



**TEGOVA**

The European Group  
of Valuers' Associations

# EUROPEAN VALUATION STANDARDS



# CONTENTS

Preface.....	11
Introduction.....	15
Members of the European Valuation Standards Board, Secretariat.....	17
Acknowledgements.....	19

## I. European Valuation Standards and Guidance Notes 21

<b>I.A. European Valuation Standards</b> .....	<b>23</b>
<b>EVS 1 Market Value</b> .....	<b>27</b>
1. Introduction	28
2. Scope	28
3. European Valuation Standard 1 – Definition of Market Value	29
4. Commentary	30
<b>EVS 2 Valuation Bases Other than Market Value</b> .....	<b>43</b>
1. Introduction	44
2. Scope	44
3. Basis of value	44
4. Fair Value	44
5. Special Value	46
6. Investment Value	47
7. Mortgage Lending Value	49
8. Insurable Value	50
9. Value for local and national taxation purposes	51
10. Values for compulsory purchase and/or compensation	51

<b>EVS 3</b>	<b>The Qualified Valuer.....</b>	<b>53</b>
	1. Introduction	54
	2. Scope	54
	3. General	54
	4. The Qualified Valuer	55
	5. Commentary	57
<b>EVS 4</b>	<b>The Valuation Process.....</b>	<b>61</b>
	1. Introduction	62
	2. Scope	62
	3. Terms of engagement	62
	4. Liaison with client's advisers, auditors and others	64
	5. Commentary	64
	6. Supporting the valuation	69
	7. Valuation review	70
<b>EVS 5</b>	<b>Reporting the Valuation.....</b>	<b>75</b>
	1. Introduction	76
	2. Scope	76
	3. Valuation Report – Definition	76
	4. The Valuation Report	76
	5. The EVS Valuation Report for Residential Property	78
<b>ANNEX</b>	<b>EVS Valuation Report for Residential Property</b>	<b>81</b>
<b>EVS 6</b>	<b>Valuation and Energy Efficiency.....</b>	<b>91</b>
	1. Introduction	92
	2. Scope	93
	3. European Valuation Standard 6 – Valuation and Energy Efficiency	94
	4. Commentary	94
<b>ANNEX</b>	<b>Examples of automatic renovation obligations</b>	<b>97</b>

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## I.B. European Valuation Guidance Notes 103

<b>EVGN 1</b>	<b>Portfolio Valuation.....</b>	<b>103</b>
	1. A portfolio valuation	104
	2. Undertaking a portfolio valuation	105
	3. The result	107
	4. Values of the component properties	108
	5. Reporting the Fair Value of a portfolio for accounts	108
<b>EVGN 2</b>	<b>Fair Value for Financial Reporting.....</b>	<b>111</b>
	1. Introduction	112
	2. Scope	112
	3. IFRS 13 Fair Value Measurement	113
	4. IFRS 13 Definition of Highest and Best Use	113
	5. Fair Value hierarchy	115
	6. The role of the valuer in determining Fair Value hierarchy	118
	7. Valuation methods	118
	8. Fair Value compared with Market Value	120
<b>EVGN 3</b>	<b>Valuation for Insurance Purposes.....</b>	<b>123</b>
	1. Introduction	124
	2. Scope	125
	3. Definitions	125
	4. The assessment	127
	5. Reporting	129
	6. Special provisions and recommendations for damage assessment	130
<b>EVGN 4</b>	<b>Apportionment of Value between Land and Buildings.....</b>	<b>133</b>
	1. Introduction	134
	2. Scope	134
	3. Definitions	135
	4. Commentary	137
	5. Apportionment in practice	139
	6. Apportionment between components of buildings under IFRS accounting standards	142

## II. Valuation Methodology 147

---

1. Introduction	150
2. Scope	151
3. Definitions	151
4. Valuation approaches	151
5. General observations	152
6. The Comparative Method	154
7. The Income Approach, methods and models	156
8. The Cost Approach	168
9. The Residual Method	186
10. Using more than one valuation method	187
11. The final check	188

## III. Valuation and Sustainability 191

---

1. Introduction	194
2. Sustainability	197
3. Sustainability and property users	200
4. Developing "green" standards for property	207
5. Valuation and sustainability	214

## IV. European Valuation Information Papers 223

---

<b>EVIP 1</b>	<b>The Impact of the Energy Performance of Buildings Directive on Property Valuation.....</b>	<b>225</b>
1. Introduction		226
2. Scope		226
3. Definitions		226
4. Commentary		227

<b>EVIP 2</b>	<b>Valuation and Other Issues for Recurrent Property Taxation.....</b>	<b>237</b>
	1. The European Semester and recurrent property taxation	240
	2. Defining the properties	241
	3. Valuation	241
	4. Maintaining the valuation register	246
	5. Revaluation	246
	6. Challenges, disputes and appeals	249
	7. Applying the tax	250
	8. Exemptions and reliefs	250
	9. Higher or additional charges	252
<b>EVIP 3</b>	<b>Multiple Interests in Residential Property.....</b>	<b>255</b>
	1. Introduction	256
	2. Valuation	257
	3. Multiple ownerships	257
	4. Tenancies and other rights	260
	5. Residential caravan parks	267
	6. Inalienable and unassignable property	267
<b>EVIP 4</b>	<b>Listed Residential Property (property protected by law).....</b>	<b>271</b>
	1. Introduction	272
	2. Scope	272
	3. Terminology	272
	4. Guidance	273
	5. Valuation	274
<b>EVIP 5</b>	<b>Residential Tenancies and Rent Control.....</b>	<b>279</b>
<b>EVIP 6</b>	<b>Residential Valuations and Equity Release.....</b>	<b>283</b>

<b>EVIP 7</b>	<b>Advanced Statistical Models.....</b>	<b>287</b>
	1. Definition	289
	2. Introduction	289
	3. Commentary	291
	4. European Banking Authority criteria for advanced statistical models for valuation and EVS commentary	292
	5. The valuer's use of statistical tools	293

## **V. Measurement, Education and Qualifications 299**

---

	European Code of Measurement.....	301
--	-----------------------------------	-----

	1. Introduction	302
	2. Scope	302
	3. Definitions	302
	4. Building measurements in practice	307

	Summary of TEGOVA's Minimum Educational Requirements.....	313
--	-----------------------------------------------------------	-----

	1. Introduction	313
	2. Outline Syllabus	314

	Recognition of Qualifications by TEGOVA.....	317
--	----------------------------------------------	-----

## **VI. European Valuers' Code of Conduct 321**

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## VII. European Union Legislation and Property Valuation 325

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1. General Introduction	328
2. The EU Internal Market	331
3. Health and Safety	348
4. Energy	351
5. Environment	355
6. The Common Agricultural Policy	367
7. Schedule of EU Legislation	369
<b>Membership of TEGOVA.....</b>	<b>377</b>
<b>Glossary of terms.....</b>	<b>385</b>
<b>Notes.....</b>	<b>392</b>



# PREFACE



These lines are written in the eye of the storm. The Covid-19 pandemic has disrupted our way of life and our very livelihoods as businesses and workers weather the continuing onslaught of the disease and the measures taken to curtail it. Commercial property is among the hardest hit, with existential challenges for retail and even office property.

For valuers there is, sadly, an element of vindication. Our profession is never more vitally relevant than when the economy and real estate are in free-fall. Gone are the false certainties about value. Vanished, the faith in algorithms crunching out-of-date data. Badly shaken, the confidence of so many that they could gauge the market for themselves. In crisis, valuers come into their own, relying on their experience, intuition and intimate local market knowledge to ascertain value.

Valuation practice is the conciliation of a paradox: deriving value from hard evidence while also identifying market phenomena with a lasting impact on value. A key purpose of valuation standards is to alert valuers to change and provide them with the tools for integrating it into their determination of value. Mirroring this, EVS 2020 is both a continuation and a disruption.

EVS 2020 continues to adapt valuation standards to the ever-increasing sway of EU law over financial and real estate markets. EU law permeates the Blue Book even more than in previous editions, all definitions and concepts are in line with those of EU law and policy – witness the adaptation of EVS's approach to AVMs to the recent Guidelines of the European Banking Authority – and the impacts of EU law on real estate markets and on valuation are analysed in ever greater detail and are expected to be well understood by Blue Book valuers.

Since the last edition, the European authorities have confirmed their faith in EVS. Most notably, the European Central Bank in the 2018 edition of its Asset Quality Review manual for the valuation of banks' real estate collateral reiterated that EVS takes precedence over all other standards.

These marks of confidence in EVS inspired us to help the European authorities further in the present edition, most crucially by addressing the confusion generated by radically differing EU legal language versions of 'arm's-length transaction' in the Capital Requirements Regulation's definition of 'Market Value'.

Alongside this continuing Europeanisation of the profession, EVS 2020 also brings disruption, coming to grips with the imperative of determining the value of energy efficiency in buildings in a Union in which climate leadership is the top priority. The tipping point came this year with the publication of EU-mandated member state Long-term Renovation Strategies, several of which contained legal obligations to renovate a building to a higher level of

energy efficiency by a fixed date or at a certain inflection point (e.g. rental, sale) creating an unavoidable major cost impacting value. Accordingly, EVS 2020 upgrades energy efficiency valuation to Standard status and advises valuers to integrate these costs into their determination of Market Value.

The transparency of financial and real estate markets and the climate impact of buildings are systemic and existential issues of our time. Valuers' key role in these places a great responsibility on TEGOVA, which the European Valuation Standards Board has risen to in this ninth edition of EVS, providing our 70,000 valuers, their clients and the European and national public authorities with the underpinning for rigorous evidence-based determination of value.



**Krzysztof Grzesik REV FRICS**  
Chairman of the Board of TEGOVA





# INTRODUCTION

Building on the foundation of its predecessors, this ninth edition was designed with the particular objective of providing standards that are relevant and easily comprehensible to valuers, clients and the public authorities. All sections have been reviewed in that light, and all new parts passed through that filter.



EVS 2020 enhances European valuation practice with:

- ▶ Greater clarity on the key concept of Market Value, compensating flaws that have crept into various language versions of EU law;
- ▶ A common European Valuation Report for Residential Property;
- ▶ Energy efficiency valuation upgraded to Standard level;
- ▶ New Guidance Notes and Information Papers on subjects of real interest to practicing valuers;
- ▶ Clarification of the role of advanced statistical models in line with the new EBA Guidelines;
- ▶ A comprehensive approach to Valuation Methodology including detailed exposition of key concepts such as income approach and depreciated replacement cost;
- ▶ A unique, landmark exposé of European Union Legislation and Property Valuation enabling practicing valuers to understand how much of the real estate regulatory environment is based on EU law, equally valuable to European and national supervisory authorities, policy makers and academics.

The Standards were designed in the belief that the valuation profession must be conscious of the real added value that quality valuation brings to markets and society and must imbue clients and public authorities with an understanding of how the valuer reached the determination of value.

It was a collective effort based on a clear concept of the needs of society and the future of the profession.

EVS 2020 is effective from 1 January 2021.

A handwritten signature in blue ink, appearing to read 'M. Reinberg', written in a cursive style.

**Michael P. Reinberg PHD REV FRICS CRE**  
Chairman of the European Valuation Standards Board





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To the Blue Book's designers, Caroline Piette and her colleagues Félicie Bouckaert, Alexandre Marly and Isabelle Moulart of Hoet&Hoet whose work speaks for itself.



I.

# European Valuation Standards and Guidance Notes



# I.A. European Valuation Standards

## EVS Summary

### EVS 1 Market Value

Valuers must use the following definition of Market Value corresponding to the definition in the Capital Requirements Regulation:

*"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."*

Due to diverging interpretation of 'arm's length transaction' in the various language versions of the CRR definition, TEGOVA has a universally usable common guidance-definition:

*"The estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller acting independently of each other after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion."*

Valuers must use the following definition of Market Rent:

*"The estimated amount for 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 acting independently of each other 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 must 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 must 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 undertaken by 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.

### **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 6 Valuation and Energy Efficiency**

A legal obligation to renovate a building to a higher level of energy efficiency by a fixed date or at a certain inflection point (e.g. rental, sale) creates an unavoidable major cost that impacts Market Value, as the owner at that date or inflection point will have to pay for renovation works.

Valuers must be aware of these legal deadlines and inflection points and when they appear, must estimate the cost of a renovation deep enough to meet the required new level of energy efficiency or future requirements that are sufficiently close to coming into force and consider the extent to which these costs affect the Market Value at the date of valuation.



# EVS 1 Market Value

Valuers must use the following definition of Market Value corresponding to the definition in the Capital Requirements Regulation:

*"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."*

Due to diverging interpretation of 'arm's length transaction' in the various language versions of the CRR definition, TEGOVA has a universally usable common guidance-definition:

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*"The estimated amount for 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 acting independently of each other after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion."*

1. Introduction
2. Scope
3. European Valuation Standard 1 – Definitions of Market Value and Market Rent
4. Commentary

## 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.
- 1.2. '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 her/him when judged against the person's 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.
- 1.3. These assumptions are explored in Section 4 below.
- 1.4. 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.
- 1.5. 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 at paragraphs 3.1 and 3.4 rely on the range of assumptions explored in Section 4.

### 3. European Valuation Standard 1 – Definition of Market Value

#### 3.1. The EU Capital Requirements Regulation Definition

*"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."*

Due to diverging interpretations of 'arm's length transaction' in the various language versions of the CRR definition, TEGOVA has a universally usable common guidance-definition:

*"The estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller acting independently of each other*

*after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion."*

- 3.2. TEGOVA's definition of Market Value is to be used as the basic definition and interpreted in accordance with the commentary in Section 4 below.
- 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. **"Market Rent"**

*"The estimated amount for 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 acting independently of each other 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 4 below.
- 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. Commentary

### 4.1. General

- 4.1.1. 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 of the market by the parties.

## 4.2. The result

- 4.2.1. "*The estimated amount ...*" – This refers to a price expressed in terms of money (normally in the local currency), payable for the property in a transaction between parties acting independently of each other. 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.
- 4.2.2. 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.
- 4.2.3. 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.
- 4.2.4. Special Value is considered with related issues under EVS 2 – Valuation Bases Other Than Market Value.

## 4.3. The real property being valued

- 4.3.1. "*... 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.
- 4.3.2. 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 property to be valued. If the determination 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. The valuer 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 will require an adjustment to the Rental Value.

**4.3.3.** 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.

**4.3.4.** The concept of 'highest and best use'(HABU) is integral to Market Value and is the use of a property that is physically possible, reasonably probable, legal or likely to become so, and that results in the highest value of the property at the date of valuation.

**4.3.4.1.** '**Physically possible**' – There can be a reasonably probable and legal use which offers the highest value for the property, but is inoperable if, for instance, poor soil quality means that the foundations could not bear the size of the construction envisaged.

**4.3.4.2.** '**Reasonably probable**' – Disregarding specialist uses that might occur to a single bidder. It also allows consideration of uses thought likely to become possible, as for example, where existing infrastructure constraints or other physical limitations are currently in place but are likely to be eased in the future (for example by the building of a new road or a flood alleviation scheme).

**4.3.4.3.** '**Legal or likely to become so**' – Potential buyers perceive that:

- ▶ A planning authority is likely to allow a change of use or permit a proposed development in the foreseeable future; or
- ▶ Legislation is likely to change to render a currently illegal use or development legal;
- ▶ A licensing regime is considered likely to become more or less stringent.

**4.3.4.4.** '**The highest value**' – It will reflect an appraisal of the probability that the market places on the highest value use or development being achieved, the costs likely to be incurred and, where relevant, the return on investment likely to be earned in doing so, the time scale and any other associated factors in bringing it about.



A valuation taking into account a "*likely*" or "*reasonably probable*" use will only reflect an element of the uplift in value that is expected to result once such use is fully permitted or where relevant, other constraints have been lifted.

- 4.3.5. In most cases valuers will quickly ascertain that HABU is the same as existing use. Sometimes they may identify a more valuable use but conclude that the costs of such change of use would be too great and therefore HABU would still equal value in existing use at the date of valuation.

#### 4.4. The transaction

- 4.4.1. "*... 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.
- 4.4.2. 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.
- 4.4.3. 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.
- 4.4.4. 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.
- 4.4.5. The hypothetical sale is by "*private contract*" and so is the subject of negotiation.
- 4.4.6. 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.

## 4.5. The date of valuation

**4.5.1. "... 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.

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

**4.5.3.** The phrase "*date of valuation*" (and also "*valuation date*") is used to refer to the date at which the valuation is 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 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.

**4.5.4.** 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).

## 4.6. The parties – Hypothetical, willing and competitive

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

- 4.6.2. 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.
- 4.6.3. 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.
- 4.6.4. Equally, the motivated bidder cannot be presumed to be reluctant or unwilling. He or she is attending to this as a practical business person.
- 4.6.5. The State Aid rules refer to an "*arm's length buyer*" unconnected with and independent of the seller.
- 4.6.6. "*... 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 on the 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.
- 4.6.7. Again, for Market Rent, the lessor is a hypothetical one, not the actual owner. He or she 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.
- 4.6.8. Thus, while the property is 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.
- 4.6.9. Market Value and Market Rent are thus independent of and uninfluenced by the objectives of the client instructing the valuation.
- 4.6.10. "*... 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.

#### 4.7. The marketing

- 4.7.1. **"... 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.
- 4.7.2. If the Market Rent is to be determined for a property, then it is 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.

#### 4.8. The parties' consideration of the matter

- 4.8.1. **"... 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.
- 4.8.2. 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.
- 4.8.3. **"... 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.

**4.8.4.** *"... 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.

## 4.9. Assumptions

**4.9.1.** 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 4.10.7 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.

**4.9.2.** Valuers make an assumption where they assume (or are instructed to assume) something on a matter of fact which they do not or cannot know or reasonably ascertain.

**4.9.3.** 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 which, in the absence of full information, are 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 the possibility of inaccuracy in the Report.

**4.9.4.** The following is an indicative, non-exhaustive, list of items 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 case, valuers would have to assume the position they consider most likely, also stating that they accept 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 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 their use together with reference to any policies or proposals by statutory bodies that could impact value positively or adversely;
- ▶ 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 no such risks exist;
- ▶ 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 been flooded, 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 instructed are considered in EVS 4 at 6.2.3.

#### **4.10. Special assumptions, including alternative use value and forced sale value**

- 4.10.1.** In distinction to an assumption that the valuer has to make to undertake the task, the valuer may make a special assumption when assuming, 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.

**4.10.2.** This, to be stated in the Valuation Report, is to inform the client as to the valuation in those different circumstances. 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.

**4.10.3.** Two particular examples are considered below:

- ▶ Alternative use value (at 4.10.6);
- ▶ Forced sale value (at 4.10.7).

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

**4.10.5.** 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).

#### **4.10.6. Alternative use value**

**4.10.6.1. Definition** – The value of the property under a use other than the present one.

**4.10.6.2. 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.

**4.10.6.3.** 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.

#### **4.10.7. Forced sale value**

**4.10.7.1. 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.

**4.10.7.2. Commentary** – Forced sale value is 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.

- 4.10.7.3. 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.
- 4.10.7.4. 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.
- 4.10.7.5. 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.
- 4.10.7.6. 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 constraint.



## 4.11. Other matters

- 4.11.1. 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 and to anyone else who might reasonably seek to rely on it or appraise it in accordance with EVS 4.
- 4.11.2.** The definition of Market Value (or, if appropriate, Market Rent) should be recorded in both the terms of engagement and the Valuation Report.
- 4.11.3. 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.
- 4.11.4.** 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.
- 4.11.5.** 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 realization costs."*
- 4.11.6.** In such cases, valuers may choose to state the Market Value both before and after these costs of disposal. In either case, they 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

The valuer must 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 must 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**
- 2. Scope**
- 3. Basis of value**
- 4. Fair Value**
- 5. Special Value**
- 6. Investment Value**
- 7. Mortgage Lending Value**
- 8. Insurable Value**
- 9. Values for local and national taxation purposes**
- 10. Values for compulsory purchase and/or compensation**

## 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 made for the purposes of 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 2020 are suitable for the completion of an instruction, a clear and transparent definition of the basis used must be expressly stated, and the valuer must 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 must be stated. Any assumptions or special assumptions used must 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:

- 4.1.1. 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 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.

- 4.1.2. 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 2. 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 2.8 for a discussion of possible differences between Fair Value and Market Value*).

## 4.2. Commentary – Fair Value for Financial Reporting

- 4.2.1. In respect of financial reporting under IFRS 13 (see *EVGN 2*), 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.
- 4.2.2. The determination of Fair Value is discussed in greater detail in *EVGN 2*, Fair Value for 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.
- 4.2.3. Fair Value will generally be determined on the basis of the property's highest and best use as defined by IFRS 13, that is, the most valuable use of the property that is physically possible, legally permissible and financially feasible at the date of valuation. This is a different definition from the EVS definition of HABU.

## 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 an individual for whom the property has a higher value than for other market participants.

### 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 needed in order to complete the 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. Definitions

- 6.1.1. The value of a property to an owner or prospective buyer, calculated on the basis of their individual investment criteria. Whilst every prospective buyer will individually calculate the investment value of a property for the purposes of establishing a price at which to bid for the property, the value so calculated may equal the Market Value of the property but may also be higher or lower than the Market Value.

**6.1.2.** Investment Value is most often used for the purposes of measuring the performance of a property investment.

## **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 determine 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 her/his own actual concerns, rather than a hypothetical party;
- ▶ Do not assume an exchange of property between parties.

**6.2.2.** It is important to be able to establish a way to determine the value that the property to be acquired has for specific investors.

**6.2.3.** 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, public subsidy or a combination. Hence, the investor's assumptions about the asset's profitability and potential for 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.

**6.2.4.** This basis of value is used to assess the investment value of a property for a known individual investor. This process is to be distinguished from the determination of Market Value: whereas Market Value is the best price that would be reasonably expected in the 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 her/his specific investment requirements.

**6.2.5.** This 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.

**6.2.6. Information to be gathered** – In order to assess investment value, the valuer will need:



- ▶ Any specific characteristics of client's business or property portfolio that might have an influence on the future cash flows generated by the subject property;
  - ▶ The client's investment, purchase or rental criteria (such as a target rate of return or the hold period).
- 6.2.7. Reporting** – The Valuation Report, prepared in accordance with EVS 5, must state that the basis of value adopted is Investment Value and that the Market Value may be different.
- 6.2.8.** It must make clear that it is prepared only for the particular client to whom it is addressed, that it contains specific requirements and assumptions relating solely to that client and that it is not to be relied on by any third parties.
- 6.2.9.** The Report must record the criteria required and the information provided by the client.

## 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.
- 7.1.1.** The definition of MLV varies between countries and even within them due to differing practices of financial institutions. Valuers using MLV must state which definition and/or legislation they are using.
- 7.2. Commentary**
- 7.2.1.** The above definition is incorporated in Regulation (EU) N° 575/2013 on prudential requirements for credit institutions and investment firms (Capital Requirements Regulation (CRR)).
- 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.

- 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. 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*).
- 7.2.4. Reporting** – The Valuation Report, prepared in accordance with EVS 5, must state that the basis of value adopted is MLV and that the Market Value may be different.

## 8. Insurable Value

### 8.1. Definition

- 8.1.1.** Insurable value is the cost of replacing the damaged property with materials of like kind and quality without any deduction for depreciation.

### 8.2. Commentary

- 8.2.1.** The insurable value should include, inter alia, any appropriate additional values including, inter alia, fees for architects, engineers and service providers, planning permissions, licenses and approvals. Except if instructed otherwise, plant and machinery and any other material that do not form an integral part of the structure should be exempted (as they are usually covered by another insurance).
- 8.2.2.** 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 mud-slide). In some countries such damages are under separate coverage.
- 8.2.3.** The report should fulfil the relevant requirements of the EVS Valuation Report for Residential Property.

## 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 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 EVS.



# **EVS 3** The Qualified Valuer

Each valuation carried out in accordance with these Standards must be undertaken by 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**
- 2. Scope**
- 3. General**
- 4. The Qualified Valuer**
- 5. Commentary**

## 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 requires that the Valuation Report be undertaken by a Qualified Valuer. All valuers contributing to a Report must have sufficient expertise and work to professional standards and, where considering valuation issues, must meet the expectations of this Standard.

## 3. General

- 3.1. A valuation must be undertaken by a Qualified Valuer delivering the professional skills, knowledge, competence and independence consistent with the requirements of EVS including the European Valuers' Code of Conduct. The work must meet the requirements of a professional service. 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 valuers to satisfy themselves that they possess 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 valuers to ensure that they are aware of potential conflicts of interest and ensure that they can meet the requirement of independence.

## 4. The Qualified Valuer

*(All references to 'valuer' in this book are to a 'Qualified Valuer')*

**4.1. Definition** – A **Qualified Valuer** is a natural person, whether self-employed or employed by a valuation company or other legal entity, who is responsible for undertaking valuations and who can demonstrate:

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** – Qualified Valuers are competent when they can demonstrate:

- ▶ 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 they have obtained suitable assistance from competent and knowledgeable person(s);
- ▶ Where required by home country national legislation or regulations, any required licence to practise as a valuer or membership of a professional association;
- ▶ Compliance with all legal, regulatory, ethical and contractual requirements related to the valuation;
- ▶ That they will at all times maintain the highest standards of honesty and integrity and conduct their activities in a manner not detrimental to clients, the public, the profession, or their respective national professional valuation bodies. 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 Conduct;
- ▶ That they hold professional indemnity insurance appropriate to the valuation work undertaken (unless the Member Association does not require it);
- ▶ They have maintained and enhanced their professional knowledge through a relevant programme of continuing education.

**4.3. Enhanced competence** – Qualified Valuers reach this level when they 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 V of these Standards and the TEGOVA website)*

**4.4. 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 Part V and its more detailed requirements are set out on the TEGOVA website, [www.tegova.org](http://www.tegova.org).

**4.5. 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 Part V and its more detailed requirements are set out on the TEGOVA website, [www.tegova.org](http://www.tegova.org).

**4.6. 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 Part V and set out in detail on the TEGOVA website, [www.tegova.org](http://www.tegova.org).

**4.7. Continuing professional development** – Qualified Valuers must maintain their expertise by keeping up to date with all relevant developments, whether legislative, technical or otherwise, affecting instructions to be undertaken so that they continue 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.

### 5.2. Conflicts of interest

5.2.1. The requirements of the valuers in terms of professional objectivity mean that they must be aware of anything that could be perceived as a conflict of interest. In their initial enquiries, they must 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 must 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.

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. EU definition

5.3.3.1. The Mortgage Credit Directive 2014/17/EU (MCD) states in Article 19(2) 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."*

### 5.4. 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. Valuers may seek to limit their liability in the terms of their contracts with the clients. 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 professionals, valuers' fundamental duty is to their clients. Any limitations on their liability should not be at the expense of the professionalism of the valuation.
- 5.4.7. Valuers should undertake tasks within their competence and fulfil them professionally within their 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** – Valuers must not accept instructions outside their 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 of the need for 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

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**
- 2. Scope**
- 3. Terms of engagement**
- 4. Liaison with client's advisers, auditors and others**
- 5. Commentary**
- 6. Supporting the valuation**
- 7. Valuation reviews**

## 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 or valuation company 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 must be agreed in writing before the valuation is undertaken.
- 3.3. Terms of engagement as agreed may require subsequent amendment, and any variations must be recorded in writing to avoid misunderstanding and consequential dispute.
- 3.4. Terms of engagement must be regularly evaluated to recognise client feedback or amended client requirements; recent legislation, regulation, requirements of the valuer's professional association and any update or new edition of EVS.

- 3.5. Failure to issue written terms will result in non-compliance with EVS and the requirements of TEGOVA's European Valuers' Code of Conduct. This may also result in an inadequate defence to any legal action relating to fees, negligence or performance.
- 3.6. 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 must confirm in writing that these terms continue to apply unless otherwise agreed with the client. The client must be notified in writing of any subsequent variations as soon as they come into force.
- 3.7. The minimum terms to be submitted and agreed are as follows:
- ▶ The client's identity;
  - ▶ The purpose of the valuation;
  - ▶ The physical property being valued;
  - ▶ The ownership;
  - ▶ The basis or bases of value;
  - ▶ A specific date of valuation;
  - ▶ Confirmation that no conflict of interest 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 from EVS;
  - ▶ 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;
  - ▶ Consistency with European Valuation Standards;
  - ▶ The basis of fee to be charged;
  - ▶ Basic disclaimer;
  - ▶ Timetable for work.

*(see table under 5.10)*

## 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/she 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.
- 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	Details
The client's identity	
The purpose of the valuation	The valuer must declare that the valuation only relates to the specific purpose stated.
The physical property being valued	<p>The address must be stated.</p> <p>The following must be considered:</p> <ul style="list-style-type: none"> <li>▶ Where the boundaries of the property being valued are undefined, reference to a plan or other fixed object may be required;</li> <li>▶ Where fixtures, fittings, plant or machinery are present in a property, specify what will be assumed to remain with the property;</li> <li>▶ 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.</li> </ul>
The ownership	If more than one legal interest or legal estate exist, specify which is/are being valued.

The basis or bases of value	The basis or bases of value that will be reported must be specified. A basis of value recognised in EVS should be used. This may be determined by the client, the professional body, legislation or regulation.
A specific date of valuation	
Confirmation that no conflict of interest exists. Declaration of any previous involvement with the property or the parties involved	<i>(see EVS 3.5.2)</i>
The identity and status of the valuer	<p>State that the valuer is acting in an external and independent capacity. Compliance with the valuer's professional association's and with TEGOVA's European Code of Conduct and Ethics must be confirmed.</p> <p>The qualifications and designations of the valuer should be set out, including REV or TRV, if awarded.</p>
Assumptions, special assumptions and departures from EVS	<p>All assumptions and special assumptions required by the client in preparing the valuation or Valuation Report must be specified. Reference must be made to any departures from EVS, setting out the reasoning and justification for departure.</p> <p><i>(see EVS 1)</i></p>
The scope and extent of investigations	The scope and extent of the investigations must be clearly set out. The extent of the inspection (internal and external) must be mentioned.

<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 must state that the valuer will rely upon this information and will not seek to verify the accuracy of the information provided.</p> <p>The valuer does not accept liability where the client has withheld information or given incorrect information.</p>
<p>Any restriction placed on publication</p>	<p>If any restrictions regarding publication, reproduction, public reference or circulation of the Valuation Report are agreed, they must be stated.</p>
<p>The extent to which a duty of care will be provided</p>	<p>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.</p>
<p>Consistency with European Valuation Standards</p>	<p>Where the valuation has been rendered consistent with EVS, reference must be given with the title European Valuation Standards.</p>
<p>The basis of fee to be charged</p>	<p>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.</p>
<p>Basic disclaimer</p>	
<p>Timetable for work</p>	

## 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 property, the report-signing valuer or a named and qualified person mandated by the report-signing valuer must make her/his own visual inspection of it. This will include the interior of the buildings, the locality and the environment to record all matters which appear relevant to the value of the property.
- 6.2.1. The Valuation Report must contain the following inspection information:
- ▶ Date of inspection;
  - ▶ Information to be received and examined: list of documents and other information originating from third parties e.g. cadastre information, surfaces, current occupancy, leases, etc., including origin of data and supporting evidence;
  - ▶ Confirmation that the inspection was made by the valuer or by a suitably qualified person under the valuer's responsibility;
  - ▶ The name and qualifications of the person who physically inspected the property and the extent of the inspections carried out must be stated. If the inspection has been less complete than usually required for this type of valuation, this must be stated;
  - ▶ Responsibility for the inspection: falls to the valuer signing the report;
  - ▶ The extent of the property that it was possible to inspect.
- 6.2.2. 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.
- 6.2.3. 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, as factors which could significantly affect the property's value may not have been identified.

- 6.3. Consideration should be given to establishing relevant financial, legal and regulatory points regarding the property.
- 6.4. Having inspected the property, valuers should seek out and consider available comparables (sold or for sale, or rented or for rent as appropriate) and analyse them comprehensively on a common basis as to evidence of prices and/or yields.
- 6.5. 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.
- 6.6. Figures reported should be supported, not just stated. The valuation is the culmination of valuers' investigations and research that demonstrates their skill in being able to bring together data from various sources, use that information efficiently and provide a considered opinion.
- 6.7. The contents of a Valuation Report will be determined by the purpose and agreed Terms. EVS 5 deals with Valuation Reporting.
- 6.8. 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.

## **7. Valuation review**

- 7.1. A valuation review is an assessment of another valuer's report, not a revaluation.

- 7.2. The term **valuation review** can have different meanings:
- ▶ An assessment of the report of another valuer taking the form of a Valuation Review Report;
  - ▶ A check of the overall accuracy of a portfolio of valuations (*see EVGN 1*) on the basis of a representative sample of properties including the main findings of the assumptions and checks performed;
  - ▶ The review performed by banks according to Article 208 paragraph 3 point b) of Regulation (EU) n. 575/2013 which EVS interprets as meaning a 'revaluation'.
- 7.3. This Standard covers **valuation review** as defined under 7.2, first indent.
- 7.4. The **review objectives** are to:
- ▶ Provide an assessment of the compliance of the valuation work under review with European Valuation Standards;
  - ▶ Examine the documents relied on and assess their proper and accurate use;
  - ▶ Identify any nonconformities and their impact on the conclusions.
- Note – The objective is not to provide a new valuation figure, as that would require a new valuation.*
- 7.5. Apart from the elements needed to achieve the review objectives, **the Valuation Review Report shall state at least:**
- ▶ The identity of the client and other intended users;
  - ▶ The intended purpose of the review, and intended use of the review results;
  - ▶ The professional independence requirements based on which the reviewing valuer shall express an unbiased opinion with no influence whatsoever from any third party;
  - ▶ Whether or not discussions with the original valuer have taken place;
  - ▶ The assumptions and special assumptions in the valuation review.
- 7.6. The **scope of the review work** must be clearly stated, in a manner that must not be misleading to either the contracting parties or any independent competent third party having legitimate access to the contract that covers the scope of work.
- 7.7. The **Review Report** must be clearly presented and must contain sufficient information so as not to mislead the client and the intended users about the review results.

**7.8. The reviewing valuer must be:**

- ▶ A Qualified Valuer, as defined in EVS 3;
- ▶ Independent from the valuer who originally performed the valuation;
- ▶ In possession of (at least) all the facts and information relevant to the property on the date of valuation on which the first valuer relied. If the reviewing valuer does not have this information, or has it only partially, this must be clearly stated.

**7.9. The requirements to be met by the reviewing valuer:**

- ▶ The reviewing valuer must assess compliance with the valuation standards effective at the valuation date;
- ▶ Whilst reviewing valuers may refer to sections of the reviewed report deemed relevant in backing up their assessment, they must specify to what extent they relied on the reviewed report under 'special assumptions'.







# **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.

- 1. Introduction**
- 2. Scope**
- 3. Valuation Report – Definition**
- 4. The Valuation Report**
- 5. The EVS Valuation Report for Residential Property**

## 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 must therefore be exact, transparent and understandable to the client.

## 2. Scope

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

## 3. Valuation Report – Definition

The **Valuation Report** is the comprehensive communication of the valuer's professional judgement of Market Value to the client. It is 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.

## 4. The Valuation Report

### 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 details of comparables used. It must 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 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 an actual or potential conflict of interest, that conflict must be stated with a record that it was notified to the client and with details of the measures taken to ensure that the conflict did not adversely affect the valuer's objectivity.

## 4.2. Content 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 different clients, for different reasons, on different occasions. In some cases, clients will be very familiar with the property, whereas in others they may be discovering it when they read 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 informed of the current value of the 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. The Report must 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 retrofitting.
- 4.2.6. Valuers must state whether in undertaking the valuation they have 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.
- 4.2.7. Where the market for the property being valued is affected by unusual uncertainty and this is relevant to the valuation, the valuer must proceed with caution, comment on the issue to the client and make appropriate statements in the Report.
- 4.2.8. **Length of validity of the reported value** – Valuations are prepared with reference to a specific date of valuation. As such, the value may not be the same the day after that date. 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 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 or by the requirements of the contract.
- 4.2.9. All Valuation Reports must include a statement that the Qualified Valuer responsible for the valuation to the client has conformed to the requirements of these European Valuation Standards. The valuer must 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.

## 5. The EVS Valuation Report for Residential Property

*(see Annex)*







**ANNEX**  
**EVS VALUATION**  
**REPORT FOR**  
**RESIDENTIAL**  
**PROPERTY**

# A. BASIC ELEMENTS OF THE INSTRUCTION

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## A.1. The property

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1. **The property** – Name (if any).
2. Address.
3. Cadastre/land register reference + identification on a map.

## A.2. The client

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4. Identification of instructing client (name, details).
5. How the client instructed the valuer + any modification since the date of instruction.
6. **Third party reliance** – Where it has been agreed that certain identified third parties will be able to rely on the Report, those third parties must be identified.
7. **Limitations on the Report/confidentiality clause** – The valuer must state any limitations on the use of the Report as well as any limitations relating to its publication.

## A.3. The valuer

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8. **Identification of the valuer** – When the valuation instruction is given to a company, the individual valuer conducting the report must be identified.
9. The qualifications of the valuer (*EVS 3*).
10. The status of the independent valuer (external or internal).
11. Confirmation that the valuer has the experience and market knowledge necessary to value the property.
12. **Confirmation that there are no conflicts of interest** – Where conflicts exist, the Report must state that these were brought to the client's attention and detail the measures taken to ensure the valuer's objectivity was not affected.

13. **Use of specialist valuers or advisers** – Where the signing valuer has used the services of third party specialists, they must be identified and the client's agreement to their use recorded.

#### A.4. The scope of work

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14. The purpose of the valuation (mortgage loan and other banking use, sale/purchase, taxation, renovation, extension, etc.).
15. Basis of value instructed including full relevant EVS definition (e.g. Market Value) and reference to the appropriate EVS or to the law or regulation that defines the basis of the valuation.
16. The legal interest in the property being valued (freehold/outright ownership, leasehold or other, ownership percentage, etc.).
17. If a special assumption is being made, the valuer must clearly state in the conclusion of the Valuation Report alongside the opinion of value that the latter has been derived under that special assumption.
18. Investigations carried out.

#### A.5. The available information

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19. **Information received and examined** – List of documents and other information originating from third parties e.g. cadastre information, surfaces, current occupancy, leases, etc., including origin of data and supporting evidence (*attached as annexes*).
20. Source of measurement data and measurement standards used.
21. Valuers must state any important assumptions made as regards documents or information not made available to them, or about information they were not able to verify.
22. Reliance on information obtained from the client and from third parties must be recorded.

## A.6. The inspection

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23. The scope of the inspection to be carried out. Purely visual with no coverage of hidden defects.
24. Date of inspection.
25. Confirmation that the inspection was made by the valuer or by a suitably qualified person under the valuer's responsibility.
26. The name and qualifications of the person who physically inspected the property and the extent of the inspections carried out must be stated. If the inspection has been less complete than usually required for this type of valuation, this must be stated.
27. **Responsibility for the inspection** – Falls to the valuer signing the Report (*identified above under A.3.8*).
28. The extent of the property that it was possible to inspect.

# B. DESCRIPTION

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## B.1. The location

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29. Relevant neighbourhood characteristics.
30. Availability of public means of transportation.
31. Identification and description of the geographical area relevant to the property being valued (Relevant maps and photographs must be included as annexes).
32. Valuer's opinion of the market characteristics that tend to influence property value in the identified area.

## B.2. The property

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33. Site analysis:
  - ▶ Distance from the city centre, major transportation services (airport, railway, bus station), access to the property (adequate vehicular access from the main roads, etc.) and any other relevant information (proximity to employment, schools, shopping areas, etc.);
  - ▶ Description of the land plot on which property is built (size, shape, topography and local infrastructure).
34. Description of the physical characteristics of the property (architecture, built-in furniture and equipment, the energy performance certificate's rating, view, luminosity, state of repair, attractiveness and character, etc.) must include photographs as annexes.
35. Comment on the physical characteristics as to quality, both in isolation and relevant to the average neighbourhood quality.

### **B.3. The legal situation**

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- 36. Ownership and tenure** – Including comment on any covenants, third party rights over the property, restrictions or obligations that could have an effect on value.
- 37. Tenancies** – 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.
- 38. Town planning and development control** – Information about the current zoning in the relevant development plan(s), allowed uses, forest fire, earthquake, flood risk, etc.
- 39. Judgment of the impact of the legal situation on the value.**

# C. VALUATION

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## C.1. The methodology

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- 40. **Methodology** – Description of valuation approaches that were considered; which approaches and which methods have been used.
- 41. **Key assumptions** – It is recommended that the choice of these key inputs be explained with reference to the comparables listed.

## C.2. The selection criteria for relevant market data

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- 42. The criteria chosen for selections of comparables (market area, size, type, etc.) must be clearly stated and consistent with the property's characteristics.
- 43. Information of transactions in respect of comparable properties (redacted as appropriate for confidentiality and privacy) and other market data must be clearly set out together with the source of such information and the criteria chosen for selections of comparables (geographical area relevant to the property being valued, size, type, etc.).

## C.3. The analysis of the market data

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- 44. Description of each comparable (photographs may be included as annexes, chosen as appropriate in terms of confidentiality and privacy).
- 45. **Adjustments to the values of comparable properties with accompanying commentary** – The valuer must provide appropriate comment reflecting the logic and reasoning for the adjustments provided.

## C.4. Valuation

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- 46. Final calculation supporting opinion of Market Value.

## D. CONCLUSION

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47. The reported value must be clearly and unambiguously stated, together with confirmation that sufficient investigation has been undertaken to justify the opinion of value reported.
48. Confirmation of value.
49. Date of valuation.
50. A clear statement as to whether transaction costs such as VAT, fees, etc. are or are not included in the reported value.
51. **Currency** – The reported value must 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 must state the conversion rate used.
52. Statement of compliance with the General Data Protection Regulation (GDPR).
53. Statement of compliance with EVS.
54. Basic disclaimer.
55. The Valuation Report must be signed and dated by the valuer (*identified above under A.3.8*).







# **EVS 6** Valuation and Energy Efficiency

A legal obligation to renovate a building to a higher level of energy efficiency by a fixed date or at a certain inflection point (e.g. rental, sale) creates an unavoidable major cost that impacts Market Value, as the owner at that date or inflection point will have to pay for renovation works.

Valuers must be aware of these legal deadlines and inflection points and when they appear, must estimate the cost of a renovation deep enough to meet the required new level of energy efficiency or future requirements that are sufficiently close to coming into force and consider the extent to which these costs affect the Market Value at the date of valuation.

- 1. Introduction**
- 2. Scope**
- 3. European Valuation Standard 6 – Valuation and Energy Efficiency**
- 4. Commentary**

## 1. Introduction

- 1.1. Containing climate warming has become the top short, medium and long-term priority of the European Union. All relevant EU policy without exception – energy efficiency, renewables, environment, transport, internal market, competition, state aid, economic and monetary policy, economic governance, taxation, digitalisation, agriculture, fisheries, regional policy, research and innovation, accession negotiations, neighbourhood policy, foreign trade, foreign affairs, foreign development, Covid-19 recovery funding and the EU budget (the 2021-2027 Multiannual Financial Framework) – must be designed or redesigned to contribute to the reduction of carbon emissions and to carbon capture.
- 1.2. Under current EU law, member states must by 2030 achieve 32.5% improvement in energy efficiency compared to projections and the share of energy from renewable sources in the EU's gross final consumption must be 32%. This equates with a 40% reduction in carbon emissions by 2030 and a 60% reduction by 2050.
- 1.3. However, the European Climate Law under discussion as these Standards go to print sets new EU targets of at least 55% reduction in green house gas (GHG) emissions by 2030 and net carbon neutrality by 2050 ('net' meaning reduction in carbon emissions combined with carbon capture).
- 1.4. This cannot be achieved without a regulation-led economic paradigm shift. Regulation will 'make' the market, nowhere more so than for the real estate economy as buildings account for 36% of EU carbon emissions, far ahead of any other sector, and the overall EU targets cannot be met without rapid decoupling of the building stock from fuel and gas and its linkage to green power along with accelerated renovation.
- 1.5. The Union has traditionally energy-regulated the building stock via Directives and the main significant impacts have been:
  - ▶ The obligation to energy efficiency renovate when the owner freely decides to undertake a major renovation;
  - ▶ All new buildings must be near-zero energy;
  - ▶ Member states must energy renovate 3% of central government buildings every year;

- ▶ Buildings put up for rent or sale must have an energy performance certificate (EPC) with a rating;
  - ▶ Regular inspection of heating and cooling systems.
- 1.6. This is nowhere near enough to reach the EU targets, yet there are great practical and political obstacles to any EU regulation that would be more detailed than this. Accordingly, the new EU policy is to focus on the EU targets and to allow the member states great freedom in the choice of the precise instruments for reaching them. However, new EU law puts the member states under obligation to submit to the European Commission detailed explanations of the national regulation deployed to reach the targets.
- 1.7. In 2020, each member state had to submit to the European Commission an integrated National Energy and Climate Plan (NECP) for its overarching climate strategy and a Long-term Renovation Strategy (LTRS) specifically for buildings.
- 1.8. Those LTRS's available on 01.10.2020 show the emergence of:
- ▶ Deeper energy renovation obligations for owners deciding to undertake major renovations;
  - ▶ Obligations to renovate independently of the owner's decision to do so;
  - ▶ Greater use of EPCs as renovation obligation triggers, with a corresponding effort to make them more reliable and enforceable;
  - ▶ Increased and simplified subsidies and tax breaks and;
  - ▶ Accelerated renovation of the central and local government building stock.
- 1.9. Valuers must be aware of all of these factors, but the most discernible impact on Market Value derives from the first three.

## 2. Scope

This Standard covers the obligations impacting Market Value stemming from national building regulation aimed at meeting the EU GHG emissions targets.

### 3. European Valuation Standard 6 – Valuation and Energy Efficiency

- 3.1. A legal obligation to renovate a building to a higher level of energy efficiency by a fixed date or at a certain inflection point (e.g. rental, sale) creates an unavoidable major cost that impacts Market Value, as the owner at that date or inflection point will have to pay for renovation works.
- 3.2. Valuers must be aware of these legal deadlines and inflection points and when they appear, must estimate the cost of a renovation deep enough to meet the required new level of energy efficiency or future requirements that are sufficiently close to coming into force and consider the extent to which these costs affect the Market Value at the date of valuation.
- 3.3. Until now, often buyers have chosen, and building regulations allowed, partial renovations that only marginally impact energy efficiency and entail only marginal cost, but the new legal obligations create a situation where these partial solutions are no longer sufficient.

### 4. Commentary

- 4.1. Some of the Long-term Renovation Strategies submitted to the European Commission by the member states in 2020 announce the automatic energy renovation obligations that impact Market Value.
- 4.2. Some contain plans to improve the quality of the EPC and render its rating enforceable as a threshold for the renovation requirement.
- 4.3. Most of the Strategies were based on meeting the existing EU energy efficiency and renewables targets and not the much stricter GHG emissions targets in the European Climate Law currently in the legislative pipeline. This probably means that those governments that thought they could avoid automatic renovation obligations under the old targets will all be obliged to instate them in the near future.
- 4.4. There follow examples of national automatic renovation obligations taken from the LTRS's submitted by 01.10.2020. Valuers from those countries must inform themselves of whatever missing detail is useful for them.

*(see Annex)*







# ANNEX

# EXAMPLES OF

# AUTOMATIC

# RENOVATION

# OBLIGATIONS

Taken from the national Long-term Renovation Strategies  
submitted to the European Commission by 1 October 2020

# BELGIUM

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## BRUSSELS CAPITAL REGION

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### ► Residential

New EPC: No more three recommendations for works. Instead, indication of the technical measures to be implemented in order to achieve the overall energy performance objective set (by type) by the Brussels Capital Region.

A renovation plan will be produced for the work and will be mandatory in the case of planning permission requiring the assistance of an architect. It will be produced by an architect.

Energy efficiency renovation work to be carried out in five stages to achieve a minimum performance level by 2050. This minimum level will be defined by type. Owners will choose the measures to be carried out from among the priority measures recommended by the EPC. By each deadline set by the legislation, owners must prove that the work has been correctly carried out.

Housing that does not meet energy efficiency and health criteria and/or a minimum level of energy performance will not be rentable.

### ► Non-residential

Mandatory system of work to be carried out by certain deadlines, similar to the system established for the residential sector.

## FLANDERS

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### ► Residential

Updated EPC provides specific advice with a roadmap including indication of the cost price for single-family dwellings to enable the dwelling to progress towards the 2050 objective. *"The indication of the renovation cost offers neutral arguments to potential buyers to negotiate the sale price".*

EPC for common parts of an apartment building.

Gradual tightening-up of the standards of the Flemish Housing Code concerning the maximum EPC figure, taking into account the benchmarks of the long-term objective for 2050.

## ▶ Non-residential

**Mandatory renovation after transfer of ownership:** From 2021 the building must undergo deep energy renovation within no more than five years of a notarial deed of transfer of full ownership. Specific approach under preparation.

**Mandatory minimum energy performance from 2030:** From 2030, these buildings must achieve a minimum energy performance to an EPC level still to be defined.

# CYPRUS

As of 1 July 2020, all residential buildings undergoing major renovation must be of energy class A, and all other buildings are to be of energy class B+.

# FRANCE

## ▶ Residential

### 1. Information:

- ▶ The energy performance certificate (EPC) is to be rendered reliable and enforceable\* by 01.01.2021;

*\* Necessary for 2 below*

- ▶ EPCs and leases will have to state the building's real energy consumption, primary and final, and contain a theoretical estimate of the building's complete energy costs by 01.01.2022;
- ▶ All advertising will have to display the energy cost estimate by 01.01.2022.

2. **For the worst performing buildings (EPC 'F' and 'G', 25% of the entire housing stock):**

- ▶ Obligatory energy audit as of 2022;
- ▶ In areas subjected to rent controls, upward revision of rent levels is conditional on energy renovation as of 01.01.2021;
- ▶ Legal obligation to energy-renovate by 2028;
- ▶ Sanctions for non-compliance with the renovation obligation as of 2028. The sanctions will be made known by 2023.

3. **As of 01.01.2023, energy performance will become a criterion for judging housing decency.** Housing with consumption in excess of a certain threshold set by decree **will no longer be rentable.**

▶ **Non-residential**

**Binding regulation** to reduce energy consumption by 40% in 2030, 50% in 2040 and 60% in 2050 compared to 2010.

**Applies as of a threshold of 1000 m<sup>2</sup> which can be reached either per unit or cumulatively** (in a mainly commercial building or on a site with several buildings). All categories of activity are covered, public and private, with very few exceptions (temporary buildings, churches, defence, civil security and national security).

## NETHERLANDS

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▶ **Non-residential**

It will no longer be possible to rent out offices with less than a 'C'-rated EPC as of 2023, 'A'-rated as of 2030.

# SPAIN

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- ▶ **Residential**

Extension of the EPC obligation to all buildings even if they are not put up for sale or rent.

- ▶ **Residential and non-residential**

Plan to turn EPCs into regulatory tools by raising their currently low technical quality, improving their legibility and visibility, revising the rating scales, indicating energy efficiency renovation pay-back terms and optimal staging of renovations.

Currently under study: setting of minimum standards of energy efficiency (possible further link to housing decency), possibly based on the EPC and serving either as the threshold for sale or rental of the property or for preferential tax treatment.



# I.B. European Valuation Guidance Notes

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## EVGN 1 Portfolio Valuation

1. A portfolio valuation
2. Undertaking a portfolio valuation
3. The result
4. Values of the component properties
5. Reporting the Fair Value of a portfolio for accounts

## 1. A portfolio valuation

- 1.1. For property valuation, a portfolio is a collection of properties owned by a single person or entity and which are to be valued as a whole. Whether the properties are many or few, inter-dependent or distinct, the basis of portfolio valuation is the instruction that they are to be valued as a whole. That understanding removes the issue of considering whether a portfolio has to comprise a minimum number of properties.
- 1.2. While the valuer might also be required to provide values for the separate properties within the portfolio and that might often be part of the work in preparing a portfolio valuation, the portfolio value might be greater or lesser than the total of the values of the portfolio's component parts. Any difference between those two figures might then be a guide to the client's business policy, marketing strategy or for other purposes.
- 1.3. The difference between the two approaches could be seen as:
  - ▶ A portfolio valuation being "*top down*" with the asset being the combined portfolio;
  - ▶ A component valuation being "*bottom up*" working from the value of each property identified within the portfolio.
- 1.4. It is most direct for the instruction to define a portfolio of properties as the single entity to be valued without needing to make an assumption or special assumption as:
  - ▶ The valuer should know from the instruction whether or not the properties are to be valued as a whole or separately. In cases where either the instruction is unclear or the situation cannot be absolutely established (as perhaps with contested ownerships) the approach of making the assumption of a portfolio valuation may be appropriate where consistent with the instruction;
  - ▶ To be a special assumption, the statement would have to be false at the time. It would, thus, be a hypothetical circumstance such as where a property might be added to other properties, increasing or creating a portfolio or potentially enhancing or detracting from a portfolio.
- 1.5. Examples of property portfolios include:
  - ▶ A collection of investment properties where these might be sold for whatever reason as a whole;



- ▶ A country estate where the main house, amenity and other land with other dwellings may in some circumstances offer a collective value above the value of the component parts;
- ▶ Land being assembled for a prospective development project;
- ▶ Properties subject to securitised mortgages;
- ▶ A collection of properties held by public authorities, such as schools.

1.6. In the context of a portfolio of properties, value might lie variously in:

- ▶ Where a portfolio makes properties available and attractive to a different type of bidder, as where the chance to buy a thousand dwellings could be of interest to private or institutional investors but not to the individuals who might want single properties for occupation;
- ▶ The diversification of risk given by a varied portfolio;
- ▶ Synergies in cost and management;
- ▶ Circumstances where separate disposals would be too onerous, slow or uncertain, with a risk of the disposals not being fully completed;
- ▶ Other reasons.

1.7. It is entirely a matter for the circumstances and markets at the time as to whether:

- ▶ A portfolio of properties has a different value from the total of the values of its component parts;
- ▶ Any such difference is positive or negative.

Where a portfolio offers a premium so that it is worth more as a whole than the simple total of the values of its parts, then it is more likely to be retained, marketed as a whole or perhaps expanded by acquisition. Where the portfolio has a value that is less than the sum of its parts, that may, subject to operational issues, tend to encourage its disposal in parts. The potential to unlock those separate values may be one possible reason for purchase.

## 2. Undertaking a portfolio valuation

2.1. The valuation of a number of properties as a portfolio is undertaken in the same way as the valuation of an individual property with instruction and engagement, inspection, research, analysis, forming an opinion as to value and reporting. While the scale of the work for larger or more diverse portfolios may affect how those

processes are undertaken, the task remains that of the professional production of an opinion as to the value of the portfolio.

- 2.2. The full scale of the portfolio will need to be defined and recorded. There should be no doubt as to what property has been considered and so to what the valuation relates. That may require assumptions as to uncertain boundaries or facts.
- 2.3. A portfolio of a large number of properties may, of practical necessity, be undertaken by closer inspection of only a fraction or sample of properties, so that the valuer uses them to appraise the issues that are relevant and, so far as they are representative of the portfolio as whole, determine its value. That requires care both in selecting the sample involved so that it is informative as to the portfolio as whole and in the professional use of any statistical techniques that are used in this task.
- 2.4. **Using statistical tools and AVMs** – The valuer might use statistical tools to test measures of the distribution and variance of values and the sensitivity of the outcome to particular assumptions. These may be bespoke tools, general statistical packages or derived from an Automated Valuation Model (AVM). This is discussed in EVGN 3.
- 2.5. That issue may, according to the scale of the portfolio, prompt consideration of the use of an AVM. As a desktop exercise, this is more apt for large scale valuations than for individual properties.
- 2.6. Where valuers are confident in:
  - ▶ The representative nature of the data being used, including its relevance to properties in the portfolio (such as geographical area and market sector), its type (actual results from transactions or just asking prices or other valuations) and its volume; and
  - ▶ The appropriateness of the rules that the model uses to estimate price, potentially including how they are reviewed for changing markets;an AVM may assist them in forming the final opinion of value.
- 2.7. It is important to remember that statistical techniques, statistical tools and AVMs are mathematical aids to calculation and do not offer the professional judgment that is needed to report on value: that is the valuer's task and responsibility.

- 2.8. **Using other valuers and professionals** – A valuer instructed to value a large portfolio may need the assistance of others to handle the instruction. Where a portfolio includes different types of property, the valuer may need to retain the services of another valuer skilled in properties outside her/his expertise or other professionals able to offer contributory expertise.
- 2.9. Such a need may particularly apply where:
- ▶ A portfolio includes a more unusual asset (such as, for example, a quarry) or a property in a specialist use;
  - ▶ The portfolio is geographically diverse, in more than one country or across the European Union, making it harder for the valuer to inspect or understand all the properties with possible issues of differing law, language and culture to be considered. Where a portfolio includes properties in different jurisdictions, it will frequently be wise for the valuer to retain the services of another valuer knowledgeable in those areas;
  - ▶ The portfolio includes other things to be valued than property, such as business interests, plant and machinery, renewable energy installations operated by the client or fine art.
- 2.10. In such cases, the instructed valuer may act as the central co-ordinator for the project, carrying overall responsibility for the work undertaken by others.
- 2.11. As with a single property, the task is the professional production of a professional opinion as to the value of the portfolio as a whole on which the client can rely and which can be defended. The procedures taken should be covered by the terms of engagement and recorded in the Valuation Report.

### 3. The result

- 3.1. The result is the valuer's opinion as to the value of the portfolio as a whole. It is not a valuation of the parts of the portfolio considered separately though that might also be requested.
- 3.2. If the instruction is for a portfolio valuation, then any further observation is only commentary. As well as any discussion of Market Risk, that might include any view as to whether the portfolio value offers a premium or discount to the total of the values of the component properties.

- 3.3. One possible issue for a commentary on the valuation is whether any single asset, factor or other feature within the portfolio might have a disproportionate effect on the portfolio value. While that might be either a positive or negative influence, it might be more important where that individual property has a negative value.

## 4. Values of the component properties

- 4.1. The client's instruction may also require a valuation of the portfolio's component properties. That would be a different opinion as to value, this time on the basis that the properties would be sold separately.
- 4.2. On occasion, that may require a judgment as to the level to which the portfolio is disaggregated. That might rest on a view as to the lots in which the portfolio might best be marketed (if it is not marketed as a whole). It could still be that several potentially separate properties would still be sold together because of value that would offer. That might be the case for agricultural fields or where development plots would be best sold in larger units or where a group of properties offers a synergy.
- 4.3. In practice, a portfolio valuation is likely to require sufficient appraisal of the portfolio's components to enable the valuer to form a view of their individual values and so the totality of those values. However and unless instructed, that might not have been prepared to the standards required for such a view to be a professional opinion as to the value of each component.

## 5. Reporting the Fair Value of a portfolio for accounts

*(see EVGN 2 for a larger discussion of measuring Fair Value for IFRS)*

- 5.1. IFRS 13, Fair Value Measurement refers to the asset to be valued as the "unit of account" which might be a portfolio of properties. It provides that:

*"The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. A fair value measurement requires an entity to determine all of the following (IFRS 13:B2):*

- ▶ *The particular asset or liability that is the subject of the measurement (consistently with its unit of account);*

- ▶ *For a non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use);*
  - ▶ *The principal (or most advantageous) market for the asset or liability;*
  - ▶ *The valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorised."*
- 5.2. IFRS 13 requires that the unit of account be established before determining the fair value. It is to be defined as the level at which an asset or a liability is aggregated or disaggregated in an IFRS for recognition purposes.
- 5.3. The "*portfolio exception*" allowed by IFRS 13.48 appears to apply directly only to financial instruments within IAS 39 where defined financial assets and financial liabilities are managed together with offsetting market risks or counterparty credit risks as a portfolio and then only for qualifying entities. On those terms, this exception does not appear relevant to property.
- 5.4. However, the guidance to consider the most advantageous market for the asset and the reference to "*its highest and best use*" (as defined by IFRS for this purpose) points to the opportunity to value a portfolio of properties for this purpose on a portfolio basis, at least where that produces a higher value than a component valuation. In practice, it is likely that relevant factors will include:
- ▶ The nature of the properties in question;
  - ▶ The business or other policy purpose for which the client holds them.
- 5.5. With the issues involved, the basis for reporting should be discussed with the client and, if possible, the client's accountant so that an informed instruction is given to the valuer.
- 5.6. Where the portfolio is the valuation unit (rather than its components) successive valuations must be consistent with that unless the client instructs otherwise. If this basis is changed, that must be reported.
- 5.7. With the varying approaches of IAS 16 (owner occupied property), IAS 17 (leases), IAS 40 (investments) and IAS 41 (agriculture), a view may also have to be taken that a portfolio includes a mixture of any of owner-occupied property, investment property, property held on lease and agricultural property. Leases pose the additional question of whether they are, for IFRS purposes, finance or operational leases.



# **EVGN 2** Fair Value for Financial Reporting

1. Introduction
2. Scope
3. IFRS Fair Value Measurement
4. Highest and Best Use
5. Fair Value hierarchy
6. The role of the valuer in determining Fair Value hierarchy
7. Valuation methods
8. Fair Value compared with Market Value

## 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. Most of the International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) have been adopted in European law by European Commission Regulations, in particular Regulation 1255/2012 which adopted IFRS 13 Fair Value Reporting. Since 2005, consolidated accounts of listed companies domiciled in EU member states have had to be prepared in conformity with IFRS financial reporting standards.
- 1.2. 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.
- 1.3. Fair Value is one of the two allowed accounting bases for real estate assets (the other is cost accounting). It 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 1<sup>st</sup> 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

This Guidance Note applies to the valuation of properties for the purpose of financial reporting under IFRS (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.



### 3. IFRS 13 Fair Value Measurement

#### 3.1. Definition of Fair Value – IFRS 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:

- 3.1.1. **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.
- 3.1.2. **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.
- 3.1.3. **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.
- 3.1.4. **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.

### 4. IFRS 13 Definition of Highest and Best Use

- 4.1. IFRS 13 paragraph 27 states that *"A fair value measurement of a non-financial asset 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"*.
- 4.2. In relation to the interpretation of highest and best use IFRS 13 also provides the following:

4.3. Paragraph 28: *"The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible, as follows:*

*(a) A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (eg the location or size of a property);*

*(b) A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (e.g. the zoning regulations applicable to a property);*

*(c) A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use."*

*Paragraph 29: "Highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset."*

4.4. 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 valuers to have stated in their reports that they have 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/she must state this and give the reasons for not doing so. The reporting entity will then in turn be able to include this information in its report.

## 5. Fair Value hierarchy

- 5.1. IFRS 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.
- 5.2. It is important to note that the concept of Fair Value hierarchy in IFRS 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.
- 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.
- 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.

- 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.
- 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.
- 5.7. It should be noted that 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 observers are novices in the market, much information may be unobservable to them. In contrast, if the observers are experienced valuers with access to a lot of confidential information, a great deal more information will be "*observable*" for them.
- 5.8. 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.).

- 5.9. 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.
- 5.10. In virtually all cases the valuer will therefore be deciding whether an input 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. 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 the subject property. Examples of cases where Level 2 might nevertheless be possible 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 on similar floors of the same office building.
- 5.11. Adjustments to inputs occur in the choice of estimated rental values (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. Valuers will therefore have to judge for themselves what is significant. It is not possible to indicate a range of percentage adjustment that might be considered significant.
- 5.12. The appreciation of what is significant will vary according to the type of property and the quality and transparency of the market information 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.
- 5.13. 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. Therefore 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).

## 6. The role of the valuer in determining Fair Value hierarchy

- 6.1. Valuers must 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.
  
- 6.2. Who will be responsible for identifying the hierarchy of inputs? The valuer is the closest to the "measurement" (i.e. the valuation) and is therefore probably 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 are:
  - ▶ 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.
  
- 6.3. 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. The final Level 2/ Level 3 decision should therefore be taken by the reporting entity. The valuer's role is to give sufficient details about the various inputs for the client to be able to make the final decision on the level to be ascribed to the Fair Value measurement of each asset. In order to do this, the valuer must state which inputs are significant.

## 7. Valuation methods

- 7.1. 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".
  
- 7.2. 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".

7.3. IFRS 13 sets out three valuation techniques: market approach, cost approach and income approach (*IFRS 13.62*).

- ▶ 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 is a value per unit of floor area, adjusted to take account of differences between the subject property and the sale comparables. Another common example is 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 rental values (ERVs) 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.

7.4. 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 be 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, city to city and even 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.

7.5. 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, too, can affect the quantity, quality and reliability of the evidence available.

## 8. Fair Value compared with Market Value

- 8.1. EVS 2 already compares Fair Value for IFRS accounting purposes with Market Value and it is not necessary to repeat that discussion here. In most cases Market Value and Fair Value are interchangeable. However Fair Value and Market Value are not synonymous, particularly in circumstances where property being valued is not in its highest and best use at the date of the valuation. While the definition of HABU under IFRS 13, pertinent to Fair Value, identifies only uses that are legal at the date of valuation, the TEGOVA definition of Highest and Best Use pertinent to Market Value (*EVS 1*) encompasses uses that are legal or likely to become so at the date of the valuation, reflecting an element of the uplift in value which will result once such use is fully permitted or where relevant, other constraints have been lifted.
  
- 8.2. In any case, where valuers choose to report a Fair Value significantly lower than the Market Value, it is strongly recommended that they highlight this fact to the client and explain the reason for the difference.







# **EVGN 3** Valuation for Insurance Purposes

1. Introduction
2. Scope
3. Definitions
4. The assessment
5. Reporting
6. Special provisions and recommendations for damage assessment

## 1. Introduction

- 1.1. This Guidance Note is a guideline in assessing the insurable value and the cost of damage to, or losses on, real properties.
- 1.2. The valuer must 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.
- 1.3. 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.
- 1.4. 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.
- 1.5. In some cases, the valuer must be assisted by persons having a detailed knowledge of the value of special items and complicated structures and installations.
- 1.6. Where the basis of cover is to be full reinstatement, the valuer must 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 in order to make an accurate assessment of the cost of reinstatement.

## 2. Scope

This Guidance Note considers the assessment:

- ▶ 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;
- ▶ Of damages to insured buildings;

## 3. Definitions

- 3.1. The **insurable value** of a property (*see EVS 2*).
- 3.2. **Damage** means physical damage and/or, loss of 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 or restore what is damaged or destroyed to the state it was in before the event. It is not to cover improvements or extensions, save where such changes are required at the time by law or regulation.
- 3.3.1. Reinstatement means the rebuilding or repair of the property to a condition equal to, but not better or more extensive than, its condition as defined in the insurance contract.
- 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 regulation. 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 the cost of replacing 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 must 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. **Full rebuilding value – Full replacement cost – Guaranteed replacement cost – Full coverage**
- 3.7.1. **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 set 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, indemnity will be provided for the part of the damage corresponding 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.
- 3.7.2. **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 obliged 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% more than for the actual-cash-value coverage.
- 3.7.3. **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 obliged 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% 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.

- 3.7.4. 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. In 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.

- 3.8. 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.
- 3.9. Fixed sum** – The sum insured is set 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.
- 3.10. 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).
- 3.11. Reconstruction value** is understood as the cost of reconstructing a corresponding or essentially corresponding building at the place and 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 setting the reconstruction value.
- 3.12. Special items** such as historical buildings, artworks, special architectural features etc. In such cases the valuer must consider being assisted by persons having detailed knowledge of the value of such items.

## 4. The assessment

- 4.1.** 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 must 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.

- 4.2. 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.
- 4.3. 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 their damage reports, valuers shall include such additional costs in the cost of reinstatement.
- 4.4. 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.
- 4.5. 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 their damage reports valuers must also take this into account.
- 4.6. 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 *EVIP 1*). Valuers must include such calculations in their damage reports.
- 4.7. Fees for architects, surveyors, engineers and 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 valuers must also take these factors into account when calculating the value of the claim in their damage reports.

- 4.8. 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 local practice and with the basis adopted by authors of any recognised cost guides.
- 4.9. 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.

## 5. Reporting

- 5.1. The valuer must undertake an assessment and provide an adequate description of the following:

### 5.1.1. 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.

### 5.1.2. Specific to Insurable Value

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

### 5.1.3. Specific to damages

- ▶ The cause of the damage must be stated. However, arson 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 report;
- ▶ 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.

## 6. Special provisions and recommendations for damage assessment

A typical list of procedures is as follows:

- ▶ The assignment is acknowledged;
- ▶ The representative of the insured is contacted without delay;
- ▶ Inspection is carried out with all involved parties present;
- ▶ The damaged property and the damage to it are recorded;
- ▶ The cause of the damage is established;
- ▶ Any disagreement by the insured party with the valuer's conclusions is reported;
- ▶ The underlying cause of the damage is described;
- ▶ For natural disasters the following is 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 the property is not in compliance with building regulations is there a relationship between the non-compliance 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 construction, and who was responsible.
- ▶ The need for any immediate measures to safeguard the property and avoid further damage is reported;
- ▶ The damage report contains 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 is produced to estimate budgetary figures for costs;
- ▶ In some cases, recording of the parties' agreement on procedures for demolition to determine the exact cause and extent of the damage;
- ▶ A method of repair is recommended;
- ▶ The Final Report is produced.



# **EVGN 4** 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 2 – Fair Value for Financial Reporting, makes reference to apportionment.
- 1.2. 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.
- 1.3. This Guidance Note reviews the assessment of apportionment between land and buildings on that 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.
- 1.4. 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.
- 1.5. 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 be prepared in accordance with best practice and can be supported if they are subsequently challenged.

## 2. Scope

- 2.1. The purpose of this Guidance Note 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 law 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 operational properties (IAS 16) 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 Guidance Note 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 regulation 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.

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 IAS 16 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 IAS 16 as *"the cost of an asset, or other amount substituted for cost, less its residual value"*.
- 3.4. **Residual value** – Under IAS 16, 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** – IAS 16 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 other owners would have attributed to the building if it had not been surplus to their needs. If asked to establish or to assist in establishing the useful life of buildings, the valuer should therefore liaise with the reporting entity, so as to be aware of the entity's intentions for the various buildings.
- 3.6. **Depreciated Replacement Cost** of a building is the cost of replacing it so as to 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 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 the 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. The valuer's judgment and selected methodology will determine the adjustments necessary to provide a realistic and justifiable opinion of apportionment.
- 4.2. 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 (historic cost).
- 4.3. In some jurisdictions there may be policies for apportionment of certain classes of property established by law, government agencies or local practice. They may or may not be mandatory. The valuer may need to explain or justify the method used.
- 4.4. In some countries, 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.
- 4.5. 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:
  - ▶ 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
  - ▶ 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

- ▶ 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.
- 4.6. **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. 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 must not include any development potential over and above that required for the buildings being considered.
- 4.7. Bare land in an undeveloped state might still have significant infrastructure installations, the costs of which will, for the most part, be depreciable amounts. Land without any infrastructure might be worth very little, so care is required to avoid double counting.
- 4.8. If an entity is being valued under a **DRC approach** due to a lack of market transactions for what might be a specialised use, the availability of land transactions for that use is likely to be lacking. If the requirement is for special permits or licences which may be possible in only a few locations there may be an element of premium pricing for land in that use. Equally, where the entity is of low value compared to other uses, the land might be worth a small amount.
- 4.9. Some valuers and auditors in these circumstances have adopted a value for land that a **prevailing local use** might generate. For example, a site for a school may be in a residential area and the prevailing use would be residential. The logic is that a purchaser would compete to acquire the land at its highest value and may then choose to use it for a lower value end use.
- 4.9.1. This creates a valuation problem in that there may be no planning approval for the alternative use and it may not be obtained. One common approach is to discount the alternative use value by a percentage, but this has no evidential base.
- 4.9.2. If the land value is greater than the value under existing use, then the basis for valuing the land needs to form part of the apportionment to maintain consistency.

- 4.10. **"Excess land" or "surplus land"** is not included in the apportionment. Excess land must 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 excess land must be deducted from the purchase price before apportioning the remainder between land and buildings. The value of any excess land must 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 4.5 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, valuers will then use their professional judgment to justify the selection and application of the apportionment procedure used and any subsequent adjustment in reaching their final figures.
- 5.2. **Determining 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 on the market. If no comparables are available, valuers can use a residual or DCF development appraisal, procedures that they will usually be familiar with.
- 5.3. Again, 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 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. The exception to this is as per 4.9 where existing use values are not easily determined.
- 5.4. The land should be valued on the basis of the unimproved site, ignoring the value of any 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 land value will often 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.
- 5.6. For this reason, valuers should be cautious about adopting '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 methods often only work correctly for new or very recent properties.
- 5.7. **Determining the 'value' of the buildings, then deducting it from the value or price**  
– This procedure is more often used:
- ▶ Where there is little or no evidence of values for relevant land;
  - ▶ Under jurisdictions that apply a building tax to the book value of the building;
  - ▶ When dealing with property where there are other owners in the building and where rights of common interest might exist;
  - ▶ When applying the procedure in 4.5, 1<sup>st</sup> indent, 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. The presence of other owners in the building, and the existence of common interest on their part, should be established as part of the examination of titles and other documentation prior to the completion of the valuation. There might be cases where complications are encountered in defining or ascertaining the rights of the other owners, but it is essential that if common interest exists, its

effect be taken into account. The valuer dealing with an apportionment of value in cases where common interest exists has to judge to what extent, if any, the apportionment and the residual amount in particular should be adjusted to allow for that common interest on the part of other owners in the building. When dealing with property where there are other owners in the building, and where rights of common interest might exist, the apportionment of the valuation of the asset for depreciation purposes should be carried out by calculating the net current replacement cost of the building.

- 5.10. **Calculating both values, then determining the apportioned amounts on a 'pro-rata' basis** – Again, 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 valuers' judgement based on their confidence in each figure and their knowledge of the property and its market.
- 5.11. **Checking and reconciling values before reporting** – Again, 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 4.5, 1<sup>st</sup> indent, and 4.5, 2<sup>nd</sup> indent, above*) give the same results. Valuers will therefore generally have to review the values obtained and decide whether they can be reported as such or whether further adjustment is needed.
- 5.12. If the value that remains for the building component under the procedure in 4.5, 1<sup>st</sup> indent, is higher than the replacement cost of the building when adjusted for physical deterioration, the valuer must thoroughly analyse the value found. This value may include the benefit of intangible assets or personal property. Intangibles may be subject to depreciation or annual impairment testing and the useful lives of intangible components often differ from the useful lives of buildings. The valuer should liaise with the client on the accounting treatment to be applied to any intangibles or personal property, which may have to be excluded from the apportionment or expressed separately.
- 5.13. In relation to trading potential, recognised accounting practice suggests that it would not be appropriate to treat that which is associated with the property as a separate component of the value of the asset if its value and life are inherently inseparable from that of the property. Trading potential is a property attribute that will exist within the land and buildings whether or not operational.

- 5.14. 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 insofar as the properties in it are comparable. This sample-based approach must 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 IAS 16 (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 accounting. Valuers who are asked to apportion a price or value between components should familiarise themselves with the relevant parts of IAS 16.
- 6.2. According to IAS 40, the investment properties should be valued at fair value each year and therefore the buildings of these properties are not depreciated. Apportionment between land and buildings is not necessary in this case. The same treatment should be applied to surplus properties. The over-rented properties may have a contract advantage for a period of time but they should be valued at fair value (IAS 40) and apportionment is not needed.
- 6.3. **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 IAS 16 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"*.

6.4. The process of identifying components can therefore be summarised as:

- ▶ Identify the components that have a "significant" cost in relation to the value of the whole; then
- ▶ Identify their useful life and depreciation method; then
- ▶ Group together parts that have similar useful lives and depreciation methods.

*Note that there is no definition or quantification in IAS 16 of what is deemed to be "significant".*

6.5. 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, a valuer who is asked to identify the components should involve the entity fully in the final decision process and seek written confirmation of the entity's agreement to the components that have been identified.

6.6. 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, four or five 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 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.

6.7. Nevertheless, in cases such as older buildings that have been partially renovated, particularly large complexes such as shopping centres, where the various technical installations may have different useful lives and depreciation patterns, it is appropriate to take this into account. In such cases, valuers must 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.

6.8. **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.

- 6.9. 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. Those records will also make it easier to interpret the figures for any subsequent apportionment.







# II. Valuation Methodology



- 1. Introduction**
- 2. Scope**
- 3. Definitions**
- 4. Valuation approaches**
- 5. General observations**
- 6. The Comparative Method**
- 7. The Income Approach, methods and models**
- 8. The Cost Approach**
- 9. The Residual Method**
- 10. Using more than one valuation method**
- 11. The final check**

## 1. Introduction

- 1.1. Technically speaking, **methodology** is a system of methods used in a particular area of study or activity.
- 1.2. In valuation, the term **methodology** is used to describe the process by which a valuer undertakes the valuation of the 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 models or techniques in order to interpret the valuation inputs and reach conclusions based on them.
- 1.3. There is a hierarchy of definitions; Approaches, Methods and Models. An approach is the first level in a hierarchy of definitions. The three recognised approaches are Market, Income and Cost (*see section 4 below*). All of these are based on the underlying economic principles of price formation and the choice of approach will vary depending on the purpose and nature of the valuation. Each of these principal valuation approaches includes different detailed methods of application and within these methods, there are different models. Some models are quantitative in nature, others more qualitative but all are techniques that allocate value to the component characteristics of a property.
- 1.4. EVS 2020 does not impose any specific valuation methodology, as (unless there is applicable regulation) they are 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/methods – it would be inappropriate to attempt to restrict future evolution by insisting on valuers retaining certain of today's recognised methods/models.
- 1.5. However, valuation methodology is implicit in valuation standards, and it is for that reason that this section on valuation methodology has been prepared. Standardised valuation 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.

## 2. Scope

This section refers to Europe-wide accepted methodologies for the valuation of any kind of real property for any purpose, as detailed in the following sub-sections.

## 3. Definitions

- 3.1. **Basis of value** – A statement of the fundamental assumptions for undertaking a valuation for a defined purpose.
- 3.2. **Valuation approach** – The fundamental way in which, having regard to 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 an estimate of value.
- 3.4. **Valuation model** – A specific technique 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. All valuation methods need to reflect 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), the income and the cost approaches.
- 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 a particular market. These methods will be used for one or more of the three basic approaches, as appropriate for the valuation based on 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 property with the evidence obtained from market transactions that fulfil the criteria for the relevant basis of value and property type.
- 4.6. The **Income Approach** is for the valuation of all property where its 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 rental 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 operating 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 property compared with a brand new equivalent one.

## 5. General observations

- 5.1. **The importance of analysing the property and the market** – Before describing the most relevant methods and models in detail, it is necessary to stress the importance of analysing the market and the market evidence in 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 to 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 investigate 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 type of property to be valued** is the second important factor, for on this, together with the locality, the decision will largely rest as to the valuation method to be adopted. While market-based comparison of transaction values may be natural for many types of property in many areas, certain common factors that tend to occur in most markets may prompt other approaches.
- 5.5. For example, in the case of the office 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.
- 5.6. 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 value, the valuer will have to include sustainability issues when analysing evidence. For example many banks today have a preference for lending in respect of green certified commercial properties and this has manifested itself in terms of lower discount rates and higher Market Values or putting other properties at discounted values.
- 5.7. The property should usually be distinguished from the business that may be using it.
- 5.8. **The relevant local market** – 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 com-

parable evidence to look for and whether the comparison approach or an income method is likely to be preferred.

- 5.9. 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.
- 5.10. 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.
- 5.11. **The analysis of evidence, an essential rule** – 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.
- 5.12. 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. For specific properties (for example a castle or feet-in-the-water property), a global value of a property could also be a relevant 'unit value'. All valuations are ultimately based on an understanding and comparison of previous transactions in the market.

## 6. The Comparative Method

- 6.1. The Comparative Method is regarded as the preferred method to arrive at Market Value as it provides the most direct link to the actual market transactions.
- 6.2. Ideally the Comparative Method assesses Market Value through an analysis of prices obtained from sales or lettings of properties similar to the subject property followed by adjustment of the unit values to take account of differences between the comparable properties and the subject property. However, valuers should also have regard to other relevant market information and data upon which they may

need to place greater reliance particularly in those markets or situations where information about transactions is either unreliable or simply not available.

*See Pricing to Market – An investigation into the use of comparable evidence in property valuation, by Nick French, June 2020.*

- 6.3. 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 be defined and measured in the same way for all the properties within a particular class.
- 6.4. Judgments have to be made about the relative merits of the property and the comparable properties 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. The more dissimilar the comparable properties are to the subject property, the less reliable is the value resulting from the comparative method.
- 6.5. There are a number of factors to be considered when examining the reliability of the evidence obtained in respect of comparable properties:
  - ▶ 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 in respect 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 financial and reputational strength of the tenant, the percentage of the property occupied or vacant and the net to gross area ratio (in the case of investment properties);
  - ▶ The number of comparable transactions is another important question and valuers will need to decide what they deem to be an acceptable number. This is a matter of judgment and could vary, for example, according to the purpose of the valuation;

- ▶ 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 comparable, 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.
- 6.6. As mentioned earlier, it is important that the unit of comparison be 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 V.
- 6.7. In many cases, the analysis of comparable evidence and determination of Market Value are based on the valuer's individual expertise, knowledge, experience and intuition. This is a heuristic process and is a valid and accepted valuation model. However with the advent of increasingly sophisticated computerised models, the valuer now has access to more quantitative techniques to analyse market evidence. However the valuer should be aware that any such analytical tool is only as reliable as the accuracy and quality of the data that is fed into it. It should also be kept in mind that the value of a property cannot be calculated by just using mathematical or statistical techniques. All valuation models whether heuristic or quantitative are tools that allow valuers to capture market data to help them estimate the Market Value of the subject property. The valuer's estimate of the value of the subject property has to be based on best and sound judgement.

## 7. The Income Approach, methods and models

- 7.1. 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).

- 7.2. 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.
- 7.3. 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.
- 7.4. The income method used within the Income Approach can be divided into two types of model:
- ▶ Traditional income growth-implicit models, known as **Capitalisation methods**, including direct capitalisation, term and reversion, layer (hardcore and top slice) and growth-implicit discounted cash flow models; and
  - ▶ Income growth-explicit models usually known as **Discounted Cash Flow (DCF)**. The main feature of the growth-explicit discounted cash flow method (explicit DCF) is that anticipated growth in income and costs is explicitly incorporated into the model by the valuer.
- 7.5. 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 model, 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 growth in the cash flow. Conversely, in an explicit DCF model the valuer will usually want to explicitly include anticipated future growth in rents, in which case the discount rate adopted will generally be higher, in order to reflect the risk involved in predicting future income growth. The same applies to any cost items included in the valuation – future inflation of costs should not be included in a growth-implicit model, whereas it will be taken into account in a growth-explicit model.

- 7.6. **Capitalisation methods** – Traditional capitalisation methods can be broken down into two types:
- ▶ **Perpetual models** where the Market Rent is, for the purpose of the implicit model, considered to be the same forever (all growth and future sales are captured in the yield);
  - ▶ **Reversionary models** where in today's terms the rent passing is below or above the Market Rent that will be received at a future reversion to Market Rent.
- 7.7. **Perpetual 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 usually involves perpetual capitalisation of the first year's income for the subject property, this model does not reflect any potential future variation in rental income, unless an adjustment is made to the yield to reflect this.
- 7.8. Capitalisation is a market based model which relies on strong evidence of Market Rents and market yields (capitalisation rates). It relies on an active and liquid property market, both for investment and for lease, and requires sound analysis of property sales and property leases.
- 7.9. Capitalisation, in established markets, is usually applied in the valuation of investment properties for which purchasers customarily base the price on a certain multiplier (inverse of capitalisation rate) of the rental income. These almost liquid properties are usually fully or almost fully leased at Market Rent or expected to be leased at Market Rent. However, in more challenging or emerging markets, where there is a scarcity of comparable evidence, it becomes difficult to derive a capitalisation rate from market analysis and the valuer has to resort to other, alternative methods of establishing the capitalisation rate or resort to alternative valuation models including discounted cash flow under which net annual rental income is set out explicitly over a typical 5 to 10 year cash flow period. The latter "*explicit*" model differs from "*implicit*" capitalisation which usually involves the capitalisation of today's net Market Rental income by means of a so called "*all risks yield*" which reflects the market's future risk and growth expectations. Capitalisation may be undertaken by means of a very simple mathematical model albeit in certain cases it may be more complex.

- 7.10. If at the date of valuation, property is leased at a Market Rent it can be assumed that this income is perpetual (i.e. income assumed to be constant at Market Rent) and, if it is possible to derive capitalisation rates from market transactions, **direct capitalisation** is applied based on the formula: capital value equals net operating income divided by the capitalisation rate. Thus direct capitalisation involves converting income expectancy into an indication of Market 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). This model does not reflect any potential future variation in rental income, unless an adjustment is made to the yield to reflect this. The capitalisation rate (all risks yield) reflects all of the market's perceived expectations about risks, expectations of positive benefits (in the form of income growth or growth in capital value) and other expectations of investors in the market. It includes the market's perception of rental growth and/or capital growth of the property. The better the location and quality of the property, the lower the risk perceived by investors who are therefore more willing to buy a property at a lower capitalisation rate.
- 7.11. **Reversionary models** – If at the date of valuation the rent paid differs from the Market Rent, then account must be taken of the actual rent and how long it will be paid until reversion to Market Rent, usually at the end of a lease and at rent review. In such case the valuer reflects projected changes in net income at certain defined future events, particularly at the end of a lease, rent review, or when major capital expenditure may be required. There are three models for dealing with such situations:
- ▶ **Term and Reversion** divides the cash flow vertically, and is usually applied when the term rent is below Market Rent (under-rented property);
  - ▶ **The Layer Model** divides the cash flow horizontally, and is usually applied when term rent is above Market Rent (over-rented property);
  - ▶ **Growth Implicit Discounted Cash Flow**, is a more sophisticated form of the term and reversion method typically presented in the form of a 5 to 10 year cash flow and a terminal value, both discounted at a so called **Equivalent yield**, being the single discount rate which, when applied to all income flows, results in a present value equal to the capital value of the investment. It is in the internal rate of return that the cash flow changes are allowed for implicitly. The income flows reflect current, actual and Market Rents and costs.
- 7.12. **Capitalisation rate** – The most difficult part of income capitalisation is the determination of an appropriate capitalisation rate. The most common way of establishing the capitalisation rate is through the analysis of transactions in respect of comparable properties that are rented. However, each property is different in its

characteristics and lease terms, and available sales data might not be sufficiently comparable. In such cases, the valuer will have to exercise professional judgement and adjust the capitalisation rate (all risks yield) obtained from the available market data so as to reflect the differences between the comparable properties and subject property. Adjustments must be based on the valuer's knowledge of the impact that various factors have on Market Value or Market Rent. When capitalising net income, valuers are technically discounting future benefits and expressing them in terms of their present value. The Income Approach requires a consideration of the future, but most valuers are very cautious about making such predictions or forecasts. Conventionally, the use of a capitalisation rate which is derived from sale prices of properties leased at Market Rent reflects all risks and positive benefits that investors perceive. Whilst this implies that a prediction has been made, it is not made explicitly.

- 7.13. The capitalisation rate includes both the recovery of the original capital invested and expectations of capital appreciation, which allows an investor to overcome risk relating to the time value of money (money invested today has more purchasing power than the same amount of money in the future), risks relating to liquidity (time needed to dispose of property at some point in the future, uncertainty of sales price), tenant risk, lease agreement risk, risk inherent to the property itself and location, legal risk, taxation risk, legislation risk, and other risks as well as uncertainties related to the macro and micro economy, politics, demography and more.
- 7.14. The valuer will wish to take account of a number of factors when choosing the rate to be adopted, including:
- ▶ 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 law and regulation that might affect the potential for rents to increase or decrease during or at the end of the leases;
  - ▶ The financial and reputational strength of the tenants.
- 7.15. Valuers will apply the same criteria to their analysis of comparable investment sales, adjusting the adopted yield to take account of the relative strengths or weaknesses of the subject property. Sale prices must be analysed on a consistent basis and valuers should have all details about the relevant sales and lease transactions.



- 7.16. Valuers may also rely with caution on market studies published by reputable agencies and market analysts. In some markets, whilst there may be a general lack of investment transactions, there is nevertheless some evidence of transactions in respect of prime commercial properties. Given that a hierarchical pattern of yields can nowadays be discerned across property sectors in Europe and within countries, valuers may also consider deriving a capitalisation rate having regard to yields reflected in known transactions and adjusting such yields in the valuation of the subject property for differences in location, sector, quality and other value-significant factors.
- 7.17. **Income from real estate** – The basis for calculating the income from real estate is the rental revenue it generates. Rental income also includes income from advertising boards, mobile phone antennas, ATMs, car parks etc.
- 7.18. The valuation is based on the income from the property accounted for annually, customarily assuming for ease of calculation and market analysis that it is obtained at the end of the year notwithstanding that in most cases income is received monthly or quarterly in advance.
- 7.19. The direct capitalisation method entails the use of current rents derived from the analysis of actual rents being paid on the market.
- 7.20. Typically, an analysis of rent paid for most buildings is done on the basis of Net Internal Floor Area or Gross Internal Floor Area, depending on the type of the property. It is very important that a valuer understand which area is specified in the lease.
- 7.21. The valuer must analyse all current occupational lease agreements and pay attention to value-significant factors including:
- ▶ Length of lease;
  - ▶ Area under lease;
  - ▶ Agreed rent;
  - ▶ Responsibilities and liabilities of each contractual party;
  - ▶ Any incentives;
  - ▶ Fixed rent or inflation-indexed rent;
  - ▶ Break clauses.

- 7.22. If it is customary in a particular local market to express gross monthly rents in lease agreements, valuers must deduct all expenses which relate to the operation of the building and arrive at a net operating income. Such expenses can be categorised under insurance, management, maintenance, taxes and repairs.
- 7.23. **Rent consistency** – Whichever capitalisation method is used, valuers should be careful to follow market practice as regards capitalising net rents or gross rents. For example, if the yields obtained from comparable transactions are based on gross rents, valuers will under-estimate the value if they apply the same levels of yields to net rents.
- 7.24. **Transactional costs** – Transactional costs are not reflected when assessing Market Value. However, when giving investment advice, valuers may be requested to estimate the return on total capital invested, and to express a value net of those costs.
- 7.25. **Discounting models** – Discounting models are based on present value calculations of expected income or cash flow projected over a specific calculation period. Unlike the capitalisation models, (which imply a future sale but don't explicitly express its date), a reversionary value is normally calculated and discounted at the end of a notional hold period. Consequently, a time horizon, projected cash flow and reversionary 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.
- 7.26. **Explicit Discounted Cash Flow** (explicit DCF) is a discounting method that has gained popularity over the past decades, and is now widely used among valuers and investors. The model is based on the premise that the value of the property is equal to the sum of the present value of all future cash flows. The process of adding the present value for each future cash inflow and the present value of the resale price at the end of the period is called discounted cash flow analysis.
- 7.27. The conventional model for assessing the Market Value of commercial properties is direct capitalisation or derivatives thereof (term and reversion or layer techniques). However, because it is grounded on comparison and the exclusive use of market data at the date of valuation, without any explicit forecasts of market expectations, the explicit DCF model – once predominantly used for project feasibility analysis and estimation of investment value – is today also widely applied. The explicit DCF model requires the valuer to forecast the cash flow based on market expectations and to discount it at a rate (target rate of return) expected by investors in the market.

- 7.28. Whichever model is used, valuers must be sure that it reflects the behaviour of market participants. It is always better to use comparable evidence generated from market transactions whenever possible with application of a pricing technique that is commonly used by market participants.
- 7.29. In the assessment of investment value, the valuer is advised of the forecasted cash flow (which may differ from market expectations) and the discount rate by the client. They should reflect the opportunity cost of investment capital and the perceived risk.
- 7.30. In assessing the Market Value by means of an explicit DCF model, it is difficult for the valuer to find a market-supported discount rate or any other key variables in the cash flow. Such a valuation can be very subjective. Thus, valuers have to make some reasonable assumptions in order to construct the most likely cash flow and to calculate the discount rate which they believe a typical buyer of the subject property would apply. The valuer will estimate the most probable rent over the investment holding period, based on in-depth analysis of past and current market conditions ensuring that the past is not simply extended into the future. In valuing investment property by means of the explicit discounted cash flow model, the valuer will seek to discount the projected cash flows by means of a so called **Target Yield** (also known as an Equated Yield). This is the discount rate applied to the cash flow projected during the life of the investment and to the reversionary or exit value at the end of the hold period. Under such scenario, income projections reflect expected future rental changes. The calculation reflects the valuer's views about Market Rental growth or decline. It is an expected Internal Rate of Return where cash flows are allowed for explicitly.
- 7.31. **The hold period** – Cash flows are estimated over a certain period during which the hypothetical buyer will own the property 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 many markets. There is no particular rule as to how long the hold period should be, although it is generally considered that it should be sufficiently long to allow for all leases to expire and for subsequent renewals or re-lettings. In some countries there might be statutory requirements in relation to specific valuation purposes requiring cash flows to be forecasted over the whole economic life of the building. This could reflect several market cycles within the holding period.
- 7.32. **Growth-explicit cash flows** – As stated above, in an explicit DCF valuation, valuers will wish to make their assumptions as explicit as possible, countering the criticism of capitalisation models that *"it's all in the yield"*. This will include estimating

the future upward or downward movements of rents, lease indexation clauses, and future inflation of costs that have been built into the cash flow.

- 7.33. **Assumptions at lease end** – Since one of the principles of the explicit DCF method is that assumptions should be made explicit, valuers will generally be expected to make it clear whether they have assumed that tenants will renew the lease, 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.
- 7.34. **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 in 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.
- 7.35. 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.
- 7.36. Valuers should choose the discount rate in the light of the general level of risk inherent in the model – if the 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.
- 7.37. Individual rates reflecting the motivations of the individual investor or requirements of alternative investments are used when estimating an investment value for a particular investor.
- 7.38. 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.
- 7.39. Alternatively, where valuers have sufficiently detailed information of a recently sold comparable property, they can carry out their own analysis on a DCF basis and deduce the discount rate that way.

- 7.40. Where neither of those is possible, valuers often determine the discount rate by alternative analysis, 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 income growth has been made explicit in the cash flow;
  - ▶ Estimating the weighted average cost of capital of a typical buyer of such a property.

Each technique has its merits and its disadvantages and it is not the purpose here to discuss them. The valuer's choice may be affected by market preferences in the area where the property is situated.

- 7.41. **Reversionary value at the end of the hold period** – The DCF model assumes a sale at the end of the hold period. The value of the property at the end of the hold period is usually assessed by means of implicit direct capitalisation of the net income at the end of the last year of the hold period. This value is included in the income stream of the property over the hold period, and discounted to the present value. Alternatively, depending on the type of the property, the reversionary value can be obtained using a comparative method.
- 7.42. Typically, investors either assume the capitalisation rate at the end of the hold period (exit yield/future capitalisation rate) to be equal to the capitalisation rate prevailing at the date of valuation, or they assume a capitalisation rate on exit that is higher than the current capitalisation rate to account for the uncertainty of future cash flows expected to be received by the property over the hold period and because of the depreciation of the building over the hold period.
- 7.43. A valuer can also use historical capitalisation rate data in respect of the property type and market under consideration, applying personal knowledge of the local marketplace.
- 7.44. **Cash in-flows and out-flows** – Under the growth explicit DCF model, the valuer should make assumptions as explicitly as possible, given that the alternative direct capitalisation method suffers the criticism of including "*all in the capitalisation rate*".

- 7.45. This will include forecasting future upward or downward movements of rents due to any lease indexation clauses, potential future growth in Rental Values and future operating cost inflation.
- 7.46. Income and operating cost information can be obtained from either primary or secondary sources. Primary sources are property owners and those who manage the property, accountants and real estate agencies. Secondary sources are selected published professional articles. Valuers must be critical towards all published professional articles when relying on them as reflecting market activity. They should also critically review the historical performance of the property itself. The income and expense forecasts should also reflect aspects of the property which may not fall within a typical range published in professional articles.
- 7.47. Cash flow is usually designated in the currency in which the income is contracted.
- 7.48. Valuers should begin their analysis with a review of current or hypothetical lease terms typical for the type of the property in the local market.
- 7.49. It is important to identify who under the lease agreement is responsible for paying operational expenses.
- 7.50. The valuer should give special attention to the following issues in the lease agreement:
- ▶ Lease extension option and under what conditions;
  - ▶ Terms of any rental indexation;
  - ▶ Rent renewal clauses;
  - ▶ Possibility of termination of the lease by the tenant;
  - ▶ Tenant's investment in the property;
  - ▶ Restrictions against allowing competing tenants.

Based on thorough analysis of:

- ▶ The market place and current Market Rental levels;
- ▶ Typical lease agreements for relevant type of property and passing lease;
- ▶ Condition of the subject property.

- 7.51. The valuer should estimate:
- ▶ **The Potential Gross Income (PGI)** – The total revenue that can be derived from the property, being fully leased;
  - ▶ **Effective Gross Income (EGI)** – This is derived from PGI making allowance for the loss due to both the current and an expected vacancy rate in the property and loss due to the possibility of not collecting rents over the lease period;
  - ▶ The **Net Operating Income (NOI)** of the property should be assessed by subtracting from the EGI all operating costs which fall on the lessor. Operating costs include both fixed and variable costs:
    - ▶ Fixed costs are all costs necessary to maintain the normal operation of the property and to achieve the expected revenue;
    - ▶ Variable costs depend on the occupancy rate of property and include costs of management, administration, utilities, cleaning/maintenance, and security.
- 7.52. Special attention should be paid not to include expenses such as corporate taxes, income taxes, loan/debt servicing and accounting depreciation. After subtracting the operating costs, the valuer should also subtract the estimated budget for necessary long lasting renewal works and short term repairs.
- 7.53. Finally, it should be noted that explicit DCF is a highly complicated model relying on predictions of the future fluctuation 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 be checked against other market indicators, such as yields and prices per square metre and perhaps also against values obtained using other methods.
- 7.54. **Models based on the accounts of the current or a theoretical occupier** – In some countries, the term Income Approach refers to valuations based on the accounts of the enterprise that is operating on the property. EVS consider that as a specific Accounts Method within the Income Approach.
- 7.55. This method is 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, explicit discounted cash flow models are preferred to the conventional accounts model but the principles behind it are essentially the same.

- 7.56. 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.
- 7.57. In assessing the reliability of actual income to the enterprise, care should be exercised to ensure 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 by the enterprise away from the property.

## 8. The Cost Approach

- 8.1. 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.
- 8.2. 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 are significant data available to enhance the accuracy of the procedure.
- 8.3. 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 even so, the cost approach should not 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.

- 8.4. 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 transparent and/or less volatile.
- 8.5. 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 cost approach is not a market-driven model, it should not be looked on as a primary valuation model.
- 8.6. **Depreciated Replacement Cost (DRC)** – In its traditional form, DRC is a cost-based method of arriving at a value for real estate assets which are normally never exposed to the market.
- 8.7. The reasons why such assets might not be exposed to the market are many and varied, but will normally be because the real estate is operated for an unusual use, with sales rarely or never taking place for that use. One of the areas of common application in valuation using DRC is in public sector assets which, in providing a service to a local or wider community, are rarely, if ever, traded.
- 8.8. It might also be the case that there may be a lack of transactions or Market Value and as such, a comparables-based approach is not available. In the absence of a transaction market, it might be useful to contemplate an income approach to a valuation, but again this may not be appropriate, particularly in the absence of any profit motive of the entity to be valued. The DRC remains as a valid method in the absence of other methodologies.
- 8.9. Where an historic use ceases and the asset is traded as surplus or redundant, unless a similar use is forecast, the DRC valuation is unlikely to represent any proxy for sale proceeds. As a cost-based valuation, a DRC may not be reliable as net realisable value.

- 8.10. One of the primary uses of the DRC methodology is for financial statements, where a corporate entity is involved and in the case of public sector occupiers, often used as a device for ascertaining the monetary worth of the benefits of occupation.
- 8.11. The concept of 'value to the owner' is of note. The traditional use of DRC required the directors of a company (where a DRC was being transposed into financial statements) to certify that the entity was, at the date of the entry, a going concern. In the case of public sector property where there is often a lack of profit motive, the authority in owner-occupation was required to state that such use would continue for the foreseeable future.
- 8.12. Those requirements still hold good and from that, it is evident that the value is of greatest significance to the user of the asset rather than any third party and underlines the 'value in use' to the owner/occupier.
- 8.13. A DRC valuation is not a development appraisal, a residual valuation or an insurable amount. Common elements to an assessment of value for these purposes exist within a DRC approach, but only as to elements of it.
- 8.14. The DRC approach does not envisage actual redevelopment, actual expenditure on accrued repairs, actual remediation of any type of obsolescence, but seeks to measure where that current entity sits in value terms in relation to a modern equivalent property. The "*depreciation*" amount in a DRC reflects all of these reductions, losses or impairments over the modern option.
- 8.15. The primary question in DRC analysis of existing buildings is their future economic performance.
- 8.16. The valuer is not suggesting improvements or necessarily deciding how long a property would benefit from an improvement. That would be a feasibility study or a development appraisal. In a DRC, the valuer sees how far removed the existing property is from the modern improved or replaced equivalent. Actual expenditure is not envisaged.
- 8.17. If the application of the method is to derive a figure to assess potential disposal proceeds, the method may not prove reliable as a proxy for disposal proceeds.
- 8.18. A valuation for alternative use is not a DRC and is more likely to be a "*Development Appraisal*".

8.19. The definition of 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."*

8.20. **Additional use of DRC** – The Cost Approach is an integral component of the principle of substitution, and as such, it can serve as a check against the sales comparison and/or Income Approach, allowing the valuer to analyse current market conditions in relation to the cost of new construction and possibly make a statement in her/his reconciliation about the potential extreme rise or decline of prices.

8.21. There are numerous valuer inputs required to a DRC approach and many consider the approach to be flawed as it lacks an evidential transaction base. However, in many countries where markets are not developed, it is a useful tool in arriving at a valuation statement.

8.22. **Recent trends** – The financial crash of 2008/2009 left many traditional markets for real estate in a moribund or semi-moribund state with a dearth of transactions and consequently, very few 'market'-led comparables on which to base any comparison method of valuation. As a consequence, DRC became a primary method.

8.23. This was particularly evident in those markets that saw the biggest collapse. Greece is an interesting example; faced with little or no active transactions for most commercial property, those involved in administering companies, loans, banks, and others still needed some reliable method of assessing current value. In Greece, the DRC method evolved out of necessity to form, in effect, the *"going concern value"*. In other words, the sign-off historically provided by the Directors was replaced by the perception that the use or similar use by a third party would be financially viable and therefore a DRC was a default valuation methodology. This welcome modernisation of the traditional DRC approach has brought real transaction evidence into the DRC equation.

8.24. With the benefit of hindsight some years later, it can be shown following the re-emergence of a market for most property types that the DRC proxy was a fairly accurate pro-tem measure. This expands the use of the method away from just current users and owners to use in third party deliberations over real estate asset value.

- 8.25. For many years, DRC was often regarded as the method of last resort for valuers, when there really is no evidence for a valid comparative approach or income and expenditure for whatever reason are not relevant to the asset being valued. For a long period, values were expressed in *"DRC and not in Market Value"*.
- 8.26. Consultancy firms and worldwide accounting standards started to influence the DRC approach and there was an interim period when properties were valued at Market Value (DRC).
- 8.27. The modern use is just Market Value. This, interestingly, carries dangers, because to the uninitiated, there is the perception that a property could be bought and sold for the DRC figure. The justification for the label Market Value is that like-users would trade a property between themselves at a DRC derived figure. For example, one hospital could be transferred to a different health authority provider and DRC would be the Market Value for both parties. This, of course, is where few, if any, of these assets are traded in their current use.
- 8.28. **Cost and value** – One of the fundamental problems for all cost-based valuations is that cost does not necessarily equal value. For new properties, there may be less of a problem, but the valuer still needs to exercise extreme caution in adopting actual build costs of an asset on the assumption that the entity funding it got value for money. Issues surrounding the choice to be made by the valuer in assessing building costs are many, but it is certainly the case that an actual new build cost should not automatically be the DRC valuation in year one, without further enquiry.
- 8.29. **The use of DRC** – DRC having been more widely used than perhaps historically justified, it is necessary for the valuer to step back and ask some pertinent questions.
- 8.30. In Germany, Greece and Italy, the DRC is widely used. As the basis of reduction remains subject to the financial viability of the entity, banks and lending institutions in the absence of any other option, have adopted a DRC approach in lending decisions.
- 8.31. In the UK, by contrast, banks, as a policy, will not lend against a DRC figure as they regard it as wholly inappropriate. In the UK, if there is a loan default, the bank will seek to realise the asset. In most cases, this will be a sale of either the property or the corporate entity in default of the loan where the entity has collapsed. That may mean the asset will be used in the future for a different use and the DRC 'existing use test' will fail. UK banks do not accept that a sale price is likely to be derived from a DRC approach and are therefore not willing to use a DRC as collateral.

- 8.32. A good example of why banks in some countries reject this approach might be a football stadium valued on a DRC. Often expensive to build, its use is heavily restricted to a stadium. In a town with one football club, if the club closes, what is the value of the stadium?
- 8.33. The banks will look at Market Value which conventionally is for a different use, often a housing development site (dependent on location and local planning laws).
- 8.34. The banks could not recover the loan from the sale as a stadium so they measure the collateral on a market comparison basis, which by the nature of DRC will most likely be for another use.
- 8.35. **Terms of engagement** – The application of a DRC approach involves the client to a potentially greater degree than other methods of valuation and the valuer will need detailed instructions.
- 8.36. Fundamental to the use of the DRC is an understanding with the client of how the valuation is to be used and for what purpose.
- 8.37. **Financial statements** – If the DRC valuation is to be used for accounting or financial statements, then this needs clarification as to what is included. For example, a user may have many extensive bespoke alterations to a property that are already being reflected in company accounts, and to include these in a DRC valuation may be double-counting.
- 8.38. Many specialised properties will contain plant and machinery, and in some uses, the property altogether may be largely described as plant and machinery. Again, care is required that these assets are not already reflected in other parts of a financial statement.
- 8.39. **Componentisation** – A modern request for financial statements is componentisation, which also includes property assets valued under a DRC approach. Taking the component parts of a building needs some care and thought, because individual parts such as walls, a roof, etc., may have defined costs but do not normally exist in isolation of each other. If under componentisation, different depreciation allowances are made, the valuer will need to decide how that relates to the whole. For example, if an assumption is made that the wall cladding will last 30 years and a roof 50 years, the valuer might assume that the whole will become unusable at 30 years rather than part at 30 and part at 50. Assumptions made and applied

need to be explained to the client and set out within any reported value on DRC. **Componentisation is a separate exercise to the determination of the DRC overall value. The DRC figure can be a starting point for a componentisation exercise.**

- 8.40. **Going Concern/Continued Use** – In the case of a business entity occupying a property to be valued using DRC, it will be necessary for the valuer to obtain confirmation from the client that the entity is profitable, is a going concern, and realistically likely to continue in that form. A written assurance from a Director of the company using the property is of additional comfort to the valuer here.
- 8.41. In the public sector, where there are potentially no receipts, profit or profit motive, it is normally necessary to ascertain from the user that the service offered from the property is liable to continue and that a suitable demand for the service exists.
- 8.42. The valuer will need to establish with the client how the asset is used and will continue to be used. With these more specialised assets, valuers will need to place greater reliance on information provided by the client or other professional advisers than they might ordinarily expect with less specialised assets. Detailed reporting is essential to give credibility to the DRC approach and it is recommended that detailed record keeping be maintained on each of these valuations.
- 8.43. **The building costs** – Valuers should keep in mind that they are seeking to derive a figure for an asset that already exists, not one yet to be built. Therefore, how a new build is to be funded, with what interest rate and by whom, is not a relevant feature. However, if a structure has been built using third party grants or state or EU funding, then the question should be posed as to whether an entity would actually build without subsidy.
- 8.44. Grants have been shown to enable larger buildings to be erected than might otherwise be the case, perhaps on a presumption of future additional demand. In the public and private sectors, these types of structure can also, in some cases, be subject to a degree of architectural excess.
- 8.45. In a DRC, the valuer is tasked with identifying the cost to replace an asset with a modern equivalent of equal utility but usually the modern replacement utility where there are no abnormal building costs and not excessively expensive. That is not to say that grants should be deducted from build cost. The valuer should enquire as to what would be prudent to provide assuming there is no grant. Where

it is not financially feasible to build without a grant, this might lead to special assumptions which need very careful explanation in the Valuation Report.

*(see also 'Impairment of Value', supra)*

- 8.46. **Replacement** is the cost to replace a structure with a substitute structure of at least equal utility using current standards of materials and design. A current acceptable utility may exceed the historic utility requirements of the use and may have evolved to adopt more modern requirements.
- 8.47. If an asset is new, the actual cost might be the relevant figure to adopt in assessing the build cost. In adopting this figure, the valuer would need to be satisfied that there was no excessive expenditure, or feature of the construction that is not relevant to the economic purpose of the property.
- 8.48. Enquiry as to how the build cost was agreed is also necessary. The valuer should not assume that the actual build achieved value for money. That needs to be tested.
- 8.49. **Sources of information for building costs** – In most countries, there are indices available based on simple contracts. With these, a price for building different structures in different uses can be identified at least to a range. The more specialised the site, the greater the likelihood that any sample contracts will be fewer. Specialist cost consultants may need to be consulted if a modern equivalent cost cannot be ascertained in any other way.
- 8.50. **Included in building costs:**
- ▶ **Fees and other costs** – To build a new entity as an equivalent modern asset, there will be professional fees. These should be identified and added to the cost of construction.
- 8.51. **Not included in building costs:**
- ▶ **Demolition** – For a DRC, it is not proposed to actually replace the asset – merely to identify the gap between the modern equivalent and the existing. Accordingly, the existing asset will not be demolished as part of the valuation and demolition costs should not be included;
  - ▶ **Finance** – DRC is not a residual valuation or feasibility study. The property is assumed to already exist, so long term funding is not a consideration. Short term construction finance can however be considered as a cost providing a modern equivalent substitute;

- ▶ **Period of construction** – Most valuers assume a cost at date of valuation. An asset, however, may take months or years to build and costs may escalate during the actual build programme. This is irrelevant. The valuer is making a comparison at the date of valuation between an existing asset and a replacement asset that has by assumption been built using today's costs and values. There should be no addition or allowances for a build period. It is assumed the property is there at the valuation date.
- 8.52. **The Modern Equivalent Asset of Equal Utility** – One of the more difficult areas in presenting a DRC approval to a client is the concept of a modern equivalent asset which underpins the whole approach.
- 8.53. Taking the modern equivalent at its extreme, the valuer is entitled to consider a new structure of a different size in a different location to deliver the modern requirement of the business. It is against this background that the "*deficiencies*" of the current asset are depreciated. In order to do this, the valuer will need to have a fairly detailed understanding of the functions required and currently performed, including, where necessary, the most appropriate modern technical solution in asset provision. The valuer is most unlikely to be an expert in any of these solutions and will need to rely on the client or industry experts to understand what the best solution for a modern equivalent would be at the date of valuation.
- 8.54. If the valuer is to seek guidance beyond the client, then the scope, source and cost of that data need to be discussed and agreed with the client as the data might be both commercially sensitive and expensive.
- 8.55. **Modern equivalent** – Measuring depreciation for DRC is a difficult science, and the problem is exacerbated with a modern equivalent, as the comparison may not be like-for-like. Indeed, the modern equivalent may have radically different life span, cost in use, use of certain materials, design features, and/or performance standards.
- 8.56. The further away in concept the modern equivalent is from the existing, the greater the difficulty in making a comparison and potentially the much larger depreciation figure attaching to the existing structure(s).
- 8.57. **Depreciation and obsolescence**



- 8.58. In the context of a DRC depreciation, the valuer ascertains the size of the gap between the modern equivalent replacement and the existing asset.
- 8.59. **Depreciation** is an opinion of a structure's lower value due to any cause in relation to its replacement or reproduction cost.
- 8.60. **The fact that the asset may have been depreciated to a figure in accounting terms is not relevant to the consideration of depreciation under a DRC.**
- 8.61. Broadly, there are three main types of DRC depreciation:
- ▶ Physical deterioration;
  - ▶ Functional (and/or technical) obsolescence;
  - ▶ Economic/external obsolescence.
- 8.62. All three types of depreciation may have an impact on value.
- 8.63. **Physical deterioration** is loss in value associated with the passage of time and use (combination of use, effect of aging process, structural defects).
- 8.64. Most types of property physically deteriorate with use and, depending on the type of property and use, the rate of depreciation may be materially different.
- 8.65. The effect of physical deterioration may be more important for some uses than others as the usability of the asset may become affected more readily. By way of example, some new structures have been designed with a life of probably as little as 20-25 years. At Year 10, the property is therefore halfway through its design life, whilst a period structure, though potentially requiring more regular repair and refurbishment, may have a much longer life span.
- 8.66. For DRC, the asset is valued in its existing condition. The valuer will need to take into account disrepair which may have accelerated physical deterioration.
- 8.67. **Valuers should be less interested in the expectations of the physical life of the building than in the expected economic life.**

- 8.68. **Economic life** is the period in which the building can provide economic benefits to the owner, generally shorter than the physical life. The remaining economic life is the time in which the building will still contribute to the total value of the property and is a matter of professional judgment.
- 8.69. The ultimate test for physical deterioration is for the valuer to consider the anticipated economic life of the asset, having regard to the constituent parts and the rate at which they will deteriorate.
- 8.70. **Functional (and technical) obsolescence** is lack of functional adequacy and/or utility.
- 8.71. **Depreciation caused by functional obsolescence** is the loss in value due to reduced utility or desirability of all or part of the building, because industry or modern use requirements have changed over time. This could apply to all types of property. The most obvious might be industrial processes but it can also be relevant to other classes of property valued on DRC. For example, leisure properties with the wrong mix of uses for the current requirements. Hotels with the wrong number of rooms or ancillary accommodation to be currently viable or even offices (where valued on DRC) that no longer meet modern user specifications.
- 8.72. Even a new building can be functionally obsolescent by the time of building completion.
- 8.73. Particularly in specialised manufacturing processes, it is likely that historic specification no longer fulfils the modern requirement of that industry and may also cease to efficiently deliver its original design function.
- 8.74. The result can be dramatic in that a structure might actually be no longer fit for purpose at all, or in other cases may still be used but at a lower than optimum efficiency.
- 8.75. It may also affect newly built commercial properties when there is a rapid change of users' requirements.
- 8.76. The depreciation adopted by the valuer needs to reflect the cost of bringing the original asset into line with a modern equivalent of equal utility or if not possible, reflect the consequence of a continued operation at lower efficiency. If the entire structure is no longer fit for purpose, the value of the structure itself as opposed to the land may be nil.

- 8.77. A very common problem is **technical obsolescence**, usually where economies of scale have been made, machines are quicker, smaller and have re-defined different space and quality of space in which to operate. Technical or functional obsolescence can also be driven by legislative change. Environmental regulations, waste production and disposal may all feature in an industrial setting and for all sectors, health and safety, together with disabled access, requirements may give rise to differing degrees of technical obsolescence.
- 8.78. **Economic/external obsolescence** is loss in value due to influences outside the property. It is the type of depreciation that is not inherent to the building itself, but rather to factors that influence the way the building is used.
- 8.79. **Economic obsolescence** occurs where a market for an output has declined, altered or disappeared and there is surplus capacity. That would apply to all types of situation, not just industrial processes. Schools, for example, may have insufficient 'places' for pupils during a high birth rate period, but beyond, may express a large amount of surplus accommodation. That is a structural change in the market.
- 8.80. Logistics have moved to a 'just in time' delivery pattern which may mean less on-site storage of warehouse stock with redundant buildings but larger off-site logistics facilities, not necessarily in the same ownership.
- 8.81. The valuer will need to take a wide view of the 'economy' in which the entity operates including the general sentiment towards a particular use, whether it is stable, declining or growing. These are difficult for a valuer to quantify.
- 8.82. Some common features requiring a valuer's adjustment might be:
- ▶ Physical capacity versus requirements;
  - ▶ Labour availability versus requirements;
  - ▶ Working capital availability versus requirements;
  - ▶ Location of current-day customers for the products or use versus location of the provision;
  - ▶ Energy availability versus requirements;
  - ▶ Potential legislative controls against emissions.

8.83. **External factors** that cause locational disutility may be:

- ▶ Market changes. Lack of requirement for product or service provision;
- ▶ Incompatible land uses in the locality.

8.84. Also sometimes expressed as **financial obsolescence**, this needs care from the valuer because the form of obsolescence is not necessarily a reflection of the profitability of the entity operating the asset.

8.85. The problem is the overall demand in the wider economy for whatever the asset is contributing. Taking into account demand fluctuations in the wider economy may be difficult for the valuer and it is also likely to be cyclical, so the valuer will need some knowledge at the date of valuation as to where that industry or service provision might be in the current cycle. Even defining the cycle might be problematic for the valuer.

8.86. **Measuring depreciation** – This is a difficult task involving many assumptions by the valuer which need to be accurately recorded in the Valuation Report.

8.87. Depreciation is not a constant, either across industry and service providers or on a year-on-year basis.

8.88. Depreciation for accounting purposes tends to adopt a fixed approach that is consistent across the profession. Accounting depreciation is usually subject to a taxation allowance, year on year.

8.89. For valuation under a DRC, it is possible and, some assume, likely, that the depreciated figure may change year on year and not necessarily on a defined basis. For example, a simplistic approach might be to say that a physical structure depreciates in function and economics by say 2% per annum, so by the time it is 50 years old, the asset is no longer fit for purpose and is in valuation terms written down to nil.

8.90. In practice, that outcome is very unlikely. Most assets merely have a nil value and may attract refurbishments through a lifespan which extends economic (physical and functional) life beyond the original design life. Assets subjected to a DRC may have been refurbished. The valuer will need to decide whether at that point the structure is once more delivering 100% or something less, because it is not new. Purely age-related scales of depreciation are unlikely to be very accurate. They may, however, have advantages where multiple DRC valuations are being

undertaken across a portfolio of similar-use properties. In the public sector, the valuation of schools might be a good example, where a consistent approach is required across a generally large number of properties.

- 8.91. These assumptions need careful consideration by the valuer and, ideally, agreement with the client as to the appropriate approach to be adopted.
- 8.92. More complex models of depreciation have suggested an 'S' curve, where depreciation is low in its early years, accelerates over time and then levels out when it is relatively old. Or equally it may quickly deteriorate from new, level out in mid-life span and accelerate again towards the end of economic life.
- 8.93. There may be a great deal of logic to the 'S' curve approach. However, accurate measurement of the "S" – and where an asset is on that timeline and on the valuation date – may be problematic for the valuer simply due to lack of data. To that extent, a straight line approach may be simpler to present and understand, relying less on actual data. By definition, however, the simplistic approach is likely to be more theoretical than actual.
- 8.94. There will be cases where, in measuring depreciation, the obsolescence is total:

#### 8.94.1. Physical obsolescence

If the cost of repairing, refurbishing or re-fitting the asset to render it usable in the modern sense exceeds the cost of a modern replacement, the existing asset arguably has a nil value.

Physical depreciation is usually defined by actual age/economic life.

#### 8.94.2. Functional/technical obsolescence

If new technology has rendered existing technology obsolete, there may be little demand other than as salvage. However, care is required here, because often this obsolescence is cost-driven where automation has overtaken manual labour. Labour rates vary worldwide and so-called "old" or obsolete industry is sometimes exported to other parts of the world where it can still function economically, using lower labour rates, so a total value write-down should be approached with care. The value of technically obsolete facilities in different locations will vary.

In calculating a DRC, no expenditure is envisaged. The valuer is valuing at the date of valuation, if functional obsolescence can be rectified by the provision of more modern facilities. The cost of that revised facility may assist the valuer in arriving

at the level of depreciation. Retrofitting existing facilities may cost more than a modern replacement and still have a shorter economic life. Care is required by the valuer in such a comparison.

### **8.94.3. Economic obsolescence**

If demand for a product or service has collapsed globally or within the trading radius and is not expected to resume, there may be no demand for the asset and again it may potentially have nil value.

- 8.95. If the analysis of the existing buildings reveals significant functional/technical or economic obsolescence, they can be assigned nil value. The land may still carry a positive value.
- 8.96. **Alternative use** – A DRC can rarely be performed in a vacuum and alternative use may feature at different times during the application of a DRC approach.
- 8.97. A particular location, or asset (or both) may become, over time, more useful or valuable in an alternative use than for its original purpose. In location terms, that may be driven by development in the locality, or by town planning regulations for other uses in an area. The client's historic use may be environmentally damaging to neighbours, making it non-conforming.
- 8.98. Equally, redundant industrial buildings have been converted to leisure space, residential and museum uses often at greater value than the historic DRC on industrial use might suggest.
- 8.99. In cases where the use of DRC would be considered wholly inappropriate for measurement of collateral for bank lending, the alternative use is often adopted for the purpose of underpinning any lending decision.
- 8.100. **Remaining economic life** – Under a DRC approach, a valuer has to decide what the likely remaining economic life is, having taken into account the three types of depreciation likely to be present.
- 8.101. For economic life, consideration beyond the current user or client is required in order to judge how long any industry or service provider would make use of it, not just the individual client. It is the remaining economic life at the date of valuation

that is relevant. Further planned refurbishments should not be taken into account at the date of valuation.

- 8.102. There may be guidance on the lifespan of certain assets or constituent parts obtainable from industry specialists. These data scores should be explained and detailed in the Valuation Report.
- 8.103. When considering a component approach to lifespan, care should be exercised with any averaging procedure as, if a component is scheduled to fail after a given lifespan, giving the component an apparently longer lifespan by averaging with other components of a longer lifespan will be inappropriate. It may be that some adjustment is required, but any fundamental component part of a structure which affects economic viability usually needs to be considered in the light of the component with the shortest predicted lifespan.
- 8.104. As stated, accounting depreciation and valuer depreciation are not necessarily the same measure.
- 8.105. **Land value** – When considering a DRC approach, it is not normal to make any depreciation from the cost of acquiring a modern equivalent site in the market because land in ownership rarely depreciates. The value of the land is therefore added to the depreciated asset values without depreciation adjustment.
- 8.106. The purpose of a DRC is to establish the cost of providing a modern equivalent which includes the site. It may be the case that in order to acquire a site in a certain locality, a higher price may have to be paid if the predominant use in the locality is a higher value use and the alternative site in question is also fit for that predominant use. In these circumstances, it is the cost of an equivalent site somewhere else that should be adopted. The value of the land for an alternative site should be brought to the attention of the client. Some clients may make their own policy assumptions to be included in the valuer's instructions.
- 8.107. If all land that is suitable for alternative operational purposes is land that has a higher alternative use value, then that value may need to be adopted, subject to detailed explanation of the assumptions made.
- 8.108. Such an approach can lead to value of the land element appearing disproportionate to the value of the structure. Detailed explanation will be necessary.

- 8.109. If due to a change in planning conditions, the existing land is potentially available for a much more valuable use, this should be reported to the client. Care should be taken in adopting a value for the land in alternative use even if a bid for another use would need to be made to secure the site for the current less valuable use. In a DRC, because the method allows the valuer to consider a site elsewhere, that may be of less cost than the current site with any new planning definition. That alternative site might be preferable for adoption as a modern substitute as opposed to importing a higher land value to the current site.
- 8.110. **Land value apportionment** – In some countries, DRC is being used to arrive at the land value of a property, i.e. that element that is not depreciated for accounting purposes. This is not a true DRC. The land value is apportioned from the total using a cost-based approach but it is not a DRC valuation.
- 8.111. **Problems with land value in specialised use** – The main reason for adopting a DRC approach towards an asset valuation is a lack of transaction or market evidence on which to base any other consideration of value.
- 8.112. A cost-based approach to valuation of an asset structure is achievable, but it leaves the problem of the land. By the very nature of a specialised use, there are little or no transactions, so transactions in land for such use will also be extremely rare or non-existent. The variable will therefore be land in another use. If higher value uses are likely to be permitted, the purchase of the land for the DRC purpose may have to compete with the higher value uses of the acquired site. That may distort the overall value. For green field or existing land bought at low value, this is rarely a problem, but in more urban areas where there may be competing land uses, this will increase the value.
- 8.113. In extreme cases, where a use requires specialist licensing, for example for environmental emissions, it may be that the choice of locations is severely restricted on that basis. In these circumstances, the purchase may need to be made at a premium value to secure the site.
- 8.114. These considerations need to be explained by the valuer in each instance.
- 8.115. Where no evidence of land transactions exists or can be of any assistance, some valuers have resorted to a percentage of build cost as the land value element. That is not recommended, as it has no real basis. Any such methodological choice would need to be justified and explained.



- 8.116. **Final adjustments** – The DRC calculation draws together many elements, most of which are capable of significant adjustment by the valuer in individual circumstances.
- 8.117. The measurement of obsolescence for depreciation purposes is not a uniform view against a type of property of a certain age and the measurement adopted could be different for similar properties in different locations. The difference is sometimes material. Valuers are required to look at the answer and ask whether it is credible against their knowledge. When the work is completed, the valuer is obliged to look at the end result and consider its sense by way of a credibility check.
- 8.118. Herein lies a further problem. As a cost-based approach, this last stage is often described as "*stand back and look*". Any adjustment at this stage is based on the judgment of the valuer that the result of the DRC is somehow wrong. We already know there are no market comparables which is why a DRC approach has been adopted, and we are faced with a defence that the valuer is 'uncomfortable' with the assigned DRC result and wishes to adjust it.
- 8.119. That judgment may be borne out of extensive knowledge and experience and may, on those grounds alone, be perfectly sound for a qualified valuer to do. Nonetheless, the judgment calls underpinning final adjustments need to be founded in logic and assumptions applied, all of which must be explained and annotated in the Report.
- 8.120. **Impairment of value** – Subsidies impact DRC reporting. For example, in Greece, currently a subsidy exists for the construction of new hotels in some areas. Arguably, with that subsidy at the time of writing being 40%, the modern equivalent will only ever cost a sector investor 60% of the modern equivalent replacement cost. Accordingly, unless an existing structure has greater than 40% depreciation in a DRC approach, the resultant figure will exceed the substitute value.
- 8.121. This market intervention should be regarded as a final adjustment on a special assumption which will affect only those properties in that use class that attract the subsidy and for as long as the subsidy endures.
- 8.122. The effect is an impairment of value. It will only apply against properties where such a subsidy would be available either geographically or by type in any jurisdiction.

- 8.123. The concept of impairment limited to those individual or unusual circumstances should be carefully reported as the "*impairment*" against all properties subjected to a DRC in the same use or category and in locations where such subsidy is made.
- 8.124. If at the final stage the valuer decides to make adjustments and these changes do not have any other basis than just an opinion, then that should also be stated.
- 8.125. **Reporting** – The DRC approach is a complex methodology with a great number of elements requiring major assumptions and often relying on third party technical considerations.
- 8.126. Accordingly, it is not unusual for DRC opinions from different valuers to vary on the same asset. That underlines the need for a comprehensive report at each stage of the process.
- 8.127. The DRC approach is based on the assumption that the entity will continue as a going concern or as a service provision as in the public sector.
- 8.128. If these circumstances change, the DRC may no longer be valid. The consideration of alternative values is not strictly within the remit of a DRC approach, however, alternatives need to be considered for site values and potentially for replacement locations, so consideration of alternatives may be at least partly inherent.
- 8.129. If an alternative is likely to give a materially different valuation outcome, it is good practice that this factor be noted even if not formally reported.

## 9. The Residual Method

- 9.1. The residual method is used to arrive at the value of vacant land ripe for development or of land and building/s with the 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.

- 9.2. 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 major effects on the final answer.
- 9.3. The residual method comprises the estimation of the '**gross development value**' of the site or the buildings in a developed or redeveloped form, either by comparison or by the investment method. The valuer must take great care in applying the available evidence to establish the gross development value.
- 9.4. The valuer must deduct from this 'gross development value' all costs 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, infrastructure works, construction costs, professional fees, agency fees and the interest costs of financing the development.
- 9.5. A so called '**developer's profit**' must also be deducted from the gross development value. This 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.
- 9.6. After deducting all development costs and developer's profit from the gross development value, the result is a residual value. The latter comprises the Market Value of the property/site plus related acquisition costs and finance costs incurred in holding the property over the development period (costs of borrowing for property purchase or opportunity cost). These costs then need to be deducted from the residual value to arrive at the Market Value of the property.
- 9.7. The analysis and judgments in the valuation must be explained in the report.

## 10. Using more than one valuation method

- 10.1. 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 is expected to use just one single method.

- 10.2. No general rule can be set as to whether the use of a single method or several methods leads to a more accurate and reliable valuation. However, where valuers have used only a single method it is recommended that they at least check their 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.
  
- 10.3. 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.

## 11. The final check

The valuer's final act in assessing value is to step back from the analysis that has been done and consider whether someone would actually pay the sum determined. Great effort can be invested in complex analysis and arithmetic to achieve a wrong or unrealistic answer. That review may lead to revisiting and improving the analysis or the application of the valuer's judgment to give the client a professional opinion as to the value of the property in question.





# III. Valuation and Sustainability





- 1. Introduction**
- 2. Sustainability**
- 3. Sustainability and property users**
- 4. Developing "green" standards for property**
- 5. 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 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, not only with greater scientific knowledge and the experience of policy but also the much enhanced focus on climate change mitigation and adaptation. For mitigation, several EU member states have adopted the target of reducing greenhouse gas emissions to "net zero" by 2050 and this theme has now been taken up by the 2019 EU Commission which brought forward proposals in December 2019 for a European Green Deal with 49 proposals for using regulation, trade and investment policy to cut carbon emissions. Adaptation is about resilience in the face of climatic change, whether that be flooding, extreme heat, water shortage or storm. Both those pressures and the gathering momentum of policy interventions in response seem likely to drive major changes. As the incoming President of the Commission, Ursula von der Leyen, told the COP25 climate change conference:

*"Our goal is to be the first climate neutral continent by 2050. If we want to achieve that goal, we have to act now."*

Land use and buildings are among the key policy issues seen as both problems and solutions in this context with property now forming 10 per cent of global investment portfolios.

- 1.3. Illustrating those challenges:
  - ▶ As seen in areas from Venice and the Elbe catchment to the lower Danube and the French Mediterranean coast, built property with people's lives, businesses and investments may be at risk from flooding whether from sudden storms, widespread rainfall or rising sea levels with consequent effects on development potential;
  - ▶ Periods of extreme heat result in increasing mortality, make many buildings uncomfortable for use and increasing the risk of landscape-wide fires;

- ▶ Heat and water shortage constrain both development and food production as well as imposing stress on forestry;
- ▶ Some land use patterns in Europe result in serious soil erosion with resulting problems;
- ▶ Globally, such changes drive hardship and pressure for migration.

That has led to financial authorities developing approaches from the Task Force for Climate-related Disclosure to warnings of the risk of mis-pricing assets that might prove to be unsustainable as current trends unfold.

- 1.4. While promoting adaptation and resilience in the face of those challenges, policy makers are emphasising measures for climate change mitigation, many bearing on property, including:
  - ▶ Carbon sequestration through land management, including the 4 per 1000 initiative launched at the Paris Climate Conference to raise soil organic carbon levels, removing carbon from the atmosphere and potentially beneficial to much of agriculture and aiding water management, as well as forestry and peat land restoration;
  - ▶ The development of renewable energy using land and buildings, with location (including access to a grid connection and planning constraints) often mattering;
  - ▶ With buildings seen to account for 40 per cent of energy consumption in the EU and 36 per cent of its greenhouse gas emissions, driving for greater energy efficiency when net zero buildings set a standard in advance of most current construction;
  - ▶ The consequences for property of measures taken to decarbonise transport, potentially changing values by location.
- 1.5. Wider issues around other environmental themes from biodiversity to the quality of air and water are all now feeding into the discussion of sustainability, the optimal use of resources for the future.
- 1.6. 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) and new markets such as for carbon 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, 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.

- 1.7. The increasing salience of energy issues, driven by cost, resource issues and now climate change concerns, give a good example of this evolution. The introduction of gradually strengthening regulation (such as the now re-cast EU Energy Performance of Buildings Directive with its Energy Performance Certificates (EPCs) and other tools) for new and existing building stock will lead to more sensitivity concerning a building's energy performance and efficiency. With further pressure for this proposed in the European Green Deal, 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.
- 1.8. 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 any less important.
- 1.9. Valuers must act within the limits of their professional skills and current market expectations. 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 Part III of EVS 2020 is offered to assist valuers' awareness of and sensitivity to these issues and so their understanding of markets as they evolve.

## 2. Sustainability

- 2.1. 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. Resilience is the capacity to withstand, absorb and recover from shocks.
- 2.2. 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 ecosystems.
- 2.3. **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.

- 2.4. It has proved to be an enduring, 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.

- 2.5. 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.
- 2.6. A variety of tools and concepts has evolved to consider environmental issues for property, including Life Cycle Assessment, Cradle to Cradle, Ecological Footprint Analysis and green buildings. More widely, the use of concepts such as Natural Capital and Ecosystem Services play a part in policy and public choice, influencing private behaviour. 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.
- 2.7. 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.
- 2.8. 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.
- 2.9. Increasing knowledge, sophistication and scientific advance also open up new challenges – few would have been troubled by CO<sub>2</sub> emissions forty years ago – but also new ways of mitigating and adapting to them.

- 2.10. As the concepts become clearer in practice and guidance develops so they are likely to create intangible assets which will themselves need valuation where they can be separated from the underlying asset.
- 2.11. These developments naturally become a topic for exploration by the valuation profession. The Vancouver Valuation Accord of 2007 was an early 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"*, to make it a mainstream consideration.
- 2.12. **Natural capital and ecosystem services valuations** – A growing body of work, at first for determining and applying economic and environmental policy but now bearing on property valuation and management, is developing approaches 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. Noting the existing guidelines for integrating ecosystem services into decision making, the European Union Green Deal proposes that *"All EU policies should contribute to preserving and restoring Europe's natural capital"*.

- 2.13. The underlying model is to see the stock of nature, whether recognised by markets or not, as natural capital giving rise to services from food to the quality of air and water, from cultural landscapes to soil quality and pollination. Eroding natural capital diminishes the stock of nature; generating more ecosystem services may augment it.
- 2.14. The developing exploration of these concepts as tools for public policy choices and potentially for private transactions to place values, agreed between buyers and sellers, 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. An example of this is the biodiversity net gain proposal for development in England. Building on the experience of biodiversity offsetting for development, this would impose a statutory requirement for development to result in a 10 per cent gain in biodiversity (using official metrics), whether achieved on-site, off-site or through the purchase of credits.

While promoting the policy goal, that could encourage development towards less damaging sites or sites with less biodiversity (noting that some brownfield land may have higher diversity value).

- 2.15. Such approaches, commonly developed from an environmental economics background but using words recognisable to valuers, tend to identify values that can be on very different assumptions from those required by the valuation profession's standards and which might not always be objective. The resulting assessments, commonly reflecting externalities and often very sensitive to changes in assumptions, can nonetheless 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 a Fair Value.
- 2.16. Such values assessed for Natural Capital seem best understood as representing the Investment Value (*see EVS 2*); the worth to society (or another interested party) of what is being measured. That helps policy makers make choices, when ranked against the costs of options, and so inform them as buyers, acting for society, seeking changes in behaviour in the private sector. Those more economics-based ecosystem valuations appear of greater relevance for comparing options using relative values, rather than identifying absolute values.
- 2.17. Where that leads to purchase of public goods, whether directly by state agencies or by other bodies such as companies acting in this area for their own objectives, it sees the emergence of transaction prices where it is mutually beneficial to buyers and potential providers of such services to come to an agreement. Those prices may become analogous to Fair Value, and even in time to Market Value, as a greater body of experience and comparables accumulates.

### 3. Sustainability and property users

- 3.1. Especially since the 2015 Paris Agreement on climate change, work on sustainability is increasingly driven by climate concerns and so focuses on energy and carbon issues. This bears on all aspects of a business including property and buildings as well as many other issues from air quality to biodiversity for which the EU's Green Deal proposes a Biodiversity Strategy.
- 3.2. 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.



- 3.3. 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.
- 3.4. 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 4.4 below*) are a means to try to reconcile the common imbalance of interests between landlords and tenants in these matters.
- 3.5. 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:
- ▶ The increasing expectation on them to report on their performance in this area;
  - ▶ 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".

3.6. 34 central banks and financial supervisors, representing the supervision of two thirds of the global systemically important banks and insurers, created the Network for Greening the Financial System (NGFS) in 2017 which has agreed to:

- ▶ Integrate the monitoring of climate-related financial risks into day-to-day supervisory work, setting expectations that finance considers the financial risks from climate change, embedding an awareness of risks;
- ▶ Ease access to data on climate-related risks;
- ▶ Build capacity and knowledge on managing climate-related risks across the financial system.

It encourages the development of metrics and classification systems to identify which economic activities contribute to the transition to a green and low-carbon economy, supporting financial actors to make sustainable investment and lending decisions. As the Governors of the French and UK Central Banks set out in a joint letter of April 2019 with the chair of the NGFS, the aim is to avoid:

*"a climate-driven 'Minsky moment' – the term we use to refer to a sudden collapse in asset prices."*

The incoming President of the European Central Bank, Christine Lagarde, has said that the ECB's Strategic Review in 2020:

*"... will include the immense challenge that climate change is addressing to each and every one of us, wherever located, and whatever our mission and duties ... we will take up the fight that is taken up by the European Commission and I hope other European institutions, and see where and how we can participate in that particular endeavour."*

*(Statement and Press Conference, 12<sup>th</sup> December 2019)*

The ECB's tools for this include:

- ▶ Banking supervision, by raising awareness of risk so that banks manage them;
- ▶ Financial stability, communicating the risks posed to the financial system by climate change;
- ▶ Some investment in green bonds.

3.7. The international Task Force for Climate-related Financial Disclosure (TCFD), now with supporters across banks, asset managers, pension funds, insurers, credit rating agencies, accounting firms and shareholder advisory services with balance sheets totalling over \$120 trillion, has a critical role in this. It is driving climate disclosure as part of financial decision making at this level with the bearing that will have on property, forming 10 per cent of global investment portfolios, including:

- ▶ Physical risks from the exposure of mortgage books to flood risk and the impact of extreme weather events on sovereign risk;
- ▶ Transition risks including exposures to carbon-intensive sectors and property lending with new energy efficiency requirements.

The work of the TCFD is also intended to promote the allocation of financial resources to financing resilient and sustainable development.

- 3.8. These trends are being transmitted through the financial system. The IMF's financial stability report now includes a chapter on sustainable finance, including this view:

*"The potential impact of climate risks is large, non-linear and hard to estimate. Losses from climate-related risk affect the financial system directly and indirectly through lower economic growth and tighter financial conditions. Insurance claims from natural losses have already quadrupled since the 1980s."*

In 2017, One Planet brought together a group of wealth funds, including Kuwait Investment Authority, with \$15 trillion of assets and the aim of integrating climate change into portfolios. There is a growing recognition that these issues may affect the way that allocations of capital continue to move between sectors, assets and locations, leaving some "stranded" while driving new approaches to infrastructure and the use of land.

- 3.9. Various answers are being developed to the problems of the necessary measurement of environmental performance, such as the EU's recently agreed Green Taxonomy for classifying green investments and the Green Bond Standard to indicate companies' progress in transition as well as whether they are of the highest standard or not. The development of these approaches will in turn influence how property and other markets evolve.
- 3.10. **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 associated waste; 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.

- 3.11. 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.
- 3.12. 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. More generally, it may be associated with concern to reduce reputational risk and include control of its supply chain.
- 3.13. 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.
- 3.14. **Responsible Property Investment (RPI)** is a framework for investors to maximise the positive effects and minimise the negative effects of property ownership, management and development on society and the natural environment. The United Nations Environment Programme (UNEP) Finance Initiative is now delivering regional roundtables on sustainable finance. With its Principles for Responsible Banking and for Sustainable Insurance, it 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*". Its Property Working Group aims to drive best practice in innovation and regulation to these ends with such work as the Sustainable Real Estate Investment Framework. Recognising the constraint of a tenant's legal possession, it sees the role of the property investor (and so the owner) as particularly critical for construction, refurbishment, management of common space and the opportunities given by lease termination. At each point, that direct investment provides more control over sustainability issues than an investment in equities (including REITs) can have with a financial stake. The responsible property 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.

3.15. When considering investment, properties might be screened for:

- ▶ The location – sustainability grounds might point to those with better public transport or on brownfield sites (though these can have higher biodiversity than greenfield ones);
- ▶ Physical characteristics – do the buildings meet environment standards such as the Building Research Establishment Environmental Assessment Methodology (BREEAM), Leadership in Energy and Environmental Design (LEED), the Comprehensive Assessment System for Built Environment Efficiency (CASBEE), the Deutsche Gesellschaft für Nachhaltiges Bauen (DGNB), the Haute Qualité Environnementale (HQETM), the Sustainable Building Tool (SBTool) and Green Star (*see also 4.2 below*). The effect of such standards can be to channel investors' choices, 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.

3.16. 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 and in the case of EPCs, for existing buildings being sold or rented out. For an EPC, that 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.

3.17. **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.

- 3.18. 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.
- 3.19. The Eco Management and Audit Scheme (EMAS), developed by the European Commission for companies and other organisations to evaluate, report, and improve their environmental performance, 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 (EU Regulation 1221/2009 as amended by 2017/1505), 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.
- 3.20. **Life cycle costs** – There is increasing discussion of judging the sustainability of a property across its whole life cycle together with its associated externalities. Concern over greenhouse gas emissions often points to making the best of existing buildings in preference to demolition and replacement.
- 3.21. 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. 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 V: 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.
- 3.22. A move to life cycle assessment may move the balance towards property renovation from building anew, given the embedded costs of construction even with ultra low carbon concrete and steel.

## 4. Developing "green" standards for property

### 4.1. "Green buildings"

4.1.1. A "green" or "sustainable building" is one that is identified as using resources such as energy, water, materials and land more efficiently than buildings constructed to existing minimum standards. It may produce less waste and fewer emissions and potentially offers a better internal working environment, benefitting health, comfort and usefulness with fewer contaminants despite being more airtight. As 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.

4.1.2. 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". Since updated and underpinning the International Green Construction Code 2018, it stated:

*"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."*

4.1.3. 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.

4.1.4. 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 from threats to its location such as flooding or earthquakes or those caused by its siting and design (as with flooding from hard surfaces);
- ▶ The design and layout of a 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;
- ▶ The building's resilience to potentially rising costs of energy, water and waste management.

## 4.2. Certification of buildings and green rating tools

4.2.1. 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.

4.2.2. Internationally recognised schemes offering a more useful common standard for international investors include:

- ▶ BREEAM (Building Research Establishment Environmental Assessment Method) which scores the performance of a building for eight criteria (energy, transport, pollution, land use and ecology, health and welfare, 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 four pass grades;
- ▶ LEED (Leadership in Energy and Environmental Design) set by the US Green Building Council (USGBC) applies to new buildings and renovations scoring them out of 100 points, again 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 LEED standards showed:
  - ▶ 8-9 per cent lower operating costs;



- ▶ 3.5 per cent higher occupancy rates;
- ▶ 3 per cent higher rents;
- ▶ a 6.6 per cent higher return on investment;
- ▶ a 7.5 per cent increase in Market Value;

but as noted elsewhere there may be many factors influencing this.

- 4.2.3.** Other standards noted internationally are DGNB in Germany, CASBEE in Japan, Green Star, NABERS in Australia, HPIU in Ireland, HQE in France and Verde in Spain. Individual countries may have their own domestic standards or codes. Each scheme varies in what and how it assesses; all are regularly revised. Their appraisal methods often tend to be prescriptive rather applying underlying principles to form assessments.
- 4.2.4.** 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.
- 4.2.5.** 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 EVIP 1).*

- 4.2.6.** 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 built to "near-zero energy" standards from the start of 2021 (see EVIP 1).

### 4.3. "Level(s)" – The EU initiative for sustainable building construction

4.3.1. With that need under the Energy Performance of Buildings Directive for new buildings to be nearly zero energy from 2021, the EU, with others such as Skanska, St Gobain and the Sustainable Building Alliance, is developing the Level(s) initiative as a common EU voluntary reporting framework to assess environmental performance in the design and construction of buildings that are sustainable by virtue of using less energy, using fewer materials and benefiting occupiers' comfort and health. It uses existing standards and a lifecycle or circular economy approach for the building sector with its demands for energy, minerals and water and generation of waste. This broadens the focus of attention from the use of a building (overall accounting for 28 per cent of global emissions) to include the emissions and resources embodied in it (a further 11 per cent of emissions), so responding to the EU's Circular Economy Action Plan and the desire for substantially improved efficiency in the use of resources.

4.3.2. The then EU Commissioner for Environment, Maritime and Fisheries, Karmenu Vella, outlined its intention in October 2019:

*"The Commission's framework for sustainable buildings – Level(s) – aims to unite the whole sector value chain around a common European language for better building performance. It looks at the full lifecycle of buildings to address their huge potential for emissions reductions, efficient and circular resource flows, and supporting the health and wellbeing of those they are built to serve.*

*Level(s) will serve as a galvanising force for actors across Europe's building sector in understanding how they can collaborate to create a sustainable built environment for all Europeans. It will be a powerful source of data and insights for national policy-makers looking to build sustainability and circularity into their building codes. We have an opportunity to grow Europe's sustainable building sector into a world leader, in a growth area for the construction and real estate sector globally."*

*(<https://ec.europa.eu/environment/eussd/buildings.htm>)*

4.3.3. After a period of testing from spring 2018 on 136 projects (74 residential and 62 non-residential) in 21 countries, Level(s) is to be launched fully from summer 2020 with the object of making this approach conventional and, in turn, stimulating awareness of demand for more resource efficient buildings.

- 4.3.4. With its focus on the life cycle of a building, Level(s) moves beyond many current green certification schemes but has been supported by BREEAM, DGNB, HPI, HQE and Verde which intend to explore alignment with it. In this it draws on work by some member states such as:
- ▶ The Netherlands which, since 2012, has required applications for permission for new buildings of more than 100m<sup>2</sup> to be supported by an environmental performance calculation report, reviewing its life cycle emissions and resources use;
  - ▶ France which launched a life cycle based assessment label, E+C-, in 2016 in preparation for new regulations in 2020.
- 4.3.5. The intention is that Level(s) will support standardisation of data, giving a mutually intelligible basis for architects, assessors, contractors, suppliers, investors and others to consider these issues for a property. Each indicator can be used in a graduated way with levels from simple assessments using basic metrics to more thorough and complex ones, through to a full Life Cycle Assessment. It can be used as a building project progresses from design (using the plans) to completion (as built), post completion once commissioned and tested and then actual occupation in real use.
- 4.3.6. Level(s) uses a series of indicators linked to the EU's priorities for sustainability:
- ▶ **Greenhouse gas emissions** over the life cycle of the building, moving from energy performance to life cycle global warming potential to a full "cradle to cradle" Life Cycle Assessment;
  - ▶ **Resource efficiency and circular material life cycle**, moving from a life cycle assessment of materials used to considering scenarios for a building's lifespan, adaptability and demolition to the waste and materials in construction and demolition to a full "cradle to cradle" Life Cycle Assessment;
  - ▶ **Efficient use of water resources**, considering water consumption in use;
  - ▶ **Healthy and comfortable spaces**, moving from indoor air quality to assessing the extent to which it may be outside the thermal comfort range and then reviewing light and noise issues;
  - ▶ **Adaptation and resilience to climate change**, with scenarios for possible climatic conditions and then a review of extreme weather events and floods;
  - ▶ **Life cycle cost and value**, with assessment of life cycle costs in €/m<sup>2</sup>/year and then considering value creation and risk factors.
- 4.3.7. Once developed and launched after the present testing, Level(s) could then be used to assess the comparative performance of buildings, aiding potential property users, managers and investors and so, like EPCs, come to play a part in decisions in the marketplace and so in valuations.

#### 4.4. "Green leases"

4.4.1. There is growing discussion of the concept of "green leases" which may again have an impact on the valuation of some properties. This has partly 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. A prospective tenant could want confirmation that the building can reasonably achieve the proposed environmental targets if the tenant complies with the covenants in the lease. Whether the building is new or retro-fitted, the landlord may in turn need equivalent warranties from the developer or architect.

4.4.2. With the concept first developed in Australia but now more widely spread, there is no precise definition of green leases that is widely accepted in the market. In general, a green lease refers to a lease of a sustainable/energy-efficient property on terms that promote sustainability with regard to green or energy-efficient standards or operational control and audit procedures related to energy performance measurements. Such provisions might:

- ▶ Govern the tenant's use of the building;
- ▶ Require the tenant's initial fit out and any subsequent works to meet a specified energy efficiency, insulation or ventilation standard;
- ▶ Adjust service charges to penalise tenants who do not meet specified energy efficiency targets;
- ▶ Require the landlord to keep in good and efficient working order all equipment that affects the energy use of the building;
- ▶ Impose requirements on assignment or sub-letting for the assignee or sub-tenant to covenant with the landlord to comply with the landlord's environmental policy;

as well as cover building management, waste disposal, transport, catering and janitorial services.

- 4.4.3. Such terms vary widely in practice. 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*". 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.
- 4.4.4. The Australian Government has 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 sustainability management committee including the landlord.
- 4.4.5. 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.

## 5. Valuation and sustainability

- 5.1. A valuer can only provide an opinion of value on the basis of evidence, reflecting the experience of the marketplace. That opinion cannot state that something should have a value or that a current value might not be sustained in the future, 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.
- 5.2. 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. Ultimately, within any regulatory framework these are issues of supply and demand and so may be influenced by changes in the patterns of demand by businesses, investors and, beyond them, consumers.
- 5.3. 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.
- 5.4. 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 circum-

stances 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.

- 5.5. 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.
- 5.6. 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*” or see it as giving them a commercial advantage.
- 5.7. 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. The story of sustainability has seen the emphasis move between particular issues over time, with climate change related concerns now more likely to be dominant.

- 5.8. One way of analysing this behaviour is to observe that those parties are approaching their decisions on the basis of Investment Value (see EVS 2) in assessing the value of a property to them for their own objectives. Where the Investment Value of the property to an investor on its criteria is markedly greater than its Market Value, that investor may see an opportunity.
- 5.9. 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 risk standing at a discount to the value of more compliant properties.
- 5.10. 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.
- 5.11. 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.
- 5.12. Legal intervention, including any prospective limitations on letting or using properties that do not meet particular specifications, may also colour views. An approach once generally limited to the habitability of a property or the provision of basic services such as sanitation, is now being extended to energy efficiency and could be developed more widely.
- 5.13. 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.

- 5.14. Many may say that they would pay a premium for a property meeting a stated standard, 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.
- 5.15. 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.
- 5.16. **"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.
- 5.17. More specifically, green value is the concept that a green building may have a value that is greater than that of an equivalent but 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.
- 5.18. **Approaches** – While ever greater attention is being focused on sustainability issues, it is often commented that they may often not be reflected in Market Values. However, as any one issue becomes of general concern to buyers, so it just becomes part of the general matrix of factors underlying Market Value. Moreover, as some studies show from analysis of large data samples for transactions, the effects may be subtle but pervasive, not distinct in themselves and possibly only driven by a fraction of buyers or tenants but sufficient to affect values. The effect may, of course, not be that of a premium over other properties, but that less compliant properties may be at a discount.
- 5.19. 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 automatically and of itself 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.

- 5.20. All existing valuation methods – mainly direct value comparison, income 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.
- 5.21. In some markets, valuers may try to apply advanced statistical methods to identify green value as part of the 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 to do this 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 on 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.
- 5.22. Discounted Cash Flow (DCF) can be a way of taking into account and comparing differing profiles of operating and refurbishment costs.
- 5.23. 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.
- 5.24. 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.

- 5.25. 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.
- 5.26. 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.
- 5.27. Any recognised certification or rating awarded to the property should usually be reported.
- 5.28. **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 the Valuation Report, either as aspects within the usual structure of the 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 checklist 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.
- 5.29. 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 points (such as heat bridges or the type of windows) and quality in terms of durability and 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 the property, 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 well-being;
- ▶ 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*").

5.30. 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?

5.31. Where a development proposal or other change requires an Environmental Impact Assessment, that is likely to involve a review of many sustainability issues.

5.32. The suitability or potential of a property, such as but not only farmland or forestry, to offer opportunities in its use or management to meet sustainability objectives or commitments, whether for transactions to deliver biodiversity offsetting to enable developments elsewhere or for its use for carbon sequestration, flood attenuation, air quality improvement, renewable energy development or other purposes, may offer additional value to the property.

5.33. The combination of policy concerns over climate change, resource efficiency and the natural environment, requiring progressive change over the coming years, are increasingly relevant to decisions about the use and value of property. Some properties threatened by the effects of climate change or unable to meet new

standards may lose value; others may find value in new opportunities. The expectations of property markets will take such factors into account where buyers and tenants think them relevant, whether in response to physical facts, sentiment, legislation or taxation. Property management and its cost structures will come to take full account of these matters, perhaps especially as lifecycle costing may often point to making the best use of existing properties, renovating them for these demands, rather than replacing them with new buildings. Fundamentally, the market place will still consider the usefulness of a property to its potential users, and so these issues will be taken into account alongside its practical adaptability and flexibility with the space and facilities it offers. The valuer's task is to understand and interpret these issues, where relevant, and the market's reaction to them, applying professional judgment to the evidence available in finding a property's value at a given time to enable a client to take informed decisions.



**IV.**

# European Valuation Information Papers





# **EVIP 1** The Impact of the Energy Performance of Buildings Directive on Property Valuation

1. Introduction
2. Scope
3. Definitions
4. Commentary

## 1. Introduction

EVS 6 – Valuation and Energy Efficiency advises valuers to integrate the cost of energy efficiency valuation in their determination of Market Value when the obligation to energy renovate is imposed by law by a fixed date or at a certain inflection point (e.g. rental, sale). This Information Paper, on the other hand, concerns the still currently more common situation in which the owner retains control over when to renovate. When that decision is freely taken, a certain number of energy efficiency renovation obligations originating in EU law ensue. This Information Paper provides guidance on those obligations and their impact on value.

## 2. Scope

This Information Paper applies to consideration of energy efficiency issues in the valuation of property in the context of the measures to be taken by EU member states under Directive 2010/31/EU as amended by Directive 2018/844 (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.

## 3. Definitions

- 3.1. The definitions cited here are, unless otherwise stated, drawn from the Energy Performance of Buildings Directive 2010/31/EU as amended by Directive 2018/844 (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 space heating, space cooling, ventilation, domestic hot water, built-in lighting, building automation and control, on-site electricity generation, or for a combination thereof, including those systems using energy from renewable sources, of a building or building unit."

*(Article 2(3))*

## 4. Commentary

### 4.1. General

- 4.1.1. Among its measures most likely to be 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).

- 4.1.2.** Alongside those, the Directive requires that by 2021 all new buildings meet a "nearly zero-energy use" requirement. It also imposes regimes for:
- ▶ New buildings to have self-regulating devices to regulate the temperature of individual rooms or zones, and for these to be added to existing buildings, where technically and economically feasible, when "heat generators"(using fuel combustion, electric resistance or heat pumps) are replaced;
  - ▶ Provision for electromobility where a building is new or subject to major renovation (see 5.4 below);
  - ▶ The regular inspection of larger heating and air conditioning systems with resulting recommendations.
- 4.1.3.** The Directive further requires the European Commission to adopt an "optional common Union scheme" for rating the "smart readiness" of buildings, to "cover features for enhanced energy savings, benchmarking and flexibility, enhanced functionalities and capabilities resulting from more interconnected and intelligent devices" so that it can be adapted to "the needs of the occupant and of the grid and to improve its energy efficiency and overall performance".
- 4.1.4.** The valuer will need to understand the provisions applying in the member state where the property is situated.

## **4.2. New buildings – Nearly zero-energy**

### **4.2.1.** "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))*

- 4.2.2.** With nearly zero-energy buildings defined at 3.5 above, 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.

## **4.3. Existing buildings and "major renovation"**

- 4.3.1.** 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".

**4.3.2. "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).

**4.3.3.** 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 ..."*

**4.3.4.** 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))*

**4.3.5.** Where valuers are required to advise on this, they should know which option has been chosen in the relevant member state.

**4.3.6.** 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 does 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).

**4.3.6.1.** 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% of the apportioned value of the building.

**4.3.7.** 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).

**4.3.8.** 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.

**4.3.9.** 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.

#### **4.4. Adaptation of parking areas for the charging of electric vehicles ("electromobility")**

The Directive now lays down specifications for the provisions to be made for non-residential and residential buildings, either new or as part of undergoing major renovation, with more than ten parking spaces in or adjacent to the building:

##### **4.4.1. Non-residential**

- ▶ One recharging point per building;
- ▶ Ducting to enabling the later installation of points for at least one in five parking spaces;

- ▶ Member states are to specify by 2025 the number of points required for buildings with more than 20 parking spaces, taking into account *"relevant national, regional and local conditions, as well as possible diversified needs and circumstances based on area, building typology, public transport coverage and other relevant criteria, in order to ensure the proportionate and appropriate deployment of recharging points"* (Recital 26 of the 2018 Directive).

Member states are able to exclude from these rules buildings owned and occupied by small and medium sized enterprises, those in the EU *"outermost regions"* and ducting that would rely on *"micro-isolated"* systems (defined in Directive 2009/72/EC).

#### 4.4.2. Residential

- ▶ Ducting for every parking space.

#### 4.4.3. For non-residential and residential buildings

- ▶ These requirements are to apply only if the building has more than ten parking spaces and if the renovation includes the car park or the electrical infrastructure of the building (for the adjacent car park, the electrical infrastructure of the car park);
- ▶ No recharging point or ducting need be installed where the cost of installation exceeds 7% of the total cost of the renovation of the building;
- ▶ Member states are to address the regulatory barriers to electromobility building and renovation, including barriers caused by permission and approval procedures.

### 4.5. Energy performance certificates (EPCs)

- 4.5.1. 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 (*Directive 2009/28/EC as amended by Directive 2018/2001/EU*). 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. The reported efficiency rating is to be shown in advertisements marketing the property and the EPC is to be given to the prospective purchaser or tenant.

- 4.5.2.** The policy purpose of the EPC in informing the property market is described in the 2010 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)*

- 4.5.3. 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.

- 4.5.4.** 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 250m<sup>2</sup>, occupied by a public authority and frequently visited by the public;

- 4.5.5.** Unless so instructed, it is not the valuer's responsibility to obtain the EPC or a report on any technical building systems.

- 4.5.6. 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.

- 4.5.7.** Member states are also free to exempt the following categories of buildings from the obligation to issue an EPC:

- ▶ 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.

- ▶ 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.

- ▶ Temporary buildings to be used for 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 horticulture.
- ▶ 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.

- ▶ Stand-alone buildings with a total "useful" floor area of less than 50m<sup>2</sup>.

**4.5.8.** 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.

**4.5.9. 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.

**4.5.10.** 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.

- 4.5.11. 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.
- 4.5.12. Where an EPC is required, the reported efficiency rating may have an impact on value. Valuers are to judge that from their knowledge of the market place, in which effects on value, if evident, may vary by type of property, region and other factors.
- 4.5.13. Valuers 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 their report as seems appropriate in the circumstances and available knowledge.
- 4.5.14. 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.
- 4.5.15. 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.
- 4.5.16. Any significant recommendations in reports on technical building systems may also be taken into account where relevant.
- 4.5.17. The valuer may on occasion be instructed to advise the client on economic improvement of the property in the light of the EPC. Valuers should only do so if it is within their professional competence. If the valuer undertakes this task, her/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 the 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.

**4.5.18.** Valuers will take account of the rating and recommendations so far as relevant, reflecting market circumstances, in providing their opinion as to the value of the property on a recognised basis of valuation.

**4.5.19. Looking ahead** – While policies affecting property are currently relying on the EPC rating, it is possible that assessed carbon dioxide emissions (an environmental impact rating and already included in at least some EPCs) may come to be used more. Further ahead, attention may come to bear on energy use as assessed not only on theoretical energy consumption but over the life cycle of a building, including the energy embedded in its construction and materials used, so tending to encourage refurbishment, rather than replacement, of existing buildings.



# **EVIP 2** Valuation and Other Issues for Recurrent Property Taxation

## Summary

1. The European Semester and recurrent property taxation
2. Defining the properties
3. Valuation
4. Maintaining the valuation register
5. Revaluation
6. Challenges, disputes and appeals
7. Applying the tax
8. Exemptions and reliefs
9. Higher or additional charges

## Summary

- S1** As part of the European Semester (or Economic Governance) programme, the EU is encouraging member states to shift the tax burden from a higher incidence of tax on labour to 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** 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. The 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 so that all properties are treated equally. The process should be transparent to the taxpayer.
- S3** While it is likely that most properties can be valued on the basis of market transactions, sales or lettings, relevant to the valuation date, there will always be some properties for which there may be little or no evidence and for which other approaches will have to be found. These will need to be tested carefully as they are developed.
- S4** A property taxation system requires an accurate and comprehensive register of properties that is kept up to date. European Semester recommendations have focused on the need for member states to have current and accurate registers; most have taken measures to comply.
- S5** 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 to 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 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.

- S6** An effective and independent appeal system is important both to achieve accurate and fair valuations and also for the political respect that a property tax system needs among taxpayers.
- S7** 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.
- S8** Fundamentally, a good tax system must be efficient, serve its objectives, not have perverse outcomes and command taxpayers' respect.

## 1. The European Semester and recurrent property taxation

- 1.1. The EU's European Semester involves a shift of the tax burden to property and away from the distinctively high taxes on labour that are levied in many member states whilst having a neutral effect on the overall level of taxation. The EU favours annual recurrent taxation as opposed to transaction tax so as to, inter alia, promote labour mobility.
- 1.2. That approach is followed through in the regular editions of country specific recommendations by the European Council. As a result, Malta is the only member state that has not had a recurrent tax on property, though the introduction of a general recurrent tax failed politically in Croatia and is now no longer planned, there being, however, municipal fees and a charge on holiday homes based on their area in m<sup>2</sup>.
- 1.3. Nonetheless, the European Commission still noted in 2018 that:

*"Recurrent property taxes remain low in a majority of Member States and there may be scope to increase them, while avoiding negative redistributive impacts on low-income households. In countries where the current systems of housing taxation rely heavily on transaction taxes, an internal shift from transaction taxes towards recurrent taxes could also bring efficiency gains."*

*(Tax Policies in the European Union: 2018 Survey)*

- 1.4. The Commission's Country Reports for the European Semester 2019 specifically remark on the low levels of recurrent property taxation (using 2017 figures) in:
  - ▶ Austria at 0.5% of GDP but the third highest share of labour taxes in total revenue;
  - ▶ Estonia at 0.3% of GDP where *"property ... taxes could be used to finance a further shift away from labour taxation"*;
  - ▶ Finland at 0.8% of GDP where *"real estate taxation reform has been postponed"* until 2022 at the earliest. Values, updated by a construction index, were below Market Values with the gap widening;
  - ▶ Latvia at 0.8% of GDP;
  - ▶ Lithuania at 0.3% of GDP with no further changes planned;
  - ▶ Slovakia, seeing a figure of 0.4% of GDP as *"an indication that Slovakia may be underutilising property ... taxation as revenues"*;



- ▶ Slovenia at 0.5% of GDP;
- ▶ Spain where recurrent property taxation raised 1.2% of GDP.

## 2. Defining the properties

- 2.1. 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.
- 2.2. 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.
- 2.3. 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 was distorted by buyers delaying the registration of properties into their names to avoid the associated charges.

## 3. Valuation

- 3.1. 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.
- 3.2. It may be handled by national or local government agencies, whether using in-house valuation departments or retaining external valuers. The valuers' skills are applied to the properties recorded on the register of properties. The register needs to be maintained so as to provide a comprehensive and accurate base for the tax.
- 3.3. 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 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.

- 3.4. In order to provide a generally agreed common basis for such valuations, European Valuation Standards 2020 defines "Market Value" in EVS 1 as:

*"The estimated amount for which the property should exchange on the date of valuation between a buyer and a seller acting independently of each other after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion."*

As that is drafted in terms of capital values, EVS 1 also gives an equivalent definition of "Market Rent":

*"The estimated amount for which the property should be leased on the date of valuation between a lessor and a lessee on the terms of the actual or assumed tenancy agreement acting independently of each other after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion."*

- 3.5. The choice between capital value and Rental Value as the base for valuation and so for 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 another market 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. Northern Ireland has moved its domestic rates valuations from a rental to a capital basis;
- ▶ **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** – The French property wealth tax is, as the name implies, based on capital values though applied to the total value held by the taxpayer, so that the same property could have a different tax effect according to the other circumstances of the taxpayer;
- ▶ **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 the liable person, the occupier or the owner? Once known, that will affect the terms of new agreements between them.

- 3.6. In practice, such issues may often drive separate approaches for residential and non-residential property.
- 3.7. 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.
- 3.8. Where a full valuation of all affected properties is to be done, it has to be undertaken on a common basis for all properties subject to the charge and at a common date, 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.
- 3.9. One question is whether improvements made by the current occupier are to be disregarded or not.
- 3.10. Where a property is very individual, say a mediaeval college, and the answer is thought inappropriate, then it could be that the value of a hypothetical modern equivalent property serving that same function might be considered instead.
- 3.11. If a rental basis is to be used for valuation, then standard terms for a lease also need to be assumed – as, for example, identifying whether landlord or tenant is to be liable for repairing and insuring liabilities for the property. This may be stated in the relevant legislation.

- 3.12. With those questions answered, the valuation of many properties will be relatively straightforward 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.
- 3.13. 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 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 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).
- 3.14. 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.
- 3.15. Other problems can arise where the application of existing law to innovation produces apparently conflicting outcomes. As an example, in Scotland the application of the same legislation for which plant and machinery should be considered now produces very different valuation outcomes for different types of renewable energy generation, disadvantaging hydro-electric installations in comparison to wind turbines.

- 3.16. **Actual Approaches** – 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.
- 3.17. Within Market Value-based countries, dwellings will generally be valued using transactions 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.
- 3.18. **Land value tax (site value rating)** – 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 just that 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.
- 3.19. 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. Estonia, in particular, is understood to tax only land value.
- 3.20. This assessment may be problematic in countries without detailed land use zoning and more specifically in areas (particularly found in city centres) where there are few comparables for such bare land sales or lettings yet high or very high values may be at stake, of a scale that can affect the overall distribution of the tax charges across the area or economy. 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 the resulting charge to be paid by the occupier or the landlord?

## 4. Maintaining the valuation register

- 4.1. However the valuation is done, the result should be a valuation register as at a common valuation date so 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.
- 4.2. When a new taxable property is created, it will need to be added to the register and given a value. For equity, that should be at the common valuation date for that register.
- 4.3. 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 at the same common valuation date, so looking backwards rather than at its current value.
- 4.4. 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 give 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 15 years ago?

## 5. Revaluation

- 5.1. The pace of change and volatility in the property market and the economy will rapidly make valuations dated with the result that each taxpayer's relative share of the liability may no longer reflect current circumstances. 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.
- 5.2. That drives a need for regular comprehensive revaluations, the more so for more dynamic economies. However, this can be politically contentious and it is noticeable (and noticed by the European Commission) that many registers have

not been revalued for some decades, even in systems that presume much more regular revaluations.

- 5.3. The cost and effort involved will rarely make an annual revaluation appropriate. It could also be likely that a significant number of appeals against the previous valuation would still be outstanding, complicating the process.
- 5.4. A continuous, rolling process of re-valuation, in which a fraction of properties is re-assessed each year, might ease the burden of the task but with no common valuation date might not be (or be seen to be) equitable between taxpayers.
- 5.5. However, as time passes 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 impact 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.
- 5.6. On balance, undertaking revaluations on a cycle of some three to 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.
- 5.7. 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 reality.
- 5.8. **EU pressure for revaluation** – One of the most clear 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.

5.9. As examples, the European Council's July 2019 recommendations to member states for the European Semester 2019 advised:

- ▶ Austria that *"there remains scope for shifting the tax mix towards sources that support more inclusive and sustainable growth. In particular, recurrent property taxes are found to be relatively growth-friendly and progressive, as higher-income earners are likely to possess more housing wealth. However, due to a largely outdated tax base, revenue from recurrent property taxes in Austria remains low and well below the Union average. A revaluation of the tax base would help generate more revenue and address fairness issues that arise when land/real estate values are decoupled from market prices"* (Recital 11);
- ▶ Italy that *"tax bases less detrimental to growth, such as property and consumption, are underused, leaving room to shift the tax burden away from labour and capital in a budgetary neutral way. The recurrent property tax on first residences was repealed in 2015, including for wealthier households. In addition, land and property values (or 'cadastral' values), which serve as the basis for calculating property tax, are largely outdated, and a reform to align them with current Market Values is still pending"* (Recital 11);
- ▶ Latvia that *"capital and property are relatively undertaxed and the freezing of the values used to calculate land and property taxes will reduce their revenue further"* (Recital 9). Revision of those values of 2012/13 had been postponed with relative undervaluation of new apartments and agricultural land (*European Semester 2019 Country Report*).

Other member states had already acted to comply with such recommendations in previous years.

5.10. Ireland replaced its previous rating system based on valuations that had last been 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.

5.11. 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 and previous taxes that were largely on more substantial properties. At the same time Greece cut taxes on property transactions from 8-to-10% to 3%.



- 5.12. 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 was that a full revaluation be undertaken. This was completed in mid-2014 with 1<sup>st</sup> January 2013 as the valuation date. That identified a further 300,000 taxable properties, with a 1% 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.

## 6. Challenges, disputes and appeals

- 6.1. 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 always be some mis-valuations.
- 6.2. 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 to a lower valuation band and so a lower tax charge.
- 6.3. **Valuer's professional advice** – The process of challenge may work best if the taxpayer, taking professional advice from a relevant valuer, can raise a 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 ensues, there needs to be an independent tribunal that can receive evidence from the taxpayer and the official valuer and settle 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.

- 6.4. Such a system, working within each national judicial framework, is essential to the proper functioning of the 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.

## 7. Applying the tax

- 7.1. 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.
- 7.2. 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.
- 7.3. The proposed German reforms of 2019 provide for a higher level of charge to be applied to undeveloped land deemed suitable for development. That could be seen to follow the argument of the Irish Vacant Sites Levy, again designed to drive land forward for development, especially housing. This can be controversial where a longstanding owner has other intentions and for farmed land.
- 7.4. Where there is major revaluation it may be politically or economically necessary to allow a phasing in of new liabilities.

## 8. Exemptions and reliefs

- 8.1. 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.
- 8.2. An exemption may usually mean that the property does not have to be valued. 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.
- 8.3. The different taxes in member states will offer exemptions reflecting domestic concerns and history. Religious and heritage properties may often have an exemption. Agricultural and/or forestry land and/or buildings often have their own treatment having, as examples, a separate regime (the current "Property Tax A" in Germany) and exemption in the United Kingdom, partly on the basis of being seen as part of the food production process rather than premises within which business

activity happens. Embassies and other diplomatic buildings are generally exempt. All or some government buildings are taxed in some countries but not in others.

- 8.4. 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.
- 8.5. 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.
- 8.6. 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.
- 8.7. Several countries offer initial exemption or relief to new dwellings or other properties. The proposed 2019 reforms in Germany would allow a reduced federal rate on social housing properties, local/community housing corporations or housing cooperatives on the basis that they are rented out to provide affordable housing, rather than for profit.
- 8.8. The size of household can affect liability to residential tax with some countries such as Spain giving reliefs for larger households, England allows a discount for sole occupiers and Lithuania has in 2018 introduced both progressive banding by value with adjustment for family circumstances.
- 8.9. 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.
- 8.10. The European Commission has noted differing levels of tax (0.2% to 1.5%) and rebates (up to 90%) between municipalities in Latvia (*European Semester 2019 Country Report*).

## 9. Higher or additional charges

- 9.1. In some countries there is provision for higher charges to discourage particular uses, such as second homes or supermarkets.
- 9.2. **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.
- 9.3. 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 3** Multiple Interests in Residential Property

1. Introduction
2. Valuation
3. Multiple ownerships
4. Tenancies and other rights
5. Residential caravan parks
6. Inalienable and unassignable property

## 1. Introduction

- 1.1. There are many situations in which more than one person has a legal interest in a residential property. These can produce complex questions for valuation.
- 1.2. Multiple interests can arise through structures of ownership involving more than one person, such as
  - ▶ Co-ownership of the dwelling by several owners, often family members;
  - ▶ Collective forms of ownership of a property including several dwellings (as with a block of apartments) which may according to the situations and the national law be condominiums and other forms).
- 1.3. There may be lesser interests in a property than ownership that should be considered. These might include:
  - ▶ Leases which may be:
    - ▶ Very long, long, short, very short or running on a periodic monthly, quarterly or annual basis;
    - ▶ For occupation or for building;
    - ▶ Transferable or not assignable;
    - ▶ Allowing sub-letting or being barred from sub-letting;
    - ▶ Simply at rent or with a premium;
    - ▶ Generally with other rights and obligations between the landlord and the tenant;
  - ▶ Structures of such leases and sub-leases which might variously be held by individuals or jointly or by companies;
  - ▶ Right of use such as usufruct.

There may usually be a framework of national law as well as the agreement for the tenancy or right which will establish the legal character of the tenancy or right with its benefits and obligations.

- 1.4. It may be necessary to consider how far the dwelling has been altered by works (as for energy efficiency) that have altered it and so questions including:
  - ▶ How is a landlord's investment in a property treated?
  - ▶ How is a tenant's expenditure on the property to be treated?



- ▶ Have items become part of the property or remained the legally removable personal property of the occupier?
- ▶ Are these improvements or dilapidations?

Much of this may be governed by specific national law.

## 2. Valuation

- 2.1. Subject to the client's instruction, the valuation will be to determine the Market Value (*see EVS 1*) of the specific identified interest in the dwelling with its physical and legal characteristics, both beneficial and burdensome, at the current or past date for which the valuation is prepared.
- 2.2. That will take account of the limitations that may be imposed by there being other interests in the property but also of the reasonable expectations that potential buyers in the market place might have of any change in those circumstances as, for example, of a tenancy ending to give vacant possession of the dwelling. That would be as relevant as any wider change the market might take into account that could bear on value such as, for example, the opportunities for re-development of the property given the legal interests currently held by others in the property.

## 3. Multiple ownerships

- 3.1. **Co-ownership** – Such a situation can arise where there is more than one owner, as where:
  - ▶ A husband and wife jointly own a dwelling; or
  - ▶ A house is inherited by children in equal shares.

And similarly where a single tenancy of a property is held by more than one person. While, in a residential context, such co-owners may often be members of the same family, they could be entirely unrelated – as where friends share a tenancy or agree to buy a house together in an expensive housing market.

- 3.2. That ownership will usually be co-ownership of the whole, in undivided shares. Occasionally, joint owners may have specific interests in parts of a single property.

- 3.3. Such joint ownership or tenancies can give rise to valuation questions when there is a need to value the interest of only one of the co-owners. The outcome may be affected by the operation of national law on the situation and any limitations it may impose on the disposal of the entire property and how shares in its ownership can be transferred (most often relevant on the death of a co-owner). Even where the share in the ownership is transferable, it is likely that the Market Value of a fractional interest will be at a discount to the underlying value, with smaller shares of ownership seeing greater discounts. That may not apply when determining the special value of that share in valuing between the co-owners.
- 3.4. **Example** – The valuer is required to determine the Market Value of the interest of one of two sisters who jointly own a house worth €250,000. As the hypothetical buyer of her interest would be buying into a house already and equally occupied by the other sister, the buyer is likely to bid less than half the value of the house. For instance, that Market Value of a half share might be €110,000 though the actual figure would vary with the facts of the case. That depreciatory effect might be greater if interest valued were that of one of three or four co-owning siblings, and so a third or a quarter share in the house.
- 3.5. In some jurisdictions, one joint holder of a tenancy can bring the whole tenancy to an end by a notice to quit; in others, such a notice would not have that effect, so that some joint tenancies could continue indefinitely by successive transfers or family relationships creating new rights to remain.
- 3.6. **Shared ownership** – Housing affordability issues in some countries have led to some purchasers taking part ownership of a dwelling and paying rent for the remainder. Arrangements may then vary from the purchaser progressively buying the remainder of the property to simply being able to sell the part share on to a future buyer, the nature of the buyer sometimes being limited by reference to the buyer's locality or income level. The other owner may be part of the social housing sector or an interest created by a developer who may have been required to provide such housing as part of securing permission for a larger development.
- 3.7. The valuation issue will turn on the specific contractual provisions for the property in question. As this is normally offered to ease access to the housing market, the purchaser's share is likely to be accepted to be the equivalent proportion of the Market Value of the whole dwelling (without discount) as the other owner is likely to be supportive of the scheme and occupation is not shared with a third party. However, the value of the whole property may be reduced if the arrangement is in breach of standard covenants for mortgage lending, thereby limiting finance

for purchasers, especially where the property can only be bought by someone meeting certain approved criteria.

- 3.8. **Collective ownership of several dwellings** – This will most commonly arise for a block of apartments with ancillary common and service areas where each dwelling may have an 'owner' with transferable rights but the owners may be collectively involved in the management or ownership of the larger block.
- 3.9. **Shares in a company owning residential property** – Residential property, whether a single dwelling or a portfolio, may be owned by a company. While that company may buy or sell residential properties in the same way as any other owner, the property held by the company can (with any other activities it may have) be sold by selling company shares. There may be situations where this structure is a useful means of managing ownership within families, handling inheritance issues, is suitable for taxation or answers other objectives.
- 3.10. When asked to value shares in such a company, the valuer is considering the company's value (rather than just the assets held by it) and then the ability of the shareholding in question to secure that value. Subject to national law on companies, the main options are:
- ▶ One person owns all the shares. That person's interest is effectively the value of the company;
  - ▶ Where one shareholder has enough voting shares to resolve on the liquidation of the company they may usually have direct access to their fraction of that value after allowing for any further obligations to minority shareholders;
  - ▶ Where the shareholding is sufficient to give management control, but not to liquidate the company, it has secure control over the income but not the ultimate ability to secure full value;
  - ▶ Shareholdings below that figure may have some control through combinations with other shareholdings but the smaller they are, the more their value will turn on the income they can receive;
  - ▶ Where a shareholding is too small to block the liquidation of the company then its value will be little more than that of the income it can earn.
- 3.11. **Statutory protection of other persons' rights in the house** – The law may intervene to protect the interests of other occupiers in the dwelling in ways that may affect its value.

- 3.12. A common example of this is a house lived in by a married couple but which is owned by just one of them. National law may give the other party rights to occupation which may override other claims. That might be relevant where only the owner is party to a mortgage secured on the house and the lender is seeking possession. Different national jurisdictions may offer potential claims to other family members and co-habitees.
- 3.13. National law for residential tenancies may create similar claims in the context of tenancies.
- 3.14. Some countries with turbulent histories may still allow claims to properties by former owners and their heirs.

## 4. Tenancies and other rights

- 4.1. **Tenancies** – There can be multiple layers of ownership where a property is subject to one or more tenancies. Depending on the tenancy agreement and the legal regime governing it, that may:
  - ▶ Affect the value of ownership, sometimes depreciating it and sometimes making it attractive as an investment;
  - ▶ Create a value for the tenancy, especially where it is long term or secure, transferable and at a below-Market Rent;
  - ▶ Require valuations where the landlord might buy out the tenant;
  - ▶ Require valuations where the tenant might buy out the landlord or seek an extended tenancy.

In some countries and in some circumstances, national legislation may bear on transactions in tenancies.

- 4.2. While a tenancy may usually be for the occupation of a dwelling, there is a range of possible structures, including:
  - ▶ A very long lease of land so that a dwelling or dwellings may be built;
  - ▶ A tenancy or tenancies intervening between the ultimate property owner and the tenancy giving occupation, whether to suit differing family or financial interests or as means of managing a collective block of property.

- 4.3. Where a tenancy is held by more than one person, national laws may make different provisions for the situation where one joint tenant wishes to leave the tenancy. The law may either end the whole tenancy or leave the other joint tenants with the tenancy, its benefits and liabilities.
- 4.4. For the purposes of valuation, the **owner's interest** in the tenancy will usually be seen as an investment interest unless the tenancy is very close to its end and at a Market Rent. There will often be evidence of market sales of similar investment properties that can be analysed to assist this valuation, directly as to value but also illustrating yield. The valuer should usually consider the expectations as to opportunities for vacant possession.
- 4.5. Where the tenancy is long term, either by contract or law, and the rent is below a current Market Rent, the landlord's interest in the property may have a lesser value as an investment:
- ▶ The present rent may be lower than a Market Rent (but could be more secure);
  - ▶ The reversion to vacant possession is more remote (and potentially uncertain).
- 4.6. There may be a need to value the **tenant's interest**. This can call for care in understanding whether this is to be:
- ▶ A Market Value of the tenant's interest;
  - ▶ A valuation for a transaction between the tenant and the landlord, so considering special value and especially marriage value (also known as synergistic value).
- 4.7. The value of the tenant's interest will be most obvious where the tenant has the ability to assign the tenancy for value with the potential for analysable comparables. This will, in principle, usually turn on the extent to which:
- ▶ The property is let at less than a Market Rent, as it might be where the rent is an old one without the means for it to be reviewed, is depressed by official rent control or where the tenant has improved the property with his work disregarded at a review;
  - ▶ How long that is expected to be the case.

The difference between the actual rent and the Market Rent can then be capitalised at an appropriate rate to give the premium that a bidder would pay to have that tenancy rather than another one of an equivalent property at a Market Rent. That figure might then be adjusted for other factors such as any end of tenancy

claims between the parties, as for dilapidations. The result of that assessment is what the market might expect to be paid for that tenancy as an asset.

- 4.8. However, the particular relationship of landlord and tenant can create a situation where it may be to their mutual interest to unlock value between them. This is most likely to arise where the investment value is below the vacant possession value of the dwelling. The difference between the two, called the vacant possession premium, can be unlocked by either party buying the other's interest and so uniting both ownership and occupation. The practical question of how that premium is divided between them will reflect the balance of motivations and circumstances in the case in question. Does the landlord desperately need to raise money or have non-financial reasons to gain possession? Does the property suit the tenant so well that he/she would prefer to be there with ownership control than anywhere else? Is the tenant likely to leave or die anyway? There is no necessary reason for the value of the premium to be divided equally between them and so this is a value to be found in the circumstances.
- 4.9. Such an assessment can see more value unlocked where the departure of a long term tenant might enable valuable redevelopment of the property, whether dividing a larger house into flats or a more comprehensive project. The approach would be the same but the value and motivations involved might be greater.
- 4.10. **Development tenancies** – An owner of a dilapidated property who cannot afford to renovate it but does not wish to sell it can have the option of leasing the property on terms requiring renovation by the tenant typically compensated by a low rent and/or a long lease.
- 4.11. **Multiple tenancies in one dwelling** – There are circumstances where a landowner may grant a long lease to a developer to build housing. The developer then sells the houses or flats on with long sub-leases which are re-saleable in the market place. The developer may then retain or sell the head lease, whether to an investor or a body that will manage the property on behalf of sub-tenants (national legislation may prescribe structures for this).
- 4.12. **Valuation of long residential leases** – Such leases for residential occupation may be for such a length of time and so transferable that they may have much of the practical character of ownership albeit subject to a rent (whether nominal or substantial) and other restrictions.

4.13. This creates valuation issues such as:

- ▶ Valuing the interest of the ultimate owner, with a long term right to a very secure, often low (but sometimes increasing) rent and the ultimate reversion;
- ▶ Valuing the head tenancy with its income from the usually still low rents but perhaps also liabilities to the property, whether just to the common parts of the estate or more generally. The levels of those sub-rents will reflect market circumstances in that a developer will usually want capital receipts to make an immediate profit to cover costs, rather than a longer term income stream. Capital receipts are maximised by setting the rents for the long term house leases at low values. Higher rents would reduce the ability of the purchasers of the sub-leases to buy with mortgage finance and that liability would directly reduce their free income to repay the mortgage;
- ▶ Valuing the residential leases as time passes for everything from sale or re-mortgage to divorce or lease extension. The issues become more critical as the remaining term of the lease reduces with time. That effect is enhanced in markets where residential values are reliant on mortgage finance. Where properties are more likely to be bought by people who can buy outright, values can reflect their preferences more directly. As examples, it might be that:
  - ▶ If a residential lease has over 100 years left to run, its value may be very close to that of an ordinary freehold;
  - ▶ If it has less than 30 years to run, any buyer knows that the resale value will fall shortly and so bid less themselves;
  - ▶ Where the purchase is likely to be assisted by a mortgage secured on the lease, then the mortgage company's concern for its security will reduce the sum it will offer as the outstanding term of the lease falls below, say, 80 years left to run. With mortgage lasting say 25 years, the lender is interested in the potential for resale throughout that period. Those concerns will then have a wider effect for properties in markets influenced by mortgage finance.

4.14. That can lead such a tenant to want to negotiate with the landlord for a new or extended lease, whether within any statutory framework or otherwise. Valuations of the various interests involved will be important to those negotiations.

4.15. There may be particular national structures for long residential leases, such as the *amphythéose* in France, and they may more generally be governed by specific national legislation.

- 4.16. **Rental Value** – While the situations discussed here commonly assume an arrangement at an agreed rent between parties acting independently of each other, there may be cases where tax law will require the assessment of a Market Rent between parties seen to be connected. Thus, where a child leases a house from a parent at a low rent, tax law might assume a Market Rent when assessing the parent's income to tax. That Rental Value would then need to be provided.
- 4.17. The process would be exactly the same as with any other determination of a residential Market Rent, relying on an appraisal of the property, a knowledge of rents in the relevant market place and a consideration of the terms of the tenancy agreement or other obligations including those as to repairs.
- 4.18. National law may require the rent to be assessed on a different basis, as in areas subject to one of the forms of statutory rent control whether that:
- ▶ Requires the rent to be set on a particular basis (as say a 'fair' rent);
  - ▶ Limits how existing rents may increase.

Where this requires a valuation judgement, there will usually be body of national practices and decisions on disputes to assist that.

- 4.19. The valuer may then also need to consider the expectations as to opportunities to revert to a Market Rent or vacant possession value.
- 4.20. **Other statutory intervention** – National law may intervene on other matters than rent and security of tenure. There may be relevant issues arising over the quality and physical character of the dwelling that may require works or prevent it from being let. For example, the drive for improved energy efficiency of properties is being applied in some countries to limit the letting of the least efficient properties without some works being undertaken. The valuer will need to be aware of the issues relevant to the dwelling in question.
- 4.21. **Usufruct and similar interests** – Usufruct (other names may be used in some countries) refers to a form of limited property right found in civil law and mixed jurisdictions which unites both:
- ▶ The right to use or enjoy the property directly and without altering it; and
  - ▶ **The right to derive profit from it as by leasing out a dwelling** – The "*fruits*" are any renewable proceeds from the property. It is this aspect that distinguishes a usufruct from a simple right to occupy a property.



The asset itself is to be left intact as granted, with an obligation to maintain it and respect its character. The rights to sell, give, exchange alter or destroy the property constitute full ownership rather than a usufruct. In some jurisdictions, a usufruct may be held by multiple parties – if granted for a lifetime it would then run until the last death. A usufruct can be granted for a term, such as a lifetime or less; national law may limit the period for which a company can hold a usufruct. Any lease granted by the usufructuary must be for less than the length of the right.

- 4.22. The usufructuary can be required to account for the state of the asset at the end of the usufruct, making an initial record of condition or inventory helpful.
- 4.23. It can arise in some countries under inheritance law as a protection for the surviving spouse and children at the expense of other heirs. Mutually agreed reorganisation of that would commonly require valuation.
- 4.24. The usufructuary would usually have to meet the costs and taxes of occupation but property insurance may lie with the owner.
- 4.25. Aspects of the relationship between the usufructuary and the owner may be regulated by national law and courts.
- 4.26. Where a usufruct has to be valued, it will commonly be based on the value of the dwelling and the remaining expected life of the usufructuary or the outstanding period of the term of the grant. The value should be based on the property as it is, not as it might be developed by a full owner.
- 4.27. **Similar interests in property** – In common law systems, life interest in a dwelling would be very similar to a usufruct giving benefits to the holder but not a capital interest.
- 4.28. **Property subject to usufruct** – The owner of the property from which a usufruct right has been granted is commonly called a "*bare owner*" (sometimes the "*main proprietor*") with her/his interest being the bare or naked property (*nue propriété*). In a common law jurisdiction, that person would more usually be called a remainderman.
- 4.29. The bare owner cannot interfere with the usufructuary's use or enjoyment of the land within the rights granted but may seek to protect the property against misuse by the usufructuary.

- 4.30. The usufructuary may have to waive her/his right if the bare owner is to mortgage the property. Any sale, transfer or inheritance of the bare property would be subject to the usufruct.
- 4.31. Subject to any terms of the grant of the right or other relevant circumstances, the value of bare property is at best the current value of the expectation of the reversion on the end of the usufruct.
- 4.32. **Improvements** – Consideration may need to be given to whether the landlord or the tenant have improved or altered the residential property or added items to it.
- 4.33. Where a landlord improves a residential property during the course of a tenancy this may be for statutory, economic or personal reasons. It will usually have required the tenant's agreement for the landlord to have access to the property to effect the work. It may according to national law or any agreement with the tenant result in a rent increase or make possible a later increase in Rental Value – as on a subsequent letting.
- 4.34. A tenancy agreement may usually require the tenant to obtain the landlord's approval before making any significant works to the property. That agreement may consider how any substantial investment is to be handled whether by a providing basis for compensation if the tenant leaves while there is still value in the work, by an extension of the tenancy or by some other means. It might well be that the improvement would be disregarded at any rent review for the current tenant though it may add to the Rental Value for subsequent letting to a new tenant.
- 4.35. Where a tenant installs items, such as for heating or in kitchens, it may be a matter of fact and national law whether those items have become so fixed to the property that they belong to it and so should not be removed by the tenant later or at the end of the tenancy.
- 4.36. **Dilapidations** – Where the tenant's use of the property has caused it to deteriorate, whether by the tenant's actions or negligence, there may also be a need to value dilapidations at the end of tenancy. They might be offset against the tenant's deposit for the tenancy or be the subject of a financial claim against the tenant. It will be a matter of law whether that assessment is to be based on the cost of the remedial work or the diminution of the value of the property.

## 5. Residential caravan parks

Residential accommodation can be made available by a caravan park owner leasing sites on the park for permanent occupation in mobile homes. The site owner commonly provides all services and often other facilities. Transactions in the mobile homes, both purchase and sale, are commonly required to be with the park owner as part of the management of the park and as a business activity. Thus, the homes themselves will usually have limited value (their affordability and location being relevant to tenants) but the park overall may be valued as property managed by a business.

## 6. Inalienable and unassignable property

6.1. There can be valuable rights in property which the holder cannot sell or assign but which may still, on occasion, need to be valued.

6.2. This will typically arise where:

- ▶ A property has been given to a public body or charity on terms excluding its disposal so that it is preserved for the public good as is the case for some houses of historic, cultural or architectural importance. The asset may still have a positive value or have to be recognised as a liability;
- ▶ A dwelling has been leased to a tenant on a lease that forbids legal transfer, perhaps because the landlord wishes to control who occupies the property. That lease might still have value in itself, especially if it is at less than a Market Rent or offers other advantages compared to the market for equivalent properties. If it were a significant liability the tenant might seek to repudiate it.

Similar issues can arise where the tenant has the use of the property for life or a usufruct in a property.

6.3. Making a property inalienable does not remove its value. It does mean that the value cannot be realised as a capital sum while the capital value of the property is not available to secure lending. Nonetheless, there could still be reasons why someone might wish to pay to take such a property and it may offer valuable benefits or an income.

- 6.4. In some cases, it may be important to distinguish between the value of a business using the property and the value of the property itself. That may be most clear where the business is using a tenanted property which it cannot legally transfer but is at an under-rent.
- 6.5. Among the important questions for a valuer instructed in such a case are:
- ▶ **What is the purpose of the valuation?** It is useful to know if the dwelling is to be valued for a balance sheet, a divorce, a partnership dissolution, taxation, compulsory purchase or valued for rent. Valuing between parties such as landlord and tenant or family members might mean finding a fair or special value, often turning on synergistic or marriage value, rather than a Market Value. In some situations, the task might be to find the investment value of the dwelling to an individual;
  - ▶ **How absolute is the restriction on disposal?** While the position may vary between jurisdictions, it may be that the law offers a means for such a prohibition to be challenged in the courts.
- 6.6. In other circumstances, there may be the commercial opportunity to pay to have the prohibition removed by agreement with the person imposing it. In such cases, the situation becomes closer to those where there are statutory or contractual restrictions on who can own or occupy a property which can see varying levels of discount applied to an unencumbered value for sale. It may be that while the property is not technically inalienable, a complex ownership structure might make it so in practice, with substantial obstacles before disposal is possible.
- 6.7. Where a company owns the dwelling, then, while the company must remain the owner, the effective ownership may pass with the sale of the company but the critical valuation is likely to be of the company's shares.
- ▶ **Does the restriction allow or prohibit the dwelling being let on a lease (sub) lease for which a rent or premium could be taken?** Allowing the property to be leased out would offer a means to achieve value while preserving ultimate ownership and control;
  - ▶ **Is it the site of the dwelling that is inalienable or is the dwelling itself to be preserved as well?** That distinction may show whether or not there are development possibilities.

- 6.8. According to the circumstances and instructions, the standard approach to determining the capital value of such a property (as may be required for tax purposes) is to consider what someone would pay to acquire the interest in the dwelling subject to the restriction on disposal. One way to consider that is to:
- ▶ Take the property in question as it is;
  - ▶ Assume that the restriction is lifted to allow one disposal;
  - ▶ Recognise that the buyer or person or entity the property is to be legally transferred to would then be bound by the restriction.

and consider what would be the Market Value for that transaction.

- 6.9. That can be illustrated by a non-legally transferable long term tenancy of a dwelling for which the rent is the only issue and so there are no other factors in play:
- ▶ If the tenancy is already at a Market Rent and has no other attraction when compared to other equivalent properties, then it may have no value;
  - ▶ However, if the tenancy is at a rent well below the prevailing Market Rent for such a property that difference has a value based on the period for which it can be expected to last. That will give a value for the tenancy as an asset.
- 6.10. When considering the ownership of a dwelling, someone may see buying an inalienable interest as the equivalent of buying a lifetime's right to occupy it without rent and so a value can be approached that way, recognising the obligations of ownership in doing so.
- 6.11. Such situations call not only for careful analysis and review, but also clarity in reporting. That last point might be especially evident in a divorce case where a value may be put on the dwelling in accordance with the instructions to the valuer but it would be helpful to the parties and court in considering a division of assets to understand that, as an unsaleable property, this is not a realisable value, but one that is only available to the holder of the interest in question.



# **EVIP 4** Listed Residential Property (property protected by law)

1. Introduction
2. Scope
3. Terminology
4. Guidance
5. Valuation

## 1. Introduction

Buildings and structures that are officially listed as being of historic, architectural or other significance or in conservation areas can be identified all over Europe. They can be either state or private properties; they can be found in remote locations or city centres. There are many different types of listed or historic buildings. A valuer accepting an instruction to value a listed building should not only be familiar with the particular type of listed building but also be able to assess or find out whether a property to be valued is listed.

## 2. Scope

- 2.1. The scope of this Information Paper is to assist the valuer when instructed to value a building or structure that may be listed. Such properties may be of historic or architectural importance in their own right, or be located within conservation areas protected by different, but often equivalent, regulations.
- 2.2. Although the following paragraphs may assist in the valuation process for non-residential Historic or Ancient Monuments, this IP is not designed for them.

## 3. Terminology

- 3.1. **Listed building** – State or private property which, by decision of a public authority, is protected because of its architectural, historic or other significance.
- 3.2. **Listed Structures** – Although most listed structures are buildings, other structures such as boundary walls can also be listed.
- 3.3. **Conservation Areas** – Areas designated by law as being of special architectural or historic interest with the object of preserving or enhancing that character. Whether urban areas, town centres, villages or open countryside, dwellings and other buildings in a conservation area are protected, with development more tightly controlled. Other areas protected for ecological or habitat reasons are discussed below.



- 3.4. Protective designations not covered by this Information Paper are:
- ▶ **Historic and ancient monuments** – These properties are unlikely to be valued for conventional purposes though some may need assessment for public sector balance sheets. This Information Paper is only relevant to historic and ancient monuments with a current residential status;
  - ▶ **Nature areas** – They may, on occasion, include dwellings that need to be valued in which case the probable restrictions on use or development will need to be reviewed. Any residential development that may be approved within them, despite all restrictions, is likely to require the provision of compensatory habitat.

## 4. Guidance

- 4.1. Once a building is listed, it becomes subject to special planning controls whereby consent from competent authorities is required for works that affect its special interest. These works might be either internal or external and be anything from the smallest project to complete demolition. Consent has to be obtained for any alterations and demolitions. There may be additional costs of ownership or occupation such as heating, insurance (sometimes requiring specialist advice on re-building costs) and maintenance while parts of the property may, as historic features, not be usable or that use may be limited by other factors such as the presence of bats.
- 4.2. The valuer must be able to determine if the property to be valued is listed or is otherwise in a protected area. In most countries, the register of listed buildings is public and such information is accessible on the relevant authority's website. The client may often be able to advise on this, as where the status is mentioned in the property's documents, title deeds, architectural layouts or other state decisions. If the matter cannot be verified, that should be stated in the Report.
- 4.3. Where the property is identified as listed, the valuer should identify whether that is in respect of all or part of the property. It is not always the case that the entire building is listed; the listing may be of just the facade of the building, a single wall of the property or even the internal painting of a single wall. There may be a greater official tolerance of works to the building that do not affect the part that is listed and which may help maintain the building in good order.
- 4.4. Listed status may also be relevant to the requirement that a building meet minimum energy performance requirements or possess an energy performance certificate (EPC). Article 4(2)(a) of Directive 2010/31/EU on the energy performance

of buildings states that member states may decide not to set or apply the Directive's minimum energy performance requirements to *"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"*. Article 12(6) extends this exemption option to EPCs.

- 4.5. The valuer should also investigate and report whether the area surrounding the property is a conservation area or otherwise protected. Any restrictions that apply to the entire area could limit the use of the property or impose important restrictions on planning and construction.
- 4.6. There may be specific areas in the property that are to be available for public viewing, perhaps as a condition of beneficial tax treatment, the award of public grants to support the building or other reasons. This may limit the way the property may be used and impose additional costs.
- 4.7. The valuer should then identify the potential uses for the listed property, investigating whether there are restrictions on these and any potential for them to be changed or removed. A listed building may also offer opportunities for value, including possible tax advantages or grants, while the importance of maintaining buildings of the greatest interest may warrant permission for other enabling development to create the funds to do this.

## 5. Valuation

- 5.1. Before deciding on the appropriate approach to the valuation of a listed property, the valuer should consider the nature of the market in which it sits. In some markets, houses that are listed may be considered more attractive than other properties because of their character or because of their setting that is associated with their being listed; in others, their costs and limitations may reduce their value when compared to equivalent properties that are not listed. That discount may often be more likely still for non-residential properties, especially where a commercial use is considered.
- 5.2. It is important for the valuer to understand the procedures and standards required for works to a listed property, including its renovation, and how they differ from the rules for other property. It can take a significantly longer time to obtain all the necessary permits and approvals and their requirements may be more onerous. Works

to a listed building are likely to be more costly than for other buildings because of the higher costs of project managers and skilled workers with relevant expertise and of the materials used for the renovation and preservation of listed properties. Given the attention to detail that is likely to be required, works on listed buildings can take longer.

- 5.3. The valuation methods that could be applied to listed properties are the comparison, income and residual methods. The depreciated replacement cost (DRC) method could also be adopted in very specific circumstances but it will generally be inappropriate given both the complexity of estimating the depreciated construction cost for an equivalent property to a listed building and the questionable relevance of such a task in the light of the building's status.
- 5.4. The **comparison method** should, as for most properties, be the first choice of method for valuing a listed residential property. It is most suitable where there is an active market for similar properties in comparable circumstances.
- 5.5. Valuation may be more difficult where a listed property requires substantial renovation with housing as a potential use. The valuer should ideally use comparables that are in a similar condition and have the same permitted uses. Where these are not available, the adjustments required to use renovated properties as comparables for valuing a listed property needing renovation or vice versa are complicated and, without care, can lead to misleading results.
- 5.6. For the **income approach**, the **direct capitalisation** of income can only be applied to income producing properties and not to vacant properties in need of restoration. As unrenovated properties may not normally produce income, this method is likely to be of little use for them.
- 5.7. Another method that may be used is the **residual method**. This method can be adopted to estimate the current value of a listed property which is to be renovated. Under this approach, the valuer starts by assessing the value of the renovated property and then deducts costs for renovation, construction, marketing, legal fees and relevant taxes. The remaining sum would be seen as the current value of the existing construction. This requires very considerable care as it makes the value the difference between two estimates of substantial sums of money and so is sensitive to any variations or uncertainties about them. Thus, it requires a final review to consider if the result is genuinely a price that someone could be expected to pay.

- 5.8. One approach to this problem is to consider the costs of the required renovation and the related risks as to cost, time and success to help make that adjustment. For an unrenovated property, the valuer should take account of the costs of renovating the property, the time and professional input needed for design and securing permissions and then undertaking the building works with the potential complications associated with each stage. This task will be facilitated if the valuer is able to review the proposed designs and the construction contract.





# EVIP 5 Residential Tenancies and Rent Control

1. Official intervention in housing markets under pressure can take several forms of which rent regulation, often combined with other measures, is among the more common. While these regimes have traditionally been applied country-wide, there is now a trend toward their local application in particular cities or even areas of cities.
2. Although that regulation might apply to all tenancies, the management of social housing tends to be considered separately and so it is more commonly considered for tenancies of privately owned dwellings, sometimes only those let under particular statutory codes. Social security regimes that provide support for housing costs can serve to support rent levels in the private let sector, though such lettings may not be accepted as security by some lenders.
3. There is a range of typical forms for such regulation, including:
  - ▶ A simple cap on increases in agreed rents, sometimes linked to general inflation;
  - ▶ A means for a tenant to refer a proposed change in a rent to some form of review, sometimes using some concept of "*fair value*" which will depend on its statutory definition and judicial interpretation;
  - ▶ More thorough-going regimes in which rent control is buttressed by other regulation of lettings, notably those extending the tenant's security of tenure and possibly with additional protected rights of occupation for members of the tenant's family or household. That imposed security of tenure would make rent control more effective for tenants who intend to remain in the property.
4. Other approaches that can be found in pressured housing markets include regulation of who may occupy certain rental properties, for instance by the tenant's local origin, type of work or income level. That tends to limit the rent levels that can be achieved but this time by affecting the balance of supply and demand.

- 5. All such intervention is likely to have an effect on the value of affected properties –** Indeed, to the extent that it displaces either the supply of housing or the demand from would-be occupiers, it may also in turn have effects on the wider housing markets, in particular on the non-regulated segments.
  
- 6. The main critical factors for the value of a let dwelling under such regulation will typically be:**

  - ▶ The ability of the owner to recover possession of the property either for sale with vacant possession or for re-letting;
  - ▶ The extent to which the rent that can be achieved for the property is below the Market Rent.
  
- 7. Many markets with such regulation will have sufficient evidence of sales of let properties to use the comparative method of valuation relying on the figures achieved for other properties under the same regime. Equally, those factors in themselves bear on both the prime motives for holding investment property and the term and reversion analysis for the valuation of assets. It is, thus, relevant to the value if:**

  - ▶ The expectation of the reversion to vacant possession, with the option that that event would give to leave the let sector or to re-let, is distant and uncertain;
  - ▶ If the income from it is depressed.
  
- 8. Additional factors for the valuer may lie in how far other regulation may add to the costs of being a landlord or of changing tenants. That may be through:**

  - ▶ Requirements for improvements, whether for health and safety, energy efficiency or changing national standards for accommodation;
  - ▶ Restrictions on the extent to which tenants may pay for the costs of taking a tenancy (costs of preparing the inventory or the lease, seeking credit references, paying the estate agent's fee, etc.).
  
- 9. The valuer appraising a dwelling that is let or suitable for letting may take into account:**

  - ▶ The regime governing the rent and other key terms of the tenancy for, as relevant, the current letting and any prospective re-letting;
  - ▶ The current rent, how it may be reviewed and any rent for a new tenancy;
  - ▶ The ability or otherwise to re-let promptly and on what terms;



- ▶ The prospect and timing of vacant possession being available and the uncertainties attending that, as well as any opportunities for earlier possession. With a statutory security of tenure regime this may turn on life expectancy;
- ▶ Any legislation under which the tenant can extend the lease, pre-empt a sale or have the right to buy the dwelling;
- ▶ The evidence as to let and vacant capital values for such property;
- ▶ The availability of and terms for mortgage finance for the let property in question and the existence of buyers not needing to borrow;
- ▶ The current condition of the property and any market expectations or legal requirements for it to be improved.



# EVIP 6 Residential Valuations and Equity Release

1. There is a growing financial market in which a property owner pledges some or all of the value of a property, usually a dwelling, in exchange for an income for a period of years, or to death. This is often referred to as equity release, using unencumbered value in the property to secure money as income or capital.
2. It is a means to provide an income in retirement or old age, potentially supplementing a pension or funding social care. This commonly sees an insurance company taking the dwelling as security for a stated sum which is then recovered, typically at death. This market, shown by experience to be of greatest interest to property owners aged around 70, is thought likely to grow with the aging populations in most European countries.
3. With that structure, it can be seen to be similar to the various forms of **viager**, found in France as a property investment market (as well as the topic of Maupassant's nineteenth century short story, *Le Petit Fût*).
4. A conventional mortgage sees the sum lent fixed in nominal terms, secured on the property valued for the basis of the loan. That sum will commonly be reduced steadily by repayments of principal over the term of the mortgage. Even with an interest only mortgage, inflation will see that nominal sum erode in real terms. While the value of dwellings has tended to rise over time, price falls make it possible for the borrower to be in "*negative equity*" where the value of the dwelling as security is less than the outstanding loan. In general and over time, repayments and inflation tend to reduce the risk of negative equity for the lender (and, indeed, the borrower if the dwelling is sold).
5. By contrast, where equity release is used as a source of income for the remainder of a life, the funder's risk of negative equity – the property being worth less at death than the income advanced – grows with time.

6. Thus, while it is for the funder to consider the actuarial and other issues involved, equity release agreements depend on a valuation of the property on which the agreement is based. That valuation can only be at the time of the agreement. The funder can consider how little income to advance on that value but, in a competitive market, other funders may seek to bid for the business and the property owner might not accept a poor deal.
  
7. A distinctive set of risks attend an equity release mortgage, particularly the risk of the condition of the property decaying over time. The arrangement is often taken because the property owner has little income; the additional income may not be sufficient to enable repairs. Advancing age, deteriorating health and potential move to a care home tend to mean that the property is not always kept in full repair, re-decorated or modernised in ways that preserve its marketability. That may have differing effects on Market Value for different properties in different markets and times, sometimes limited but sometimes significant, but is always risk assumed by the funder.
  
8. Negative equity at death may lead to attempts by insurers to recover value from other assets of the deceased. That may be answered by a "*no negative equity guarantee*" from the insurer. It might however not apply where, for example:
  - ▶ The borrower repays the loan early without selling the property;
  - ▶ The borrower's beneficiaries wish to keep the property after the borrower has died or moved permanently into long-term care and intend to repay the loan from funds other than the proceeds of sale;
  - ▶ The property is sold, but not at Market Value;
  - ▶ The property has not been kept "*in a good state of repair*".
  
9. Given the issues involved for the property owner and the funder, equity release is likely to be increasingly regulated by the financial authorities.
  
10. How might such issues be taken into account?
  
11. The agreement might include conditions such as requiring maintenance to be undertaken so that, at the least, the property is kept "*in a good state of repair*" or, alternatively, requiring the owner to make insurance provision for this issue. In reality, such provisions may prove difficult to monitor or to enforce and attempts to do so may create more financial stress or difficulty. It could also be in breach of the developing regulation of this market addressing concerns about aging and vulnerability.

12. The valuer is likely to be the only person who has visited the property. The valuer will have given a professional opinion as to the current value of the property but cannot give a valuation for a future date, least of all for the unknown date of death. There are at least two other ways in which the valuer could provide value for an equity release arrangement:
- ▶ By advising as to the current value of the property on the special assumption that it is in a poor state of repair;
  - ▶ If instructed to provide revaluations at specified intervals to assist any review clauses in the agreement.



# **EVIP 7** Advanced Statistical Models

1. Definition
2. Introduction
3. Commentary
4. European Banking Authority criteria for advanced statistical models for valuation and EVS commentary
5. The valuer's use of statistical tools

EVS adheres to the European Banking Authority's Guidelines.

## **Relevant excerpts from the EBA Final Report – Guidelines on loan origination and monitoring; 7 Valuation of immovable and movable property; 7.1 Valuation at the point of origination – 29 May 2020**

209. At the point of origination, institutions should ensure that the value of all immovable property collateral for loans to consumers and micro, small, medium-sized and large enterprises is assessed by an internal or external valuer using full visit with internal and external assessment of the property.

210. As a derogation from paragraph 209, for the purposes of a valuation of residential real estate in well-developed and mature property markets, the value may be assessed by means of a desktop valuation, carried out by an internal or external valuer and supported by advanced statistical models. The valuer remains responsible for the valuation, while the advanced statistical models should be used as supporting tools, meeting the conditions set out in Section 7.4, and including a confidence measure to indicate the robustness of the value proposal and other relevant property-specific information. In this case, the value proposal should be assessed, reviewed and approved by the internal or external valuer, who should understand all inputs and assumptions considered in the model. If the confidence measure in the supporting advanced statistical model indicates low robustness, and/or other property-specific information gives rise to uncertainty about the value proposal, the valuer should choose a valuation method other than desktop valuation.

[...]

225. When the conditions for a review in accordance with Article 208(3)(b) of Regulation (EU) No 575/2013 are met, institutions should update the value of the immovable property collateral by means of a revaluation carried out by a valuer who is potentially supported by appropriate advanced statistical models that meet the conditions set out in Section 7.4 and account for individual characteristics of the property and geographical area. Institutions should not use these models as the sole means of the revaluation.



## 1. Definition

- 1.1. **Advanced statistical models** are the most modern and sophisticated automated valuation models (AVMs), statistically-based computer programmes which use property information to generate property-related values or suggested values.
- 1.2. **A statistical method of valuation** seeks to arrive at the value of a property directly through the application of a mathematical algorithm to a data base of transaction prices and property characteristics whilst omitting a professional valuer's qualitative assessment of the value.

Hence, in the context of real estate valuation, an AVM is simply the mechanical application of an algorithmic procedure to the data presented to it, without taking into account a valuer's opinion as to other relevant information, without a physical inspection of the property and ignoring the weighting a valuer would place on the relevant information.

- 1.3. A stand-alone AVM estimate is not a valuation and cannot give a Market Value as defined by EVS 1. It can be used by qualified valuers as one input in their comprehensive analysis of the market provided they are satisfied with their knowledge of the AVM's input data and model.

## 2. Introduction

- 2.1. Used as a tool for valuing properties quickly and at low cost, AVMs have intrinsic limitations:
  - ▶ They can only work from the figures for the transactions reported without information or insight into their context;
  - ▶ There is no inspection of the property. They must rely on an implicit assumption that the property is in marketable condition;
  - ▶ Limited coverage of relevant data in some areas;
  - ▶ Limited coverage of relevant recent data for some properties;
  - ▶ A limited ability to reflect any unique characteristics of the property;
  - ▶ They are unlikely to be relevant for specialist properties.

There is little hard impartial evidence in the public domain or independent evaluation of the accuracy of AVMs for individual properties as European AVM manufacturers are reluctant to release details and the underlying data or the construction of the algorithms are not made available for analysis<sup>1</sup>.

2.2. Those limitations have less potential negative consequences concerning the standard uses of AVMs in considering properties collectively, as for:

- ▶ Banks identifying property that needs revaluation;
- ▶ In-arrears assessment in banks;
- ▶ Identification of fraudulent activity in banks;
- ▶ Full valuation audits in banks;
- ▶ Determining capital adequacy ratios in banks;
- ▶ Mark-to-Market portfolio of properties in banks;
- ▶ Mass Appraisal for local taxes by government;
- ▶ Estimating relocation compensation by government;
- ▶ Cost/Benefit analysis for potential public expenditure.

2.3. In recent years, AVMs have become much more widespread as a result of a drive towards rationalisation in the property and financial sectors. Abusive use of AVMs was one of the reasons for the financial crisis, as was stated in the final report of the parliamentary committee of inquiry of 27 January 2016 regarding the **Irish banking crisis**<sup>2</sup>:

*"More widely, however, the demand for asset valuations increased significantly as the property boom took hold and reliance on informal valuation standards, such as 'desktop' and 'drive-by' valuations, became more prevalent. These did not involve any physical inspection of the property, but were a limited (and sometimes fully automated or computer generated) process of estimating value. A Central Bank review of financial institutions found that many used these informal valuations as if they were formal valuations.*

*[74 – Central Bank Report, Valuation Processes in the Banking Crisis – Lessons Learned – Guiding the Future, 18 December 2012, PUB00252-008]*

1 [http://www.tegova.org/data/bin/a591190c05b2c3\\_Geoge\\_Matysiak\\_Valuation\\_Report.pdf](http://www.tegova.org/data/bin/a591190c05b2c3_Geoge_Matysiak_Valuation_Report.pdf)

2 <https://inquiries.oireachtas.ie/banking/wp-content/uploads/2016/01/02106-HOI-BE-Report-Volume1.pdf>

*A number of developers gave evidence that they continued to rely on professional valuations.*

*Valuations exert significant impact on a financial institution's credit risk management. As mitigation against risk, it is imperative that the valuation process is robust and that the value attributed to the underlying assets can be relied upon when fully assessing the risk of a credit decision or the ongoing management of the loan. For that reason a reliable valuation document is central to the credit risk decision."*

*[75 – Central Bank Report, Valuation Processes in the Banking Crisis – Lessons Learned – Guiding the Future, 18 December 2012, PUB00252-016]*

- 2.4. As they can only work by projecting forward from past data, they are likely to be pro-cyclical in effect at points where the relevant market is turning.
- 2.5. These intrinsic drawbacks and their contribution to the financial crisis inspired the restrictions on use of AVMs laid down by the EU legislator.

### 3. Commentary

- 3.1. *"209. At the point of origination, institutions should ensure that the value of all immovable property collateral for loans to consumers and micro, small, medium-sized and large enterprises is assessed by an internal or external valuer using full visit with internal and external assessment of the property."*
  - 3.1.1. This is the default principle.
- 3.2. *"210. As a derogation from paragraph 209, for the purposes of a valuation of residential real estate in well-developed and mature property markets, the value may be assessed by means of a desktop valuation, carried out by an internal or external valuer and supported by advanced statistical models. The valuer remains responsible for the valuation, while the advanced statistical models should be used as supporting tools, meeting the conditions set out in Section 7.4, and including a confidence measure to indicate the robustness of the value proposal and other relevant property-specific information. In this case, the value proposal should be assessed, reviewed and approved by the internal or external valuer, who should understand all inputs and assumptions considered in the model. If the confidence measure in the supporting advanced statistical model indicates low robustness, and/or other property-specific information gives rise to uncertainty about the value proposal, the valuer should choose a valuation method other than desktop valuation."*

**3.2.1.** This is a derogation from the default principle, allowed only under three cumulative conditions:

- ▶ It is allowed only for residential real estate. All other forms of real estate require full visit with internal and external assessment of the property;
- ▶ The advanced statistical models are never sufficient by themselves. They are restricted to serving as supporting tools for a valuer carrying out a desktop valuation and who remains responsible for the valuation;
- ▶ If the AVM's obligatory confidence measure is not robust and/or other property-specific information gives rise to uncertainty about the AVM's value "*proposal*", then the valuer "*should choose a valuation method other than desktop valuation*" which necessarily means either a full visit with internal and external assessment of the property or a drive-by.

**3.3.** *"225. When the conditions for a review in accordance with Article 208(3)(b) of Regulation (EU) No 575/2013 are met, institutions should update the value of the immovable property collateral by means of a revaluation carried out by a valuer who is potentially supported by appropriate advanced statistical models that meet the conditions set out in Section 7.4 and account for individual characteristics of the property and geographical area. Institutions should not use these models as the sole means of the revaluation."*

**3.3.1.** The reference is to the Capital Requirements Regulation and review of the valuation "*when information available to institutions indicates that the value of the property may have declined materially relative to general market prices*".

**3.3.2.** The revaluation is carried out by a valuer who is potentially supported by appropriate advanced statistical models.

**3.3.3.** Here too, the models should not be "*the sole means of the revaluation*". A valuer must be in charge.

## **4. European Banking Authority criteria for advanced statistical models for valuation and EVS commentary**

*(full reproduction of EBA Guidelines on loan origination and monitoring; 7 Valuation of immovable and movable property; section 7.4)*

**4.1.** *"236. Institutions should set out, in their policies and procedures, the criteria for using advanced statistical models for the purposes of valuation, revaluation and monitoring the values of collateral. These policies and procedures*

*should account for such models' proven track record, property-specific variables considered, the use of minimum available and accurate information, and models' uncertainty."*

**4.1.1. EVS commentary** – Credit institutions should familiarise external and internal valuers with these policies, procedures and criteria.

**4.2.** *"237. Institutions should ensure that the advanced statistical models used are: a. property and location specific at a sufficient level of granularity (e.g. postcode for immovable property collateral); b. valid and accurate, and subject to robust and regular backtesting against the actual observed transaction prices; c. based on a sufficiently large and representative sample, based on observed transaction prices; d. based on up-to-date data of high quality."*

**4.2.1. EVS commentary** – Credit institutions should ensure that external and internal valuers are familiarised with all of these characteristics.

**4.3.** *"238. When using these advanced statistical models, institutions are ultimately responsible for the appropriateness and performance of the models, and the valuer remains responsible for the valuation that is made using an advanced statistical model. Institutions should understand their methodology, input data and assumptions of the models used. Institutions should ensure that the documentation of models is up to date."*

**4.3.1. EVS commentary** – As the valuer remains responsible for the valuation that is made using an advanced statistical model, the credit institution should also make the valuer familiar with the methodology, input data and assumptions of the models used.

**4.4.** *"239. Institutions should have adequate IT processes, systems and capabilities in place and sufficient and accurate data for the purposes of any statistical model-based valuation or revaluation of collateral."*

## 5. The valuer's use of statistical tools

**5.1.** An AVM is never more than a tool contributing to valuers' estimation of value, for which they remain responsible. Furthermore, a stand-alone AVM estimate is not a valuation and cannot give a Market Value as defined by EVS 1. It can be used by qualified valuers as one input in their comprehensive analysis of the market provided they are satisfied with their knowledge of the AVM's input data and model.

## 5.2. Statistical techniques

- 5.2.1.** As discussed in EVS 4 – The Valuation Process, a professional valuation relies on the valuer appraising the property in its context, researching and verifying all matters having a bearing on the value of the property.
- 5.2.2.** The quality of the information will impact the quality of the valuation, so the valuer will need to verify any information sources, including their date. The valuation is the culmination of the valuer's investigations – in which visiting and inspecting the property play a key part – and research of all information and file notes, demonstrating the valuer's skill in bringing together data from all the various sources, using that information efficiently and providing a considered opinion.
- 5.2.3.** EVS Part II (Valuation Methodology) discusses the importance of analysing the market. The examination, investigation and analysis of the available market evidence is one of the most important parts of the valuation process. 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.
- 5.2.4.** Analysis of market evidence is possible using sophisticated techniques such as:
- ▶ Regression analysis, both linear and non-linear;
  - ▶ Time series analysis;
  - ▶ Geographically weighted models.
- 5.2.5.** Mathematical or statistical techniques can only serve as an assistance to the valuer. Valuers' estimate of the value of the property has to be based on their best and sound judgement drawing on their professional skill applied to their knowledge of the property market.
- 5.2.6.** 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;
  - ▶ The analytical technique it uses.
- 5.2.7.** Valuers must be very cautious in using any analytical tool as an integral part of their valuation reports, since the final opinion of value is their sole responsibility.
- 5.2.8.** If the valuer is satisfied with her/his knowledge of the input data and its relevance, he/she may use analytical tools as support in, for example:

- ▶ Statistical analysis of the prices/rents in a particular segment of the property market, stating which data have been used and which model;
  - ▶ Preparing maps of selected sales/rents.
- 5.2.9.** The valuer must also explain the input data and source, offering transparency to the client.
- 5.2.10.** Most often, the valuer will use descriptive statistics such as: coefficient of co-variation, mean value, median, mode, standard error, standard deviation, range, minimum, maximum, number of samples.
- 5.2.10.1.** Based on such comprehensive market analysis, the valuer may be able to derive key inputs which will be applied as a component of the valuer's EVS-compliant valuation process.

### 5.3. Models

- 5.3.1.** As huge volumes of data about real estate become more readily available, a widening range of models based on statistical analysis becomes available on the market.
- 5.3.2.** AVMs are one class of statistical model, often a combination of complex models producing a price estimate of a property at a specific date.
- 5.3.3.** AVMs typically comprise the following standard components:
- ▶ Input data;
  - ▶ The predictive model with the mathematical rules used to calculate the estimated price (algorithm). This is no more than an automated mathematical calculation, and not an exercise in valuation judgment;
  - ▶ The outputs of the model (price estimates).
- 5.3.4.** AVMs use large scale of data from various sources. In order to use data as selected by the AVM, the valuer must know:
- ▶ The scope of the data source used by the AVM (regional, national, all transacted properties, only mortgaged properties ...);
  - ▶ The type of data (sale prices, asking prices, valuation results);
  - ▶ The volume and homogeneity of data under investigation;
  - ▶ How regularly the source of information is updated;
  - ▶ The criteria applied by the AVM provider for the inclusion or exclusion of data.

and then consider its relevance to the property.

- 5.3.5.** Valuers must understand the predictive model used and assess their confidence in it and in its strengths and deficiencies as a representation of the market.
- 5.3.6.** When valuers consider information supplied by a third party, they must be sure that it is credible enough to be relied on. As valuers have sole responsibility for the valuation opinion, they must decide if they can rely on any of the data provided by the AVM.
- 5.3.7.** When valuing the property, valuers can only use the output from the AVM as one possible element in their consideration of indications of value.







V.

Measurement,  
Education and  
Qualifications



# 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. Definitions

### 3.1. General definitions

3.1.1. 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.

3.1.2. 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.

### 3.1.3. 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 (m<sup>2</sup>);
- ▶ 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 (m<sup>3</sup>).

#### 3.1.4. 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.

#### 3.1.5. 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.

#### 3.1.6. 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.

**3.1.7. 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.

### **3.1.8. Typical issues**

- ▶ The area of the property as documented for the valuer may not be the correct one. Older documentation may be obsolete;
- ▶ 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;
- ▶ 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;
- ▶ 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;
- ▶ **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;
- ▶ 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;
- ▶ 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.



- 3.1.9.** Valuers should cite the source (and its date) for the property area reported in their valuations.
- 3.1.10.** 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.

## **3.2. Specific definitions of building areas**

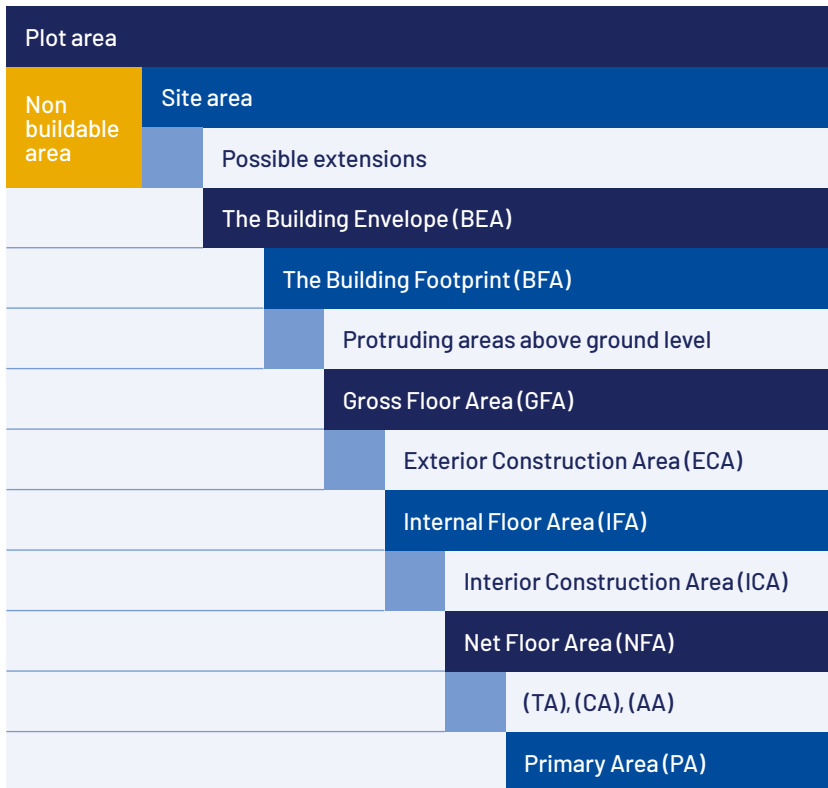
- 3.2.1.** **Site area** is the part(s) of the plot area used for one or more buildings or intended for their construction.
- 3.2.2.** **The Building Envelope Area (BEA)** is the plan of the part of the site area that is physically occupied by the building both above and below ground, using its maximum dimensions.
- 3.2.3.** **The Building Footprint Area (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.
- 3.2.4.** **Gross External Area (GEA, 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*").
- 3.2.5.** **Exterior Construction Area (ECA)** is the area of the perimeter walls themselves.
- 3.2.6.** **Gross Internal Area (GIA, also called Internal Floor Area (IFA))** is the Gross External Area after deducting the Exterior Construction Area ("*intra muros*"). Thus,  $GIA = GFA - ECA$ .
- 3.2.7.** **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.
- 3.2.8.** **Net Floor Area (NFA) (also called the Effective Floor Area)** is the Internal Floor Area (IFA) after deducting the Interior Construction Area (ICA). Thus,  $NFA = IFA - ICA$ .
- 3.2.9.** **Gross Lettable Area (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.

**3.2.10. Areas for Technical Services (TA), circulation (CA), amenities (AA) etc.** are the areas common to all users, measured as Net Floor Area.

**3.2.11. 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 – Technical 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)

- ▶ 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.
- ▶ 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)

- ▶ 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);
- ▶ Measurements are to be taken at a specified height above the floor. Where ceilings are sloping, valuers should explain how they have 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:

- ▶ 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);
- ▶ Measurements are to be taken at a specified height above the floor. Where ceilings are sloping, the rules for measurement must be specified;

- ▶ 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:

- ▶ Those areas set aside for the provision of facilities or services to the building not for the exclusive use of occupiers of the building;
- ▶ 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).*

- ▶ 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

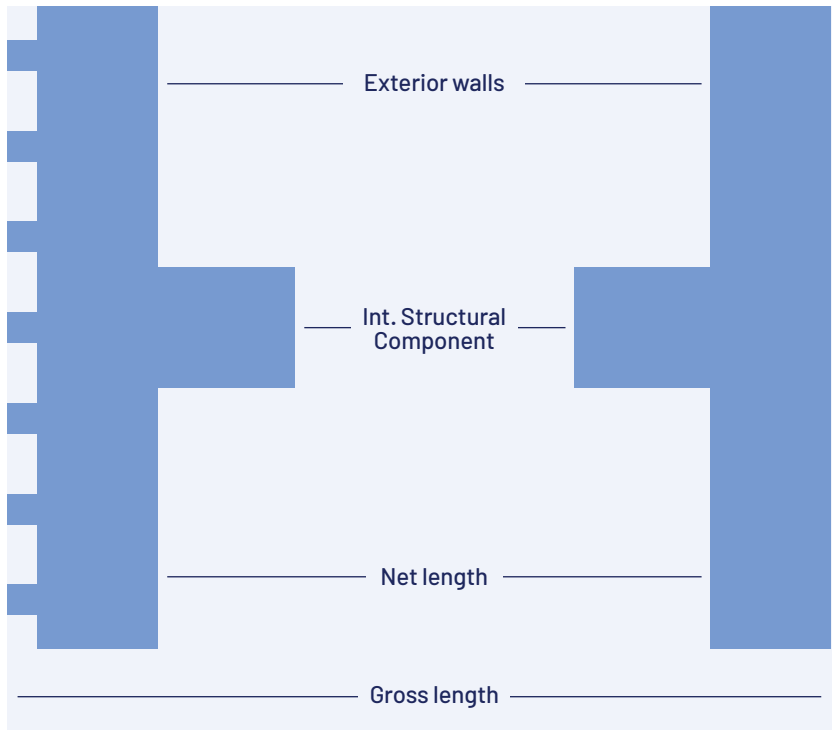
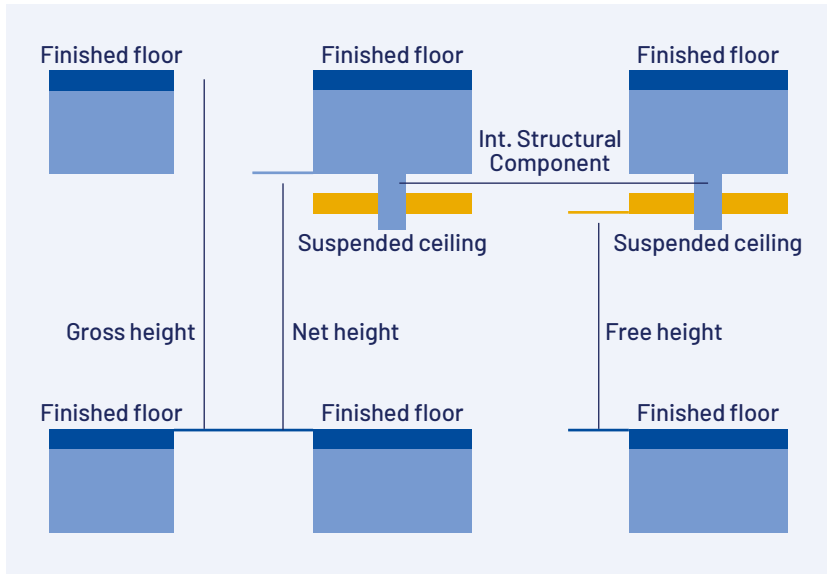


Figure 3 – Illustration of bases for measuring heights of buildings



## 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.

## 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.





# 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.
- 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.
- 1.3. MER requirements are equivalent to and consistent with the EU's Directive 2005/36/EC on the Recognition of Professional Qualifications. In applying MER, Member Associations in countries outside the EU must adopt the requirements of the 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 valuers will be specialists in particular sectors. Some geographical areas will be affected by factors that do not apply elsewhere and thus, the knowledge required there will vary. However, the essential disciplines of valuation will be fundamental to all valuers' 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 focused 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:
  - ▶ Understanding;
  - ▶ General knowledge; and
  - ▶ 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<sup>3</sup>;
- ▶ Government Policies and Land Use<sup>3</sup>;
- ▶ Valuation under Statute<sup>3</sup>;
- ▶ Valuation Standards<sup>3</sup>.

3 *Denotes in-depth knowledge required relative to the country and sector of practice.*



# Recognition of Qualifications by TEGOVA

## Recognised European Valuer (REV) and TEGOVA Residential Valuer (TRV)

The REV and TRV statuses are the marks of excellence in real estate valuation, demonstrating to international and local clients that the valuer is qualified to a consistent high European standard of practice. They are awarded by leading valuation associations across Europe.

The letters 'REV' and 'TRV' enable cross-border real estate investors to identify local valuers qualified to a recognisable European level. This gives both large and small local valuation firms the opportunity to tap into the steadily increasing market for pan-European investor clients.

Yet REV and TRV's greatest impact is on local clients. In times of economic uncertainty, local clients seek out professionals with special knowledge and experience who can help them make difficult investment and pricing decisions. Here, the competitive edge for REV and TRV valuers lies in their guaranteed minimum level of education and experience and the capacity to interpret global and local valuation impacts that comes from demonstrated familiarity with European Valuation Standards.

REV and TRV valuers display the initials 'REV' and 'TRV' after their name on their business cards, are provided with a numbered REV or TRV impress stamp on their Valuation Reports and appear on the TEGOVA REV/TRV online register consulted by clients and practitioners from all over Europe.

### Application and Awarding Procedures

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 a Full or Associate TEGOVA Member Association 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 by TEGOVA of awarding status AMA (for REV) or R-AMA (for TRV) to the Member Association. The second stage is the awarding of the recognition to the individual practicing valuer applicant by the AMA or the R-AMA.
  
4. To achieve awarding status, the Member Association 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 awarding Member Association.
  
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 her/his 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@tegova.org](mailto:info@tegova.org) or from the TEGOVA website [www.tegova.org](http://www.tegova.org).







# VI. European Valuers' Code of Conduct

TEGOVA expects valuers in its member associations to adhere, as a matter of personal responsibility, to this Code which is founded on:

- ▶ The principles of professional behaviour; and
- ▶ The expectation of clients that a valuation will be prepared professionally by a qualified valuer.

Valuers are to uphold and demonstrate professional standards in their work and so safeguard the trust placed in them by clients to whom a duty of care is owed, regulatory authorities and, more generally, by society.

This TEGOVA Code embeds the values of:

- ▶ Fairness;
- ▶ A proper professional respect for others and for standards;
- ▶ Responsibility and trustworthiness.

Such professional standards extend beyond the requirements of law (which bear on all persons) and require a duty of care to the client and respect for others, acting to the best of the valuer's ability without discriminating against individuals in respect of their nationality, ancestry, race or social origin, colour, religion, belief or political opinion, marital status, gender, gender expression or sexual orientation, age or disability.

A breach of this Code by a valuer may give rise to disciplinary action by the relevant member association and possible loss of the valuer's status as a Recognised European Valuer (REV) or TEGOVA Residential Valuer (TRV).

## The Code

- A. The valuer must act with honesty, integrity and diligence at all times with a duty of care to the instructing party and all others expected to rely on the valuation advice.
- B. The valuer must exercise professional judgement objectively and independently in undertaking work and, as relevant, honour the duties of a professional to a court, tribunal or equivalent forum.
- C. The valuer must maintain a level of professional knowledge and technical skill that is at least that required by the professional valuation body of which the valuer is a member or, for valuers who are REV or TRV, by those requirements, keeping up to date with professional matters and relevant current developments so as to be competent in professional practice.
- D. The valuer must be transparent and accountable to the instructing party in undertaking professional work for them.
- E. The valuer must avoid all actual or potential conflicts of interest regarding the property in question, the valuation process and the result of the valuation, must not have any direct or indirect interest in the property and must not be related to either the buyer or the seller of the property. The valuer must inform the instructing party in writing when a conflict of interest arises and before issuing the valuation report.
- F. When the client commissioning the valuation report is a credit institution, the valuer must not be involved in the loan application, assessment, decision or administration and must not be guided or influenced by the borrower's creditworthiness.
- G. The valuer must not disclose privileged or confidential information.
- H. The valuer must have or be subject to a procedure for handling complaints that may be made concerning professional conduct and must advise instructing parties in writing of its existence.

Where a valuation must be signed in the name of a valuation company rather than by a named individual valuer, this Code applies to the company and also to any individual employed by the company to undertake valuation work.



**VII.**

European Union  
Legislation and  
Property Valuation



- 1. General Introduction**
- 2. The EU Internal Market**
- 3. Health and Safety**
- 4. Energy**
- 5. Environment**
- 6. The Common Agricultural Policy**
- 7. Schedule of EU Legislation**

**Caution** – This text is prepared as a brief, general review of EU legislation as it may apply to property and/or property valuation. It offers signposts for, not guidance on, what are often complex technical subjects. Most of the legislation under review has been made by Directives. This means that Member States will generally have used their own legislation to implement it. Likewise, many provisions of Regulations may be incorporated and/or supplemented in national legislation. It is thus likely that there will be local features of significance as well as interactions with other domestic law.

The present text 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 1 October 2020. Where an issue is relevant to a valuation, the valuer is advised to seek further specific information or advice on appropriate points.

## 1. General Introduction

- 1.1. **European Union (EU) legislation and property valuation** – The 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. Legislation and policy relevant to the property are part of that matrix.
- 1.2. In particular, it should be underlined that EU legislation has an increasingly important impact on the use, management, associated costs, development opportunities and value of property. Indeed, whereas Article 345 of the Treaty on the Functioning of the European Union (TFEU) states that “[t]he Treaties shall in no way prejudice the rules in Member States governing the system of property ownership”, their general economic provisions do have an impact on property. This impact is twofold. EU legislation may of course directly apply to property or activities closely associated with its ownership, occupation or use. But the impact can also be indirect, where EU legislation applies to an activity on an area or site specific basis, creating opportunities or imposing limitations according to location.
- 1.3. For instance, while housing policy is not covered by the TFEU, the EU is active in legislating in a growing number of policy areas that affect property markets and professions. These include the promotion of energy efficiency and 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, 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 topics are reviewed in this chapter.

- 1.4. In some cases, EU legislation makes specific provisions for property valuation. 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 credit institutions by successive Capital Requirements Directives. Likewise, the State aid rules underline the need to have an independent expert valuation on the basis of generally accepted valuation standards.
- 1.5. **Scope of EU legislation** – For more than three decades, two particular areas of EU policy have developed enormously in ways that affect property and property valuation, namely the internal market programme and the environmental policy. In addition, the EU has adopted an array of instruments in relation to energy, health, safety and the Common Agricultural Policy which can also have direct and indirect effects on immovable property.
- 1.6. From its creation the EU has sought to promote the **internal market** in goods, services, labour and capital.
- 1.7. The creation of the internal market has had an impact on property markets. Indeed, while real estate, being '**immovable**', is not subject to EU law ensuring the free movement of goods between Member States, the TFEU and EU legislation do ensure the free movement of capital and so the ability to buy or sell property anywhere in the EU. In particular, the 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. In turn, this has affected matters relevant to valuations.
- 1.8. Its spirit and rules also influence legislation bearing on property. For instance, the EU framework for Value Added Tax (VAT) has a number of specific exemptions and reductions for transactions involving property. This affects transactions and has consequences for those who cannot fully recover VAT. In addition, reference can be made to the **Jäger case** (C-256/06) which 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. More generally, the non-discrimination provisions of EU law have forced changes in national taxation legislation.

- 1.9. The EU internal market legislation not only affects property markets and valuations, it also touches upon the profession of valuers. For instance, the Services Directive 2006/123/EC 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.
- 1.10. The increasing importance of the EU in driving **environmental policy** has led to the adoption of various instruments on various matters, such as resource protection, water, pollution, asbestos and biodiversity. Much of this affects property. For instance, policy on the protection of flora and fauna can affect both the potential for and the costs of land development. The classification of land for nature conservation and for subsidy purposes also has an influence on valuation of relevant property. Section 5 below reviews the main regimes as they may be relevant to property and/or property valuation. There are, however, other provisions that apply to individual sectors or issues which may be pertinent to specific properties.
- 1.11. The focus on measures to fight climate change is also reflected in the **energy policy**. In this context, property is seen not only to pose key problems of energy consumption and inefficiency to be tackled but also to offer solutions in terms of climate change mitigation and renewable energy as well as opportunities for the construction industry.
- 1.12. Finally, from almost the earliest days of the EU, the **Common Agricultural Policy** has affected rural property. At first, this influence was indirect through intervention in the market, in particular by supporting prices. Nowadays, the measures adopted as part of this policy may affect the use and value of agricultural land in several ways.
- 1.13. **Nature and impact of EU legislation** – Most of the EU legislation under review in the following sections has been made by Directives which Member States must implement into their legislation.
- 1.14. In particular, once a Directive is agreed it is binding as to the result to be achieved within the time specified by that Directive. The effect of a Directive will, thus, depend on how it is drafted. For instance, in **Commission v UK (C-56/90)** the Court of Justice of the European Union (CJEU) has ruled that where a Directive prescribes an outcome, such as a particular quality of bathing water, that outcome has to be achieved. In such a case, it is not sufficient to take all practical steps. Conversely, when a more general 'framework' Directive does not specify outcomes

so precisely, the compliance with that Directive and its assessment may turn more on the approach the Member States have taken.

- 1.15. In some cases, the European requirements will interact with other existing domestic regimes or be implemented alongside other domestic measures. In this context, the CJEU ruled in **Marleasing** (C-106/89) that national legislation must, as far as possible, be interpreted "*in the light of the wording and the purpose of the directive in order to achieve the result pursued by the latter*". Moreover, while EU Regulations apply directly in Member States, they are frequently covered by domestic legislation, supplying further operational matters to ensure an effective implementation.
- 1.16. In view of these elements, much of this common framework and increasing influence is not directly evident to many who are active in their local marketplaces. However, although much EU legislation is applied through national laws, that does not detract from the EU's key role as the source of much that affects the valuation of property.
- 1.17. **EU legislation and the EVS** – There follows a brief description of the main policy areas and instruments that, directly or indirectly, have an impact on property and/or property valuation. Considering the broad range of EU legislation, that has grown and seems likely to develop substantially, this text can of course not be exhaustive in its review of the Directives and Regulations affecting the valuation of specific properties, but outlines the most significant areas.

## 2. The EU Internal Market

### 2.1. Provisions on the Valuation of Property

#### 2.1.1. Valuation of Property for Company Accounts

- 2.1.1.1. **Statutory audits and auditors** – Companies have to prepare financial statements and provide a true and fair view of their financial position. The EU has introduced rules to ensure consistent and comparable financial reporting.
- 2.1.1.2. Directive 2014/56/EU amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts sets out the framework for statutory audits and the audit profession. A statutory audit is a legally required review of financial records. Statutory audits may only be carried out

by statutory auditors or audit firms approved by the Member State's competent authorities. Member States must keep a public register of these. Statutory auditors and audit firms should be independent when carrying out statutory audits and avoid conflicts of interest. Adequate internal organisation of statutory auditors and audit firms should help to prevent any threats to their independence.

- 2.1.1.3. Listed companies** – Regulations 1606/2002 and 1126/2008 provide that, with a view to harmonising the financial information and ensuring a high degree of transparency and comparability of financial statements, consolidated accounts of listed companies must be prepared in conformity with international accounting standards. These include the International Financial Reporting Standards (IFRS) which also provide standards on fair value measurement (*IFRS 13*).
- 2.1.1.4. Limited liability companies** – In the Accounting Directive 2013/34/EU, the European Commission introduced new requirements for the annual financial statements of limited liability companies. This Directive ensures the clarity and comparability of financial statements and allows for exemptions or simplifications in financial reporting obligations for micro-undertakings and SMEs. According to Article 6(1)(i) of this Directive, items recognised in the financial statements shall be measured in accordance with the principle of purchase price or production cost. However, Member States may permit or require the measurement of specified categories of assets (other than financial instruments) at amounts determined by reference to "fair value" (*Article 8(1)(b) of the Directive*).
- 2.1.1.5. Insurance companies** – In the case of insurance undertakings, Directive 91/674/EEC provides that Member States may permit or require that the value of land and buildings is assessed on the basis of the "Market Value" on the date of valuation. Article 49(2) of this Directive defines "Market Value" 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 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".

### Legislation

Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings

Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards

Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC

Commission Regulation (EC) No 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council

Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC

Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts

## 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 basic rules for calculating the amount of capital that a credit institution should hold against its liabilities. In order to calculate the capital that a credit institution is required to hold, the regulators apply a ratio to the value of the available assets depending on the class of the assets. For this purpose, there are also rules for assessing values of property on which lending has been secured, as this is one of the major asset classes involved.
- 2.1.2.2. The EU has addressed these issues in successive legislation on capital requirements. In 2013 the Capital Requirements Directive (CRD) IV package entered into force, comprising Directive 2013/36/EU and Regulation 575/2013. This package provides a regulatory framework for credit institutions and their operation.
- 2.1.2.3. The Capital Requirements Regulation 575/2013 lays down the following rules regarding the valuation of assets when assessing compliance with the Basel capital requirements:

- ▶ It provides the definition of "**Market Value**" for the purposes of immovable property, 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*" (Article 4(76));
- ▶ It provides the definition of "*mortgage lending value*" as "*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*" (Article 4(74));
- ▶ It defines an "*independent valuer*" as being "*independent from the credit decision process*" (Article 208(3)(b)).

2.1.2.4. The provisions for the regulation of banking, including those concerning the Basel requirements, are further developed and standardised by the European Banking Authority (EBA) in the so-called Single Rulebook. This document provides a set of harmonised prudential rules which institutions throughout the EU must respect. The EBA is also mandated to produce a number of Binding Technical Standards (BTS) for the implementation of the CRD IV package which, once adopted by the European Commission, will be legally binding and directly applicable as national law in Member States (unless otherwise agreed). Furthermore, the EBA is coordinating a Q&A process. Through this process, the EBA is in charge of answering questions from stakeholders on the practical implementation of the CRD IV package.

2.1.2.5. As one of the reactions to the 2008 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, for the valuation of real estate, European Valuation Standards were to prevail in the event of any conflict with other standards. In June 2018 the ECB has updated its manual for the Asset Quality Review which contains the methodology for assessing the valuations of bank assets from a prudential perspective. This manual (p.145) confirms the leading role of the European Valuation Standards:

*"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, with EVS-2012 taking precedence in*

*the event of any conflict (for the avoidance of doubt, this should be considered to apply throughout the document)."*

- 2.1.2.6. Further guidance on the valuation of immovable and movable property is provided in Section 7 of the EBA guidelines on loan origination and monitoring of 29 May 2020. These guidelines apply to any valuation, monitoring and revaluation of immovable property and movable property collateral conducted after 30 June 2021.
- 2.1.2.7. **Residential mortgages** – The EU has also put in place rules for the valuation of property for the purposes of lending to consumers, essentially residential mortgages. These rules are laid down in the Mortgage Credit Directive 2014/17/EU.
- 2.1.2.8. Among other matters, this Directive requires Member States to ensure that reliable valuation standards are used when assessing residential property for mortgage purposes. In this context, Recital 26 of the Mortgage Credit Directive states that for standards to be reliable they should take into account internationally recognised valuation standards, specifically mentioning the 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"*.
- 2.1.2.9. Article 19 of the Mortgage Credit Directive requires that property valuers be *"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"*.

### Legislation

Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC

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

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 and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010

Single Rulebook of the European Banking Authority

Manual for the Asset Quality Review of the European Central Bank

Guidelines of the European Banking Authority on loan origination and monitoring

### 2.1.3. Valuation of Property for Insurance and Reinsurance Institutions

2.1.3.1. **Solvency II and Omnibus II** – The insurance and reinsurance sector is governed by the Solvency II regime established by the Solvency II Directive 2009/138/EC. This framework Directive requires the Solvency Capital Requirement of each insurance and reinsurance institution to be calculated at least once a year. Member States must ensure that, unless otherwise stated, these institutions value their assets *"at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction"* (Article 75(1) of the Directive).

2.1.3.2. Recital (46) of the Directive states that *"valuation standards for supervisory purposes should be compatible with international accounting developments, to the extent possible, to limit the administrative burden [...]"*.

2.1.3.3. The Omnibus II Directive 2014/51/EU and Solvency II Delegated Regulation 2015/35 amended the Solvency II regime in a number of ways. For instance, Article 9(3) of the Solvency II Delegated Regulation provides that, where necessary, Article 75 of Solvency II Directive prevails over international accounting standards. In addition, Article 10(7) of the Solvency II Delegated Regulation gives guidance on the use of the market, income and cost approaches to valuation.

2.1.3.4. EIOPA Guidelines – Article 2(22) of the Omnibus II Directive provides that the European Insurance and Occupational Pensions Authority (EIOPA) can lay down technical standards on matters such as valuation. On 14 September 2015 the EIOPA issued Guidelines on recognition and valuation of assets and liabilities other than technical provisions (EIOPA-BoS-15/113). Guideline 3 regarding investment property and other properties provides that:

*"For the purposes of Article 10 of Delegated Regulation (EU) 2015/35 when valuing investment property and other properties, undertakings should select the method in accordance with Article 10(7) thereof that provides the*



*most representative estimate of the amount for which the assets could be exchanged between knowledgeable willing parties in an arm's length transaction. In accordance with Article 10(6) of that regulation these methods should be based on the following:*

*a) current prices in an active market for properties of a different nature, condition or location, or subject to different lease or other contractual terms, adjusted to reflect those differences;*

*b) recent prices of similar properties on less active markets, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices;*

*c) discounted cash flow projections based on reliable estimates of future cash flows, supported by the terms of any existing lease and other contracts and, when possible, by external evidence such as current Market Rents for similar properties in the same location and condition and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows."*

### Legislation

Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)

Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014 amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No 1060/2009, (EU) No 1094/2010 and (EU) No 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority)

Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)

Guidelines of the European Insurance and Occupational Pensions Authority of 14 September 2015 on recognition and valuation of assets and liabilities other than technical provisions

Valuation of Property for Alternative Investment Funds

**2.1.3.5. Legal framework** – Alternative investment funds, including real estate funds, hedge funds and private equity funds, are designed for professional investors and are regulated by Directive 2011/61/EU on alternative

investment fund managers (AIFM). This Directive has been supplemented by the Commission Delegated Regulation 231/2013.

**2.1.3.6. Valuation of assets** – The AIFM Directive introduced the following rules for the valuation of assets:

**2.1.3.7.** The process for valuation of assets and calculation of the net asset value should be functionally independent from the portfolio management and the remuneration policy of the AIFMs and other measures should ensure the prevention of conflicts of interest and of undue influence on the employees (*Recital 29*);

- ▶ The valuation procedures shall ensure that the assets are valued and the net asset value per unit or share is calculated at least once a year (*Article 19(3)*);
- ▶ Subject to certain conditions and qualifications, AIFMs should be able to appoint an external valuer to perform the valuation function (*Article 19(5)*).

### Legislation

Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision

### 2.1.4. Valuation of Property for State Aid Rules

**2.1.4.1. General** – With the promotion of the internal market, the EU has sought to regulate the extent to which governments and public bodies can use subsidies, both express and implied, as a protectionist tool, distorting the free operation of that market. The State aid rules have been a major part of this policy, providing a legal framework in which actions in Member States can be regulated, approved or forbidden. These rules have also been used to regulate the valuation of property, the methods for disposing of property and the management of State owned property.

- 2.1.4.2. The notion of State aid is defined in Article 107(1) TFEU that provides the following:
- "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."*
- 2.1.4.3. Accordingly, for a national measure to be considered as State aid, this measure must (i) give the recipient an economic advantage, (ii) be financed by the State or through State resources, (iii) selectively favour certain undertakings or the production of certain goods and (iv) distort competition and affect trade between Member States.
- 2.1.4.4. In 2016 the European Commission issued the Notice on the notion of State aid that gives general guidance on all aspects of the definition of State aid. In particular, the Notice explains when public spending falls within, and outside, the scope of EU State aid control. It also replaces previous Commission Communications and Notices, such as the Communication on State aid elements in sales of land and buildings by public authorities.
- 2.1.4.5. For property valuation the main element will be to determine the existence/size of an economic advantage.
- 2.1.4.6. The notion of "advantage" is not defined in the TFEU, but the CJEU has ruled that it is to be interpreted in a broad manner. It embraces not only positive benefits, but also interventions which mitigate the charges which are normally included in the budget of an undertaking and which, without being subsidies in the strict meaning of the word, are similar in character and have the same effect. In short, an advantage within the meaning of Article 107(1) TFEU can be defined as any economic benefit which an undertaking would not have obtained under normal market conditions.
- 2.1.4.7. Economic transactions carried out by public bodies (including public undertakings) do not confer an advantage, and therefore do not constitute State aid, if they are carried out in line with normal market conditions. To assess whether a range of economic transactions carried out by public bodies takes place under normal market conditions, the European Commission and the CJEU developed the market economy operator (MEO) test. The purpose of this test is to assess whether the public bodies acted as a market economy operator would have done in a similar situation. If this is not the case, the beneficiary undertaking has received an economic advantage which it would not have obtained under normal market conditions,

placing it in a more favourable position compared to that of its competitors. This principle has been developed with regard to different economic transactions. For instance, the "*market economy investor principle*" is used to identify the presence of State aid in cases of public investment. The "*private creditor test*" has been developed to examine whether debt renegotiations by public creditors involve State aid, comparing the behaviour of a public creditor to that of hypothetical private creditors that find themselves in a similar situation. Finally, the CJEU has developed the "*private vendor test*" to assess whether a sale carried out by a public body involves State aid, considering whether a private vendor, under normal market conditions, could have obtained the same or a better price.

- 2.1.4.8. In addition, in the **Altmark** judgment (C-280/00), the CJEU made clear that the granting of an advantage can be excluded as regards compensation for costs incurred to provide a service of general economic interest (SGEI).
- 2.1.4.9. **Valuation of public property** – The sale of public land must be considered in line with the private vendor test.
- 2.1.4.10. The application of this MEO test depends on the available information. In this context, a distinction should be made between situations in which the transaction's compliance with market conditions can be directly established through transaction-specific market data and situations in which, due to the absence of such data, the transaction's compliance with market conditions has to be assessed on the basis of other available methods.
- 2.1.4.11. The compliance with market conditions can be directly established through transaction-specific market information (i) where the transaction is carried out "*pari passu*" by public entities and private operators or (ii) where it concerns the sale (or other comparable transactions) of assets carried out through a competitive, transparent non-discriminatory and unconditional tender procedure in line with the principles of the TFEU on public procurement. In such cases, if the specific market information concerning the transaction shows that it does not comply with market conditions, it would not normally be appropriate to use other assessment methodologies to reach a different conclusion.
- 2.1.4.12. If a transaction has not been realised through a tender or if the intervention of the public bodies is not "*pari passu*" with that of private operators, this does not automatically mean that the transaction does not comply with market conditions. In such cases compliance with market conditions can still be assessed in the light of the terms under which comparable transactions carried out by comparable private operators have taken place in comparable situations (benchmarking) or on the basis of a standard

assessment method. According to the European Commission, *"such a methodology must be based on the available objective, verifiable and reliable data, which should be sufficiently detailed and should reflect the economic situation at the time at which the transaction was decided, taking into account the level of risk and future expectations"*. The appropriate assessment methodology may also depend on the market situation, data availability or the type of transaction. In this context, the European Commission underlines that *"in the case of sales of land, an independent expert evaluation prior to the sale negotiations to establish the Market Value on the basis of generally accepted market indicators and valuation standards is in principle satisfactory"*.

- 2.1.4.13. In a judgment of 22 May 2019 in relation to a settlement agreement concluded between Madrid City Council and the football club Real Madrid CF to offset the liabilities following a failed land swap, the CJEU confirmed that the value of a plot of land must be assessed taking into account the situation at the date of the transaction (judgment in the case T-791/16, **Real Madrid Club de Fútbol v Commission**). In the case at hand, the CJEU noted that, at that date, the plot at issue was part of public land and could not be transferred, it being only possible to grant a right of use. Accordingly, the value of the plot *"had to correspond to the value which it had for that city council, and thus to the right of use of that plot and not the hypothetical value it would have had had it been transferrable"*.
- 2.1.4.14. **State subsidies for social housing** – In many Member States the provision of social housing is qualified as an SGEI. The financing of social housing may therefore benefit from the so-called SGEI Package and be subject to less rigorous State aid control. In particular, the SGEI Decision 2012/21/EU exempts Member States from the obligation to notify public service compensation for providers of social housing to the European Commission.
- 2.1.4.15. This exemption is of course subject to the conditions laid down in the SGEI Decision. In particular, the State subsidies will only be exempted if they are specifically targeted at *"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"*. In the same vein, the CJEU has held that the qualification of social housing as an SGEI can only be upheld for the provision of accommodation to a clearly defined target group of disadvantaged citizens or socially less advantaged groups (judgment in the joined cases T-202/10 and T-203/10 RENV II, **Stichting Woonlinie and Others v Commission**). Activities such as the construction and renting out of apartments to higher income groups cannot qualify as an SGEI. In addition, the CJEU has underlined that it is for the Member State to demonstrate that it complies with this definition. In this context, a

reference to the maximum value of the dwellings is not acceptable because such reference is not linked to a clearly defined target group of disadvantaged citizens.

### Legislation

Article 107(1) of the Treaty on the Functioning of the European Union

Commission Decision of 20 December 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 (2012/21/EU)

Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)

## 2.2. Value Added Tax (VAT) and Property

### 2.2.1. General

2.2.1.1. **VAT Directive** – VAT is a tax on the value added in the supply of goods and services. The current EU legislation on VAT is laid down in the Seventh VAT Directive 2006/112/EC. This Directive provides a common framework regarding the scope of application (*Articles 1 to 30*), the way VAT is to be applied in the Member States (*Article 31 to 92*), the standard rates (*Articles 93 to 130*), the exemptions (*Articles 131 to 166*) and the deductions (*Articles 167 to 192*).

2.2.1.2. **Impact on property valuation** – VAT can be a significant factor in property transactions. With the significant VAT rates applicable in many Member States, failing to recognise the impact of VAT on a transaction could prejudice the property valuation. This is especially the case in markets where some buyers are not able to fully recover the VAT. The valuer should therefore understand or, if necessary, seek instruction on the VAT status of the property being valued. In particular, it will be important for a valuer to know whether the property is exempt or whether the exemption has been waived and, if it is subject to tax, what VAT rate applies to the property transaction at issue.

2.2.1.3. **Taxable persons and transactions** – In principle, VAT is applied to all transactions carried out in the EU for consideration (payment) by a taxable person, i.e. any individual or body that supplies taxable goods and/or services in the course of business (*Articles 12 and 13*). Taxable transactions include supplies of goods or services within a single Member State,

intra-EU acquisitions of goods (goods supplied and dispatched or transported by a business in one Member State to a business in another) and imports of goods into the EU from outside (*Articles 14 to 30*).

- 2.2.14. Transfer of rights, shares and interests** – Member States may consider the transfer of the following rights, interests and shares as a transfer of goods: (i) certain interests in immovable property, (ii) rights in rem giving the holder thereof a right of use over immovable property and (iii) shares or interests equivalent to shares giving the holder thereof de jure or de facto rights of ownership or possession over immovable property or part thereof (*Article 15(2)*).
- 2.2.15. Interpretation of VAT rules and concepts** – The rules and notions in the Directive constitute independent concepts of EU law which are to be interpreted solely under EU law (judgment in the case C-278/18, **Sequeira Mesquita**), unless when stipulated otherwise in the Directive. While a Member State's land and property law may be relevant in understanding the nature of the property transactions, it is irrelevant to the interpretation of the applicable VAT rules. When it is unclear how certain VAT rules should be applied, national courts may refer questions to the CJEU for a preliminary ruling on how the rules should be applied. Exemptions provided for in the Directive must be interpreted strictly (judgments in the cases C-278/18, **Sequeira Mesquita** and C 532/11, **Leichenich**).

## 2.2.2. The Supply of Land and Buildings

- 2.2.2.1. New buildings and building land** – In line with Article 12(1) of the Directive, the supply, before first occupation, of a building and of the land on which the building stands and the supply of building land are subject to VAT. Member States may apply criteria other than that of first occupation, such as the period elapsing between the date of completion of the building and the date of first supply or the period elapsing between the date of first occupation and the date of subsequent supply, provided that those periods do not exceed five years and two years respectively.
- 2.2.2.2. Existing buildings and other types of land** – The supply of buildings or parts thereof, land on which a building stands and land which has not been built on is, in line with Article 135(1)(j) and (k) of the Directive, exempted from VAT.
- 2.2.2.3.** However, according to Article 137(1)(b) and (c) of the Directive, Member States may allow taxpayers to opt for VAT on these transactions. If the taxpayer opts for this, VAT will be chargeable on the supply of property but

the taxpayer can recover the VAT on its inputs. The CJEU clarified that, for the purposes of this VAT exemption waiver, buildings or parts of buildings and the land on which they stand cannot be dissociated from each other (judgment in the case C-400/98, **Breitsohl**). Therefore, a taxable person who supplies both buildings and the land on which they stand may either use the VAT exemption for the buildings and the land taken as a whole, or opt for taxation of the whole.

- 2.2.2.4. The notions of "land" and "building"** – It is clear from the above that the VAT rules for the supply of land depend on the type of land supplied. It is therefore important to clarify the three types of "land" that the Directive distinguishes: building land, land on which a building stands and land which has not been built on.
- 2.2.2.5. Building land is defined as "any unimproved or improved land defined as such by the Member States" (Article 12(3) of the Directive).** The Directive leaves it entirely to the Members States to determine what is meant by the land on which a building stands (Article 12(2) of the Directive) and does not specify what is meant by land which has not been built on. However, the CJEU clarified that land which has not been built on but is intended to be built should be considered as building land even if at the time of the transaction the works have not yet started (judgments in the cases C-543/11, **Woningstichting Maasdriel**, C-461/08, **Don Bosco Onroerend Goed** and C-468/93, **Gemeente Emmen**).
- 2.2.2.6. A building is defined as "any structure fixed to or in the ground" (Article 12(2) of the Directive).**
- 2.2.2.7. One single supply or multiple supplies** – Where the supply of immovable property is accompanied by the supply of services or movable property linked to the immovable property, one should verify whether these supplies should be assessed separately from the point of view of VAT. For VAT purposes, every supply must in principle be regarded as distinct and independent. However, if a transaction comprises several elements, the question arises whether it is to be regarded as one single supply or as several distinct and independent supplies which must be assessed separately.
- 2.2.2.8. According to settled case-law of the CJEU, a transaction entailing several supplies must be regarded as one single supply if the supplies (i) form a single, indivisible economic supply, which would be artificial to split or (ii) consist of one principal supply in relation to which the other supplies are ancillary, i.e. when these supplies do not constitute for customers an end but a means of better enjoying the principal supply.**



- 2.2.2.9. Accordingly, where there is a single supply involving land on which a building stands and the supply of that land predominates, the whole transaction may be VAT exempt. Conversely, if the sale of land or buildings is ancillary to a taxable supply, it may be treated in accordance with the VAT status of that supply.

### 2.2.3. Leasing or Letting of Immovable Property

- 2.2.3.1. **VAT exemption** – Pursuant to Article 135(1)(l) of the Directive, Member States must exempt from VAT the leasing or letting of immovable property under conditions that they have to determine. However, according to Article 137(d) of the Directive, Member States may allow taxpayers to opt for VAT on these transactions.

- 2.2.3.2. **Scope of application** – Although the concepts of immovable property, letting and leasing are not defined by the Directive, they have to be analysed under EU law and not under the Member State's national laws.

- 2.2.3.3. The CJEU clarified that the concept of "*immovable property*" does not require that the property must be indissociably incorporated into the ground. It is sufficient that the property is not mobile nor easily movable, even where it is to be removed at the end of the lease. For instance, the CJEU considered as immovable property prefabricated buildings used as temporary housing which were bolted onto a concreted area, even though the buildings could be dismantled by eight persons in ten days and then re-erected elsewhere (judgment in the case C 315/00, **Maierhofer**). In the same vein, the CJEU decided that a houseboat without any propulsion system should be qualified as immovable property, on the grounds that it was immobilised on a river for many years and could not be removed without effort and considerable cost, was rented exclusively for the permanent operation of a restaurant discotheque and was connected to the water and electricity mains (judgment in the case C 532/11, **Leichenich**).

- 2.2.3.4. In order for there to be "*letting*" of immovable property within the meaning of the Directive, the transaction must satisfy the following characteristics: the conferring by a landlord on a tenant, for an agreed period and in return for rent, of the right to occupy that property as if that person were the owner and to exclude any other person from enjoyment of such a right (see, for instance, the judgment in the case C-278/18, **Sequeira Mesquita**).

- 2.2.3.5. The condition that the agreement should be concluded for an agreed period is interpreted rather broadly. It is not necessary that the period of the lease be fixed at the time the contract is concluded. Consequently,

granting a license to several businesses to share premises, with no set duration and a rent partly linked to the passage of time may be considered to be a lease (judgment in the case C 284/03, **Temco Europe**). However, as a general rule, the agreement may not be occasional and temporary (judgments in the cases C 55/14, **Régie communale autonome du stade Luc Varenne** and C 532/11, **Leichenich**).

**2.2.3.6.** A lease transaction in the meaning of the Directive also implies that the lessee has the exclusive right to occupy the property as if it was the owner. An agreement which grants only limited rights of possession or control on the immovable property concerned should therefore not be considered as a leasing agreement (see, to that effect, the judgment in the case C-275/01, **Sinclair Collins**). On the other hand, the mere fact that the tenant does not have the right to make changes to the property does not preclude an agreement from being qualified as a lease agreement (judgment in the case C-278/18, **Sequeira Mesquita**). As regards the exclusive nature of the tenant's right to occupy the property, it has been clarified that a restriction to this right does not preclude the occupation from being exclusive as regards all other persons not permitted to exercise a right over the property in question. A lease could therefore also relate to transactions where certain parts of a property must be used in common with other occupiers (judgment in the case C-284/03, **Temco Europe**). The same holds true where the property is occasionally occupied by another when the lessee is not using it for himself. For instance, by judgment of 3 March 2005 the CJEU ruled that the lease of (mooring) berths for boats fell within the scope of the exemption for leasing even though the berths were occasionally used by others when the lessee's boat was away (judgment in the case C-428/02, **Fonden Marselisborg Lystbådehavn**). In a more recent judgment, the CJEU ruled that an agreement whereby the owner grants a fishing club the right to fish in its ponds does not fulfil the condition of exclusivity if the owner reserves the right to fish in those waters for himself or one guest per day (authorised by the owner) (judgment in the case C 451/06, **Walderdorff**).

**2.2.3.7. Exceptions** – Article 135(2) of the Directive provides the following four exceptions to this VAT exemption:

*“(a) the provision of accommodation, as defined in the laws of the Member States, in the hotel sector or in sectors with a similar function, including the provision of accommodation in holiday camps or on sites developed for use as camping sites;*

- (b) *the letting of premises and sites for the parking of vehicles;*
- (c) *the letting of permanently installed equipment and machinery;*
- (d) *the hire of safes."*

- 2.2.3.8.** Member States may limit the scope of the exemption further but may not broaden it (*Article 135(2) of the Directive*). For example, the CJEU confirmed that Member States may decide to make all leasing and letting of immovable property liable to VAT except for residential property (judgment in the case C-12/98, **Amengual Far**).
- 2.2.3.9.** **One single supply or multiple supplies** – If a transaction comprises several elements, the question may also arise whether it is to be regarded as one single supply or as several distinct and independent supplies.
- 2.2.3.10.** In this context, the CJEU ruled that the lease of a restaurant together with the equipment and kitchen appliances constitutes one single supply (judgment in the case C 17/18, **Mailat**). In the same vein, the CJEU decided in its judgment of 28 February 2019 that the transfer of the use of vineyards which also entailed the transfer of certain assets and intangible rights was to be considered as one single supply (judgment in the case C 278/18, **Sequeira Mesquita**). In its judgment of 27 September 2012, the CJEU did not provide a straightforward answer to the question whether lease agreements which also cover the supply of services linked to the lease (such as the supply of water, heating, repair services, cleaning and security) should be considered as one single supply or multiple supplies (judgment in the case C-392/11, **Field Fisher Waterhouse**). In this judgment, the CJEU nonetheless clarified that the existence of a right to terminate the lease if the tenant fails to pay the service charges seems to indicate that there is a single supply. Moreover, the mere fact that a third party could in principle supply the services provided together with the lease, does not preclude that the lease and the services could constitute one single supply.
- 2.2.3.11.** Conversely, the qualification of letting does not apply if the transaction essentially concerns the supply of services rather than simply making property available. In this respect, the CJEU observed that making available sport facilities such as a golf course or a football stadium generally entails not only the passive activity of making the course available but also a large number of commercial activities. In such cases, the use of the facilities will only qualify as a lease if it constitutes the main service supplied in the transaction (judgments in the cases C-551/15, **Pula Parking** and C-150/99, **Stockholm Lindöpark**).

## 2.2.4. Works to Property

- 2.2.4.1. **Optional reduced rates** – Directive 2009/74/EC amended the VAT Directive to allow Member States to adopt reduced VAT rates on certain transactions. These rates may not be less than 5 per cent, unless the Member State applied a lower rate on 1 January 1991 (*Articles 98 and 110 of the Directive*). As this is an option which each Member State can take up or not, valuers should verify the applicable rate in the Member State in which the works are carried out.
- 2.2.4.2. **Scope of application** – In particular, Member States may apply a reduced VAT rate in relation to the *"provision, construction, renovation and alteration of housing, as part of a social policy"* (*Annex III(10) of the Directive*). Likewise, a reduced VAT rate may be applied to the *"renovation and repairing of private dwellings, excluding materials which account for a significant part of the value of the service supplied"* (*Annex III(10a) of the Directive*).

### Legislation

Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

Council Directive 2009/47/EC of 5 May 2009 amending Directive 2006/112/EC as regards reduced rates of value added tax

## 3. Health and Safety

- 3.1. **Requirements for the workplace** – One of the objectives of the EU's social policy is the improvement of health and safety at work. As part of this policy, the Council adopted Directive 89/654/EEC. This Directive lays down minimum health and safety requirements for the workplace, in particular with respect to ventilation, emergency routes and exits, room lighting, elevators and sanitary equipment.
- 3.2. **Measures for persons with a disability** – In addition, several Directives have been adopted to improve the accessibility of buildings and the provision of accommodation for persons with a disability.
- 3.3. For instance, Directive 89/654/EEC requires that both new and existing workplaces must be organised to take account of handicapped workers. This particularly applies to doors, passageways, staircases, showers, washbasins, lavatories and

workstations used or occupied directly by handicapped workers (*Annexes I(20) and I(15) of the Directive*).

- 3.4. Moreover, Directive 2000/78/EC on equal treatment in employment and occupation provides that reasonable accommodation should be provided to persons with disabilities. In particular, Article 5 of the Directive stipulates 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"*.
- 3.5. Article 4(4) of Directive 2019/882 on the accessibility requirements for products and services, also referred to as the European Accessibility Act, furthermore provides that Member States may impose requirements to the built environment in which certain services are provided in order to improve their accessibility for disabled persons. These requirements relate, amongst others, to entrances, exits, evacuation routes, approaches to buildings, paths, sanitary facilities and equipment and facilities used in the provision of the service (*Annex III of the Directive*). However, only a few services that fall within the scope of the European Accessibility Act are (or could be) provided in buildings. The most relevant services are consumer banking services and certain travel information services (*Article 2(2) of the Directive*).
- 3.6. **Control of hazards involving dangerous substances** – The Seveso III Directive 2012/18/EU on the control of major-accident hazards involving dangerous substances lays down several rules on land-use planning in the vicinity of sites of hazardous activity. This Directive is named after the catastrophic accident that occurred in 1976 nearby the Italian town Seveso resulting in the emission of a high amount of dioxins close to a residential area.
- 3.7. The Directive is applicable to all locations where dangerous substances are present in one or more installations (*Articles 2(1) and 3(1) of the Directive*). The dangerous substances are listed in Annex I of the Directive and include, amongst others, flammable and explosive substances, petroleum products, alternative fuels and ammonium nitrate.
- 3.8. Pursuant to Article 13 of this Directive, Member States are required to adopt land-use policies and/or other relevant policies which include the objectives of preventing major accidents and limiting the consequences of such accidents for human

health and the environment. These policies must take account of the need (i) to maintain appropriate safety distances between locations where dangerous substances are present and residential areas, buildings and areas of public use, recreational areas, and, as far as possible, major transport routes and (ii) to protect areas of particular natural sensitivity or interests in the vicinity of these hazardous locations. Moreover, Member States must carry out controls on new developments in the vicinity of existing hazardous locations and on the siting of new hazardous locations. It is obvious that these policies and controls may restrict the use of land close to major industrial sites and can thus affect its value. They may also require valuations for compensation or mitigation.

- 3.9. **Safety standards for lifts** – If the valuation concerns buildings with lifts, the valuer should also bear in mind that these lifts must fulfil the safety standards which are harmonised by Directive 2014/33/EU.

#### Legislation

Council Directive 89/654/EEC of 30 November 1989 concerning the minimum safety and health requirements for the workplace (first individual directive within the meaning of Article 16 (1) of Directive 89/391/EEC)

Council Directive 2000/78/EC of 27 November 2000 establishing a general framework for equal treatment in employment and occupation

Directive 2012/18/EU of the European Parliament and of the Council of 4 July 2012 on the control of major-accident hazards involving dangerous substances, amending and subsequently repealing Council Directive 96/82/EC

Directive 2014/33/EU of the European Parliament and of the Council of 26 February 2014 on the harmonisation of the laws of the Member States relating to lifts and safety components for lifts

Directive (EU) 2019/882 of the European Parliament and of the Council of 17 April 2019 on the accessibility requirements for products and services

## 4. Energy

- 4.1. **Energy policy framework** – In line with Article 194(1) TFEU, Union policy on energy inter alia aims to promote energy efficiency and energy saving and the development of new and renewable forms of energy, the main emphasis being on buildings, as they represent 40% of the EU's energy consumption and 36% of its greenhouse gas emissions.
- 4.2. **Main EU targets** – The framework sets two main targets. First, pursuant to Article 3(1) of the Renewable Energy Directive 2018/2001, the share of energy from renewable sources in the Union's gross final consumption of energy in 2030 must be at least 32%. Second, Article 1(1) of the Energy Efficiency Directive 2018/2002 establishes a headline EU energy efficiency target for 2030 of at least 32.5% compared to projections.
- 4.3. **Energy performance in buildings** – The renovation of existing buildings and a better design of new buildings can play a key role in the clean energy transition. In this context, the revised Energy Performance of Buildings Directive 2010/31/EU provides a set of rules to boost the Union's efforts to decarbonise its building stock:
- ▶ The development of a long-term renovation strategy to support the renovation of the entire national building stock – residential and commercial, public and private – into a highly energy efficient and decarbonised building stock by 2050 (*Article 2a*);
  - ▶ The application of minimum energy performance requirements for buildings undergoing a so-called "major renovation" (*Article 7*), i.e. where "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 where "more than 25% of the building envelope undergoes renovation" (*Article 2(10)*);
  - ▶ The adaptation of parking areas of residential and non-residential buildings to electromobility (*Article 8(2)-(7)*);
  - ▶ The obligation to ensure that all new buildings are nearly zero-energy by 31 December 2020 and that all new buildings occupied and owned by public authorities are nearly zero energy by 31 December 2018 (*Article 9(1)*);
  - ▶ The issuance of energy performance certificates (EPCs) for almost all buildings up for rental or sale (*Articles 11 and 12*).

- 4.4. **Energy efficiency of buildings** – The EU also adopted a number of measures to improve energy efficiency in buildings. In particular, the revised Energy Efficiency Directive 2012/27/EU requires the energy efficiency renovation of 3% of the central government building stock every year (*Article 5(1)*), the performance of an energy audit by large companies at least every four years (*Article 8(4)*) and the introduction of smart meters for electricity and gas (*Article 9*).
- 4.5. **The EU's long-term strategy** – On 28 November 2018, the European Commission published a European strategic long-term vision for a climate neutral economy. This Communication highlights the findings of the October 2018 Special Report on the impact of global warming of 1.5°C of the Intergovernmental Panel on Climate Change (IPCC) that disastrous and irreversible impacts will take place as soon as the planet warms by more than 1.5°C above pre-industrial levels and that the only way to stay below 1.5°C is for the world to be at net-zero CO<sub>2</sub> emissions by 2050.
- 4.6. According to the European Commission, the Union's current trajectory is not sufficient to reach this goal and to confirm the Union's global leadership in the transition towards a net-zero-greenhouse gas emissions economy.
- 4.7. The Communication therefore identified seven "*main strategic building blocks*" to reach a net-zero greenhouse gas emissions economy by 2050. In particular, the European Commission underlines the importance of taking further action in relation to (i) energy efficiency, (ii) the deployment of renewables and the use of electricity to fully decarbonise Europe's energy supply, (iii) clean mobility, (iv) the circular economy, (v) smart network infrastructure and inter-connections, (vi) bio-economy and forestation and (vii) carbon capture and storage. These seven policy areas are not equal. It is no coincidence that energy efficiency is n° 1, with special emphasis on buildings and higher renovation rates:

*"Energy efficiency will play a central role in decarbonising industrial processes but much of the reduced energy demand will occur in buildings, in both the residential and services sectors, which today are responsible for 40% of energy consumption. Given that most of the housing stock of 2050 exists already today, this will require higher renovation rates, fuel switching with a large majority of homes that will be using renewable heating (electricity, district heating, renewable gas or solar thermal), diffusion of the most efficient products and appliances, smart building/appliances management systems, and improved materials for insulation. Sustainable renewable heating will continue to play a major role and gas, including liquefied natural gas, mixed with hydrogen, or e-methane produced from renewable electricity and biogas mixtures could all play a key role in existing buildings as well as in many industrial applications. To achieve and sustain higher renovation rates, adequate financial instruments to overcome existing market failures, sufficient*



*workforce with the right skills and affordability for all citizens are of central importance. An integrated approach and consistency across all relevant policies will be necessary for the modernisation of the built environment and mobilisation of all actors. Consumer engagement, including through consumer associations, will be a key element in this process."*

**4.8. Governance Regulation** – One of the key instruments for achieving these long-term ambitions is the Energy Governance Regulation 2018/1999. Its specific purpose is to establish a governance mechanism to ensure that the EU and Paris targets are met. It organises a form of perpetual, rolling oversight by the European Commission of Member State progress on all fronts, via the obligation on Member States to produce integrated national energy and climate plans, updates of these plans, progress reports on the plans and updates, and separate long-term strategies. Member States will be reporting all the time, and all of these plans, updates, progress reports and long-term strategies have to specifically cover national measures taken as part of the long-term building renovation strategy which, in its new, enhanced version in the revised Energy Performance of Buildings Directive 2010/31/EU, covers the transformation of existing buildings into nearly zero-energy buildings. On top of this comes the annual State of the Energy Union report which also specifically covers, biennially, an overall progress report on the renovation of the national stock of residential and non-residential buildings, both public and private, in line with the roadmaps set out in the long-term renovation strategies that each Member State shall establish in accordance with Article 2a of Directive 2010/31/EU and, every four years, an overall progress report on Member States' increase in the number of nearly zero-energy buildings in accordance with Article 9(5) of Directive 2010/31/EU.

**4.9. European Green Deal** – On 11 December 2019, the European Commission unveiled the European Green Deal which announces a European Climate Law enshrining 2050 carbon neutrality and a new EU 2030 climate target of 50% – 55% reduction of GHG emissions compared to 1990. These much more radical targets will mechanically increase the pressure on the building stock as it accounts for by far the most important portion of total EU energy consumption and carbon footprint. The European Green Deal outlines a package of initiatives the EU and its Member States should undertake in order for the EU to achieve its climate goal, addresses, amongst others, the need for a (building) renovation wave throughout the EU, and announces new initiatives related to the energy performance of buildings:

*"To address the twin challenge of energy efficiency and affordability, the EU and the Member States should **engage in a 'renovation wave' of public and private buildings**. While increasing renovation rates is a challenge, renovation lowers energy bills, and*

*can reduce energy poverty. It can also boost the construction sector and is an opportunity to support SMEs and local jobs.*

*The Commission will rigorously enforce the legislation related to the energy performance of buildings. This will start with an assessment in 2020 of Member States' national long-term renovation strategies. The Commission will also launch work on the possibility of including emissions from buildings in European emissions trading, as part of broader efforts to ensure that the relative prices of different energy sources provide the right signals for energy efficiency. In addition, the Commission will review the Construction Products Regulation. It should ensure that the design of new and renovated buildings at all stages is in line with the needs of the circular economy, and lead to increased digitalisation and climate-proofing of the building stock.*

*In parallel, the Commission proposes to work with stakeholders on a new initiative on renovation in 2020. This will include an open platform bringing together the buildings and construction sector, architects and engineers and local authorities to address the barriers to renovation. This initiative will also include innovative financing schemes under InvestEU. These could target housing associations or energy service companies that could roll out renovation including through energy performance contracting. An essential aim would be to organise renovation efforts into larger blocks to benefit from better financing conditions and economies of scale. The Commission will also work to lift national regulatory barriers that inhibit energy efficiency investments in rented and multi-ownership buildings. Particular attention will be paid to the renovation of social housing, to help households who struggle to pay their energy bills. Focus should also be put on renovating schools and hospitals, as the money saved through building efficiency will be money available to support education and public health."*

- 4.10. **Impact on property valuation** – This framework has direct and indirect effects on property and its use. Valuers may therefore find it important to consider the commercial issues arising from this framework when appraising immovable property. Predictable events are accelerated depreciation of non-renovated properties, significant EU and national subsidies for the renovation of the owner-occupied housing stock and obligations on landlords to renovate at 'trigger points' evoked in revised Energy Performance of Buildings Directive 2010/31/EU, probably points of rental or sale, as, for example, in the new requirement under Dutch law that offices can only be put up for rent as of 2023 if they have a 'C'-grade EPC. In addition, the EU framework on energy may affect the economics of some businesses.

## 4.11. Legislation

Directive 2010/31/EU of the European Parliament and of the Council of 19 May 2010 on the energy performance of buildings

Directive 2012/27/EU of the European Parliament and of the Council of 25 October 2012 on energy efficiency, amending Directives 2009/125/EC and 2010/30/EU and repealing Directives 2004/8/EC and 2006/32/EC

Directive (EU) 2018/844 of the European Parliament and of the Council of 30 May 2018 amending Directive 2010/31/EU on the energy performance of buildings and Directive 2012/27/EU on energy efficiency

Directive (EU) 2018/2001 of the European Parliament and of the Council of 11 December 2018 on the promotion of the use of energy from renewable sources

Directive (EU) 2018/2002 of the European Parliament and of the Council of 11 December 2018 amending Directive 2012/27/EU on energy efficiency

Regulation (EU) 2018/1999 of the European Parliament and of the Council of 11 December 2018 on the Governance of the Energy Union and Climate Action, amending Regulations (EC) No 663/2009 and (EC) No 715/2009 of the European Parliament and of the Council, Directives 94/22/EC, 98/70/EC, 2009/31/EC, 2009/73/EC, 2010/31/EU, 2012/27/EU and 2013/30/EU of the European Parliament and of the Council, Council Directives 2009/119/EC and (EU) 2015/652 and repealing Regulation (EU) No 525/2013 of the European Parliament and of the Council

Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions of 11 December 2019 – The European Green Deal

## 5. Environment

### 5.1. General

**5.1.1. Valuations and environmental regulation** – Environmental regulation can impose large costs on property owners and users, making it important to understand the potential for its impact in any particular situation and its consequence for property values. These concerns will be shared by lenders and also need to be considered in lettings.

**5.1.2. Growth of EU environmental legislation** – The EU has over the past decades put in place a broad range of environmental legislation.

- 5.1.3.** 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. Nowadays, the activity of the EU in environmental policy is mainly extending on the basis that many issues see both causes and effects extending beyond the reach of individual countries.
- 5.1.4.** The EU's role in environmental policy is now also confirmed in Article 191(2) TFEU stating that *"Union 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 Union. It shall be based on the precautionary principle and on the principles that preventive action should be taken, that environmental damage should as a priority be rectified at source and that the polluter should pay"*. In addition, Article 11 TFEU states that *"environmental protection requirements must be integrated into the definition and implementation of the Union's policies and activities, in particular with a view to promoting sustainable development"*.
- 5.1.5.** 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. However, it should be noted that environmental protection is not an overriding objective. In this context, the CJEU has explained that *"although protection of the environment must be integrated into the definition and implementation of EU policies, particularly those which have the aim of establishing the internal market, it does not constitute, per se, one of the components of that internal market, defined as an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured"* (judgment in the case T-356/15, **Austria v Commission**). Accordingly, the CJEU found that State aid for the promotion of nuclear energy cannot be called into question by its possible effects on the implementation of the principle of protection of the environment, the precautionary principle and the polluter pays principle.
- 5.1.6. Environment Action Programme** – The EU not only agrees specific legislation but also frames general environmental policies. In 2013 the European Parliament and the Council adopted the seventh Environment Action Programme (EAP) that sets the principles guiding European environment policy until 2020. The EAP identifies three key objectives, namely (i) to protect, conserve and enhance the Union's natural capital, (ii) to turn the EU into a resource-efficient, green, and competitive low-carbon economy and (iii) to safeguard the EU's citizens from environment-related pressures and risks to health and well-being. The EAP also sets out a vision of where it wants the EU to be by 2050:

*"In 2050, we live well, within the planet's ecological limits. Our prosperity and healthy environment stem from an innovative, circular economy where nothing is wasted"*

*and where natural resources are managed sustainably, and biodiversity is protected, valued and restored in ways that enhance our society's resilience. Our low-carbon growth has long been decoupled from resource use, setting the pace for a safe and sustainable global society."*

**5.1.7. European Green Deal** – The European Green Deal of December 2019 outlines several initiatives relating to the EU's environmental policies. In particular, the Green Deal announces several legislative and policy actions which will have high impact for land and buildings:

- ▶ Possible extension of the EU Emissions Trading System to buildings;
- ▶ New EU Strategy on Adaptation to Climate Change;
- ▶ EU model for separate waste collection;
- ▶ Circular economy action plan.

## 5.2. Environmental Assessments

**5.2.1. EU and spatial planning** – In general, the EU has intervened relatively little in spatial planning policy. The most far-reaching intervention in spatial planning is through Directives 2011/92/EU and 2001/42/EC requiring environmental assessments prior to obtaining authorisation for carrying out certain environmental developments.

**5.2.2. Environmental impact assessments for projects** – Article 2(1) of the Environmental Impact Assessment Directive 2011/92/EU provides that projects which are likely to have effects on the environment must in principal be made subject to a development consent and an environmental impact assessment (EIA) prior to that consent. In general, the projects concerned relate to interventions in the natural surroundings and landscape which are likely to have significant effects on the environment by virtue, inter alia, of their nature, size or location, including the execution of construction works or of other installations or schemes (*Article 1(2)(a) of the Directive*).

**5.2.3.** Annex I of the Directive contains a list of projects which must always be subject to consent and a prior EIA whereas Annex II concerns a list of projects for which Member States must decide on a case-by-case basis whether they must be made subject thereto based on the significant effects they might have on the environment (*Articles 2(1) and 4(1) and (2) of the Directive*). When Member States carry out a case-by-case examination, they should take into account the selection criteria set out in Annex III of the Directive (*Article 4(3) of the Directive*).

**5.2.4.** In order to carry out an EIA, the developer must provide information on the environmental impact of the project for which it requests an authorisation (*Article 5 of*

*the Directive*). Subsequently, the developer must inform and consult the (environmental and other) authorities involved as well as the public (*Articles 6 and 7 of the Directive*). The competent authority decides whether it grants authorisation for the project taking into consideration the results of the EIA and the consultations and communicates this decision to the public together with its reasons and considerations (*Articles 8 and 9 of the Directive*). This decision can be challenged by the public (*Article 11 of the Directive*).

**5.2.5.** Projects that are subject to an EIA may not be developed without a prior EIA. If these projects have nevertheless been developed, the lack of an EIA may not be remedied with a retrospective authorisation and Member States must revoke or suspend consent already granted (judgments in the cases C 215/06, **Commission v Ireland** and C 41/11, **Inter-Environnement Wallonie and Terre wallonne**). However, it is possible to regularise projects developed without an EIA by conducting a new EIA if the following two conditions are fulfilled (judgments in the joined cases C 196/16 and C 197/16, **Comune di Corridonia** and in the case C 117/17, **Comune di Castelbellino**):

- ▶ The regularisation does not provide the parties concerned with an opportunity to circumvent EU law or to dispense with applying it;
- ▶ The EIA is not conducted solely in respect of the project's future environmental impact, but also takes into account its environmental impact from the time of its completion.

**5.2.6. Environmental assessments for plans and programmes** – Directive 2001/42/EC introduced the obligation of conducting an environmental assessment (EA) with respect to plans and programmes which are likely to have significant environmental effects (*Article 3(1) of the Directive*). According to settled case-law of the CJEU, "plans and programmes" may relate to "any measure which establishes a significant body of criteria and detailed rules for the grant and implementation of one or more projects" (judgments in the cases C 305/18, **Associazione 'Verdi Ambiente e Società – Aps Onlus' and Others** and C 160/17, **Thybaut and Others**).

**5.2.7.** Pursuant to Article 2(a) of the Directive, an EA must be prepared if the plans and programmes satisfy two conditions:

- ▶ They are subject to preparation and/or adoption by an authority, or are prepared by an authority for adoption through a legislative procedure;
- ▶ They are required by legislative, regulatory or administrative provisions.

**5.2.8.** The plans and programmes concerned include those which are prepared for agriculture, forestry, fisheries, energy, industry, transport, waste management, water management, telecommunications, tourism, town and country planning or land use and which set the framework for future development consent of projects

listed in Annexes I and II of Directive 2011/92/EU (*Article 3(2)(a) of the Directive*). An EA is also mandatory for plans and programmes which are subject to an assessment pursuant to Articles 6 and 7 of the Habitats Directive 92/43/EEC (*Article 3(2)(b) of the Directive*). In addition, Member States must decide on a case-by-case basis whether an EA should also be carried out for other plans or programmes which are likely to have significant environmental effects (*Article 3(4) of the Directive*).

### Legislation

Council Directive 92/43/EEC of 21 May 1992 on the conservation of natural habitats and of wild fauna and flora

Directive 2001/42/EC of the European Parliament and of the Council of 27 June 2001 on the assessment of the effects of certain plans and programmes on the environment

Directive 2011/92/EU of the European Parliament and of the Council of 13 December 2011 on the assessment of the effects of certain public and private projects on the environment

Directive 2014/52/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2011/92/EU on the assessment of the effects of certain public and private projects on the environment

## 5.3. Water

**5.3.1. Water quality and protection** – The EU water policy generally focuses on water protection and the prevention of water pollution. The main piece of legislation is the Water Framework Directive 2000/60/EC.

**5.3.2.** This Directive requires Member States to identify the individual river basins on their territory, which are in fact the areas covering one or more river catchments (*Article 3 of the Directive*). For each river basin district, Member States must subsequently establish a so-called "*river basin management plan*" entailing a detailed account of how the objectives set forth in the Directive will be attained (*Articles 4, 11 and 13 of the Directive*). These objectives and the accompanying measures differ depending on whether the water constitutes surface water or ground water (*Article 4 of the Directive*). In addition, the Directive provides additional objectives for "*protected areas*" designated by the Member States, such as bathing areas and areas with water used for the abstraction of drinking water (*Articles 4, 6, 7 and 11 and Annex IV of the Directive*).

**5.3.3.** The Water Framework Directive is supplemented with several Directives aiming at preventing or reducing water pollution, each covering a specific topic. For

instance, Directive 2006/118 tackles the pollution of groundwater, whereas Directive 98/83/EC provides measures for the protecting of drinking water. Furthermore, the discharge of urban waste water and industrial waste water is regulated in Directive 91/271/EEC. Directive 91/676/EEC aims at preventing and reducing water pollution arising from nitrates from agricultural sources and, in this context, obliges Member States to designate "*nitrate vulnerable zones*" within which certain agricultural practices are to be imposed and certain waters are to be monitored. Finally, Directive 2008/105/EC imposes standards for surface water and requires Member States to set up an inventory of emissions, discharges and losses of all substances listed in that Directive.

- 5.3.4. Flooding risk** – The Floods Directive 2007/60/EC establishes a framework to prevent flooding risks.
- 5.3.5.** On the basis of this Directive, Member States are obliged to carry out an assessment for each river basin, prepare flood hazard maps and flood risk maps and set out flood management plans. Flood hazard maps not only have to indicate where floods are probable but also whether they are a low, medium or high probability (*Article 6(3) of the Directive*). For each scenario, the flood extent, the water depths or water level and the flow velocity or the relevant water flow should be mentioned (*Article 6(4) of the Directive*). Flood risk maps have to mention the indicative number of inhabitants and the type of economic activity of the area potentially affected (*Article 6(5) of the Directive*).
- 5.3.6. Importance for property valuation** – The measures under these Directives may be relevant when valuing property as they can result in domestic regulation restricting land use or developments close to water.
- 5.3.7.** For instance, the value of property may be affected when it is located in the vicinity of a "*protected water area*" or a "*nitrate vulnerable zone*". As such, Article 11 of the Water Framework Directive 2000/60/EC includes the requirement for prior regulation or for prior authorisation with respect to discharges liable to cause pollution. The existence and terms of such authorisations or licences to discharge may add to or limit the value of affected premises.
- 5.3.8.** In addition, the identification of a site as prone to flooding will obviously have important consequences for its valuation, and this due to both the practical fact of any actual flooding and the impact of that identification on the availability or cost of insurance. In some cases, the value of property can also be impacted by flood control measures that require certain land to be flooded to protect other property by managing water flow.



## Legislation

Council Directive 91/271/EEC of 21 May 1991 concerning urban waste-water treatment

Council Directive 91/676/EEC of 12 December 1991 concerning the protection of waters against pollution caused by nitrates from agricultural sources

Council Directive 98/83/EC of 3 November 1998 on the quality of water intended for human consumption

Directive 2000/60/EC of the European Parliament and of the Council of 23 October 2000 establishing a framework for Community action in the field of water policy

Directive 2006/118/EC of the European Parliament and of the Council of 12 December 2006 on the protection of groundwater against pollution and deterioration

Directive 2007/60/EC of the European Parliament and of the Council of 23 October 2007 on the assessment and management of flood risks

Directive 2008/105/EC of the European Parliament and of the Council of 16 December 2008 on environmental quality standards in the field of water policy, amending and subsequently repealing Council Directives 82/176/EEC, 83/513/EEC, 84/156/EEC, 84/491/EEC, 86/280/EEC and amending Directive 2000/60/EC of the European Parliament and of the Council

## 5.4. Liability for Environmental Damage and Waste

- 5.4.1. Environmental damage** – The Environmental Liability Directive 2004/35/CE lays down a framework for environmental liability based on the polluter-pays principle. The basic rule is that operators of certain activities causing damage to the environment must take the necessary preventive or remedial action and bear all the related costs.
- 5.4.2.** Article 3(1) of the Directive distinguishes two situations where the environmental liability regime applies.
- 5.4.3.** First, a person may be held liable for environmental damage caused by any of the activities listed in Annex III of the Directive and for any imminent threat of such damage (*Article 3(1)(a) of the Directive*). These activities include, amongst others, waste management activities, the discharge of pollutants into the air, inland surface water and groundwater, any deliberate release into the environment of genetically modified organisms, water abstraction and impoundment of water and several activities with respect to dangerous substances or goods.

- 5.4.4. Second, the liability regime applies to damage to protected species and natural habitats, or its imminent threat, caused by any activities outside Annex III, provided the operator is negligent or at fault (*Article 3(1)(b) of the Directive*).
- 5.4.5. The Directive provides a broad definition of "environmental damage". Apart from "damage to protected species and natural habitats" and "water damage", it also includes "land damage" which is defined as "any land contamination that creates a significant risk of human health being adversely affected as a result of the direct or indirect introduction, in, on or under land, of substances, preparations, organisms or micro-organisms" (*Article 2(1)(c) of the Directive*).
- 5.4.6. **Waste** – The Waste Framework Directive 2008/98/EC establishes a legal framework to protect the environment and human health by preventing or reducing the adverse impacts of the generation and management of waste. In particular, the Directive lays down a set of detailed measures for the recovery and disposal of waste without endangering human health and without using processes or methods which would harm the environment.
- 5.4.7. In this context, Member States must ensure that any waste producer or other holder carries out the treatment of waste himself or has the treatment handled by a waste collector who carries out waste treatment operations in compliance with the Directive (*Article 15 of the Directive*). The costs of waste management must be borne by the waste producer or by the current or previous waste holders (*Article 14 of the Directive*).
- 5.4.8. This framework does not apply to land (in situ) including unexcavated contaminated soil and buildings permanently connected with land (*Article 2(1)(b) of the Directive*) and to 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) of the Directive*).

#### Legislation

Directive 2004/35/CE of the European Parliament and of the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage

Directive 2008/98/EC of the European Parliament and of the Council of 19 November 2008 on waste and repealing certain Directives

## 5.5. Pollution

**5.5.1. Air quality and protection** – As part of its Clean Air Policy, the EU has adopted several Directives protecting air quality, especially by preventing and limiting air pollution from various classes of industrial and other plants.

**5.5.2.** In particular, these Directives set maximum or target values for the emission of certain pollutant substances and require that the Member States carry out controls on the air pollution (see in particular the Directives 2015/2193, 2010/75/EU, 2009/126/EC, 2008/50/EC, 2004/107/EC and 94/63/EC).

**5.5.3.** The main EU instrument regulating pollutant emissions from industrial installations is the Industrial Emissions Directive 2010/75/EU. This Directive lays down the obligation to require a permit for operating certain industrial activities giving rise to pollution above a certain threshold and the conditions under which such permits may be granted. Pursuant to this Directive, the Commission also adopts references for national authorities to set permit conditions. For instance, Commission Implementing Decision (EU) 2017/302 provides the reference for setting permit conditions for large poultry or pig farms, including, among others, limits for ammonia emissions and for excretions of nitrogen and phosphorus.

**5.5.4. European Green Deal** – According to the European Green Deal of December 2019, the European Commission will adopt in 2021 a zero pollution action plan for air, water and soil. In this context, the Green Deal points out that the European Commission will assess the existing EU legislation tackling pollution and propose new measures to align these with the Green Deal's objectives:

*"The Commission will draw on the lessons learnt from the evaluation of the current air quality legislation. It will also propose to strengthen provisions on monitoring, modelling and air quality plans to help local authorities achieve cleaner air. The Commission will notably propose to revise air quality standards to align them more closely with the World Health Organization recommendations.*

*The Commission will review EU measures to address pollution from large industrial installations. It will look at the sectoral scope of the legislation and at how to make it fully consistent with climate, energy and circular economy policies. The Commission will also work with Member States to improve the prevention of industrial accidents."*

**5.5.5. Importance for property valuation** – Compliance with the standards required by these Directives will be important for businesses. A valuer assessing plants needs to verify to what extent the business is compliant with these standards and assess the practical consequences of any shortcomings on the value of the property.

Moreover, tightening rules on vehicle use to limit pollution may also affect property in urban areas of poor air quality.

### Legislation

European Parliament and Council Directive 94/63/EC of 20 December 1994 on the control of volatile organic compound (VOC) emissions resulting from the storage of petrol and its distribution from terminals to service stations

Directive 2004/107/EC of the European Parliament and of the Council of 15 December 2004 relating to arsenic, cadmium, mercury, nickel and polycyclic aromatic hydrocarbons in ambient air

Directive 2008/50/EC of the European Parliament and of the Council of 21 May 2008 on ambient air quality and cleaner air for Europe

Directive 2009/126/EC of the European Parliament and of the Council of 21 October 2009 on Stage II petrol vapour recovery during refuelling of motor vehicles at service stations

Directive 2010/75/EU of the European Parliament and of the Council of 24 November 2010 on industrial emissions (integrated pollution prevention and control)

Directive (EU) 2015/2193 of the European Parliament and of the Council of 25 November 2015 on the limitation of emissions of certain pollutants into the air from medium combustion plants

Commission Implementing Decision (EU) 2017/302 of 15 February 2017 establishing best available techniques (BAT) conclusions, under Directive 2010/75/EU of the European Parliament and of the Council, for the intensive rearing of poultry or pigs (notified under document C(2017) 688)

Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions of 11 December 2019 – The European Green Deal

## 5.6. Asbestos

- 5.6.1. Specific measures to limit exposure to asbestos** – The Asbestos Directive 2009/148/EC primarily provides preventive measures for the protection of the health of workers exposed to asbestos. In essence, when asbestos is presumed to be present in a building, specific measures must be taken before starting any demolition, asbestos removal work, repairing or maintenance in order to limit exposure risks.

- 5.6.2. Importance for property valuation** – The 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. This can add substantially to the costs of renovation, maintenance or demolition of a property or the remediation and development of a site, and so may affect its value.
- 5.6.3.** 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

Directive 2009/148/EC of the European Parliament and of the Council of 30 November 2009 on the protection of workers from the risks related to exposure to asbestos at work

## 5.7. Biodiversity and Nature Conservation

- 5.7.1. Designation of protected sites** – Nature conservation was one of the first areas in environmental policy where EU law significantly impacted national legislation. The two Directives in this area that are of particular relevance for property valuation are the Habitats Directive 92/43/EEC and the Birds Directive 2009/147/EC. These Directives require first of all the designation of sites where the habitats and species mentioned in the Directives must be maintained or restored. These sites are called "*special areas of conservation*" under the Habitats Directive and "*special protection areas*" under the Birds Directive. Together they form the ecological network named Natura 2000. The Habitats Directive also provides a list of criteria which Member States must take into account when determining these protected sites. Designation is an objective issue and may thus not take account of economic, social and cultural requirements or regional and local characteristics (judgment in the case C-371/98, **First Corporate Shipping**).
- 5.7.2. Protected sites and project development** – Where a site is part of the Natura 2000 network, Member States have to protect it and the species for which it was designated (*Articles 12-16 of the Habitats Directive*).
- 5.7.3.** Consequently, any project that is likely to have an impact on a Natura 2000 site should be the subject of appropriate assessment. In principle, Member States may only agree on a development proposal after having ascertained that it will not adversely affect the integrity of protected sites (*Article 6(3) of the Habitats Directive*).

**5.7.4.** However, in the absence of other alternatives, some development proposals that will cause significant negative impact may still be permitted for imperative reasons of overriding public interest, including those of social or economic nature (*Article 6(4) of the Habitats Directive*). The assessment of imperative reasons of overriding public interest and that of the existence of less harmful alternatives require a weighing up against the damage caused to the site by the plan or project under consideration (judgment in the case C-521/12, **Briels and Others**). Moreover, in this case Member States must introduce “*compensatory measures*” to ensure the overall coherence of the Natura 2000 network (*Article 6(4) of the Habitats Directive*). This term is not defined in the Habitats Directive. In practice, however, these measures generally include recreating a habitat on a new or enlarged site to be incorporated into Natura 2000 or improving a habitat on part of the site or another Natura 2000 site proportional to the loss due to the project.

**5.7.5. European Green Deal** – In the European Green Deal of December 2019, the European Commission undertakes to present a new biodiversity strategy by March 2020, to be followed up by specific action in 2021. This strategy will mainly identify measures to expand the Natura 2000 network and to improve its protection and restoration:

*“The biodiversity strategy will identify specific measures to meet these objectives. These could include quantified objectives, such as increasing the coverage of protected biodiversity-rich land and sea areas building on the Natura 2000 network. Member States should also reinforce cross-border cooperation to protect and restore more effectively the areas covered by the Natura 2000 network. The Commission will identify which measures, including legislation, would help Member States improve and restore damaged ecosystems to good ecological status, including carbon-rich ecosystems. The biodiversity strategy will also include proposals to green European cities and increase biodiversity in urban spaces. The Commission will consider drafting a nature restoration plan and will look at how [to] provide funding to help Member States to reach this aim.”*

**5.7.6. Importance for property valuation** – Since the Habitats and Bird Directives can impose significant hurdles for the development or change in use of property located on a Natura 2000 site or in the vicinity thereof, they may also have an impact on the value of a site. As many Natura 2000 sites involve wetland, this can be a particular constraint on the development of coastal sites. 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 European Commission negotiated adaptations to the project. Another example was the development of Cardiff Bay as part of the city where the compensatory measures for lost tidal flats was a particular constraint on the development.

- 5.7.7. On the other hand, Member States may also grant subsidies for the management of a Natura 2000 site or for measures taken in order to compensate the damage incurred by a site, as long as they comply with State aid rules.

### Legislation

Council Directive 92/43/EEC of 21 May 1992 on the conservation of natural habitats and of wild fauna and flora

Directive 2009/147/EC of the European Parliament and of the Council of 30 November 2009 on the conservation of wild birds

Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions of 11 December 2019 – The European Green Deal

## 6. The Common Agricultural Policy

- 6.1. **Two pillars** – The Common Agricultural Policy (CAP) essentially consists of two pillars: support to the agricultural sector (first pillar) and implementation of a rural development policy (second pillar). In both pillars, EU legislation lays down several financial support measures which may impact the capital and Rental Value of the property involved as well as the use of rural land. Valuers should also take into account that the CAP legislation is reformed every few years in line with the Union's budgetary reform. The next CAP is due to be implemented by 2021 but this may be delayed.
- 6.2. **Direct payments to farmers** – The first pillar of the CAP essentially comprises support for farmers in the form of direct payments on the one hand and other measures organising the agricultural market on the other hand.
- 6.3. For the period 2015–2020, the direct payments are regulated in the Direct Payments Regulation 1307/2013 which provides two main payment schemes of which Member States must implement one, namely the Basic Payment (*Articles 21-35*) and the Single Area Payment (*Articles 36-40*). Both schemes concern payments which are granted to farmers on an annual basis and are calculated based on the area of "eligible land" which has been declared by the farmer (*Articles 24(2) and 36(2)*). Article 32 of the Regulation defines "eligible land" as any agricultural area of a farmer's holding that is (at least predominantly) used for agricultural activities or that gave right to one of the payments meant in Article 32(2)(b) of the Regulation.

Agricultural areas are considered to be allocated to a farmer's holding where the farmer enjoys sufficient autonomy to carry out his agricultural activities on those areas (judgment in the joined cases C-333/15 and C-334/15, **María del Pilar Planes Bresco**). Moreover, in order to benefit from the payments, the farmer must fulfil the criteria laid down in Article 9 of the Regulation.

- 6.4. These schemes are complemented with two compulsory payments: the so-called 'greening' payments supporting agricultural practices that are beneficial for the climate and the environment, such as crop diversification and ecological focus areas (*Articles 43-47*) and the payments for "young farmers" (*Articles 50-51*).
- 6.5. Moreover, Member States may provide for redistributive payments whereby farmers may be granted additional support for the first hectares of farmland (*Articles 41-42*), additional income support for areas with natural constraints (*Articles 48-49*), coupled with support for production, granted in respect of certain areas or types of farming for economic and/or social reasons (*Articles 52-55*) and an additional payment scheme for "small farmers" (*Articles 61-65*).
- 6.6. **Rural development support** — The second pillar of the CAP is also designed to support rural development purposes which are currently regulated in the Rural Development Regulation 1305/2013. This Regulation provides a wide variety of support measures, of which the following are the most relevant for the valuation of property:
  - ▶ Agri-environment-climate payments which support farmers which adopt, for a minimum period of at least five years, agricultural practices that make a positive contribution to the environment and climate and go beyond legal obligations (*Article 28*);
  - ▶ Payments for farmers in areas with natural or other specific constraints (*Articles 31-32*).

### Legislation

Regulation (EU) No 1307/2013 of the European Parliament and of the Council of 17 December 2013 establishing rules for direct payments to farmers under support schemes within the framework of the common agricultural policy and repealing Council Regulation (EC) No 637/2008 and Council Regulation (EC) No 73/2009

Regulation (EU) No 1305/2013 of the European Parliament and of the Council of 17 December 2013 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) and repealing Council Regulation (EC) No 1698/2005



## 7. Schedule of EU Legislation

### 7.1. Valuation of Property for Company Accounts

Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings

Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards

Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC

Commission Regulation (EC) No 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council

Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC

Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts

### 7.2. Valuation of Property for Credit Institutions

Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC

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

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 and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010

Single Rulebook of the European Banking Authority

Manual for the Asset Quality Review of the European Central Bank

Guidelines of the European Banking Authority on loan origination and monitoring

### **7.3. Valuation of Property for Insurance and Reinsurance Institutions**

Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)

Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014 amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No 1060/2009, (EU) No 1094/2010 and (EU) No 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority)

Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)

Guidelines of the European Insurance and Occupational Pensions Authority of 14 September 2015 on recognition and valuation of assets and liabilities other than technical provisions

### **7.4. Valuation of Property for Alternative Investment Funds**

Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision

### **7.5. Valuation of Property for State Aid Rules**

Article 107(1) of the Treaty on the Functioning of the European Union

Commission Decision of 20 December 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 (2012/21/EU)

Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)

## 7.6. Value Added Tax (VAT) and Property

Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

Council Directive 2009/47/EC of 5 May 2009 amending Directive 2006/112/EC as regards reduced rates of value added tax

## 7.7. Health and Safety

Council Directive 89/654/EEC of 30 November 1989 concerning the minimum safety and health requirements for the workplace (first individual directive within the meaning of Article 16(1) of Directive 89/391/EEC)

Council Directive 2000/78/EC of 27 November 2000 establishing a general framework for equal treatment in employment and occupation

Directive 2012/18/EU of the European Parliament and of the Council of 4 July 2012 on the control of major-accident hazards involving dangerous substances, amending and subsequently repealing Council Directive 96/82/EC

Directive 2014/33/EU of the European Parliament and of the Council of 26 February 2014 on the harmonisation of the laws of the Member States relating to lifts and safety components for lifts

Directive (EU) 2019/882 of the European Parliament and of the Council of 17 April 2019 on the accessibility requirements for products and services

## 7.8. Energy

Directive 2010/31/EU of the European Parliament and of the Council of 19 May 2010 on the energy performance of buildings

Directive 2012/27/EU of the European Parliament and of the Council of 25 October 2012 on energy efficiency, amending Directives 2009/125/EC and 2010/30/EU and repealing Directives 2004/8/EC and 2006/32/EC

Directive (EU) 2018/844 of the European Parliament and of the Council of 30 May 2018 amending Directive 2010/31/EU on the energy performance of buildings and Directive 2012/27/EU on energy efficiency

Directive (EU) 2018/2001 of the European Parliament and of the Council of 11 December 2018 on the promotion of the use of energy from renewable sources

Directive (EU) 2018/2002 of the European Parliament and of the Council of 11 December 2018 amending Directive 2012/27/EU on energy efficiency

Regulation (EU) 2018/1999 of the European Parliament and of the Council of 11 December 2018 on the Governance of the Energy Union and Climate Action, amending Regulations (EC) No 663/2009 and (EC) No 715/2009 of the European Parliament and of the Council, Directives 94/22/EC, 98/70/EC, 2009/31/EC, 2009/73/EC, 2010/31/EU, 2012/27/EU and 2013/30/EU of the European Parliament and of the Council, Council Directives 2009/119/EC and (EU) 2015/652 and repealing Regulation (EU) No 525/2013 of the European Parliament and of the Council

Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions of 11 December 2019 – The European Green Deal

## 7.9. Environmental Assessments

Council Directive 92/43/EEC of 21 May 1992 on the conservation of natural habitats and of wild fauna and flora

Directive 2001/42/EC of the European Parliament and of the Council of 27 June 2001 on the assessment of the effects of certain plans and programmes on the environment

Directive 2011/92/EU of the European Parliament and of the Council of 13 December 2011 on the assessment of the effects of certain public and private projects on the environment

Directive 2014/52/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2011/92/EU on the assessment of the effects of certain public and private projects on the environment

## 7.10. Water

Council Directive 91/271/EEC of 21 May 1991 concerning urban waste-water treatment

Council Directive 91/676/EEC of 12 December 1991 concerning the protection of waters against pollution caused by nitrates from agricultural sources

Council Directive 98/83/EC of 3 November 1998 on the quality of water intended for human consumption

Directive 2000/60/EC of the European Parliament and of the Council of 23 October 2000 establishing a framework for Community action in the field of water policy

Directive 2006/118/EC of the European Parliament and of the Council of 12 December 2006 on the protection of groundwater against pollution and deterioration

Directive 2007/60/EC of the European Parliament and of the Council of 23 October 2007 on the assessment and management of flood risks

Directive 2008/105/EC of the European Parliament and of the Council of 16 December 2008 on environmental quality standards in the field of water policy, amending and subsequently repealing Council Directives 82/176/EEC, 83/513/EEC, 84/156/EEC, 84/491/EEC, 86/280/EEC and amending Directive 2000/60/EC of the European Parliament and of the Council

## 7.11. Liability for Environmental Damage and Waste

Directive 2004/35/CE of the European Parliament and of the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage

Directive 2008/98/EC of the European Parliament and of the Council of 19 November 2008 on waste and repealing certain Directives

## 7.12. Pollution

European Parliament and Council Directive 94/63/EC of 20 December 1994 on the control of volatile organic compound (VOC) emissions resulting from the storage of petrol and its distribution from terminals to service stations

Directive 2004/107/EC of the European Parliament and of the Council of 15 December 2004 relating to arsenic, cadmium, mercury, nickel and polycyclic aromatic hydrocarbons in ambient air

Directive 2008/50/EC of the European Parliament and of the Council of 21 May 2008 on ambient air quality and cleaner air for Europe

Directive 2009/126/EC of the European Parliament and of the Council of 21 October 2009 on Stage II petrol vapour recovery during refuelling of motor vehicles at service stations

Directive 2010/75/EU of the European Parliament and of the Council of 24 November 2010 on industrial emissions (integrated pollution prevention and control)

Directive (EU) 2015/2193 of the European Parliament and of the Council of 25 November 2015 on the limitation of emissions of certain pollutants into the air from medium combustion plants

Commission Implementing Decision (EU) 2017/302 of 15 February 2017 establishing best available techniques (BAT) conclusions, under Directive 2010/75/EU of the European Parliament and of the Council, for the intensive rearing of poultry or pigs (notified under document C(2017) 688)

Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions of 11 December 2019 – The European Green Deal

### 7.13. **Asbestos**

Directive 2009/148/EC of the European Parliament and of the Council of 30 November 2009 on the protection of workers from the risks related to exposure to asbestos at work

### 7.14. **Biodiversity and Nature Conservation**

Council Directive 92/43/EEC of 21 May 1992 on the conservation of natural habitats and of wild fauna and flora

Directive 2009/147/EC of the European Parliament and of the Council of 30 November 2009 on the conservation of wild birds

Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions of 11 December 2019 – The European Green Deal

### 7.15. **The Common Agricultural Policy**

Regulation (EU) No 1307/2013 of the European Parliament and of the Council of 17 December 2013 establishing rules for direct payments to farmers under support schemes within the framework of the common agricultural policy and repealing Council Regulation (EC) No 637/2008 and Council Regulation (EC) No 73/2009

Regulation (EU) No 1305/2013 of the European Parliament and of the Council of 17 December 2013 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) and repealing Council Regulation (EC) No 1698/2005







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Shoqëria e Vlerësuesve të Pasurive të Paluajtshme (SVP)  
*Albanian Society of Property Appraisers (ASPA)*

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Österreichischer Verband der Immobilienwirtschaft (ÖVI)  
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## Belgium

Union des Géomètres-Experts de Bruxelles (UGEB-ULEB)  
*Union of Expert Surveyors of Brussels*

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Conseil Supérieur du Notariat (CSN)

*High Council for the Notarial Profession*

Institut Français de l'Expertise Immobilière (IFEI)

*French Institute of Real Estate Valuation*

Syndicat National des Professionnels Immobiliers (SNPI)

*National Association of Real Estate Professionals*

**Union des Syndicats de l'Immobilier (UNIS)**  
*National Union of Property Professions*

## 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  
Achverständiger (BVS)**  
*Association of Publicly Certified and Qualified Experts*

**Immobilienverband Deutschland IVD Bundesverband der Immobilienberater, Makler,  
Verwalter, und Sachverständigen e.V. (IVD)**  
*German Real Estate Professional Association*

## 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 di Estimo e Valutazione (IEV)**

*E-Valuations – Institute of Estimation and Valuation*

**Istituto Italiano di Valutazione Immobiliare (ISIVI)**

*Italian Institute for Real Estate Valuation*

## 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*

## Mexico

**Federación de Colegios de Valuadores (FECOVAL)**

*Federation of Appraisal Colleges of Mexico*

## Montenegro

**Institut Ovlašćenih Procjenjivača Crne Gore (IOPCG)**

*Institute of Certified Valuers of Montenegro*

**Nacionalno Udruženje Procjenitelja Crne Gore (NUPCG)**

*National Association of Valuers of Montenegro*

**Udruženje Nezavisnih Procjenjivača Crne Gore (CUP)**

*Association of Independent Valuers of Montenegro*

## **Netherlands**

**Nederlands Register Vastgoed Taxateurs (NRVT)**

*Real Estate Valuers Register of the Netherlands*

**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*

## **North Macedonia**

**Asocijacija na Nezavisni Procenuvaci**

*Association of Independent Valuers (AIV)*

**Biro za Sudski Vestacenja (BSV)**

*Bureau for Court Expertise*

**Komora na Procenuvaci na Republika Makedonija (KPRM)**

*Chamber of Valuers of the Republic of Macedonia*

## **Norway**

**Norsk Takst (NT)**

*Norwegian Surveyors and Valuers Association*

## **Poland**

**Polska Federacja Stowarzyszeń Rzeczoznawców Majątkowych (PFSRM)**

*The Polish Federation of Valuers' Associations (PFVA)*

## Portugal

**Associação Nacional de Avaliadores Imobiliários (ANAI)**

*National Association of Real Estate Valuers*

**Associação Profissional das Sociedades de Avaliação (ASAVAL)**

*Professional Association of Valuation Companies of Portugal*

## Romania

**Asociația Națională a Evaluatorilor Autorizați din România (ANEVAR)**

*National Association of Authorised Romanian Valuers*

## Russian Federation

**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 Udruzenje 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*

**Consejo General de la Arquitectura Técnica de España (CGATE)**  
*Spanish General Council of Technical Architecture*

## Sweden

**Samhällsbyggarna-SFF**  
*The Swedish professionals for the built environment*

## Turkey

**Türkiye Değerleme Uzmanlari Birli (TDUB)**  
*Turkish Appraisers Association*

## Ukraine

**Асоціація Спеціалістів Банківської Оцінки України (АСБОУ)**  
*Ukrainian Association of Bank Valuation Specialists*

**Українське Товариство Оцінювачів (УТО)**  
*Ukrainian Society of Appraisers*

## United Arab Emirates

**دائرة الأراضي و الأملاك دبي**  
*Dubai Land Department (TAQYEEM)*

## United Kingdom

Central Association of Agricultural Valuers (CAAV)

Institute of Revenues Rating and Valuation (IRRV)

## United States

Appraisal Institute (AI)

International Association of Assessing Officers (IAAO)





# GLOSSARY OF TERMS

## A

### Alternative use value

The value of the property under a use other than the present one.

### 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.

## B

### Basis of value

A statement of the fundamental assumptions for undertaking a valuation for a defined purpose.

## C

### Comparable

A property deemed by the valuer to be similar to the one being valued.

### 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.

## D

### Date of inspection

The date at which the inspection took place.

### Date of report

The date at which the valuer signs the report.

### Date of valuation

The date to which the opinion of value applies.

### Departure

Circumstances where the mandatory application of the valuation standards may be inappropriate or impractical.

### Depreciable amount

The cost of an asset, or other amount substituted for cost, less its residual value.

*(IAS 16)*

### Development property

Land and/or buildings undergoing works of construction, reconstruction or refurbishment or which are suitable for such works in the immediate future.

## E

### Excess land (or surplus land)

Land within the property that is not essential to the operational purposes of buildings.

**F****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 a property 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.

**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.

**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 under conditions that do not conform with the definition of Market Value.

**G****Gross development value**

The end value of a completed development envisaged under a residual method of valuation.

## 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 the policy, the insurance company is obligated to fully replace or rebuild the property without any deduction for depreciation.

## H

### Highest and best use

Integral to Market Value, it is the use of a property that is physically possible, reasonably probable, legal or likely to become so, and that results in the highest value of the property at the date of valuation.

## I

### Income Approach

A form of investment analysis 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.

### Insurable value

The cost of replacing the damaged property with materials of like kind and quality and without any deduction for depreciation.

### Investment value

The value of a property to an owner or prospective purchaser, calculated on the basis of their individual investment criteria.

## M

### 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 for 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 acting independently of each other 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.

**Due to diverging non-English language versions of the CRR definition, TEGOVA has a universally usable common guidance-definition:**

*"The estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller acting independently of each other 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 of 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.

## P

### 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.

## Q

### Qualified Valuer

A natural person, whether self-employed or employed by a valuation company or other legal entity who is responsible for undertaking valuations, and who fulfils the requirements set out by TEGOVA.

## R

### Recognised European Valuer (REV)

A valuer recognised by TEGOVA for her/his qualification, knowledge and professional experience.

### 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.

## S

### Special assumption

An assumption made where instructions differ from the actual facts existing at the date of valuation.

### 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.

## T

### TEGOVA Residential Valuer (TRV)

A valuer undertaking residential valuations who is recognised by TEGOVA for her/his qualification, knowledge and professional experience.

### Terms of engagement

The specific terms of the contract between the valuer or valuation firm and the client.

## V

### Valuation approach

The fundamental way in which, having regard to 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 a determination of value.

### Valuation methodology

The process by which a valuer undertakes the valuation of the property, including the selection by the valuer of the approach or approaches to be applied, the choice of method(s) and the use of models or techniques in order to interpret the valuation inputs and reach conclusions based on them.

### Valuation model

A specific technique of data treatment conducted within a valuation method.

### 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.





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The European Group of Valuers' Associations unites 72 national valuers' associations from 38 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) are cited as reliable standards for the valuation of residential immovable property for mortgage lending purposes in the EU Mortgage Credit Directive and have been given precedence over all other standards by the European Central Bank in successive editions of its Asset Quality Review manual for the updating of banks' real estate collateral values.

Building on the foundation of its predecessors, this ninth edition was designed with the particular objective of providing standards that are relevant and easily comprehensible to valuers, clients and the public authorities.

EVS 2020 enhances European valuation practice with:

- ▶ Greater clarity on the key concept of Market Value, compensating flaws that have crept into various language versions of EU law;
- ▶ A common European Valuation Report for Residential Property;
- ▶ Energy efficiency valuation upgraded to Standard level;
- ▶ New Guidance Notes and Information Papers on subjects of real interest to practicing valuers;
- ▶ Clarification of the role of advanced statistical models in line with the new EBA Guidelines;
- ▶ A comprehensive approach to Valuation Methodology including detailed exposition of key concepts such as income approach and depreciated replacement cost;
- ▶ A unique, landmark exposé of European Union Legislation and Property Valuation enabling practicing valuers to understand how much of the real estate regulatory environment is based on EU law, equally valuable to European and national supervisory authorities, policy makers and academics.