting the credit institution, the borrower and the valuer. Approving TEGoVA’s EVS, it said “Valuations methodologies are about assumptions and judgments. ... There are clearly defined industry rules for valuers, which we support ...”. However, it found that “many had been overlooked, omitted and in some cases totally disregarded during the property boom”.

6.6 The risks of future movements in values are to be managed by the lender, albeit that the lender may need to call on the valuer’s services again in this (and the perhaps unrealistic expectation that the valuer might be able to comment usefully on the property’s marketability over the life of the loan).

6.7 Those are important conclusions from a review of one of Europe’s most difficult property markets. The lesson learnt is to promote exactly the points that TEGoVA promotes, through EVS 2016 and other vehicles. EVS 4 sets out the basis for the valuation process, including the terms of engagement which would include the instructions (including those as to the valuation basis; as, for example, Mortgage Lending Value rather than Market Value). Alongside TEGoVA’s European Code of Ethics and Conduct, EVS 3 addresses this and stresses the independence of the valuer. The valuer’s professional duty under EVS 2016 would ensure precision in his work, however deficient the client’s instructions.

6.8 Thus, the proper professional preparation of valuation reports within recognised valuations standards by independent valuers conveying an opinion as to value to the client with an explanation of relevant points is the bedrock for the profession and its work. That is the necessary foundation for more sophisticated discussion of valuation uncertainty and market risk.

7. Conclusions

7.1 At its most basic, a valuation report is a transfer of risk in the market place. Someone wanting to take a decision over a property wishes to do so with a clearer view as to its value. Much of this discussion is about the scale of the risk that can properly be transferred between the client and the valuer. That calls for clarity about the role of each and agreement as to the expectations each has of the other so that there is a mutual and positive understanding between them. It is important that the valuer understands the interests, needs and concerns of the client and that the client understands how best to use the valuer. That calls for a relationship between them in which each is open with the other. The valuer may need to help the client to be explicit as to what is reasonably required and to what purpose the report will be put – that helps frame the instruction. The valuer, possibly aware of key matters not mentioned by the client, has to be sensitive to this and, as necessary, seek clarification to ensure that a professional and useful service is provided.

7.2 The professional valuer brings his skill, experience and objectivity to that and accepts responsibility for it. It is for the client to decide how to act on the valuation – for example, whether or not to lend and, if lending, on what loan to value ratio, for what term and on what conditions. Where the client is, for example, a professional investor or a lending institution it seems proper to expect that they have their own risk management procedures. However, the valuer may be able to advise on any potential uncertainty as to the valuation and the reasons for that and also, as an informed observer of the market, offer a description of possible future risks which may offer additional value to the client in its decision making on the basis that such views are essentially speculative judgments of the unknown.

7.3 The Irish evidence is clear that the essential basis is the competent production by the valuer of an objective and professional valuation report, drawing on skill and experience. The more significant the issues, the more the report should cover the valuer's methodology, the approach(es) taken to the valuation, the discussion and weighting of arguments. Such a report is an explanation of the valuer's thought processes. He may consider factors such as the European Mortgage Federation's risk criteria reproduced as Appendix C of EVGN 9, which can at least alert the client or lender to particular points.

7.4 The valuer can only report the Market Value at the time. Knowledge of the future is beyond his professional skills. He can, though, provide a commentary giving a context for that value but, in doing so, can only comment usefully on relevant current market conditions. That commentary may convey some sense of the contemporary understanding of the state of the economic cycle or other economic trends bearing on the position of the property in the market. He may also comment on how those conditions vary from long run trends.

7.5 Where useful, the report might consider the sensitivity of the valuation to identified reasonable changes in market or other conditions. That could be by testing the assumptions on which the valuation depends. For example, what might be the position should demand markedly reduce or increase? In what circumstances might it be impossible to sell the property? This appraisal is likely to be better expressed descriptively with a qualitative view rather than attempting to quantify the risks in question. The complex and interactive nature of real property markets suggests that a simple quantitative assessment is unlikely to be illuminating – and so more likely to be misleading. Perhaps especially where there are concerns about shorter term market risk, a client might instruct an additional opinion the basis of a specific assumption about market conditions.

7.6 Nonetheless, the valuer's conclusion will be a single value as his best opinion as to the value at the date in question. It is then for the client to use that combined report in its risk management and decisions which are its commercial judgments. The valuer cannot serve as an expert witness on the future and so cannot be expected to accept any liability for views expressed about future trends if these views are not borne out by subsequent events.

EVIP 3

Apportionment of Value between Land and Buildings

- 1. Introduction**
- 2. Scope**
- 3. Definitions**
- 4. Commentary**
- 5. Apportionment in Practice**
- 6. Apportionment between Components of Buildings under IFRS Accounting Standards**

1. Introduction

1.1 Valuers often encounter situations where the value or the purchase price of a property has to be apportioned between its different components. In particular, EVGN 1, Valuation for the Purpose of Financial Reporting, makes reference to apportionment.

1.2 This information paper reviews the assessment of apportionment between developed land and buildings on land, neither of which can usually be marketed separately. This is thus a distinct topic from the valuation of undivided shares in a property (i.e. the valuation of one person or body's share in a property whose ownership is shared between several people or bodies). Apportionment may also on occasion involve equipment and machinery or intangibles. In addition, the value attributed to the buildings may have to be further apportioned between different components of the buildings.

1.3 Apportionments will generally be required in order to allow the owning entity to depreciate the value of the buildings over their remaining useful life. It is generally considered for accounting and taxation purposes that land is permanent and does not lose value. Any depreciation is therefore limited to the buildings and to any improvements to the land, hence the need for an apportionment of a price or value between the land, on the one hand, and the buildings and improvements, on the other.

1.4 The financial consequences of an apportionment can be considerable. Some entities may have special interest in improving the benefit to them and valuers must

be aware of this. Therefore it is imperative that any figures they report are prepared in accordance with best practice and can be supported if they are subsequently challenged.

2. Scope

2.1 The purpose of the current information paper is to analyse the valuer's approach to this apportionment of a property's value or purchase price. This may be required for financial reporting purposes, the classification of a lease under IFRS, or taxation. Values may also need to be apportioned for rent reviews in some jurisdictions or to apply agreements between parties. EU Directives and international and national accounting standards all require an apportionment for depreciation purposes.

2.2 In addition, entities adopting the cost approach to accounting under IFRS for either operational properties (IAS16) or investment properties (IAS 40) will be required to apportion the Fair Value of the properties between the various components of the buildings. Similar "componentisation" may also be required under some national accounting or tax regimes.

2.3 This paper will address general approaches to apportionment in the first instance, then deal in more detail with apportionments required under IFRS accounting standards. For any apportionments required under national or local accounting, taxation or other regulations or legislation, the valuer should refer to the appropriate national or local texts and associated case law and should take account of any specific requirements expressed therein.

2.4 Finally, it should be noted that if apportionments are challenged, the challenge can take place many years after the figures were originally reported and the financial consequences of a successful challenge can be serious for the reporting entity. For this reason it is important for valuers to give due consideration to the apportionments they carry out and to document them carefully, in order to be able to defend them at a much later date.

3. Definitions

3.1 Common terms used in the apportionment of the value established for a property between land and buildings on the land are:

- depreciation;
- depreciable amount;
- residual value;
- the useful life;
- depreciated replacement cost;
- excess or surplus land.

And these are defined below. Where appropriate, IFRS definitions are given. However, valuers providing apportionments for non-IFRS purposes should ascertain which regulatory or legal system applies to the work they are carrying out and read the relevant texts to see how the various terms are defined in them.

3.2 Depreciation - this is defined in IAS16 as “the systematic allocation of the depreciable amount of an asset over its useful life”. It is the reporting entity, not the valuer, who will decide how to depreciate the depreciable amount and who will prepare the depreciation calculations.

3.3 Depreciable amount - this is defined in IAS16 as “the cost of an asset, or other amount substituted for cost, less its residual value”.

3.4 Residual value - under IAS16, this is “the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life”.

3.5 Useful life - IAS16 defines useful life, as it applies to real property, as “the period over which an asset is expected to be available for use by an entity”. Therefore if a particular building is shortly to become surplus to the entity’s operational requirements and demolished, its useful life for the particular reporting entity may be less than the useful life that another owner would have attributed to the building if it had not been surplus to his needs. If he is asked to establish or to assist in establishing the useful life of buildings, the valuer should therefore liaise with the reporting entity, to ensure that he is aware of the entity’s intentions for the various buildings.

3.6 Depreciated Replacement Cost of a building is the cost to replace it so that it can fulfil the functions for which it is used, after allowing for ageing, wear and tear and obsolescence. It is generally determined by starting with the replacement cost as new using reconstruction costs current as at the valuation date. These will generally be based on current technical standards for buildings with modern materials and methods. The depreciated replacement cost will include the fees associated with the construction. It will generally be used as the basis for apportionment in cases where the valuer has decided to approach it by first determining the “value” of the buildings.

3.7 Excess Land (or Surplus Land) is land within the property that is not essential to the operational purposes of buildings. Thus, land that is used by the entity for parking or for external storage should not be considered as surplus land, whereas unused land or land let out to third parties would be considered to be surplus to the entity’s requirements.

4. Commentary

4.1 Apportionment of value between the components of a property is not a valuation. The outcome of the apportionment should not be taken as corresponding to the Market Value of the components.

4.2 In respect of apportionment, the valuer's judgment and selected methodology will determine the adjustments necessary to provide a realistic and justifiable opinion of apportionment.

4.3 The sum to be apportioned is commonly either:

- the Market Value or Fair Value of the property established by appropriate use of the three internationally recognised valuation approaches; or
- the price of the transaction by which the property was acquired by the entity.

4.4 In some jurisdictions there may be policies for apportionment of certain classes of property established by legislation, government agencies or local practice. Where such apportionment policies are in place, they must, or as appropriate, may be adopted. The valuer may need to explain or justify the method used.

4.5 Permanent buildings cannot be sold separately from the land on which they stand. Similarly, the land element of a built property cannot usually be sold separately from the buildings that stand on it (apart from any surplus land). While evidence of sales of bare land will often be available, such sales will generally have taken place on the basis of the value that the market sees in the property (including its potential uses), whereas in the theoretical world of apportionments the use of the land is deemed to be restricted to the current use. In view of all this, it is unlikely that valuers will be able to directly value either of the two component parts by directly applying evidence obtained from comparable sales of land without its buildings or buildings without the land on which they stand.

4.6 Therefore where the requirement is to apportion value between land and buildings on that land, the apportionment process will usually be dealt with in one of the three following ways:

- a. determining the value of the unimproved land for its existing use at the relevant date and then deducting this value from the value or price of the property in order to obtain the value attributable to the buildings; or
- b. determining the depreciated replacement cost of the buildings and of any improvements to the land at the relevant date and deducting it from the value or price of the property in order to obtain the value of the land; or
- c. determining the value of the unimproved land, then the depreciated replacement cost of the buildings, adding the two amounts together, then adjusting each in proportion to the relationship that the sum of the values of the two components bears to the value or price that is to be apportioned.

4.7 The Land - The component of the property that is the land is considered to be the bare land in an undeveloped state but with planning permission for construction and for the current use of the buildings. In countries where additional permits are required for particular uses (e.g. for large retail complexes), those permits are also assumed to exist and to be part of the land, assuming that they have indeed been obtained. The services that exist are assumed to be available for connection but all built improvements within the boundaries of the property such as roads, fences, paved areas and other site works are excluded, as they have to be depreciated. The valuation will thus reflect the advantages and disadvantages of the site and its location for the current use. It should not include any development potential over and above that required for the buildings being considered. Similarly, the value attributed to the land should ignore any additional value due to a potential change of use, as any depreciation is to be applied on the basis of the existing use of the reporting entity.

4.8 “Excess land” or “surplus land” is not included for the apportionment. Excess land, if there is any, should be identified and then valued separately on a market value basis with any development potential that it may have. If a purchase price of the whole property is to be apportioned then the value of any surplus land should be deducted from the purchase price before apportioning the remainder between land and buildings. The value of any excess land should be reported separately from the value of the operational land.

5. Apportionment in Practice

5.1 The use of one or other of the three procedures in 4.6 above depends on the relevance and quality of available information. It is unlikely that the first two methods, even where supported by good evidence, will give the same result, as they involve different concepts and the “value” of the whole property may therefore differ from the sum of its separate parts. If only one of the first two methods is used, the valuer will then use his professional judgment to justify the selection and application of the apportionment procedure used and any subsequent adjustment in reaching his final figures.

5.2 Determination of the “value” of the land, then deducting it from the value or price – in many instances valuers will be more comfortable with this approach, as it starts with a valuation of land for a particular purpose, which can sometimes be based on a comparison with other land sales in the open market. If no comparables are available, the valuer can use a residual or DCF development appraisal, which are procedures that he will usually be familiar with.

5.3 As stated above, it is essential to determine the value of the land solely on the basis of the existing use of the property, i.e. the type of property (retail, offices,

warehousing, etc.) and the existing built floor area. Where the current property is not in its highest and best use, this will often give a land value that is lower than the price that could be obtained if the actual land were sold with vacant possession on the open market. However, that higher value should not be used for apportionment purposes if the reporting entity proposes continuing the current use, which is generally the theoretical basis on which apportionments are prepared.

5.4 The land should be valued on the basis of the unimproved site, ignoring the value of any roads, foundations, paved areas, on-site pipework or tanks, etc. as all of these items are generally depreciable.

5.5 Where existing buildings are nearing the end of their useful life, or where major expenditure would be required to bring them back up to modern standards, the valuer will often find that the land value will represent a very high proportion of the total value or price to be apportioned. In extreme cases, such as where a developer has bought a property to demolish it and redevelop the site, the land element may represent close to 100% of the value of the property. High percentages for the land are often seen, for example, with office buildings that were built several decades ago and have not been significantly improved since. This is a logical conclusion of the depreciation process: the buildings have aged considerably and thus the majority of the value is in the land, so valuers should not be surprised by such a result.

5.6 For this reason, valuers should be very careful if they are tempted to adopt “short cut” methods of apportionment, such as tables that purport to give percentages to be applied to a purchase price per square metre in order to obtain the land value. Such short cut methods often only work correctly for new or very recent properties.

5.7 Determination of the “value” of the buildings, then deducting it from the value or price - this procedure is more often used:

- a. where there is little or no evidence of values for relevant land;
- b. under jurisdictions that apply a building tax to the book value of the building;
- c. when dealing with property where there are other owners in the building and where rights of common interest might exist;
- d. when applying the procedure in 4.6.a results in a value of the building that also includes intangible assets or personal property, which may limit the value of the figure so deduced.

5.8 Where the depreciated replacement cost of a building is used, the value to be applied may vary according to whether any consideration has been given to its possible economic obsolescence. Generally speaking, the objective is to reflect the age and suitability of the buildings for their current use – if there is a high degree of obsolescence then the value attributed to the buildings will represent a lower percentage of the total value than would be the case for a more modern property. The choice of percentage

deductions for age, obsolescence, etc. is for the valuer to make according to the circumstances of the particular property.

5.9 Calculating both values, then determining the apportioned amounts on a “pro-rata” basis - as stated above, the total of the notional land value and the notional building value is often different from the amount that is to be apportioned. In such cases valuers may decide that it is best to apportion the value or price on the basis of a pro-rata calculation based on the values obtained for each of the two elements. This will be a matter for valuer judgement based on his confidence in each figure and his knowledge of the property and its market.

5.10 Checking and reconciling values before reporting - as stated above, the apportionment of price or value between land and buildings is a theoretical exercise and not a true valuation. It is rare that the first two approaches (in 4.6.a and 4.6.b above) give the same results. The valuer will therefore generally have to review the values he has obtained and decide whether they can be reported as such or whether further adjustment is needed.

5.11 If the value that remains for the building component under the procedure in 4.6.a is higher than the replacement cost of the building when adjusted for physical deterioration it is recommended that the valuer thoroughly analyses the value he has found. It is possible that this value may include the benefit of intangible assets or personal property. It may be the case that intangibles will be subject to depreciation or annual impairment testing and that the useful lives of intangible components often differ from the useful lives of buildings. The valuer should liaise with his client on the accounting treatment that is to be applied to any intangibles or personal property, which may have to be excluded from the apportionment or expressed separately.

5.12 On occasion, valuers are required to apportion the value of a portfolio of properties between land and the buildings on the land. One approach to this is to establish the appropriate apportionment for a representative sample of properties and then extrapolate that to the larger portfolio so far as the properties in it are comparable. This sample-based approach should not be applied unthinkingly, as some properties in the portfolio may not have buildings at all or may differ significantly from the sample in terms of building density, age, quality and condition.

6. Apportionment between Components of Buildings under IFRS Accounting Standards

6.1 Entities that have adopted the cost approach to accounting under IAS16 (as opposed to fair value) will have to apportion prices or values between land and buildings and then further apportion the value of the land element between the various

components of the buildings. This will be particularly the case for operational properties (those occupied by an entity for its own business purposes), for which the cost approach to accounting is recommended for IFRS. Valuers who are asked to apportion a price or value between components should familiarise themselves with the relevant parts of IAS16.

6.2 Identification of the components - the first step in this exercise is to identify the components between which the value has to be apportioned. Paragraph 43 of IAS16 states that "Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately". According to paragraph 45, "A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and depreciation method of another significant part of the same item. Such parts may be grouped in determining the depreciation charge".

6.3 The process of identifying components can therefore be summarised as:

- a. Identify the components that have a "significant" cost in relation to the value of the whole, then
- b. Identify their useful life and depreciation method, then
- c. Group together parts that have similar useful lives and depreciation methods.

It will be noted that there is no definition or quantification in IAS16 of what is deemed to be "significant".

6.4 It is the responsibility of the reporting entity to determine the appropriate components for depreciation purposes. The financial consequences of a wrong choice of components could be serious for the entity and will often only become apparent many years after the original apportionment was carried out. For this reason, if the valuer is asked to identify the components, it is recommended that he should involve the entity fully in the final decision process and seek written confirmation of their agreement to the components that have been identified.

6.5 In the absence of relevant case law it may often be unclear whether it is appropriate to go into great detail or, on the contrary, adopt a pragmatic approach based on, say, 4 or 5 families of components. Given that the initial apportionment between land and buildings is a theoretical exercise and therefore often somewhat approximate, many entities prefer that valuers approach the apportionment of the building value between the building's components in a pragmatic way, only identifying those significant features that differ greatly in character. Excessive subdivision is indeed likely to lead to implausible values of little assistance to the client or other advisers and to yield results that may necessarily differ substantially between valuations according to the assumptions and interpretations applied.

6.6 Nevertheless, there may be cases, such as older buildings that have been partially renovated, particularly in the case of large complexes such as shopping centres, where, for example, the various technical installations may have different useful lives and depreciation patterns and where it would be appropriate to take account of this. In such cases valuers are advised to obtain as much information as possible on site and from their client about the ages of the main technical installations and the dates when major renovations or refurbishments were carried out.

6.7 Apportionment between the identified components - components of a building can generally not be sold separately from the rest of the building, so no sale evidence will be available. Generally apportionments will therefore be carried out with reference to the relative cost of the various components when new, with appropriate adjustments in cases where some components are much nearer the end of their useful life than others.

6.8 Finally, it is particularly important to prepare and retain accurate notes as to how the apportionment was carried out and the reasons behind the valuer's key decisions. An apportionment prepared for accounting purposes is likely to be audited and the valuer's report will help in the audit process. Finally, those records will also make it easier to interpret the figures for any subsequent apportionment.

EVIP 4

Valuation and Other Issues for Recurrent Property Tax Purposes

Summary

1. **EU Economic Governance and Recurrent Property Taxation**
2. **Taxation of Property**
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Summary

S1 As part of the Economic Governance programme, the EU is encouraging member states to move the tax burden away from a higher incidence of tax on labour towards recurrent taxes on property, environmental taxes and consumption taxes. There are anyway practical reasons why states have often found property to be a useful part of their tax base, being identifiable and immovable.

S2 With the political sensitivity of many taxpayers to property taxation, this move raises many questions about the optimal design of such a tax in the context of the history and circumstances of each tax-raising state. This Paper explores those issues to aid clarity of thinking about the purpose of the tax and equity in its application, which may vary substantially between countries, reflecting their differing histories, economics and cultures.

S3 A property taxation system requires an accurate and comprehensive register of properties and that that register be kept up to date.

S4 A basis must be decided for determining the value of each taxable property. That might use capital values or rental values, whether of the property as it is or of the land underneath it, and whether assessed on ownership or on occupation. Those choices may reflect local circumstances and may be different between classes of property, such as residential and non-residential. Those valuations will need agreed assumptions which should be applied to all comparable properties so that they are assessed on the same basis. All valuations should be as at the same date of valuation, so that all properties are treated equally. That process should be transparent to the taxpayer.

S5 While it is likely that most properties can be valued on the basis of market transactions, sales or lettings, relevant to the date of valuation, there will always be some properties for which there may be little or no evidence, for which other approaches will have to be found. These approaches will need to be tested carefully as they are developed.

S6 An effective and independent appeal system is important, both to achieve accurate and fair valuations and also in order to be able to command the political respect that a property tax system needs among taxpayers.

S7 Valuations need to be reviewed and updated on a regular basis so that the tax base accurately follows changes in relative property values. This Paper suggests that revaluing all properties on a regular 3 or 5 year cycle is likely to strike the right balance between fairness of valuations and uncertainty. Leaving this task too long will see values used for the tax become increasingly out of date and this will compound the political difficulty of re-valuing; annual review may be too demanding and not allow appeals to be heard before the next review takes effect.

S8 Property tax systems commonly have defined exemptions, full or partial reliefs and sometimes higher rates for particular classes of property or particular types of potential tax payer.

S9 All these issues resolve into the essential points that a good tax system must be efficient, serve its objectives, not have perverse outcomes and command the respect of those who have to pay the tax.

1. EU Economic Governance and Recurrent Property Taxation

1.1 Governments have raised taxes on property for many centuries more than they have raised them on income. The European Union's Economic Governance programme is placing renewed emphasis on property as part of the tax base, especially in preference to the distinctively high taxes on labour that are levied in some member states, so encouraging a shift in the way tax is raised rather than an increase in the overall level of

taxation. While property taxes include those on transactions, on gains (real or deemed), and on inheritances, the EU is promoting annual recurrent taxation.

1.2 The EU's position was summarised in Communication (2014) 400 on the *2014 European Semester: Country-Specific Recommendations*:

"The structure of tax systems, and particularly the shifting of the tax base from labour to other sources, is an essential aspect of on-going reforms ... More generally, progress can still be made to reduce the overall tax burden and/or to make the tax system more efficient and less distortive. It is possible to conduct such reforms in a way that improves the efficiency of the tax collection, encourages economic activity and job creation and brings greater fairness to the tax system. Some recommendations thus focus on ... further shifting the tax base away from labour to taxation which is less detrimental to growth such as environmental or recurrent property taxes."

1.3 That followed an established line of Commission analysis as set out in its paper, *Tax Reforms in EU Member States 2013*, which included section 3.2.2, headed: "Room for Manoeuvre: Potential for Increasing Consumption, Property or Environmental Taxes", identifying that:

"Member States are considered to have room to shift taxes away from labour if their tax burden is relatively low in at least one of the following three areas: consumption taxes, recurrent property taxes or environmental taxes."

It is understood that this is particularly focussed on those countries with high taxes on labour. The accompanying Q&A paper advised that:

"Around one third of the Member States are found to have scope for shifting taxation away from labour to tax bases less detrimental to growth. In these cases, a high tax burden on labour (including specific labour market groups) coexists with some room for increasing growth-friendly taxes, i.e. consumption taxes, recurrent housing taxes and environmental taxes."

That also implies a level of national discretion about the specific design of such alternative taxes.

1.4 That paper developed the Commission's thinking, saying:

"A second category of less growth-harmful taxation comprises recurrent taxes on immovable property, though these generate substantially less revenue than consumption taxes. In terms of revenue, property taxes can be considered particularly low in 19 Member States, which could raise their revenues by 0.4 percentage points or more by bringing revenue in line with the EU-27 average. However, the revenue from the tax on imputed rent, which is applied in a limited number of countries, is not included in the data."

This could explain the very low revenue from recurrent taxes on immovable property in some countries (e.g. in Luxembourg and the Netherlands). As discussed in Chapter 4 (Subsection 4.2.2), revenue from recurrent taxes on immovable property could, first of all, be increased by bringing the cadastral values of housing in line with market values. Tax rates could be increased as a second step.

1.5 That subsection 4.2.2, headed “Housing Related Taxation”, set out the Commission’s detailed thinking on the approach to property taxation, which underlies the proposals then made to member states including those with relatively low levels of tax on labour and high recurrent taxes on property. Its only specific references are to housing, rather than to commercial or other property, and in particular:

- it tends to support a **shift from taxing property transactions** to a recurrent annual tax on property. Transactions taxes “tend to discourage transactions, which implies that the market is likely to be thinner and the price discovery process hampered.” “Tax systems that rely heavily on taxes on property transactions provide scope for reform. A shift from taxes on property transactions to recurrent taxes on immovable property would reduce the distortions introduced by the tax, as there would be a more limited negative impact on the overall allocation of resources in the economy.” “A gradual shift from taxing immovable property transactions to a recurrent tax on housing could potentially improve the functioning of the housing market in several Member States.” The Q&A observes that “Countries with relatively high transaction taxes on property transfers and relatively low recurrent tax on property could consider shifting taxation from transaction to recurrent taxes”;
- while taxation of property is normally on capital values, “housing can also be regarded as consumption of a service with taxation designed in line with other consumption taxes. Another possibility is to regard the tax as a payment for local public services.”;
- in principle, if housing is taxed on a capital basis that should be neutral between different forms of investment and so “returns from residential property would be taxed as other capital income” envisaging that would be a liability to Income Tax on the rent or imputed rent less depreciation allowances and interest charges. A recurrent annual tax would be a proxy for that tax on imputed rents. The level of that tax will depend on the treatment of income from other investments;
- a recurrent tax may be more practical than a tax on imputed rents for owner occupied housing;
- a first step is to ensure that base for tax is brought in line with the properties’ market value;
- whether a recurrent tax or a tax on imputed rents, the values for the tax base should be regularly updated. Failing to capture properties that are rising in relative value will tend to support rising house prices;
- it recognises a need to consider the “distributional concerns” found with housing taxation, such as pensioners owning high value property but with low incomes (noting that might be handled by deferrals or ceilings);

That approach is then followed through in the regular editions of country specific recommendations by the Commission.

1.6 The incidence of overall property taxation (not just annual recurrent taxes) across the EEA varies widely between member states. In 2011:

- as a share of GDP they ranged from 0.3 per cent in Estonia , 0.4 per cent in Slovakia and 0.5 per cent in Austria, the Czech Republic and Lithuania to 3.2 per cent in Belgium (understood to be primarily registration and inheritance taxes) and 4.2 per cent in the United Kingdom;
- as a share of total taxation, they ranged from 1.0 per cent in Estonia and 1.2 per cent in Austria to 6.4 per cent in Spain, 7.2 per cent in France and 11.5 per cent in the United Kingdom.

2. Taxation of Property

2.1 There are longstanding reasons for property forming an important part of a country's tax base:

- its location is fixed, which is increasingly important in a world of globalisation and the internet in which both capital and income can be footloose between countries. International firms will still pay property taxes wherever they are registered for company taxation purposes;
- its ownership and/or occupiers are normally easy to identify. Countries increasingly have registers of property ownership and other interests, while many other ways exist to identify those in control of a property. Further developments are now in train for the identification of the beneficial owners of companies;
- those factors make tax collection and enforcement relatively easy - in the extreme, by taking possession to meet unpaid liabilities;
- its relative illiquidity means that differences in the incidence of taxation have to be significant to distort economic behaviour to the extent that can be swiftly achieved under other taxes. However, inappropriate levels will, over time, affect behaviour in the market: high liabilities may make some properties unattractive or reduce rents and investment, with the converse where liabilities are low, supporting higher prices and rents.

However, in each jurisdiction such a tax will interact with the other taxes on property in general, or on particular classes of property. With the specific nature of each property and the cost and effort of transactions in it, adversely-affected taxpayers may not always be able to adjust their circumstances swiftly.

2.2 A recurrent property tax is likely to be a relatively stable part of the tax base, attractive to governments, as it is less responsive than income and company taxes and VAT to changes in economic activity (which is perhaps a drawback for taxpayers).

2.3 The real theoretical and practical issues concern the interlinked questions of the purpose of the tax and how it is to be raised. The policy purposes are usually more political than theoretical but may then be constrained by both the most practical ways to manage the tax and the political constraints on the design of the system and on any changes to it. Key questions include:

- is the purpose of the tax to be a tax on property as wealth or on its value for occupation?
- might it be taxed on the services it offers (say, through Income Tax) or as a means of saving, as an asset?
- is it to be assessed on a capital, rental or other value?
- for developed land, is it the value of the underlying land or the value to an occupier of the building on it? Or the value as it might be developed?
- should there be the same framework for residential and commercial property?
- how are owner-occupied and leased properties to be treated appropriately?

Each answer to those questions offers a different economic stimulus with differing effects on the market place and the economy.

2.4 Economic theory points to the underlying land being taxed to encourage its efficient use. Its supply is essentially fixed and so should not be substantially affected by even a significant rate of tax, though that tax might usually be reflected in the value of the land subject to it – the market can still be expected to pay the same sum overall for the property. In reality, the operation of relevant development control systems does introduce some ability to move land between designations and so alter its supply for particular uses with effects on the balance between supply and demand.

2.5 The main Commission papers on this subject focus on housing rather than property more generally, even though the Commission Staff Working Paper on Ireland of June 2014 implied that the Irish tax base should be broadened to include non-residential property.

2.6 Residential property offers services to its occupier and an asset often offering benefits, income or otherwise, to its owner.

2.7 The role of business property as a factor of production can suggest the economic argument that it should not be taxed at all, to avoid distorting commercial choices about the use of competing factors or business structures. While it would be politically contentious to relieve businesses of that taxation, those issues may be compounded where the tax liability on such property is high. For example, some retail users of property are now feeling the burden of taxation when competing with internet retailers who do not have the same liability for retail property taxes. For international companies such property costs may be one factor bearing on their choice of location.

2.8 Political practice often results in a single tax on land and built property combined, with regimes then applying to residential and non-residential property. Separating them creates an operational issue for the approach to properties with mixed business and residential uses.

2.9 Property taxation is also very visible to its taxpayers and so its design will necessarily reflect local or national circumstances and culture. There will be differences between countries as to whether taxation is seen to be better linked to wealth or to current income or consumption. That can become more contentious where taxpayers continue to be liable for a property that no longer reflects their current financial circumstances.

2.10 Recurrent property taxation can be seen to challenge the famous dictum of Jean Colbert, the seventeenth century French Minister of Finances, that

“The art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least possible amount of hissing”.

Indeed, an IMF Working Paper (WP 13/129, *Taxing Immoveable Property: Revenue Potential and Implementation Challenges*) noted:

“The tax on immovable property has been characterized as probably the most unpopular among tax instruments, in part because it is salient and hard to avoid. But economists continue to emphasize the virtues of the property tax owing to its relatively low efficiency costs, benign impact on growth, and high score on fairness.”

2.11 By contrast to payroll taxes, it is generally paid directly by the person liable for the tax, rather than deducted at source. It is not part of a larger price paid by the consumer, as is the case with VAT. That difference can mean that taxpayers see the property taxes they pay directly as especially salient. Furthermore, property is often one of the major assets of most taxpayers – for many individuals, the major asset – and, for example, many homeowners will have gone to efforts to improve their property. This can make this topic a subject of great sensitivity, especially where the system adopted allows disparities between the tax assessment and the ability to pay it. That can be seen as both:

- stimulating democratic engagement because the tax payment is generally obvious, and
- acting as a political constraint on how much can be raised in addition to economic considerations.

Experience shows that this political dimension can then encourage inertia when considering updating the tax base to current values, with the result that relative current property values tend to drift away over time from actual relative tax liabilities. It also

leads to the creation and defence of particular exemptions and reliefs. It is politically challenging to introduce a new property tax. Its design will be equally limited by the administrative capacity of the taxation and valuation authorities.

Example 1 - *The Swiss canton of Lucerne voted in 2014 to abolish its property tax with taxpayers arguing that they already paid a wealth tax while other charges on homes were higher than in other cantons.*

Example 2 - *Annual property taxation (rates) was a central topic of British politics in the late 1980s. Properties had last been valued in the early 1970s for the rental-based rates system that partly funded local government, with subsequent revaluation abandoned. Rising levels of rates, especially in London and some other metropolitan areas, had made them contentious when a revaluation in Scotland proposed major changes in liabilities for rates. The resulting controversy led to the accelerated replacement of domestic rates with the Community Charge, a flat rate tax due on each adult, first in Scotland and then England and Wales, with major changes in incidence. That antagonised those adversely affected, to the point where the issue was a major factor in the fall of Margaret Thatcher and fed an already accumulating sense of Scottish separateness. The Community Charge was then replaced by the Council Tax, based on property values as at 1991, allocated to bands with the tax on each band set in a fixed ratio to the central band, substantially relieving higher value dwellings. Since then, only Wales has undertaken a revaluation of residential properties for the Council Tax and has since shown no wish to repeat that exercise.*

Example 3 - *The taxation of housing has been controversial in Italy. The housing tax, IMU, which had been introduced by the Monti government as a response to the financial crisis, was abolished from the start of 2014 as a condition of the grand coalition then governing Italy. Silvio Berlusconi campaigned in the February 2013 election principally on a promise not only to abolish IMU but to reimburse it. Assessed on an area basis, IMU had replaced a previous tax, ICI, which exempted primary dwellings for national owner-occupiers. In turn, it was to be replaced by a service tax, TASI, levied on the occupier rather than the owner of the dwelling and so was in turn an issue for both larger, poorer families and those with second homes.*

2.12 On the basis that at any given moment, the tax on property is to raise an expected sum of money, the valuation of each property simply determines its share of the tax base. If all values double, then each property is left paying the same share of the tax levied at half the previous tax rate. However, economic change means that over time the property market will see values in some areas or for some sectors rise or fall compared to other areas and sectors. Without revaluations, the incidence of the tax is less related to actual property values.

2.13 Any such system depends on accurate valuations with a common date of valuation in order to ensure the fair treatment of taxpayers compared with each other and thus to maintain political respect for the system among taxpayers. It depends on

a register of properties which are then regularly valued. Increases in tax yield may arise from a growing tax base (more properties, possibly at higher values) or increasing the rate of tax – the ability to do that is constrained by political processes and by questions as to where it would create economic problems.

3. Defining the Properties

3.1 Such a tax relies on a full and current list of taxable properties so that each can be identified. The valuer will need sufficient detail of the property to assess it and for it to be useful as a comparison when considering other properties. That detail will need to include the property's nature, floor area, accommodation and layout.

3.2 As properties are improved, their use changed or new properties created, so a system will be needed to ensure that the register is updated for these changes, triggering valuations as appropriate.

3.3 The lack of complete records of the Mapping and Surveying Authority was one of the arguments put to the Slovene Constitutional Court in spring 2014 when it ruled that a new real estate tax was unconstitutional, as it did not determine the value of property clearly enough. Defects in Russia's cadastral register delayed the proposed introduction of a property tax there. It is understood that the register in Cyprus has been distorted by buyers delaying the registration of properties into their names to avoid the associated charges.

4. Valuation

4.1 General Comments

4.1.1 In principle, the establishment or periodic updating of the tax base in a developed country with administrative capacity is a conventional valuation exercise, albeit on a very large scale.

4.1.2 It may be handled by national or local government agencies, whether using in-house valuation departments or retaining external valuers. Those valuers' skills are applied to the properties recorded on the register of properties. That register needs to be maintained so that it provides comprehensive and accurate base for the tax.

4.1.3 The process needs an established and clear basis for the valuation – whether capital or rental, on what assumptions, on market value or other basis. This is needed not simply to aid the task of the professional valuers concerned, but also to ensure taxpayer confidence in the system with the important requirement that it be clear that all are assessed fairly. That transparency should apply to the procedure as well as to the basis of valuation.

4.1.4 In order to provide a generally agreed common basis for such valuations, *European Valuation Standards 2016* defines “Market Value” in EVS 1 as:

“The estimated amount for which the property should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion.”

As the above definition is drafted in terms of capital values, EVS 1 also gives an equivalent definition of “Market Rent”:

“The estimated amount of rent at which the property should be leased on the valuation date between a willing lessor and a willing lessee on the terms of the tenancy agreement in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion.”

4.1.5 The choice between capital value and rental value as the base for valuation and so tax assessment may reflect a number of factors, including:

- availability of evidence - a market with substantial numbers of sales transactions will more readily support capital valuations while one with much rental evidence will more readily support a rental basis. That will differ between national markets and between sectors – business and residential markets may have different characteristics on this point. For example, when the annual property tax system for England, Wales and Scotland was heavily revised in 1991, a capital value base was adopted for residential taxation, but a rental base retained for non-residential taxation;
- whether the tax is more acceptable in the national political culture as a tax on the current use value of the property or the wealth it may represent;
- whether it is better seen as a tax on occupation or on the services that the property provides to an occupier or a tax on ownership.

These issues pose particular questions for let (or investment) property. Who is to be liable to pay the tax, the occupier or the owner? Once that is known, it will affect the terms of new agreements between them.

4.1.6 In practice, such issues may drive separate approaches for residential and non-residential property.

4.1.7 That analysis reveals again the essential combined influence of policy purpose, political acceptability and practicality. The disproportionate visibility of such property taxes should encourage structures that are easy to assess, accepted as relevant and intelligible to taxpayers.

4.1.8 Where a full valuation is to be done, it has to be undertaken on a common basis for all properties subject to the charge and as at a common date of valuation, requiring a range of standard assumptions to be imposed, whatever may be the actual terms of occupation for any individual property. Such potential assumptions might include:

- that the property is as it stands but is assumed to be in good repair – so that poorly kept property does not benefit. Nonetheless, less tax would be due from a property with poor facilities than for an otherwise equivalent property with better facilities;
- that it is vacant, so ignoring current occupation arrangements;
- that, where relevant, moveable machinery is ignored but the potential of the property for it is recognised. Similarly, a house might be assumed to be unfurnished.

4.1.9 One question that has to be tackled is whether improvements made by the current occupier are to be disregarded or not.

4.1.10 Where a property is very individual, say a mediaeval college, and assessment as such is thought inappropriate, then it could be that the value of a hypothetical modern equivalent property serving that same function might be considered instead.

4.1.11 If a rental basis is to be used for valuation, then standard terms for a lease also need to be assumed – as, for example, setting out clearly who is assumed to undertake what repairing and insuring liabilities for the property.

4.1.12 With those questions answered, the valuation of many properties will be relatively straightforward in cases where the evidence of transactions from active markets can be readily applied. Many countries maintain registers of land with records of transaction prices available to those assessing values for taxation. The usefulness of this may depend, especially for more individual properties, on accurate knowledge of the nature and location of the property and any relevant legal considerations.

4.1.13 However, in any such comprehensive exercise there will always be a significant number of properties for which this will be more difficult:

- there may be little relevant evidence – what is the value of a reservoir? Railways, oil rigs and fibre optic networks are also little-traded properties that may need to be valued;
- it may be felt that applying current values is inappropriate for domestic political reasons;
- there may be interactions with exemptions or reliefs, as in cases where part of a property is taxable (say residential) and part not (because it is an exempt use or subject to a different tax, such as one on businesses).

4.1.14 Where there is no sufficient market evidence, then it may be possible to arrive at a value by other valuation techniques:

- the value of many commercial properties may be tackled by working from the income they will yield, applying a capitalisation rate if a capital value is needed or identifying a standard way relevant to the sector in question to move from that to a rent. Yields for this may well vary between areas, sectors and qualities of property;
- it may be possible to consider some specialist trading premises on the basis of an agreed relevant fraction of typical profits;
- if, as may be the case for some specialist industrial property, neither comparison nor income methods appear valid, then it may be necessary to work from a construction cost and then identify an annual equivalent as a rental value.

4.2 Actual Approaches

4.2.1 There is a wide variety of approaches taken under the many different property taxes in EU member states. Overall, it may be that the larger the share of taxation that is raised by the tax, the more it is likely to be based on market values, whether capital or rental, albeit that their registers of values may now often be very dated. By contrast, countries that have had to put a system in place swiftly before property markets developed tend to apply standard values or mass appraisal with varying levels of adjustment to measured area.

4.2.2 Within market value-based countries, dwellings will generally be valued using transactional evidence, but income methods may be more used for commercial property. Many systems will resort to replacement cost methods to assess values for specialist, often industrial, property. Systems that tax land and buildings separately may use market value for land but sometimes a cost-based approach for buildings.

4.3 Land Value Tax (Site Value Rating)

4.3.1 If the tax base is just the value of land without the buildings on it (bringing undeveloped or vacant land into tax alongside developed land), the valuation requires an assessment of the land assumed vacant, so that tax can be raised on the potential of the land at the time of the valuation and so, in principle, encourage land to be moved into its most valuable use.

4.3.2 A century ago, this was tackled in the United Kingdom by the Valuation Office which was created in 1910 to do just this. The register of property values was completed by 1920 when the proposed tax was abandoned. Land value taxes have been implemented in Denmark, some states in Australia and the United States and parts of the Far East.

4.3.3 This assessment may be problematic in those areas (perhaps particularly areas found in city centres) where there are few comparables for such bare land sales or lettings, yet high values may be at stake. Its application can then lead to disruptive questions - for example, what is the position for a three storey dwelling subject to a lease with five years to run when the vacant value of the site might be that for a 30 storey building? Is it fair to charge tax based on a high land value that cannot be realised today? Is the resulting charge to be paid by the occupier or the landlord?

5. Maintaining the Valuation Register

5.1 However the valuation is done, the result should be a valuation register as at a common valuation date so that all properties are treated equally. With changing markets, that valuation date will soon become historic, while properties subject to the tax will change physically or develop new uses and new properties will be created.

5.2 Where a new taxable property is created, it will need to be added to the register and given a value. For equity's sake, that value should be as at the common valuation date for that register.

5.3 Commonly, changes to a property, whether it is extended or part is demolished or it is improved or its use changed, may again be occasions for a revaluation, again as at the same common valuation date, so looking backwards rather than at its current value.

5.4 Ordinarily, this is a practical exercise, though ever more retrospective as the valuation date becomes historic. The register itself and the evidence on which it is based gives the official valuer an enormous data base for reference. However, this may be more difficult for properties in sectors with substantial technological change, since there may not have been comparable properties at the valuation date – where were data centres a decade ago?

6. Revaluation

6.1 The pace of change and volatility in the property market and the economy will rapidly make valuations dated, such that each taxpayer's relative share of the liability may no longer reflect current relative values. As values move relative to each other over time, with some areas or sectors becoming more or less valuable relative to others, so that distribution of liability for tax will become less appropriate. Keeping that liability in line with current values assists the political credibility of the system as a tax basis.

6.2 That drives a need for regular comprehensive revaluations, the more so for more dynamic economies, but this can be politically contentious and it is noticeable

(and noticed by the Commission) that many registers have not been revalued for some decades, even in systems that presume much more regular revaluations.

6.3 The cost and effort involved will rarely make an annual revaluation appropriate. It could be that valuer-assisted mass appraisal techniques could increasingly do much of this more automatically, but even they will still leave a substantial number of properties requiring individual attention and judgment and for which mass appraisal techniques are not suitable. In addition, if revaluations are very frequent it could also well be that a significant number of appeals against the previous valuation would still be outstanding, complicating the process.

6.4 A continuous, rolling process of re-valuation, in which a fraction of properties are re-assessed each year, might ease the burden of the task but with no common valuation date may not be (or may not be seen to be) equitable between taxpayers.

6.5 However, as time elapses it becomes politically harder to undertake a revaluation. There will inevitably be taxpayers whose liability will change as a result (otherwise there is no point to it) and, with the visibility of property taxes, those who lose will object. With the greater political salience of economic losses, those who gain tend not to provide a counter-balancing force to the objectors. That pressure for inertia is of itself a major reason for revaluing at regular and fairly close intervals so that the discrepancies being tackled do not become too great. Delay sees the forces for that inertia accumulate.

6.6 On balance, undertaking revaluations on a cycle of some three or five years may often balance these pressures best. That may also reduce the pressure that can accrue to introduce further reliefs while giving both some certainty and the time for necessary appeals to be completed before the next review.

6.7 Of itself, this process may be one of the political factors setting a limit to how much tax can be raised through an annual recurrent property tax. Without revaluations, some taxpayers will increasingly resist a tax incidence that does not reflect circumstances. On a revaluation, taxpayers whose properties see increases in value will resist the extent of that increase.

6.8 EU Pressure for Revaluation - One of the clearest themes in the EU's approach to property taxation is the need for regular revaluations so that the tax base is assessed on contemporary values. This has been particularly stressed as one component of the economic adjustment programmes for countries needing financial support.

6.9 Ireland replaced its previous rating system and its valuations last reviewed in 1935, first with a one-off charge of €100 on all households in 2012 and then from mid-2013 with a Local Property Tax based on a property's value. Among the exempted properties are state buildings. The European Commission urged that the Local Property

Tax be extended to cover a wider range of property including farmland, development and derelict sites.

6.10 As a condition of its rescue package, Greece introduced a new property tax, replacing several previous taxes, levied on all types of property whether income generating or not, including housing, commercial property, vacant property, agricultural land and sports fields. The new tax, based on the property as an asset rather than on value to an occupier, replaced the property supplement to electricity charges first introduced and previous taxes largely on more substantial properties. At the same time Greece cut taxes on property transactions from 8-10 per cent to 3 per cent.

6.11 In Cyprus, values from 1980 were used for its Immoveable Property Tax and it was thought that the register had not been maintained. A condition for the financial support extended by the EU to the country was that it undertake a full revaluation which was completed in mid-2014 with 1st January 2013 as the valuation date. That identified a further 300,000 taxable properties with a 1 per cent tax to be applied to those over €200,000. However, protests in reaction to the revaluation led to the old register being used for 2014 assessments.

7. Challenges, Disputes and Appeals

7.1 It is inevitable that in large and complex property markets, there will be disagreements about the value of properties, especially where there are significant taxation consequences. The valuation system has to accept and manage that, as there will be some mis-valuations.

7.2 Some systems manage part of this by placing properties into valuation bands with each band carrying the same tax charge. In such a system it is only worth a taxpayer appealing where there is realistic prospect of the property moving between bands and so different tax charges. However, that leads to more obvious changes when a revaluation moves a property between bands.

Example 4: *The Council Tax revaluation in Wales for 2005 (valued as at 2003) of dwellings previously valued as at 1991 saw a third of properties put into a higher band while 8 per cent dropped at least one band.*

7.3 The process of challenge may work best if the taxpayer, taking professional advice from a relevant valuer, can raise his concern about the valuation with those managing the official register. That may be to ask them to review it, providing evidence either:

- as to the way in which the property had been mis-described;
- even if it has been correctly described, showing that it should be given a different value.

It may be very obvious from that review that an error has been made or the position appears correct but can be better explained to the taxpayer. However, if a disagreement remains, there needs to be an independent tribunal that can receive evidence from the taxpayer and the official valuer and determine the dispute. A specialist valuation tribunal is more likely to have the skills for this work but, occasionally, there may be points of law that need to go further into the law courts.

7.4 Such a system, working within each national judicial framework, is essential to the proper functioning of such a property tax. The prospect of challenge and independent determination should ensure good practice and support professional standards in the whole process and so aid taxpayer acceptance of the system.

8. Applying the Tax

8.1 Once a value is established, the tax regime can be applied to it. In some systems there is a *de minimis* threshold below which very low value properties are not taxed.

8.2 The common approach is that the tax rate is set as a percentage of the value. That may be a common percentage but sometimes higher or lower rates may be applied to particular types of property (second homes sometimes see a discount or a higher rate according to the view taken of them). Exemptions and reliefs are considered below.

8.3 Where there is major revaluation it may be politically or economically necessary to allow a phasing in of new liabilities.

9. Exemptions and Reliefs

9.1 While there may be some exemptions or reliefs that are necessary for practical reasons, these will more commonly reflect the accumulation of political concerns during the life of the regime. The political process tends to develop more exemptions and reliefs to resolve issues as they arise, but each extension of these narrows the tax base, to the cost of other taxpayers.

9.2 An exemption may usually mean that the property does not have to be valued, while a relief may give partial or full relief from the tax assessment and may have to be claimed by the taxpayer or be applied automatically.

9.3 The different taxes in member states will offer exemptions reflecting domestic concerns and history. Religious and heritage properties may often have an exemption as also may agricultural and/or forestry land and/or buildings. Embassies and other diplomatic buildings are generally exempt, but all or some government buildings are taxed in some countries but not in others.

9.4 Rate relief or exemption is often seen as a way to assist businesses. It may be offered to small businesses, enterprise zones and other development areas (promoting investment as well as easing the costs of business users) or favoured categories. It is understood that Greece and Malta give some relief to hotels, recognising the scale of the investment that they may involve.

9.5 Vacant property benefits from relief in some systems but England and Wales have greatly limited that relief for both commercial and residential properties to encourage their re-use, if only at lower rents.

9.6 The United Kingdom offers a general discretionary relief mitigating the impact of property taxes on charities, while some countries (such as Spain) focus on their Red Cross, but there may also be countries where many charitable works are undertaken by exempt religious bodies.

9.7 Several countries offer initial exemption or relief to new dwellings or other properties.

9.8 The size of households can affect liability to residential tax, with some countries giving reliefs for larger households (Spain) while England allows a discount for sole occupiers.

9.9 There may usually be assistance to poorer residential taxpayers through national social security systems. Relief may be offered to both residential and commercial taxpayers affected by natural emergencies such as sustained flooding.

10. Higher or Additional Charges

10.1 In some countries there is provision for higher charges to discourage particular uses, such as second homes or supermarkets.

10.2 Second Homes - The English Council Tax system started with discounts for second homes but has now developed options for local councils to apply higher than standard rates of tax.

10.3 An alternative approach has been taken by the Esch sur Alzette commune in Luxembourg in applying tax to empty dwellings, initially based on €100 per metre of façade and per floor, to encourage owners to sell or rent such properties, following measures taken by the Beckerich and Diekirch communes.

EVIP 5

Valuation Methodology

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1. Introduction

1.1 Generally speaking, *methodology* is a system of methods used in a particular area of study or activity.

1.2 In valuation, the term *methodology* is mostly used as a general noun, mainly in the singular, to describe the way in which a valuer deals with the whole matter of valuing the subject property. Thus, for a given valuation, methodology includes the selection by the valuer of the approach or approaches to be applied, the choice of method(s) and the use of the analytical processes or techniques in order to interpret the valuation inputs and reach conclusions based on them.

1.3 EVS 2016 does not impose any specific valuation methodology, as (unless there is legislation or statute applicable) it is a matter for the professional judgement of the valuer in each case, according to the nature of the property and the context and purpose of the valuation. In addition, methodology can be expected to evolve in the future as a result of many influences, including market behaviour and advances in calculation and analytical tools – it would be inappropriate to attempt to restrict future evolution by insisting on valuers retaining certain of today's recognised methods.

1.4 However, valuation methodology is implicit in valuation standards, and it is for that reason that this technical information paper on valuation methodology has been prepared. Standardised appraisal methods facilitate transparency and comprehension by readers of valuation reports; up to date valuation standards in turn reinforce good practice in, and the accuracy of, valuations and appraisals.

2. Scope

2.1 This Information Paper refers to Europe-wide accepted methodologies for the valuation of any kind of real property for any kind of purpose, as detailed in the following sections.

2.2 The intention in this paper is not to set out rules to be rigidly followed or to attempt to provide a valuation textbook, but rather to express principles to be adhered to in a context of evolving market practice and analytical techniques. It sets out the generally accepted methodologies applied throughout Europe.

3. Definitions

3.1 Basis of value - A statement of the fundamental assumptions for assessing a valuation for a defined purpose.

3.2 Valuation approach - The fundamental way in which, considering the available evidence, the valuer considers how to determine the value of the subject property.

3.3 Valuation method - The particular procedure, based on one or more valuation approaches, used by the valuer to arrive at the assessment of value.

3.4 Valuation technique - A specific analytical process of data treatment, conducted within a valuation method.

4. Valuation Approaches

4.1 In order to perform a valuation founded on the relevant basis of value, one or more valuation approaches will be used.

4.2 Valuation methodology is based fundamentally on the workings of a free market economy. Thus, an understanding and subsequent modelling of the dynamics of the price mechanism of supply and demand that influences market pricing is essential. Any normative models always need to be tested against the economic fundamentals of the real world.

4.3 Although there are certain differences in application and greater differences in nomenclature, there are, in fact, only three basic approaches for valuing land and buildings: the market (or comparative) approach, the income approach and the cost approach.

4.4 Within the three basic approaches of valuation, there are a number of valuation methods that are used, depending on how property pricing practice developed in the relevant country or market. They are nevertheless generally just methods based on one or more of the three basic approaches, often adapted to adjust the valuation procedure to the valuation situation, the kind of property, the available data, the purpose of the valuation, the nature of the client, the local legal framework, etc.

4.5 In the **Market Approach**, the valuation is produced by comparing the subject property with the evidence obtained from market transactions that fulfil the criteria for the relevant basis of value.

4.6 The **Income Approach** is used to describe any valuation method whereby the capital value is found by capitalising or discounting the estimated future income to be derived from the property, whether this income is rent or whether it is income generated by the business that is carried out on the property. In some countries, the form of income approach whereby the actual or potential rent flow is analysed and capitalised, is treated as a sub-division of the market approach; in those countries, what would be widely understood as the income approach is reserved for valuations based on the accounts of the enterprise that is being carried out on the property.

4.7 The **Cost Approach** provides an indication of value based on the economic principle that a buyer will pay no more for a property than the cost to obtain a property of equal utility, whether by purchase or by construction, including the cost of sufficient land to enable that construction. It will often be necessary to make an allowance for obsolescence of the subject property compared with a brand new equivalent one.

5. General Observations

5.1 The importance of analysing the market - Before going on to analyse the most relevant methods and techniques in detail, it is necessary to stress the importance of analysing the market and the market evidence in great detail before deciding which method or methods should be used to carry out the valuation. The examination, investigation and analysis of the available market evidence is one of the most important parts of the valuation process.

5.2 'Looking behind' the evidence - It is important to try and find out what matters had a particular influence on the respective parties and influenced them in arriving at the end result of the transaction that is being analysed. It is only when this process has been carried out that a realistic analysis of the evidence can be attempted.

5.3 Relevant factors - The valuer will look to see where the bulk of the market evidence is to be found, and this will depend on, for example: the nature of the local

market; the type of property to be valued and its condition; the demographics of the immediate and wider locality; the financial climate at the time of the transactions; the date of comparable transactions; or the business or activity carried out on the premises. This process enables the valuer to determine which market transactions are the most relevant and to give due weight to each piece of relevant evidence

5.4 The Local Market

5.4.1 It is important to examine in some detail the nature of the local market – what types of property are represented there and whether the market for the property to be valued is predominately an owner-occupier market or a rental market. This last factor can be important in deciding what sort of comparable evidence to look for and whether the comparison approach or an income method is likely to be preferred.

5.4.2 A standard part of the valuer's work is identifying the most valuable locations and the local factors that can affect not only the actual value, but also the methods that might be used to arrive at the value. Proximity to particular business or transport hubs is a typical factor to be taken into account.

5.4.3 It may be that the property is located in a sub-market that has its own pricing practices, or variations on standard ones. In that case, the valuer will generally want to ensure that the methodology used takes this into account.

5.5 The Type of Property to be Valued

5.5.1 The second important factor is the type of property that has to be valued, for on this, together with the locality, the decision will largely rest as to the valuation method to be adopted. There are certain common factors that tend to occur in most markets.

5.5.2 For example, in the case of the offices market, in many countries there will tend to be more evidence of rental transactions than there is of sales. In view of this, and as this is an asset class that is traditionally attractive to investors, the income approach can be adopted and yields can be established from the comparison of sales data. In contrast, for highly specialised properties, such as an oil refinery or a chemical or steel works, the type of property is so specialised that there is generally no market, capital or rental, so the cost approach is usually adopted for many valuation purposes.

5.5.3 Prospective buyers or tenants may be willing to pay an additional sum for a location along a tree-lined street or with a view overlooking a lake, irrespective of the type of property. There is also growing evidence in some locations that 'green features' in some or all types of property may add value. As sustainability indicators may impact on value, the valuer will have to include sustainability issues when analysing evidence.

5.6 The Process of Evidence Analysis – an essential rule

5.6.1 When it comes to analysing the evidence, there are a number of processes to be gone through but, whatever method is used the end result is usually the same in essence: a unit of value is derived from the evidence and is used to value the property or properties in question.

5.6.2 This unit of value will often either be a capital value per square metre or a rental value per square metre. In the case of hotels, it could be a value per bedroom or, in the case of petrol filling stations, it could be a value per thousand litres of throughput (these are relatively crude “shortcut” approaches which are sometimes used as approximations in the absence of detailed financial models, or as a check against other valuation procedures). In the case of land, it could be a price per square metre or a price per hectare or, for development land, a price per square metre of building that could be erected on the site.

6. Overview of Valuation Methods and Analytical Techniques

6.1 Introduction

This section deals with the most common methods of real estate valuation throughout Europe, based on one or more valuation approaches as discussed above. Reference is also made to some of the analytical techniques specific to those methods.

Unless there is legislation or statute applicable, valuers will choose the method or methods that, in their opinion, are the most appropriate to the property being valued and the purpose of the valuation, so that they would produce the most reliable value figure.

6.2 The Comparative Method

6.2.1 This method (including both the comparative sales and comparative rental versions) must be regarded as the preferred method to arrive at market value and should be adopted wherever it is appropriate or acceptable to do so. This is because it provides the most direct link to the actual market transactions that have been analysed to produce a valuation.

6.2.2 The comparative method estimates market value by analysing prices obtained from sales or lettings of properties similar to the subject property and adjusting the unit values to take account of differences between the comparables and the subject property.

6.2.3 The comparative method has worldwide application for most property types. The ideal situation would be to have evidence of recent market transactions involving identical properties, but this is hardly ever the case. Every property is unique in terms of location, physical form, legal interest, permitted use, etc. This means that the valuer may have to make several different adjustments to the unit values obtained from comparables.

6.2.4 The prices from the comparable transactions are usually related to one or more units of comparison, such as the size of the property or the expected annual net operating income. Depending on property type and the data available, different units of comparison are used. It is important that the units of comparison are defined and measured in the same way for all the properties within a particular class.

6.2.5 Judgments have to be made about the relative merits of the subject property and the comparable property so that adjustments for differences can be made to the price of each comparable property to obtain an estimated price appropriate for the property being valued. Obviously, the more dissimilar the comparables are to the subject property, the less reliable is the value resulting from the comparative method.

6.2.6 There are a number of factors that have to be considered when examining the reliability of the comparables:

- their location as compared with the location of the property to be valued;
- the time factor, i.e., the time that has passed between the transaction of the comparable property and the date of valuation. The valuer needs to decide how far back in time the comparable transactions should be accepted and what adjustments need to be made. Market conditions clearly change with time and in some circumstances even quite recent transactions may no longer be good indicators of market conditions at the valuation date. Generally speaking, the most recent transactions are considered to provide the best comparable evidence;
- the degree of obsolescence of buildings and their fittings – physical, technical and economic;
- the strength of the covenant of the tenant, the percentage of the property occupied or vacant and the gross to net area ratio (in the case of investment properties);
- the number of comparable transactions is another important question and the valuer will need to decide what he deems to be an acceptable number of comparables. This is a matter of judgment and could vary, for example, according to the purpose of the valuation (reg. the use of IT-tools, see par. 6.1.8 below);
- it is important to take into consideration that there may be considerable differences between the properties that have already been sold or let and the property that is to be valued. The comparative method should only be

considered when there are properties with characteristics that are reasonably comparable to the subject property, although it may sometimes be necessary to accept as comparables properties that are not really ideal in this respect. This is because some evidence is better than no evidence at all. However, in such a situation it may be advisable to look at another valuation method in order to check the result produced by the use of the comparative method.

6.2.7 As mentioned earlier, it is important that the unit of comparison is the same for all the comparable properties and the subject property (for example, if gross internal area is the unit of comparison, it must be measured in the same way for each property). Definitions of how the various types of area are measured can be found in the European Code of Measurement in Part 2.

6.2.8 The development of increasingly sophisticated IT tools has made it possible to use refined techniques to analyse market evidence. Techniques used in the framework of the comparative method might include:

- regression analysis, both linear and non-linear;
- time series analysis;
- geographically weighted models;
- simulation models, e.g. Monte Carlo simulation;
- neural network models;
- option pricing models;
- fuzzy logic-based models.

6.2.9 In creating models, the valuer must be especially careful that the underlying assumptions are not invalidated by the technique used and, in order to avoid this, the valuer needs to be fully aware of the interaction between the analytical technique used and the method adopted. In addition, as a general rule, the valuer should be aware that any analytical tool is only as reliable as the data that is fed into it. Finally, it should also be kept in mind that the value of a property cannot be calculated by just using mathematical or statistical techniques. Such techniques can only serve as guidelines for the valuer. The valuer's estimate of the value of the subject property has to be based on his best and sound judgement.

6.3 Valuation Methods within the Income Approach

6.3.1 General aspects of the Income Approach

6.3.1.1 In general terms, the income approach is a form of investment analysis. It is based on a property's capacity to generate net benefits (i.e. usually monetary benefits) and the conversion of these benefits into a present value. The benefits may simply be regarded as the net operating income. In the valuation of properties based on operating profits (such as hotels), the valuer will often work on the basis of EBITDA (earnings before interest, tax, depreciation and amortisation).

6.3.1.2 To estimate a market value, the procedure starts from the conditions on the actual market. This means that all data and assumptions must be market-derived. If the purpose is to estimate an investment value (i.e. the value that the property may have for a particular identified purchaser), the calculation starts from the situation of an individual investor i.e. it is a subjective value.

6.3.1.3 When applied to investment properties, all methods based on the income approach will be grounded on the interaction of the following elements:

- current and expected future net income;
- the timing of future events that can be expected to affect the net income;
- the way in which potential buyers would account for this interaction of money flows over time – this is taken into account by the choice of yield or discount rate.

6.3.1.4 Generally speaking, methods used within the income approach can be divided into two families:

- a. inflation-implicit methods, usually known as “capitalisation” methods; and
- b. inflation-explicit methods, of which the best known is the Discounted Cash Flow method. The main feature of inflation-explicit methods is that growth in income and costs is explicitly incorporated into the model by the valuer, as explained below.

6.3.1.5 It is important, when carrying out a valuation, to ensure that there is no double counting for inflation in rents, rental values and cost items. Thus, when a valuer is using a capitalisation approach, the rate of return adopted will normally implicitly reflect the anticipated increase in rental value. It would therefore be wrong to then make a separate provision for rental inflation. Conversely, in a DCF method the valuer will usually want to explicitly include anticipated future inflation in rents, in which case the discount rate adopted will generally be higher, in order to reflect the risk involved in predicting future inflation rates. The same applies to any cost items included in the valuation – future inflation of costs should not be included in a growth-implicit approach, whereas it will be taken into account in a growth-explicit one.

6.3.2 Capitalisation methods

6.3.2.1 Main types - Capitalisation methods can be broken down into two main types:

- a. direct capitalisation, and
- b. more sophisticated capitalisation methods

6.3.2.2 Direct capitalisation - Direct capitalisation involves converting income expectancy into an indication of value by applying an appropriate yield to the estimated income (most often net rental income or net operating income). The income that is capitalised is the expected income for one year (usually for the first year of calculation). Since direct capitalisation involves perpetual capitalisation of the first year's income for

the subject property, this method does not reflect any potential future variation in rental income, unless an adjustment is made to the yield to reflect this.

6.3.2.3 Sophisticated capitalisation methods - For this reason, a number of more sophisticated capitalisation methods have been developed, whereby the valuer takes account of projected changes in net incomes at certain defined future events, particularly lease ends, rent reviews, or when major capital expenditure may be required. It could be argued that such methods are actually based on discounting, rather than capitalisation. However, unlike the DCF method (see below), these capitalisation methods do not envisage a future sale and the calculations are generally growth-implicit, rather than growth-explicit, with the result that the rates of return adopted are closer to yields observed in the property market than to discount rates used in DCFs. For this reason, they are considered here under capitalisation methods.

6.3.2.4 Capitalisation rate - The rate or rates used for capitalisation must reflect current market value assessments of the time value of money and the risks specific to the asset. The valuer will wish to take account of a long list of factors when choosing the rate to be adopted, including the following points:

- the location of the property, taking account of any likely future changes that may make it more or less desirable to tenants and/or buyers;
- the physical aspects of the property – construction, quality of finishes, etc.;
- the nature, length and review patterns of leases;
- the obligations of the respective parties to any leases;
- local and national laws and regulations that might affect potential for rents to increase or decrease during or at the end of the leases;
- the strength of the tenants' covenants.

The valuer will apply the same criteria to his analysis of comparable investment sales, adjusting the adopted yield to take account of the relative strengths or weaknesses of the subject property.

6.3.2.5 Rent consistency - Finally, whichever capitalisation method is used, the valuer should be careful to ensure that he follows market practice as regards capitalising net rents, semi-net rents or gross rents. For example, if the yields obtained from comparable deals are based on gross rents, the valuer would under-estimate the value if he applied the same levels of yields to net rents.

6.3.3 Discounting methods

6.3.3.1 Main elements - Discounting methods are based on present value calculations of expected income or cash flow projected over a specific calculation period. Unlike the capitalisation methods, a residual value is normally calculated and discounted at the end of a notional hold period. Consequently, a time horizon, projected cash flow and a

residual value have to be determined. To calculate present value, the estimated income or cash flow has to be discounted and a discount rate has to be determined.

6.3.3.2 DCF - Discounted Cash Flow (DCF) is a discounting method that has gained popularity over the past decades, and is now widely used among valuers and investors.

6.3.3.3 The hold period - Cash flows are estimated over a certain period during which the hypothetical buyer will own the building, before finally selling it. In many cases a period of 10 years is adopted, largely because that period works well with lease patterns generally observed in the USA, the birthplace of the DCF. There is no particular rule as to how long the hold period should be, although it is generally considered that the hold period should be sufficiently long to allow for all leases to expire and for subsequent renewals or re-lettings.

6.3.3.4 Growth-explicit cash flows - As stated above, in a DCF valuation the valuer will usually be seeing to make his assumptions as explicit as possible, countering the criticism of capitalisation methods that "it's all in the yield". This will include estimating the future upward (or downward) movements of rents due to any indexation clauses, potential future growth in today's estimated rental values and future inflation of costs that have been built into the cash flow. Nevertheless, growth-implicit DCF methods are used in several countries, with the advantage that future rental and cost inflation do not have to be estimated, but the disadvantage that discount rates cannot be easily compared with those applied to other investment products.

6.3.3.5 Assumptions at lease end - Since one of the principals of the DCF method is that assumptions should be made explicit, the valuer will generally be expected to make it clear whether he has assumed that tenants will renew at lease end, or leave and be replaced by new tenants. Some models allow for a weighted approach, allowing the valuer to adjust the weighting according to the circumstances of the property and even those of each tenant.

6.3.3.6 Capitalisation at the end of the hold period - The DCF method assumes a sale at the end of the hold period. The future sale price is calculated by applying a yield to the modelled net income at the end of the hold period, and allowing for the deduction of appropriate sale taxes and costs. It is important that the net income is stabilised, excluding any one-off effects such as rent-free periods, stepped rents or unusual non-recurring expenditure. The yield to be adopted will be determined from market comparisons. However, if market yields are unusually high or low at the effective date, there is a case for asking oneself whether such a level is likely in, for example, 10 years' time. It may sometimes be appropriate to adjust current yields to obtain a rate that is more sustainable over the life of the hold period.

6.3.3.7 The discount rate(s) - All in-flows and out-flows in the cash flow model, including the projected future sale price, are discounted using discount rates. From a

theoretical point of view, different rates should be used in one model to reflect the different levels of risks corresponding to the different in- and out-flows, but most frequently they are summarised into one single discount rate. As such, the discount rate is a key element of the DCF method. The discount rate is intended to reflect the hypothetical buyer's assessment of the risk inherent in the property.

6.3.3.8 The discount rate should be consistent with the cash (or profit) flows estimated in the model, i.e. it must be based on the same assumptions in terms of timing, inflation, costs, financing and taxes. The discount rate chosen should not reflect risks for which the future cash flow estimates have been adjusted.

6.3.3.9 The valuer should choose the discount rate in the light of the general level of risk inherent in the model – if his assumptions are generally optimistic, it would be appropriate to choose a somewhat higher discount rate, whereas cautious assumptions would call for a lower discount rate.

6.3.3.10 Individual rates reflecting the motivations of the individual investor or alternative investments are used when estimating an investment value for a particular investor.

6.3.3.11 Ideally, the valuer would have evidence of discount rates adopted by purchasers when bidding for comparable properties that have been sold recently. Unfortunately, such information is available in very few countries and markets.

6.3.3.12 Alternatively, where the valuer has sufficiently detailed information of a recently sold comparable property, he can carry out his own analysis on a DCF basis and deduce the discount rate that way.

6.3.3.13 Where neither of those is possible, valuers often determine the discount rate by alternative approaches, the most common of which include:

- adding risk premiums to a “risk-free” investment yield, such as long-term government bond yields;
- applying a property yield, adjusted to reflect the fact that inflation has been made explicit in the cash flow;
- estimating the weighted annual cost of capital of a typical buyer of such a property.

Each method has its merits and its disadvantages and it is not the purpose of this paper to discuss them. The valuer's choice may be affected by market preferences in the area where the subject property is situated.

6.3.3.14 As already stated, in some cases, valuers may choose to apply different discount rates to different parts of the cash flow (or one rate to the hold period cash flow and a second one to the proceeds of the re-sale at the end of the hold period) if they consider that the two periods present very different risk profiles.

6.3.3.15 Finally, it should be noted that, despite its apparent sophistication, DCF is a highly complicated method relying on predictions of the future behaviour of a large number of economic and property market indicators. The results of a DCF should therefore be treated with caution and it is recommended that the resulting values should be checked against other market indicators, such as yields and prices per square metre and perhaps also against values obtained using other methods. It is interesting to note that, in the 2014-2015 USPAP Standards used in the USA, Statement on Appraisal Standards No. 2 on the use of DCF Analysis concludes that “DCF analysis is an additional tool available to the appraiser and is best applied in developing value opinions in the context of one or more other approaches”. Nevertheless, DCF is the trend method in many European countries for many different valuation purposes when valuing income generating properties.

6.3.4 Methods based on the accounts of the current or a theoretical occupier

6.3.4.1 In some countries, the term Income Approach refers to valuations based on the accounts of the enterprise that is being carried out on the property. EVS 2016 consider that as a specific group of methods within the Investment Approach.

6.3.4.2 These methods are essentially used for market or investment valuations of properties designed and adapted for a particular use and for which comparable sales are not frequently available, and the valuation is made by reference to the gross turnover that can be generated by business activity in the property. In many countries discounted cash flow techniques have largely superseded this income approach concept, but the principles behind it are essentially the same.

6.3.4.3 Typical cases where these methods are suitable are found in the leisure industry, such as leisure centres, sports stadia for professional sports, theatres, hotels, restaurants and clubs, and also, in some cases, in the valuation of forests and certain agricultural properties.

6.3.4.4 In assessing the reliability of actual income to the enterprise, care should be exercised in ensuring that elements of over-trading peculiar to a particular occupier are properly adjusted. It is the expected normal income, often termed Fair Maintainable Trade, which the Valuer should be seeking, which avoids special circumstances that might distort value. Care should also be exercised in looking at the content of income streams because it is the subject property that is being valued and not the business. Value that is accruing to a particular brand over another may require adjustments as might significant income earned away from the property but by the enterprise may also require adjustment.

6.4 The Cost Approach

6.4.1 General overview

6.4.1.1 The cost approach is most commonly used to estimate the replacement value of specialised properties and other properties that are very seldom, if ever, sold or let in the market. This means that the cost approach is generally only ever used when a lack of market activity precludes the use of the comparative method and when the properties to be valued are not suited for valuation by the income approach. There are, however, circumstances where it is used as a principal market-related procedure, particularly where there is significant data available to enhance the accuracy of the procedure.

6.4.1.2 Because cost and market value are usually more closely related when properties are new, use of the cost approach is easier when estimating the market value of new or relatively new constructions, but this is not to say that the cost approach should be adopted for this type of property unless there is a total absence of market evidence, or in the situations alluded to above. Indeed, in some cases the rental, occupational or investment markets may have changed considerably between the date when the construction cost was fixed and the date of final completion of the project, in which case the value obtained by the cost approach may no longer be a reliable measure of the market value. Using the cost approach for older properties can cause difficulties because of a lack of market data, both for construction costs and for depreciation, although this can also be true for certain newer properties.

6.4.1.3 Opinion varies across Europe as to the extent to which the Cost Approach can give a reliable indication of Market Value. It would appear that the countries that are against the use of this approach tend to be the ones where the market is more transparent and where more rental, yield and price evidence is therefore available. In addition, where markets are more volatile there is resistance against using cost as an indicator of value, as building costs react more slowly to cyclical changes than do market prices and rents. In contrast, the Cost Approach is often more widely used in markets that are less volatile and/or less transparent.

6.4.1.4 Use of the Cost Approach will therefore vary across Europe and from market to market. In some countries, the Cost Approach is used where there is market evidence but, as the approach is not a market-driven method, it should not be looked on as a primary approach.

6.4.2 Depreciated replacement cost (DRC)

6.4.2.1 One of the most frequently-encountered methods within the cost approach is Depreciated Replacement Cost (DRC). Under this method, the valuer is required to provide a considered opinion of the Market Value of the land in its existing use, plus

the hypothetical cost of constructing similar buildings to the existing ones and relevant site works. Deductions are made from this gross sum to account for matters that would influence the value of any existing property, compared to any replacement property. Allowance is made for factors including depreciation, age, condition, and economic and functional obsolescence. The choice of depreciation rate is a valuation judgment.

6.4.2.2 The use of the method will require, amongst other things, a practical knowledge of current building control regulations, current building costs and any relevant health and safety regulations.

6.5 The Residual Method

6.5.1 The residual method is used to arrive at a value for a vacant site or a site or a building that has potential for redevelopment or refurbishment. It assumes that the process of development, redevelopment or refurbishment is a business and, by adopting this assumption, it is possible to assess the market value of land or land and buildings in their existing form, reflecting development potential as a part of that process.

6.5.2 This is a method that is simple in concept but needs great skill and experience in application, as what appear to be minor changes to the assumptions made in carrying out the valuation can have dramatic effects on the final answer. In particular, variables relating to rental income, investment yield and building costs must be analysed in terms of testing the sensitivity of the residual value. This might be achieved by the creation of a discounted cash flow (DCF) that illustrates the present value of the future development.

6.5.3 The residual method comprises the estimation of the market value of the site or the buildings in a developed or redeveloped form, either by comparison or by the investment method.

6.5.4 From this 'gross development value', all costs have to be deducted that will be incurred in putting the property into the form that will command that price. These costs will include demolition of any existing buildings, design costs, infra-structure works, construction costs, professional fees, finance costs and costs of letting and sale.

6.5.5 From the resultant figure, the 'developer's profit' will have to be deducted; it is an allowance for the risk of undertaking the development. Developer's profit will either be expressed as a percentage of costs employed in a project, or a percentage of the gross development value, and percentages adopted will vary, depending on a variety of factors linked mainly to the risk inherent in the project and the letting and sale of the completed properties. By deducting these liabilities from the final market value a residue is produced and this represents what the developer can afford to pay for the site for redevelopment. The residual value comprises the site value, related acquisition costs and finance costs incurred in holding the land over the development period.

These costs then need to be deducted to arrive at the value of the site. If the land cost is known, the residual calculations can establish the likely 'developer's profit'.

6.5.6 The opinion of value arrived at using the Residual Method should be the subject of a sensitivity analysis as changing any of the inputs can dramatically affect the resulting land value.

6.5.7 Risk forms an important element in valuations and appraisals of development sites. Much of the uncertainty for the developer derives from the time taken to complete the process, from identifying demand through to site acquisition, planning consent, construction, letting and sale or owner occupation. The time delay is one reason for the typical cyclical pattern of real estate markets. All stages are subject to potential delay, and there is always a risk that consumer demand will change, or that interest rates and the economic cycle will alter significantly. The valuer, in interpreting the market, is reflecting the perceptions as to future events that are current at the date of valuation.

7. Using More Than One Valuation Method

7.1 In some countries, it is normal practice, or even a legal obligation for some valuation purposes in some instances, to value a property using two or more different methods, which therefore give a number of different resulting values. The valuer then considers the various results and makes a professional judgement as to the value to report. In contrast, in other countries the valuer expects and is expected to use just one single method.

7.2 No general rule can be set out as to whether the use of a single method or several methods leads to a more accurate and reliable valuation. However, where a valuer has used only a single method it is recommended that he should at least check his conclusions against other market indicators, if they exist. For example, where a property has been valued using a method within the income approach, the valuer will often want to compare the resulting value per square metre with prices observed on the market for similar properties at the valuation date.

7.3 In some instances, valuers prepare valuations using two or more different methods, then apply mathematical weightings to the two or more resulting values to obtain a weighted value, which is then reported as the Market Value. Such an approach should be used with caution – there may be merit in it if the weightings are chosen for each individual property according to the valuer's own view of the relative reliability of the values that result from each of the various methods. However, it may be dangerous to apply standard weightings to a series of valuations or to a whole portfolio of properties, as such an approach precludes any consideration of the reliability of the various methods on a property-by-property basis.

EVIP 6

Automated Valuation Models (AVM)

1. **Introduction**
2. **Definition**
3. **Scope**
4. **Comments**

1. Introduction

1.1 Automated Valuation Models (AVM) are used to value properties quickly and at low cost. In recent years they have become much more widespread and in many countries they are now the most widely used tool for valuing apartments and houses. Increased cost pressure and a drive towards rationalisation in the property and financial sector are primarily responsible for this. Indeed, efficiency gains, i.e. reductions in cost and time are viewed as a key advantage of the use of AVMs.

1.2 Another reason for the use of AVM's is progress in information technology and in developing large property and transaction databases. Improvements in storing, managing and analysing information will continue to favour the use of AV models when valuing property in the future, particularly since the pressure of competition leaves little room for alternatives.

2. Definition

2.1 Automated Valuation Models (AVMs) can be defined as statistic-based computer programmes, which use property information (e.g. comparable sales and property characteristics etc.) to generate property-related values or suggested values.

2.2 For this purpose, the user must first record selected data in relation to the property to be valued. Specific information is then attributed to this data and this permits a direct appraisal of the value. The information is attributed using algorithms which search for suitable comparable data in very large electronic databases. The search depends in particular on the valuation approach being used, on country-specific rules and practices, on the type of property, on the purpose of the valuation and on the available data.

3. Scope

3.1 AVMs are mainly used in the context of monitoring and adjusting of values of standardised residential properties in the context of supervisory requirements for credit institutions. They also play a role in property valuation for securitization, taxation, auditing and credit risk ratings.

3.2 The usage of AVMs depends on the valuation purpose. In the case of valuations for transaction purposes, an AVM produces a market value on a fully computerised basis. Valuations for lending purposes (mortgage origination) produce market and/or mortgage lending values and require control mechanisms by a professional valuer at all instances of the process in order to comply with banking supervisory rules.

3.3 For the avoidance of doubt, as properties valued using AVMs have generally not been inspected, neither inside nor outside, such valuations will therefore not be EVS compliant, even if the valuation process is valuer-assisted. If the property has been inspected then the valuation can be EVS compliant, as long as the valuation process has been valuer-assisted.

4. Comments

4.1 Requirements for AVM Use

4.1.1 As AVMs materialise in computer programmes they possess some inherent strengths and weaknesses. Their strengths include that they are ideally suited for valuing properties which are typical of the market, in view of the very low cost and significant time savings that they offer. On the other hand, if the subject properties are characterised by unusual features which impact significantly on their value, use of the models can lead to distorted results. The quality of AV results is determined decisively by the quality of the algorithms and the underlying property and market databases.

4.1.2 AV models must meet certain requirements if they are going to generate property valuations which are both reliable in terms of content and are officially recognised. Valuations must therefore be based on comprehensive databases with reliable price and rental data derived from actual sale prices. Offer price data should be used only as a complementary source. The databases must be continuously updated and evidence of sources must be supplied. It is most important that the search algorithms and the approaches followed in order to evaluate the data employ the latest techniques and are both comprehensively documented and also generally accepted. The statistical model used to evaluate the databases should not be chosen in advance. Depending on

the composition and the comparability (homogeneity) of the properties, both hedonic methods and approaches based on direct comparisons of properties are available.

4.1.3 Therefore, specific attention should be dedicated to the following areas:

- Nature of data: The quantity, quality and timeliness of data can limit the use of AVMs, i.e. where there are too few transactions in some geographical areas for an AVM to function correctly.
- Reliability or accuracy of the result: In the absence of a physical inspection of the property, an AVM has to make a key assumption, namely that the property is in a marketable condition. What is more, depending on the strength of the model, there is a risk of over/under valuation for non-standardised property and property in certain geographical locations. There is a risk the AVMs will produce poor results in very volatile and/or non-liquid markets.
- AVM methodology: Another challenge consists of AVM methodologies not fully meeting all regulatory requirements of the target market.

4.2 Data Base

4.2.1 As AVMs are necessarily based on retrospective data, the reliability and credibility of the database are of particular importance. The quality of data is specifically challenged in rapidly moving or illiquid property markets. In order to secure data quality, a variety of sources are available such as requested sales prices or property transaction data. However, AVMs only relying on requested sales prices might over-emphasise the offer side of real estate markets. Ideally, sales prices are linked with real transaction prices.

4.2.2 Several statistical tools can be used to calibrate AVM models. AVMs can be based on comparables analysis, repeat sales analysis, hedonic methods and time series analysis. The latter can be used to develop a multiplier or index factor to update existing property values or to adjust sales prices for individual properties to the valuation date.

4.2.3 AVMs must be valuer-assisted. It is the role of the valuer to screen the quality of the data base and to double-check the reliability of the inputs to the model. More precisely, all main valuation parameters such as estimation of costs, land prices, construction cost, capitalisation rates, comparative prices and/or rents to be incorporated into the programme must be clearly documented with respect to their empirical provenance. Should these figures rely on statistical or econometric models, these models shall also be documented and disclosed if requested.

4.2.4 AVM users must be aware that the quality of the AVM relies on the quality of the data. With respect to this correlation, the origin of all input data must be transparent and should be updated on a regular basis.

4.3 Valuation Algorithm

4.3.1 AVMs should rely on recognised valuation methods which are the comparison, income and replacement cost methods. They should reflect market practice and give the same priority to methods as if they had been applied by the valuer.

4.3.2 Depending on the purpose of the valuation and its basis of value, the model must enable different valuation inputs within the same valuation parameters.

4.3.4 The valuation programme must be in line with the assembling of the valuation data in order to ensure a factual concordance between the valuation scales of the programme and the inputs be derived from statistics and data banks.

4.4 Legal Framework

The compilation and application of an AVM is determined by the regulatory framework of the country where the AVM is supposed to operate. The domestic legal and statutory provisions are at the basis of the AVM algorithm and assessment criteria. AVMs must therefore be adapted to the national legal environment and regularly be updated to comply with the prevailing framework of the respective country.

4.5 Validation

4.5.1 Validation is particularly important to the acceptance of AVM-based valuations. The benchmark could consist of actual sales prices, as market values generated by the model must correspond to them on average. At this stage again, valuer's assistance is required. AVM values shall be submitted to a plausibility check by a professional valuer. Valuers shall have the possibility to validate values on a single property basis, i.e. to manually overwrite AVM values if necessary.

4.5.2 More generally, all AVM results shall be validated through comprehensive statistical analysis. Back-testing can be conducted through a comparison between market values and sales prices on the basis of a large number of cases. Statistical reviews should disclose the conclusions of the validation exercise.

4.5.3 In order to ensure both the suitability and quality of the chosen AVM model, it is recommended to process regular model validations by qualified third parties, whose skills should ideally include knowledge of the limitations of the tool.

4.6 Data Protection and IT Security

The use of AVMs by credit institutions must be compatible with data protection requirements of the European Union and the respective Member State. The programmes must comply with banking supervisory rules on IT security and outsourcing of services.

EVIP 7

European Property and Market Rating: A Valuer's Guide

- 1. Introduction**
- 2. Definitions**
- 3. Rating System**
- 4. Rating of Developments**
- 5. Rating of Portfolios**
- 6. Rating Templates**

1. Introduction

1.1 In an increasingly risk sensitive environment driven in part by the Basel Committee on Banking Supervision and European Union regulation, rating systems have significantly gained importance not only for capital market investors but also in the context of banking supervision. A rating is commonly defined as an evaluation or an assessment of something in terms of quality, quantity or a combination of both.

1.2 Rating tools were initially developed by rating agencies for risk assessment purposes on behalf of issuers of securities on capital markets. Since the introduction of the Basel Accords, external and internal bank rating systems also play a pivotal role in banking supervision. More recently, rating systems also spread out to other sectors like real estate.

1.3 In 2004, TEGoVA developed the Property and Market Rating (PaM) for assessing the quality of real estate. PaM enables a standardised and objective risk assessment of properties, identifies risks and reveals opportunities. This tool not only provides transparency of property risks but can also be used for a number of other purposes like real estate portfolio analysis and controlling, risk assessment of property portfolios for securitisation purposes or the analysis of real estate investment or disinvestment decisions. As PaM uncovers the profile of "risk and opportunities" of properties, it is particularly well suited as a portfolio management tool measuring the risk exposure of financial services providers or real estate investors. By this means, it also contributes to a high level of transparency in property valuation.

1.4 Since 2004, climate change and sustainability issues emerged be increasingly relevant for the real estate industry and consequently for the valuation profession. Valuers are expected to assess the impact of sustainability issues on the value of properties. PaM reflects these issues through the sub-criterion 'ecological sustainability' in the property criteria class, but does not provide a new specific 'sustainability' or 'green value' criteria class. Advice is provided on how to take sustainability issues into consideration through the underlying measurement standards at national level.

1.5 The Property and Market Rating has been designed to achieve standardised measurements of the quality of properties in their relevant markets. This approach is based on the Market Value of the property.

2. Definitions

2.1 Rating Definition for Completed Properties

Property and Market Rating is a standardised procedure aiming to display the sustainable quality of a property's value in its relevant market, judged by the medium-term sales prospects at a price that would be agreed between parties with access to all property and market information. Thus, PaM is future-oriented.

2.2 Rating Definition for Developments

2.2.1 The rating of project developments is a standardised procedure to show the quality of a project in its relevant market taking into account the property as hypothetically completed with the intervening development risks and opportunities. That quality is judged by the sales prospects of the project on the rating date at an adequate price between parties with access to all property and market information.

2.2.2 Since the circumstances of such a property will continually change during the process of development (status of building permits, construction progress, selling situation, etc.), its sales prospects can only be determined as at the rating date.

3. Rating System

3.1 Rating Scale

3.1.1 Property and Market Rating follows the pattern used by rating agencies and the internal rating scales of banks. It consists of 10 grades, with 1 representing an excellent rating, 5 an average one and 10 a disastrous one. A rating below 5 represents opportunities, a rating above 5 represents risks.

3.1.2 PaM differentiates between 4 types of property: residential property, retail property, office properties and warehousing, distribution and production properties.

3.2 Criteria Classes

3.2.1 The essential features influencing the sustainable quality of a property are divided into the following four criteria classes: market, location, property and quality of the property cash flow.

3.2.2 As detailed in section 6 below, each criteria class consists of several sub-criteria that are weighted according to their influence on the medium-term sales prospects of the individual property in its relevant market. Examples of objective or measurable sub-criteria are purchase power figures or space efficiency. Subjective sub-criteria are, for example, the quality of the architecture or location of the plot of land. The weighting of each sub-criterion might differ with the property type assessed.

3.3 Measuring Standards

3.3.1 While the measurable sub-criteria are easy to assess on the basis of a standardised comparison, it is crucial for the reliability of PaM that valuers share a common understanding of the rating of the subjective sub-criteria. In order to achieve this, measuring standards should be defined at national level for each of the sub-criteria, differentiated by property types. The present Guide does not include such measuring standards. These standards should determine the standard representing the average for each criterion in the relevant market, so allowing assessment of whether the property in question is better or worse than the average.

3.3.2 Sustainability issues do not exist in isolation, but overlap with many other factors. Although being recognised as sub-criteria 'ecological sustainability' within the 'Property' criteria class, sustainability issues have also an impact on the quality of the working environment, the location and the property market itself. This explains why PaM does not provide a separate criteria class specifically for 'sustainability'.

3.3.3 Instead, valuers are to consider sustainability issues within the underlying measurement standards where such aspects play a role. For example, environmental issues have to be assessed in the 'Market' criteria class through the sub-criterion class 'acts of God'. Sustainability issues have an impact on the sub-criterion 'socio-demographic development'. Sustainable aspects have also to be considered in the 'Location' criteria class through the sub-criteria 'transportation infrastructure' and 'local supply facilities'. Two other important areas where sustainability is of concern are 'usability by third parties' and 'recoverable or non-recoverable expenses' of the criteria class 'Quality of the cash flow'. Future market developments will further shape the impact of sustainability on measuring standards as well as on benchmarking.

4. Rating of Developments

4.1 Criteria Classes for Developments

4.1.1 To arrive at a rating for a development project, all the above mentioned criteria classes have to be rated as if the property had been completed. The assessment has to concentrate on the sales prospects of the hypothetically completed property, because that is the conclusion of the development project for those who have invested in it.

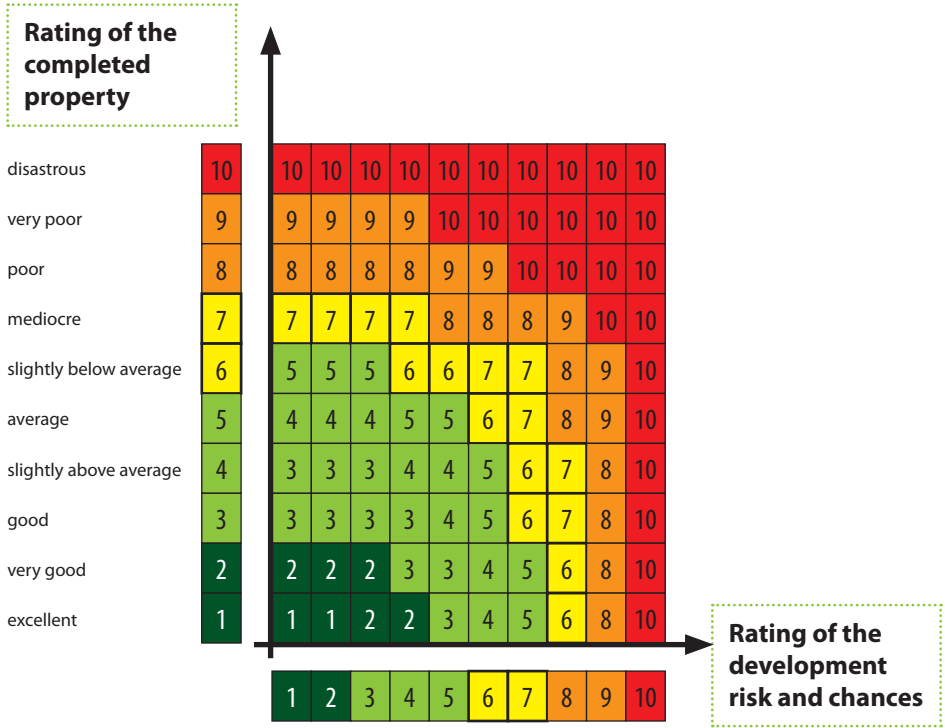
4.1.2 However, a specific fifth criteria class must be added to assess the development risks and opportunities inherent in the project. In this context, the 'project' means the planning, construction and marketing of a building (commercial and residential use) on a plot of land within existing building regulations. This does not include the development of unplanned plots of land without development permission.

5th Criteria Class "Development risks and chances of a development project"

Sub-criteria	Weighting	
	Sub-criterion	Criteria class
5.1 Letting and selling	60 %	see matrix below
5.2 Planning and permits	15 %	
5.3 Construction and costs	25 %	
Result of the development risks and chances rating	100 %	

4.2 Sales Prospects of a Project

The rating of the sales prospects of the project at the rating date is to be determined using the attached matrix that takes into account all possible combinations of the rating for the hypothetically completed property and the rating for the risks and opportunities of the development.



5. Rating of Portfolios

5.1 Besides enabling a standardised and objective risk assessment for individual properties, the PaM also offers a wide range of options to assess the quality of real estate portfolios. Real estate investors require transparency of real estate portfolios' risks and expect a high level of accuracy in portfolio valuation. Credit institutions or consultant companies increasingly scrutinise transactions of large real estate holdings and provide advice to their clients concerning all details of the transaction. In this context, PaM is an appropriate instrument to make real estate opportunities and risks more transparent with the aim to facilitate objective portfolio decisions. Hence, PaM is well suited as a portfolio management tool. The same applies to lending decisions when credit institutions finance portfolio transactions.

Portfolio Report

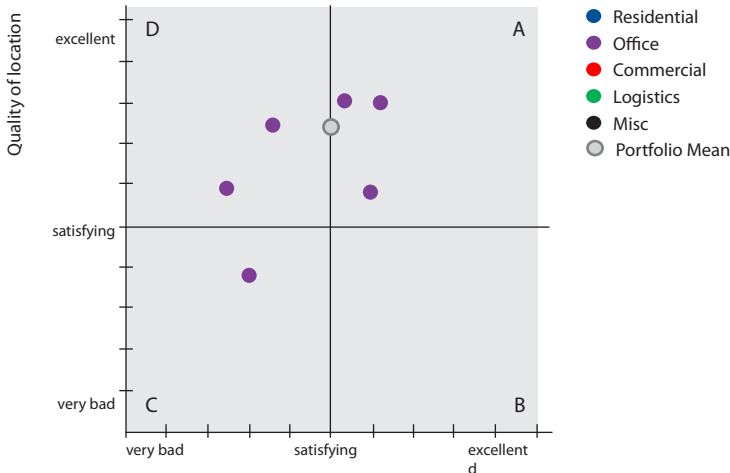
Figure 1 (Portfolio Report)

List of objects							Market			Location					Property						Quality of cash flow						T.			
Property type (Order N°)	Post code	City	Street	Closing date	Market Value (Eur)	Per-centage	1.	1.1	1.2	2.	2.1	2.2	2.3	2.4	2.5	3	3.1	3.2	3.3	3.4	3.5	3.6	4.	4.1	4.2	4.3	4.4	4.5	4.6	
10 office (101-2014 A)	AXXX	A-City	A-street		5,100,000	7.75%	3	2	4	5	3	4	4	3	8	4	4	3	3	7	3	3	4	3	5	4	3	5	4	4
10 office (102-2014 A)	BXXX	B-City	B-street		3,000,000	4.56%	4	2	5	4	4	5	4	6	3	7	7	6	8	5	7	4	8	9	5	7	9	8	5	6
10 office (103-2014 A)	CXXX	C-City	C-street		16,900,000	25.68%	2	2	2	3	3	4	3	3	6	7	6	8	5	8	7	6	7	3	5	8	8	5	5	
10 office (104-2014 A)	DXXX	D-City	D-street		10,000,000	15.2%	2	2	2	2	2	4	2	5	6	6	6	7	7	6	5	6	4	5	4	5	3	5	4	3
10 office (105-2014 A)	DXXX	D-City	E-street		27,500,000	41.79%	2	2	2	2	3	2	5	4	5	4	4	5	5	4	5	3	3	3	2	4	4	5	3	
10 office (106-2014 A)	EXXX	E-City	F-street		3,300,000	5.02%	5	2	6	7	7	8	4	7	5	7	8	7	8	6	7	4	7	7	7	8	8	7	4	7
Total portfolio (weight: percentage)					65,800,000	100%	2	2	2	3	3	4	3	4	5	6	5	6	6	5	5	5	4	5	4	4	5	6	5	4

5.2 The portfolio report would contain the property master data, e.g. the most important quantitative values that are placed before the actual portfolio table, and the property analysis data of each property (see Fig. 1). They may deviate from each other individually. The market values associated with the properties could be shown separately in the property analysis data with the aim of weighting the analytical results recorded and achieving a plausible portfolio valuation in the calculations.

Figure 2 (Portfolio Quality Scheme)

Portfolio quality



Quality of location: 40% Criteria group 1 (Market), 60% Criteria group 2 (Location)
 Quality of property: 40% Criteria group 3 (Object), 60% Criteria group 4 (Cash flow)

5.3 The structure of prospects and risks becomes even clearer when analysed by the portfolio quality scheme (cf. pic 2). The criteria class 1 (market) and 2 (location) are combined and applied for the y-axis. In total they are named "Quality of Location Rating". Synonymously, the criteria class 3 (property) and 4 (quality of the cash flow) are applied for the x-axis and named "Quality of Property Rating".

5.4 The best performing assets appear in the same sector (A). Accordingly, the advice for an investor would be to hold them, whereas the properties in sector D need serious thought as to whether increased investment is warranted. The advice for the investor would be either to liquidate them or to invest further in them. The property provided with a low "Location Rating", as well as a weak "Property Rating" are found in sector C. In this case the advice would be to sell the property. The fourth quarter (sector B) typically would provide properties whose location conditions are weak, but whose property characteristics may still guarantee good cash flow performance, depending on whether the location is so poor that it hinders letting or re-letting.

6. Rating Templates

6.1 The following rating templates set out the full range of criteria classes with their sub-criteria for all four property types and show the weight accorded to each sub-criterion both in its criteria class and its share in the overall rating.

6.2 It would not reflect the market, if a very poor rating of one sub-criterion was only included in the result according to its weighting. Instead, that very poor rating must be reflected in the assessment given to the whole criteria class. Thus, a rating of 10 for one sub-criterion will lead to the entire criteria class being rated at 10.

Retail Properties

1. Criteria Class “Market” (national and regional) - Retail

Sub-criteria	Weighting		
	Sub-criterion	national/ regional	Criteria class
1.1 national			
1.1.1 Acts of God	5 %	30 %	Criteria class 1 20 %
1.1.2 Socio-demographic development	20 %		
1.1.3 Overall economic development and international attractiveness	20 %		
1.1.4 Political, legal, taxation and monetary conditions	15 %		
1.1.5 Property market: retail	40 %		
1.2 regional			
1.2.1 Acts of God	5 %	70 %	
1.2.2 Socio-demographic development	25 %		
1.2.3 Economic situation and attractiveness	25 %		
1.2.4 Property market: retail	45 %		
Result for the market rating		100 %	

2. Criteria Class “Location” - Retail

Sub-criteria	Weighting	
	Sub-criterion	Criteria class
2.1 Suitability of the micro location for the property type and target occupiers	30 %	Criteria class 2 30 %
2.2 Image of the quarter and the location	20 %	
2.3 Quality of transportation infrastructure of the plot and quarter	15 %	
2.4 Quality of local supply facilities of the plot and quarter for target occupiers	15 %	
2.5 Acts of God	20 %	
Result for the location rating	100 %	

3. Criteria Class “Property” - Retail

Sub-criteria	Weighting	
	Sub-criterion	Criteria class
3.1 Architecture / type of construction	20 %	Criteria class 3 20 %
3.2 Fitout	10 %	
3.3 Structural condition	15 %	
3.4 Plot situation	25 %	
3.5 Ecological sustainability	10 %	
3.6 Profitability of the building concept	20 %	
Result for the property rating	100 %	

4. Criteria Class “Quality of the property cash flow” - Retail

Sub-criteria	Weighting	
	Sub-criterion	Criteria class
4.1 Tenant / occupier situation	20 %	Criteria class 4 30 %
4.2 Rental growth potential / value growth potential	30 %	
4.3 Letting prospects	20 %	
4.4 Vacancy / letting situation	10 %	
4.5 Recoverable and non-recoverable operating expenses	10 %	
4.6 Usability by third parties	10 %	
Result for the rating of the quality of the property cash flow	100 %	

Residential Properties

1. Criteria Class “Market” (national and regional) - Residential

Sub-criteria	Weighting		
	Sub-criterion	national/ regional	Criteria class
1.1 national			
1.1.1 Acts of God	5 %	20 %	Criteria class 1 20 %
1.1.2 Socio-demographic development	30 %	20 %	
1.1.3 Overall economic development and international attractiveness	15 %		
1.1.4 Political, legal, taxation and monetary conditions	10 %		
1.1.5 Property market: residential	40 %		
1.2 regional			
1.2.1 Acts of God	5 %	80 %	Criteria class 2 30 %
1.2.2 Socio-demographic development	35 %		
1.2.3 Economic situation and attractiveness	15 %		
1.2.4 Property market: residential	45 %		
Result for the market rating		100 %	

2. Criteria Class “Location” - Residential

Sub-criteria	Weighting	
	Sub-criterion	Criteria class
2.1 Suitability of the micro location for the property type and target occupiers	30 %	Criteria class 2 30 %
2.2 Image of the quarter and the location	20 %	
2.3 Quality of transportation infrastructure of the plot and quarter	15 %	
2.4 Quality of local supply facilities of the plot and quarter for target occupiers	15 %	
2.5 Acts of God	20 %	
Result for the location rating	100 %	

Criteria Class "Property" - Residential

Sub-criteria	Weighting	
	Sub-criterion	Criteria class
3.1 Architecture / type of construction	20 %	Criteria class 3 20 %
3.2 Fitout	10 %	
3.3 Structural condition	15 %	
3.4 Plot situation	25 %	
3.5 Ecological sustainability	10 %	
3.6 Profitability of the building concept	20 %	
Result for the property rating	100 %	

4. Criteria Class "Quality of the property cash flow" - Residential

Sub-criteria	Weighting	
	Sub-criterion	Criteria class
4.1 Tenant / occupier situation	20 %	Criteria class 4 30 %
4.2 Rental growth potential / value growth potential	30 %	
4.3 Letting prospects / fungibility	20 %	
4.4 Vacancy / letting situation	10 %	
4.5 Recoverable and non-recoverable operating expenses	10 %	
4.6 Usability by third parties	10 %	
Result for the rating of the quality of the property cash flow	100 %	

Office Properties

1. Criteria Class “Market” (national and regional) - Office

Sub-criteria	Weighting		
	Sub-criterion	national/ regional	Criteria class
1.1 national			
1.1.1 Acts of God	5 %		
1.1.2 Socio-demographic development	10 %	30 %	Criteria class 1 20 %
1.1.3 Overall economic development and international attractiveness	30 %		
1.1.4 Political, legal, taxation and monetary conditions	15 %		
1.1.5 Property market: office	40 %		
1.2 regional			
1.2.1 Acts of God	5 %	70 %	
1.2.2 Socio-demographic development	15 %		
1.2.3 Economic situation and attractiveness	35 %		
1.2.4 Property market: office	45 %		
Result for the market rating		100 %	

2. Criteria Class “Location” - Office

Sub-criteria	Weighting	
	Sub-criterion	Criteria class
2.1 Suitability of the micro location for the property type and target occupiers	25 %	Criteria class 2 30 %
2.2 Image of the quarter (office district) and the location	15 %	
2.3 Quality of transportation infrastructure of the plot and quarter	25 %	
2.4 Quality of local supply facilities of the plot and quarter for target occupiers	15 %	
2.5 Acts of God	20 %	
Result for the location rating	100 %	

3. Criteria Class "Property" - Office

Sub-criteria	Weighting	
	Sub-criterion	Criteria class
3.1 Architecture / type of construction	20 %	Criteria class 3 20 %
3.2 Fitout	10 %	
3.3 Structural condition	15 %	
3.4 Plot situation	25 %	
3.5 Ecological sustainability	10 %	
3.6 Profitability of the building concept	20 %	
Result for the property rating	100 %	

4. Criteria Class "Quality of the property cash flow" - Office

Sub-criteria	Weighting	
	Sub-criterion	Criteria class
4.1 Tenant / occupier situation	20 %	Criteria class 4 30 %
4.2 Rental growth potential / value growth potential	30 %	
4.3 Letting prospects	20 %	
4.4 Vacancy / letting situation	10 %	
4.5 Recoverable and non-recoverable operating expenses	10 %	
4.6 Usability by third parties	10 %	
Result for the rating of the quality of the property cash flow	100 %	

Warehousing, Distribution, and Production Properties

1. Criteria Class “Market” (national and regional) - Warehousing, distribution, and production

Sub-criteria	Weighting		
	Sub-criterion	national/ regional	Criteria class
1.1 national			
1.1.1 Acts of God	5 %		
1.1.2 Socio-demographic development	15 %	30 %	Criteria class 1 20 %
1.1.3 Overall economic development and international attractiveness	25 %		
1.1.4 Political, legal, taxation and monetary conditions	15 %		
1.1.5 Property market: warehousing, distribution, and production	40 %		
1.2 regional			
1.2.1 Acts of God	5 %	70 %	
1.2.2 Socio-demographic development	20 %		
1.2.3 Economic situation and attractiveness	30 %		
1.2.4 Property market: warehousing, distribution, and production	45 %		
Result for the market rating		100 %	

2. Criteria Class “Location” - Warehousing, distribution, and production

Sub-criteria	Weighting	
	Sub-criterion	Criteria class
2.1 Suitability of the micro location for the property type and target occupiers	10 %	Criteria class 2 40 %
2.2 Use-relevant conditions (regulations, decrees, etc.)	25 %	
2.3 Quality of transportation infrastructure of the plot and quarter	40 %	
2.4 Economic situation	20 %	
2.5 Acts of God	5 %	
Result for the location rating	100 %	

3. Criteria Class "Property" - Warehousing, distribution and production

Sub-criteria	Weighting	
	Sub-criterion	Criteria class
3.1 Architecture / type of construction	10 %	Criteria class 3 20 %
3.2 Fitout	10 %	
3.3 Structural condition	20 %	
3.4 Plot situation	25 %	
3.5 Ecological sustainability	10 %	
3.6 Profitability of the building concept	25 %	
Result for the property rating	100 %	

4. Criteria Class "Quality of the property cash flow" - Warehousing, distribution and production

Sub-criteria	Weighting	
	Sub-criterion	Criteria class
4.1 Tenant / occupier situation	20 %	Criteria class 4 20 %
4.2 Rental growth potential / value growth potential	25 %	
4.3 Letting prospects	25 %	
4.4 Vacancy / letting situation	10 %	
4.5 Recoverable and non-recoverable operating expenses	10 %	
4.6 Usability by third parties	10 %	
Result for the rating of the quality of the property cash flow	100 %	

EVIP 8

Fair Value Measurement under IFRS 13

- 1. Introduction**
- 2. Scope**
- 3. Definition of Fair Value in IFRS 13**
- 4. Real Property Valuation and Fair Value Hierarchy**
- 5. The Choice of Level 2 or Level 3 for Property Valuation Inputs**
- 6. The Role of the Valuer in Determining Fair Value Hierarchy**
- 7. Implications for the Preparation of Valuation Reports**
- 8. Conclusions**

1. Introduction

1.1 Since 2005 consolidated accounts of listed companies domiciled in EU states must be prepared in conformity with IFRS financial reporting standards. Fair Value is relevant for the measurement and reporting of the value of property assets in accordance with a number of standards and particularly:

- IAS 16 - Property, Plant and Equipment (particularly owner-occupied property used for the purposes of providing goods or services), and
- IAS 40 - Investment Property.

1.2 Fair Value is one of the two allowable accounting bases for real estate assets (the other is cost accounting). Under IAS 40 Fair Value is the preferred basis for investment properties. Even if reporting entities account for IAS 16 properties on a cost basis, they are required to provide Fair Values in the annexes to their accounts and are required to review these values when they are considered to have changed significantly. All EU listed companies therefore have to measure the Fair Value of their properties at various times for their consolidated accounts.

1.3 Fair Value was originally defined in IAS 40, but questions of its measurement were dealt with in a number of the IFRS standards. A new standard, IFRS 13 "Fair Value Measurement", was introduced in May 2011 and is applicable for all accounts concerning periods starting on or after 1st January 2013. IFRS 13 introduces a number of new criteria for Fair Value measurement and reporting that are important to real estate valuers and will have an impact on the way they prepare their valuations and their valuation reports.

2. Scope

2.1 This Information Paper only applies to valuations in connection with the determination of Fair Value for IFRS financial reporting (for example, annual valuations for listed property companies). It has no application for the determination of Fair Value in the sense of the price to be set for a transaction between two known parties, nor for the assessment of Market Value.

2.2 This subject has been treated in outline in EVS 2, section 4 and then in more detail in EVGN 1, section 6. This information paper will not repeat those comments, so readers of this paper should be familiar with those two documents before reading this paper. With that background, this paper discusses the more practical aspects of the valuer's role in Fair Value measurement and his reporting of the information that his client will require in order to comply with the standard's requirements.

3. Definition of Fair Value in IFRS 13

3.1 As stated in EVS 2, section 4 and EVGN 1, section 6.5, IFRS 13 defines Fair Value as:

“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”.

3.2 It should be noted that, under the new definition, Fair Value is intended to be a sale price (or “exit price”) in the open market. The standard makes it clear that Fair Value must be assessed from the point of view of actors in the market. If the reporting entity considers that the asset has an additional value to it for its particular needs, that additional value should not be included if actors in the market would not include it in their purchase price.

3.3 EVS 2 and EVGN 1 already compare Fair Value for IFRS accounting purposes with Market Value and it is not considered necessary to repeat that discussion here. In most cases Market Value and Fair Value are interchangeable, although there may be cases, particularly involving properties with future development potential or hope value, where the two values are not the same.

4. Real Property Valuation and Fair Value Hierarchy

4.1 IFRS 13 was drafted in the aftermath of the sub-prime crisis and the subsequent shocks to major financial institutions. It is clearly aimed more at the valuation of complex financial instruments than at the valuation of real property. Indeed, very few of the many

examples stated in IFRS 13 refer to real property situations, thus confirming that real property valuations were not the principal target of this initiative. This creates difficulties for property valuers in applying the standard to their daily work. In particular, the concepts of “observable” and “unobservable” inputs lack clarity – one is tempted to ask “observable to whom?” If the observer is a novice in the market, much information may be unobservable to him. In contrast, if the observer is an experienced valuer with access to a lot of confidential information, a great deal more information could be considered as “observable” for him.

4.2 IFRS allows the use of three main types of method, “the market approach”, “the income approach” and “the cost approach”.

- The **market approach** is essentially valuation by reference to sale prices achieved for similar properties, as is used widely for residential owner-occupier properties. In many markets, comparisons will be made on a floor area basis, in which case the valuer’s principal input would be a value per unit of floor area, adjusted to take account of differences between the subject property and the sale comparables. Another common example would be the price per hectare for agricultural land.
- The two main variants of the **income approach** in property valuation are generally capitalisation methods, on the one hand, and the discounted cash flow (DCF) method, on the other. Both methods involve inputs such as estimated market rental values and yields, as well as various deductions and allowances for non-recoverable expenditure, void periods, capital expenditure, etc. In addition, the DCF approach, where it seeks to make all assumptions explicit, will contain assumptions about future growth in rental values and, in some markets, future indexation of rents.
- The **cost approach** requires the valuer to estimate or determine construction costs and other ancillary expenditure in the first instance, then estimate the value of the land on which the property stands. A depreciation factor is often applied to the estimated construction cost, in which case the depreciation factor is an input that will often be significant in the determination of the final value.

4.3 Valuers therefore use a wide variety of inputs, depending on the valuation method they adopt. Most of these inputs will be based on evidence obtained from the market, whether it is evidence of price, yield, cost, void periods, etc. The quality and reliability of this evidence will vary according to the type of property and also from country to country, from city to city and even from sub-market to sub-market within a town or city. In addition, in most markets the quantity of such evidence is comparatively limited, as the number of properties that are let or sold each year often represents only

a modest percentage of the total stock of such properties. There will nevertheless be exceptions, such as sales of new properties on a sizeable estate of very similar ones.

4.4 The quantity, quality and reliability of the evidence will also vary according to where the valuation date falls in the market cycle. For example, a downward phase of the cycle often starts with a period of much reduced market activity in which few transactions take place and thus little evidence is available to the valuer. In addition, at some stages in the market cycle participants may be more or less inclined to share information about prices or rents achieved and this can once again affect the quantity, quality and reliability of the evidence available.

4.5 Under IFRS 13, Level 1 inputs are unadjusted quoted prices in active markets for items identical to the asset being measured. Real estate assets are rarely identical to each other not least because no two assets ever occupy exactly the same physical space, which means that even two very similar houses may have different views or orientations. Similarly an office suite on the top floor of a building will often have more natural light and a better view than a similar-sized suite on a lower floor. As regards “quoted prices”, in most property markets prices achieved on sales or lettings of properties are often not quoted and are thus rarely available to the general public. (This last aspect may, however, change with time with the increasing spread of internet sites offering information on recent rents and sale prices. Nevertheless, information obtained from such sites should be treated with caution as “headline” rents and prices may mask actual transaction details such as onerous lease terms, deferred payments, stepped rents, etc.).

4.6 For all these reasons it is therefore considered most unlikely that Level 1 measurements will arise in property valuation. The valuer’s choice will therefore most likely be between Levels 2 and 3.

5. The Choice of Level 2 or Level 3 for Property Valuation Inputs

5.1 In virtually all cases the valuer will therefore be deciding whether an input he has used is to be classified as Level 2 or Level 3. It should be noted that the reporting entity only has to give the hierarchy of inputs that are considered to be “significant” to the measurement of value.

5.2 Adjustments to inputs. This occurs in the choice of ERVs and yields for the great majority of valuations of investment properties, which are amongst those that are the most concerned by IFRS 13. IFRS 13 states that if an adjustment to a Level 2 input is “significant”, the input should be considered as thereafter falling in Level 3. The word “significant” is not defined in the standard. The valuer will therefore have to judge himself what is significant. It is not possible to indicate a range of percentage adjustment that might be considered significant.

5.3 The appreciation of what is significant will vary according to the type of property and the quality and transparency of the market information that is available. Valuers generally have an idea of the degree of accuracy of the information they have at their disposal, and hence of the degree of accuracy of any value they produce. It is suggested that valuers could measure the significance or otherwise of any adjustment against the level of accuracy that they believe is implied in their value.

5.4 Because of the inherently unique nature of property assets and the limitations on evidence discussed above, valuers are very often required to adjust significant inputs. Some would even say that if no significant adjustments were required there would be no need for valuers! It is therefore considered that in many cases Level 3 is the most likely conclusion for the main inputs used in the valuation of investment property (particularly ERVs and yields).

5.5 For an input to be Level 2, sufficient good evidence of the required input must be available from identical or near-identical properties. In particular, this evidence must be sufficiently recent for it to be applied directly without any significant adjustment for the passage of time between the dates of those transactions and the valuation date of the subject property. Even if the evidence comes from very recent transactions, the valuer will still have to be satisfied that the supply and demand situation remains unchanged between the date of the evidence and the valuation date of his subject property. Examples of cases where Level 2 might nevertheless be possible could include:

- sale prices of identical or very similar residential units;
- rents of identical or very similar light industrial units on the same estate;
- rents for suites let off on similar floors of the same office building.

6. The Role of the Valuer in Determining Fair Value Hierarchy

6.1 Who will be responsible for identifying the hierarchy of the inputs? The valuer is the closest to the “measurement” (i.e. the valuation) and is therefore probably the best able to categorise the various inputs. Valuers undertaking Fair Value valuations for the consolidated accounts of EU listed companies can therefore be expected to be asked to comment on the hierarchy of the main inputs in their valuations. Two possibilities might be:

- where similar valuation methods have been used for a whole portfolio, comments at a general portfolio level, highlighting the exceptions, if any, or
- comments on a property-by-property basis.

6.2 It is the responsibility of the reporting entity to report on the level that will be applied to the value measurement (i.e. the valuation) as a whole. We therefore consider that the final Level 2 / Level 3 decision should be taken by the reporting entity. The valuer’s role is to give his client sufficient details about the various inputs for the

client to be able to make the final decision of the level to be ascribed to the Fair Value measurement of each asset. In order to do this, the valuer may also have to state which inputs are considered to be significant.

7. Implications for the Preparation of Valuation Reports

7.1 Valuers undertaking Fair Value valuations for the consolidated accounts of entities that have adopted IFRS accounting (and in particular for EU listed companies) can be expected to be asked to comment on the hierarchy of the main inputs in their valuations. It is therefore suggested that valuers should identify the inputs that they consider to be “significant” and then state which of Level 1, 2 or 3 they consider to be appropriate for each one, with brief explanations why. The valuer will wish to ascertain the level of detail required by his clients and their auditors, but it is suggested that it may be possible in many cases to deal with this in brief tabular format. Nevertheless, it is highly recommended that valuers seek confirmation from their clients (and perhaps also their client’s auditors) of their reporting requirements at an early stage in the instruction and preferably before confirming their terms of engagement.

7.2 Reporting requirements will clearly vary according to the nature of the properties valued, their tenure, their geographical locations, etc. The more varied the portfolio, the more detail is likely to be required.

8. Conclusions

8.1 It is considered likely that in most markets many of the significant valuation inputs will fall into Level 3. This means that valuers will have to provide the information about the significant inputs and their Level 1, 2 or 3 hierarchy when they prepare valuation reports for properties valued for companies that are subject to Fair Value reporting. This will particularly concern investment property owned by companies listed on the stock exchange of an EU country, but could also involve operational property owned by listed companies.

8.2 Valuers of such properties will therefore have to be familiar with the IFRS13 vocabulary (“observable” and “unobservable” inputs, for example) and with these and other concepts, in order to meet the requirements of their clients and their auditors.

8.3 Finally, as stated above, valuers are strongly recommended to discuss reporting requirements in detail with their clients at the earliest opportunity in order to ensure that they provide the required level of service. This will also help the valuer to draft correct Terms of Engagement and to take account of reporting requirements in determining the appropriate level of remuneration for the instruction.

Summary of TEGoVA's Minimum Educational Requirements

1. Introduction

1.1 TEGoVA requires each Member Association to set educational standards for its members that are at least as demanding as the Minimum Educational Requirements (MER) set by TEGoVA. MER were first introduced by TEGoVA in January 2003 as a basic requirement for every valuer elected to practice by a member association. Many Member Associations have more stringent educational requirements.

1.2 TEGoVA regularly reviews and updates the MER to support the development of professional standards among its members and so for those who require their services. The latest revision was adopted by the General Assembly of TEGoVA at its meeting in November 2010.

1.3 MER requirements are equivalent to and consistent with the EU's Second Diploma Directive relating to the Mutual Recognition of Professional Qualifications (92/51/EEC). In applying MER, Member Associations in countries outside the EU must adopt the requirements of the Second Directive and develop a syllabus that matches the criteria of the Directive.

1.4 Professional services delivered by valuers across Europe vary considerably and many will be specialists in particular sectors. Some geographical areas will be affected by factors that do not apply elsewhere. Thus, the knowledge they require will vary. However, the essential disciplines of valuation will be fundamental to their work and so are central to the MER syllabus. Member Associations develop their educational requirements in line with the Directive and the MER syllabus, though national variations will take account of differing legislation, tax regimes and client requirements. Valuations in, for example, forestry or agriculture may be more prevalent in some countries or for some associations while different types of commercial activity may prevail in others. The Member Association is charged with the responsibility to interpret the MER to ensure consistency with the professional demands of its members.

1.5 The globalisation of real estate markets, continuing European integration, together with an improved free flow of services across the EU and rising client expectations, are the drivers for change in the breadth and depth of knowledge expected of real estate professionals. The industry is now not only focussed on transaction-orientated business but also demands the delivery of added value, with valuers asked for strategic consultancy with appropriate knowledge in all areas of business, the built environment, corporate governance and corporate social responsibility.

1.6 TEGoVA provides additional and separate guidance in respect of its Recognised European Valuer (REV) and TEGoVA Residential Valuer (TRV) Programmes (see next section). Valuers who have achieved this status are subject to additional requirements including continuing professional development.

1.7 The subject areas within the MER are grouped into three levels of knowledge expected of the valuer:

- a. understanding,
- b. general knowledge, and
- c. in-depth knowledge.

2. Outline Syllabus

2.1 Valuers require an **understanding** of:

- Principles of Economic Theory;
- Practical Economics for Real Estate;
- Business and Finance.

2.2 Valuers require a **general knowledge** of:

- Marketing Real Estate;
- Energy, Environmental and Resource Protection;
- Buildings and construction.

2.3 Valuers require an **in-depth knowledge** of:

- Valuation;
- Professional practice;
- Law relevant to Property*;
- Government Policies and Land Use*;
- Valuation under statute*;
- Valuation standards *.

*Denotes in-depth knowledge required relative to the country or sector of practice

Summary of Recognition of Qualifications:

TEGoVA's Recognised European Valuer (REV)

and

TEGoVA Residential Valuer (TRV)

1. The recognitions Recognised European Valuer with the designation REV and TEGoVA Residential Valuer with the designation TRV can be awarded to individual practising valuers and are pan-European indicators of ability and experience that assure clients of their valuation proficiency.
2. Applications for the REV and TRV recognitions are open to qualified practising valuers who meet the relevant TEGoVA requirements and belong to an authorised Full or Associate TEGoVA Member Association (TMA) that has obtained the consent of TEGoVA to award the recognitions (Awarding Member Association or AMA for REV, Residential Awarding Member Association or R-AMA for TRV), and to individual valuers of a valuation company which itself is a member of an AMA or an R-AMA (if applicable). Applications have to be made by the valuer directly to a home country AMA or R-AMA.
3. The process of awarding REV or TRV recognition is divided into two stages. First is the granting of awarding status AMA or R-AMA to the TMA by TEGoVA. The second stage is the awarding of the recognition to the applicant by the AMA or the R-AMA.
4. To achieve awarding status, the TMA must demonstrate that it has in place effective means, policies and quality systems to ensure that applicants meet the TEGoVA requirements as regards education, ethics, experience and lifelong learning.
5. The second stage is the assessment of the applicant by the AMA or R-AMA to ascertain whether the applicant meets the relevant TEGoVA requirements and, if successful, the granting of the recognition and the right to use the designatory letters REV or TRV.
6. Recognition of competence is granted in the name of TEGoVA by the AMA or R-AMA in the form of a certificate of recognition signed jointly by the Chairman of TEGoVA and the Chairman/President of the TMA.

7. The applicant who has been awarded Recognised European Valuer or TEGoVA Residential Valuer recognition is permitted to use this title and the designatory letters REV or TRV after his/her name for a period of five years after which time the valuer must seek renewal of the recognition.
8. Details are available from the TEGoVA Secretariat, e-mail info@tegovala.org or from the TEGoVA website www.tegovala.org.

Glossary

Alternative use value. The market value of the property without presuming the continuation of its present use.

Assumption. A fact or condition about the property assumed by the valuer (whether instructed or otherwise) which he or she does not or cannot know or reasonably ascertain.

Automated valuation model (AVM). A statistic-based computer programme which uses property information (e.g. comparable sales and property characteristics, etc.) to generate property-related values or suggested values.

Bankruptcy-remote entity. A special purpose vehicle (SPV) with a specially designed legal status to make its obligations secure even if the parent company goes bankrupt.

Basis of value. A statement of the fundamental assumptions for assessing a valuation for a defined purpose.

Cost approach. A valuation approach which provides an indication of value based on the economic principle that a buyer will pay no more for a property than the cost to obtain a property of equal utility, whether by purchase or by construction, including the cost of sufficient land to enable that construction. It will often be necessary to make an allowance for obsolescence of the subject property compared with a brand new equivalent one.

Cost-benefit analysis. A technique to assist in decision making when comparing alternative properties, sites or projects. The technique involves the consideration and measurement in financial terms of all costs and benefits.

Damage. Physical damage to, loss of or destruction or damage or loss of use of tangible property, including conversion, trespass, nuisance or wrongful interference with the enjoyment of rights over property.

Date of valuation. The date to which the opinion of value applies (and for which the evidence supporting it is to be relevant) which cannot be later than the date when the valuation report is completed.

Departure. Circumstances where the mandatory application of the valuation standards may be inappropriate or impractical, or where the valuer may be required to comply with standards other than EVS.

Depreciable amount. The cost of an asset, or other amount substituted for cost, less its residual value. *IAS 16*.

Depreciated replacement cost. The cost to replace it so that it can fulfil the functions for which it is used, after allowing for ageing, wear and tear and obsolescence.

Depreciation. The systematic allocation of the depreciable amount of an asset over its useful life. *IAS 16*.

Development property. Property which is in the process of converting land to a new purpose by constructing buildings or making use of its resources.

European Valuation Standards (EVS). A set of *TEGoVA technical documents*, periodically updated, including all *TEGoVA standards*, as well as *guidance notes*, *information papers*, *codes* and *specifications* as agreed.

Excess land (or surplus land). Land within the property that is not essential to the operational purposes of buildings.

External Valuer. A valuer who has no material links with the client, acting on behalf of the client in an external capacity.

Fair Value (for accounting purposes). 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. *International Accounting Standards Board (IASB), International Financial Reporting Standards (IFRS) 13, par. 1*.

Fair value (general definition). The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between identified willing market participants possessing full knowledge of all the relevant facts, making their decision in accordance with their respective objectives.

Finance lease. A lease which transfers substantially all the risks and rewards relevant to ownership. *IAS 17*.

Financial statements. Written statements of the financial position of a person or a corporate entity, and formal financial records of prescribed content and form. These statements carry a measure of public accountability within a regulatory framework of accounting standards and the law.

First loss insurance. A type of insurance of property and interests which covers damage within the stated sum insured. Under-insurance will not be claimed.

Fixed sum. The sum insured fixed by the Insured and stipulated in the insurance policy.

Forced sale value. A sum that could be obtained for the property where, for whatever reason, the seller is under constraints that require the disposal of the property.

Full coverage. Any form of insurance that provides for payment in full (e.g., without a deductible or coinsurance limitation) of all losses caused by the perils insured against.

Full rebuilding value. A type of insurance of buildings which covers the buildings with an amount corresponding to the reconstruction value.

Full replacement cost. The payable amount limited to the insured value as stated in the insurance policy.

Future value. See *hope value*.

Guaranteed replacement cost. The payable amount limited to the insured value as stated in the insurance policy, but if the damage exceeds the limits on your policy, the insurance company is obligated to fully replace or rebuild the property without any deduction for depreciation.

Highest and best use. The use that is at the same time physically possible, legally permissible, and financially feasible and that gives the best value for the property. *IFRS 13, 29*.

Hope value. A surplus amount that, at the date of valuation, the market is willing to pay in the hope of a higher value use or development opportunity being achievable than is currently permitted under development control, existing infrastructure constraints or other limitations currently in place.

Income approach. A valuation approach which involves any valuation method whereby the capital value is found by capitalising or discounting the estimated future income to be derived from the property, whether this income is rent or whether it is income generated by the business that is carried out on the property.

Insurable value. The sum stated in the insurance contract applying to a property as the liability of the insurer should damage and financial loss be caused to the insured by a risk specified in the insurance contract occurring to that property.

Internal valuer. A valuer who is employed by the company or organisation that requires a valuation.

Investment properties. Property (land or buildings, or part of a building, or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation, or both, rather than for: use in the production or supply of goods or services or for administrative purposes; or sale in the ordinary course of business. *IAS 40.*

Investment value. The value of a property to a particular identified party for investment, owner-occupation or operational purposes.

Major renovations. Those where the total cost of the renovation related to the building shell and/or energy installations such as heating, hot water supply, air-conditioning, ventilation and lighting exceeds 25% of the value of the building, excluding the value of the land upon which the building is situated, or those where more than 25% of the building shell undergoes renovation. Directive 2010/31/EU.

Market approach. A valuation approach where the valuation is produced by comparing the subject property with the evidence obtained from market transactions that fulfil the criteria for the relevant basis of value.

Market Rent. The estimated amount of rent at which the property should be leased on the valuation date between a willing lessor and a willing lessee on the terms of the tenancy agreement in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion.

Market Value. The estimated amount for which the property should exchange on the valuation date between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion.

Marriage value. See *synergistic value*.

Minimum Educational Requirements (MER). A syllabus, divided into three levels of knowledge, to be required to all valuers who are members of TEGoVA Member Associations.

Mortgage Lending Value. The value of immovable property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property.

Mortgage-backed securities (MBSs). PRABSs backed by pools of mortgage credits, which can mainly be residential (RMBSSs) or commercial (CMBSSs).

Natural disasters. Floods, storms, landslides and avalanches, storm surges, earthquakes or volcanic eruption.

Net asset value (NAV). A measure of the aggregate current value of assets, less all liabilities.

Operating lease. A lease which transfers substantially all the risks and rewards relevant to ownership. *IAS 17.*

Owner-occupied property. A property occupied by the person who owns the bundle of rights relevant to that property.

Price. The amount asked, offered or paid for a property.

Property. Land and buildings on, below or above ground including pipes, cables and other equipment connected thereto.

Property, plant and equipment. Tangible items that are held for use in the production or supply of goods or services, for rental to others or for administrative purposes and are expected to be used during more than one period. *IAS 16.*

Property-related asset-backed securities (PRABSs). Investment instruments backed by pools of cash flow-generating assets and sold to a bankruptcy-remote special purpose vehicle (SPV). Such instruments may be either mortgage-backed securities (MBS) or property-backed securities where the asset is the property itself. Some instruments will combine the two, such as PRABS based on receipts from a property project.

Property securitisation. The procedure of creating and marketing financial assets assembled from debt and equity interests in real property that are managed by financial professionals and quoted in the securities markets.

Property surplus to operational requirements. Land with or without buildings that is surplus to the foreseeable future operational uses of the undertaking, and will normally be held for sale.

Qualified valuer. A person who is responsible for preparing and supervising valuations, bearing liability for them as included in financial statements and for other authorised purposes, and who fulfils the requirements set out by TEGoVA.

Reacquisition value. The costs of reacquiring corresponding insured items at the date of the damage.

Rebuilding, repair and restoration. Replacement by methods or with materials that satisfy current building, fire and other regulations or legislation. It shall also include the cost of demolition, site clearance, shoring and propping-up, together with all professional and statutory fees that will be incurred in the reconstruction.

Recognised European Valuer (REV). A valuer recognised by TEGoVA in order to assure clients, especially from other countries, of his qualification, knowledge and professional expertise.

Reconstruction value. The cost of reconstructing a corresponding or essentially corresponding building at the place of the damage at the date of the damage.

Reinstatement. A principle which means to replace what might be damaged or destroyed as it was before the event.

Replacement cost. The cost to replace the damaged property with materials of like kind and quality, without any deduction for depreciation.

Residual value. The estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. *IAS 16*.

Risk profile. A detailed summary of the risks associated with a property or group of properties being issued as collateral.

Special assumption. An assumption made where instructions differ from the actual facts existing at the date of valuation.

Special purchaser. A purchaser who can optimise the usefulness of an asset compared to other market participants and whose opinion of price equates to a Special Value.

Special purpose vehicle (SPV). An entity expressly created to acquire and finance specific assets, usually established by the institution holding the underlying assets.

Special value. An opinion of value that incorporates consideration of characteristics that have a particular value to a special purchaser.

Specialised trading properties. Properties normally valued on the basis of their trading potential.

Sustainable net asset value or Sustainable asset value. The sustainable value that an asset may be expected to achieve or maintain over the long term

Synergistic value. A higher value, created when the total value of several properties (or of several legal interests in the same property) combined is greater than the value of the sum of their parts.

TEGoVA code. A TEGoVA *tecÚical document* consisting of a systematic collection of rules, methods or principles produced by TEGoVA.

TEGoVA guidance note. A TEGoVA *tecÚical document*, based on *standards*, providing advice about specific aspects, such as valuation methodologies, scenarios, procedures or property types, which are of importance across Europe.

TEGoVA information paper. A TEGoVA *tecÚical document* providing information on valuation matters.

TEGoVA position paper. A TEGoVA *tecÚical document* addressing and giving an opinion about a valuation issue, including consultation responses.

TEGoVA Residential Valuer (TRV). A valuer undertaking residential valuations who is recognised by TEGoVA because of his qualification, knowledge and professional experience.

TEGoVA specification. A TEGoVA *tecÚical document* containing a detailed description of the relevant steps to follow in order to perform a specific kind of valuation.

TEGoVA standard. A TEGoVA *tecÚical document* stating the Europe-wide generally accepted concepts, definitions and requirements applicable to the basic elements of valuation work.

TEGoVA technical document. A written piece of work, prepared or supported by TEGoVA, dealing with any matter related to valuation, presenting standards, guidance, information or a position in order to improve the quality of the valuation work, based on results consolidated through science, *tecÚology* and experience.

Terms of engagement. The specific terms of the contract between the valuer or valuation firm and the client.

Trading stock. Property classified not as fixed assets, but as current assets for balance sheet purposes.

Useful life. The period over which an asset is expected to be available for use by an entity. *IAS 16*. In the context of Assessment of *investment value*, the useful life is the period during which the property will be capable of being effectively used for its purpose.

Valuation approach. The fundamental way in which, considering the available evidence, the valuer considers how to determine the value of the subject property.

Valuation method. The particular procedure, based on one or more valuation approaches, used by the valuer to arrive at the assessment of value.

Valuation methodology. The way in which a valuer deals with the whole matter of valuing the subject property. Thus, for a given valuation, methodology includes the selection by the valuer of the approach or approaches to be applied, the choice of method(s) and the use of the analytical processes or techniques in order to interpret the valuation inputs and reach conclusions based on them.

Valuation report. A document detailing the scope, key assumptions, valuation methods, and conclusions of an assignment, providing a professional opinion of value supported by a recognised basis or bases of valuation within the framework of European Valuation Standards.

Valuation technique. A specific analytical process of data treatment, conducted within a valuation method.

Wasting asset. Assets, such as mineral deposits and waste disposal sites, with a finite life which, when consumed, cannot be renewed in the existing physical location in which they occur.

Worth. See *investment value*

Members of the European Valuation Standards Board

John Hockey REV - INSTITUTE OF REVENUES RATING AND VALUATION (IRRV)
Chair

Jeremy Moody Hon REV - CENTRAL ASSOCIATION OF AGRICULTURAL VALUERS (CAAV)
Vice-Chair

Leandro S. Escobar-Torres REV - ASOCIACIÓN PROFESIONAL DE SOCIEDADES DE VALORACIÓN (ATASA) - Professional Association of Valuation Companies of Spain

Wolfgang Kälberer Hon REV - VERBAND DEUTSCHER PFANDBRIEFBANKEN e.V. (vdp)
Association of German Pfandbrief Banks

Eric Larsen REV - NORGES TAKSERINGSFORBUND (NTF)
Norwegian Surveyors and Valuers Association

Michael Morris REV - Consultant

Membership of TEGoVA

Albania

- SHOQERIA E VLERESUESVE TE PASURIVE TE PALUAJTSHME (SVP)
Albanian Society of Property Appraisers (ASPA)

Austria

- ÖSTERREICHISCHER VERBAND der IMMOBILIENWIRTSCHAFT (ÖVI)
Austrian Real Estate Association
- VERBAND ÖSTERREICHISCHER IMMOBILIENSACHVERSTÄNDIGER (ARE)
Austrian Association of Real Estate Experts

Belgium

- FÉDÉRATION ROYALE DU NOTARIAT BELGE (FRNB) KONINKLIJKE FEDERATIE VAN HET BELGISCH NOTARIAAT (KFBN)
Royal Federation of Belgian Notaries
- UNION DES GÉOMÈTRES-EXPERTS DE BRUXELLES (UGEB-ULEB)
Union of Expert Surveyors of Brussels

Bulgaria

- КАМАРА НА НЕЗАВИСИМИТЕ ОЦЕНИТЕЛИ В БЪЛГАРИЯ (КНОБ)
Chamber of Independent Appraisers in Bulgaria (CIAB)

Canada

- APPRAISAL INSTITUTE OF CANADA (AIC)
Institut canadien des évaluateurs

Croatia

- HRVATSKA STRUKOVNA UDRUGA EKSPERATA I SUDSKIH VJEŠTAKA (HSUESV)
Croatian Association of Experts and Expert Witnesses
- HRVATSKO DRUŠTVO SUDSKIH VJEŠTAKA I PROCJENITELJA (HDSViP)
Croatian Association of Court Expert Witnesses and Valuers – CACEWaV

Czech Republic

- CESKA KOMORA ODHADCU MAJETKU (CKOM)
The Czech Chamber of Appraisers (CCA)

Denmark

- DANSK EJENDOMSMAEGLERFORENING (DE)
The Danish Association of Chartered Estate Agents

France

- ASSOCIATION FRANCAISE DES SOCIÉTÉS D'EXPERTISE IMMOBILIÈRE (AFREXIM)
French Association of Property Valuation Companies
- CHAMBRE DES EXPERTS IMMOBILIERS DE FRANCE (CEIF-FNAIM)
Chamber of Real Estate Valuers of France
- CONFÉDÉRATION DES EXPERTS FONCIERS (CEF)
Confederation of Land Valuers
- CONSEIL SUPÉRIEUR DU NOTARIAT (CSN)
High Council for the Notarial Profession
- INSTITUT FRANCAIS DE L'EXPERTISE IMMOBILIÈRE (IFEI)
French Institute of Real Estate Valuation
- SYNDICAT NATIONAL DES PROFESSIONNELS IMMOBILIERS (SNPI)
National Association of Real Estate Professionals

Georgia

- საქართველოს დამოუკიდებელ შემფასებელთა საზოგადოება
Independent Valuers Society of Georgia (IVSG)

Germany

- BUND DER ÖFFENTLICH BESTELLTEN VERMESSUNGSINGENIEURE e.V. (BDVI)
German Association of Publicly Appointed Surveyors
- BUNDESVERBAND ÖFFENTLICH BESTELLTER UND VEREIDIGTER SOWIE QUALIFIZIERTER SACHVERSTÄNDIGER (BVS)
Association of Publicly Certified and Qualified Experts
- BUNDESVERBAND ÖFFENTLICHER BANKEN DEUTSCHLANDS e.V. (VÖB)
Association of German Public Banks

- HypZert GmbH
Certification body
- IMMOBILIENVERBAND DEUTSCHLAND IVD BUNDESVERBAND der
IMMOBILIENBERATER, MAKLER, VERWALTER, und SACHVERSTÄNDIGEN e.V. (IVD)
German Real Estate Professional Association
- INGENIEURBÜRO WESELMANN GmbH
Ship valuation company
- VERBAND DEUTSCHER PFANDBRIEFBANKEN e.V. (vdp)
Association of German Pfandbrief Banks

Greece

- ΣΥΛΛΟΓΟΣ ΕΚΤΙΜΗΤΩΝ ΕΛΛΑΔΟΣ (ΣΕΚΕ)
Association of Greek Valuers (AVAG)
- PEOPLECERT HELLAS
Certification body

Hungary

- MAGYAR INGATLANSZÖVETSÉG (MAISZ)
Hungarian Real Estate Association (HREA)

Ireland

- INSTITUTE OF PROFESSIONAL AUCTIONEERS AND VALUERS (IPAV)

Italy

- ASSOCIAZIONE SOCIETÀ DI VALUTAZIONI IMMOBILIARI PER LE BANCHE (ASSOVIB)
Association of Property Valuation Companies for the Banking Sector
- CEPAS srl
Certification body
- CONSIGLIO NAZIONALE GEOMETRI e GEOMETRI LAUREATI (CNGeGL)
National Council of Italian Surveyors
- ISTITUTO ITALIANO di VALUTAZIONE IMMOBILIARE (IsIVI)
Italian Institute for Real Estate Valuation

Kazakhstan

ҚАЗАҚСТАННЫҢ КӘСІБИ БАҒАЛАУШЫЛАРЫНЫҢ ПАЛ ТАСЫ (ҚҚБП)
ПАЛАТА ОЦЕНЩИКОВ «ПАЛАТА ПРОФЕССИОНАЛЬНЫХ ОЦЕНЩИКОВ»
Chamber of Professional Appraisers (CPA)

Kosovo

- SHOQATES SE VLERESUESVE TE KOSOVES (SHVK)
Kosovo Appraisers Association (KAA)

Latvia

- LATVIJAS IPASUMU VERTETAJU ASOCIACIJA (LIVA)
Latvian Association of Property Appraisers

Lithuania

- LIETUVOS TURTO VERTINTOJU ASOCIACIJA (LTVA)
Lithuanian Association of Property Valuers

Macedonia

- BIRO ZA SUDSKI VESTACENJA (BSV)
Bureau for Court Expertise
- KOMORA NA PROCENUVACI NA REPUBLIKA MAKEDONIJA (KPRM)
Chamber of Valuers of the Republic of Macedonia

Montenegro

- INSTITUT OVLAŠĆENIH PROCJENJIVAČA CRNE GORE (IOPCG)
Institute of Certified Valuers of Montenegro
- UDRUŽENJE NEZAVISNIH PROCJENJIVAČA CRNE GORE (CUP)
Association of Independent Valuers of Montenegro

Netherlands (The)

- NEDERLANDSE VERENIGING VAN MAKELAARS IN ONROERENDE GOEDEREN EN VASTGOEDDESKUNDIGEN (NVM)
Dutch Association of Real Estate Brokers and Real Estate Experts

- VastgoedPRO
Association of Real Estate Agents and Valuers of the Netherlands
- VBO MAKELAAR
Dutch Association of Real Estate Agents and Valuers
- WAARDERINGSKAMER
The Netherlands Council for Real Estate Assessment - NCREA

Norway

- NORGES TAKSERINGSFORBUND (NTF)
Norwegian Surveyors and Valuers Association

Poland

- POLSKA FEDERACJA STOWARZYSZEN RZECZOZNAWCÓW MAJATKOWYCH (PFSRM)
The Polish Federation of Valuers' Associations (PFVA)

Portugal

- ASSOCIAÇÃO PROFISSIONAL DAS SOCIEDADES DE AVALIAÇÃO (ASAVAL)
Professional Association of Valuation Companies of Portugal

Romania

- ASOCIATIA NAȚIONALĂ A EVALUATORILOR AUTORIZAȚI DIN ROMÂNIA (ANEVAR)
National Association of Authorised Romanian Valuers

Russian Federation

- НЕКОММЕРЧЕСКОЕ ПАРТНЕРСТВО «НАЦИОНАЛЬНЫЙ СОЮЗ ЭКСПЕРТНЫХ ОРГАНИЗАЦИЙ» (НП «НСЭО»)
Non-profit Partnership «National Union of Experts» (NP NUE)
- ПАРТНЕРСТВО РОССИЙСКОГО ОБЩЕСТВА ОЦЕНЩИКОВ (ПРОО)
Partnership of the Russian Society of Appraisers (PRSA)
- РОССИЙСКАЯ КОЛЛЕГИЯ ОЦЕНЩИКОВ (РКО)
Russian Board of Appraisers (RBA)
- РОССИЙСКОЕ ОБЩЕСТВО ОЦЕНЩИКОВ (РОО)
Russian Society of Appraisers (RSA)

Serbia

- NACIONALNO UDRUŽENJE PROCENITELJA SRBIJE (NUPS)
National Association of Valuers of Serbia (NAVS)

Slovenia

- SLOVENSKI INSTITUT ZA REVIZIJO (SIR)
Slovenian Institute of Auditors

Spain

- ASOCIACIÓN ESPAÑOLA DE ANÁLISIS DE VALOR (AEV)
Spanish Association of Value Analysis
- ASOCIACIÓN ESPAÑOLA DE VALORACIÓN INMOBILIARIA Y URBANÍSTICA (AEVIU)
Spanish Association of Real Estate and Urban Appraisal
- ASOCIACIÓN PROFESIONAL DE SOCIEDADES DE VALORACIÓN (ATASA)
Professional Association of Valuation Companies of Spain

Sweden

- SAMHÄLLSBYGGGARNA-SFF
The Swedish professionals for the built environment

United Arab Emirates

- دائرة الأراضي و الأملاك - مركز التقييم العقاري
Dubai Land Department (TAQYEEM)

United Kingdom

- CENTRAL ASSOCIATION OF AGRICULTURAL VALUERS (CAAV)
- INSTITUTE OF REVENUES RATING AND VALUATION (IRRV)

United States

- APPRAISAL INSTITUTE (AI)

NOTES

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The European Group of Valuers' Associations

unites 63 national valuers' associations from 34 countries representing 70 000 qualified valuers either self-employed or employed by specialist consultancies, private sector companies, government departments or financial institutions both local and international. Its European Valuation Standards (EVS) were cited as reliable standards for the valuation of residential immovable property for mortgage lending purposes in the EU Mortgage Credit Directive and were given primacy over all other standards by the European Central Bank in its Asset Quality Review Manual for the updating of banks' real estate collateral values. It fosters and unifies a European valuation elite by awarding the Recognised European Valuer (REV) and TEGoVA Residential Valuer (TRV) titles and ensures high pan-European levels of education and ethics with its Minimum Educational Requirements and European Valuers' Code of Ethics and Conduct.

