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RICS Valuation – Professional Standards
January 2014

Incorporating the IVSC International Valuation Standards
Preface

January 2014

This new edition of the RICS Valuation – Professional Standards, the Red Book as it has become widely known, is the culmination of a comprehensive review of the content, framework and format of the 2012 and earlier editions. It also includes new material relating to business valuation and intangible assets.

This 2014 edition adopts and is fully compliant with the International Valuation Standards (IVS), which are reproduced as an annex in both hard copy and digital versions. RICS not only embraces these high level valuation principles itself but also supports the adoption and implementation of such universal standards globally. While the RICS Red Book continues to cover in considerable detail the valuation of assets in the form of real estate (land, buildings and interests therein), its coverage extends to all types of asset, including associated liabilities where appropriate.

This edition incorporates a number of significant changes and updates, including its layout and format, to enhance its clarity and ease of use, and to ensure a robust framework for consistency and best practice in the execution and delivery of valuations.

Material that previously appeared in different parts of the 2012 edition has been brought together to improve clarity and avoid repetition.

The Valuation Standards VS1–6 of the 2012 edition, including the associated Appendices, have been reviewed and incorporated into Global Professional Standards (PS) and Global Valuation Practice Statements (VPS). All members providing a written valuation are required to comply with these Professional Standards and Valuation Practice Statements – in other words, unless stated otherwise, they are mandatory.

The guidance notes included within the 2012 edition have also been reviewed and updated and are now included as RICS Global Valuation Practice Guidance – Applications (VPGA). These Applications focus on the relevance and implementation of the professional standards and valuation practice statements in specific contexts, whether for a particular purpose or in relation to a particular property or asset type. While the applications are primarily advisory in nature, all members are expected to be familiar with them.

Alongside this new edition of the Red Book, work is being taken forward to secure that real estate around the world is also measured consistently. Thus RICS is a member of an international coalition, initially comprising 20 founder member organisations, to establish International Property Measurement Standards (IPMS), the first edition of which is due to publish in 2014. Such measurement standards will relate to and interconnect with all RICS published material.
Acknowledgments

The RICS appraisal and valuation manual was originally published as two separate titles:

- *Guidance notes on the valuation of assets*, 1st (1976), 2nd (1981) and 3rd (1990) editions, published under the title, Statement of asset valuation practice and guidance notes and


The RICS Appraisal and Valuation Standards were first published in 2003. Nine amendments were published between March 2003 and April 2007.


The 7th edition of the RICS Valuation Standards – Global and UK was published in April 2011.

The 2012 edition of the RICS Valuation – Professional Standards (Global and UK) was published in March 2012.

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Extracts from International Financial Reporting Standard 13 (IFRS 13) *Fair Value Measurement* in VPS 4 and from International Accounting Standard 17 *Leases* in UKGN 1:

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RICS would like to thank the Chartered Institute of Public Finance and Accountancy (CIPFA) for its help in revising UK appendix 5.

RICS would like to thank Communities and Local Government (formerly ODPM) for its help in revising UKGN 5, Local authority disposal of land for less than best consideration.

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The Institute of Revenues Rating and Valuation (IRRV) is the largest UK professional body operating in the field of revenues, benefits and valuation. IRRV valuer members usually have dual membership of RICS and IRRV.
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IVSC International Valuation Standards (IVS) 2013
1 Introduction

Overall purpose

1 Consistency, objectivity and transparency are fundamental to building and sustaining public confidence and trust in valuation. In turn their achievement depends crucially on possessing and deploying the appropriate skills, knowledge, experience and ethical behaviour, both to form sound judgments and to report opinions of value clearly and unambiguously to clients and other valuation users.

2 Globally recognised high level valuation principles and definitions are now embodied in the International Valuation Standards (IVS) published by the International Valuation Standards Council (IVSC). RICS has long been a supporter of the development of such universal standards, and not only fully embraces them itself, but also proactively supports their adoption by others around the world.

3 But acceptance alone is not enough – effective implementation is the key. If confidence and public trust in the valuation process is to be achieved, standards must not only be uniformly interpreted and consistently applied but also actively monitored and enforced.

4 That is the rationale for this new global edition of RICS Valuation – Professional Standards 2014, commonly referred to as the ‘Red Book’. This formally recognises and adopts the IVS by requiring members to follow them. It also complements the IVS by providing detailed guidance and specific requirements concerning their practical implementation.

5 This approach is reinforced by the RICS professional standards regarding ethics, skills and conduct; and is assured by a well-established system of regulation and by progressive introduction of a system of practising valuer registration. The whole ensures the positioning of RICS members and regulated firms as the leading global providers of IVS-compliant valuations.

6 The aim is simply stated – it is to engender confidence in, and to provide assurance to, clients and recognised users alike, that a valuation provided by an RICS-qualified valuer anywhere in the world will be undertaken to the highest professional standards overall.

Coverage

From the valuation provider’s perspective

7 For members, these professional standards and valuation practice statements set out procedural rules and guidance which:

(a) include the principles set out in the IVSC Code of Ethical Principles for Professional Valuers and expressly comply with the RICS Rules of Conduct
1 Introduction

(b) impose on individual valuers or firms registered for regulation by RICS certain mandatory obligations regarding competence, objectivity and transparency

(c) establish a framework for uniformity and best practice in the execution and delivery of valuations.

8 They do not:

(a) instruct members on how to value in individual cases

(b) prescribe a particular format for reports: provided the mandatory requirements in these standards are met, reports should always be appropriate and proportionate to the task

(c) override standards specific to individual jurisdictions – see PS 1 paragraph 4, Compliance with other standards, and PS 1 paragraph 5, RICS national association valuation standards.

From the valuation user’s perspective

9 For clients and other valuation users these professional standards and valuation practice statements ensure:

(a) consistency in approach, aiding understanding of the valuation process and hence of the value reported

(b) credible and consistent valuation opinions by suitably trained valuers with appropriate qualification and adequate experience for the task

(c) independence, objectivity and transparency in the valuer’s approach

(d) clarity regarding terms of engagement, including matters to be addressed and disclosures to be made

(e) clarity regarding the basis of value, including any assumptions or material considerations to be taken into account

(f) clarity in reporting, including proper and adequate disclosure of relevant matters where valuations may be relied on by a third party.

Arrangement of RICS global material

10 The RICS global material in this edition has been grouped under three distinct headings, the first two covering matters relevant to valuation assignments generally, the third covering matters relating to particular applications. The intention is to make clear to members what is mandatory and what is advisory – thus collected together under the first two headings is the mandatory material and under the third the advisory material.

11 This signals a new approach to identifying and classifying valuation practice guidance. This will be issued either in the form of Guidance Applications, covering specific asset types or situations that are closely linked to one or more practice statements, or in the form of Guidance Notes, in all other cases. Guidance Applications and Guidance Notes are of equal status – they contain advisory and not mandatory material. But for the convenience of users, the Guidance Applications are reproduced in full in this edition, whereas appropriate cross-references are included in relation to Guidance Notes.
RICS Professional Standards (PS) – mandatory

RICS Professional Standards as they apply to valuers are denoted by the use of a PS reference number and are mandatory (unless otherwise stated) for all members providing written valuations. They define the parameters for compliance with the Red Book, including adoption of the International Valuation Standards; set out the associated RICS regulatory requirements; and clarify the detailed application of the RICS Rules of Conduct when members are undertaking valuation work. They comprise:

- **PS 1** – Compliance with standards and practice statements where a written valuation is provided
- **PS 2** – Ethics, competency, objectivity and disclosures

RICS Global Valuation Practice Statements (VPS) – mandatory

RICS Valuation Practice Statements are denoted by the use of a VPS reference number and contain specific, mandatory requirements and related implementation guidance, in relation to the process of providing a valuation that is IVS-compliant. They comprise:

- **VPS 1** – Minimum terms of engagement
- **VPS 2** – Inspections and investigations
- **VPS 3** – Valuation reports
- **VPS 4** – Bases of value, assumptions and special assumptions

RICS Global Valuation Practice Guidance – Applications (VPGA) – advisory

RICS Valuation Practice Guidance – Applications are denoted by the use of a VPGA reference number and provide further implementation guidance in the specific instances listed. While not mandatory, they embody ‘best practice’ – that is procedures that in the opinion of RICS meet a high standard of professional competence. They comprise:

- **VPGA 1** – Valuation for inclusion in financial statements
- **VPGA 2** – Valuation for secured lending
- **VPGA 3** – Valuation of businesses and business interests
- **VPGA 4** – Valuation of individual trade related properties
- **VPGA 5** – Valuation of plant and equipment
- **VPGA 6** – Valuation of intangible assets
- **VPGA 7** – Valuation of personal property, including arts and antiques
- **VPGA 8** – Valuation of portfolios, collections and groups of properties
- **VPGA 9** – Valuation in markets susceptible to change: certainty and uncertainty

Publication

The primary resource for accessing these standards is the Red Book section of the RICS website (www.rics.org/redbook). In addition it provides links to the national...
1 Introduction

association valuation standards (see below), guidance notes, exposure drafts, valuation alerts and other valuation material. It also includes all amendments and newly published material issued after the date from which this edition takes effect.

All versions of these standards, including translations, are available directly from RICS at www.rics.org/guidance

Amendments and exposure drafts

16 The content of these standards is under regular review, and amendments and additions will be issued from time to time, when required. These will be made to the web-based publication as required, but for the printed version they will be included only in the subsequent editions.

17 Where amendments may have a substantial effect, for instance the rewriting of a valuation practice statement (VPS) or valuation practice guidance application (VPGA), they may be published as an exposure draft. An exposure draft will contain the text authorised for public comment by the RICS Valuation Standards Board, see www.rics.org/redbook

18 The purpose of an exposure draft is to enable members to comment on the approved text, and possibly identify flaws, before incorporation into the Red Book. The text of an exposure draft will, after consideration of any comments made and final approval of the RICS Valuation Standards Board, become mandatory on the effective date of the next Red Book update following its publication.

19 The RICS Valuation Standards Board would also be pleased to receive suggestions for inclusion of additional material or requests for clarification of the text.

Effective date

International Valuation Standards

20 The International Valuation Standards reproduced with kind permission from IVSC in this Red Book edition are those approved by the IVSC Standards Board on 1 July 2013 with an effective date of 1 January 2014 (although IVSC encouraged earlier adoption).

21 Members are reminded that IVSC reserves the right to make further amendments to IVS at any time. Any consequential amendments to this Red Book edition will be accessible on the RICS website (see under the heading Publication above), but will not be incorporated in hard copy versions until the next edition.

RICS material

22 The RICS material included in this edition takes effect from 6 January 2014 and applies to all valuations where the valuation date is on or after that day. Again, any amendments to this Red Book edition will be accessible on the RICS website (see under the heading Publication above), but will not be incorporated in hard copy versions until the next edition.
Copies of the RICS Red Book text current at any given date may be obtained through the RICS library.

National standards

RICS also publishes – separately from the global standards – a number of national standards (see PS 1 paragraph 5, RICS national association valuation standards) and national guidance material. They are designed to cover specific statutory or regulatory requirements in local jurisdictions, while being consistent with relevant international standards. This approach is fully in accord with United Nations voluntary guidelines encouraging jurisdictions to enhance transparency and overall consistency in valuation. National association valuation standards and guidance are available directly from RICS at www.rics.org/guidance

It is the member’s responsibility to be aware of changes since the date of publication of this edition to legislation or to its interpretation through case law – and also to be aware of amendments to the International Valuation Standards or to any other valuation standards relevant to the particular valuation assignment. Valuers should refer to the RICS website for any updates regarding RICS material.
2 RICS glossary

This glossary defines various terms used in these RICS standards that have a special or restricted meaning. Terms not appearing in the glossary follow their common dictionary meaning. Where a term is used as defined below, it is identified in the text with *italic* font. Where the glossary includes terms that are defined in the IVS, the IVS wording has been adopted. A full list of IVS definitions is included in the IVS annex of this publication.

National association *valuation standards* may have additional terms and these will be defined in the context of the specific national standard.

**assumption**
A supposition taken to be true. It involves facts, conditions or situations affecting the subject of, or approach to, a valuation that, by agreement, do not need to be verified by the valuer as part of the valuation process. Typically, an *assumption* is made where specific investigation by the valuer is not required in order to prove that something is true. *See IVS Framework paragraphs 48–51.*

**basis of value**
A statement of the fundamental measurement assumptions of a valuation.

**cost approach**
An approach that provides an indication of value using the economic principle that a buyer will pay no more for an asset than the cost to obtain an asset of equal utility, whether by purchase or construction.

**date of the report**
The date on which the valuer signs the report.

**date of valuation**
See *valuation date*.

**departure**
Special circumstances where the mandatory application of the *valuation practice statements* may be inappropriate or impractical or the valuer may be required to comply with standards other than those of RICS.

**depreciated replacement cost (DRC)**
The current cost of replacing an asset with its modern equivalent asset less deductions for physical deterioration and all relevant forms of obsolescence and optimisation.

**external valuer**
A valuer who, together with any associates, has no material links with the client, an agent acting on behalf of the client or the subject of the assignment.
fair value

There are two distinct definitions, and great care must be exercised in selecting and specifying the correct definition according to the valuation context.

1. 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)

2. The estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties. (IVS 2013). This does not apply to valuations for financial reporting – see IVS 300.

(For more detailed explanation of these definitions see VPS 4 paragraph 1.5, Fair value, and VPGA 1, Valuation for inclusion in financial statements.)

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 are published to provide information to a wide variety of unspecified third party users. Financial statements carry a measure of public accountability that is developed within a regulatory framework of accounting standards and the law.

firm

The firm or organisation for which the member works, or through which the member trades.

goodwill

Any future economic benefit arising from a business, an interest in a business or from the use of a group of assets that is not separable.

guidance note (GN)

Further material and information on good practice appropriate for particular types of circumstances. Where procedures are recommended for specific professional tasks they are intended to embody 'best practice' and are procedures which, in the opinion of RICS and IRRV, members should normally adopt in order to demonstrate the required level of professional competence.

income approach

An approach that provides an indication of value by converting future cash flows to a single current capital value.

inspection

A visit to a property or inspection of an asset, to examine it and obtain relevant information, in order to express a professional opinion of its value. However, physical examination of a non-real estate asset, e.g. a work of art or an antique, would not be described as 'inspection' as such.
intangible asset

A non-monetary asset that manifests itself by its economic properties. It does not have physical substance but grants rights and economic benefits to its owner.

internal valuer

A valuer who is in the employ of either the enterprise that owns the assets, or the accounting firm responsible for preparing the enterprise’s financial records and/or reports. An internal valuer is generally capable of meeting all the requirements of independence and professional objectivity required under PS 2 paragraph 4, Independence, objectivity and conflict of interest, but, for reasons of public presentation and regulation, may not always be able to satisfy any additional criteria for independence under PS 2 paragraph 8, Disclosures, in certain types of assignment.

International Financial Reporting Standards (IFRS)

Standards set by the International Accounting Standards Board (IASB) with the objective of achieving uniformity in accounting principles. The standards are developed within a conceptual framework so that elements of financial statements are identified and treated in a manner that is universally applicable. These standards were previously known as International Accounting Standards (IAS).

investment property

Property that is land or a building, or part of a building, or both, held by the owner to earn rentals or for capital appreciation, or both, rather than for:

(a) use in the production or supply of goods or services, or for administrative purposes, or
(b) sale in the ordinary course of business.

investment value, or worth

The value of an asset to the owner or a prospective owner for individual investment or operational objectives. (May also be known as worth.)

market approach

An approach that provides an indication of value by comparing the subject asset with identical or similar assets for which price information is available.

market rent (MR)

The estimated amount for which an interest in real property should be leased on the valuation date between a willing lessor and willing lessee on appropriate lease terms in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.
market value (MV) The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

marriage value See synergistic value.

member A Fellow, professional member, associate member or honorary member of the Royal Institution of Chartered Surveyors (RICS), or a Fellow, member (diploma holder) or member (honours) of the Institute of Revenues Rating and Valuation (IRRV).

real estate Land and all things that are a natural part of the land (e.g. trees, minerals) and things that have been attached to the land (e.g. buildings and site improvements) and all permanent building attachments (e.g. mechanical and electrical plant providing services to a building), that are both below and above the ground.

real property All rights, interests and benefits related to the ownership of real estate, including any negative rights, interests or benefits (i.e. obligations, encumbrances or liabilities) relating to the interest being valued.

registered for regulation/registered by RICS (a) A firm that is registered for regulation by RICS under the RICS bye-laws.

(b) A member who is registered as a valuer under RICS Valuer Registration (VR).

special assumption An assumption that either assumes facts that differ from the actual facts existing at the valuation date or that would not be made by a typical market participant in a transaction on the valuation date.

special purchaser A particular buyer for whom a particular asset has a special value because of advantages arising from its ownership that would not be available to other buyers in a market.

special value An amount that reflects particular attributes of an asset that are only of value to a special purchaser.

specialised property A property that is rarely, if ever, sold in the market, except by way of a sale of the business or entity of which it is part, due to the uniqueness arising from its specialised nature and design, its configuration, size, location or otherwise.
synergistic value, or marriage value
An additional element of value created by the combination of two or more assets or interests where the combined value is more than the sum of the separate values. (May also be known as marriage value.)

terms of engagement
Written confirmation of the conditions that either the member proposes or that the member and client have agreed shall apply to the undertaking and reporting of the valuation. See IVS 101 Scope of Work.

third party
Any party, other than the client, who may have an interest in the valuation or its outcome.

trade related property
Any type of real property designed for a specific type of business where the property value reflects the trading potential for that business.

trading stock
Stock held for sale in the ordinary course of business, for example, in relation to property, land and buildings held for sale by builders and development companies.

valuation date
The date on which the opinion of value applies. The valuation date shall also include the time at which it applies if the value of the type of asset can change materially in the course of a single day.

valuation practice guidance – application (VPGA)
Applications support the implementation of the professional standards and the valuation practice statements in specific contexts, whether for a particular purpose or in relation to a particular asset type. VPGAs set out the key issues that need to be taken into account and, where appropriate, direct members’ attention to other sources of guidance and information that are or may be relevant.

valuation practice guidance
• Application
• Note
RICS Valuation Practice Guidance – Applications and Guidance Notes are of equal status. They provide implementation guidance and recommendations for specific professional tasks. While not mandatory, they embody ‘best practice’ – that is procedures that in the opinion of RICS meet a high standard of professional competence.

valuation practice statement
Contains specific, mandatory requirements and related implementation guidance, in relation to the process of providing a valuation that complies with the International Valuation Standards (IVS).

valuation standard
A statement of the highest professional standards that apply mandatorily to members when providing written valuations.

worth
See investment value.
3 RICS professional standards [PS]

PS 1 Compliance with standards and practice statements where a written valuation is provided

All RICS and IRRV members, whether practising individually or within an RICS-regulated or non-regulated firm, who provide a written valuation are required to comply with the professional standards and valuation practice statements set out in Parts 3 and 4 of this edition of the Red Book. This includes compliance with the International Valuation Standards (IVS) issued by the International Valuation Standards Council (IVSC).

RICS members must also comply with the requirements of RICS valuer registration (VR).

Implementation

1 Mandatory application
2 Compliance within firms
3 Compliance with IVS
4 Compliance with other valuation standards
5 RICS national association valuation standards
6 Exceptions
7 Departures
8 Regulation: monitoring compliance with these professional standards and valuation practice statements
9 Application to members of the IRRV

The following professional standards (PS) and valuation practice statements (VPS) have been approved by both the RICS and IRRV as a comprehensive set of professional standards for the practice and delivery of valuation services by their members.
1 Mandatory application

1.1 All members and regulated firms must comply with the professional standards (PS) and valuation practice statements (VPS) in parts 3 and 4 of this edition (RB 2014) in accordance with RICS bye-law B5.2.1(b) Liability of Members and RICS bye-law B5.3.1 Liability of Firms. The professional standards and valuation practice statements are therefore of mandatory application to any member of RICS or RICS-regulated firm involved in undertaking or supervising valuation services by the provision of written valuation advice. IRRV has similarly adopted these standards as being of mandatory application to their members (see paragraph 9, Application to members of the Institute of Revenues, Rating and Valuation (IRRV)). Together with the implementation guidance relating to specific valuation applications in part 5 of this publication, they are commonly referred to as the RICS ‘Red Book’.

1.2 The phrase ‘undertaking or supervising valuation services’ includes any person who is responsible for, or accepts responsibility for, analysing and communicating a written opinion of value. This may include individuals who produce but do not sign valuation reports within their organisation, and conversely individuals who sign by way of supervision or assurance but do not produce valuation reports within their organisation.

1.3 These professional standards and valuation practice statements have been written as they apply to the individual member. Where it is necessary to consider the application of a standard or a statement to a firm registered for regulation by RICS, it is to be interpreted accordingly.

2 Compliance within firms

2.1 There is an individual responsibility on the part of all RICS and IRRV members to comply with these professional standards and valuation practice statements, whether they practise as individuals or within firms. In the latter case, how this responsibility is put into practice will depend, to a certain extent, on the nature of the firm:

- **Firms regulated by RICS**: The firm and all RICS members within the firm must ensure that all processes and valuations are fully compliant with these standards. This includes valuations that are not the responsibility of an RICS member.

- **Firms not regulated by RICS**: While such firms may have their own corporate processes over which RICS cannot exert control, individual members in these firms who are responsible for valuations are required to comply with these standards.

2.2 There may be circumstances where the firm’s processes expressly prevent compliance with a particular aspect of a professional standard or valuation practice statement. In such cases the member is entitled to depart from the specific standard or statement, but must:

- be satisfied that the non-compliance does not lead to clients being misled or to unethical behaviour
- identify in the report the specific areas where compliance with any standard or practice statement has been precluded, together with the reason for this non-compliance and
Comply with all other aspects of these standards and practice statements.

Where the member contributes to a valuation, it is expected that the contribution will comply with these professional standards and valuation practice statements.

3 Compliance with International Valuation Standards (IVS)

RICS recognises the International Valuation Standards Council (IVSC) as the setter of International Valuation Standards (IVS), which comprise internationally accepted high level valuation principles and definitions. These RICS professional standards (PS), valuation practice statements (VPS), and valuation practice guidance – applications (VPGA) require members to adopt and comply with the IVS, and set out specific requirements for, together with additional guidance on, their practical implementation. The International Valuation Standards (IVS) 2013 are set out in full as an annex to this edition and take effect from 1 January 2014.

Where there is a requirement that a valuation complies with IVS, a statement should be made that in complying with the Red Book the valuation will also be compliant with IVS. (See VPS 1 paragraph 9(k), Confirmation that the valuation will be undertaken in accordance with the IVS, and VPS 3 paragraph 7(k), Confirmation that the valuation will be undertaken in accordance with the IVS.)

Where a statement is made that a valuation will be or has been undertaken in accordance with IVS it is implicit that all relevant individual IVS standards are complied with. Where a departure from IVS is necessary, this should be clearly explained. (See VPS 1 paragraph 9(k), Confirmation that the valuation will be undertaken in accordance with the IVS, and VPS 3 paragraph 7(k), Confirmation that the valuation will be undertaken in accordance with the IVS.)

4 Compliance with other valuation standards

RICS recognises that a member may be requested to provide a report that complies with standards other than these professional standards and valuation practice statements. This will normally arise in relation to the particular requirements that apply within individual jurisdictions.

In these cases a statement must be included in the terms of engagement and the report (VPS 1 paragraph 9(k), Confirmation that the valuation will be undertaken in accordance with the IVS, and VPS 3 paragraph 7(k), Confirmation that the valuation will be undertaken in accordance with the IVS) that:

- the named standards have been complied with
- the valuation will also comply with the Red Book and, if appropriate,
- the valuation will also comply with IVS.

5 RICS national association valuation standards

RICS national association valuation standards have mandatory status in the countries or states to which they apply and are intended to supplement the relevant global valuation standards to meet local statutory or regulatory requirements where these are not embodied in a self-contained set of standards of the type envisaged in paragraph 4 above.
5.2 Where the valuation involves assets in two or more countries or states with different valuation standards, the member must agree with the client which standards will apply to the instruction.

6 Exceptions

6.1 It is recognised that for some purposes the mandatory application of VPS 1 to VPS 4 would not be appropriate – these instances are specified below. Although not mandatory in such circumstances, the adoption of the relevant standards is nevertheless encouraged where not precluded by the specific requirement or context.

6.2 The areas of exception are where:

• the member is performing a statutory function, whether by virtue of the office held or otherwise – this exception does not extend to the provision of a valuation for inclusion in a statutory return to a tax authority
• the valuation advice is provided expressly in preparation for, or during the course of, negotiations or litigation
• the valuation advice is provided purely for internal purposes, without liability, and is not communicated to any third party
• the valuation advice is provided as part of agency or brokerage work in anticipation of receiving instructions to dispose of, or acquire, an asset. In such cases valuers should refer to the RICS guidance note Real Estate Agency and Brokerage Standards, (2011) – this exception does not extend to a purchase report that includes a valuation
• the valuation advice is provided in anticipation of giving evidence as an expert witness, in which case valuers should refer to the RICS practice statement Surveyors acting as expert witnesses (2008).

6.3 For the avoidance of doubt, a replacement cost figure for assets other than personal property that is provided, either within a report or separately, for the purpose of insurance is not a 'written opinion of value' for the purpose of 'undertaking valuation services' as defined in PS 1 paragraph 1.2, Mandatory application, above.

7 Departures

7.1 No departure is permitted from PS 1, Compliance with standards and practice statements where a written valuation is provided, or PS 2, Ethics, competency, objectivity and disclosures, in these standards, which are mandatory in all circumstances.

7.2 If there are special circumstances where it is considered inappropriate to comply, in whole or in part, with VPS 1, Minimum terms of engagement, VPS 2, Inspections and investigations, and VPS 3, Valuation reports (reflecting any modification by an RICS national association standard under paragraph 5.1, RICS national association standards, above, or in consequence of adoption of another valuation standard under paragraph 4.1, Compliance with other valuation standards, above) and those circumstances do not fall within the exceptions in paragraph 6,
Exceptions, above, then these must be confirmed and agreed with the client as a departure and a clear statement to that effect included in the terms of engagement, report, and any published reference to it.

7.3 For most valuation purposes, one of the bases of value recognised by IVS and defined in VPS 4, Bases of value, assumptions and special assumptions, will be appropriate. Where another basis is used, this must be clearly defined and stated in the report. If adoption of that basis is mandatory in the particular context or jurisdiction, then adoption does not by itself constitute a departure, though the mandatory requirement to do so must be made clear. RICS does not encourage the voluntary use of a basis of value not defined in VPS 4, and will always regard such voluntary use as involving a departure.

7.4 Similarly, if the valuation falls to be provided in compliance with prescribed statutory or legal procedures not falling within paragraphs 4, Compliance with other valuation standards, and 5, RICS national association standards, above, (such as a prescribed basis of value that differs from those in IVS and VPS 4, Bases of value, assumptions and special assumptions) then again, provided those requirements are mandatory in the particular context or jurisdiction, compliance does not by itself constitute a departure – though the requirement to do so must be made clear.

7.5 A member who makes a departure may be required to justify the reasons for this to the RICS or IRRV.

8 Regulation: monitoring compliance with these professional standards and valuation practice statements

8.1 Members undertaking valuations, to which VPS 1, Minimum terms of engagement, VPS 2, Inspections and investigations, and VPS 3, Valuation reports, apply, must comply with the RICS valuer registration requirements. Full details of the registration requirements can be found at www.rics.org/vrs

8.2 As a self-regulatory body, RICS has a responsibility to monitor and seek assurance of compliance by its members and regulated firms with these professional standards and valuation practice statements. It has the right under its bye-laws to seek information from members or firms. The procedures under which such powers will be exercised in relation to valuations are set out at www.rics.org/regulation

9 Application to members of the Institute of Revenues Rating and Valuation (IRRV)

9.1 The IRRV Code of Conduct (www.irrv.net) requires members to comply with technical guidance where this has been issued or endorsed by the IRRV. These professional standards and valuation practice statements have been issued jointly by RICS and IRRV, and are therefore binding on members who are also members of the IRRV. The enforcement of the IRRV Code of Conduct is a matter for its Professional Conduct Committee, which provides guidance on what is expected of members and deals with complaints received. Sanctions for proven breaches of the Code include suspension or removal from membership. IRRV and RICS may request
PS 1 Compliance with standards and practice statements where a written valuation is provided

...
PS 2 Ethics, competency, objectivity and disclosures

As it is fundamental to the integrity of the valuation process, all members practising as valuers must have the appropriate experience, skill and judgment for the task in question and must always act in a professional manner free from any undue influence, bias or conflict of interest.

Implementation

1 Responsibility for the valuation
2 Professional and ethical standards
3 Member qualification
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1 Responsibility for the valuation

1.1 Each valuation to which these professional standards and valuation practice statements apply must be prepared by, or under the supervision of, an appropriately qualified, and named, valuer who accepts responsibility for it.

1.2 Where the valuation has been prepared with input from other members or valuers, or a separate valuation report on some specific aspect is incorporated, the resultant valuation remains the responsibility of the named valuer under
paragraph 1.1 above, but the others involved may be acknowledged (together with the statements required under VPS 3, Valuation reports, paragraph 7(k)).

1.3 RICS does not allow a valuation to be prepared by a ‘firm’ (as stated in IVS 103 Reporting (a) Identification and status of the valuer). However, the use of ‘for and on behalf of’ under the responsible valuer’s signature is an acceptable substitution.

1.4 The member is discouraged from referring to any valuation or report as either ‘formal’ or ‘informal’, as these terms may give rise to misunderstanding, particularly regarding assumptions that the member may or may not have made.

1.5 The member must exercise great caution before permitting valuations to be used for purposes other than those originally agreed. It is possible that a recipient or reader will not fully appreciate the restricted character of the valuation and of any qualifications in the report, and that it may be misquoted out of context. It is essential therefore that the terms of reporting appropriately address this risk. See also paragraph 5, Maintaining strict separation between advisers, below.

2 Professional and ethical standards

2.1 All RICS members are bound by the RICS Rules of Conduct. To assist members in their observance of the Rules, RICS has published a Global framework for Professional and Ethical Standards. The framework contains five standards that require members to:

- act with integrity
- always provide a high standard of service
- act in a way that promotes the profession
- treat others with respect
- take responsibility.

More detail is available at www.rics.org/ethics

2.2 Similarly, the IRRV Code of Conduct (www.irrv.net) requires their members to comply with technical guidance where this has been issued or endorsed by IRRV. These standards have been issued jointly by RICS and IRRV, and are therefore binding on members who are also members of the IRRV. The enforcement of the IRRV Code of Conduct is a matter for its Professional Conduct Committee, which provides guidance on what is expected of members and deals with complaints received. Sanctions for proven breaches of the Code include suspension or removal from membership. IRRV and RICS may request each other to deal with alleged breaches of these standards by those who are members of both bodies, and may share information with a view to ensuring compliance.

2.3 The IVSC has published both a Code of Ethical Principles for Professional Valuers and A Competency Framework for Professional Valuers. These are reflected in this section, the content of which fully meets the IVSC criteria.

3 Member qualification

3.1 The test of whether an individual is appropriately qualified to accept responsibility for or supervise the inputs into a valuation, involves satisfying the following criteria:
3.2 Members of RICS have to achieve and maintain defined standards of training and competence that meet or exceed the criteria set out in the IVSC publication *A Competency Framework for Professional Valuers*. However, as members are active across a wide range of specialisms and markets, membership of (including the holding of a qualification from) RICS or registration as a valuer does not of itself imply that an individual necessarily has the practical experience of valuation in a particular sector or market: this must always be verified by appropriate confirmation.

3.3 In some countries or states valuers are required to be certified or licensed to undertake certain valuations, and in such cases PS 1 paragraph 4, Compliance with other valuation standards, will apply. In addition, either the client or RICS national association valuation standards may stipulate more stringent requirements.

3.4 If the member does not have the required level of expertise to deal with some aspect of the commission properly then he or she should decide what assistance is needed. The member should then assemble and interpret relevant information from other professionals, such as specialist valuers, environmental surveyors, accountants and lawyers.

3.5 The personal knowledge and skill requirements may be met in aggregate by more than one member within a firm, provided that each meets all the other requirements of this valuation standard.

3.6 The client’s approval must be obtained if the member proposes to employ another firm to provide some or all of the valuations that are the subject of the instruction (see also VPS 3, Valuation reports, paragraph 7(a), Identification and status of valuer).

3.7 Where more than one valuer has undertaken or contributed to the valuation, a list of those valuers must be retained with the working papers, together with a confirmation that each named valuer has complied with the requirements of PS 1, Compliance with standards and practice statements where a written valuation is provided.

4 Independence, objectivity and conflict of interest

4.1 Members are required to exercise independence and objectivity in all instructions. For some purposes, statutes, regulations, rules of regulatory bodies or client’s special requirements may set out specific criteria that the member must also
meet in order to achieve a defined state of independence and objectivity. Frequently such additional criteria provide a definition of the acceptable level of independence and may use terms such as ‘independent expert’, ‘expert valuer’, ‘independent valuer’, ‘standing independent valuer’ or ‘appropriate valuer’. It is important that the member confirms compliance with these criteria both when confirming acceptance of the instruction and in the report, so that the client and any third party relying on the report can be assured that the additional criteria have been satisfied.

4.2 There is a general duty to treat information relating to a client as confidential where that information becomes known as a result of the professional relationship and is not in the public domain. The risk of disclosure of confidential information is a material factor that the valuer should consider in assessing whether or not there is a potential conflict of interest. A factor to be borne in mind is that it may be necessary to disclose some details of the valuer’s involvement in the subject of the valuation. If an adequate disclosure cannot be made without breaching the duty of confidentiality, then the instruction should be declined. The duty of confidentiality is continuous and ongoing, and includes current, past and even potential clients.

4.3 Although the member may meet the stipulated criteria for the particular appointment, the general RICS ethical requirements referred to in this section will still apply. It is therefore necessary for the member to identify any threats to their independence and objectivity, and take the appropriate action before accepting the instruction.

4.4 Members shall at all times act with integrity and avoid any actions or situations that are inconsistent with their professional obligation. Where a conflict, or potential conflict, is identified, consideration has to be given as to whether the instruction should be accepted or declined. To provide an audit trail, a note of all conflict of interest checks and their resolution must be retained with the working papers.

4.5 It is not possible to provide a definitive list of situations where a threat to a member’s independence or objectivity may arise. However, the following are examples of where it will usually be necessary for the member either to make an appropriate disclosure and propose a way to satisfactorily manage the conflict (see also paragraph 5, Maintaining strict separation between advisers) or, where it is considered that any conflict that might arise cannot be resolved or managed in a satisfactory way in accordance with these professional standards, to decline to act:

- acting for the buyer and the seller of a property or asset in the same transaction
- acting for two or more parties competing for an opportunity
- valuing for a lender where advice is also being provided to the borrower
- valuing a property or asset previously valued for another client
- undertaking a valuation for third-party consumption where the valuer’s firm has other fee-earning relationships with the client and
- valuing both parties’ interests in a leasehold transaction.

4.6 Additional guidance on conflicts of interest is available to RICS members at www.rics.org/guidance including the RICS guidance note, Conflicts of interest, (2012). Although the latter is written specifically to assist valuers of any discipline who are appointed to resolve disputes, it is of relevance to valuation assignments more generally as it contains in its appendices detailed examples of conflicts of interest in a hierarchical format.
4.7 The extent to which any potential conflict of interest will compromise the member’s overriding obligation to act with independence and objectivity will depend on the circumstances of each case. Material factors may include the particular context and purpose of the valuation, the client's motivation and objectives and the practicality of managing conflicts in accordance with the guidance specified in paragraph 3.5, Member qualifications, above. The interest of any third parties in the valuation, and the reliance they may place on it, will also be a relevant consideration. If the member doubts his or her ability to avoid or manage any threat to independence, the instruction should be declined.

4.8 In choosing to explain and seek agreement to the proposals for managing the conflict, the member must consider the standing and nature of the client, or prospective client. A large corporate client will find it easier to give an informed consent than a small business or an individual who rarely employs professionals. The member may have reason to believe that a prospective client does not have sufficient awareness of the issues to make an informed decision on the implications of any potential conflict, or the proposals for its management. In such case, the member should either decline the instruction, or advise the prospective client to take advice from another professional (for example, a lawyer or accountant) about the situation.

4.9 A member may be asked to act for both parties to a proposed transaction. Careful consideration must be given as to whether it is desirable to accept such an instruction, such as weighing the possibility of a conflict of interest arising in the future because of divergence of the clients’ respective interests. If the member concludes that it is not inappropriate or unwise, the written consent of both parties should be obtained before accepting the commission and reference to that consent must be included in the report.

4.10 A threat to the member’s objectivity can arise where the outcome of a valuation is discussed before its completion with either the client or another party with an interest in the valuation. While such discussions are not improper, and indeed may be beneficial to both the member and the client, the member must be alert to the potential influence that such discussions may have on his or her fundamental duty to provide an objective opinion. Where such conversations take place, the member must make a written record of any meetings or discussions, and whenever the member decides to alter a provisional valuation as a result, the grounds for doing so must be carefully noted.

4.11 The member may need to discuss various matters, such as the verification of facts and other relevant information (for example, confirming the outcome of rent reviews or clarifying the boundaries of a property), before forming a preliminary opinion of value. At any stage in the valuation process such discussions give the client an opportunity to understand the member’s viewpoint and evidence. It is expected that the client would disclose facts or information, including information about transactions in the property, asset or liability, relevant to the valuation task.

4.12 In providing a client with preliminary advice, or a draft report or valuation in advance of its completion, the member must state that:
- the opinion is provisional and subject to completion of the final report
- the advice is provided for the client's internal purposes only and
- any draft is on no account to be published or disclosed.
If any matters of fundamental importance are not reflected, their omission must be declared.

4.13 Where discussions with a client occur after the provision of preliminary material or opinions, it is important that such discussions do not, and can be shown not to, lead to any perception that the member’s opinion has been influenced by those discussions, other than to correct inaccuracies or incorporate any further information provided.

4.14 To demonstrate that the discussions have not compromised the member’s independence the file notes of discussions with the client on draft reports or valuations should include:
- the information provided, or the suggestions made, in relation to the valuation
- how that information was used to consider a change in material matters or opinions and
- the reasons why the valuation has or has not been changed.

4.15 If requested, this record should be made available to auditors or any other party with a legitimate and material interest in the valuation.

5 Maintaining strict separation between advisers

5.1 RICS has strict guidelines on the minimum standards that must be adopted by organisations when separating the advisers acting for ‘conflicting’ clients. Any arrangement (colloquially known in some jurisdictions as a ‘Chinese wall’) that is established must be robust enough to offer no chance of information or data passing from one set of advisers to another. This is a strict test; taking ‘reasonable steps’ to operate an effective separation is not sufficient. Accordingly, any arrangement set up and agreed to by affected clients must ensure that:
- the individual(s) acting for conflicting clients must be different – note that this extends to secretarial and other support staff
- such individuals or teams must be physically separated, at least to the extent of being in different parts of a building, if not in different buildings altogether
- any information or data, however held, must not be accessible to ‘the other side’ at any time and, if in a written form, must be kept secure in separate, locked accommodation to the satisfaction of the compliance officer, or another senior independent person, within the firm
- the compliance officer or other senior independent person:
  - should oversee the setting up and maintenance of the arrangement while it is in operation, adopting appropriate measures and checks to ensure it is effective
  - must have no involvement in either of the instructions and
  - should be of sufficient status within the organisation to be able to operate without hindrance and
- there should be appropriate education and training within the firm on the principles and practices relating to the management of conflicts of interest.
5.2 Effective arrangements are unlikely to work without considerable planning, as their management needs to be an established part of a firm’s culture. It will therefore be more difficult, and often impossible, for smaller firms or offices to operate them.

6 Duty of care to third parties

6.1 Where a duty of care is owed to a third party who is identifiable from the outset, the disclosures in accordance with paragraph 8, Disclosures where the public has an interest or upon which third parties may rely, must be made promptly to that party before the valuation is undertaken. In addition to the disclosures required under paragraph 8 there must also be disclosure of any circumstances where the valuer or the firm will gain from the appointment beyond a normal fee or commission. This gives third parties the opportunity to object to the appointment if they feel that the member’s independence and objectivity may be compromised.

6.2 However, in many cases the third parties will be a class of individuals, for example, the shareholders of a company, where disclosure at the outset to all interested third parties would clearly be impractical. In such cases the earliest practical opportunity for disclosure will be in the report or any published reference to it. A greater onus thus lies on the member to consider, before accepting the instruction, whether those third parties relying on the valuation will accept that any involvement requiring disclosure does not unduly compromise the member’s objectivity and independence. See paragraph 8, Disclosures where the public has an interest or upon which third parties may rely, for further detail about disclosures in relation to specific categories of valuation.

6.3 Valuations in the public domain, or which will be relied on by third parties, are frequently subject to statute or regulation. There are often specific stipulations that the member must meet in order to be deemed suitable to provide a truly objective and independent view. For certain purposes RICS professional standards may also impose specific restrictions or conditions on the member providing valuation advice where there was previous involvement with the asset or a party with an interest in it. However, there are no specific criteria for most valuations, and the onus is on the member to ensure that there is an awareness of potential conflicts and other threats to independence and objectivity.

7 Terms of engagement

7.1 It is fundamental that by the time the valuation is concluded, but prior to the issue of the report, all the matters material to the report have been fully brought to the client’s attention and appropriately documented. This is to ensure that the report does not contain any revision of the initial terms of engagement of which the client is unaware.

7.2 Members should take care that they understand their clients’ needs and requirements fully, and appreciate that there will be occasions when they may need to guide clients to choose the most appropriate advice for the given circumstances.

7.3 The standards for minimum terms of engagement are set out in VPS 1, Minimum terms of engagement. Where VPS 1 is not mandatory the minimum terms of engagement may nevertheless provide a guide to the drafting of terms to suit the specific case.
7.4 As disputes may arise many years after the completion of a valuation, it is essential that the agreement of the terms of engagement is contained in, or evidenced by, comprehensive documentation maintained in a recognised and acceptable business format.

8. Disclosures where the public has an interest or upon which third parties may rely

8.1 Disclosure requirements

8.1.1 Certain types of valuation may be relied on by parties other than the client that either commissioned the report or to whom it is addressed. Examples of this type of valuation would include those for:

- a published financial statement
- a stock exchange, or similar body
- publication, prospectus or circular
- investment schemes or
- takeovers or mergers.

Where the valuation is of an asset that has previously been valued by the valuer, or the valuer’s firm for any purpose, the following disclosures must be made in the terms of engagement, in the report, and in any published reference to the valuation:

- the relationship with the client and previous involvement
- rotation policy
- time as signatory
- proportion of fees.

8.1.2 The disclosures required by this professional standard may be extended by requirements that apply to a specific country or state (where PS 1, paragraph 4, Compliance with other valuation standards, applies), or that are incorporated into the relevant national association valuation standard (where PS 1 paragraph 5, RICS national association valuation standards, applies). For additional or modified requirements in relation to valuation for secured lending see VPGA 2, Valuation for secured lending.

8.2 The relationship with the client and previous involvement

8.2.1 Although the requirement for the member to act with independence, integrity and objectivity is clear, it does not require disclosure of all the working relationships between the member and the client. The member is not expected to establish and evaluate every possible set of circumstances, but should reflect the principles and their spirit. In cases of doubt it is recommended that a disclosure is made. The extent and duration of the relationship of the member’s firm with the client for any purpose shall be disclosed as required by the following paragraphs.

8.2.2 To expose any potential conflict of interest where the member, or the member’s firm, has been involved with the purchase of one or more properties for
8.2.3 In considering the disclosures required by this professional standard, it is necessary to identify the ‘client’ and ‘firm’.

8.2.4 There are many different relationships that may be considered to fall within the identification of the client and firm. To be consistent with the minimum terms of engagement (see VPS 1, Minimum terms of engagement) and reporting (see VPS 3, Valuation reports), the client is the entity that agrees the terms of engagement and to which the report is addressed. The firm is the entity that is identified in the confirmation of the terms of engagement and the report.

8.2.5 Closely connected companies within a group should properly be regarded as a single client or firm. However, due to the often complex nature of modern business it is frequently the case that the other entities have only a remote legal or commercial connection with the client for which the member’s firm also acts. There may also be practical difficulties in identifying such relationships, for example, between the associates of the member’s firm in other countries or states and the client. Sometimes it is the member’s commercial relationship with a party other than the client that could create a perceived threat to independence.

8.2.6 The member is expected to make reasonable enquiries proportionate to the circumstances: it is not necessary to establish every potential relationship that there may be, provided the member adheres to the principles of this standard.

8.2.7 The following are examples of where the disclosure requirements will relate to and include parties other than the entity giving the valuation instruction:

- subsidiaries of an instructing holding company
- where instructions are from a subsidiary company, those other companies connected by the same holding company or
- a third party issuing valuation instructions as agent for different legal entities, for example, the managers of a property fund.

8.2.8 Similar considerations apply in identifying the extent of the member’s firm for disclosure purposes, where there may be separate legal entities in different locations and/or undertaking different types of work. It may not be relevant to include all organisations connected with the firm undertaking the valuation where the activities are remote or immaterial – for example, they do not involve the provision of asset valuation or similar advice. However, if there is a series of closely connected entities trading under a common style, the extent of the client’s relationship with all those entities should be disclosed – for example, a firm where one arm is undertaking valuations and another undertaking all other property advice and management.

8.2.9 National association valuation standards or local regulation may extend this requirement by applying additional requirements.
8.3 Rotation policy

8.3.1 The obligation to disclose the firm’s rotation policy will arise only where the member has provided a series of valuations over a period of time. Where it is a first or one-off instruction, it is clear that it would be inappropriate to comment on any general rotation policy.

8.3.2 Where the member responsible for the valuation in accordance with this standard holds that responsibility for many years, familiarity with either the client or the asset valued could lead to the perception that the member’s independence and objectivity has been compromised. This may be addressed by arranging for the rotation of the member who accepts responsibility for the valuation.

8.3.3 The method by which a firm arranges for any rotation of those responsible for valuations is for the firm to decide, after discussion with the client if appropriate. However, RICS recommends that the individual responsible for signing the report, no matter the standing of that member in the firm, has that responsibility for a limited number of years. The exact period will depend on:

- the frequency of valuation
- any control and review procedures in place such as ‘valuation panels’, which assist both the accuracy and objectivity of the valuation process and
- good business practice.

RICS considers it good practice, albeit not mandatory, to rotate valuers at intervals of not more than seven years.

8.3.4 If a firm is of insufficient size to rotate the signatory, or to have in place ‘valuation panels’, other arrangements could be made to comply with the principles of this standard. For example, where the same valuation instruction is undertaken on a regular basis, an arrangement for the valuation to be periodically reviewed at intervals not greater than seven years by another member would assist in demonstrating that the member is taking steps to ensure that objectivity is maintained and thus may retain the confidence of those relying on the valuation.

8.4 Time as signatory

8.4.1 The purpose of this requirement is to provide any third party with information on the length of time that a member has continuously been the signatory to valuations for the same purpose. It also requires a similar disclosure as to the length of time the member’s firm has been carrying out valuations of that asset for the same client, and the extent and duration of their relationship.

8.4.2 In relation to the member, the disclosure should relate to the continuous period of responsibility for the valuation up to the date of the report. It is possible that the member was the signatory to previous reports for the same purpose, but due to the firm’s rotation policy (as set out earlier) there was a period of time when the member did not have that responsibility. There is no requirement to include that earlier period in the disclosure.

8.4.3 The member is not required to provide a comprehensive account of all work ever undertaken by the member’s firm for the client. A simple, concise statement that discloses the nature of other work done and the duration of the relationship is all that is required.
8.4.4 If there is no relationship other than the valuation instruction in question, a statement to that effect should be made.

8.5 Previous involvement

8.5.1 The purpose of this requirement is to expose any potential conflict of interest where the member, or the member’s firm, has valued the asset for the same purpose, or has been involved with the purchase of the same asset for the client within the period of 12 months preceding the date of instruction or date of agreement of the terms of engagement (whichever is earlier), or a specific longer period prescribed or adopted in a particular state or country.

8.5.2 Where the valuation is provided for inclusion in a published document in which the public has an interest, or upon which third parties may rely, the member shall make the following disclosures:

(a) where a valuation is of an asset that has previously been valued by the member or the member’s firm, for the same purpose:

(i) in the terms of engagement, a statement about the firm’s policy on the rotation of the valuer responsible for the valuation and

(ii) in the report, and published reference to it, a statement of the length of time the valuer has continuously been the signatory to valuations provided to the client for the same purpose as the report and, in addition, the length of time the valuer’s firm has continuously been carrying out the valuation instruction for the client;

(b) the extent and duration of the relationship of the valuer’s firm with the client for any purpose;

(c) where the report, and any published reference to it, includes one or more assets acquired by the client within the 12 months preceding the valuation date, and the member or member’s firm, has in relation to those properties:

(i) received an introductory fee or

(ii) negotiated that purchase on behalf of the client.

The report should be endorsed in accordance with PS 2 paragraph 8.6, Proportion of fees, below.

8.5.3 National association valuation standards or local regulation may extend this requirement by applying additional criteria. For additional or modified requirements in relation to valuation for secured lending see VPGA 2.

8.6 Proportion of fees

8.6.1 A statement should be made that the proportion of the total fees payable by the client during the preceding year relative to the total fee income of the member’s firm during the preceding year are minimal, significant or substantial.

8.6.2 A proportion of fees less than 5% may be considered to be ‘minimal’. Between 5% and 25% may be considered to be significant, and above 25% is substantial.

8.6.3 National association valuation standards or local regulation may extend this requirement by applying additional criteria.
8.7 Other disclosures

8.7.1 Care should be taken to make sure that, in addition to the various disclosures required under VPS 1 to VPS 3, all other disclosures required for a particular valuation or purpose are made. Disclosure requirements that may require more specific information related to the purpose of the valuation include:

- material involvement
- the status of the member
- specific requirements as to independence
- knowledge and skills of the member
- extent of investigations
- management of any conflicts of interest
- the valuation approach
- disclosures required by any regulatory body governing the purpose of the valuation.

9 Reviewing another valuer’s valuation

9.1 A valuer may quite properly be requested to review all or part of a valuation prepared by another valuer in circumstances that include the following, though the list is not exhaustive:

- assisting the consideration of risk assessment
- providing comment on a published valuation, for instance in a takeover situation, without providing a separate independent valuation
- commenting on valuations produced for use in legal proceedings
- assisting an audit enquiry.

9.2 It is important to make a clear distinction between a critical review of a valuation and an audit of a valuation or an independent valuation of a property, asset or liability included in another valuer’s report.

9.3 In carrying out any review the member is expected, by reference to the valuation date and to the facts and circumstances relevant to the asset at the time, to:

- form opinions as to whether the analysis in the work under review is appropriate
- consider whether the opinions and conclusions are credible and
- consider whether the report is appropriate and not misleading.

9.4 The review must be undertaken in the context of the requirements applicable to the work under review, and the member must develop and report opinions and conclusions together with the reasons for any disagreement.

9.5 A member must not undertake a critical review of a valuation prepared by another valuer that is intended for disclosure or publication, unless the member is in possession of all the facts and information upon which the first valuer relied.
4 RICS global valuation practice statements [VPS]

Throughout Part 4, the International Valuation Standards (IVS) are in bold; RICS text is in normal type.

VPS 1 Minimum terms of engagement

1 The terms of engagement provided in accordance with PS 2, paragraph 7, Terms of engagement, must be in writing and must also comply with this valuation practice statement. The terms in IVS 101, Scope of Work, have been included in this valuation practice statement.

2 The IVS 101 Scope of Work terms are:

(a) Identification and status of the valuer
(b) Identification of the client and any other intended users
(c) Purpose of the valuation
(d) Identification of the asset or liability to be valued
(e) Basis of value
(f) Valuation date
(g) Extent of investigation
(h) Nature and source of the information to be relied upon
(i) Assumptions and special assumptions
(j) Restrictions on use, distribution or publication
(k) Confirmation that the valuation will be undertaken in accordance with the IVS
(l) Description of report

3 The additional RICS requirements are inclusion of:

(m) the basis on which the fee will be calculated
(n) where the firm is registered for regulation by RICS, reference to the firm’s complaints handling procedure, with confirmation that a copy is available on request and
(o) a statement that compliance with these standards may be subject to monitoring under RICS’ conduct and disciplinary regulations.
VPS 1 Minimum terms of engagement

4 Normally the terms of engagement will be settled between the client and the valuer when instructions are first received and accepted (the initial confirmation of instructions). However, it is recognised that a valuation commission may range from a single asset to a substantial portfolio, thus the extent to which all the minimum terms of engagement can be confirmed in the initial confirmation could also vary.

5 Valuers should take care to ensure that they understand their clients’ needs and requirements fully, and appreciate that there will be occasions when they may need to guide clients to choose the most appropriate advice for the given circumstances.

6 It is fundamental that by the time the valuation is concluded, but prior to the issue of the report, all the matters listed under a) to o) above have been fully brought to the client’s attention and appropriately documented. This is to ensure that the report does not contain any revision of the initial terms of engagement of which the client is unaware.

7 Firms may have a standard form of terms of engagement, or standing terms of engagement in place that may include several of the minimum terms required by this statement. The valuer may need to amend such a form to refer to those matters that will be clarified at a later date.

8 Whenever the valuer or client identifies that a valuation may need to reflect an actual or anticipated marketing constraint, details of that constraint must be agreed and set out in the terms of engagement. The term ‘forced sale value’ must not be used (see VPS 4 paragraph 4, Valuations reflecting an actual or anticipated market constraint, and forced sales).

9 The IVS 101 content follows in bold together with additional RICS implementation guidance.

a) Identification and status of the valuer

A statement confirming:

(i) the identity of the valuer. The valuer may be an individual or firm;

(ii) that the valuer is in a position to provide an objective and unbiased valuation;

(iii) whether the valuer has any material connection or involvement with the subject of the valuation assignment or the party commissioning the assignment;

(iv) that the valuer is competent to undertake the valuation assignment. If the valuer needs to seek material assistance from others in relation to any aspect of the assignment, the nature of such assistance and the extent of reliance shall be agreed and recorded.

1 With regard to (i), a valuation is the responsibility of an individual valuer. RICS does not allow a valuation to be prepared by a ‘firm’ as stated. The use of ‘for and on behalf of’ is an acceptable substitution by an identified signatory when issuing a report. If the valuation has been undertaken by a member under the supervision of an appropriately qualified valuer, the valuer fulfilling the supervisory function must ensure, and be satisfied, that the work undertaken meets the same minimum standards as if he or she had been solely responsible for the task.
VPS 1  Minimum terms of engagement

2 With regard to (ii), for some purposes the valuer may be required to state if he or she is acting as an internal or external valuer. Where the valuer is obliged to comply with additional requirements regarding independence, PS 2 paragraph 4, Independence, objectivity and conflict of interest, will apply.

3 With regard to (iii), in considering the extent of any material involvement, whether past, current or possible future, the valuer must state such involvement in the terms of engagement. Where there has not been any previous material involvement, a statement to that effect must be made in the terms of engagement and valuation report (see VPS 3 paragraph 7(a)(3), Identification and status of valuer.)

4 With regard to (iv), this statement may be limited to a confirmation that the valuer has sufficient current local, national and international (as appropriate) knowledge of the particular market, and the skills and understanding to undertake the valuation competently. It is not necessary to provide any details. Where the provisos in PS 2 paragraph 4, Independence, objectivity and conflict of interest, apply, an appropriate disclosure is to be made.

b) Identification of the client and any other intended users

Confirmation of those for whom the valuation assignment is being produced is important when determining the form and content of the valuation report to ensure that it contains information relevant to their needs.

Any restriction on those who may rely upon the valuation assignment shall be agreed and recorded.

1 Requests for valuations will frequently be received from representatives of the client, and the valuer should ensure that the client is correctly identified. This is particularly relevant where:
   • the request is made by the directors of a company, but the client is the company and the directors have a separate legal standing or
   • the valuation is required for loan purposes and, although commissioned by the borrower, the report may be for the lender, the true client.

c) Purpose of the valuation

The purpose for which the valuation assignment is being prepared shall be clearly stated, e.g. the valuation is required for loan security, to support a share transfer or to support an issue of shares. The purpose of a valuation will determine the basis of value.

It is important that valuation advice is not used out of context or for purposes for which it is not intended.

1 If the client declines to reveal the purpose of the valuation, valuers should be aware that it may be difficult to comply with all aspects of the RICS Valuation – Professional Standards 2014. If the valuer is willing to proceed with the valuation, the client must be advised in writing that this omission will be referred to in the report. In this case the report must not be published or disclosed to third parties.
VPS 1 Minimum terms of engagement

2 If an unusually qualified valuation is to be provided, the terms of engagement must state that it is not to be used for any other purpose than that originally agreed with the client.

d) Identification of the asset or liability to be valued

Clarification may be needed to distinguish between an asset and an interest in or right of use of that asset.

If the valuation is of an asset that is utilised in conjunction with other assets, it will be necessary to clarify whether those assets are included in the valuation assignment, excluded but assumed to be available or excluded and assumed not to be available (see IVS Framework paragraphs 23 and 24).

1 When valuing a real property interest that is subject to a tenancy, it may be necessary to identify any improvements undertaken by tenants and to clarify whether or not these improvements are to be disregarded on renewal, or review, of the lease, or even if they may give rise to a compensation claim by the tenant when vacating the property.

e) Basis of value

The valuation basis must be appropriate for the purpose. The source of the definition of any basis of value used shall be cited or the basis explained. This requirement is not applicable to a valuation review where no opinion of value is to be provided or no comment is required on the basis of value used. The valuation bases recognised by IVS are defined and discussed in the IVS Framework, but other bases may be used. It may also be necessary to clarify the currency in which the valuation will be reported.

1 Where a valuation basis is expressly defined in these practice statements, that definition must be reproduced in full. Where these statements supplement the definition with conceptual framework or explanatory material, it is not necessary to reproduce that framework or explanation. However, there is discretion to reproduce it should the valuer consider that it assists the client to understand the reasoning behind the basis of value adopted.

2 For certain purposes or classes of asset these practice statements, or external regulations governing the purpose for which the valuation is provided, stipulate that a specific basis of value is used. In other cases the appropriate basis or bases is a matter for the valuer’s professional judgment.

3 Where the basis of value is market value, this basis will reflect the highest and best use of the asset (see IVS Framework paragraphs 32–34 and VPS 4 paragraph 1.2, Market value).

4 Where the basis of value is fair value, care must be taken to select the correct definition, in the light of the specific purpose or context of the valuation (see VPS 4 paragraph 1.5, Fair value.)

5 It is recognised that for some purposes a projected value may be required in addition to a current valuation. Any such projection should comply with the applicable jurisdictional and/or national association standards.

6 If a valuation has to be translated into a currency other than that of the country in which the asset is located, the basis of the exchange rate is to be agreed.
f) Valuation date

The valuation date may be different from the date on which the valuation report is to be issued or the date on which investigations are to be undertaken or completed. Where appropriate these dates should be clearly distinguished.

1 The specific valuation date will need to be agreed with the client – an assumption that the valuation date is the date of the report is not acceptable. See also IVS 103 paragraph 5(f), Valuation date, and IVS Framework paragraph 30(c), Valuation date.

2 Where, exceptionally, the advice being provided relates to a future date, see VPS 3, Valuation reports, paragraph 7(f) and VPS 4 paragraph 5, Special assumptions related to projected values, regarding the reporting requirements.

g) Extent of investigation

Any limitations or restrictions on the inspection, inquiry and analysis for the purpose of the valuation assignment shall be set out in the scope of work.

If relevant information is not available because the conditions of the assignment restrict the investigation, if the assignment is accepted, then these restrictions and any necessary assumptions or special assumptions made as a result of the restriction shall be recorded in the scope of work.

1 A client may require a restricted service; for example, a short timescale for reporting may make it impossible to establish facts that would normally be verified by inspection, or by making normal enquiries; or the request may be for a valuation based on the output of an automated valuation model (AVM). Note that the provision of an AVM-derived output would be regarded as the provision of a written valuation for the purpose of these standards. Accordingly valuers should be alert to, and aware of, the implications of either accepting or manually modifying an AVM output. A restricted service will also include any limitations on assumptions made in accordance with VPS 2, Inspections and investigations.

2 It is accepted that a client may sometimes require this level of service, but it is the duty of the valuer to discuss the requirements and needs of the client prior to reporting. Such instructions, when related to real property, are often referred to as ‘drive-by’, ‘desk-top’ or ‘pavement’ valuations.

3 The valuer should consider if the restriction is reasonable, with regard to the purpose for which the valuation is required. The valuer may consider accepting the instruction subject to certain conditions, for example that the valuation is not to be published or disclosed to third parties.

4 If the valuer considers that it is not possible to provide a valuation, even on a restricted basis, the instruction should be declined.

5 The valuer must make it clear when confirming acceptance of such instructions that the nature of the restrictions and any resulting assumptions, and the impact on the accuracy of the valuation, will be referred to in the report. (See also VPS 3, Valuation reports.)

6 VPS 2, Inspections and investigations, contains general requirements with regard to inspections.
h) Nature and source of the information to be relied upon

The nature and source of any relevant information that is to be relied upon and the extent of any verification to be undertaken during the valuation process shall be agreed and recorded.

1 Where the client will provide information that is to be relied on, the valuer has a responsibility to state that information clearly in the terms of engagement and, where appropriate, its source. In each case the valuer must judge the extent to which the information to be provided is likely to be reliable.

2 Information that is accepted as reliable should be referred to as an assumption.

3 The client may expect the valuer to express an opinion (and, in turn, the valuer will wish to express an opinion) on legal issues that affect the valuation. The valuer must therefore make clear in the report any information that must be verified by the client’s or other interested parties’ legal advisers before the valuation can be relied on or published.

i) Assumptions and special assumptions

All assumptions and any special assumptions that are to be made in the conduct and reporting of the valuation assignment shall be recorded.

Assumptions are matters that are reasonable to accept as fact in the context of the valuation assignment without specific investigation or verification. They are matters that, once stated, are to be accepted in understanding the valuation or other advice provided.

A special assumption is an assumption that either assumes facts that differ from the actual facts existing at the valuation date or that would not be made by a typical market participant in a transaction on the valuation date.

Special assumptions are often used to illustrate the effect of changed circumstances on value. Examples of special assumptions include:

- that a proposed building had actually been completed on the valuation date;
- that a specific contract was in existence on the valuation date which had not actually been completed;
- that a financial instrument is valued using a yield curve that is different from that which would be used by a market participant.

Only assumptions and special assumptions that are reasonable and relevant having regard to the purpose for which the valuation assignment is required shall be made.

1 Further guidance on assumptions and special assumptions, including the case of projected values (i.e. future state of the asset or of any factors relevant to its valuation) can be found in VPS 4, Bases of value, assumptions and special assumptions.

j) Restrictions on use, distribution or publication

Where it is necessary or desirable to restrict the use of the valuation advice or those relying upon it, this shall be recorded. If matters are identified that are likely to cause the valuation advice to be qualified, this shall also be recorded.
1 Limitations are only effective if notified to the client in advance.

2 The valuer should keep in mind that any insurance that protects against claims for negligence under professional indemnity insurance (PII) policies may require the valuer to have particular qualifications, and to include certain limiting clauses in every report and valuation. If this is the case the relevant words should be repeated, unless the insurers agree to either a modification or a complete waiver. If in doubt, valuers should refer to their insurance policy before accepting instructions.

3 Some valuations will be for purposes where the exclusion of third party liability is either forbidden by law or by an external regulator. In other cases, it will be a matter for clarification or agreement with the client, having regard also to the judgment of the valuer.

4 Where the client is a lender, it may be part of a syndicate or, having lent on an asset, may sell on tranches of the loan to other lenders. Although the third party limitation clause may provide some protection, the valuer may thus become exposed to the risk of a duty of care to unknown third parties. It may therefore be wise, particularly in the case of valuations for lending on commercial property, for the valuer to add to the usual limitation clause a statement to the following effect:

   ‘in the event of a proposal to place the loan on the subject asset in a syndicate, the client must notify the valuer, with a view to agreeing responsibility to the further named parties.’

k) Confirmation that the valuation assignment will be undertaken in accordance with the IVS

While confirmation of conformity with IVS is required, there may be occasions where the purpose of the valuation assignment requires a departure from IVS. Any such departure shall be identified together with justification for that departure. A departure would not be justified if it results in a valuation that is misleading.

1 This requirement is modified for the RICS standards to read ‘Confirmation that the valuation will be undertaken in accordance with the RICS Valuation – Professional Standards 2014’. Adoption of such endorsement – or references to the commonly used name RICS ‘Red Book’ – without reference to the year of issue of the edition will be taken to mean the global edition of the standards extant at the valuation date, provided that it is on or before the date of signature of the report. Where country- or state-specific editions of these professional standards and valuation practice statements are being followed, which include both global and national RICS standards, this should be made clear, for example, ‘RICS Valuation – Professional Standards 2014’ UK edition or ‘RICS Red Book UK edition’.

2 Where the valuation is expressly required to comply with either the IVS or other standards (see PS 1, Compliance with standards and practice statements where a written valuation is provided) a statement should be made, where appropriate, either that:

   • compliance with the RICS professional standards and valuation practice statements gives assurance also of compliance with the IVS or
VPS 1 Minimum terms of engagement

- the other specified standards will be complied with.

3 All permitted and agreed departures from the IVS, or national professional standards and/or the global or national valuation practice statements, should be referred to within this confirmation of compliance. (See PS 1 paragraph 7.1, Departures).

l) Description of report

Confirmation of the format of the report to be provided shall be agreed and recorded. Reference shall be made to any of the report contents specified in IVS 103 Reporting that are to be excluded.

1 VPS 3, Valuation reports, sets out the mandatory minimum terms of reporting. Where it is agreed that any of the minimum reporting contents are to be excluded they shall be treated as departures, be agreed in the terms of engagement and be referred to in the valuation report.

2 A report prepared in accordance with these professional standards and valuation practice statements must not itself be described as a certificate or statement, the use of such language implying either a guarantee or a level of certainty that is often inappropriate. However, a valuer may use the term ‘certified’, or similar words, within the body of a report where it is known that the valuation is to be submitted for a purpose that requires formal certification of a valuation opinion.

3 Valuers should be aware that the terms ‘certificate of value’, ‘valuation certificate’ and ‘statement of value’ have specific meanings in certain countries or states in-designating statutory documents. One common factor is that these documents require a simple confirmation of price or value, without any requirement to understand the context, fundamental assumptions or analytical processes behind the figure provided. A valuer who has previously provided a valuation or advised on a transaction involving the asset may prepare such a document where the client is required to provide it by statute.

m) The basis on which the fee will be calculated

1 The level of the fee is a matter to be settled with the client, unless there is a fee basis prescribed by an external body that binds both parties. RICS does not publish any scale of recommended fees.

n) Where the firm is registered for regulation by RICS, reference to the firm’s complaints handling procedure, with a copy available on request

1 This requirement is included to emphasise the need for firms registered for regulation by RICS to comply with the RICS Rules of Conduct for Firms, paragraph 7.

o) A statement that compliance with these standards may be subject to monitoring under RICS’ conduct and disciplinary regulations.

1 The purpose of this statement is to draw the attention of the client to the possibility that the valuation may be investigated for compliance with these standards.

2 Guidance on the operation of the monitoring regime, including matters relating to confidentiality, is available at www.rics.org/regulation
VPS 1  Minimum terms of engagement

3  Clients should be aware that this statement cannot validly be made by any valuer who is not a member or practising within an RICS-regulated firm.
VPS 2 Inspections and investigations

1 Inspections and investigations must always be carried out to the extent necessary to produce a valuation that is professionally adequate for its purpose. The valuer must take reasonable steps to verify the information relied on in the preparation of the valuation and, if not already agreed, clarify with the client any necessary assumptions that will be relied on. The principles in IVS 101 Scope of Work and IVS 102 Implementation should be followed and have been included in this valuation practice statement.

2 The following requirements and guidance relate primarily to inspections and investigations when valuing real property. With regard to other types of asset the extent of investigation and enquiry will depend on the nature of the asset but it should be appropriate and adequate having regard to the purpose of the valuation.

3 In settling the terms of engagement the valuer must agree the extent to which the subject asset is to be inspected and any investigation is to be made. Where a property is inspected the degree of on-site investigation that is appropriate will vary, depending on the nature of the property and the purpose of the valuation.

4 A valuer meeting the criteria in PS 2 paragraph 3, Member qualification, will be familiar with, if not expert on, many of the matters affecting either the type of property or the locality. Where an issue, or potential issue, that could affect value is within the valuer’s knowledge or evident from an inspection of the property or the immediate locality, or from routine enquiries, it should be drawn to the client’s attention no later than when the report is issued, and ideally in advance of the report where the impact is significant.

5 While a client may request, or consent to, an assumption being made, nevertheless if – following an inspection – the valuer considers that such an assumption would not realistically be made by a prospective purchaser, then its continued adoption becomes a special assumption (see VPS 4 paragraph 3, Special assumptions).

6 If relevant information is not available because the conditions of the instruction prevent inspection, or where it is agreed that inspections and investigations may be limited, if the instruction is accepted, the valuation will be on the basis of restricted information and VPS 1 paragraph 9(g), Extent of investigations, will apply. Any restriction on inspection or lack of relevant information should be set out in the terms of engagement and valuation report. If the valuer considers that it is not possible to provide a valuation even on a restricted basis, the instruction should be declined.

7 Many matters which become apparent during the inspection of real property may have an impact on the market’s perception of the value of the relevant interest in the property. When valuing real property these can include:
   (a) characteristics of the surrounding area, and the availability of communications and facilities that affect value
   (b) characteristics of the property
(c) dimensions and areas of the land and buildings
(d) construction of any buildings and their approximate age
(e) uses of the land and buildings
(f) nature of the accommodation
(g) nature of the installations, amenities and services
(h) fixtures, fittings and improvements
(i) any plant and equipment that would normally form an integral part of the building (see also VPGA 5, Valuation of plant and equipment)
(j) the apparent state of repair and condition
(k) natural hazards such as ground instability, mining or mineral extraction, radon gas, risk of flooding from all mechanisms, including pluvial and fluvial sources
(l) non-natural hazards such as contamination where substances are in, on or under the ground resulting from current or historic uses
(m) other hazardous materials present in or kept on the property, such as (but not limited to) regulated hazards, including chemicals, radioactive substances, explosive materials, waste management activities, asbestos, ozone depleting substances, oils and deleterious materials, such as building materials that degrade with age, causing structural problems, for example, high alumina cement, calcium chloride or woodwool shuttering and finally
(n) any physical restrictions on further development, if appropriate.

8 Other relevant information when valuing an interest in real property may include:
(a) improvements to leasehold properties: when valuing leases and reversions, where the property included in the original letting may subsequently have been altered or improved, care needs to be taken to ascertain what is to be valued that may not exactly equate with what is seen and measured on the ground. If the valuer is unable to inspect the lease, or due to the absence of documented licences the extent of alterations or improvements cannot be confirmed, the valuer should proceed on the basis of stated assumptions
(b) planning (zoning) controls: controls and the need for licences or permissions for increased or altered use, including development, will vary between countries or states and the extent of the particular enquiries that are appropriate and need to be made in individual cases will be informed by the valuer’s knowledge of the relevant market, by the nature and extent of the property, and by the purpose of the valuation
(c) the incidence of local or state property taxes
(d) information on any substantial outgoings and running costs, and the level of recovery from the occupier
(e) information on any quotas imposed or other trading restrictions that may be made by the country or state in which the property is located and
(f) information revealed during the normal legal enquiry processes before a sale takes place.

9 While the valuer should take reasonable care to verify any information provided or obtained, any limitations on this requirement must be clearly stated. (See VPS 1, Minimum terms of engagement). When preparing a valuation for financial statements...
the valuer should be prepared to discuss the appropriateness of any assumptions that were made with the client’s auditor, other professional adviser or regulator.

**10** To be in a position to respond effectively to a future enquiry, legible notes (which may include photographs) of the findings and, particularly, the limits of inspection and the circumstances in which it was carried out must be made and retained in an appropriate business format. The notes should also include a record of the key inputs and all calculations, investigations and analyses considered when arriving at the valuation.

### Revaluation without inspection

**11** A revaluation without a re-inspection of real property previously valued by the valuer or firm must not be undertaken unless the valuer is satisfied that there have been no material changes to the physical attributes of the property, or the nature of its location, since the last inspection.

**12** It is recognised that the client may need the valuation of its property updated at regular intervals and that re-inspection on every occasion may be unnecessary. Provided that the valuer has previously inspected the property, and the client has confirmed that no material changes to the physical attributes of the property and the area in which it is situated have occurred, a revaluation may be undertaken. The terms of engagement must state that this assumption has been made.

**13** The valuer must obtain from the client information of current or anticipated changes in rental income from investment properties and any material changes to the non-physical attributes of each property, such as other lease terms, planning consents, statutory notices and so on.

**14** Where the client advises that there have been material changes, or if the valuer is otherwise aware or has good reason to believe that such changes have taken place, the valuer must inspect the property. In all other cases, the interval between inspections is a matter for the professional judgment of the valuer who will, among other considerations, have regard to its type and location.

**15** If the valuer believes that it is inappropriate to undertake a revaluation without re-inspection because of material changes, the passage of time or other reasons, the valuer may nevertheless accept an instruction to proceed without inspection providing the client confirms in writing, prior to the delivery of the report, that it is required solely for internal management purposes, that no publication or disclosure will be made to third parties and that the client accepts responsibility for the associated risk. A statement declaring this position and that the report must not be published must be set out unequivocally in the report.
VPS 3 Valuation reports

1. The terms in IVS 103 Reporting should be followed and have been adopted in this valuation practice statement.

General principles

2. The report must clearly and accurately set out the conclusions of the valuation in a manner that is not ambiguous or misleading, and does not create a false impression. If appropriate, the valuer should draw attention to, and comment on, any issues affecting the degree of certainty, or uncertainty, of the valuation. See Valuation Practice Guidance – Application 9, Valuation in markets susceptible to change: certainty and uncertainty (VPGA 9), which provides more detail.

3. The report must also deal with all the matters agreed between the client and the valuer in the terms of engagement (VPS 1, Minimum terms of engagement) and include the minimum information referred to in PS 2 paragraph 7, Terms of engagement. The report should convey a clear understanding of the opinions being expressed by the valuer and should be couched in terms that can be read and understood by someone with no prior knowledge of the subject asset.

4. The format and detail of the report is a matter to be agreed between the valuer and the client in the terms of engagement. See VPS 1 paragraph 9(l), Description of report, with regard to the description of a report. Where the report is to be provided on a form supplied by the client and the terms of the report do not accord with VPS 3 paragraph 7, Report content, below, then either the initial service agreement or the terms of engagement – or an appropriate combination of the two – must clearly address these matters and so confirm that the valuation has been undertaken in accordance with the RICS professional standards and valuation practice statements. Where multiple reports are to be made to a single client over a period of time, with identical terms of engagement, it must be made clear to the client and to any others who may rely on the valuation advice provided, that the terms of engagement and form of report must always be read together.

5. A valuer may provide the client with preliminary valuation advice, or a draft report or valuation in advance of the completion of the final report – see PS 2 paragraphs 4.12–4.15, Independence, objectivity and conflict of interest.

6. Notwithstanding the provisions of these professional standards and valuation practice statements, the valuer is reminded that any valuation advice provided, in whatever format, creates a potential liability to the client, or under certain circumstances a third party. The terms ‘certificate of value’, ‘valuation certificate’, and ‘statement of value’ should not be used in connection with the provision of valuation advice. However a valuer may use the term ‘certified’, or similar words in the body of the report where it is known that the valuation is to be submitted for a purpose that requires formal certification of a valuation opinion.
Report content

7 IVS 103 Reporting sets out a list of IVS requirements. References to valuer include a valuation reviewer and references to a valuation assignment include a valuation review. The requirements are:

(a) Identification and status of the valuer
(b) Identification of the client and any other intended users
(c) Purpose of the valuation
(d) Identification of the asset or liability to be valued
(e) Basis of value
(f) Valuation date
(g) Extent of investigation
(h) Nature and source of the information relied upon
(i) Assumptions and special assumptions
(j) Restrictions on use, distribution or publication
(k) Confirmation that the assignment has been undertaken in accordance with the IVS
(l) Valuation approach and reasoning
(m) Amount of the valuation or valuations
(n) Date of the valuation report

The IVS 103 Report contents are listed in bold below together with additional RICS implementation guidance. IVS references to a valuer include a valuation reviewer and references to valuation assignment include a valuation review.

a) Identification and status of the valuer

The valuer can be an individual or a firm. A statement confirming that the valuer is in a position to provide an objective and unbiased valuation and is competent to undertake the valuation assignment shall be included.

The report shall include the signature of the individual or firm responsible for the valuation assignment.

If the valuer has obtained material assistance from others in relation to any aspect of the assignment, the nature of such assistance and the extent of reliance shall be referenced in the report.

1 A valuation is the responsibility of an individual member. RICS does not allow a valuation to be prepared by a ‘firm’ as stated in IVS 103(a), Reporting, although the use of ‘for and on behalf of’ under the responsible valuer’s signature is an acceptable substitution.

2 In all cases the signatory’s RICS (or IRRV) designation (e.g. MRICS) or other relevant professional qualification, must be made clear.

3 Where it is a requirement to do so, the valuer will state if he or she is acting as an internal or external valuer. Where other criteria have been adopted they must be confirmed, together with a statement that the valuer meets them.
4 In considering the extent of any material previous involvement, whether past, current or possible future, the valuer must have regard to the requirements of PS 2 paragraph 8, Disclosures. Any disclosures or statements made in accordance with VPS 1, Minimum terms of engagement, paragraph 9(a)(3), Identification and status of valuer, must be repeated in the valuation report. Where there has not been any previous material involvement, a statement to that effect must be made in the valuation report. See also PS 2 paragraph 4, Independence, objectivity and conflict of interest, relating to the resolution of conflicts of interest.

5 A statement should be made that the valuer has sufficient current local, national and international (as appropriate) knowledge of the particular market, and the skills and understanding to undertake the valuation competently. Where more than one valuer within a firm has contributed, confirmation that PS 2 paragraph 1.2, Responsibility for valuation, has been satisfied is needed, though it is not necessary to provide any details.

6 Where the valuer incorporates into the report a valuation prepared by another valuer or firm see paragraph (k) subparagraphs 4–5 below, Confirmation that the assignment has been undertaken in accordance with the IVS.

7 In some countries or states the national association valuation standards may require additional disclosures to be made with regard to the status of the valuer.

b) Identification of the client and any other intended users

The party commissioning the valuation assignment shall be identified together with any other parties whom it is intended may rely on the results of the assignment (see also (j), Restrictions on use, distribution or publication, below).

1 The report must be addressed to the client or its representatives. The source of the instructions and the identity of the client must be stated, if different from the addressee. Other known users of the report are to be named.

2 For some purposes valuers may be unable to exclude liability to third parties (see PS 2 paragraph 6, Duty of care to third parties). Any limitation on disclosure of a valuation based on restricted information or instruction should be included (see VPS 1 paragraph 9(g), Extent of investigation).

c) Purpose of the valuation

The purpose of the valuation assignment shall be clearly stated.

1 The report must be unambiguous. Where the purpose of the valuation is not disclosed by the client, the valuer should seek clarification why this is so. The valuation report must include an appropriate statement to clarify the circumstances.

d) Identification of the asset or liability to be valued

Clarification may be needed to distinguish between an asset and an interest in or right of use of that asset.

If the valuation is of an asset that is utilised in conjunction with other assets, it will be necessary to clarify whether those assets are included in the valuation assignment, excluded but assumed to be available, or excluded and assumed not to be available (see IVS Framework paragraphs 23 and 24).
1 The legal interest in each asset or liability should be stated. Clarification is essential to distinguish between the characteristics of the asset in its entirety and the particular right or interest that is being valued. Where the asset is a property, the extent to which vacant possession is, or may be available (if required), should also be noted.

2 Where the properties are located in more than one country or state, the report must list the properties within each country or state separately and should be arranged so that all the properties in one country or state are grouped together. The valuation must be reported in the currency (or currencies) that have been agreed with the client. The legal interest in each asset or liability should be stated.

3 An entity will usually require asset values to be expressed in the currency of the country in which it is based. For financial statement purposes, this is known as the ‘reporting currency’. Irrespective of the location of the client, valuations are to be made in the currency of the country in which the property, asset or liability is located.

4 Where the client requires the valuation to be translated into a different currency (for example, into the reporting currency), unless agreed otherwise the exchange rate to be adopted is the closing rate (also known as the ‘spot rate’) on the valuation date.

5 The report must also declare in respect of each country or state within which the property, asset or liability is situated, whether the valuer has made allowance for existing or proposed local legislation relating to taxation on the realisation of the property or asset.

6 Where the terms of engagement have required separate identification of assets by their use, category or class, the report should be structured accordingly.

7 The terms of engagement should state the format in which the valuation of portfolios or collections should be presented and this should be referred to in the valuation report. VPGA 8, Valuation of portfolios, collections and groups of properties, provides guidance on this aspect. Where formal agreement is not required it is recommended that the report contain a brief description of these matters.

e) Basis of value

This shall be appropriate for the purpose. The source of the definition of any basis of value used shall be cited or the basis explained. Some common valuation bases are defined and discussed in the IVS Framework.

This requirement is not applicable to a valuation review where no opinion of value is to be provided or no comment is required on the basis of value used.

1 The basis of value, together with its definition (but not supporting explanatory material), must be stated in full in the report. Where the basis of value is not a market-based figure and the valuation is materially different from market value, a statement to that effect must be made.

2 It is recognised that although market value is the most appropriate basis of value for a wide range of applications, it may be appropriate to adopt alternative bases of value in specific circumstances (see VPS 4, Bases of value, assumptions and special assumptions).
3 Where the *basis of value* is *market value*, this basis will reflect the highest and best use of the asset (see **IVS Framework paragraphs 32–34** and **VPS 4** paragraph 1.2, Market value).

4 Where, exceptionally, a valuation is also provided relating to a future date this must be made explicit (see VPS 3 paragraph 7(f), Valuation date, below and VPS 4 paragraph 5, Special assumptions related to projected values). It should always be separately reported with confirmation that it complies as appropriate with any applicable jurisdictional and/or national association standards. A projection may take one of a number of forms and does not constitute a distinct *basis of value* in itself. But, as it rests entirely on special assumptions, which may or may not be borne out by actual events, it is of a different character from advice relating to a current or past date and must not be represented as if it were on an equal footing. In particular it must never be described or represented simply as ‘*market value*’.

5 Where the *basis of value* is not market-based, the user of the valuation is alerted to the possibility that, although relevant for the specified purpose, the valuation may not bear any relation to the price that could be obtained if the property, asset or liability were placed on the market. Unless agreed otherwise in the terms of engagement the valuer is not required to provide a valuation on any alternative *basis of value*.

6 Where the *basis of value* is *fair value*, care must be taken to set out the correct definition from the two available. The two recognised definitions of *fair value* are:

(a) the definition adopted by the International Accounting Standards Board (IASB) in IFRS 13 for financial reporting purposes and

(b) the definition adopted by IVSC in **IVS Framework paragraph 38** where IFRS 13 does not apply.

See VPS 4 paragraph 1.5, Fair value, for more detail.

1) Valuation date

The *valuation date* may be different from the date on which the valuation report is issued or the date on which investigations are to be undertaken or completed. Where appropriate, these dates shall be clearly distinguished in the report.

This requirement does not apply to a valuation review unless the reviewer is required to comment on the valuation date used in the valuation under review.

1 The *valuation date* must be stated (see VPS 1 paragraph 2(f), Valuation date, and **IVS Framework paragraph 30(c) Valuation date**).

2 If there has been a material change in market conditions, or in the circumstances of a property, asset or portfolio, between the *valuation date* (where this is earlier than the date of the report) and the date of report, the valuer should draw attention to this. It may also be prudent in appropriate instances for the valuer to draw the client’s attention to the fact that values change over time and a valuation given on a particular date may not be valid on an earlier or later date.

3 Additional care is needed when providing a projection of value, in order to ensure that the client understands that the actual value at the future date, on
whatever basis is adopted, may diverge from that being reported and almost certainly will if the then state of the asset or conditions of the market differ from the special assumptions statements made at the time of the projection.

g) Extent of investigation

The extent of the investigations undertaken, including the limitations on those investigations set out in the scope of work, shall be disclosed in the report.

1 Where the asset is real property, the report must record the date and extent of any inspection, including reference to any part of the property to which access was not possible (see VPS 2, Inspections and investigations). Equivalent steps, appropriate to the class of asset concerned, should be taken in relation to tangible personal property.

2 The valuer must make it clear if the valuation has been made without an opportunity to carry out an adequate inspection (see VPS 2 paragraphs 2 and 5, Inspections and investigations) or equivalent check.

3 In the case of a revaluation, the report should also refer to any agreement in respect of the requirement for, or frequency of, an inspection of the property (see VPS 2 paragraph 12, Inspections and investigations).

4 Where a substantial number of properties are being valued, a generalised statement of these aspects (i.e. regarding inspection) is acceptable, provided that it is not misleading.

5 Where the asset is not real or tangible personal property, the report should note the extent to which investigations were possible.

h) Nature and source of the information relied upon

The nature and source of any relevant information relied upon in the valuation process and the extent of any steps taken to verify that information shall be disclosed. To the extent that information provided by the commissioning party or another party has not been verified by the valuer, this should be clearly stated with reference, as appropriate, to any representation from that party.

1 Where the client has provided information that is to be relied on, the valuer has a responsibility to state clearly that the information is covered by, or in, the terms of engagement (see VPS 1, Minimum terms of engagement) and, where appropriate, to specify its source. In each case the valuer must judge the extent to which the information to be provided is likely to be reliable and whether any further, reasonable steps are required to verify it.

2 Information that is accepted as reliable should be referred to as an assumption. The valuer must make it clear if the valuation has been carried out without information that would normally be, or be made, available. The valuer must also indicate in the report if verification (where practicable) is needed of any information or assumptions on which the valuation is based, or if any information considered material has not been provided.

3 If any such information or assumption requiring verification is material to the amount of the valuation, the valuer must make clear that the valuation should not be relied on without that verification (see VPS 1 paragraph 9(h), Nature and source of information to be relied on). In the case of a revaluation, a statement of any material changes advised by the client or a stated assumption that there have been no material changes, should be included.
4 The client may expect the valuer to express an opinion, and in turn the valuer may wish to express an opinion, on legal issues that affect the valuation. In these circumstances the valuer must therefore make clear in the report any information that must be verified by the client’s or other interested parties’ legal advisers before the valuation can be relied on or published.

5 The report should state any additional information that has been available to, or established by, the valuer, and is believed to be crucial to the client’s ability to understand and benefit from the valuation, with regard to the purpose for which it has been prepared.

i) Assumptions and special assumptions

All assumptions and any special assumptions made shall be clearly stated.

1 All assumptions made must be stated, together with any reservations that may be required. Where the assumptions vary in different countries or states the report must make this clear.

(a) Where a report includes a valuation made on the basis of special assumptions, they must be set out in full, together with a statement that they have been agreed with the client. Both the valuation conclusion (and the executive summary if provided) should explicitly set out all special assumptions that have been made to arrive at the reported figure.

(b) Where the valuation is undertaken on the basis of restricted information, or is a revaluation without an inspection, the report must include full particulars of the restriction (see VPS 1 paragraph 9(g), Extent of investigation). Any departures from the standards must be stated and explained (see PS 1 paragraph 7, Departures).

2 A statement must be made as to whether or not any express allowance has been made for liability for taxation, whether actual or notional, that may arise on disposal and whether or not the valuation that would appear in a hypothetical contract of sale or equivalent legal document (see VPS 4 paragraph 1.2.2, Market value) has been altered to reflect costs of acquisition or realisation. In some countries or states value added tax (or similar taxes) and acquisition- or sale-related costs can be substantial.

3 Where statements rely on the prospect of future growth in rental and/or capital values, a statement must be made to the effect that such growth may not occur, and that values can fall as well as rise.

4 Where appropriate the valuer should consider (following discussion with the client, and agreement and confirmation in writing) including in the report special assumptions to reflect any issues affecting the certainty of the valuation and give a full and clear account as to why these assumptions are being included (see VPS 1 paragraph 9(l), Valuation approach and reasoning). However special assumptions should only be used if they are realistic, relevant and valid in connection with the circumstances of the valuation (see VPS 4 paragraph 3, Special assumptions). Further guidance on valuation certainty can be found in VPGA 9, Valuation in markets susceptible to change: certainty and uncertainty.

j) Restrictions on use, distribution or publication

Where it is necessary or desirable to restrict the use of the valuation or those relying upon it, this shall be stated.
VPS 3 Valuation reports

1 Where the purpose of the report requires a published reference to it, the valuer must provide a draft statement for inclusion in the publication. This should be provided as a separate document, which may be annexed to the report.

2 A report may be published in full, for instance in the annual accounts of a company, but it is more common for only a reference to be made to it. In this case it is essential that the valuer has a close involvement in the publication statement to ensure that all the references are accurate and that the reader is not misled.

3 If the whole report is not to be published, the draft statement should be prepared as a separate document and provided to the client at the same time as the report. The content of the statement may be governed by rules issued by local regulatory bodies, but it should contain the following minimum information:

   • the name and qualification of the valuer, or the valuer’s firm
   • an indication of whether the valuer is an internal or external valuer, and where required, that the specific criteria relating to this status has been met
   • the valuation date and basis (or bases) of value, together with any special assumptions
   • comment on the extent to which the values were determined directly by reference to market evidence or were estimated using other valuation techniques
   • confirmation that the valuation has been made in accordance with these standards, or the extent of and reason(s) for departure from them and
   • a statement indicating any parts of the report prepared by another valuer or specialist.

4 Examples of published references to valuation reports can be found in UK Appendix 6: Examples of published references to valuation reports.

5 For valuations in which the public has an interest or which may be relied on by parties other than the client commissioning the report or to which it is addressed, the valuer shall make additional disclosures in the valuation report and any published reference to it. These are set out in PS 2 paragraph 8, Disclosures.

6 ‘Publication’ does not include making the report or the valuation figure available to a mortgage applicant or borrower.

7 The valuer should check the accuracy of any other relevant material referring to the properties or to the valuation that is to be published.

8 The valuer is also advised to read the whole document in which the report or reference is to be published to ensure that there is no misstatement of any other matter or opinion of which the valuer may have knowledge.

9 The valuer should insist that a copy of the final proof of the document or the reference is supplied before issue, and attach that proof to the letter of consent. Any pressure by other parties or persuasion to delegate power to sign should be resisted.

10 The valuer is permitted to exclude information of a commercially sensitive nature from a report that is published in full, subject to any legal requirements that may apply in a particular country or state.
11 An opinion may be expressed which, if included in a public document, might have some effect on a matter that is in dispute, under negotiation or subject to certain rights between the owner and a third party (for example, an opinion of the rental or capital value of a property with an imminent rent review). The report may also include information about a company’s trading that would not usually be in the public domain. Such information is commercially sensitive and the client must decide, subject to the approval of the auditors and any regulatory body, whether it should be included in the publication.

12 In the published reference the valuer must refer to the omission(s) and state that this has been done on the express instructions of the client and with the approval of the regulatory body and/or auditors. Without this note the valuer may be inadvertently placed in a situation where there is unjustifiable criticism.

13 Where the full report is not published, the publication statement must refer to any special assumption made and any additional valuation provided. Similarly, sufficient reference to any departures should be made in any published document.

14 In each case the onus is on the valuer to determine what constitutes a ‘sufficient reference’. A reference would not be regarded as ‘sufficient’ if it failed to alert the reader to matters of fundamental importance as to the basis or amount of the valuation, or if there was any risk that the reader might be misled.

15 It is expected that a valuer would not normally consent to the publication of a projected value. Where, in exceptional cases, consent is given, great care should be taken to ensure that any associated provisos or disclaimers are accurately reproduced.

k) Confirmation that the assignment has been undertaken in accordance with the IVS

While confirmation of conformity with the IVS is required, there may be occasions where the purpose of the valuation assignment requires a departure from the IVS. Any such departure shall be identified, together with justification for that departure. A departure would not be justified if it results in a valuation that is misleading.

1 This requirement is modified for RICS members to ‘Confirmation that the valuation has been undertaken in accordance with the RICS Valuation – Professional Standards 2014 – including the International Valuation Standards’.

2 RICS professional standards and valuation practice statements are consistent with the principles and definitions of the IVS (as at 1 January 2014). RICS considers that a valuation that complies with these standards and statements will also comply with the IVS and a statement to that effect may be made in the report when relevant.

3 Confirmation that the valuation accords with the RICS professional standards and valuation practice statements must be unequivocal, but may include a cross-reference to any agreed departures. This confirmation will include any statement required under PS 1 paragraph 4, Compliance with other valuation standards. All permitted and agreed departures from the IVS, or national professional standards and/or the global or national valuation practice statements, should be referred to within this confirmation of compliance. (See PS 1 paragraph 7.1, Departures).
4 Where the valuer incorporates into the report a valuation prepared by another valuer or firm, it must be confirmed that such valuations have been prepared in accordance with these standards, or other standards that may apply in the particular circumstances.

5 Circumstances may arise where the valuer wishes to obtain a valuation from another valuer or firm (for example, a plant and equipment valuation, or a valuation of an asset in another country or state where local expertise is required). When this situation occurs, the client must agree to the employment of valuers or firms not connected with the valuer, and reference to this should be included in the terms of engagement.

6 The valuer may be requested to incorporate a valuation commissioned directly by the client. In such cases the valuer must be satisfied that any such report has been prepared in accordance with these standards.

I) Valuation approach and reasoning

To understand the valuation figure in context, the report shall make reference to the approach or approaches adopted, the key inputs used and the principal reasons for the conclusions reached.

Where the report is of the results of a valuation review it should state the reviewer’s conclusions about the work under review, including supporting reasons.

This requirement does not apply if it has been specifically agreed and recorded in the scope of work that a report shall be provided without reasons or other supporting information.

1 Where different valuation approaches and assumptions are required for different assets it is important that they are separately identified and reported.

m) Amount of the valuation or valuations

This shall be expressed in the applicable currency.

This requirement does not apply to a valuation review if the valuer is not required to provide their own valuation opinion.

1 In the main body of the report the opinion of value is required in words, as well as in figures.

2 Where the valuation instruction includes a number of properties falling into different use categories or geographic location, it would normally be inappropriate to produce an aggregate valuation of the whole, although this will depend on the purpose for which the valuation is required. Where a portfolio includes freehold and leasehold assets, the value of the tenure groups may be subtotalled, together with a statement of the overall value.

3 Where the valuation instruction requires the opinion of value to be reported in more than one currency (such as with cross border portfolio valuations), the opinion of value should indicate the currencies adopted and the amount should be shown in words and figures in the main body of the report. In addition the exchange rate adopted should be as at the valuation date and this should be stated in the valuation report.

4 If the identification of individual properties and their values is consigned to a schedule(s) appended to the report, a summary of values must be included
within the body of the report. If there has been a material change in market conditions, or in the circumstances of a property asset or portfolio, between the valuation date (where this is earlier than the date of the report) and the date of report, the valuer should draw attention to this. It may also be prudent in appropriate instances for the valuer to draw the client’s attention to the fact that values change over time and a valuation given on a particular date may not be valid on an earlier or later date.

5 ‘Negative values’ and liabilities may arise and must always be stated separately. They should not be offset.

6 There will be occasions where it would be correct to indicate a nil value for a property or asset, for example, where the expense of meeting a liability outweighs the positive value but there is no legal liability on the owner to incur this expense.

n) Date of the valuation report

The date on which the report is issued shall be included. This may be different from the valuation date (see (f) above).
VPS 4 Bases of value, assumptions and special assumptions

The valuer must determine the basis of value, together with any assumptions, or special assumptions that are appropriate for every valuation reported.

1 Bases of value
   1.1 Recognised bases of value
   1.2 Market value
   1.3 Market rent
   1.4 Investment value
   1.5 Fair value

2 Assumptions

3 Special assumptions

4 Valuations reflecting an actual or anticipated market constraint, and forced sales

5 Special assumptions related to projected values

1.1 Recognised bases of value

1.1.1 In accordance with the IVS definition (see IVS Framework paragraph 25 Basis of Value), a basis of value is a statement of the fundamental measurement assumptions of a valuation, and for many common valuation purposes these standards stipulate the basis (or bases) of value that is appropriate. IVS Framework paragraphs 26–28 Basis of Value contains further commentary on the definition.

1.1.2 For most valuation purposes it will be appropriate to use one of the bases defined in these standards. RICS does not encourage the use of a basis that is not recognised by these standards. However, if no recognised basis of value is suitable for a particular assignment, the valuer must define clearly the basis adopted and explain in the report why use of a basis recognised by these standards is considered inappropriate (see PS 1 paragraph 7, Departures). Valuers are cautioned that the use of an unrecognised or bespoke basis of value without good reason could result in breach of the requirement that the valuation report should not be ambiguous or misleading (see VPS 3, Valuation reports, paragraph 2).
1.1.3 The following bases of value are recognised in these standards:

- market value
- market rent
- investment value (worth)
- fair value – IFRS definition
- fair value – IVS definition.

1.1.4 It is important to note that these bases of value are not necessarily mutually exclusive. The worth of a property or asset to a specific party, or the fair value of a property or asset in exchange between two specific parties (using the IVS definition and not the IFRS one – see VPS 4 paragraph 1.5, Fair value), may match the market value even though different assessment criteria are used.

1.1.5 Because bases other than market value may produce a value that could not be obtained on an actual sale, whether or not in the general market, the valuer must clearly distinguish the assumptions, or special assumptions that are different from, or additional to, those that would be appropriate in an estimate of market value. Typical examples of such assumptions and special assumptions are discussed under the appropriate heading.

1.2 Market value

1.2.1 The definition of market value as defined in IVS Framework paragraph 29 is:

the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

1.2.2 Market value is the basis of value that is most commonly required, being an internationally recognised definition. It describes an exchange between parties that are unconnected and are operating freely in the marketplace and represents the figure that would appear in a hypothetical contract of sale, or equivalent legal document, at the valuation date, reflecting all those factors that would be taken into account in framing their bids by market participants at large and reflecting the highest and best use of the asset. The highest and best use of an asset is the use of an asset that maximises its productivity and that is possible, legally permissible and financially feasible – see IVS Framework paragraphs 32–34 Market Value.

1.2.3 It ignores any price distortions caused by special value or synergistic value. It represents the price that would most likely be achievable for an asset across a wide range of circumstances. Market rent applies similar criteria for estimating a recurring payment rather than a capital sum.

1.2.4 In applying market value, regard must also be had to the conceptual framework set out in IVS Framework paragraphs 30–34 Market Value, which includes the requirement that the valuation amount reflects the actual market state and circumstances as of the effective valuation date.

1.2.5 Valuers must ensure in all cases that the basis is reproduced or clearly identified in both the instructions and the report. There is no mandatory requirement
to refer to the IVS conceptual framework (IVS Framework paragraphs 30–34) in the
valuer’s report but, in appropriate cases, it may be useful to do so if it is considered
likely to assist the client.

1.2.6 However, a valuer may be legitimately instructed to provide valuation advice
based on other criteria, and therefore other bases of value may be appropriate. In
such cases the definition adopted must be set out in full and explained. Where such
a basis differs significantly from market value it is recommended that a brief
comment is made indicating the differences.

1.2.7 Notwithstanding the disregard of special value (see definition in IVS
Framework paragraphs 43–46 Special Value), where the price offered by
prospective buyers generally in the market would reflect an expectation of a change
in the circumstances of the asset in the future, the impact of that expectation is
reflected in market value. Examples of where the expectation of additional value
being created or obtained in the future may have an impact on the market value
include:

• the prospect of development where there is no current permission for that
development and

• the prospect of synergistic value (see definition in IVS Framework paragraph
47) arising from merger with another property or asset, or interests within the
same property or asset, at a future date.

1.2.8 The impact on value arising by use of an assumption or special assumption
should not be confused with the additional value that might be attributed to an asset
by a special purchaser.

1.2.9 Note that in some jurisdictions a basis of value known as ‘highest and best
use’ is adopted and this may either be defined by statute or established by common
practice in individual countries or states.

1.3 Market rent

1.3.1 Market rent as defined in IVS 230 Real Property Interests paragraph C9 is:

the estimated amount for which an interest in real property should be
leased on the valuation date between a willing lessor and a willing lessee
on appropriate lease terms in an arm’s length transaction, after proper
marketing and where the parties had each acted knowledgeably,
prudently and without compulsion.

1.3.2 The definition of market rent is a modified definition of market value: IVS 230
Real Property Interests paragraphs C8–C11 provide additional commentary.

1.3.3 Market rent will vary significantly according to the terms of the assumed lease
contract. The appropriate lease terms will normally reflect current practice in the
market in which the property is situated, although for certain purposes unusual terms
may need to be stipulated. Matters such as the duration of the lease, the frequency
of rent reviews and the responsibilities of the parties for maintenance and outgoings
will all impact the market rent. In certain countries or states, statutory factors may
either restrict the terms that may be agreed, or influence the impact of terms in the
contract. These need to be taken into account where appropriate.
1.3.4 Market rent will normally be used to indicate the amount for which a vacant property may be let, or for which a let property may re-let when the existing lease terminates. Market rent is not a suitable basis for settling the amount of rent payable under a rent review provision in a lease, where the actual definitions and assumptions have to be used.

1.3.5 Valuers must therefore take care to set out clearly the principal lease terms that are assumed when providing an opinion of market rent. If it is the market norm for lettings to include a payment or concession by one party to the other as an incentive to enter into a lease, and this is reflected in the general level of rents agreed, the market rent should also be expressed on this basis. The nature of the incentive assumed must be stated by the valuer, along with the assumed lease terms.

1.4 Investment value [or worth]

1.4.1 Investment value as defined in IVS Framework paragraph 36 is:

the value of an asset to the owner or a prospective owner for individual investment or operational objectives.

1.4.2 Investment value may also be known as worth. IVS Framework paragraph 37 provides further commentary on this definition.

1.5 Fair value

1.5.1 There are two recognised definitions of fair value – it is essential that the valuer makes explicit which definition is being adopted in any given case. The two definitions are:

(a) the definition adopted by the International Accounting Standards Board (IASB) in IFRS 13:

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.

and

(b) the definition adopted by the IVSC in IVS Framework paragraph 38:

The estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties.

1.5.2 It is important to recognise that the two definitions of fair value are not the same. When adopting the basis of fair value it is essential that the valuer establishes the correct definition for the purpose and sets it out in full in the terms of engagement and the report.
1.5.3 The guidance in IFRS 13 includes:

**Overview of fair value measurement approach**

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:

- 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.

The references in IFRS 13 to market participants and a sale make it clear that for most practical purposes the concept of *fair value* is consistent with that of *market value*, and so there would be no difference between them in terms of the valuation figure reported.

1.5.4 In applying the IVS definition, valuers should refer to IVS Framework paragraphs 38–42.

1.5.5 For more detailed guidance on the application of *fair value* for financial statements see VPGA 1, Valuations for inclusion in financial statements.

## 2 Assumptions

2.1 An *assumption* – as defined in the IVS – is made where it is reasonable for the valuer to accept that something is true without the need for specific investigation or verification.

2.2 It will almost always be necessary to couple a *basis of value* with appropriate *assumptions* or *special assumptions* that describe the assumed status or condition of the property or asset at the *valuation date*. A typical *assumption* might concern occupation, for example, ‘the *market value* subject to a lease’ or might concern the status of the asset, for example, an *assumption* that it is ‘of good legal title’. A typical *special assumption* might be that a property or asset has been altered in some defined way, for example, ‘the *market value* on the *special assumption* that the works had been completed’.

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RICS global valuation practice statements (VPS)

VPS 4 Bases of value, assumptions and special assumptions

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2.3 An assumption is often linked to a limitation on the extent of the investigations or enquiries that could be undertaken by the valuer. Therefore all assumptions that are likely to be included in the report must be agreed with the client and included in the terms of engagement. Where it is not possible to include assumptions in the terms of engagement, they should be agreed in writing with the client before the valuation report is issued.

2.4 If, after inspection or investigation, the valuer considers that an assumption agreed in advance with the client is likely to be inappropriate, or should become a special assumption, the revised assumptions and approach must be discussed with the client prior to the conclusion of the valuation assignment and delivery of the report.

2.5 Information and guidance is given on the following assumptions in relation to real property assets:

(a) title
(b) condition of buildings
(c) services
(d) planning (zoning)
(e) contamination and hazardous substances
(f) environmental matters and
(g) sustainability.

This list is not exclusive and care should be taken to identify any assumptions that may have to be made in order to fulfil a particular instruction. There are no ‘standard’ assumptions that do not need to be stated.

(a) Title

1 The valuer must have information on the essential details of the interest being valued. This may take the form of a synopsis obtained from the client or a third party or copies of the relevant documents. However, unless provided with a current detailed report on title by the client’s lawyers, the valuer must state what information has been relied on and what assumptions have been made. For example, the valuer would state that apart from anything revealed in the information provided, it is assumed that there are no encumbrances on title.

2 In order to assist the client in the particular circumstances giving rise to the valuation or appraisal, the valuer may have to make assumptions about the interpretation of legal documents. However, it must be appreciated that this is ultimately a matter for lawyers. Therefore the valuer must state that the assumptions made must be checked by the client’s legal advisers and that no responsibility or liability will be accepted for the true interpretation of the client’s legal title in the property or asset. Otherwise, the valuer will assume no less a burden than the law imposes on a competent lawyer if legal advice is given expressly or by implication.

(b) Condition of buildings

1 Even if competent to do so, a valuer would not normally undertake a building survey to establish the details of any building defects or disrepair. However, it would also be wrong for the valuer to ignore obvious defects...
VPS 4 Bases of value, assumptions and special assumptions

that would have an impact on the value, unless a special assumption to that effect has been agreed. The valuer must therefore clearly state that the inspection will not amount to a full building survey. In addition the limits that will apply to the valuer’s responsibility to investigate and comment on the structure or any defects must be defined. It should also be stated that an assumption will be made that the building(s) is in good repair, except for any defects specifically noted.

(c) Services

1 The presence and efficiency of building services and any associated plant and equipment will often have a significant impact on value: however, detailed investigation will normally be outside the scope of the valuation. The valuer will need to establish what sources of information are available, and the extent to which these can be relied on, in undertaking the valuation. It is usual to agree on an assumption that the services and any associated controls or software are in working order or free from defect.

(d) Planning (zoning)

1 The valuer needs to establish whether the property has the necessary statutory consents for the current buildings and use, and whether there are any policies or proposals by statutory authorities that could impact the value positively or adversely. This information will often be readily available, but delays or expenses may be incurred in obtaining definitive information. The valuer should state what investigations are proposed, or what assumptions will be made, where verification of the information is impractical within the context of the valuation.

(e) Contamination and hazardous substances (whether from historic or current use of the land or buildings)

1 A valuer will not normally be competent to advise on the nature or risks of contamination or hazardous substances, or on any costs involved with their removal. However, where a valuer has prior knowledge of the locality and experience of the type of property being valued, the valuer can reasonably be expected to comment on the potential that may exist for contamination, and the impact that this could have on value and marketability. Therefore the valuer should state the limits on the investigations that will be undertaken and any sources of information or assumptions that will be relied on.

(f) Environmental matters

1 Some property will be affected by environmental factors that are an inherent feature of either the property itself, or the surrounding area, and could have an impact on the value of the property interest. Examples include ground instability issues (such as swelling and shrinking clay, historic and current mineral extraction) and the risk of flooding from any mechanism. Although detailed commentary on their effects will normally be outside the realm of the valuer’s expertise, their presence, or potential presence, is something that can often be established in the course of a valuation inspection through normal enquiries or by local knowledge. The valuer should state the limits that will apply to the extent of the investigations and the assumptions that will be made in relation to environmental matters.
(g) Sustainability

1 While not a defined term, sustainability encompasses a wide range of physical, social, environmental and economic factors that can impact on value and of which valuers should be aware. The range of issues includes, but is not limited to, key environmental risks, such as flooding, energy efficiency and climate, as well as matters of design, configuration, accessibility, legislation, management and fiscal considerations. As commercial markets become more sensitised to sustainability matters, so they may begin to complement traditional value drivers, both in terms of occupier preferences and in terms of purchaser behaviour.

2 The pace at which sustainability may feed into value will vary depending on the property type and the geographic market/submarket in which the asset is situated. In order to respond appropriately as markets change, valuers should continuously seek to enhance their knowledge of sustainability. The role of valuers is to assess value in the light of evidence normally obtained through analysis of comparable transactions. While valuers should reflect markets, not lead them, they should be aware of sustainability features and the implications these could have on property values in the short, medium and longer term.

3 In summary:
   • Valuers are advised to collect appropriate and sufficient sustainability data, as and when it becomes available, for future comparability, even if it does not currently impact on value.
   • Only where market evidence would support this, should sustainability characteristics be built into a report on value.
   • Valuers are often asked to provide additional comment and strategic advice. In these cases valuers will need to consult with the client as to the use and applicability of sustainability metrics and benchmarks that are applicable in each case. For example, when preparing investment values (commonly known as ‘worth’), sustainability factors that could influence investment decision-making may properly be incorporated, even though they are not directly evidenced through transactions.

4 Where appropriate, in order to comply with best practice in reporting, valuers are recommended to:
   • assess the extent to which the subject property currently meets sustainability criteria and arrive at an informed view on the likelihood of these impacting on value, i.e. how a well-informed purchaser would take account of them in making a decision as to offer price
   • provide a clear description of the sustainability-related property characteristics and attributes that have been collected, which may, where appropriate, include items not directly reflected in the final advice as to value
   • provide a statement of their opinion on the relationship between sustainability factors and the resultant valuation, including a
comment on the current benefits/risks that are associated with these sustainability characteristics, or the lack of risks and
• provide a statement of the valuer’s opinion on the potential impact of these benefits and/or risks to relative property values over time.

5 The RICS guidance note, Sustainability and commercial property valuation (2013) provides guidance on the identification, assessment and impact of sustainability issues on commercial valuations.

3 Special assumptions

3.1 A special assumption – as defined in the IVS – is made where an assumption assumes facts that differ from those existing at the valuation date. It includes circumstances where assumptions about a future state or event are being made.

3.2 Where special assumptions are necessary in order to adequately provide the client with the valuation required, these must be expressly agreed and confirmed in writing to the client before the report is issued.

3.3 Special assumptions may only be made if they can reasonably be regarded as realistic, relevant and valid for the particular circumstances of the valuation.

3.4 The valuer may include in the report some comment or assessment of the likelihood of the special assumption being fulfilled. For example, a special assumption that permission had been granted to develop land may have to reflect the impact on value of any conditions that might be imposed.

3.5 If a client requests a valuation on the basis of a special assumption that the valuer considers to be unrealistic, the instruction should be declined.

3.6 Circumstances where it may be appropriate to make special assumptions include, for example:
   • a situation where a bid from a special purchaser has been made, or can be reasonably anticipated
   • a situation where the interest being valued cannot be offered freely and openly in the market
   • a past change in the physical aspects of the property or asset where the valuer has to assume those changes have not taken place
   • an impending change in the physical aspects of the property, such as a new building to be constructed or an existing building to be refurbished or demolished
   • an anticipated change in the mode of occupation or trade at the property
   • the treatment of alterations and improvements carried out under the terms of a lease.

3.7 Some illustrations of special assumptions are that:
   • planning consent has been, or will be, granted for development (including a change of use) at the property
   • a building or other proposed development has been completed in accordance with a defined plan and specification
VPS 4  Bases of value, assumptions and special assumptions

- the property has been changed in a defined way (for example, removal of process equipment)
- the property is vacant when, in reality, at the valuation date it is occupied
- the property is let on defined terms when, in reality, at the valuation date it is vacant or
- the exchange takes place between parties where one or more has a special interest and that additional value, or synergistic value, is created as a result of the merger of the interests.

Where a property has been damaged the special assumptions may include:
- treating the property as having been reinstated (reflecting any insurance claims)
- valuing as a cleared site with development permission assumed for the existing use
- refurbishment or redevelopment for a different use reflecting the prospects of obtaining the necessary development permissions.

3.8 The adoption of some of these special assumptions may qualify the application of market value. They are often particularly appropriate where the client is a lender and special assumptions are used to illustrate the potential effect of changed circumstances on the value of a property as a security.

3.9 Where valuations are prepared for financial statements the normal basis of value will exclude any additional value attributable to special assumptions. However, if (exceptionally) a special assumption is made, this must be referred to in any published reference. See VPS 3 paragraph 7(j)(14), Restrictions on use, distribution and publication.

4 Valuations reflecting an actual or anticipated market constraint, and forced sales

4.1 The valuer may be instructed to undertake a valuation reflecting an actual or anticipated market constraint. Wherever the valuer, or client, identifies that a valuation may need to reflect an actual or anticipated marketing constraint, details of that constraint must be agreed and set out in the terms of engagement.

4.2 If a property or asset cannot be freely or adequately presented to the market, the price is likely to be adversely affected. Before accepting instructions to advise on the likely effect of a constraint, the valuer should ascertain whether this arises from an inherent feature of the asset or interest being valued, or from the particular circumstances of the client.

4.3 If an inherent constraint exists at the valuation date, it is normally possible to assess its impact on value. The constraint should be identified in the terms of engagement, and it should be made clear that the valuation will be provided on this basis. It may also be appropriate to provide an alternative valuation on the special assumption that the constraint did not exist at the valuation date in order to demonstrate its impact.

4.4 Greater care is needed if an inherent constraint does not exist at the valuation date, but is a foreseeable consequence of a particular event or sequence of events.
Alternatively, the client may request a valuation to be on the basis of a specified marketing restriction. In either case the valuation would be provided on the special assumption that the constraint had arisen at the valuation date. The precise nature of the constraint must be included in the terms of engagement. It may also be appropriate to provide a valuation without the special assumption in order to demonstrate the impact that the constraint would have if it arose.

4.5 A special assumption that simply refers to a time limit for disposal without stating the reasons for that limit would not be a reasonable assumption to make. Without a clear understanding of the reasons for the constraint, the valuer would be unable to determine the impact that it may have on marketability, sale negotiations and the price achievable, or to provide meaningful advice.

4.6 A marketing constraint should not be confused with a forced sale. A constraint may result in a forced sale, but it can also exist without compelling the owner to sell.

4.7 The term ‘forced sale value’ must not be used. A ‘forced sale’ is a description of the situation under which the exchange takes place, not a distinct basis of value. Forced sales arise where there is pressure on a particular vendor to sell at a specific time — for example, because of the need to raise money or to extinguish a liability by a given date. The fact that a sale is ‘forced’ means that the vendor is subject to external legal or personal commercial factors, and therefore the time constraint is not merely a preference of the vendor. The nature of these external factors and the consequences of failing to conclude a sale are just as important in determining the price that can be achieved within the length of time available.

4.8 While a valuer can assist a vendor in determining a price that should be accepted in forced sale circumstances, this is a commercial judgment and a reflection of the investment value or worth to that particular vendor. Any relationship between the price achievable by a forced sale and the market value is coincidental; it is not a valuation that can be determined in advance. Consequently, although advice may be given on the likely realisation in forced sale circumstances, the term is a description of the situation under which the sale takes place, and so it must not be used as a basis of value.

4.9 It is a common misconception that in a poor or falling market there are automatically few ‘willing sellers’ and that, as a consequence, most transactions in the market are the result of ‘forced sales’. Accordingly, the valuer may be asked to provide forced sale advice on this basis. This argument has little merit because it suggests that the valuer should ignore the evidence of what is happening in the market. The commentary for market value in VPS 4 paragraph 1.2, Market value, makes clear that a willing seller is motivated to sell at the best terms available in the market after proper marketing, whatever that price may be. The valuer should be careful not to accept instructions on the basis of a misconception and should explain to clients that, in absence of a defined constraint affecting either the asset or the vendor, the appropriate basis is market value. In a depressed market, a significant proportion of sales may be made by vendors that are obliged to sell, such as liquidators and receivers. However, such vendors are normally under a duty to obtain the best price in the current circumstances and cannot impose unreasonable marketing conditions or constraints of their own volition. These sales will normally comply with the definition of market value.

4.10 For further guidance on forced sales see IVS Framework paragraphs 52–54.
5 Special assumptions related to projected values

5.1 By their nature, projected values rely wholly on special assumptions. For example, the valuer may make various assumptions about the state of the market in the future – yields, rental growth, interest rates, etc.

5.2 Great care is required to ensure that the special assumptions made are:
  • in accordance with any applicable national or jurisdictional standard
  • realistic and credible
  • clearly and comprehensively set out in the report.

5.3 Any special assumptions relating to projected values should be agreed with the client prior to reporting an opinion of value.

5.4 The valuation report should make reference to the higher degree of uncertainty that is likely to be implicit with a projected value, where by definition, comparable evidence will not be available.
5 IVSC International Valuation Standards [IVS] 2013

The International Valuation Standards (IVS) 2013 are reproduced in full (with kind permission from IVSC) as an annex in this edition of the RICS Red Book. They are those approved by the IVSC Standards Board on 1 July 2013 with an effective date of 1 January 2014 (although IVSC encouraged earlier adoption).

IVS contain procedures for undertaking valuation assignments using generally recognised concepts and principles.

All RICS and IRRV members, whether practising individually or within an RICS-regulated or non-regulated firm, who provide a written valuation are required to comply with the International Valuation Standards issued by the International Valuation Standards Council.

RICS professional standards and valuation practice statements are consistent with the principles and definitions of the IVS (as at 1 January 2014). RICS considers that a valuation that complies with these standards and statements will also comply with the IVS.
6 RICS global valuation practice guidance – applications [VPGAs]

Introduction

This part of the Red Book is concerned with the application and implementation of professional standards and valuation practice statements in specific contexts, whether for a particular purpose or in relation to a particular asset type. All RICS and IRRV members, whether practising individually or within an RICS-regulated or non-regulated firm, who provide written valuations covered by the following Valuation Practice Guidance – Applications (VPGAs) are expected to be familiar with them.

These applications are intended to set out the key issues that need to be taken into account and, where appropriate, to direct valuers’ attention to other sources of guidance and information that are, or may be, relevant. They are therefore primarily advisory in nature rather than mandatory – to aid clarity in this part (Part 6) any mandatory requirements are signposted in bold type. All other material is advisory.

For the avoidance of doubt, where there is an IVS Valuation Standard covering the relevant subject area or asset type, this should be followed – for convenience these are cross referred to in the material below.

VPGA 1 – Valuation for inclusion in financial statements
VPGA 2 – Valuation for secured lending
VPGA 3 – Valuation of businesses and business interests
VPGA 4 – Valuation of individual trade related properties
VPGA 5 – Valuation of plant and equipment
VPGA 6 – Valuation of intangible assets
VPGA 7 – Valuation of personal property, including arts and antiques
VPGA 8 – Valuation of portfolios, collections and groups of properties
VPGA 9 – Valuation in markets susceptible to change: certainty and uncertainty
VPGA 1 Valuation for inclusion in financial statements

1 Scope

1.1 The material in this Valuation Practice Guidance – Application (VPGA) provides additional commentary on the practical implementation of IVS 300, Valuations for Financial Reporting, in relation to property, assets and liabilities. Any mandatory requirements are highlighted in bold type.

1.2 Valuations for inclusion in financial statements require particular care as they must comply strictly with the applicable financial reporting standards adopted by the entity. Valuers are strongly advised to clarify at the outset which standards their clients have adopted. Although the International Financial Reporting Standards (IFRS) are nowadays widely adopted, and the application guidance within IVS 300 Valuations for Financial Reporting gives background information on common valuation requirements under them, other financial reporting standards may or will still apply in individual jurisdictions.

1.3 Where IFRS does not currently apply, care should be taken to identify and follow any RICS national association standards concerning the valuation requirements.

1.4 In all cases, valuers are reminded that both IFRS and non-IFRS financial reporting standards continue to evolve – they should always refer to the standards current at the date to which the financial statements relate.

1.5 Where the entity has adopted IFRS the basis of value will be fair value (see also VPS 4 paragraph 1.5, Fair value) and IFRS 13 Fair Value Measurement will apply. It is essential that the valuer is familiar with IFRS 13 requirements, especially the disclosure requirements. IFRS 13 may be obtained from www.ifrs.org

2 Valuations of public sector assets under International Public Sector Accounting Standards [IPSAS]

2.1 Where public sector assets fall to be included in financial statements complying with IPSAS, care must be taken to refer to the version of the standards applicable at the financial reporting date, which can be accessed at www.ifac.org/public-sector

3 Other cases

3.1 Legislative, regulatory, accounting or jurisdictional requirements may require the modification of this application in some countries/states or under certain conditions. Any departure due to such circumstances must be referred to and clearly explained in the report.
VPGA 2 Valuation for secured lending

1 Scope

1.1 The material in this Valuation Practice Guidance – Application (VPGA) provides additional commentary on the practical implementation of IVS 310, Valuations of Real Property Interests for Secured Lending. Any mandatory requirements are highlighted in bold type.

1.2 This application embraces the valuation of real property interests and other types of tangible assets, e.g. plant and equipment, trade fixtures and equipment, etc.

2 Background

2.1 The following are the most common examples of security where a valuer’s advice is likely to be sought:

(a) property that is, or will be, owner-occupied
(b) property that is, or will be, held as an investment
(c) property that is fully equipped as a trading entity and valued with regard to trading potential and
(d) property that is, or is intended to be, the subject of development or refurbishment.

Each of the above examples is discussed further in paragraph 6.2 of this application.

2.2 This application deals with the following matters that are specific to valuations for secured lending:

- taking instructions and disclosures
- objectivity and conflicts of interest
- basis of value and special assumptions and
- reporting and disclosures.

2.3 There is a wide variety of assets offered as security and a range of lending products available, and so each case will require a slightly different approach. It is therefore open to the valuer and lender to agree variations, subject to PS 1 paragraph 4, Compliance with other valuation standards. The overriding objective is that the valuer should understand the lender’s needs and objectives, including the terms of the loan being contemplated, and the lender should understand the advice that is given.

2.4 Where a financial institution has a valuation department that provides valuation advice as an internal valuer, PS 1 paragraph 6.2, Exception, recognises that it may
be regarded as an exception for valuing and reporting purposes. However, it is considered good practice to adopt the principles of Parts 3 and 4 of the standards and to follow the guidance in the applications (Part 6) where appropriate. If the valuation advice is intended to be provided to a third party then it ceases to be within an exception.

3 Objectivity and conflicts of interest

3.1 Members shall at all times act with integrity, independence and objectivity, and avoid conflicts of interest and any actions or situations that are inconsistent with their professional obligations. Members should also declare any potential conflicts of interest – personal or professional – to all relevant parties (see PS 2 paragraph 4, Independence, objectivity and conflict of interest).

3.2 Valuers who comply with the provisions for independence and objectivity under PS 2 paragraph 4, Independence, objectivity and conflict of interest, may confirm that they are acting as ‘independent valuers’.

3.3 The lender may specify additional criteria for independence for a valuation for secured lending. In the absence of any specification, the additional criteria shall be deemed to include a stipulation that the valuer has had no previous, current or anticipated involvement with the borrower, or prospective borrower, the asset to be valued or any other party connected with a transaction for which the lending is required. ‘Previous involvement’ would normally be anything within the period of 24 months preceding the date of instruction or date of agreement of the terms of engagement (whichever is earlier), but a specific longer period may be prescribed or adopted in individual jurisdictions.

3.4 In accordance with IVS 310 paragraph 2 Scope of Work (IVS 101), any previous or current involvement with the borrower or the property or asset to be valued must be disclosed to the lender. Disclosure should also extend to any anticipated future involvement. (References to ‘borrower’ include a prospective borrower or any other party connected with the transaction for which the lending is required.) Examples of such involvement that may result in a conflict of interest include situations where the valuer or firm:

- has a long-standing professional relationship with the borrower or the owner of the property or asset
- is introducing the transaction to the lender or the borrower, for which a fee is payable to the valuer or firm
- has a financial interest in the asset or in the borrower
- is acting for the owner of the property or asset in a related transaction
- is acting (or has acted) for the borrower on the purchase of the property or asset
- is retained to act in the disposal or letting of a completed development on the subject property or asset
- has recently acted in a market transaction involving the property or asset
- has provided fee earning professional advice on the property or asset to current or previous owners or their lenders and/or
- is providing development consultancy for the current or previous owners.
3.5 The valuer must consider whether any previous, current or anticipated involvement with either the property or asset or related parties is sufficient to create a conflict with the valuer’s duty to be independent and objective. Matters such as the quantum of any financial interest in a connected party, the scope for the valuer or firm to benefit materially from a particular valuation outcome and the level of fees earned from any connected party as a proportion of total fee income may all be material.

3.6 If the valuer considers that any involvement creates an unavoidable conflict with his or her duty to the potential client, the instruction should be declined.

3.7 If the client considers that any disclosed involvement does create a conflict, the valuer should decline the instruction. If the valuer and the client agree that any potential conflict can be avoided by introducing arrangements for managing the instruction, those arrangements must be recorded in writing, included in the terms of engagement and referred to in the report.

3.8 Although a valuer may take into account the views of the prospective client in deciding whether a recent, current or anticipated involvement creates a conflict, it remains the valuer’s professional responsibility to decide whether or not to accept the instruction having regard to the principles of the RICS Rules of Conduct. If the instruction is accepted where material involvement has been disclosed, the valuer may be required to justify this decision to RICS. If a satisfactory justification is not provided, RICS may take disciplinary measures.

3.9 General guidance on conflicts of interest can be found in PS 2 paragraph 4, Independence, objectivity and conflict of interest.

4 Taking instructions and disclosures

4.1 IVS 310 paragraphs 2–5 cover the scope of work as defined in IVS 101 Scope of Work. Valuers are reminded that the terms of engagement must incorporate the minimum requirements of VPS 1 paragraph 2, Minimum terms of engagement. Where the lender has additional or alternative requirements, they will need to be confirmed and particular care must be taken to agree and record any special assumptions that have to be made.

4.2 In some circumstances a valuation for secured lending may be commissioned by a party that is not the intended lender, for example, a prospective borrower or broker. If the party does not know, or is unwilling to disclose, the identity of the intended lender, it must be stated in the terms of engagement that the valuation may not be acceptable to a lender. This may be because some lenders do not accept that a valuation procured by a borrower or an agent is sufficiently independent, or because that particular lender has specific reporting requirements.

4.3 The valuer should enquire if there has been a recent transaction or a provisionally agreed price on any of the properties to be valued. If such information is revealed, further enquiries should be made, for example, the extent to which the property was marketed, the effect of any incentives, the price realised or agreed and whether it was the best price obtainable.

4.4 The valuer should request details of the terms of the lending facilities being contemplated by the lender.
4.5 The valuer must ensure that all the relevant disclosures required by the instructions, in compliance with VPS 1 paragraph 2, Minimum terms of engagement, and paragraph 6 below, are made.

5 Basis of value and special assumptions

5.1 Market value is the appropriate basis of value that should be used for all valuations or appraisals undertaken for secured lending.

5.2 Any special assumptions (see VPS 4 paragraph 3 Special assumptions) made in arriving at the market value must be agreed in writing with the lender in advance and referred to in the report.

5.3 Circumstances that often arise in valuations for secured lending where special assumptions may be appropriate include, for example:

- planning consent has been granted for development at the property
- there has been a physical change to the property, such as new construction or refurbishment
- a new letting on given terms, or the settlement of a rent review at a specific rent, has been completed
- there is a special purchaser, which may include the borrower
- a constraint that could prevent the property being either brought or adequately exposed to the market is to be ignored
- a new economic or environmental designation has taken effect
- any unusual volatility in the market as at the valuation date is to be discounted
- any lease or leases between connected parties has been disregarded.

This list is not exhaustive, and the appropriate special assumptions will depend on the circumstances under which the valuation is requested and the nature of the property to be valued.

5.4 As some special assumptions may qualify the application of market value, any valuation for secured lending purposes arrived at by making a special assumption must be accompanied by a comment on any material difference between the market value with and without that special assumption. See IVS 310 paragraph 7(e) Reporting (IVS 103 Reporting) for additional requirements.

6 Reporting and disclosures

6.1 In addition to the matters set out in VPS 3 paragraph 7, Report content, the report must include the following:

- disclosure of any involvements (see paragraph 4 of this application, Taking instructions and disclosures) identified in the original or subsequent amendment to, the terms of engagement, or any arrangements agreed for avoiding a conflict of interest. If the valuer has had no involvement, a statement to that effect is to be made.
6.2 The following paragraphs indicate matters that it may be appropriate to include when valuing different categories of property, as listed in paragraph 2.1, Background, of this application.

a) Property that is, or will be, owner-occupied

1 Typical special assumptions that may arise when valuing this category of property include:
   • planning consent has been, or will be, granted for development, including a change of use of the property
   • a building or other proposed development has been completed in accordance with a defined plan and specification
   • all necessary licences are in place
   • the property has been changed in a defined way (for example, removal of equipment or fixtures) and
   • the property is vacant when, in reality, at the valuation date it is occupied.

b) Property that is, or will be, held as an investment

1 Additional report contents include:
   • a summary of occupational leases, indicating whether the leases have been read or not, and the source of any information relied on
   • a statement of, and commentary on, current rental income, and comparison with current market rental value. Where the property comprises a number of different units that can be let individually, separate information should be provided on each
VPGA 2  Valuation for secured lending

- an assumption as to covenant strength where there is no information readily available, or comment on the market’s view of the quality, suitability and strength of the tenant’s covenant
- comment on sustainability of income over the life of the loan, with particular reference to lease breaks or determinations and anticipated market trends and
- comment on any potential for redevelopment or refurbishment at the end of the occupational lease(s).

2 Typical special assumptions that may arise in valuing this category of property include whether:
- a different rent has been agreed or determined, for example, after a rent review
- any existing leases have been determined, and the property is vacant and to let or
- a proposed lease on specified terms has been completed.

c) Property that is fully equipped as a trading entity and valued with regard to trading potential

1 The closure of the business could have a significant impact on the market value. The valuer should therefore report on this impact, either individually or as a combination of one or more of the following special assumptions:
- the business has been closed and the property is vacant
- the trade inventory has been depleted or removed
- the licences, consents, certificates and/or permits have been lost or are in jeopardy and/or
- accounts and records of trade are not available to a prospective purchaser.

2 Typical special assumptions that may arise in valuing this category of property include:
- assumptions made on the trading performance and
- projections of trading performance that materially differ from current market expectations.

d) Property that is, or is intended to be, the subject of development or refurbishment

1 Additional report contents include:
- comment on costs and contract procurement
- comment on the viability of the proposed project
- if the valuation is based on a residual method, an illustration of the sensitivity of the valuation to any assumptions made
- the implications on value of any cost overruns or contract delays and
- comment on the anticipated length of time the redevelopment or refurbishment will take, as this may affect the current value due to inconvenience and/or temporary lack of utility.
2 Typical special assumptions that may arise in valuing this category of property include whether:

- the works described had been completed in a good and workmanlike manner, in accordance with all appropriate statutory requirements
- the completed development had been let, or sold, on defined terms or
- a prior agreed sale or letting has failed to complete.

3 Where a valuation is required on the special assumption that the work had been completed as of a current valuation date, the value reported should be based on current market conditions. If a valuation is required on the special assumption that the work has been completed as of a future date and the valuation date is as of that future date, the valuer is required to develop and report the value opinion in accordance with VPS 1 paragraph 9(f), Valuation date, VPS 3 paragraph 7(f), Valuation date, and VPS 4 paragraph 5, Special assumptions related to projected values.

6.3 It is good practice to attach any instruction letter and the terms of engagement to the report and refer to these documents in the body of the report.
1 Scope

1.1 The material in this Valuation Practice Guidance – Application (VPGA) provides additional commentary on the practical implementation of IVS 200, Businesses and Business Interests. Any mandatory requirements are highlighted in bold type.

2 Introduction

2.1 For the purposes of this application, a ‘partial interest’ means ownership of a right or rights that represent less than all of the rights in a tangible or intangible asset, such as the right to use but not sell an asset or property. ‘Fractional interest’ means ownership of a percentage of the right or rights in a tangible or intangible asset, whether such rights are in the entirety of the asset, or a partial interest in the asset, such as the ownership of an asset shared by more than one party.

2.2 IVS 200 Businesses and Business Interests, paragraph C2 defines a business as ‘a commercial, industrial, service or investment activity’. This application is concerned with the valuation of entire businesses – whether companies, sole traders or partnerships (including limited liability partnerships) – together with interests therein, such as company stocks and shares or partnership interests.

2.3 This VPGA does not deal with intangible assets, the valuation of land, plant and machinery, or other tangible assets that may sometimes constitute part of a business. However, a business valuer may often be required to rely on the valuation of such assets provided by other specialist valuers, for example, of real estate, and mineral rights.

2.4 Valuation of loan capital, debentures, options, warrants, convertibles and fixed interest securities may form part of a business valuation assignment.

2.5 The definitions of many of the terms used in this VPGA are from the International Glossary of Valuation Terms, produced by the International Valuation Standards Council (IVSC), and can be found at www.ivsc.org/glossary

2.6 To satisfy PS 2 paragraph 3, Member qualification, it is important that the valuer is regularly involved in business valuation, as practical knowledge of the factors affecting any particular property, asset, business or share, is essential.
3 Scope of work and terms of engagement

3.1 The valuation knowledge of clients will vary widely. Some will have a thorough understanding of business valuation, while others will be unfamiliar with the terms and concepts used by business valuers.

3.2 It is imperative that both the scope of the work to be undertaken and the terms of engagement are understood and agreed between the valuer and the client prior to commencement of the assignment. The asset or liability, or the specific interest in the asset or liability that is to be valued, or the right (or rights to) that are to be appraised should be recorded. Such record should specify:

- the legal structure of the business entity
- whether the asset to be valued is the interest in its entirety or a fractional interest
- if the asset to be valued is confined to, or excludes, certain assets or liabilities, and
- the class (or classes) of shares concerned.

3.3 Any assumptions that are made must be clearly stated in compliance with VPS 4 paragraph 2, Assumptions, and VPS 4 paragraph 3, Special assumptions. For example, the valuer should state whether he or she assumes that the owners of shares or partial interests are intending to sell or retain such interests, or whether certain assets or liabilities owned by the business are to be disregarded.

3.4 Valuers may wish to develop standard letters of engagement that can be used for any type of valuation instruction. Where a valuation has to comply with the RICS Red Book the valuer must produce terms of engagement that comply with the minimum terms set out in PS 2 paragraph 7, Terms of engagement, and VPS 1, Minimum terms of engagement, adapted as necessary to refer to business valuation.

There may be situations where the interest in the asset to be valued is shared with others, and in such cases, it should be clearly specified.

4 Businesses and business interests

4.1 A business valuation may either comprise the whole of the activity of an entity or a part of the activity. The valuer must distinguish between the entirety value, the value of a partial interest (such as shares or a specific business activity carried on by the entity), the values of specific assets or liabilities of the entity, and the intended use of the valuation (for example, for tax planning, or management’s internal purposes), prior to commencing the valuation.

4.2 It is essential to be clear about the ‘purpose’ of the valuation, and its ‘intended use’. Purpose may refer to the provision of an opinion in accordance with a specific basis of value, for example, market value or fair value. Intended use may refer to a type of transaction or activity, for example, financial reporting.

4.3 Where individual assets, divisions and liabilities are to be valued, and are capable of being independently transferred, they should, where possible, be valued at their respective market values rather than by apportionment of the entirety value of the business.
4.4 When valuing a business or interest in a business the valuer should consider whether a higher value could be arrived at on a liquidation basis and, if so, consider the prospect of realising such value, having regard to the ownership interest.

4.5 Whatever the ownership interest – whether a proprietorship, a partnership, or in corporate form – the rights, privileges and conditions attaching to that interest have to be considered in the valuation. Ownership interests may be the entire business, or part or shares therein, and it may be important to distinguish between legal and beneficial ownership, rights and obligations inherent to the interest and those rights that may be contained in any agreement between current shareholders. Ownership rights will usually be set out in legally binding documents such as articles of association, articles of incorporation, business memoranda, bye-laws, partnership articles or other agreements, and shareholder agreements.

4.6 The documents referred to in paragraph 4.5 may contain transfer restrictions and may state the basis of value (defined by IVS as ‘a statement of the fundamental measurement assumptions of a valuation’) that has to be used on a transfer of the business interest. It is important to distinguish between rights and obligations inherent in the interest to be valued. For example, the ownership documentation may require the valuation to be done on a pro-rata proportion of the entity value, regardless of size of interest. The valuer will then have to comply with such requirements and the rights attaching to any other class of interest. IVS 200 Businesses and Business Interests paragraph C5, Ownership Rights, may be relevant in this connection.

4.7 A non-controlling interest may have a lower value than a controlling one, although a majority interest does not necessarily control the entity. Voting control and other rights will be set out by the legal frameworks mentioned in paragraph 4.5 and may give control or veto even to minority interests in certain circumstances. There are often different equity classes in a business, each with different rights.

4.8 The reason why the valuer has been instructed to perform a business valuation is important to understand, as the valuation may be required for a wide variety of purposes. Examples include financial reporting, taxation, public sector assignments, transactions and flotations, fairness opinions, banking arrangements, insolvency and administration, knowledge management, or portfolio review. The purpose will introduce various bases of value, some governed by statute and case law, and others by international and national standards of professional valuation practice.

4.9 Bases of value typically encountered for these valuations are fair value, fair market value, market value, open market value, investment value, owner value and net realisable value. Valuers should be mindful of the requirements of PS 1 paragraph 3, Compliance with IVS, PS 1 paragraph 4, Compliance with other valuation standards, and PS 1 paragraph 7, Departures, relating to the use of a basis of value not recognised in the Red Book.

4.10 Depending on the rules and practice followed in respect of the basis of value, valuations of the same asset may be different. For example, because of the rules concerning tax valuations, a tax authority might view a valuation differently to a litigant, merger partner or special purchaser.

4.11 While the valuer should consider future returns likely to be received from the business, as well as the often theoretical aspects of valuation (particularly fiscal factors), ultimately the business that is to be valued is the one that actually exists, or
the one that could exist on a commercial basis as at the valuation date. The valuer therefore needs to account for the future expectations of operation of the business. These expectations may be based partly on actual historic performance and partly on a notional unachieved one. They will be those of the market participants as identified by the valuer, following appropriate research as to the business and outlook for the industry, and discussions with the operators of the business as to their expectations.

4.12 As the underlying concept revolves around the profits that the purchaser might expect to accrue from ownership, these are generally measured after deducting the commercial costs of managing the business entity. Therefore, where a business entity does not bear actual management costs, the valuer will need to consider the deduction of notional management costs at a market rate in arriving at profitability for business valuation purposes.

4.13 In many cases it may be necessary to apply more than one valuation method, particularly where there is insufficient information or evidence to enable the valuer to rely on just one. In such cases, the valuer may use additional methods, adjusted perhaps on a weighted basis, to arrive at the final valuation. The valuer should consider all valuation approaches, giving reasons why any particular approach has not been completed.

5 Information

5.1 Business valuation often depends on information received from the proprietors and their advisers or representatives. The valuer should specify what reliance has been placed on what information, as well as stating the rationale for accepting and using, without verification, information provided by the client or that person’s representative. Some information may have to be verified in whole or in part, and this will need to be stated in the valuation report. Although the value may largely depend on future expectations, the history may assist in determining what these expectations might reasonably be. See IVS 101 Scope of Work paragraph (g) Extent of investigation.

5.2 The valuer needs to be aware of any relevant economic developments, industry trends and the context in which the valuation is being prepared, for example, political outlook, government policies, inflation and interest rates, and market activity. Such factors may affect businesses in different sectors in distinct ways.

5.3 The interest being valued will reflect the financial standing of the business at the valuation date. The nature of the assets and liabilities needs to be understood, and the valuer is expected to know which ones are employed for income generation, and which ones are redundant to such activities at the valuation date. The valuer should also take account of off-balance sheet assets or liabilities where necessary.

6 Valuation investigation

6.1 As a minimum requirement, valuers should not contemplate carrying out a valuation in the absence of a detailed knowledge and understanding of the history of, and activities associated with, the business and or asset(s). They will also need a comprehensive understanding of, as appropriate, management structures and
personnel, state of the subject industry, the general economic outlook and political factors. In addition, a thorough grasp of such issues as the rights of minority shareholders and, in the UK, unfair prejudice, is also a prerequisite. For these reasons, valuers should have appropriate competency in business valuation.

6.2 Typical information requirements to assist the valuer in understanding the subject company and/or asset(s) could include:

- most recent financial statements, and details of current and prior projections or forecasts
- description and history of the business or asset, including legal protections
- information about the business or asset and supporting intellectual property and intangibles (e.g. marketing and technical know-how, research and development, documentation, design graphics and manuals)
- articles of association, company memorandum (for UK pre-Companies Act 2006 entities), shareholders’ agreements, subscription agreements, other collateral agreements
- precise activities of the business, and its associated companies or subsidiaries
- class rights of all share and debenture classes (security over assets)
- previous valuation reports
- product(s) dealt in, supported or extended by the business and intangibles
- company’s market(s) and competition, barriers to entry in such markets, business and marketing plans, due diligence
- strategic alliances and joint venture details
- whether contractual arrangements can be assigned or transferred in any intangible asset or royalty agreement
- major customers and suppliers
- objectives, developments or trends expected in the industry and how these are likely to affect the company or asset
- accounting policies
- strengths, weaknesses, opportunities and threats (SWOT) analysis
- key market factors (e.g. monopoly or dominant market position, market share)
- major capital expenditure in prospect
- competitor positions
- seasonal or cyclical trends
- technological changes affecting business or asset
- vulnerability of any source of raw materials or supplier arrangement
- whether there have been any recent acquisitions or mergers in the sector around the valuation date, and the criteria that were applied
- whether there have been any significant developments or changes to the business since the latest accounting date (e.g. management information, budgets, forecasts)
- offers to acquire the business, or discussions with banks and other sponsors to go public
management of research and development (e.g. non-disclosure agreements, subcontractors, training and incentives).

6.3 Much of the information relied on will be derived from the client(s) and it may not be possible to verify it. In such cases, the valuation report should make this clear. It may, however, extend to information obtained from other specialist valuers or other comment or informed sources, as set out at paragraph 5.1 Information above, and it should be made clear if reliance has been placed on such information.

7 Valuation methodology

7.1 In broad terms, valuation theory recognises four distinct approaches in the valuation of shares and businesses. These are the market approach (sometimes known as the direct market comparison approach), the income approach, the cost approach, and the asset based approach.

7.2 While the market and income approaches can be used for the valuation of any business or business interest, the cost approach will not normally apply except where profits and cash flows cannot reliably be determined, for example, in start-up businesses and early stage companies.

7.3 The other method that may apply to the valuation of businesses and interests in businesses is the asset-based approach, which is based on the underlying assets being revalued, if necessary. This would include, for example, property holding and investment companies, and investment businesses holding listed company shares.

7.4 Involvement of market participants, who are able to provide insights to transactions and market conditions that are critical to proper use of the data in analysis, is advisable wherever possible.

Market approach

7.5 The market approach measures the value of an asset by comparing recent sales or offerings of similar or substitute property and related market data to the business being valued.

7.6 The two primary market approaches are the ‘market multiple method’ and the ‘similar transactions method’. These approaches are based on data derived from three principal sources:

- public stock markets
- the acquisition market where entire businesses are traded and
- prior transactions in the shares of the entity being valued, or offers for that subject business.

7.7 The market multiple method focuses on comparing the subject asset to guideline similar, publicly traded, companies and assets. In applying this method, valuation multiples are derived from historic, though sometimes from forecast, operating data of comparables. These are selected, where possible, from the same industry, or one affected by the same economic factors as that of the subject business, and are evaluated on both a qualitative and quantitative basis. The data is then adjusted having regard to the strengths and weaknesses of the subject asset relative to the selected companies, and applied to the appropriate operating data of
the subject asset to arrive at an indication of value. Appropriate adjustments (as supported by market-derived information presented in the report) to reflect different properties or characteristics, are usually made to the derived data. Examples of such matters are differences in perceived risk and future expectations, and differences in ownership interest, including level of control, marketability and size of holding.

7.8 The similar transactions method uses valuation multiples based on historical change of control transactions that have occurred in the subject company’s and/or asset’s direct or related industries. These derived multiples are then adjusted and applied to the appropriate operating data of the subject asset to arrive at an indication of value.

7.9 In certain industries, businesses are bought and sold on the basis of established market practices or rules of thumb, often (though not exclusively) derived from multiples or percentages of turnover, and not linked to profitability. Where such rules of thumb exist, and there is evidence that buyers and sellers in the actual market rely on them, they may need to be considered by the business valuer. However, it would be sensible to cross check the results arising from such market practices against one or more other methods.

**Income approach**

7.10 The *income approach* has a number of variants, but essentially this approach is based on the income that an asset is likely to generate over its remaining useful life or a specified period. This estimation is determined by reference to both historic performance and forecasts. Where these are not available, the single period capitalisation method may be appropriate instead.

7.11 The single period capitalisation method approach commonly estimates the value by capitalising that income. A thorough understanding of accounting and economic profits, their historical record based usually on historic financial statements, and forecasting is necessary in each case. Maintainable or normalised profits after tax are determined and, if necessary, adjusted to reflect differences between actual historic cash flows and those that could be expected to be received by a purchaser of the business at the *valuation date*.

7.12 Further adjustments may include restating non-arm’s length transactions and costs incurred with related parties to commercial terms, and reflecting the effect of non-recurring events whether of income or cost. Examples of this include one-off redundancies, exceptional profits or losses. Comparison of depreciation, taxation and inventory accounting should be on a like-for-like basis.

7.13 Profits are then capitalised by the price to earnings (P/E) ratio. A similar exercise can be carried out by applying a suitable capitalisation multiple to maintainable or normalised profits before tax. A suitable capitalisation multiple will often be applied to earnings before interest and tax (EBIT), or earnings before interest, tax, depreciation and amortisation (EBITDA). Care must be taken in these cases to distinguish between enterprise value (which also considers the debt of the business and any liquid assets owned by the entity that might mitigate the acquirer’s purchase price) and equity value (i.e. the value of the shares).

7.14 Business value is often derived by capitalising profits or cash flows before costs of servicing debt, using a capitalisation or discount rate that is the weighted average cost of capital (WACC) of a comparable mix of debt and equity. The equity
value is the enterprise value less the market value of the net debt, but can be established by measuring the equity cash flow itself.

7.15 Present value techniques measure the value of an asset by the present value of its future economic cash flow, which is cash that is generated over a period of time by an asset, group of assets, or business enterprise. These can include earnings, cost savings, tax deductions, and proceeds from its disposition. When applied to business valuation, value indications are developed by discounting expected cash flows, estimated, where appropriate, to include growth and price inflation, to their net present value at a rate of return. The rate of return incorporates the risk-free rate for the use of funds, the expected rate of inflation and risks associated with the particular investment and the market. The discount rate selected is generally based on rates of return available from alternative investments of similar type and quality as at the valuation date. Expressions such as ‘rate of return’ may mean different things to different individuals so valuers should consider defining what is meant by such terms.

7.16 The values of redundant or surplus assets, namely those owned but not used in the business operations, need to be taken into account in enterprise or equity values.

7.17 The income approach, as applied using the dividend basis of value, is common in company valuation, principally in relation to minority shareholdings. For business valuations, value indicators are developed by determining a share’s future dividends and prospect of dividends, and a rate of return, using dividend discount and initial yield models.

Cost approach

7.18 The cost approach (see IVS 210 Intangible Assets paragraphs C36–C38) indicates the value of an asset by the cost to create or replace the asset with another similar one, on the premise that a purchaser would not pay more for an asset than the cost to obtain one of equal usefulness. This method is frequently used in valuing investment companies or capital intensive firms. However, it would normally not be used except when the other two approaches have been considered but deemed not applicable, and the report would contain an explanation as to why this was so.

7.19 When applied to business valuation, obsolescence, maintenance and the time value of money are considerations. If the asset being valued is less attractive than a modern equivalent, by reason of age or obsolescence, it may be necessary to adjust the cost of the perceived modern equivalent, thus arriving at the depreciated replacement cost.

Asset-based approach

7.20 The asset-based approach measures the value of a business and asset by reference to the value of individual assets and liabilities. This approach is commonly adopted in the area of property investment and share investment portfolio situations (investment trusts). This approach is not normally the preferred one for trading businesses, except where they are failing to achieve an adequate return on the tangible assets used in the business, or where a trading business also has
substantial investment activity or surplus cash. The net asset value per share can be discounted or enhanced by the addition of a premium.

**7.21** The valuation *assumptions* and inputs may be based either on actual data or on assumed information. The *market approach* is likely to be based on actual inputs, such as prices achieved on sales of similar assets or businesses and actual income or profits generated. Assumed inputs might include cash flow forecasts or projections. For valuations adopting the cost approach, actual inputs might include the actual cost of an asset, whereas assumed inputs may have regard to an estimated cost of an asset and other factors, such as the perceived attitude to risk of other players in the market.

**7.22** As a general rule, valuation by summation, sometimes known as valuation by assembly, should be avoided. Accordingly, when valuing the totality of various assets or component parts of an entity, the valuer must avoid arriving at the value of the whole merely by adding together the values indicated for the various separate assets or component parts.

### 8 Reports

**8.1** Where the valuation has to comply with the RICS Red Book, the valuer must produce a report that complies with the minimum terms set out in *VPS 3, Valuation reports*. Generally the report has a brief introductory section or executive summary that defines the assignment, summarises the conclusion and sets the stage for the details of the report. The structure should move from the general to the specific, providing a logical flow of data and analysis within which all the necessary considerations can be incorporated, leading to the valuation conclusions.

**8.2** Most reports will have the following major sections, although not necessarily in this order:

- introduction
- purpose and *basis of value*
- subject of valuation
- description and history of the business
- management and personnel
- accounting and accounting polices
- financial statement analysis
- business and marketing plan analysis, and prospects
- search results for comparables and comparative transactions
- industry in which the business operates, economic environment, yields and risk assessment
- valuation methods and conclusion
- caveats, disclaimers and limitations.

**8.3** Some reports will have a separate section containing a general discussion of valuation methodology, which will often follow the introduction. If national, regional and economic data are important to the company and asset, each may have its own section.
8.4 Where appropriate, factual information, or sources thereof, should be identified either in the body of the report or in the appendices. Where the opinion of an expert is required for litigation purposes, the report must adhere to the requirements imposed by the local jurisdiction (for example, in the UK, the Civil Procedure Rules (CPR) Part 35) and must therefore contain all relevant disclosures including the statement of the expert’s qualifications and the statement of truth.

9 Confidentiality

9.1 Information in respect of many business assets will be confidential. Valuers should use their best endeavours to preserve such confidentiality, particularly in relation to information obtained in respect of comparable assets. Where required by the client, business valuers will comply with any requests to enter into non-disclosure or similar agreements.
1 Background

1.1 Certain trade related properties are valued using the profits method (also known as the income approach) of valuation. This Valuation Practice Guidance – Application (VPGA) sets out the principles of this method of valuation but does not concern itself with the detailed approach to a valuation, which may vary according to the property to be valued.

1.2 This VPGA relates only to the valuation of an individual property that is valued on the basis of trading potential.

1.3 Certain properties are normally bought and sold on the basis of their trading potential. Examples include hotels, pubs and bars, restaurants, nightclubs, casinos, cinemas and theatres, and various other forms of leisure property. The essential characteristic of this type of property is that it has been designed or adapted for a specific use, and the resulting lack of flexibility usually means that the value of the property interest is intrinsically linked to the returns that an owner can generate from that use. The value therefore reflects the trading potential of the property. It can be contrasted with generic property that can be occupied by a range of different business types, such as standard office, industrial or retail property.

1.4 Valuers who prepare valuations of trade related property usually specialise in this particular market, as knowledge of the operational aspects of the property valuation, and of the industry as a whole, is fundamental to the understanding of market transactions and the analysis required.

1.5 The use of comparable information may be derived from a wide variety of sources, not just transactional evidence. Also, information may be drawn from different operational entities with regard to the component parts of the profits valuation. The valuer should emphasise within the report that the valuation is assessed having regard to trading potential and should refer to the actual profits achieved. If the trading potential and/or the actual profits vary, there could be a change in the reported value (see VPS 3 paragraph 7(i)(4), Assumptions and special assumptions, and VPGA 9, Valuation in markets susceptible to change: certainty and uncertainty).

1.6 This VPGA assumes that the current trade related use of the property will continue. However, where it is clear that the property may have an alternative use that may have a higher value, an appropriate comment should be made in the report. Where such an alternative use value is provided, it should be accompanied by a statement that the valuation takes no account of the costs of business closure, disruption or any other costs associated with realising this value.
2 Terms used in this application

2.1 The terms used in this application may have different meanings when used by other professional disciplines.

Adjusted net profit

2.2 This is the valuer’s assessment of the actual net profit of a currently trading operational entity. It is the net profit that is shown from the accounts once adjustments for abnormal and non-recurring expenditure, finance costs and depreciation relating to the property itself, as well as rent where appropriate, have been made. It relates to the existing operational entity and gives the valuer guidance when assessing the fair maintainable operating profit (FMOP).

Earnings before interest, taxes, depreciation and amortisation (EBITDA)

2.3 This term relates to the actual operating entity and may be different from the valuer’s estimated FMOP.

Fair maintainable operating profit (FMOP)

2.4 This is the level of profit, stated prior to depreciation and finance costs relating to the asset itself (and rent if leasehold), that the reasonably efficient operator (REO) would expect to derive from the fair maintainable turnover (FMT) based on an assessment of the market’s perception of the potential earnings of the property. It should reflect all costs and outgoings of the REO, as well as an appropriate annual allowance for periodic expenditure, such as decoration, refurbishment and renewal of the trade inventory.

Fair maintainable turnover (FMT)

2.5 This is the level of trade that an REO would expect to achieve on the assumption that the property is properly equipped, repaired, maintained and decorated.

Market rent

2.6 This is the estimated amount for which an interest in real property should be leased on the valuation date between a willing lessor and a willing lessee on appropriate lease terms in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion. Whenever market rent is provided the ‘appropriate lease terms’ that it reflects should also be stated.

Market value

2.7 This is the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.
Operational entity

2.8 An operational entity usually includes:

- the legal interest in the land and buildings
- the trade inventory, usually comprising all trade fixtures, fittings, furnishings and equipment, and
- the market's perception of the trading potential, together with an assumed ability to obtain/renew existing licences, consents, certificates and permits.

Consumables and stock in trade are normally excluded.

Personal goodwill [of the current operator]

2.9 This is the value of profit generated over and above market expectations that would be extinguished upon sale of the trade related property, together with financial factors related specifically to the current operator of the business, such as taxation, depreciation policy, borrowing costs and the capital invested in the business.

Reasonably efficient operator (REO)

2.10 This is a concept where the valuer assumes that the market participants are competent operators, acting in an efficient manner, of a business conducted on the premises. It involves estimating the trading potential rather than adopting the actual level of trade under the existing ownership, and it excludes personal goodwill.

Tenant’s capital

2.11 This may include, for example, all consumables, purchase of the inventory, stock, and working capital.

Trade related property

2.12 This is any type of real property designed for a specific type of business where the property value reflects the trading potential for that business.

Trading potential

2.13 This is the future profit, in the context of a valuation of the property, that an REO would expect to be able to realise from occupation of the property. This could be above or below the recent trading history of the property. It reflects a range of factors (such as the location, design and character, level of adaptation and trading history of the property within the market conditions prevailing) that are inherent to the property asset.

3 Profits method of valuation

3.1 The profits method of valuation involves the following steps:

Step 1: An assessment is made of the FMT that could be generated at the property by an REO.
Step 2: Where appropriate, an assessment is made of the potential gross profit, resulting from the FMT.

Step 3: An assessment is made of the FMOP. The costs and allowances to be shown in the assessment should reflect those to be expected of the REO – which will be the most likely purchaser or operator of the property if offered in the market.

Step 4:
(a) To assess the market value of the property the FMOP is capitalised at an appropriate rate of return reflecting the risk and rewards of the property and its trading potential. Evidence of relevant comparable market transactions should be analysed and applied.

(b) In assessing market value the valuer may decide that an incoming new operator would expect to improve the trading potential by undertaking alterations or improvements. This will be implicit within the valuer’s estimate of FMT at step 1. In such instances, an appropriate allowance should be made from the figure resulting from step 4 to reflect the costs of completing the alterations or improvements and the delay in achieving FMT. Similarly, if the property is in need of repair and/or decoration to enable the REO to achieve the FMT, then an appropriate allowance should be made from the figure resulting from step 4(a) to reflect the cost of such repairs and decorations.

(c) To assess the market rent for a new letting, the rent payable on a rent review or the reasonableness of the actual rent passing (particularly when preparing an investment valuation), an allowance should be made from the FMOP to reflect a return on the tenant’s capital invested in the operational entity – for example, the cost of trade inventory, stock and working capital. The resultant sum is referred to as the divisible balance. This is apportioned between the landlord and tenant having regard to the respective risks and rewards, with the landlord’s proportion representing the annual rent.

3.2 Certain extended or more detailed approaches to a profits method of valuation may be appropriate, particularly for some larger or more complex trade related properties. Consideration of discounted cash flow assessments and different income streams may be adopted. Such knowledge will aid in the analysis and review of historic and current trading performance, as well as with forecasts that may show increases or decreases on actual trade. This can assist in forming an opinion of the FMT and FMOP considered achievable by a likely purchaser or REO.

3.3 It is important that the valuer is regularly involved in the relevant market for the class of property, as practical knowledge of the factors affecting the particular market is required.

3.4 When preparing a trade related property valuation it is essential that the valuer reviews the cumulative result of the different steps of the valuation process. The valuation should be considered having regard to the valuer’s general experience and knowledge of the market.

4 Valuation special assumptions

4.1 A trade related property will usually be valued to market value or market rent, but valuers are commonly asked for a valuation subject to special assumptions.
VPGA 4  Valuation of individual trade related properties

Typical *special assumptions* are:

(a) on the basis that trade has ceased and no trading records are available to prospective purchasers or tenants

(b) on the same basis as (a) but also assuming the trade inventory has been removed

(c) as a fully equipped operational entity that has yet to trade (also known as ‘day one’ valuation) and

(d) subject to stated trade projections, assuming they are proven. This is appropriate when considering development of the property.

5 Valuation approach for a fully equipped operational entity

5.1 The valuation of a *trade related property* as a fully equipped operational entity necessarily assumes that the transaction will be either the letting or the sale of the property, together with the trade inventory, licences, etc., required to continue trading.

5.2 However, care must be taken because this *assumption* does not necessarily mean that the entire trade inventory is to be included in the valuation of the property. For example, some equipment may be owned by *third parties* and therefore would not form part of the interest being valued. Any *assumption* made about the trade inventory included in the valuation should be clearly set out in the report.

5.3 There may be tangible assets that are essential to the running of the operational entity but are either owned separately from the land and buildings, or are subject to separate finance leases or charges. In such cases, an *assumption* may need to be made that the owners or beneficiaries of any charge would consent to the transfer of the assets as part of a sale of the operational entity. If it is not certain that such an *assumption* can be made, the valuer must consider carefully the potential impact on the valuation that the lack of availability of those assets would have to anyone purchasing or leasing the operational entity and comment accordingly in the report.

5.4 When *trade related properties* are sold or let as fully equipped operational entities, the purchaser or operator normally needs to renew licences or other statutory consents and take over the benefit of existing certificates and permits. If the valuer is making any different *assumption*, it should be clearly stated as a *special assumption*.

5.5 Where it is not possible to inspect the licences, consents, certificates and permits relating to the property, or other information cannot be verified, the *assumptions* made should be identified in the report, together with a recommendation that their existence should be verified by the client’s legal advisers.

6 Assessing the trading potential

6.1 There is a distinction between the *market value* of a *trade related property* and the *investment value* – or its *worth* – to the particular operator. The operator will derive *worth* from the current and potential net profits from the operational entity operating in the chosen format. While the present operator may be one potential bidder in the market, the valuer will need to understand the requirements and
achievable profits of other potential bidders, along with the dynamics of the open market, to come to an opinion of value for that particular property.

6.2 A *trade related property* is considered to be an individual trading entity and is typically valued on the *assumption* that there will be a continuation of trading.

6.3 When assessing future trading potential, the valuer should exclude any turnover and costs that are attributable solely to the personal circumstances, or skill, expertise, reputation and/or brand name of the existing operator. However, the valuer should reflect additional trading potential that might be realised by an REO taking over the property at the *valuation date*.

6.4 The actual trading performance should be compared with similar types of *trade related property* and styles of operation. Therefore a proper understanding of the profit potential of those property types and how they compare with one another is essential. A *trade related property* valuer should test, by reference to market transactions and similar *trade related properties*, whether the present trade represents the FMT in current market conditions. When available, the actual trading accounts of the subject property and similar properties may need adjusting to reflect the circumstances of the REO.

6.5 For many trading entities, the vehicle for a transfer of the business will be the sale of a freehold or leasehold interest in the property. Such transactional evidence can be used as comparable evidence in the valuation of *trade related properties*, so long as the valuer is in a position to exclude the value of the component parts of the transaction that are not relevant. Examples include stock, consumables, cash, liabilities and *intangible assets* (such as brand names or contracts, to the extent they would not be available to the REO).

6.6 Changes in competition can have a dramatic effect on profitability, and hence value. The valuer should be aware of the impact of current and expected future levels of competition. If a significant change from existing levels is anticipated, the valuer should clearly identify this in the report and comment on the general impact it might have on profitability and value.

6.7 Outside influences, such as the construction of a new road or changes in relevant legislation, can also affect the trading potential and hence the value of the *trade related property*.

6.8 Where it is intended to reflect purchaser’s costs in the valuation (usually in the case of investment valuations), the normal *market approach* is to be adopted and an appropriate comment should be made in the report.

6.9 Where the property is trading and the trade is expected to continue, the valuation will be reported as follows:

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Market value [or market rent] as a fully equipped operational entity having regard to trading potential subject to any agreed or special assumptions … [which must be clearly set out].
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7 Valuation approach for a non-trading property

7.1 The valuation process for a non-trading property is the same as outlined in paragraph 5, Valuation approach for a fully equipped operational entity, but where the
property is empty either through cessation of trade, or because it is a new property with no established trading history, different assumptions are to be made. For example, an empty property may have been stripped of all or much of its trade inventory or a new property may not have the trade inventory installed, but either could still be valued having regard to its trading potential.

7.2 The cessation of an operational entity and the removal of some or all the trade inventory are likely to have an effect on the value of the property. It would therefore be appropriate to express the value on both the basis of one or more special assumptions, and a basis reflecting the status quo. This is often a requirement when advising a lender on the value of trade related property for loan security purposes. For example, the differences could reflect the cost and time involved in purchasing and installing the trade inventory, obtaining new licences, appointing staff and achieving FMT.

7.3 Where the property is empty, the valuation will be reported as follows:

Market value [or market rent] of the empty property having regard to trading potential subject to the following special assumptions … [which must be clearly set out].

8 Apportionment

8.1 The valuer may need, or may be requested, to provide an indicative apportionment of a valuation or a transaction price for:

- analysis as a comparable
- inclusion in financial statements to comply with the applicable accounting standards
- secured lending or
- tax purposes.

8.2 Any such apportionment of market value would usually relate to:

- the land and buildings reflecting the trading potential and
- the trade inventory.

8.3 When considering the apportionment of a transaction price, particularly where the sale is through share transfer in a limited company, the valuer should proceed with caution as the transaction may, in addition to that listed in paragraph 8.2, reflect the following:

- the trading stock, consumables and cash
- intangible assets and
- liabilities, such as salaries, taxes, debts, etc.

8.4 Apportionments for tax purposes have to be in accordance with specific legislation and are outside the scope of this application.

9 Valuation for investment purposes

9.1 The basic approach to an investment valuation of trade related property is the same as for any other category of property. Where the investment is a portfolio or group of properties VPGA 8, Valuation of portfolios, collections and groups of properties, will be relevant.
9.2 When valuing a *trade related property* investment, the valuer will need to carry out the assessment of the FMT and FMOP as set out in paragraph 3.1. It is also necessary to assess the *market rent* of the property so as to determine the security of the income stream and growth potential. The rent payable and the rent review will be determined by the terms of the subsisting or proposed lease.

9.3 The capitalisation rate adopted for investment valuations differs from that for vacant possession valuations. The investment rate of return will generally be determined by market transactions of similar *trade related property* investments. Clearly, due to the differing characteristics of *trade related property* and the wide variety of lease terms, careful analysis of comparable transactions is essential.

9.4 The valuer will include the landlord’s fixtures and fittings with the land and buildings, but probably not the trade inventory, which will usually be owned by the occupational tenant. However, the valuer should highlight the importance of the trade inventory to the trading potential and value of the property.
VPGA 5 Valuation of plant and equipment

1 Scope

1.1 The material in this Valuation Practice Guidance – Application (VPGA) provides additional commentary on the practical implementation of IVS 220 Plant and Equipment. Any mandatory requirements are highlighted in bold type.

2 Background

2.1 Plant and equipment forms a significant part of the global asset class known as tangible fixed assets, but with particular characteristics that distinguish them from most types of real property. This fact influences the approach to the classification, measurement and reporting of value in respect of plant and equipment. Plant and equipment may also be physically affixed to real property in whole or in part, and also capable of being moved or relocated. Some plant and equipment asset classes may also depreciate at a quicker or less linear rate than real property due to rapid technological change in particular market sectors. Frequently, the value will differ notably depending on whether an item of plant or equipment is valued in combination with other assets within an operational unit, or as an individual item for exchange. In addition, whether plant or equipment may be considered as either in situ (in its working place) or for removal will also affect value.

2.2 Plant and equipment may be broadly divided into the following categories:

- **Plant**: assets that are combined with others and that may include items that form part of industrial infrastructure, utilities, building services installations, specialised buildings, and machinery and equipment forming a dedicated assemblage

- **Machinery**: individual, or a collection or a fleet of machines that may be employed, installed or remotely operated in connection with a user’s industrial or commercial processes, trade or business sector (a machine is an apparatus used for a specific process) or

- **Equipment**: an all encompassing term for other assets such as sundry machinery, tooling, fixtures, furniture and furnishings, trade fixtures and fittings, vehicles and loose tools that are used to assist the operation of the enterprise or entity.

2.3 The boundaries between these categories are not always easy to define, and the criteria used may vary according to the particular market sector the assets serve, the purpose of the valuation and relevant national and international accounting conventions.
2.4 The general principle is that assets installed primarily to provide services to the buildings or personnel should be valued as part of the property interest if they would normally be included in the sale of the property and or balance sheet classification. However, exceptions to this general principle will almost certainly occur where the valuation is required for inclusion in a balance sheet or for tax purposes. In these cases the client may require a separate valuation for certain items of building service plant or allied equipment.

2.5 In a valuation for financial statements the treatment of fixed assets in the accounts of the entity will normally provide some guidance regarding the particular items of plant and equipment that may be separately valued. However, in many cases, the valuer will need to clarify with the client and advisers the items that should be included in a valuation of the plant and equipment.

2.6 When different valuers are employed to carry out property and plant valuations, careful liaison will be needed to avoid either omissions or double counting.

3 Plant and equipment usually included in valuations of the property interest

3.1 This will include:
   - items associated with the provision of services (gas, electricity, water, drainage, fire protection and security) to the property
   - equipment for space heating, hot water and air conditioning not integral to any process and
   - structures and fixtures that are not an integral part of process equipment, for instance, chimneys, plant housings and railway tracks.

3.2 Occasionally, items normally valued with the land and buildings will be subject to a third-party interest, for example, a finance arrangement or finance lease (see paragraph 5, Encumbered assets). The valuer should be particularly cautious in such cases and seek advice from the client and its advisers regarding the treatment of such assets, which may vary according to statute and jurisdiction. The valuation and report in such instances may require special assumptions, which should be agreed, in writing, at the time of engagement.

4 Plant and equipment separately valued

4.1 Plant and equipment valued separately from the property interest can be divided into broad categories of assets. ‘Fixed assets’ are often defined by the accounting standards applicable in the relevant country or state. The different categories may need to be identified and valued separately, depending on the purpose of the valuation.

4.2 Examples of ‘fixed assets’ include:
   - process and production plant and machinery
   - fixtures and fittings
   - office equipment, including computers
   - office furniture
4.3 Borderline items that may not always be regarded as ‘fixed assets’ include:
• product-dedicated items (e.g. moulds, jigs and dies)
• spare parts
• operating software, licences and consents
• stocks (inventory)
• materials-in-trade
• stores and
• work in progress.

4.4 Although intangible assets fall outside the definition of plant and equipment, the two asset classes often operate in concert, which may have an impact on their discrete and or composite values. In such cases the valuer should establish appropriate assumptions in this regard (preferably at the engagement stage) and prior to reporting a valuation. Valuers should also be aware of the fact that the definition of intangible assets may vary relative to statute, local practices and accounting convention. Examples of intangible assets include:
• commercial and administration records, drawings, designs and technical data
• licences and consents
• software
• licences, operating systems, goodwill, know how, patents, trademarks, brand names and other intellectual property.

5 Encumbered assets

5.1 It is common for plant and equipment to be subject to lease or financing arrangements. Such asset backed or based arrangements vary from a simple hire/lease purchase agreement through to complex, cross-border financing agreements. Hence valuers will need to establish the reporting basis and any special assumptions at the time of engagement, or agree and document the assumptions as the engagement progresses. In particular, the lease/finance agreement terms, stakeholders and wider commercial circumstances will need to be taken into account and the valuer may need to liaise with other advisers in this regard.

5.2 National and International Financial Reporting Standards and lending regulators’ rules regarding the treatment of leased/financed assets are subject to regular review and change. Valuers should clearly set out the basis and extent of their proposed work relative to such rules and standards, to ensure that the resulting valuation advice is appropriate to the particular reporting circumstances.

6 Material considerations

6.1 When valuing plant and equipment on the basis of market value, VPS 4 paragraph 1.2, Market value, requires an indication of whether the valuation assumes that the assets will remain in their working place, or are valued for removal
Further assumptions may also be required, depending on the purpose of the valuation.

Examples include:

- how the property is to be offered for sale (e.g. as a whole or as individual items)
- the assumed method of sale
- environmental issues
- any restriction on sale method (e.g. lease conditions preclude sale by auction)
- whether the purchaser or vendor is to bear the costs of decommissioning or removal and
- whether allowance is made for any cost of reinstatement following removal and, if so, who will bear the cost.

6.2 If a valuation is being undertaken with a view to disposing of plant and equipment separately from the property in which it is situated, there may be constraints on the time available for marketing and disposal – for example, if a lease on the property is due to expire, or determined by an earlier event (such as insolvency). If the valuer considers that this time limit is inadequate for proper marketing, as defined in the conceptual framework for market value, it may require the use of a special assumption in the reporting framework. However the valuer should always report the benchmark market value in the first instance, followed by the commercial advice (which will fall outside the Red Book) regarding the likely sale price and wider circumstances. The valuer should not describe this as a ‘forced sale’ value (see VPS 4 paragraphs 4.6 to 4.10, Valuations reflecting an actual or anticipated market constraint, and forced sales), unless such a term is required in accordance with the jurisdiction in which the valuer is reporting (e.g. the Netherlands).

6.3 If, in the opinion of the valuer, no constraint exists at the valuation date, but a client requires advice on the impact that such a constraint on the marketing period may have, a market value can be provided subject to a special assumption in the report that clarifies the time limit assumed and the reasons for it, provided that the report also advises the unrestricted market value in the first instance. This is especially important in respect of asset-based lending, foreclosure or insolvency-related instructions.

6.4 Many of the inspection requirements set out in VPS 2, Inspections and investigations, can be readily adapted to plant and equipment assets. In order to prepare a valuation, the valuer first needs to establish matters such as the type, specification, capacity and purpose of the items, then consider matters such as age, efficiency, condition, functional and economic obsolescence, and estimated total and remaining useful economic working life.

6.5 As when valuing other asset classes and taking into account the often very wide and complex range of plant and equipment (and the corresponding market sectors it serves), it will normally be impractical (and sometimes impossible) for the valuer to establish each and every material fact that could have an impact on the valuation. Therefore the extent of the valuer’s investigations, and any assumptions reflected in the valuation, will have to be agreed with the client at the time of engagement (in so far as can be reasonably be foreseen) and included in the later report.
Similarly, there will be occasions when factors affecting other asset classes (such as land and buildings) will impact the valuation of plant and equipment. Examples include where the property is held on a short lease, if there are proposals for redevelopment or if there is contamination of the land and plant that would require plant to be decontaminated prior to removal.

7 Regulatory measures

7.1 Industrial activities are frequently subject to specific legislation and regulations. Non-compliance with these legal requirements may result in the suspension of the right to use the plant and equipment in question. Many of these are specific to the plant and process being considered and wider national and local statute and regulations. Therefore, from a valuation perspective, the valuer must investigate the nature of the plant and activity, as well as the purpose of the valuation and its extent, in determining how far the regulatory measure can, or might, affect the valuation.

7.2 Where there is doubt about compliance with any regulations affecting the value of plant and equipment, the valuer should discuss the matter with the client and any related advisers and refer to the outcome in the report. This should be done either by agreeing to make assumptions in the report, or to compliance undertakings as advised by the client and any related advisers.
VPGA 6 Valuation of intangible assets

1 Scope

1.1 The international valuation standard and associated guidance for reporting valuations of intangible assets is IVS 210, Intangible Assets, which valuers are required to follow. It covers the valuation of intangible assets in respect of acquisitions, mergers and sale of businesses or parts of businesses and purchases and sales of intangible assets. The material in this Valuation Practice Guidance – Application (VPGA) provides additional commentary on the practical implementation of IVS 210 Intangible Assets. Any mandatory requirements are highlighted in bold type.

2 Introduction

2.1 IVS 210 Intangible Assets paragraph C1 defines an intangible asset as ‘a non-monetary asset that manifests itself by its economic properties. It does not have physical substance but grants rights and economic benefits to its owner.’ It is therefore an asset that is capable of being separated or divided from a business entity and sold, transferred, licensed, rented or exchanged individually or with a related asset, liability or contract. Non-identifiable intangible assets arising from contractual or legal rights that may or may not be separable from the entity, or other rights and obligations, are generally termed ‘goodwill’.

2.2 Identified intangible assets include:

- marketing related assets
typically associated with, and primarily used in, the marketing or promotion of a company’s products or services (trademarks, brands, trade names, trade dress, internet domain names, newspaper mastheads, non-compete agreements)

- customer or supplier related assets
arise from relationships with, or knowledge of, customers and suppliers, and are used in the development, procurement, management and maintenance of a company’s customers (customer lists, order or production backlog, customer contracts and related relationships, non-contractual customer relationships)

- artistic related assets
arise from artistic products or services that are protected by a contractual or legal right (copyright and design), and giving rise to benefits including royalties from artistic works (plays, operas, ballet, books, magazines, newspapers, musical works, pictures, photographs, videos, films, television programmes)
technology related assets
represent the value of technological innovation or advancements, and can arise from non-contractual rights to use technology, or be protected through legal or contractual rights (patented technology, computer software, unpatented technology, databases, trade secrets, in-process research and development, manufacturing processes and know-how).

2.3 **Intangible assets** may be either contractual or non-contractual. Contract-based assets represent the value of rights that arise from contractual arrangements (licensing, royalty, and standstill agreements; contracts for advertising, construction, management, service or supply lease agreements; construction permits; franchise agreements; operating and broadcasting rights; contractual use rights other than those expressly classified or properly regarded as tangible assets; servicing contracts; and employment contracts).

2.4 A major **intangible asset** is **goodwill**. IVS 210 Intangible Assets paragraph C11 defines goodwill as ‘any future economic benefit arising from a business, an interest in a business or from the use of a group of assets which is not separable’. The benefits that may form part of goodwill include synergies that follow a business combination and are company specific. Examples of this include economies of scale not otherwise reflected in the values of other assets; growth opportunities, such as expansion into other markets; and organisational capital, for instance the benefits obtained from an assembled network. Goodwill is often perceived to be the amount remaining after the values of other identifiable tangible and **intangible assets** have been deducted from the overall value of the business.

2.5 **Intangible assets** are differentiated from one another by characteristics such as ownership, function, market position and image. For example, ladies’ fashion shoe brands may be characterised by use of particular colours and styles, as well as price. In addition, while **intangible assets** within the same class will inevitably have similar characteristics, there will also be aspects that differentiate them from other similar ones.

2.6 It is important that the valuer is regularly involved in **intangible asset** valuation, as practical knowledge of the factors affecting any particular asset is essential (see PS 2 paragraph 3, Member qualification).

3 Terms of engagement

3.1 The valuation knowledge of clients will vary widely. Some will have a thorough understanding of intangible property rights and **intangible asset** valuation, while others will be unfamiliar with the terms and concepts used by valuers of **intangible assets**.

3.2 It is imperative that the **terms of engagement** are understood and agreed between the valuer and the client prior to commencement of the assignment. Any supplementary or contributory assets should be identified and agreement reached on whether they are to be included or not. Contributory assets are those used in conjunction with the subject asset to generate cash flows. Where contributory assets are not to be valued, it is important to clarify whether the intention is therefore for the principle asset to be valued on a stand-alone basis.

3.3 Valuers may wish to develop standard letters of engagement that can be used for any type of valuation instruction. Where a valuation has to comply with the RICS
Red Book, the valuer must produce terms of engagement that comply with the minimum terms set out in PS 2 paragraph 7, Terms of engagement, and VPS 1 paragraph 1, Minimum terms of engagement.

There may be situations where the interest in the asset to be valued is shared with others, and in such cases, it should be clearly specified.

4 Valuation concepts

4.1 The reason why the valuer has been instructed to perform a valuation is important to understand, as the intangible asset valuation may be required for a wide variety of purposes. Examples include financial reporting, tax, public sector assignments, transactions and flotations, fairness opinions, banking arrangements, insolvency and administration, knowledge management, or portfolio review. The answer will introduce various concepts of value, some governed by statute and case law, and others by international and national standards of professional valuation practice.

4.2 Valuation bases typically encountered for these types of valuations (not all of which are recognised by the IVS or the Red Book) are fair value, fair market value, market value, and open market value. Valuers should be mindful of the requirements of PS 1 paragraph 1, Mandatory application, where a written valuation is provided.

4.3 Depending on the rules and practice followed in respect of the concept, the valuation conclusion in respect of the same asset may be different. For example, because of the rules concerning tax valuations, a tax authority could view valuation differently to how a litigant, merger partner or special purchaser would.

4.4 Except in the case where there are strong indications to the contrary, the presumption is that of a ‘going concern’ and that the asset will continue to have a useful life for the foreseeable future. In some cases, this period will be based on what is specified either by law, or under the terms of any relevant agreements or protocols that govern the asset. However, for financial reporting purposes the value of an intangible asset that is to be disposed of, or abandoned, might have to be considered.

4.5 In many cases it may be appropriate to apply more than one valuation method, particularly where there is insufficient information or evidence. In such cases, the valuer may instead use additional methods, adjusted, perhaps on a weighted basis, to arrive at the final valuation.

5 Valuation due diligence

5.1 In line with PS 2 paragraph 3, Member qualification, valuers should have appropriate competency in intangible asset valuation. As a minimum requirement, a valuer should not contemplate carrying out a valuation in the absence of a detailed knowledge and understanding of such issues as:

- the rights of the owners of the asset(s)
- the history of, and activities associated, with the asset(s)
- as appropriate, the state of the subject industry, the general economic outlook and political factors.
5.2 Typical information requirements to assist the valuer in understanding the subject asset(s) could include:

- most recent income statements associated with the subject asset, and details of current and prior projections or forecasts
- description and history of the subject asset, including legal protections and rights associated with it (the extent to which such legal rights have been assessed should be disclosed)
- information about the asset and supporting documentation (e.g. registrations, territorial applications, marketing, technical research and development, documentation, design graphics and manuals)
- other collateral agreements
- details of the precise activities exploiting the intangible asset
- previous valuation reports
- product(s) dealt in, supported or extended by the business and intangibles
- whether anyone else is permitted to use the intangible asset(s), and whether there are plans to do so
- the company’s market(s) and competition, barriers to entry in such markets, business and marketing plans, due diligence
- licensing, strategic alliances and joint venture detail
- whether contractual arrangements can be assigned or transferred in any intangible asset or royalty agreement
- major customers and suppliers
- objectives, developments or trends expected in the industry and how these are likely to affect the company or asset
- accounting policies
- strengths, weaknesses, opportunities and threats (SWOT) analysis
- key market factors (e.g. monopoly or dominant market position, market share)
- major capital expenditure in prospect
- competitor positions
- seasonable or cyclical trends
- technological changes affecting the asset
- vulnerability of any source of raw materials or supplier arrangement
- whether there have been any recent acquisition or mergers in this sector around the valuation date, and the criteria that was applied
- management of research and development (non-disclosure agreements, subcontractors, training and incentives)
- whether there is an intellectual property asset schedule setting out the extent of intellectual property right (IPR) ownership, and the interests of third parties (if any)
- examination of comparable licensing of similar assets.

5.3 It will be necessary, as far as it is possible, to verify facts and information used in arriving at the valuation, and to benchmark company practices and performance against sector best practice.
5.4 Much of the information relied on by the valuer will be provided by the client(s), and it may not be possible to verify it. In such cases, the valuation report should make this clear.

6 Valuation methodology

6.1 In broad terms, valuation theory recognises three distinct methodologies (or approaches) in valuation, including intangibles. These are the market approach (sometimes known as the direct market comparison approach), the income approach, and the cost approach.

6.2 Each approach requires the valuer to adopt an estimate of the asset's remaining useful life. This could be a finite period set by the length of a contract or normal life expectancy in the sector, or it could be indefinite. A number of factors will have to be considered in determining life expectancy, including legal, technical, economic and functional aspects. The presumed life expectancy of an asset that has been licensed for a particular period may be shorter if a superior competitor product is likely to reach the market before the licence expiration. In such case, the valuer would need to take a view on this.

Market approach

6.3 The market approach measures the value of an asset by comparing recent sales or offerings of similar or substitute property and related market data. However, it is rarely possible to find such evidence relating to identical assets.

6.4 The two primary market approaches are the ‘market multiple method’ and the ‘similar transactions method’.

6.5 The market multiple method focuses on comparing the subject asset with guideline data such as industry royalty rates. In applying this method, matters such as royalty rates are evaluated and adjusted based on the strengths and weaknesses of the subject asset relative to similar assets. They are then applied to the appropriate operating data of the subject asset to arrive at an indication of value. Appropriate adjustments to reflect different properties or characteristics are usually made to the derived data.

6.6 The similar transactions method uses valuation data based on historical transactions that have occurred in the subject asset's direct or related industries. The derived data are then adjusted and applied to the appropriate operating data of the subject asset to arrive at an indication of value.

6.7 In certain industries, assets are bought and sold on the basis of established market practices or rules of thumb, often (though not exclusively) derived from data or percentages of turnover, and not linked to profit generation. Where such rules of thumb exist, they may need to be considered by the valuer.

Income approach

6.8 The income approach has a number of variants. When applied (using, for example, the discounted cash flow (DCF) method), it measures the value of an asset by the present value of its future economic benefits. These benefits can include earnings, cost savings, tax deductions, and proceeds from its disposal.
6.9 When applied to an intangible asset valuation, value indications are developed by discounting expected cash flows to their present value at a rate of return that incorporates the risk-free rate for the use of funds, the expected rate of inflation, and risks associated with the particular investment. The discount rate selected is generally based on rates of return available from alternative investments of similar type and quality as at the valuation date.

6.10 The income approach also embraces methods such as the relief-from-royalty method, defined in IVS 210 Intangible Assets paragraph C24 as one that estimates ‘the value of an intangible asset is determined by reference to the value of the hypothetical royalty payments that would be saved through owning the asset, as compared with licensing the intangible asset from a third party’.

6.11 There is also the ‘multi period excess earnings’ method. This is a method of estimating the economic benefits of an intangible asset over multiple time periods by identifying the cash flows associated with the use of the asset and deducting a periodic charge reflecting a fair return for the use of contributory assets.

6.12 The income approach, as applied using the capitalised earnings basis of value, is common in intangible asset valuation. A thorough understanding of accounting and economic profits, their historical record and forecasting is necessary in each case.

6.13 Appraisal of intangible assets and IPR includes techniques to identify the earnings specifically associated with the subject asset, such as gross profit differential, excess profits and relief from royalty. Following identification of the profit attributable to the subject asset, capitalisation of earnings and discounted cash flow techniques are adopted.

Cost approach

6.14 The cost approach indicates the value of an asset by the cost to create or replace it with another similar asset. When applied to intangible asset valuation, obsolescence, maintenance and the time value of money are considerations. When the basis of value in the valuation is market value, the indications of obsolescence must be supported by market data.

7 Present value techniques

7.1 Present value techniques (PVT) measure the value of an asset by the present value of its future economic cash flow, which is cash that is generated over a period of time by an asset, group of assets, or business enterprise.

7.2 Issues to consider in relation to this technique include:
- the number of years over which the cash flow is applied
- the capitalisation rate or discount rate applied at the end of the term
- the discount rate(s) adopted
- whether inflation is built into the cash flow
- what other variables need to be considered in respect of the cash flow in the future
- the trading profile of the asset
initial and running yields, internal rate of return (IRR) and the terminal value.

7.3 Where a PVT approach is applied, it is important that market transactions (i.e. comparables) reflecting the same approach to valuation are taken into consideration. The details of market transactions may be more difficult to obtain where a PVT approach is adopted. However, such transactions will assist in assessing the discount rate to be adopted, the IRR sought and the general approach taken by the market.

7.4 If the valuation is for a specific intangible asset, before undertaking the detailed cash flow modelling, the valuer is required to quantify the remaining useful life and deterioration rate associated specifically with the use of the asset. Typically this remaining useful life analysis will quantify the shortest of the following:

- physical life (e.g. of an underlying tangible asset)
- functional life (e.g. of an underlying tangible asset)
- technological life
- economic life
- legal life.

7.5 PVT valuation will thus involve these key components: a financial forecast identifying specific intellectual capital and associated earnings, and the discount rate (cost of capital). Unsysternatic and systematic risk will be considered, and the discount rate determination in its basic application will require identification and application of the cost of capital to known and projected cash flows.

7.6 Discounting appropriately for weighted asset cost of capital and more basic discount rate for construction will be adopted. The two basic elements of the cost of capital are the cost of debt and the cost of equity. To assist in the calculation of an appropriate rate of return and discount rates, the valuer uses a number of different methodologies, including capital asset pricing model (CAPM), arbitrage pricing theory, and hybrids depending on the particular circumstances.

7.7 Valuers may be required to consider intangible assets in a licensing context, for example, the licensing in or out of technology or patents. Much of what has been covered in this application is relevant in the calculation of an appropriate rate of return in royalty rate calculations. In practice the rate is estimated by reference to some or all of the following:

- existing licences for the intangibles (the comparables approach)
- industry norms for licences for similar assets (the market approach)
- allocation of economic benefits derived from the use of, for example, the patented invention (sometimes referred to as the available profits or analytical approach)
- licensing practice (rule of thumb approaches).

7.8 Licensing appraisal examines specifics such as:

- how other relevant licences were negotiated
- intangible asset and support
- length of the licence agreement
- exclusivity
special terms for special deals
- geography
- sector in which the intangible asset is licensed
- any special relationships.

Even if previous licensing practice is comparable, it can only provide a benchmark. Intangibles, by their nature, are unique and involve carrying out numerous required adjustments to make a fair comparison.

7.9 PVT models the approaches such as the relief-from-royalty method (see paragraph 6.10 Income approach).

8 Reports

8.1 Where the valuation has to comply with the Red Book, the valuer must produce a report that complies with the minimum terms set out in VPS 3, Valuation reports. Generally the report has a brief introductory section or executive summary that defines the assignment, summarises the conclusion and sets the stage for the details of the report. The structure should move from the general to the specific, providing a logical flow of data and analysis within which all the necessary considerations can be incorporated, leading to the valuation conclusions.

8.2 Most situations will easily form into major sections as follows, although not necessarily in this order:
- introduction
- purpose and basis of value
- subject of valuation
- description and history of the asset(s), and the business entity in which it has (they have) been used
- accounting and accounting polices
- financial statement analysis, if appropriate
- business and marketing plan analysis, and prospects
- search results for comparative transactions
- industry in which the asset is used
- economic environment, yields and risk assessment
- valuation methods and conclusion
- caveats, disclaimer, and limitations.

8.3 Some reports will have a separate section containing a general discussion of valuation methodology, which will often follow the introduction. If national, regional and economic data are important to the company and asset, each may have its own section.

8.4 Where appropriate, factual information, or sources thereof, should be identified either in the body of the report or in the appendices. Where the report is that of an expert required for litigation purposes, it must adhere to the requirements imposed by the local jurisdiction (for example, in the UK, the Civil Procedure Rules (CPR).
Part 35) and must therefore contain all relevant disclosures including the statement of the expert's qualifications and the ‘statement of truth’.

9 Confidentiality

9.1 Information in respect of many intangible assets will be confidential. Valuers should use their best endeavours to preserve such confidentiality, including information obtained in respect of comparable assets. Where required by the client, valuers of intangible assets will comply with any requests to enter into non-disclosure or similar agreements.
VPGA 7 Valuation of personal property, including arts and antiques

1 Introduction and scope

1.1 This Valuation Practice Guidance – Application (VPGA) provides additional commentary on the application of Red Book VPS 1–4 to ‘personal property’, being those assets (or liabilities) specified in 1.2 below.

1.2 For the purpose of this VPGA, ‘personal property’ means assets (or liabilities) not permanently attached to land or buildings:

- **including**, but not limited to, fine and decorative arts, antiques, paintings, gems and jewellery, collectables, fixtures and furnishings, and other general contents
- **excluding** trade fixtures and fittings, plant and equipment, businesses or business interests, or intangible assets.

Valuations of personal property may arise in many different contexts and for a variety of purposes which may include, but are not restricted to, the following:

- insurance coverage
- damage or loss
- taxation (charitable contribution, gift tax, estate tax, casualty loss)
- financial reporting
- business transactions
- litigation, including claims of fraud
- estate planning, equitable distribution, and probate
- pre-nuptial agreements
- dissolution of marriage
- dissolution of business
- advice on the acquisition or disposition of property
- loan collateral
- bankruptcy
- inventory valuation.

1.3 This list is not definitive, as national or regional variations may exist, and in any given jurisdiction the statutory requirements will take precedence, for example, where valuations are prepared for the calculation of tax liabilities, including probate.
1.4 It is essential to be clear about the purpose of the valuation, which will often determine the particular basis of value to be used. See VPS 1 paragraph 2(c), Minimum terms of engagement.

2 Terms of engagement

2.1 To properly define the valuation assignment and to understand the valuer’s responsibilities, the valuer should identify the client and any others who might rely on the valuation (intended users) to ensure that the valuation is meaningful and not misleading.

2.2 The terms of engagement, including the minimum terms set out in VPS 1, Minimum terms of engagement, will generally be agreed on by the valuer and the client prior to the commencement of the valuation engagement. When it is necessary to commence work prior to the terms of engagement being fully documented, all matters concerning those terms must be brought to the client’s attention and documented before the report is issued (see VPS 1 paragraphs 4, 5 and 6, Minimum terms of engagement).

2.3 When agreeing the terms of engagement, the valuer should advise the client of the possible effect on value of any other relevant matters, such as the provenance of the object, or the impact of groups of objects being valued as a collection, rather than individually. Not to do so could be misleading, and create a false impression – in breach of VPS 3, Valuation reports.

3 Identifying the market

3.1 Valuations are based on an understanding of the market in which the valuation takes place. Valuers should assess the nature and state of the market that provides the context for their investigations and value conclusions. IVS Framework paragraphs 10–14 The Market sets out considerations that the valuer should take into account, including the level of activity, confidence and market trends.

3.2 Personal property valuers should recognise that there are different markets within which a particular asset may be traded and that each may generate its own sales data. In particular, an asset may have a different value at the wholesale level of trade, the retail level of trade, or where trading is by auction. The valuer should identify and analyse the relevant market consistent with the property being valued and the purpose of the valuation undertaken. It should be recognised that valuations undertaken for the purpose of advising on a sale between businesses that trade in a particular form of asset may differ from that between a business and an individual collector.

3.3 In identifying the market, personal property valuers should be aware that the method of sale could affect the resultant sale price. For example, online auctions and other forms of e-transactions can open up the market for some types of property to potential purchasers who otherwise might not purchase or bid based on constraints of location or time.

3.4 In personal property, groups of assets are often held as collections which, if divided, may be worth significantly more or less per item than when held collectively. The valuer will need to assess whether holding assets collectively has any impact on their valuation, and advise accordingly.
4 Inspection, research and analysis

4.1 Valuers of personal property should collect, verify and analyse pertinent sales data, economic and market conditions, and related information that leads to realistic value conclusions. VPS 2, Inspections and investigations, and IVS 102, Implementation, set out the requirements for conducting investigations.

4.2 The personal property valuer should always be aware that the degree of reliability of previous sales data may be limited. Valuers should always assess the reliability of data used to support the analysis. The sources of information used in the analysis should be documented.

4.3 Any limitations or conditions that impede the inspection, research, and/or analysis should be taken into account by the valuer. If there are such limitations the valuer may need to make assumptions/special assumptions. VPS 4, Bases of value, assumptions and special assumptions, sets out the requirements relating to assumptions and special assumptions. Any assumptions must be discussed and agreed with the client prior to the conclusion of the valuation, and clearly documented in both the terms of engagement and the report.

4.4 The valuer should consider economic and market data, such as supply and demand in the marketplace and market movements. When there is a degree of uncertainty with respect to the information used, or the state of the market, the valuer should refer to VPGA 9, Valuation in markets susceptible to change: certainty and uncertainty.

4.5 When the valuer uses the services of other specialist consultants and/or professionals, the valuer should, to the extent necessary for the purpose of the valuation, ensure that the specialist is qualified, and that the services are carried out competently.

5 Valuation

Valuation approaches and applications

5.1 The three approaches to arriving at market value (as defined in the IVS) for personal property are:

5.1.1 The sales comparison approach
This provides an indication of value by comparing sales information of the subject asset with identical or similar assets for which sales data is available. This approach is the most commonly used in the valuation of personal property. When applying this approach, the valuer should be careful in the analysis of the appropriate comparable sales data.

5.1.2 The cost approach
This provides an indication of value based on the estimated current costs to reproduce or create a property of equal quality, utility, and marketability. This approach includes replacement with a replica and replacement with a facsimile. A replica is a copy of the original item, as near as possible to the original in terms of nature, quality and age of materials, but created by means of modern construction or
fabrication methods. A facsimile is an exact copy of the original item, created with materials of a closely similar nature, quality and age, using construction or fabrication methods of the original period. Both of these approaches (i.e. replica or facsimile) are usually only adopted for insurance purposes. When applying the **cost approach**, the valuer should analyse pertinent and appropriate cost data to estimate the cost of replacement.

**5.1.3 The income approach**

This provides an indication of value by calculating the anticipated monetary benefits (such as a stream of income) for the subject asset. When applying this approach, the valuer should analyse pertinent and appropriate data to reliably estimate the income in the relevant marketplace of the property. Valuers should base projections of future incomes and expenses on historical information, evidence and trends, current supply, demand, and competitive factors.

**5.1.4** In all approaches, the valuer should use prudent and well-informed judgment to synthesise the analysis into a logical value conclusion.

**5.1.5** All valuation conclusions should be reasonably based and clearly supported by appropriate evidence. If more than one valuation approach has been used in the analysis, the valuer should reconcile the results.

**5.1.6** RICS does not prescribe the methodology that a valuer should use. However, the valuer should be prepared to justify the rationale for the approach adopted.

**Other valuation considerations**

**5.2** In addition to the requirements of **VPS 3, Valuation reports**, the valuer’s research and analysis should consider:

- the extent of the information that should be communicated to the client and other intended users. The valuer should take account of the fact that the valuation knowledge of clients will vary and should communicate information that can be understood by all intended users of the report
- the interest to be valued (there may be situations where the interest in personal property to be valued is shared with others, and in such cases, it should be clearly specified)
- the characteristics required to establish the identity of the property (including artist or maker, material or medium, size, title, origin, style, age, provenance or history, condition, exhibition history, and citations in the literature)
- the **basis of value** and the source of the definition (e.g. market value)
- any special assignment conditions or regulatory requirements
- restrictions, encumbrances, leases, covenants, contracts, or any other items that may affect the valuation or ownership of the personal property to be valued
- the degree to which third-party information can be verified and relied on
- the relationship of the object to any **real property or intangible assets** that may affect the valuation of the property
- the importance of individual assets in an instruction that includes multiple objects with a wide range of values
- analysis of prior sales of the property being valued, if relevant
• the degree to which the market conditions and the economy affect the level of certainty of the valuation conclusion.

6 Reports

6.1 It is the responsibility of the valuer to ensure that the valuation report is clear and accurate, is not ambiguous or misleading, and does not create a false impression. It should be prepared with independence, integrity and objectivity (see PS 2 paragraph 4, Independence, objectivity and conflict of interest).

6.2 The valuer should comply with the minimum requirements listed in VPS 3, Valuation reports, and incorporate all the valuation considerations listed in paragraph 5.2, Other valuation considerations. Additionally, when the valuer has used the services of specialist consultants and/or professionals in the process of preparing the valuation, these sources and their credentials should be identified and their input acknowledged (see paragraph 4.5, Inspection, research and analysis).

6.3 The level of detail provided in the valuation report should adequately address the needs of the client and the intended user(s), the nature of the property, and the intended use of the valuation. The terminology used in the report should be understood by all intended users.

6.4 The valuer should state any limitations or conditions regarding inspection, research or analysis and explain any effect on the valuer’s conclusions.

6.5 The purpose of the valuation (for example, advice on dissolution of marriage), the basis of value (for example, market value), and the level of value (for example, auction or private treaty) should be set out clearly within the report.

6.6 The valuer should report that the conclusion complies with any special requirements of the client, other regulatory rules, or local laws.

6.7 The valuer should summarise the research conducted and the data used in the analysis. The valuer should also state the approach(es) to valuation used (that is, comparison, cost or income) and the rationale, including an explanation of why other approaches were considered but rejected. If multiple approaches were used in the analysis, a reconciliation of the results should also be included in the report.

6.8 When arriving at a valuation based on any special assumptions, such as where an aggregated value is determined, these should be specifically stated together with the effect on value, if any, of the special assumption.

6.9 The valuer should comment on any issues affecting the certainty of the valuation. The extent of the commentary will vary, depending on the purpose of the valuation and the knowledge of the user.

6.10 Photographs should be appropriate and used as required by the assignment.

6.11 Valuation instructions in certain jurisdictions that cover numerous, low value items may find the use of an RICS approved template report that complies with this guidance note helpful (available from www.rics.org).
VPGA 8 Valuation of portfolios, collections and groups of properties

1 Scope

1.1 The IVS Framework paragraphs 23–24 Aggregation refer to the valuation of portfolios, collections and groups of property or assets.

1.2 The material in this Valuation Practice Guidance – Application (VPGA) provides additional commentary on practical matters that the valuer should consider when undertaking a valuation of several properties simultaneously for the same client. Any mandatory requirements are highlighted in **bold type**.

1.3 To avoid giving misleading or inappropriate advice, particular regard must be had to matters such as ‘lotting’ or grouping, the identification of different property or asset categories and any assumptions or special assumptions relating to the circumstances under which the properties may be brought to the market.

2 Identification of separate property or assets

2.1 Where there is doubt about what constitutes a single property or asset, the valuer should generally ‘lot’, or group, the properties for valuation in the manner most likely to be adopted in the case of an actual sale of the interest(s) being valued. However, the valuer should discuss the options with the client and must confirm the approach adopted in both the **terms of engagement** and the report.

2.2 Examples of situations where specific clarification of the lotting assumption needs to be made include:

- physically adjoining properties that have been acquired separately by the current owner (e.g. where a developer has assembled a site with a view to future redevelopment, or where an investor is building a strategic stake in the locality)
- physically separate properties that are occupied by the same entity and where there is a functional dependence between the properties (e.g. a car park that is separate from, but exclusively used by, the occupier of a building)
- where ownership of a number of separate properties or assets would be of particular advantage to a single owner or occupier because of economies that may result from either increased market share or savings in administration or distribution, as with a block of flats or hotels, and
- where each individual property is an essential component of an operation covering a large geographical area (e.g. as part of a national or regional utility network, such as telecommunication masts).
2.3 The purpose of the valuation may well dictate the approach taken. For example, there may be a requirement for the value of the assets to be reported individually. The extent of what comprises an individual property or other asset will need to be clarified with the client.

2.4 Requests to value properties on an assumption that lots them in an artificial manner should normally be declined. However in certain circumstances, unusual lotting may be dealt with using a special assumption (see VPS 4 paragraph 3, Special assumptions).

3 Valuation assumptions

3.1 Once the valuer has identified the lots within a portfolio that are to be valued separately, consideration needs to be given to any particular assumptions or special assumptions that may be necessary. These need to be recorded in the terms of engagement (see VPS 1, Minimum terms of engagement) and in the report (see VPS 3, Valuation reports). Examples of situations where different assumptions can have a material effect on the valuation of a portfolio are discussed in the following paragraphs.

3.2 If a whole portfolio, or a substantial number of properties within it, were to be placed on the market at the same time, it could effectively flood the market, leading to a reduction in values. Conversely, the opportunity to purchase a particular group of properties might produce a premium. In other words, the value of the whole could exceed the sum of the individual parts, and vice versa.

3.3 If valuing for a purpose that assumes that the portfolio will continue to remain in the existing ownership or occupation, for example, for inclusion in financial statements, it would be inappropriate to make any reduction or allowance in the valuation to reflect the possible effect of flooding the market. A statement to this effect should be made in the report.

3.4 If the same portfolio were to be valued as security for secured lending, the possible adverse effect on individual properties if the whole portfolio were placed on the market at the same time should not be ignored. In such case it would normally be appropriate to state that the assumption has been made that the properties would be marketed in an orderly way and would not all be placed on the market at the same time. However, if circumstances existed that such an assumption would not be made by the market, for example, if it were known that the current owner was in financial difficulty, this would become a special assumption and its effect on the valuation should be clearly stated (see VPS 4 paragraph 3, Special assumptions).

3.5 Likewise, where the valuer ascribes a single value to a group of separate properties, any assumptions necessary to support that approach should be stated. If the valuer considers that the treatment of the portfolio on this basis is not one that the market would necessarily make, such an assumption would become a special assumption (see VPS 4 paragraph 3, Special assumptions).

4 Reporting requirements

4.1 In any case where the total value of the properties within a portfolio would differ significantly depending on whether they were disposed of individually, in groups or
as a single lot, this should be stated clearly in the report. The lotting assumptions made should also be included in any published reference.

4.2 Where a portfolio or group of properties or assets has been valued on the assumption that it would be sold as a single entity, the reported market value will relate to the whole of the group. Any breakdown of the market value of the individual properties or assets should be clearly expressed as such, with a statement that this apportionment does not necessarily equate to the market value of the interest in any individual property or asset.

4.3 Conversely, if the total of the market values for each individual property or asset in a portfolio as an aggregated figure is provided, care should be taken not to present this as the market value of the entire portfolio.
VPGA 9 Valuation in markets susceptible to change: certainty and uncertainty

1 Introduction

1.1 The purpose of this Valuation Practice Guidance – Application (VPGA) is to encourage best practice in the reporting of valuations, with specific reference to conveying a clear picture to users concerning the degree of certainty and risk attached to them.

1.2 All valuations are professional opinions on a stated basis, coupled with any appropriate assumptions or special assumptions (see VPS 4 paragraph 2, Assumptions, and VPS 4 paragraph 3, Special assumptions). A valuation is not a fact, it is an opinion. The degree of subjectivity involved will inevitably vary from case to case, as will the degree of certainty – that is, the probability that the valuer’s opinion of market value would exactly coincide with the price achieved were there an actual sale at the valuation date. Ensuring user understanding and confidence in valuations requires transparency in the valuation approach and adequate explanation of all factors that materially affect the valuation.

1.3 For some purposes it is often helpful, if not essential, to the understanding of the valuation to include supporting evidence, an explanation of the approach and the market context. Such commentary, context and explanation may not be required in all cases. However, valuers should view the provision of such supporting advice as a means to provide the user with increased confidence in the valuation.

1.4 Valuers should not treat a statement expressing less confidence in a valuation than usual as an admission of weakness. Indeed, if a failure to draw attention to material uncertainty gave a client the impression that greater weight could be attached to the opinion than was warranted, the report would be misleading and in breach of VPS 3, Valuation reports.

2 Matters that may affect valuation certainty

2.1 The following list, which is not exhaustive, provides some examples of issues that may have a material effect on the degree of certainty and confidence that can be applied to a valuation opinion:

- status of the valuer
- inherent uncertainty
- restrictions on enquiries or information provided
- liquidity and market activity and
2.2 The accuracy and relevance of the judgments required for a valuation depends on the skill and experience of the individual making them. The confidence in those judgments is also dependent on the independence of the valuer. PS 2 paragraph 3, Member qualification, and paragraph 4, Independence, objectivity and conflict of interest, set out the criteria relating to the qualification and independence of the valuer, and VPS 3, Valuation reports, requires confirmation in the report that the valuer has sufficient experience and no conflict of interest.

Inherent uncertainty

2.3 The property itself may have particular characteristics that make it difficult for the valuer to form an opinion of the likely value. For example, it may be an unusual, or even unique, type of property. Similarly the quantification of significant change, either related to potential planning permission, or the existence of a special purchaser, will be highly dependent on the assumptions made.

Restrictions on enquiries or information provided

2.4 Where the information available to the valuer is limited or restricted, either by the client or the circumstances of the valuation, less certainty can be attached to the valuation than would otherwise be the case. VPS 3 paragraph 7(h), Nature and source of information relied on, requires that the sources of information are stated and attention is drawn to any limitations.

Liquidity and market activity

2.5 In markets that are inactive with low levels of liquidity or restricted debt availability there is a reduced amount of data to provide empirical support for valuations. In such cases the valuer should be as explicit and transparent as possible to demonstrate the degree to which the conclusion is based on subjectivity. Similarly, in liquid and functioning markets the valuer should state that there is an abundance of empirical data to support the conclusions drawn.

Market volatility

2.6 Disruption of markets can arise due to unforeseen financial, macro-economic, legal, political or even natural events. If the valuation date coincides with, or is in the immediate aftermath of, such an event there may be a reduced level of certainty that can be attached to a valuation, due to inconsistent, or an absence of, empirical data, or the valuer being faced with an unprecedented set of circumstances on which to base a judgment. In such situations demands placed on valuers can be unusually testing. Although valuers should remain able to make a judgment, it is important that the context of that judgment is clearly expressed.

3 Reporting

3.1 VPS 3, Valuation reports, requires that the valuation report must not be misleading or create a false impression. The valuer should draw attention to, and
comment on, any issues affecting the certainty of the valuation. The extent of that commentary will vary, depending on the purpose of the valuation, and the format of the report agreed with the client.

3.2 Where appropriate, the valuer also should consider including the use of special assumptions and sensitivity analysis, and give a full and clear account as to why these items are being included:

- **Use of special assumptions**: Where the valuer can reasonably foresee that different values may arise under different circumstances, the valuer should enter into a dialogue with the client to consider alternative valuations using special assumptions that reflect those different circumstances. However, it is important to note the requirements of VPS 4 paragraph 3.3, Bases of value, assumptions and special assumptions, which stipulates that special assumptions may only be used if they can be regarded as realistic, relevant and valid in connection with the circumstances of the valuation.

- **Sensitivity analysis**: Where issues are identified that could have a material impact on the certainty attached to the valuation, it may be prudent to provide a sensitivity analysis to illustrate the effect that changes to these variables could have on the reported valuation.

3.3 It would not normally be acceptable for a valuation report to have a standard caveat to deal with valuation certainty. The degree to which an opinion is uncertain will be unique to the specific valuation, and the use of standard clauses can devalue or bring into question the authority of the advice given. The task is to produce authoritative and considered professional advice within the report. Issues that affect the degree of certainty should be reported in this context.

3.4 Unless specifically requested, the expression of values within a stated range is not good practice. In most cases the valuer has to provide a single figure. The use of qualifying words such as ‘in the region of’ would not normally be appropriate or adequate to convey material uncertainty without further explicit comment. Where different values may arise under different circumstances it is preferable to provide them on stated special assumptions.

3.5 If a mathematical measure of uncertainty is included in any report, it is essential that the method or model used is adequately explained, with any limitations appropriately highlighted.
7 Overview of changes made to the 2012 global valuation standards, appendices and guidance notes

1 The changes to the text are intended to clarify the application of the standards – in particular what is mandatory and what is not. The aim has been to eliminate duplication/separation of text and bring it together in a revised structure rather than wholesale fundamental changes to the existing standards.

2 Detailed text changes have not been individually referenced. However, the more significant changes from the Red Book 2012 are summarised below.

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8  RICS UK valuation standards

Introduction to the UK valuation standards

1  Purpose of the UK standards

These standards are national association valuation standards that have mandatory status in the UK (see PS 1.5, RICS national association valuation standards). They supplement, expand or amend the global valuation standards so that they meet UK statutory or regulatory requirements.

Where a valuation is for a purpose that is not included in these standards the global valuation standards are to be applied, subject to any additional requirements that have been agreed with the client.

2  Changes to financial reporting standards effective from 1 January 2015

The Financial Reporting Council has announced changes to the existing financial reporting standards. The new standards will be applicable to all companies and entities in the UK and Republic of Ireland, other than listed groups. They will be effective from 1 January 2015. Although they may be adopted early, the existing regime continues and so no changes have been made to the UK valuation standards below. During the course of 2014 UKVS 1; UK Appendices 1, 2, and 4; and parts of UKVS 2 will be rewritten and reissued as necessary.

3  Arrangement of these standards

Pending the revisions for 2015 mentioned above, the same arrangement and format has been used for the UK material as in the previous (2012) edition, but with updated cross-references to the global section as appropriate. The order of appearance is thus:

- UK valuation standards
- UK appendices
- UK guidance notes.
4 Terms used in these standards

The terms used in these standards adopt the same definitions as set out in the International Valuation Standards (IVS) and in the RICS global standards. Where terms have a specific meaning in a particular context they will be defined in the standard, appendix or guidance note as required.

5 Summary of changes from Red Book 2012

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<tbody>
<tr>
<td>UKVS 1</td>
<td>Paragraph 2 is revised to refer to the Financial Reporting Council as the accounting standard setting body.Paragraph 4 has been revised to refer to the proposed change in UK GAAP and its impact on the accounting standards.</td>
</tr>
<tr>
<td>UKVS 1.14</td>
<td>The reference in paragraph 7 has been revised to refer to the relevant section of the HMRC Business Income Manual.</td>
</tr>
<tr>
<td>UKVS 2 and</td>
<td>The Financial Services Authority (FSA) was superseded by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) in April 2013. All the cross references in these sections have been revised accordingly. Consequential amendments have also been made to UK Appendices 7 and 9.</td>
</tr>
<tr>
<td>UKVS 3</td>
<td></td>
</tr>
<tr>
<td>UK Appendix 3</td>
<td>The Companies Act schedules referred to in this appendix were repealed by the Companies Act 2006 and not directly replaced. Paragraph 3 (Director’s responsibility) has been deleted. For more detailed information on the role of directors and auditors see <a href="http://www.frc.org.uk">www.frc.org.uk</a></td>
</tr>
<tr>
<td>UK Appendix 7</td>
<td>The table to this appendix has been revised so that it matches to the list of terms set out in VPS 3, Valuation reports. Although some text has been moved into different categories, no alterations to the guidance have been made.</td>
</tr>
<tr>
<td>UK Appendix 10</td>
<td>Paragraph 2.4 has been amended to refer to the revised list of minimum requirements in VPS 1, Minimum terms of engagement. Due to the merger of some of the original terms it is not possible to state that the specification relates to all the requirements of an individual term. Care should be taken to ensure that all the requirements of VPS 2, Inspections and investigations, are met.</td>
</tr>
<tr>
<td>UKGN 2</td>
<td>Published separately as EUGN 1: European Union directives and regulations relevant to valuation. UKGN 2 is now Depreciated replacement cost method of valuation for financial reporting – it was formerly global GN 6 in the March 2012 edition of the Red Book.</td>
</tr>
<tr>
<td>UKGN 7</td>
<td>The references to the Charities Acts have been revised to include the 2011 Act.</td>
</tr>
</tbody>
</table>
6 Extent of revision

While the text of the UK material has been amended as described above, it has not been rewritten since the March 2012 edition, the content of which it therefore substantially reproduces. Accordingly members are reminded of their responsibility to be aware of changes since that date to legislation and/or to its interpretation by the courts.
UKVS 1 Valuation of real property for financial statements

UKVS 1.1 Basis of value

Valuations for inclusion in financial statements prepared in accordance with UK Generally Accepted Accounting Principles (GAAP) shall be on the basis of either:

(a) property other than specialised property – existing use value (EUV), as defined in UKVS 1.3, for property that is owner-occupied for the purposes of the entity’s business; or market value (MV), as defined in VPS 4 paragraph 1.2, Market value, for property that is either surplus to an entity’s requirements or held as an investment;

(b) for specialised property – depreciated replacement cost (DRC).

Valuations for this purpose are regulated purpose valuations (see UKVS 4.1), and the various disclosure requirements within UKVS 4.2 and UKVS 4.3 will apply.

Commentary

1 This statement will take precedence over RICS Global Valuation Practice Application 1, Valuation for inclusion in financial statements, (VPGA 1) where the client requires a valuation that complies with UK GAAP.

2 Accounting standards are issued by the Financial Reporting Council (FRC) and published as Financial Reporting Standards (FRS). An earlier form of standard, known as a Statement of Standard Accounting Practice (SSAP), continues in force where not superseded by FRSs. All the current standards are freely available at www.frc.org.uk/asb

3 FRS 15, Tangible Fixed Assets, and SSAP 19, Accounting for investment properties, contain the majority of the asset valuation requirements as detailed in this standard. Information on the accounting concepts and explanation of some of the terms used are provided in UK appendix 1.

4 The FRC announced on 22 November 2012 that the whole of UKGAAP is to be replaced with a new regime, based on IFRS that will take effect from January 2015, with earlier adoption allowed. The new regime will require a complete rewrite of UKVS 1 and associated appendices.

5 The frequency of valuations, with provision for full and interim valuations, is discussed in UK appendix 1. Both internal and external valuers may carry out full...
valuations, but a full valuation by an internal valuer is subject to review by an external valuer. The review must include the valuation of a sample of the entity's properties that is sufficient for the external valuer to express an opinion on the overall accuracy of the valuation. The external valuer must also be satisfied that the sample represents a genuine cross-section of the entity's portfolio. An interim valuation, which can be carried out on a restricted basis, may be undertaken by either an external or internal valuer.

6 The valuer should agree with the client the appropriate basis of value when confirming the terms of engagement. For different categories of property, different bases may be required. Note that under FRS 15, depreciated replacement cost (DRC) is recognised as a separate basis of value for reporting purposes. When settling the terms the valuer should indicate that although the definition of DRC may differ from that in UK appendix 1, the resultant valuation is the same. Further guidance on the identification of categories and the appropriate basis is in that appendix.

7 Clients may ask the valuer to liaise with their auditors either before the report is made or subsequently. UK appendix 3 provides information about the relationship between the valuer and the auditor.

8 FRS 15 refers to open market value (OMV) rather than market value, as it was published in 1999 when open market value was still a basis supported by RICS. As stated in the Glossary, there is no material difference between these two bases, and the correct application of either will produce the same figure. The term 'open market value' should not be used in reporting, although the valuer should include an explanatory note that its replacement, market value, produces the same figure.

Publication statement

9 VPS 3 paragraph 7(j), Restrictions on use, publication and distribution, requires the valuer to include a draft statement in the publication containing a reference to the report. UK appendix 6 provides examples of published references where the valuation is in accordance with UK GAAP.

Statements of recommended practice

10 Statements of recommended practice (SORPs) supplement accounting standards and other legal and regulatory requirements to reflect factors prevailing, or transactions undertaken, in a specialised industry or sector. SORPs are issued by the sectoral body recognised for the purpose by the Accounting Standards Board (ASB).

11 The purpose for which the valuation is being prepared may also be the subject of a SORP. The SORP may specify the basis of value, the criteria for establishing the valuer's independence or the disclosures that have to be made.

12 The following SORPs contain specific valuation requirements, and further information is provided in the relevant UKVS:

• Code of Practice on Local Authority Accounting: issued by the Chartered Institute of Public Finance (CIPFA) and covered in UKVS 1.12

• Accounting by registered social housing providers: issued by the National Housing Federation (NHF) and covered in UKVS 1.13 and
UKVS 1 Valuation of real property for financial statements

- Financial Statements of Authorised Funds (Collective Investment Schemes): issued by the Investment Management Association and covered in UKVS 2.3.

13 The following SORPs generally provide that these valuation standards shall apply, but the valuer will need to check that any specific requirements, which may provide extended related party definitions affecting the specific requirements of independence, are reflected in the report:

- Accounting for Further and Higher Education: issued by Universities UK
- Financial Reports of Pension Schemes: issued by the Pensions Research Accountants Group (PRAG)
- Charity Accounts and Reports: issued by the Charity Commission. This SORP relates only to financial statements. Where valuations are required for acquisitions or disposals UK appendix 13, Valuations for charities, will apply
- Accounting for Insurance Business: issued by the Association of British Insurers and
- Investment trusts: issued by the Association of Investment Companies.

UKVS 1.2 Valuation date

Valuations for inclusion in financial statements must be as at the date of the report, or an earlier date.

Commentary

1 There is no general restriction on the valuation date in these standards.

2 Valuations for inclusion in financial statements that may be relied on by third parties should only be as at the date of the report, or an agreed earlier date, due to the increased uncertainty of any estimate of value at a future date.

3 If valuations are prepared in advance of the date of any statement into which they have been incorporated, and there has been a significant change either in market conditions or to the property valued between the valuation date and the date of the statement, this must be referred to in any published reference.

4 Where a preliminary valuation is reported in advance of the valuation, it must be clearly marked as a draft and PS 2 paragraphs 4.10 to 4.15, Independence, objectivity and conflict of interest, will apply.

UKVS 1.3 Existing use value

Valuations based on existing use value (EUV) shall adopt the definition set by RICS. Existing use value is to be used only for valuing property that is owner-occupied by a business, or other entity, for inclusion in financial statements.

Definition:

The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction after proper marketing and where the parties had acted.
knowledgeably, prudently and without compulsion, assuming that the buyer is
granted vacant possession of all parts of the asset required by the business,
and disregarding potential alternative uses and any other characteristics of the
asset that would cause its market value to differ from that needed to replace
the remaining service potential at least cost.

Commentary

1. The definition of existing use value (EUV) is the market value definition with one
additional assumption and a further requirement to disregard certain matters. The
definition must be applied in accordance with the conceptual framework of market
value at VPS 4 paragraph 1.2, Market value, together with the following
supplementary commentary.

‘… the buyer is granted vacant possession …’

2. The assumption that vacant possession would be provided on acquisition of all
parts of the property occupied by the business does not imply that the property
would be empty, but simply that physical and legal possession would pass on
completion. Any parts of the property occupied by third parties should be valued
subject to those occupations. Properties occupied by employees, ex-employees, or
their dependants should be valued with regard to the circumstances of their
occupation, including any statutory protection. This assumption also means that it is
not appropriate to reflect any possible increase in value due to special investment or
financial transactions (such as sale and leaseback), which would leave the owner
with a different interest from the one that is to be valued. In particular the covenant
of the owner-occupier must be ignored.

‘… of all parts of the property required by the business …’

3. If parts of the property are unused and are surplus to the operational
requirements of the business, their treatment will depend on whether they can be
sold or leased separately at the valuation date. If they can be occupied separately
then they should be allocated to a separate category as surplus property and valued
on the basis of market value. If separate occupation is not possible any surplus parts
would have no more than a nominal EUV, as they would contribute nothing to the
service potential of the property and would not feature in a replacement at least
cost.

‘… disregarding potential alternative uses …’

4. ‘Existing use’, in the context of EUV, means that the valuer should disregard uses
that would drive the value above that needed to replace the service potential of the
property. An entity seeking to replace this potential at least cost will not buy a
property if its value has been inflated by bids from other potential occupiers for
whom the property has greater value because of alternative uses or development
potential that are irrelevant to its own requirements.

The valuer must ignore any element of hope value for alternative uses that could
prove more valuable. However, it would be appropriate to take into account any value
attributable to the possibility of extensions or further buildings on undeveloped land,
or redevelopment or refurbishment of existing buildings, providing that these would
be required and occupied by the entity, and that such construction could be
undertaken without major interruption to the current operation.
… disregarding … any other characteristics of the property that would cause its market value to differ from that needed to replace the remaining service potential at least cost.’

5 There are circumstances where it may be appropriate for the valuer to ignore factors that would adversely affect the market value, but would not be characteristic of a replacement. Examples include:

- where an occupier is operating with a personal planning consent that could restrict the market in the event of the owner vacating
- where the occupier holds the property under a lease and there are lease covenants that impose constraints on assignment or alternative uses
- where a property is known to be contaminated, but the continued occupation for the existing use is not inhibited or adversely affected, provided there is no current duty to remedy such contamination during the continued occupation
- where an industrial complex is overdeveloped, and the extra buildings have either limited the market value or detracted from it, but would need to be replaced to fulfil the service potential to the business
- where the existing buildings are old and so have a limited market value, but would have a higher replacement cost to the business
- where the property is in an unusual location, or is oversized for its location, with the result that it would have a very low market value, but where the cost of replacing the service potential would be significantly greater and
- where the market is composed solely of buy-to-let investors, but the valuer believes that the replacement cost (the price agreed between a willing vendor and willing owner-occupier purchaser) would be higher.

Any value attributable to goodwill should normally be ignored. The fact that a large property may be in single occupation does not necessarily mean that it has to be valued on the assumption that only bids from other potential occupiers for the whole can be taken into account. If the property is one where a higher value would be generated by the potential to divide it into smaller units for the existing use, this should be reflected in the valuation.

6 The underlying accounting concepts behind EUV are given in UK appendix 1.

7 While the definition of EUV has changed from that published in previous editions of the Red Book, the underlying principles have not. The previous definition was based on the open market value definition, which has now been removed from these standards. EUV now uses the market value definition, and the additional provisions have been reworded to define more precisely the requirements of the accounting standard. An EUV provided under the old or new definition should produce exactly the same result.

8 Many market valuations are based on the existing planning use of the property, as it usually generates the highest value. Such valuations have sometimes been described as ‘existing use valuations’. However, this is incorrect and they should properly be expressed as market values. It is emphasised that EUV is only to be used when valuing property that is occupied by the owners of the interest being valued for the purpose of their business, for inclusion in financial statements.

9 Further guidance on the interpretation of EUV is contained in the RICS guidance note, Valuations for financial statements under UK GAAP (2011).
UKVS 1.4 Differences between existing use value and market value

Where there is a significant difference between the existing use value and market value of the same property if it were surplus, the valuer must provide an opinion on both bases and explain the reasons for this in the report. Any published reference to the report must refer to the valuations on both bases, except where the difference has no material effect on the aggregate value of the entity’s properties.

Commentary

1 Where the property is of a type that is commonly traded in the market, with no higher value for an alternative use and no unusual features that could restrict marketability, there would normally be little material difference between EUV and market value. However, there will be cases where the difference between the two bases is material (as illustrated in the commentary to UKVS 1.3). Where a difference exists, this could be material to an overall assessment of the entity’s financial position, and in such cases the valuer must report both bases. In the case of a company there is an obligation for the directors to disclose if the market value of its assets is materially different from the figure that appears in the balance sheet.

2 Where the valuation involves a portfolio of properties and the difference between EUV and market value on an individual property does not make a material difference to the aggregate value of the properties, the valuer simply needs to indicate whether the market value of a particular property would be higher or lower than the reported EUV. There is no obligation to provide alternative valuations or reasons for the difference.

UKVS 1.5 Existing use value of adapted property

Where a property that is occupied by an entity for the purpose of its business has been adapted to suit the particular requirements of the entity’s operations, the valuer should provide the existing use value of the property at the valuation date either:

(a) as in its state after adaptation; or
(b) as in its state before adaptation and, as a separate amount, the depreciated replacement cost of the adaptation works.

Commentary

1 In the case of property that has been adapted, the choice of which of the two alternative bases to use will depend on the accounting policies being used. Although it is the client’s responsibility to decide which policy to adopt, it is reasonable to expect that the client will be guided by the valuer’s advice. Option (a) can only be used if the valuer believes that it is possible to identify an EUV for the property in its existing state.

2 The valuer must take care to agree with the client exactly what adaptations are to be valued and, in so doing, check that any associated fixtures and fittings are not also included in the client’s plant register to avoid double counting.
UKVS 1  Valuation of real property for financial statements

3 In many cases adaptation works will be specific to the requirements of the occupier, so there will be no comparable evidence of what might be paid for a similarly adapted property in the market. Such adaptations may have a detrimental effect on value, as most purchasers would regard them as an encumbrance. In these circumstances FRS 15 permits the carrying amount (the figure entered into the balance sheet) to be the aggregate of the EUV of the unadapted property, the depreciated cost of the adaptations and all directly attributable costs of acquisition.

4 Where the report includes a valuation using depreciated replacement cost (DRC), and the separate amount calculated is significant in relation to the EUV of the property in its state before adaptation, the resultant total value must be expressed as subject to adequate potential profitability or, in the case of property in the public sector, to the prospect and viability of continued occupation (see UKVS 1.16).

UKVS 1.6  Events after the balance sheet date

Where a valuation may be materially affected by events after the balance sheet date, the valuer must refer to those events in the report and distinguish between adjusting and non-adjusting events.

Commentary

1 Under FRS 21, Events after the Balance Sheet Date, an entity is required to adjust its statements to reflect adjusting events that occur between the balance sheet date and the date when the financial statements are authorised for issue.

2 An adjusting event is one that provides evidence of conditions (favourable and/or unfavourable) that existed at the balance sheet date. Examples include the determination of a sale price of a property on the market or the settlement of a rent review.

3 Events occurring after the balance sheet date that could not be anticipated at that time (for example, if a property is destroyed by fire) are classified as non-adjusting events. These are not to be reflected in any amendment.

4 Where non-adjusting events could influence the economic decisions of users taken on the basis of the financial statements, the entity is required to disclose the nature of the event and provide an estimate of its financial effect, or make a statement that such an estimate cannot be made.

UKVS 1.7  Costs to be excluded

The valuer must not include directly attributable acquisition or disposal costs in the valuation. Where asked by the client to reflect such costs, these must be stated separately.

Commentary

1 In determining the figure to enter into the balance sheet (the ‘carrying amount’), FRS 15 requires the addition of notional, directly attributable acquisition costs, where material, to the EUV. Likewise, where property is surplus to the entity’s requirements
and valued on the basis of *market value*, there should be a deduction for expected, directly attributable selling costs, where material. If requested to advise on these costs, the valuer should report them separately and not amalgamate them with either the EUV or *market value*. The valuation should reflect the valuer’s opinion of the consideration that would appear in the hypothetical sale and purchase contract.

2 FRS 15 states that directly attributable costs can include stamp duty, import duties and non-refundable purchase taxes, as well as professional fees. The valuer is alerted to a potential problem with a property that would, or would potentially, be subject to VAT in any transaction but the entity may not be able to reclaim that VAT. The decision whether or not to treat this as a directly attributable acquisition cost should be determined by the entity, together with its auditors. Even if this is the case the valuer should state clearly in the report what *assumptions* have been made and the likely impact of VAT in any transaction.

3 In the case of surplus properties, directly attributable selling costs that are material may need to be itemised separately. If so, they will include not only the transaction costs, but also any marketing costs that can be reasonably anticipated.

**UKVS 1.8 Apportionments for depreciation**

Where the valuer is required to advise on an apportionment of a valuation for depreciation purposes, or on the remaining useful economic life of the asset, the apportionment should be undertaken in accordance with the principles set out at UK appendix 1.

**Commentary**

1 Where land and buildings are occupied by an entity in the normal course of its business, the value of those assets, as shown in the accounts, may be adjusted to reflect their depreciation over time.

2 The accounting principles for depreciation can be found in FRS 15. It advises that depreciation is applied over the future useful economic life of the asset to the entity.

3 As depreciation is normally only applied to property occupied by the entity, the apportionment will be of EUV, or *depreciated replacement cost (DRC)*, based valuations. Depreciation should not be applied to property valued on the basis of *market value*, except as provided by SSAP 19 in relation to certain investment properties.

4 As land and buildings are usually inseparable in reality, the apportionment should be reported as being hypothetical and for accounting purposes only.

**UKVS 1.9 Treatment of leasehold interests**

Where the interest to be valued is leasehold the valuer shall, where appropriate, clarify with the client and refer in the report to the treatment of:

(a) *leases at rack rent or with short terms unexpired; and/or*

(b) *inter-company leases.*
Commentary

[a] Leases at rack rent or with short terms unexpired

1 Where a lease is held at a rack rent, or has a short term before expiry or before a review date to full rental value, the value (or in certain cases, the liability or negative value) to the business may not be material.

2 The valuer must discuss with the directors whether or not these specific leasehold interests are to be valued. If they are omitted from a valuation of an entire portfolio, the report needs to contain a reference to their omission on the grounds that their values are not material.

[b] Inter-company leases

3 Where a property is the subject of a lease or tenancy agreement between two companies in the same group, on arm’s length terms and in accordance with normal commercial practice, it is acceptable to take account of the existence of that agreement.

4 However, on consolidation of the results and balance sheets of those companies into the group accounts, the existence of the lease must be disregarded and the property must be valued with vacant possession of the areas occupied by the group company, but subject to other leases or licences to third parties.

5 If asked to produce a valuation that takes account of an inter-company agreement the valuer should disclose in the report the relationship between parties to the agreement, and should draw attention to the fact that a valuation taking full account of the lease would not be suitable for adoption in group accounts.

Accounting standards

6 Property leases are treated as either operating leases or finance leases under SSAP 21, Accounting for leases and hire purchase contracts. If 90% or more of the value of a leased asset is transferred to the lessee, the lease is usually classified as a finance lease. Although this classification differs from that in IAS 17, UK GN 1, Land and building apportionments for lease classification under IFRS, may assist in marginal cases.

UKVS 1.10 Mineral bearing land or waste disposal sites

Where land is mineral bearing or suitable for waste disposal purposes, a modified existing use value basis may be adopted.

Commentary

1 Land that is mineral bearing or suitable for waste disposal purposes may have a different use at the valuation date. In this case the normal principles of EUV require some modification because the service potential reflects not only the current use, but also the potential future use.

2 Mineral extraction and landfill consume land over a period of time, so the concept of existing use includes the interim surface use of the land and its eventual
consumption for mineral working or landfill. While landfill as a means of waste disposal is generally into worked-out mineral sites or other excavations, in some instances it is into land-raising sites where there has been no previous excavation. Here future tipping land may be available for other uses temporarily, and can be let to produce income until such time as it is required.

3 Even though no assumption should be made that a planning permission or waste management licence would be granted (unless granted as part of the earlier consent to extract or fill), the valuation should still include any element of hope value, insofar as the market reflects this.

4 The normal concept of existing use is also modified to include the after-use value, though this may involve a change of use. Where the value of the after-use is a significant proportion of the valuation, the valuer must identify it separately. In any assessment of after-use, proper consideration must be given to restoration liabilities. This includes site monitoring after waste disposal, which may be imposed on the operator as a condition of land tenure under planning law or in site licensing.

5 Where the report includes mineral-bearing or waste-disposal land valued on the basis of this valuation standard, this must be clearly stated, together with a reference to any assumptions that have been made. Further details can be found in the RICS guidance note, Mineral-bearing land and waste management sites (2011).

UKVS 1.11 Plant and equipment

The valuation of plant and equipment for inclusion in financial statements shall be on the basis of the value of plant and equipment to the business (VPEB).

Definition:

An opinion of the price at which an interest in the plant and equipment used in a business would have been transferred at the valuation date, assuming that:

(a) the plant and equipment will continue in its present use in the business
(b) there is adequate potential profitability of the business, or continuing viability of the undertaking, both having due regard to the value of the total assets employed and the nature of the operation and
(c) the transfer is part of an arm’s length sale of the business wherein both parties had acted knowledgeable, prudently and without compulsion.

Commentary

1 This basis is used to establish the plant and equipment’s value as part of an undertaking that is expected to continue in operation for the foreseeable future. In order to calculate the VPEB the valuer must consider the value of the assets as a total integrated package, rather than the sum of the individual values. Therefore, any incompatibility of particular plant assets, imbalances between the capacity of different production sections, poor plant layout and similar factors that may affect the overall efficiency of the manufacturing facility should be recognised and taken into account.

2 VPEB is normally the net current replacement cost. This is established by depreciating the gross current replacement cost to reflect the value attributable to the remaining portion of the total useful economic working lives of the assets.
UKVS 1.12 Local authority asset valuations

Valuations of local authority assets for accounting purposes shall be in accordance with the IFRS-based Code of Practice on Local Authority Accounting (the ‘Code’) published by the Chartered Institute of Public Finance and Accountancy (CIPFA).

Commentary

1 This statement applies to the valuation of local authority assets to be provided from 1 April 2012. The Code is reviewed, and normally updated, annually.
2 The Code sets out the core valuation requirements and will be developed and updated annually.
3 The general principles underlying the valuation of local authority assets are no different from those for other assets where there is a requirement to determine their value to the business.
4 The Code is based on IFRS with specific adaptation and interpretation for the public sector.
5 UK appendix 5 contains guidance on the specific valuation requirements of the Code.
6 Local authorities are the following:
   • England: a county council, a district council, a London borough council, the Common Council of the City of London in its capacity as a local authority, a parish or town council, the Council of the Isles of Scilly
   • Wales: a county council or a county borough council
   • Scotland: the council
   • Northern Ireland: a county council, a district council and the police authority for Northern Ireland and
      • police and fire authorities.

UKVS 1.13 Valuations for registered social housing providers

Valuations of social housing for the financial statements of registered social housing providers shall be on the basis of either:
(a) existing use value for social housing (EUV-SH) (for housing stock held for social housing) or
(b) market value (for housing stock that is surplus).

Definition:
Existing use value for social housing (EUV-SH) is the estimated amount for which a property should exchange, on the valuation date, between a willing buyer and a willing seller in an arm’s length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion, subject to the following special assumptions that the property will continue to be let by a body pursuant to delivery of a service for the existing use:

(a) at the valuation date, any regulatory body, in applying its criteria for approval, would not unreasonably fetter the vendor’s ability to dispose of the property to organisations intending to manage their housing stock in accordance with that regulatory body’s requirements

(b) properties temporarily vacant pending re-letting would be valued, if there is a letting demand, on the basis that the prospective purchaser intends to re-let them, rather than with vacant possession and

(c) any subsequent sale would be subject to all of the above special assumptions.

Commentary

1. A registered social housing providers is registered by the Homes and Communities Agency (HCA), Tai Cymru or Communities Scotland under the Housing Associations Act 1985, the Housing Act 1988 or, in Northern Ireland, the Department of the Environment under the Housing (Northern Ireland) Order 1992.

2. Financial statements for registered social housing providers are prepared broadly in accord with UK GAAP (see UKVS 1.1), but are subject to the provisions of a SORP published by the National Housing Federation and its equivalents in Scotland, Wales and Northern Ireland. The SORP interprets the requirements of the ASB having regard to the nature of social landlords’ obligations.

3. Properties owned by a registered social housing provider may be shown in the accounts at historic cost, net of housing association grant (HAG), or at valuation. Where the properties are shown at valuation, the figure should be the lower of replacement cost less HAG, or the recoverable amount less any HAG recovery. The terms ‘replacement cost’ and ‘recoverable amount’ are defined in the value to the business model discussed in UK appendix 1.

4. In this context the valuer should determine replacement cost by applying the basis of EUV-SH. This basis is similar to market value, but with additional assumptions reflecting the continued use of the property for social housing. Although it shares some of the characteristics of EUV, it should not be confused with this basis. The essential similarity is that both are aimed at establishing the service potential of the properties, but in the case of EUV-SH it is specifically for the delivery of the registered social housing provider’s objectives. Therefore any value that may attach to a sale of the properties with vacant possession for use other than social housing must be ignored.
5 If a registered social housing provider has embarked on a policy of disposing of properties with vacant possession, or has declared an intention to do so, then those properties will be surplus to requirements and should be valued to *market value*. Any properties valued on this basis must be separately identified in the report.

6 The report must show the values of completed schemes separately from those for properties under construction. Where properties in the course of development are valued, the valuation should be in accordance with UK appendix 2, paragraph 3.21, on land and buildings in course of development.

7 Valuations must be split between properties held for letting, shared ownership properties and properties for outright sale. In the case of shared ownership properties, 'under construction' would include properties where the initial tranche of equity remains unsold.

8 Where a discounted cash flow (DCF) method has been used to derive EUV-SH, the valuer must state the key *assumptions* made, together with the discount rate(s) used.

9 A registered social housing provider may request valuations on alternative bases, for example, *market value*, or *market value* with vacant possession, and these alternative figures may be disclosed in the notes to the accounts.

10 The registered social housing provider's portfolio may include properties not used for housing purposes, for example, lock-up shops. These properties should be valued to *market value*.

11 The SORP requires that where the value of properties is included in the balance sheet, a full valuation should be undertaken at least once every five years, or through a rolling programme that produces valuations of each property within that period. In the interim, annual reviews should also be undertaken.

**UKVS 1.14 Trading stock**

Land and/or buildings and other assets held as *trading stock* and works in progress shall be valued in accordance with Statement of Standard Accounting Practice 9 (SSAP 9), *Stocks and long-term contracts*.

**Commentary**

1 Land and/or buildings and other assets held as *trading stock* and works in progress are not fixed assets and therefore require special rules where their value is to be included in the accounts. They are normally stated in the accounts at cost or, if lower, net realisable value.

2 Net realisable value is defined in SSAP 9 as:

the actual or estimated selling price (net of trade but before settlement discounts)
less:
(a) all further costs to completion; and
(b) all costs to be incurred in marketing, selling and distributing.

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3 In addition to the cost of building work, costs to complete includes (where appropriate) site works; the fees and expenses of the architects, engineers, quantity surveyors, project managers, solicitors and other professional advisers employed on the project; and interest charges. If a finance agreement exists with another party, the prescribed rate should be adopted.

4 In assessing costs to complete, it can normally be assumed that existing financing and other contractual arrangements will continue uninterrupted. If such agreements cannot be assigned to another party this should be stated in the report. Where the net realisable value is to be incorporated in financial statements that are subject to audit, it is normally appropriate to ignore such restrictions and assume a continuation of the existing business.

5 The valuer may sometimes be concerned with the actual cost to date, having possibly been asked to assist with apportioning costs. In such cases, the cost of development will be roughly the same as costs to complete, plus the actual cost of the land. However, the inclusion of any interest charges, land acquisition costs and irrecoverable VAT will depend on the accounting policy of the undertaking. The valuer should discuss this point with the client and state in the report whether or not such items have been included in the total amount reported.

6 Except in the case of farming stock valuations, the valuer should obtain written statements from the client setting out, as at the valuation date, the details of the cost of the works to date, and/or the estimated cost to complete. Details of any contracted lettings must also be obtained.

7 In the case of farming stock valuations, the basic principles of stocktaking are laid out clearly within the HMRC Business Income Manual BIM55410 Farming: stock valuation, formerly BEN19, now help sheet IR232. All members undertaking farm stocktaking valuations should be familiar with this guidance, which can be viewed on the HMRC website.

8 Further information on the principles of the valuation of land and buildings in the course of development can be found in UK appendix 2, paragraph 3.8.

**UKVS 1.15 Central government asset valuations**

Valuations of central government assets for financial statements shall be in accordance with the Government Financial Reporting Manual (FReM), prepared by HM Treasury and the devolved administrations.

**Commentary**

1 The Government Financial Reporting Manual (FReM) sets out the detailed requirements that entities must follow when dealing with accounting for tangible fixed assets.
1.1.1 The Government Financial Reporting Manual (FReM) is the technical accounting guide to the preparation of financial statements. It complements guidance on the handling of public funds published separately by the relevant authorities in England and Wales, Scotland and Northern Ireland. The Manual is prepared following consultation with the Financial Reporting Advisory Board (FRAB) and is issued by the relevant authorities.

1.1.2 The FReM applies directly to:
- all entities (‘reporting entities’), and to funds, flows of income and expenditure and any other accounts (referred to collectively as ‘reportable activities’) that are prepared on an accruals basis and consolidated within Whole of Government Accounts (with the exception of the accounts of any reportable activities that are not covered by an Accounts Direction);
- Local Government, those Public Corporations that are not Trading Funds, and NHS Trusts and NHS Foundation Trusts. (The NHS Manual for Accounts, the NHS Foundation Trust Annual Reporting Manual and the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom are compliant with this Manual other than for specifically agreed divergences.)

1.1.3 In addition, the Welsh Assembly Government and the Department of Health, Social Services and Public Safety in Northern Ireland will apply the principles outlined in this Manual in the accounting guidance that they issue in respect of Local Health Boards in Wales, and Health and Social Services Trusts in Northern Ireland.

1.1.4 The Manual is kept under constant review. It is updated to reflect developments in international financial reporting standards (IFRS) and, where appropriate, comments received from users. The authoritative version of the Manual for any given financial year will be available by the start of the financial year to which it relates. In the event of the need for mid-year updates to the Manual, they will be issued by the relevant authorities after following due process. The Manual is available on a dedicated website: www.financial-reporting.gov.uk.

1  The relevant authorities are HM Treasury, the Welsh Assembly Government, the Scottish Government and the Executive Committee of the Northern Ireland Assembly.

2  The use of IFRS in general text in this Manual should be taken to include International Accounting Standards (IAS) and Interpretations of IAS and IFRS issued by the Standards Interpretations Committee (SIC) or the International Financial Reporting Interpretations Committee (IFRIC).

3  Due process includes consideration of proposed policies by the relevant authorities, followed by consultation with the preparers of financial statements covered by the requirements of this Manual and then consideration by the Financial Reporting Advisory Board.

• calculating the cost of the buildings and site improvements of a specialised property
• assessing depreciation
• guidance on the valuation policy outlined in the FReM
• valuation of property assets
• valuation of non-property assets (other than infrastructure assets) and enhancements.


UKVS 1.16 Valuations based on depreciated replacement cost

1 In the private sector
A valuation of a property in the private sector using a depreciated replacement cost (DRC) method should be accompanied by a statement that it is subject to the adequate profitability of the business, paying due regard to the value of the total assets employed.

2 In the public sector
A valuation of a property in the public sector using a DRC method should be accompanied by a statement that it is subject to the prospect and viability of the continued occupation and use.

3 Comparison with alternative market values
When reporting a valuation that has been estimated by using a DRC methodology, the valuer must state in the report:
(a) the market value for any readily identifiable alternative use, if higher or
(b) if appropriate, that the market value on cessation of the business would be materially lower.

Commentary

1 In the private sector

1.1 Accounting standards require entities to review their assets periodically for ‘impairment’, which is a permanent loss in the value of the asset to the entity. The appropriate figure to be included in the balance sheet for an asset following an ‘impairment review’ is the higher of either its ‘value in use’ as defined in the
accounting standard, or its *fair value* (see the Glossary), less costs to sell. In simple terms this means that the amount in the balance sheet should be the higher of either the current value of the future benefits that will be derived by the entity from the continued use of the asset, or the proceeds the entity would gain from the asset’s immediate retirement and disposal.

1.2 The *market value* of an asset derived by reference to the sales of similar assets will usually approximate to the sum that the entity could obtain from the retirement and sale of the asset. If the value in use of the asset is lower than a *market value* based on sales comparisons, the latter figure can safely be relied on as the base figure for inclusion in the accounts. This figure is an amount recoverable by the entity regardless of whether it continues to use or retire the asset.

1.3 In contrast, *depreciated replacement cost (DRC)* is used for assets that are rarely, if ever, sold except as part of a sale of the entire operation of which they form part. The *assumption* that there will be demand for the current use of the asset is an inherent feature of the method. As a consequence, a *market value* derived using this method will often not equate to the figure that would be obtained if the asset were retired and sold. If the value in use is lower than a *market value* arrived at by using a *DRC* method, the latter figure cannot be relied on as the base figure, as it may not bear any relation to the amount that the entity would receive following a cessation of operations.

1.4 The possibility that a valuation derived using a *DRC* method would be materially affected by a cessation of operations is covered by the disclosure requirement below. However, the requirement to indicate additionally that the valuation is subject to ‘adequate profitability’ emphasises to the entity that even if the value in use of the asset is lower than the reported *market value*, it may still be higher than the net realisable value on cessation. It may therefore be necessary to write the reported *market value* down to the value in use in an impairment review.

2 In the public sector

2.1 The need to consider ‘impairment’ (permanent loss in the value of the asset to the entity) is also a requirement of public sector accounting. Because public sector assets are held for service delivery rather than profit, it is therefore necessary for the valuer to make it clear that the validity of a valuation derived using the *DRC* method depends on a continuing requirement to use the asset for the provision of the service in question. Combined with any appropriate disclosure, this emphasises to users that the valuation cannot be relied on as an indication of the amount that could be recovered if the service was discontinued and the asset retired.

3 Comparison with alternative market values

3.1 As part of the process of valuing any property, the valuer needs to consider if there is potential for an alternative use that would be reflected in the *market value*. In the case of *specialised property* that can only be valued using the *DRC* method, any alternative use value is likely to relate only to the land because the buildings or other improvements may be unsuitable for any alternative use.

3.2 Where it is clear that a purchaser in the market would acquire the property for an alternative use of the land because that use can be readily identified as generating a higher value than the current use and is both commercially and legally
feasible, the value for this alternative use would be the *market value* and should be reported as such. However, the report should state that this value reflects an alternative use and does not take account of the costs of business closure or disruption, or any other costs associated with realising this value.

3.3 Realising a *market value* based on an alternative use may be inconsistent with the going concern *assumption* upon which *financial statements* are normally prepared. In addition, the costs that an entity might incur in closure or relocation could exceed any additional value that could be realised by an alternative use. Accordingly, an entity may request advice on the value derived from the *DRC* method, which assumes the existing use will continue to assist it in quantifying the extent of any redevelopment potential.

3.4 Frequently, the potential for an alternative use in the event of the specialised use being discontinued can be broadly identified, but the value for that use may not be reliably determined without significant research. For example, it may require the valuer to research into the prospects of obtaining statutory consents, the conditions that would be attached to those consents, the costs of clearance, the cost of new infrastructure, etc. In such cases a simple statement that the value of the site for a potential alternative use may be significantly higher than the value derived from using the *DRC* method will be sufficient.

3.5 If valuations are required on alternative *assumptions* these should be clearly stated.

3.6 If the valuer considers that the value of the asset would be materially lower if it ceases to be part of the going concern, this should be drawn to the attention of the client. However, there is no requirement to report that figure.
UKVS 2 Valuations for financial statements – specific applications

UKVS 2.1 Valuation reports in prospectuses and shareholders circulars to be issued by UK companies

Valuation reports for inclusion in prospectuses and circulars to the shareholders of UK companies shall be in accordance with the RICS specification in UK appendix 7.

Valuations for this purpose are regulated purpose valuations (see UKVS 4.1) and the various disclosure requirements within UKVS 4.2 and UKVS 4.3 will apply.

Commentary

1 In the UK, the Financial Conduct Authority (FCA) is the competent authority for listing pursuant to Part VI of the Financial Services and Markets Act 2000 and is responsible for:

   • the Prospectus Rules, which set out rules and guidance for companies seeking FCA approval to publish a prospectus pursuant to EU Directive 2003/71/EC (‘the Prospectus Directive’ (PD)) and European Commission Regulation 809/2004 (‘the PD Regulation’) and

   • the Listing Rules, which set out rules and guidance applicable to companies admitted, or seeking admission, to the Official List of the FCA (UK-listed companies) and which include, among other things, rules governing the contents of circulars issued by UK-listed companies to their shareholders.

2 Where a company is issuing a publication under either the Prospectus Rules or the Listing Rules, there are requirements for a valuation report to be included in that publication. However, it is recognised that reports may be substantial documents and therefore in certain circumstances the reports may be published in a condensed form.

3 The RICS specification for reports for this purpose is in UK appendix 7.

4 Valuers requiring further information about the regulatory requirements may access the full text of the rules through the FCA website (www.fca.org.uk).

5 Valuers may be requested to provide valuations for inclusion in an application for admission to the alternative investment market (AIM). On initial application, the company is required only to reveal the value of property as shown in its latest
accounts. The values do not have to be current unless they are shown as such in the
counts. Where the valuer is requested to provide current valuations, these must be
given in accordance with the particular accounting standards that the company has
adopted. For that purpose, either VPGA 1 or UKVS 1.1 will apply. However, where
the company has been listed on the AIM for at least 18 months, the publications
must comply with the FCA rules and this valuation standard.

**UKVS 2.2 Takeovers and mergers**

Valuations in connection with takeovers and mergers shall be in accordance
with the Takeover Code (the Code) issued by the Takeover Panel.

Valuations for this purpose are regulated purpose valuations (see UKVS 4.1),
and the various disclosure requirements within UKVS 4.2 and UKVS 4.3 will
apply.

**Commentary**

1. The Takeover Panel (the ‘Panel’) is an independent body, established in 1968,
whose main functions are to issue and administer the Takeover Code (the ‘Code’),
and to supervise and regulate takeovers and other matters to which the Code
applies, in accordance with the general principles and rules set out in the Code. The
Code is designed principally to ensure that shareholders are treated fairly and are
not denied the opportunity to decide on the merits of a takeover, and that
shareholders of the same class are afforded equivalent treatment by an offeror. The
Code also provides an orderly framework within which takeovers are to be
conducted. In addition, it is designed to promote, in conjunction with other regulatory
regimes, the integrity of the financial markets.

2. Since its establishment, the composition and powers of the Panel have evolved as
circumstances have changed and the marketplace has developed. In 2006 it was
designated as the supervisory body to carry out certain regulatory functions in
relation to takeovers pursuant to the European Directive on Takeover Bids. Its
statutory functions are set out in Chapter 1 of Part 28 of the *Companies Act* 2006.

3. The Code applies to all advisers who advise on matters to which the Code
applies. The valuer is considered to be an adviser and must therefore comply with
the Code.

4. The Code requires valuations to be made in accordance with these standards, but
imposes additional requirements for this purpose. Information on the effect of the
relevant parts of the Code is in UK appendix 8, Takeovers and mergers.

5. A valuer who attends meetings with clients and other advisers, such as lawyers,
stockbrokers, accountants and merchant bankers, should be wary of assuming any
role that could be regarded as that of a ‘financial adviser’ within the provisions of the
*Financial Services and Markets Act* 2000. A financial adviser must be a registered
member of a professional regulatory organisation. Although the role of a valuer
would not normally fall within the definition, any extended involvement could, for
example, in providing profit forecasts or commenting on them. If members have any
doubt about their position, legal advice should be taken, preferably before attending
any meeting.
UKVS 2.3 Collective investment schemes

Valuations for collective investment schemes shall be in accordance with the requirements of the Financial Conduct Authority (FCA) New Collective Investment Schemes Sourcebook.

Valuations for this purpose are regulated purpose valuations (see UKVS 4.1), and the various disclosure requirements within UKVS 4.2 and UKVS 4.3 will apply.

Commentary

1 Under Part XVII of the Financial Services and Markets Act 2000 only certain collective investment schemes may be promoted to the public. These are:

   • investment companies with variable capital (ICVC) constituted in the UK
   • authorised unit trusts (AUTs) constituted in the UK, which are collective investment schemes authorised by the FCA and
   • collective investment schemes constituted outside the UK and recognised by the FCA.

2 The Investment Managers Association has issued a statement of received practice (SORP) that provides guidance on the effective implementation of the accounting standards: Financial Statements of Authorised Funds is available from www.investmentfunds.org.uk

3 With regard to valuations the SORP provides that the basis of value shall be open market value. However, the valuer reports market value in accordance with the detailed requirements set out in UK appendix 9, Collective investment schemes.

UKVS 2.4 Unregulated property unit trusts

Valuations for unregulated property unit trusts shall be on the basis of market value.

Valuations for this purpose are regulated purpose valuations (see UKVS 4.1), and the various disclosure requirements within UKVS 4.2 and UKVS 4.3 will apply.

Commentary

1 Unregulated property unit trusts are a form of collective investment scheme where assets are held in trust for the participants that do not have day-to-day control over the management of those assets. They may not be marketed to the general public and are thus distinguished from AUTs (see UKVS 2.3).

2 There is no regulatory requirement for an independent valuation, but most trust deeds require an independent valuer. If the trustee and/or the manager requests an independent valuer, the valuer must check the criteria and confirm that he or she meets them (see PS 2 paragraph 4, Independence, objectivity and conflict of interest).
3 Valuations of land and buildings are critical to the pricing of units and should be reviewed at frequent intervals. Every valuation must be as up to date as possible with regard to the valuer’s judgment of the trends of the most recent transactions in the market, even if those trends may be short term.

4 In normal circumstances, the valuer is employed by, and reports to, the fund manager, but copies of the report should be provided for the trustees.

UKVS 2.5 Adequacy of financial resources of insurance companies

Valuations for inclusion in the assessment of the adequacy of financial resources for insurance companies shall be in accordance with the Prudential Regulation Authority (PRA) sourcebook for insurers (INSRU).

Commentary

1 European directives require financial institutions to make assessments of the adequacy of their financial resources. In the UK the PRA INSPRU provides that the value of assets for checking financial adequacy shall be the same as that adopted by the entity for its accounting purposes.

2 The value of assets is to be measured in accordance with:
   (a) the insurance accounts rules, or the Friendly Societies (Accounts and Related Provisions) Order 1994
   (b) FRS and SSAP issued or adopted by the ASB and
   (c) statements of recommended practice (SORPs), issued by industry or sectoral bodies recognised for this purpose by the ASB or
   (d) IAS

as applicable to the firm for the purpose of its external financial reporting (or as would be applicable if the firm were a company with its head office in the UK).

3 Valuations for this purpose will therefore be in accordance with the relevant IVS (see VPGA 1) or UKVS 1.1, and must include a statement that they comply with the provisions of the sourcebook.

4 The INSPRU sourcebook is freely available at www.fshandbook.info/FS/html/PRA/INSPRU

UKVS 2.6 Adequacy of financial resources for financial institutions

Valuations for inclusion in the assessment of the adequacy of financial resources for banks, building societies and investment firms shall be in accordance with the Prudential Regulation Authority (PRA) sourcebook for banks, building societies and investment firms (BIPRU).
Commentary

1 European directives require financial institutions to make assessments of the adequacy of their financial resources. In the UK the PRA BIPRU sets out detailed rules for which such assessments shall be made.

2 BIPRU 3.4 states:

3.4.66(1) The requirements about monitoring of property values … are as follows:
(a) the value of the property must be monitored on a frequent basis and at a minimum once every three years for residential real estate;
(b) more frequent monitoring must be carried out where the market is subject to significant changes in conditions;
(c) statistical methods may be used to monitor the value of the property and to identify property that needs revaluation;
(d) the property valuation must be reviewed by an independent valuer when information indicates that the value of the property may have declined materially relative to general market prices; and
(e) for loans exceeding €3 million or 5% of the capital resources of the firm, the property valuation must be reviewed by an independent valuer at least every three years.

(2) For the purposes of (1), ‘independent valuer’ means a person who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process.

3.4.77 The property must be valued by an independent valuer at or less than the market value. In those EEA States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions the property may instead be valued by an independent valuer at or less than the mortgage lending value.

BIPRU 3.4.66 and 3.4.77, © The Prudential Regulation Authority

Note that BIPRU states that ‘necessary qualifications’ need not be professional qualifications, but the valuer should be able to demonstrate that he or she has the necessary ability and experience to undertake the review.

3 The definition of market value is the same as adopted in these standards (see VPS 4 paragraph 1.2, Market value).

4 Mortgage lending value is not normally used in the UK. In 2006 an explanatory note on this was prepared by the European Mortgage Federation (www.hypo.org). RICS has no responsibility for the contents, and the European Mortgage Federation paper is neither mandatory nor approved guidance.

5 The full BIPRU is freely available at www.fshandbook.info/FS/html/PRA/BIPRU
UKVS 3 Valuations of residential property

UKVS 3.1 Residential property mortgage valuations

Valuations of residential property for mortgage purposes shall be in accordance with the RICS residential mortgage valuation specification (see UK appendix 10).

Commentary

1 When valuing residential properties on behalf of building societies, banks and other lenders for mortgage purposes, the valuer shall comply with the specification reproduced in UK appendix 10, unless otherwise agreed in writing, in advance, with the client.

2 The mortgage valuation specification may also be relevant to the provision of advice for the following purposes:
   - re-inspections
   - retypes and transcriptions
   - further advances
   - buy to let
   - valuations without internal inspection and retrospective valuations.

Guidance on the provision of advice for these purposes is in UK appendix 11.

3 In Scotland the accepted procedures for buying residential property differ from those in England, Wales and Northern Ireland. Due to time restrictions it may be difficult to issue terms of engagement within the requirements of VPS 1, Minimum terms of engagement. Therefore, RICS Scotland has issued advice (reproduced in UK appendix 12) that aims to reflect best endeavours on behalf of the member or firm.

Loan classification

4 In general, firms that provide advice on residential mortgages are regulated by the FCA Mortgages and home finance: conduct of business sourcebook (FCA MCOB). The regulations apply to ‘regulated mortgage contracts’. In order for a loan to fall within the definition of a regulated mortgage contract, at least 40% of the total of the land to be given as security must be used as, or in conjunction with, a dwelling. To be ‘residential property’, at least 40% of the land must normally be used as or in connection with one or more dwellings, or has been or is to be developed or adapted for such use.
A lender may ask the valuer for advice on the extent of the use of the property for residential purposes. The advice required should relate to the use of the property, and the valuer should not be influenced by the relative capital values or floor areas in isolation from the accompanying land.

**UKVS 3.2 Repossession proceedings**

Valuations of residential property for the purpose of possible possession proceedings, or the proposed sale of a repossessed property, shall be on the basis of projected market value (PMV) as expressly defined in UKVS 3.3, subject to the following special assumptions that:

- during the marketing period the property has been unoccupied and all furnishings and fittings have been removed and
- the vendor (the mortgagee) has to sell the property within a reasonable period to recover the secured debt.

**Commentary**

1. Projected market value (PMV, see UKVS 3.3 below) is a special basis of value used in relation to possession proceedings and the marketing of repossessed property.

2. The requirement to assume that the property has been empty means that the valuer has to take into account the adverse effect this may have on its marketability.

3. A valuation on the basis of PMV, in connection with possession proceedings, will exclude the value of furnishings and fittings, although it is likely that their removal will have an adverse impact on marketability and the value of the property.

4. The conceptual framework for market value in VPS 4 paragraph 1.2, Market value, applies, but the second special assumption does slightly modify ‘and without compulsion’. While a mortgagee is not compelled to sell, there is a requirement to capitalise a non-performing asset. Therefore there is less flexibility than a typical owner-occupier would have. In certain market conditions this could affect the price that could be achieved.

5. The mortgagee as vendor has a duty to secure the best price available in the prevailing market conditions and has to act reasonably. If the mortgagee imposes restrictions on the available marketing period, then these should be identified by the valuer in any special assumptions made.

6. In Scotland, in recognition of the Single Survey, the basis of value for a lender’s repossessed property, which is being exposed to the market, will be the same as any other property being brought to the market, that is, market value. Should the lender require any other method of valuation, this must be made clear in the report.

**UKVS 3.3 Projected market value of residential property**

Valuations of residential property on the basis of projected market value shall be in accordance with the definition settled by RICS, Council of Mortgage Lenders (CML) and the Building Societies Association (BSA).
Definition:
The estimated amount for which an asset is expected to exchange at a date, after the **valuation date** and specified by the valuer, between a willing buyer and a willing seller, in an arm’s length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

**Commentary**

1. The date specified by the valuer must be stated clearly whenever a PMV is provided. It should reflect the period that the valuer considers will be necessary for adequate marketing and the completion of negotiations.

2. This basis should be used to provide clients with an estimated valuation in respect of a future exchange, assuming that marketing begins on the date that the valuation is prepared.

3. The definition of PMV is based on **market value**, save for the stipulation that the valuer’s estimate should reflect what the amount is projected to be at a future, specified date. **IVS Framework paragraphs 29–34 Market Value** should therefore apply with the exception that the phrase ‘on the **valuation date**’ is modified as follows:

   ‘... at a date, after the **valuation date** and specified by the valuer ...’

The **valuation date** is the date on which the estimate is given, but represents the valuer’s opinion, based on facts, market sentiment and public forecasts then existing of anticipated market changes during the period up to the specified date. A PMV is therefore a projection and not a forecast. The definition also assumes simultaneous exchange and completion of the contract for sale without any variation in price that might otherwise occur.

4. PMV is designed to provide residential mortgage lenders with a simple numeric indication of the valuer’s opinion of short-term market trends, and it must be used only for this purpose. It recognises that most reports for this purpose are based on a simple pro-forma, and that the degree of market analysis and commentary required in commercial lending situations is inappropriate.

5. The purpose of PMV is simply to illustrate the valuer’s opinion of whether the market is likely to fall, rise or remain static in the period that it is anticipated will be necessary to complete the sale. Values can change rapidly due to unpredictable events, thus an earlier provision of a PMV is not a substitute for a current **market value**, nor is it necessarily the case that the two figures will be the same.

**UKVS 3.4 Valuations for home finance products**

Valuations for home finance products shall be in accordance with the requirements of the Financial Conduct Authority (FCA) Mortgages and home finance: conduct of business sourcebook (FCA MCOB).

**Commentary**

1. **Firms** that carry out activities related to home finance transactions are regulated by the FCA MCOB. A home finance transaction may be one of four products:
• regulated mortgage contracts (which includes lifetime mortgages)
• home reversion plans
• sale and leaseback and
• home purchase plans.

Lifetime mortgages and home reversion plans are together referred to as ‘equity release products’. Equity release products and associated valuations are highly sensitive due to the age of the occupants.

2 The regulations apply to ‘regulated mortgage contracts’ (see UKVS 3.1 paragraphs 4 and 5, Loan classification). The full regulations may be obtained at www.fca.org.uk/handbook

3 The valuation of residential property for home finance products requires consideration over and above the standard mortgage valuation specification.

4 Although the purpose for which these valuations are required is regulated, they are not regulated purpose valuations and therefore UKVS 4.1 does not apply.

Lifetime mortgages

5 In this form, repayment is deferred until the sale of the property (lifetime).

6 Apart from indicating that the provider may include a property valuation in its illustration, there are no specific valuation requirements for lifetime mortgages. Such valuations should therefore be provided in accordance with UKVS 3.1, Residential property mortgage valuations, and UK appendix 10, RICS residential mortgage valuation specification.

7 The main differences between a lifetime mortgage and a conventional mortgage are:

   (a) the redemption date is not fixed but comprises the date of death of the mortgagor and
   (b) no repayments of capital are made, and the interest is ‘rolled up’ and compounded over the length of the mortgage term.

Therefore the amount of mortgage debt to be redeemed at the end of the term (the date of death of the mortgagor) is much greater than with a conventional mortgage, because of the lack of any capital repayment during the term and the accumulation of ‘rolled up’ interest. Due to the undetermined length of the mortgage term and the higher than normal amount to be redeemed at the term date, valuation advice should include comments on sustainability (especially in respect of features of design, condition and location) that may influence value over a longer term.

8 It is also important to appreciate that the lifetime mortgage lender places more emphasis on maintenance items and the timing of essential repairs as a condition of the mortgage. The forms and guidance published by the lender should therefore be considered in order to establish if they differ from the normal mortgage specification.

Home reversion

9 In this form the occupant sells all or part of the home to a reversion company or an individual. The occupant no longer owns all or part of the home, but continues to live there rent-free for the remainder of his or her life.
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10 The regulations provide that valuations for home reversion products must be carried out by a competent valuer who is independent of the reversion provider. The reversion provider firm must also provide the customer with copies of the valuation report.

11 In the absence of any specific valuation requirements, valuations for home reversion products should be provided in accordance with VPGA 2, Valuation for secured lending. However, they should be treated in the same way as under UKVS 3.1 in most respects, except as mentioned in paragraphs 12 and 13 below.

12 Equity release products for home reversion, although for residential property, may need to be treated differently where there is some development potential reflected in the market value (in contrast to paragraph 4.2 of UK appendix 10, RICS residential mortgage valuation specification, where such value is usually excluded). The title to the property, and thus the benefit of any development potential, passes to the company on completion of the equity release transaction. The exploitation of any development potential would effectively be deferred until the company realises the value of its reversion on the death of the applicant. The development potential could be released during the term of the investment (the life of the applicant), but only with the applicant’s consent.

13 Where the market value reflects development potential, whether arising from actual planning consents or the prospect of future development, the lender should be advised accordingly. So that the lender can assess the significance for underwriting purposes, the valuer may be requested to provide further information and a valuation on the special assumption that no development would be permitted.

Sale and rent back

14 Sale and rent back (SRB) is a facility whereby individuals sell their homes to an authorised firm at a discount, in return for the right to remain as a tenant for as set period. The tenancy has to be for a minimum term of five years on a fixed-term assured shorthold tenancy (AST), or equivalent in Scotland and Northern Ireland.

15 The regulations prescribe a procedure for commissioning a valuation that has the following elements:

(a) The valuation must be commissioned jointly by the SRB firm and the customer. A standard joint instruction letter is provided by the FCA, but its use is optional.

(b) The valuation must be carried out by a valuer who is independent of the SRB firm.

(c) The SRB provider must ensure that the valuation is carried out by a valuer who owes a duty of care to the customer in valuing the property. The FCA has suggested that the following wording is to be included in the appointment letter:

‘By accepting this instruction you acknowledge that you owe a duty at common law to exercise reasonable care to both [name of firm] and [name of owner], the property owner, and in addition you agree with each of [name of firm] and [name of owner], the property owner, that you will carry out this instruction with reasonable skill and care.’

• A valuer may be considered independent if:
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- the customer can choose the valuer, subject to the SRB provider’s objection on reasonable grounds and to the valuer being competent
- the valuer owes a duty of care to the customer in valuing the property and
- the customer has an appropriate remedy against the valuer under a complaints procedure, which will allow the complaint to be referred to an independent professional whose decision is binding on the valuer.

16 The basis of value is market value at the reporting date.

Valuations for prospective lenders to sale and rent back [SRB] companies

17 Where the valuer is requested by an SRB provider or third party to provide a valuation for a prospective lender to an SRB company, it should be made clear that:

(a) while the original SRB valuation was on the basis of market value assuming vacant possession, the valuation provided to a prospective lender will be on the basis of market value on the special assumption that the property is subject to a five-year tenancy and

(b) these two valuations may be different from one another.

18 Where the valuer is requested directly by a lender to provide a mortgage valuation in respect of an application to finance an SRB purchase, the valuer must make clear to the lender that:

(a) the valuation will be on the basis of market value on the special assumption that the property is subject to a five-year tenancy and

(b) this may differ from the original SRB valuation on the basis of market value assuming vacant possession.

Home purchase plans

19 A home purchase plan serves the same purpose as a regular mortgage, but it is structured in such a way that makes it acceptable under Islamic Law.

20 The regulations do not provide any specific valuation requirements, and in the absence of specific instructions, valuations should be provided in accordance with UKVS 3.1.

UKVS 3.5 RICS HomeBuyer Service

Members accepting instructions to provide the RICS HomeBuyer Service (HBS) must comply with the extant HBS practice note.

Commentary

1 The RICS HomeBuyer Service (HBS) is a product developed and owned by RICS, designed specifically as an economical service which may be provided only by RICS members.

2 The HBS comprises:

- an inspection of the property
- a concise report based on the inspection and
UKVS 3 Valuations of residential property

• a valuation.

It reports on the general condition of the main elements of the property and particular features that affect its present value and may affect its resale. The report focuses on matters that the surveyor judges to be serious and/or urgent.

3 Members who provide the HBS must comply with the practice note as published by RICS. In particular, the standard documentation and report form must be used without alteration as set out in the current edition of the practice note.

4 The HBS documentation and reports may be used only under copyright licence obtained from RICS. Further details can be found on the Home Surveys section of the RICS website: www.rics.org/homesurveys

UKVS 3.6 The Home Report in Scotland

Members accepting instructions to provide the Home Report in Scotland must comply with the legislation set out in the Housing (Scotland) Act 2006 and the Housing (Scotland) Act (Prescribed Documents) Regulations 2008.

Commentary

1 The Home Report is legislation introduced by the Scottish Parliament. RICS Scotland has developed products in response to this legislation introducing a requirement for the provision of a report when a house or flat is brought to market. The Home Report was effective from 1 December 2008.

2 The Home Report comprises three elements, which are prescribed documents:

• Single Survey
• Energy Report and Energy Performance Certificate (EPC) and
• Property Questionnaire.

Collectively they cover the general condition of the property and particular features that affect its present value and may affect its resale. The Home Report focuses on matters that the surveyor judges to be urgent or significant, and it also includes a valuation of the property.

3 Members who provide services as part of the Home Report service must comply with the standard documentation and report form, which must be used without alteration.

Mandatory documentation

4 Mandatory documentation of the Home Report includes:

• terms and conditions, with a generic mortgage valuation report (MVR)
• terms and conditions without a generic MVR and
• Single Survey report, including the scope of inspection.

These documents ensure that members carry out the same Single Survey in accordance with the regulations and prescribed report format.
Optional documentation

Optional documentation providing guidance for the Home Report includes:
- letter of engagement with a generic MVR
- letter of engagement without a generic MVR and
- property inspection technical guidance for completing Single Surveys.

The letters of engagement are not prescribed as it is expected that members will develop their own in accordance with their firms’ style. They are therefore available as examples only.

Paper versions of all the documents are available from RICS Scotland, and digital versions can be found at www.rics.org/uk/knowledge/more-services/guides-advice/home-surveys/home-reports-in-scotland/home-report-member-information

UKVS 3.7 Shared ownership

The value of a share in a shared ownership property shall be in the same proportion of the market value of the whole interest with vacant possession as that share bears to the whole.

Commentary

1 There is a wide range of schemes that enable an individual to purchase a dwelling using a combination of part ownership and part rental. Such schemes usually allow the part owner to purchase further shares in the dwelling, called ‘staircasing’, usually in 20% or 25% tranches. The RICS guidance notes, Valuation of land for affordable housing (2010) and Valuation of land for affordable housing – Scotland (2013), contain a brief explanation of the various forms of part ownership.

2 The valuer may be asked to provide either the market value of the dwelling, where the share value is calculated according to the individual arrangements, or the value of the share to be acquired.

3 Where market value of the whole is provided, the sharing terms are ignored but any other terms that are in place, such as restrictions on purchasers or price and lease terms, are reflected. It is essential that the valuer is aware of the shared ownership document.

4 Where a share value is provided, there may be evidence that a share has sold at a higher or lower price than the same arithmetical share of the value of the whole property. If the different price can be identified and quantified, the report should include a reference to it.

UKVS 3.8 Shared equity schemes

Valuations for individual properties under a shared equity scheme shall be the market value of the whole interest.

Commentary

1 Shared equity arrangements may arise as a result of developers offering either their own shared equity scheme, or a scheme as a result of government initiatives.
Several different types of scheme exist, and valuers should ensure they are aware of the nature of the scheme proposed in respect of the property to be valued.

2 The valuer will usually be asked to provide the market value of the whole interest. Where this is provided, any restrictions on purchasers or resale price, or other restrictive terms, must be reflected. It is essential that the valuer is fully aware of the shared equity arrangements as well as any other restrictions.

3 Where there are circumstances that may unduly affect the resale value of the property because of the nature of the scheme, the valuer should provide further information to the lender and reflect this in the market value figure.

4 Generally, the buyer purchases an interest in the whole property, but only pays a percentage of the price. The remaining percentage is financed by a company in the form of an equity loan, and the company will take a second charge on the property. Some schemes require the equity loan to be repaid in full or in part at a specified date.

5 Conventional shared equity may enable the buyer to make partial repayments of the equity loan, thus increasing the purchaser’s percentage share of the whole. Fixed shared equity does not enable the buyer to make partial repayments. Perpetual shared equity, more commonly associated with social housing schemes, does not allow for the repayment of the equity loan on sale, but perpetuates the arrangement on the same terms for a new purchaser. This may also be associated with restrictions regarding the nature of purchasers, for example, key workers.

6 On sale, the proceeds are shared in the same ratio as the initial percentages. This may result in either a gain or a loss for both parties, depending on whether the sale proceeds are more or less than the original purchase price.

7 Where it is not clear that the lender is aware that the property is being purchased under a shared equity scheme, the valuer should inform the lender.

**UKVS 3.9 Secured lending valuations for registered social landlords**

Valuations of a registered social landlord’s housing stock for secured lending purposes shall be on the basis of either:

- market value
- existing use value for social housing (EUV-SH).

**Commentary**

1 This statement applies to the provision of valuations to lenders considering the provision of finance to registered social housing providers for the development, or acquisition and retention, of an equity stake in residential property that would be let as shared ownership.

2 Guidance on the approach to these valuations can be found in UK appendix 13.

**UKVS 3.10 Trustee mortgage valuations**

Valuations undertaken for trustee mortgages must be by an ‘independent valuer’ in accordance with section 8 of the Trustee Act 1925.
Commentary

1. Under the Act a trustee must obtain a report of the value made ‘by a person whom he reasonably believes to be an able practical surveyor or valuer instructed and employed independently of any owner of the property’, and the loan must be ‘made under the advice of the surveyor or valuer expressed in the report’.

2. As a result of case law it should be noted that:
   - the surveyor or valuer must be instructed and employed independently of both the mortgagor and his or her solicitor in the transaction
   - the amount or payment of the fee must not in any way depend on the proposed loan being effected and
   - where a security is introduced by the surveyor or the valuer, the latter should not be employed to make the valuation.

[Schedule 4 of the Trustee Act 2000 has since repealed Part 1 (sections 1–11) of the Trustee Act 1925.]

UKVS 3 Valuations of residential property

UKVS 3.11 Affordable rent and market rent

Rental valuations provided for registered social housing providers in connection with the assessment of affordable rent shall be at market rent.

Commentary

1. This standard applies only in England.

2. Legislation requires that the landlord of affordable rent properties funded by the Homes and Communities Agency (HCA) must be a registered provider of social housing and is therefore subject to Tenant Services Authority (TSA) regulation.

3. Registered social housing providers will be able to let a property at an affordable rent of up to 80% of the gross market rent. The regulations provide that the gross market rent is to be assessed in accordance with an ‘RICS recognised valuation method’.

4. Gross market rent has the same meaning as market rent, as defined in VPS 4 paragraph 1.3, Market rent. The valuer will provide a market rent as specified in UK appendix 14.

5. Valuations for this purpose do not fall within any of the exceptions specified in PS 1 paragraph 6, Exceptions, and therefore VPS 1–4 are of mandatory application, subject to the additional requirements set out in UK appendix 14.

6. Although the purpose requiring these valuations is regulated, they are not regulated purpose valuations and therefore UKVS 4.1 will not apply.
UKVS 4 Regulated purpose valuations

UKVS 4.1 Regulated purpose valuations

Regulated purpose valuations are:

- valuations for financial statements under VPGA 1, Valuation for inclusion in financial statements and UKVS 1.1
- valuation reports for inclusion in prospectuses and circulars to be issued by UK companies under UKVS 2.1
- valuations in connection with takeovers and mergers under UKVS 2.2
- valuations for collective investment schemes under UKVS 2.3 and
- valuations for unregulated property unit trusts under UKVS 2.4.

Commentary

1 Valuations provided for these purposes also fall under PS 2 paragraph 8, Disclosures. UKVS 4.2 and UKVS 4.3 provide more stringent requirements that must be complied with where this valuation standard applies.

UKVS 4.2 Exclusion of certain properties

Where a regulated purpose valuation includes:

(a) one or more properties acquired by the client within the 12 months preceding the valuation date; and

(b) the valuer, or the valuer’s firm, has in relation to those properties:

- received an introductory fee, or
- negotiated that purchase on behalf of the client,

the valuer shall not undertake a regulated purpose valuation of the property (or properties) identified under (a), unless another firm unconnected with the valuer’s firm has provided a valuation of that property for the client at the time of, or since, the transaction was agreed.

Commentary

1 There are many circumstances where conflicts of interest may arise (see PS 2 paragraph 8, Disclosures). This standard deals specifically with the conflict that may arise where the valuer or firm could be involved in the introduction and acquisition of property by the client and in the provision of a regulated purpose valuation of the same property.
This valuation standard requires that where the specified circumstances occur, the valuation should be provided by another firm. This will remove any perception that there could be pressure applied to justify earlier advice provided by the original valuer or the firm.

**UKVS 4.3 Disclosures**

Where a valuation is a regulated purpose valuation, the valuer shall state all of the following in the report and any draft published reference to it:

(a) in relation to the firm’s preceding financial year the proportion of the total fees, if any, payable by the client to the total fee income of the valuer’s firm expressed as either less than 5%, or if more than 5%, an indication of the proportion within a range of 5 percentage points; and

(b) where, since the end of the last financial year, it is anticipated that there will be a material increase in the proportion of the fees payable, or likely to be payable by the client, the valuer shall include a further statement to that effect, in addition to (a) above.

**Commentary**

1 In complying with this valuation standard, the valuer is not required to provide a comprehensive account of all work ever undertaken by the firm for the client. A simple, concise statement that discloses the nature of other work done and the duration of the relationship is all that is required. If no relationship exists other than the valuation instruction, a statement to that effect should be made.

2 It may be both impractical and immaterial to establish and evaluate every relationship between the firm and every party connected with the instructing party. However, it is the valuer’s responsibility to make reasonable enquiries to identify the extent of the fee-earning relationship with all parties having a material connection with the client, and to ensure that the principles of this standard are followed. Where there is a material connection or relationship, the disclosures required by this standard relate to the relationship of the valuer’s firm with all the parties involved and the aggregate fees earned from those parties.

3 The information required under item (a) of this statement should be expressed, when required, in the form of ‘between \([x]\)% and \([y]\)%’, with the difference between the two figures being no more than 5 percentage points.

4 The purpose of item (b) is to recognise that there may be circumstances where a significant increase in the proportions of fees is anticipated between the end of the previous financial year and the date of the report. Because detailed information on the proportion will probably not be readily available, the valuer will need to make enquiries and form a judgment as to the likely proportions to be disclosed.

5 Where a reference to a report is to be published, the statement for inclusion in the publication (see VPS 3 paragraph 7(j), Restrictions on use, publication and distribution) should refer to all the information given in complying with this valuation standard. A note of the enquiries made and the source of the information used in complying with this valuation standard must be retained in the file.
9 RICS UK appendices

UK appendix 1 Accounting concepts and terms used in FRS 15 and SSAP 19

1 Introduction

1.1 This appendix provides information on the accounting concepts and some of the terms used in FRS 15, "Tangible fixed assets", and SSAP 19, "Accounting for investment properties."

2 The required accounting concept

2.1 The Accounting Standards Board’s (ASB) FRS 15 requires entities that revalue their tangible fixed assets to carry those assets in financial statements at current value. Current value is determined using the ‘value to the business model’ set out in the FRS in appendix IV, paragraph 19. This can be portrayed diagrammatically, as shown in Figure 1.

Figure 1: Value to the business model
UK appendix 1  Accounting concepts and terms used in FRS 15 and SSAP 19

The terms used in Figure 1 are:

- Replacement cost: this is the expense of purchasing, at the least cost, the remaining service potential of the asset at the balance sheet date. It is an entry value.
- Value in use: this is the present value of the future cash flows obtainable as a result of an asset's continued use, including those resulting from its ultimate disposal.
- Net realisable value: this is the amount for which an asset could be disposed of, less any direct selling costs. It is an exit value.

2.2 Valuers should apply the concept of replacement cost to land and buildings on the following bases:

- market value (MV) for non-specialised properties, but existing use value (EUV) for properties that are owner-occupied for the purposes of the business or
- depreciated replacement cost (DRC) for specialised properties, subject to adequate potential profitability.

2.3 The value to the business model (Figure 1) prescribes that the value of a tangible fixed asset in the accounts must be set at a level that is sufficient to reflect the cost in the market of replacing its service potential. This is also referred to as the ‘deprival value’, which is the price of the asset that, if the organisation were deprived of a particular asset, it or any other potential owner-occupier would pay in the market to replace that asset for the same use to enable operations to continue.

2.4 In considering the concept of deprival value in relation to EUV, the actual circumstances of the owner-occupier should not be taken into account as this would be an assessment of worth. There is also a risk that the actual owner-occupier could be vested with the characteristics of a special purchaser, whose bid therefore has to be ignored under the definition of EUV. To avoid reflecting any additional bid that may be made by the actual owner-occupier because of its particular circumstances, the valuer may find it helpful to consider a bid that would be made by a hypothetical purchaser to occupy the property for the same use and in a similar manner to the actual occupier.

2.5 Alternative use values incompatible with the use of the asset in the business have no relevance in the accounts of the company. However, an alternative use that increases the value of a property owned and occupied by the entity to a level above that needed to fulfil the service potential may be relevant to an overall appraisal of the company’s situation, and should be disclosed in the directors’ report.

2.6 While the value to the business model (Figure 1) assists valuers in understanding the context in which valuations for financial statements are required, the use of the word ‘value’ in the expression ‘value in use’ does not mean that a valuer is necessarily competent to determine this figure. The term should not be regarded as an alternative valuation basis for fixed assets and should not be used by valuers when preparing valuations. The valuer’s role will normally be confined to providing advice on the replacement cost and/or the net realisable value.

2.7 Notwithstanding this caution, members with a particular knowledge of, or skill in, an asset class or industry may be competent to assist in the calculation of value in use. Requirements and guidance on the measurement of value in use can be found in FRS 11, *Impairment of Fixed Assets and Goodwill*. 

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3 Frequency of valuations

3.1 FRS 15 does not require annual revaluations, although the objective of a revaluation policy is to reflect current values as at the balance sheet date. Full guidance can be found in paragraphs 44–46 and 52 of the FRS, but in summary:

- where properties are revalued, the requirements of the FRS will be met by a full valuation at intervals of no more than five years and an interim valuation in year three
- if there has been a material change in value, further interim valuations should be undertaken in years one, two and four and
- for portfolios of properties, full valuations on a rolling basis may be carried out so that all properties are covered over a five-year cycle, subject to interim valuations on the remainder of the portfolio where it is likely there has been a material change in value. For this approach to be acceptable, the properties must be broadly similar in character, and it must be possible to subdivide the portfolio into groups of a broadly similar spread.

3.2 An interim valuation may be carried out on a restricted basis, although the FRS makes it clear that an inspection of the property or the locality should still be undertaken to the extent that this is regarded professionally necessary.

3.3 SSAP 19 states that property companies holding a substantial proportion of investment properties must have an external valuation at least every five years.

4 Small companies

4.1 The Financial Reporting Standard for Smaller Entities (FRSSE) sets out simplified financial reporting standards that may be adopted by small companies or groups, as defined in the Companies Act 2006, or by other entities that would also qualify if they were incorporated, with the exception of building societies. The current version of the FRSSE can be found at www.frc.org.uk/asb

4.2 Where an entity adopts an accounting policy of revaluation in respect of a tangible fixed asset, its carrying amount shall be its market value (or the best estimate thereof) as at the balance sheet date.

4.3 Where the directors believe that market value is not an appropriate basis, current value (that is, the lower of replacement cost and recoverable amount) may be used instead. Where current value is adopted, the basis of value is to be the same as set out in UKVS 1.1, Basis of value.

4.4 Valuations should be carried out at least every five years.
UK appendix 2 Property categorisation for company accounts

1 Introduction

1.1 This appendix provides guidance on the identification of categories and bases of value of property referred to in UKVS 1.

1.2 FRS 15 provides that where a tangible fixed asset is revalued, all other assets of the same class should also be revalued. The three classes of assets referred to in company legislation are:
   - land and buildings
   - plant and machinery and
   - fixtures, fittings, tools and equipment.

However, the standard provides that entities may, within reason, adopt narrower classes for valuation purposes.

1.3 Even though FRS 15 requires only three classes of assets, members should agree and identify the types of property that should be valued in compliance with VPS 1 paragraph 2(d), Identification of asset or liability to be valued. They should either report those values separately, or provide a breakdown where an aggregated figure is reported.

2 Categories of property

2.1 The following are examples of the different categories of property that may be identified in a valuation for incorporation in a financial statement:
   - owner-occupied
   - held as an investment
   - specialised property
   - trading stock
   - fully-equipped as an operational entity
   - held for non-specialised or specialised development
   - land and buildings in the course of development
   - minerals
   - surplus to requirements
   - joint development contracts and joint ventures and
3 Basis of value

Owner-occupied

3.1 Owner-occupied property will be valued to EUV (UKVS 1.3).

3.2 This property would usually be valued on the basis of vacant possession. It may be necessary to divide the amounts of the valuation between freehold, long leasehold (over 50 years) and short leasehold properties.

Property held as an investment

3.3 Property that is held as an investment will be valued to market value.

3.4 This is property held to earn a present or future rental income and/or for the preservation or gain of capital value.

3.5 In some cases investment properties may include those held for possible future occupation by the undertaking (sometimes called ‘reserve’ properties), or for future development, either for the purposes of the undertaking or to create an investment property.

Specialised property

3.6 Specialised property (as defined in the Glossary) is valued using the depreciated replacement cost (DRC) approach referred to in FRS 15 as a basis (see UKGN 2, Depreciated replacement cost method of valuation for financial reporting).

3.7 In deciding whether or not a property is specialised the valuer must be satisfied that it is impossible to provide an EUV. Property that might otherwise be regarded as specialised because of its construction, arrangement, size or location, and that is normally only sold as part of a sale of the business in occupation, may be properly valued by reference to its trading potential, or by a logical extrapolation of any available market evidence.

Trading stock

3.8 Trading stock is to be valued at cost or net realisable value.

3.9 This is not a fixed asset and is dealt with in different ways in financial statements according to whether or not it is classified as long-term contract work.

3.10 Where valuations for this purpose are required, trading stock is governed by SSAP 9 (see UKVS 1.14, Trading stock) and will not be included in the valuation prepared under FRS 15.

Property that is fully equipped as an operational entity

3.11 Property that is fully equipped as an operational entity will be valued to EUV if owner-occupied, or market value if surplus or held as an investment (see VPGA 4, Valuation of individual trade related properties).
3.12 Certain operations can be carried out only under statutory consents, permits and licences. Any assumption that operations will continue must be stated specifically in the report.

3.13 Where a business has been closed down and the property stripped of fixtures, fittings and furniture, it will normally be available for redevelopment, refurbishment or change of use. In such case, it should be valued accordingly as surplus to requirements, if so declared by the directors. If it is intended that the property will be re-opened for the purposes of the business, its value for balance sheet purposes must reflect the additional costs that would be incurred compared with an existing, fully-operational property, and this must be explained in the report.

Property held for non-specialised development

3.14 Property that is held for non-specialised development will be valued to market value.

3.15 This is property that is held for development for investment purposes, or that the client has declared is being held for development at a foreseeable date for future occupation by the undertaking (sometimes called ‘reserve’ property).

3.16 Where pre-development procedures have started, such as:
- where an agreement for a building lease has been signed
- steps have been taken to obtain vacant possession or
- demolition of existing buildings has begun

the valuer will need to agree with the client whether the property should be correctly classified as land and buildings in course of development. In this case, paragraph 3.21 below will apply.

Property held for specialised development

3.17 Property that is held for specialised development will be valued to market value.

3.18 Land and buildings for specialised development should be valued either:
- for the proposed use by the business, provided that planning consent has been granted or
- in its existing state.

3.19 The application of these bases is subject to the accounting policy of the undertaking. The valuer should discuss the matter with the client in the light of that policy.

3.20 The valuer may be concerned only with the value of the land. At this stage, this may not be either a material part of the total cost of the property when development is completed, or a material element in the total value of the fixed assets, thus a current valuation may not be required.

Land and buildings in the course of development

3.21 Where land and buildings in the course of development are to be revalued, they are to be included in the financial statement at their current value.
3.22 In estimating the EUV for social housing (EUV-SH), as defined in UKVS 1.13, the valuer will need to reflect the costs, including any appropriate allowances for risk and profit that are required to complete the project at the valuation date. Unless advised that the development is to be terminated or curtailed, the valuer may assume that all contracts in place at the valuation date will remain in place and can be transferred to a hypothetical buyer.

Minerals

3.23 Minerals will be valued to market value or EUV, depending on the circumstances.

3.24 Unless the minerals have been severed from the surface, the valuation may well include elements of value of the surface and minerals. These elements may include the value of the land required for extraction in the future, which can be let to produce income in the meantime.

3.25 Additional assumptions must be made for the possibility that surface land scheduled for mineral extraction may have other uses at the valuation date, and may have a future use once the mineral workings have ceased.

Property that is surplus to requirements

3.26 Property that is surplus to requirements will be valued to market value.

3.27 This is property that the directors of the undertaking declare to be no longer required for occupation for the purposes of the undertaking within the foreseeable future.

Joint developments contacts and joint ventures

3.28 Joint development contracts and joint ventures will be valued to market value.

3.29 Agreements for these purposes take many forms. The report must clearly differentiate between:
- the acquisition of a legal estate that gives the right to realise a sum of money, either in capital or income terms, linked to the underlying characteristics of the legal estate to which it is attached and
- a joint development contract, the successful performance of which will bring an entitlement to a sum of money.

3.30 In the case of large-scale projects, or development schemes involving a relatively high degree of uncertainty, developers often enter into binding, non-transferable agreements with landowners to undertake an agreed form of development. The responsibilities and risks are shared in varying proportions, and the ownership of the legal estate can be transferred to a new enterprise or another party. The valuer may be called on to undertake valuations of the interests of the parties involved. In such circumstances the valuer should discuss with the client which approach to adopt.

3.31 Joint development contracts do not require the developer to hold any legal estate, but may include an option or a licence to acquire one. The developer may therefore expect to incur financial benefit or detriment arising directly or indirectly
from its involvement. Such contracts, which often include a management fee, also allow for a profit, in accordance with a pre-determined formula, in the event of a successful outcome.

3.32 The valuation of a joint development contract will therefore involve an assessment of the value of the right to receive a financial benefit at a future date, contingent on performance. The developer, as the recipient of potential future benefit under the contract, must fulfil the obligation to perform all of the terms of the contract. The valuer should consider and interpret all relevant factors, including political, financial, fiscal, legislative, social, economic, market trends and so on, in assessing the developer's probable reward.

3.33 A joint venture may be carried out by a company that owns the land, with shares held by the former landowner and the developer in stated percentages. It can also be undertaken as a partnership between two or more parties, but a partner may have a general or limited liability. Another method is a trust for sale. Such joint ventures will usually provide a formula for the percentage holdings and trading rights of the parties.

Options and other contractual rights which may be saleable and of value

3.34 Options and other contractual rights which may be saleable and of value will be valued to market value.

3.35 The valuer must discuss with the client the actual terms of the options to establish the precise nature of the valuation required.
UK appendix 3 Relationship with auditors

1 Introduction

1.1 This appendix provides guidance to valuers on their relationship with auditors when valuations are to be included or disclosed in published financial statements. It also provides an indication of the information auditors are likely to require.

2 Auditors’ role

2.1 Auditors have a statutory obligation to express an opinion on whether or not the accounts:
   • give a true and fair view, and have been properly prepared in accordance with the Companies Act 2006 (in particular, in accordance with its disclosure requirements) and
   • have been prepared in accordance with applicable accounting standards.

2.2 The Auditing Practices Board’s Statement of Auditing Standards 520 (SAS 520), Using the Work of an Expert, states that:

   When using the work performed by an expert, auditors should obtain sufficient appropriate audit evidence that such work is adequate for the purposes of the audit. SAS 520.1
   When planning to use the work of an expert the auditors should assess the objectivity and professional qualifications, experience and resources of the expert. SAS 520.2
   The auditors should obtain sufficient appropriate audit evidence that the expert’s scope of work is adequate for the purposes of their audit. SAS 520.3
   The auditors should assess the appropriateness of the expert’s work as audit evidence regarding the financial statement assertions being considered. SAS 520.4

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This involves an assessment of whether the substance of the expert’s findings is properly reflected in the financial statements, or supports his or her assertions. It also takes account of:
   • source data used
   • assumptions and methods used
   • when the expert carried out the work
UK appendix 3  Relationship with auditors

- reasons for any changes in assumptions and methods compared with those used in the prior periods and
- results of the expert’s work in light of the auditors’ overall knowledge of the business and the results of other audit procedures.

2.3 When assessing whether the expert has used appropriate source data the auditors may consider:

- making enquiries regarding any procedures undertaken by the expert to establish whether the source data are sufficient, relevant and reliable and
- reviewing or testing the data used by the expert.

2.4 The appropriateness and reasonableness of the assumptions and methods used, as well as their application, are the responsibility of the expert. The auditors do not have the same expertise and therefore cannot necessarily challenge the expert’s assumptions and methods. However, they will seek to obtain an understanding of those used and consider whether they are reasonable, based on their knowledge of the business and the results of other audit procedures. They will also need to decide if they are compatible with the methods used for the preparation of the financial statements.

2.5 If the results of the expert’s work are not consistent with other audit evidence, the auditors will attempt to resolve the inconsistency through discussions with the entity and the expert. Additional procedures, including the possibility of engaging another expert, may also assist in resolving the inconsistency.

3  The auditor’s requests and the valuer’s response

3.1 The valuer should provide the auditors with a copy of the terms of engagement agreed with the client and any subsequently agreed variations of those terms.

3.2 The auditors may ask the valuer to produce information and explanations relating to the purposes of the audit. Legal advice obtained by RICS indicates that there is no legal relationship between the auditors and an external valuer. An external valuer can therefore refuse to produce the file, and even refuse to answer an auditor’s questions, though the valuer should be satisfied that there are reasonable grounds for refusal before taking this action. This does not apply to an internal valuer, who is an officer of the company within the meaning of the Companies Act 2006. However, if an external valuer refuses to cooperate this could constitute a limitation on the scope of the auditors’ work. It may therefore lead the auditors to qualify the reports on the accounts and make some comment that it was not possible to obtain all the information and explanations necessary to the valuation.

3.3 The valuer should therefore be prepared, and have the directors’ permission, to cooperate reasonably and responsibly with any auditors. Indeed, prior to issuing the report, the valuer should bring to the auditors’ attention and discuss as appropriate matters relating to the valuation that may have an impact on the audit and the auditor’s responsibilities. Additionally, there will be occasions when the valuer will welcome the opportunity to verify information and assumptions relevant to valuations.
In some cases a discussion between the auditor and the valuer before the latter starts to fulfil the client’s instructions can be helpful to both parties, and will promote smooth completion of the audit.

3.4 The valuer may be asked, in falling markets, whether the property value has suffered a diminution of value. The valuer should be prepared to give an opinion on the basis of a definition of ‘diminution’ provided by the auditors.
UK appendix 4  Accounting for depreciation and associated apportionments under UK GAAP

1  Introduction

1.1  This appendix provides information on the accounting concepts and standards governing the consideration of depreciation, and associated apportionments, for the purposes of financial statements.

1.2  The relevant accounting standards can be found in FRS 15, Tangible fixed assets. It applies to all tangible fixed assets, with the exception of investment properties, as defined in SSAP 19, Accounting for investment properties. Both FRS 15 and SSAP 19 deal with depreciation of assets carried in an entity’s accounts either at cost or at valuation. This appendix refers expressly to land and buildings, but the information on depreciation applies equally to plant and equipment.

1.3  Depreciation, in accordance with accounting conventions, should not be confused with the deductions made in the course of valuation, for instance, in a depreciated replacement cost (DRC) valuation. The valuer provides the amount for the asset that is included in the balance sheet. The accountant then calculates the provision for depreciation from the asset valuation, or an apportionment if required, without regard to the way in which the value of the asset was determined.

2  Depreciation

2.1  Depreciation is defined in FRS 15 as:

The measure of the cost or revalued amount of the economic benefits of the tangible fixed asset that have been consumed during the period. Consumption includes the wearing out, using up or other reduction in the useful economic life of the tangible fixed asset whether arising from use, effluxion of time or obsolescence through either changes in technology or demand for the goods and services produced by the asset.

FRS 15, © The Accounting Standards Board Limited 1999

2.2  FRS 15 requires that depreciation should be allocated on a systematic basis over the future useful economic life of a fixed asset. The depreciation method used should reflect, as fairly as possible, the pattern in which the asset’s economic
benefits are consumed by the entity. The future useful economic life of an asset is defined in FRS 15 as the period over which the entity (in whose accounts the asset is carried) expects to derive economic benefit from the asset. All buildings have a limited life due to physical, functional and environmental changes that affect their useful economic life to the business.

2.3 As indicated earlier, the future useful economic life of the tangible fixed asset is defined as the period during which the entity in whose accounts the asset is carried expects to derive economic benefit from that asset. This may be its total physical or economic life, however, if there is an expectation that the asset will be sold before the end of its physical or economic life, this period will be shorter.

2.4 In normal circumstances depreciation is not applicable to freehold or feuhold land. Exceptions to this include land that has a limited life due to depletion (for example, by the extraction of minerals), or that will be subject to a future reduction in value due to other circumstances. One example would be where the present use is authorised by a planning permission for a limited period, after which it would be necessary to revert to a less valuable use.

2.5 Leasehold assets must, by their nature, have a limited life to the lessee, although the unexpired term of a lease may exceed the life of the buildings on the land. Any contractual or statutory rights to review the rent, or determine or extend a lease, must also be considered.

2.6 The assessment of depreciation and the remaining useful economic life of the asset are the responsibility of the directors of the company, or their equivalent in other organisations. However, the valuer should expect to be consulted on matters relevant to the assessment, such as the degree of obsolescence, condition, market factors, town planning and so on.

3 The depreciable amount

3.1 As it will be desirable to maintain consistency of practice in future years, the valuer should choose the basis of calculating the depreciable amount in consultation with the directors and auditors.

3.2 FRS 15 defines the depreciable amount as the cost of a tangible fixed asset (or where an asset is revalued, the revalued amount) less its residual value.

3.3 Residual value is defined as the net realisable value of an asset at the end of its useful economic life. It is based on the price prevailing at the date of the acquisition or revaluation of the asset, and does not take account of future price changes.

3.4 Net realisable value is defined in FRS 11, *Impairment of fixed assets and goodwill*, as the amount at which an asset could be disposed of, less any direct selling costs. It should be determined using a basis consistent with that used to determine the carrying amount of the asset. For example, where an asset is valued on an existing use basis, the residual value should also be measured on an existing use basis. The carrying amount of a tangible fixed asset is its cost or revalued amount, less accumulated depreciation.
UK appendix 4  Accounting for depreciation and associated apportionments under UK GAAP

3.5 Tangible fixed assets may be carried in financial statements on one of the following bases, the selection of which will normally constitute the first stage in the calculation of the depreciable amount:

(a) cost less subsequent depreciation as appropriate. Whether acquired or self-constructed, the tangible fixed asset should initially be measured at its cost. This could be either:

(i) the price paid for a completed property, plus directly attributable costs as set out in paragraphs 7–16 and 19–30 of FRS 15 or

(ii) the cost of the land and of erecting the building, plus directly attributable costs as indicated previously;

(b) a professional valuation made in a previous year, less subsequent depreciation as appropriate or

(c) current professional valuation.

3.6 Directors may ask the valuer to provide an estimate of residual value in order to calculate the depreciable amount. Paragraph 95 of FRS 15 states that where the residual amount is material, it should be reviewed at the end of each accounting period.

3.7 In some cases the future useful economic life of the asset to the entity will be considered to be equal to the physical or economic life of the buildings composing the asset. In such cases the valuer will need to consider whether the residual value will comprise a bare site value less relevant costs, or whether the existing buildings or other site improvements will have some continuing value, for example, for refurbishment.

3.8 In other cases there may be an expectation that the asset will either become surplus, or be disposed of before the end of its physical or economic life. Under these circumstances the residual value would reflect the continuing life of the asset beyond the date at which the directors anticipated disposal. Such an expectation would also affect the life during which the asset is to be depreciated, which would become the anticipated period of ownership.

3.9 FRS 15 indicates in paragraphs 83 and 84 that land and buildings are separate components of a tangible fixed asset and, for depreciation purposes, should be accounted for separately. Therefore, where a property is carried in the balance sheet at cost, or has been the subject of a past or present valuation, the valuer will need to ascertain the amount applicable to the buildings and to the land, by an apportionment of the cost or valuation.

4 Apportionment

4.1 The purpose of the apportionment – the removal of the land element from the valuation so as to depreciate only the building element – should be kept firmly in mind. Site works, such as roads, fences, paved areas and the like, are normally included in the value of the buildings and do not, therefore, feature in the land valuation.

4.2 At the end of the useful economic life of the buildings, the full potential of the site for redevelopment within the existing use would be realisable. However, allowance would have to be made for any material costs associated with demolition, site clearance or contamination treatment.
4.3 When providing figures for the purposes of depreciation, the valuer will need to emphasise in the report that the resultant figures, the depreciable amount and the residual amount, are apportionments derived solely for accounting purposes, and that they do not represent formal valuations of the individual elements.

4.4 The apportionment is arrived at in one of the following two ways:

(a) One way is by deducting, from the cost or valuation of the asset, the value of the land for its existing use at the relevant date. In effect this calculates the residual value, unless the valuer believes that there is an additional residual value element in the buildings or site improvements. It is not appropriate to consider alternative uses unless they are reflected in the value at which the property has been included in the balance sheet.

(b) Where there is little or no evidence of land values, greater reliance will have to be placed on making an assessment of the net current replacement cost of the buildings at the relevant date. This figure will be derived from the gross current replacement cost, which is then reduced to the written-down cost or net current replacement cost to reflect the value of the asset to the business. In effect this is a direct calculation of the depreciable amount.

4.5 Gross current replacement cost is defined as either:

- the actual cost of constructing the asset if this was incurred close to the relevant date or
- the estimated cost of erecting the building, or a modern substitute building with the same gross internal area as that existing, at prices current to the relevant date. This figure may include fees, any irrecoverable VAT, finance charges appropriate to the construction period, if required by the accounting policy, and other associated expenses directly related to the construction of the building. A definition of the directly attributable costs that may be included can be found in paragraphs 7–16 and 19–30 of FRS 15.

4.6 Net current replacement cost is the gross current replacement cost, reduced to reflect the physical and functional obsolescence and environmental factors, in order to arrive at the value of the building to the business at the relevant date.

4.7 The relevant date is the effective valuation date or the date of apportionment.

4.8 In the case of leasehold land and buildings, the total value will be the depreciable amount, except where the lease is likely to continue beyond the remaining useful economic life of the asset.

4.9 The valuer should make it clear that in assessing the depreciable amount, the availability of government grants should be ignored, leaving the entity to make any appropriate adjustments.

4.10 The inclusion and exclusion of plant and equipment in a valuation of land and buildings should normally follow VPGA 5, Valuation of plant and equipment.

5 Valued as an operational entity

5.1 Where the valuation relates to property valued fully equipped as an operational entity, the valuation figures may need to be apportioned among:

- land
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- buildings
- fixtures and fittings and
- trading potential.

5.2 Paragraph 85 of FRS 15 suggests that it would not be appropriate to treat the trading potential associated with the property as a separate component of the value of the asset if its value and life were inherently inseparable from that of the property (see also VPGA 4, Valuation of individual trade related properties).

6 Future useful economic life

6.1 In order to form an opinion of the future useful economic life of buildings, the valuer will need to take into account the following matters:

- **physical obsolescence** – the age, condition and probable costs of future maintenance (assuming prudent and regular maintenance)
- **functional obsolescence** – suitability for the present use, and the prospect of its continuance or use for some other purpose by the business. In the case of buildings constructed or adapted for particular uses, including particular industrial processes, the valuer will need to consult with the directors to ascertain their future plans
- **environmental factors** – existing uses must be considered in relation to the present and future characteristics of the surrounding area, local and national planning policies, and restrictions likely to be imposed by the planning authority on the continuation of these uses
- **policy on future disposals** – the valuer will need to consult with the entity to ascertain whether there is any intention or policy to dispose of assets before the end of their natural lifespan.

6.2 It is frequently difficult, even impossible, to put a precise life on a building or a group of buildings. The valuer may therefore have to resort to ‘banding’. It should be possible to identify buildings that are unlikely to remain beyond 20 years, as well as other buildings with a life of more than 50 years, in which case, those should be noted as having a life of ‘not less than 50 years’. Clearly the valuer’s task will be made easier by the use of broad bands, and in the majority of cases it is likely that these will meet the company’s requirements.

6.3 Where a property comprises a number of separate buildings, for example, large factory premises, the buildings should be grouped and, wherever possible, a single life allocated to all buildings within each group. Such an approach can be justified by the fact that the life of individual buildings can usually be extended, within reasonable limits, by a higher standard of maintenance or minor improvement. It is normally uneconomical to carry out piecemeal redevelopment.

6.4 It would not be appropriate to group buildings if they are used for different industrial processes with different accommodation requirements, or where the client requires each building to be considered individually.

6.5 If consulted on the remaining useful economic life of leaseholds, the valuer must also consider the duration of the lease, any options to determine or extend, the date of the next rent review and whether this is to full, or a proportion of, rental value.
7 Investment properties

7.1 Under SSAP 19 periodic charges for depreciation are not required for investment properties except for those held on lease when the unexpired term is 20 years or less.

8 Depreciation of a wasting asset

8.1 Provision of depreciation for a wasting asset is not primarily the concern of the valuer. Generally, the depreciable amount will be the difference between the present market value (PMV) and the ‘after-use’ value, but associated costs, such as restoration costs, may also need to be taken into account. The future useful economic life will be assessed by the entity once it is advised of the life that the valuer has assumed for the purposes of the valuation.

9 Apportionments of value in respect of property that comprises only part of a building

9.1 Special care is recommended in dealing with the apportionment of value in respect of property that comprises only part of a building (of particular relevance in Scotland), with the remaining parts being separately owned by one or more other proprietors. This care is particularly relevant in considering the residual amount representing the value of land.

9.2 It is commonplace in Scotland for premises to be owned in perpetuity, even though those premises do not exclusively occupy the land on which they are situated. A building can contain various proprietors, and it is quite usual for this type of ownership to carry with it a common interest on the part of the various proprietors in certain sections of the building outwith the actual premises occupied by them.

9.3 The presence (or otherwise) of other proprietors within 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.

9.4 The valuer dealing with an apportionment of value in cases where common interest exists must 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.

9.5 When dealing with property where there are other proprietors 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.

9.6 There might be cases where complications are encountered in defining or ascertaining the rights of the other proprietors in the building, but it is essential that if common interest exists, its effect is taken into account. If this is done, the valuer should be able to arrive at an apportionment where the depreciable amount fairly reflects the part of the market value or cost of the whole property at the time it was acquired or valued. This can be expressed at that time as the value to the business
of the buildings on the land. Similarly, the residual amount should properly represent
the element of land value that could be realised at the end of the day.
UK appendix 5 Valuation of local authority assets

1 Introduction

1.1 The financial statements of local authorities from 2010/11 onwards must be in accordance with the International Financial Reporting Standards (IFRS)-based Code of Practice on Local Authority Accounting (the ‘Code’), published by Chartered Institute of Public Finance and Accountancy (CIPFA).

1.2 This appendix provides guidance to valuers on the application of the Code to the valuation requirements. It has been developed in conjunction with CIPFA.

1.3 The general principles underlying the valuation of local authority assets are no different from those for any entities, but the Code incorporates additional guidance for public sector bodies and introduces the concept of service potential.

1.4 The valuation requirements are the following:

- Apart from infrastructure, community and assets under construction, the basis of value for all assets is to be fair value, i.e. the IFRS 13 definition of fair value (including council housing, which will reflect the social housing nature of assets and therefore is to be valued based on EUV-SH – see section 3 below).
- Leases of land and buildings are to be separated into land and building elements, and classified and accounted for separately (see section 4 below).
- Investment property is to be valued at fair value, including investment property under construction where its fair value can be reliably determined (see section 5 below).
- Assets held for sale shall be valued at fair value less costs to sell (see section 6 below).
- For depreciation purposes assets are to be recognised on a component basis where components have a significant cost and the components have materially different asset lives, or different depreciation methods are used (see section 7 below).
- Residual values are to be based on current prices at the balance sheet date.

1.5 The valuer’s role is to provide assistance on the identification and classification of assets and, essentially, to provide the fair value of those assets in accordance with the Code where such a value is required.

1.6 Subject to any assumptions that the Code requires, fair value is the same as market value. For further guidance on fair value see VPS 4 paragraph 1.5, Fair value.

1.7 The valuer will not normally be involved in any interpretation of the Code relating to the treatment of assets in the accounts once the values have been established.
2 Classification of assets

2.1 Property assets are to be classified into one of the following groups:

- **Property, plant and equipment**: Authorities shall account for all tangible fixed assets in accordance with International Accounting Standards (IAS) 16, *Property, Plant and Equipment*, except those more specifically listed in this appendix or where the Code has detailed interpretations or adaptations to fit the public sector (see section 3 below).

- **Leases and lease type arrangements**: Authorities shall account for leased assets in accordance with IAS 17, *Leases*, except where the Code has detailed interpretations or adaptations to fit the public sector (see section 4 below).

- **Investment property**: Authorities shall account for investment property in accordance with IAS 40, *Investment Property*, except where the Code has detailed interpretations or adaptations to fit the public sector (see section 5 below).

- **Assets held for sale**: Authorities shall account for assets held for sale in accordance with IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, except where the Code has detailed interpretations or adaptations to fit the public sector (see section 6 below).

2.2 Although there is no requirement to do so in the Code, authorities may wish to divide the classifications into further groups, and the valuer will report accordingly.

3 Valuation of property, plant and equipment

3.1 Infrastructure, community assets and assets under construction (excluding investment property where the fair value can be reliably determined) shall be measured at historical cost, and the option given in IAS 16 to measure at fair value is withdrawn. Examples of this category of asset are given in section 8 below.

3.2 All other assets in this category shall be measured at fair value. The separate valuation requirements that apply to leases, investment property, assets held for sale and depreciation are dealt with in sections 4 to 7, respectively.

3.3 Pending the formal clarification by the International Accounting Standards Board (IASB) on the application of fair value to property, the Code requires the following values to be reported:

- For land and buildings, fair value is to be interpreted as the amount that would be paid for the asset in its existing use. This requirement is met by providing a valuation on the basis of EUV in accordance with UKVS 1.3.

- Where it is significantly different, market value (that is, the valuation does not disregard alternative uses) is to be reported. A statement should be made that no account has been taken of issues such as reducing the service potential or disruption, and the associated costs that would be incurred in achieving that alternative use.

Authorities will use the EUV in their financial statements. The market value will be used to inform the asset management plans/strategies of authorities.
3.4 The role of the valuer is to provide relevant valuations and discuss with authorities the reasons for the differences in the values provided. Authorities will decide the appropriate accounting treatment.

3.5 The use of depreciated replacement cost (DRC) is recognised in appropriate circumstances. The valuer must have regard to the requirements of UKVS 1.16, Valuations based on depreciated replacement cost. In addition UK GN 2, Depreciated replacement cost method of valuation for financial reporting, contains detailed information on the use and application of DRC when valuing for financial statements.

3.6 The fair value of council dwellings shall be measured using EUV-SH (as defined in UKVS 1.13). Guidance on this, Stock Valuation for Resource Accounting 2010: Guidance for valuers, was published by the Department for Communities and Local Government in January 2011. In Scotland and Wales the basis of value is also EUV-SH, but there is no specific valuation guidance covering the housing revenue account.

3.7 The Code requires that where assets are revalued, the entire class (that is, one of the classes listed in section 2 above) shall be revalued. However, a full valuation may be on a rolling basis, which would typically be over a five-year cycle, within a short period, provided the valuations are kept up to date. More frequent valuations would be required where assets experience significant and volatile changes that result in the fair value differing materially from the carrying amount.

3.8 The detailed requirements with regard to private finance initiative (PFI) and public private partnership (PPP) arrangements are in chapter 4, section 3, of the Code. In broad terms the arrangement is initially recognised under IAS 16 and measurement is based on cost. Subsequent measurement of the infrastructure is the same as other property under IAS 16, and the detailed requirements are set out in the Code in chapter 4, paragraphs 3.2.8 to 3.2.11.

3.9 With regard to playing fields, it is essential to establish their status before deciding on the basis of value. Until they have been declared ‘held for sale’ they remain part of the existing use, and paragraph 7.10 of UKGN 2 should be considered.

3.10 In considering the market value of playing fields, the valuer should take particular care to establish with the local planning authority what alternative planning permission would be available. Planning permission for building on the land is often found to be not forthcoming due to a local shortage of open space.

4 Leases and lease type arrangements

4.1 Leases are recognised, measured and accounted for in accordance with IAS 17 subject to the interpretations in the Code. Leases that are held as investment property by lessees, or investment property held by lessors under operating leases, are measured under IAS 40, Investment Property (see section 5 below).

4.2 Where the valuer is requested to provide advice to assist in the classification of a lease as being financial or operational, the guidance in IVS 300 Valuations for Financial Reporting, paragraphs G20 to G28 Lease classification, applies. In addition, the information on the approach to classification in UKGN 1, Land and buildings apportionments for lease classification under IFRS, may also be of assistance.
4.3 The amounts to be recognised in the balance sheet where a lease is a finance lease are calculated in accordance with IAS 17. In summary this states that lessees should recognise assets acquired under finance leases as such and the associated lease obligations as liabilities. The assets and liabilities should be recognised at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of the minimum lease payments.

4.4 The valuer may be requested to provide the fair value of the leased property. This is not the value of the interest in the lease, but the underlying market value of the property reflecting the presumption of a finance lease that it transfers substantially all the risks and rewards incidental to ownership of an asset.

4.5 The Code provides specific rules for the recognition of leases and distinguishes between those held as lessee and those held as lessor.

**Held as lessee**

4.6 **Operating lease**: Lease payments are recognised as an expense on a straight-line basis over the lease term, unless another systematic basis is more representative of the benefits received by an authority. No valuation is required as assets are not held on the balance sheet of a lessee under an operating lease.

4.7 **Finance lease**: Initial recognition as assets and liabilities in the balance sheet is at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. After initial recognition, leased assets are measured in the same way as any other assets under IAS 16 and are subject to impairment checks under IAS 36, Impairment of Assets.

**Held as lessor**

4.8 **Operating lease**: Initial recognition as assets in the balance sheet is at cost. After initial recognition, leased assets are measured in the same way as any other assets under IAS 16 and are subject to impairment checks under IAS 36. Income is recognised on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which the benefit derived from the leased assets is diminished.

4.9 **Finance lease**: The asset is recognised as a receivable at an amount equal to the net investment in the lease. The Code provides that the finance income shall be calculated so as to produce a constant periodic rate of return on the net investment. The valuer is not involved in this calculation.

4.10 Leases of land and buildings are classified as finance or operating leases in the same way as leases of other assets. However, the land and building elements of a lease of land and buildings are considered separately for the purposes of lease classification, therefore an apportionment is required between the land and the building elements. UKGN 1 provides detailed information on apportionment methods. An apportionment for this purpose should not conflict with any apportionment required for the calculation of depreciation (see section 7 below).
5 Valuation of investment property

5.1 An investment property is one that is used solely for rentals or capital appreciation, or both. Property that is used to facilitate service delivery, as well as for rentals or capital appreciation, is not investment property and should be recognised and measured under IAS 16.

5.2 Investment property is to be accounted for in accordance with IAS 40 at fair value and the option to measure at cost model is not permitted.

5.3 The Code requires the valuer to provide the market value of the property reflecting any current leases, current cash flows and reasonable assumptions about future rental income or outgoings.

5.4 Property held by a lessee under an operating lease may be accounted for as an investment property only if the property would otherwise meet the definition of investment property. In such cases the lease shall be accounted for as if it were a finance lease.

5.5 The fair value of investment property held under a lease (that is, where the authority is the lessee) is the lease interest, not its underlying market value.

6 Valuation of assets held for sale

6.1 The authority is required to identify and separately account for assets where they meet the strict criteria, as set out in the Code (also see IFRS 5), for classification of assets as held for sale.

6.2 Assets held for sale may be included at fair value less costs to sell (if lower than the carrying amount of the asset). Where the valuer makes an adjustment for the costs to sell, this must be made clear in the report to avoid double counting.

6.3 The Code requires the valuer to provide the market value of the property.

7 Accounting for depreciation

7.1 General guidance on depreciation for accounting purposes is given in UK appendix 4.

7.2 IAS 16 recognises that, with a few exceptions, land does not depreciate and therefore requires the land and buildings to be recognised as separate assets. The allocation of the value between these two elements has been a requirement for many years.

7.3 IAS 16 also provides 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.’ (paragraph 43)

However:

- where there is more than one significant component part of the same asset that has the same useful life and depreciation method, such component parts ‘may be grouped [together] in determining the depreciation charge’ (paragraph 45); and
‘to the extent that an entity depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant’ (paragraph 46).

7.4 In practice, IAS 16 requirements can be satisfied by separately accounting for only those significant components that have different useful lives and/or where different depreciation methods are applied to the remainder of the asset. However, an entity may choose to depreciate separately the parts of an asset that do not have a cost considered significant in relation to the total cost of the asset.

7.5 For this purpose the ‘asset’ is the non-land element recognised in the accounts. A full explanation of the principles and the accounting requirements is set out in the CIPFA Local Authority Accounting Panel (LAAP) Bulletin 86, Componentisation of Property, Plant & Equipment under the 2010/11 IFRS-based Code, published in June 2010, which should be read in conjunction with this advice.

7.6 The bulletin sets out six steps in the consideration of materiality. Briefly these are:

1 Identify a de-minimis threshold for assets to be disregarded for componentisation.
   This step is the consideration of the non-land element as a whole before considering any components.
2 Assess the materiality of the non-land element in relation to overall assets (excluding the land element).
   This step is the identification of individual assets that are below the de-minimis level and can be disregarded for componentisation on the basis that any adjustment to depreciation charges would not be material. Also groups of similar assets that individually are below de-mininis for componentisation may collectively be material for componentisation.
   Note that when assessing the materiality of individual assets relative to overall assets, it may be more practical to use carrying values (instead of cost), as a basis on which to determine materiality. However, cost must be used when determining the significance of components (of an asset) relative to that asset.
3 Set the policy for componentisation to determine which components will be depreciated separately.
4 Discussion of componentisation principles between professionals.
5 Relevant professionals to determine useful lives of significant components.
6 Attribute value to significant components.

The bulletin stresses that accountants and other professionals are required to use professional judgment when establishing materiality levels, assessing the significance, useful lives and depreciation methods of components, and apportioning asset values over recognised components. Discussions with external auditors should be held at key stages in the process.

7.7 The consideration of components is, as a minimum, required where an asset:

• is the subject of enhancement expenditure
• is acquired (with or without expenditure, for example, donated assets) and

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Identification of components

7.8 The two key considerations are the identification of the significant components of the asset and the useful life of those components in relation to the useful life of the asset (that is, the non-land element) as a whole.

7.9 When considering the number of components in the non-land element, it is not possible to specify what is ‘significant’ on a universal basis. What is significant for one building may not be significant for other similar buildings. However, the following comments may assist the valuer when providing advice:

- A structure may have many separate components, and the number to be identified will need to be established during the discussions on materiality, the agreed thresholds and any asset management requirements.
- It is likely that where many components are identified, most may have a similar life and therefore they may be aggregated for depreciation purposes. It is only those elements that normally depreciate at a different rate from the non-land element as a whole, or require a different method of depreciation, that should be identified.
- The pattern of the authority’s expenditure on similar types of building will give an indication of those elements of the asset that needed extensive repair or renewal before the expected life has been reached. For instance, there may be a rolling programme for the renewal of roofs on schools.
- Different criteria may be required where a building is identified as being close to the end of its useful life, because the proportions of the component values will change over time, or when the expected life is short, the identification of components may be irrelevant.
- For specialised buildings the DRC approach may have been developed on a component approach, and so the identification of the components would reflect the details of the calculation.

7.10 The apportionment process is set out in the following steps:

Step 1: The apportionment of the land value should be based on the same approach as currently adopted by the valuer. Deducting this figure from the total asset value provides the carrying amount of the non-land element of the asset.

Step 2: The de-minimis threshold should be applied to the non-land element to establish whether or not the asset will be considered for componentisation. Where assets are material and will therefore be reviewed for significant components, it is recommended that the minimum level of apportionment for the non-land element of assets (that are not classified as social housing) is:

- plant and equipment and engineering services and
- structure.

To assist in asset management, the authority may wish to identify more components for all its assets, but there is no requirement for this to be done. Even where the cost of a component is significant in relation to the total cost of the non-land element of an asset, from an accounting perspective it is not necessary to identify that component separately, if its useful life and required method of depreciation is in line
with the overall asset. In the case of social housing the level of componentisation will be governed by the separate accounting requirements for the Housing Revenue Account.

Step 3: The estimate of the plant and equipment element should reflect its value as part of the existing building. Various methods may be used ranging from a DRC approach to a best estimate. Having established this figure, it is deducted from the non-land element and the remaining figure represents the apportioned value of the structure.

Step 4: Where the authority has decided to recognise more than the two minimum components for specific assets, each component will be separately identified and depreciated over its separate life and/or method of depreciation. Where the original valuation is derived from a DRC approach, this should be straightforward. In other cases, particularly for plant and equipment components, it is recommended that a simplified cost calculation is made, with the difference between the value of the asset and its plant and equipment components relating to the remainder (for example, the structure) of the asset. Whatever approach is adopted, the sum of the component costs cannot exceed the reported overall value of the asset.

7.11 This appendix does not cover the de-recognition and recognition of components (that is, when enhancement expenditure takes place). This is discussed in detail in LAAP Bulletin 86, which complies with the requirements of the Code in chapter 4, paragraphs 1.2.47–1.2.48 and 42.10.

8 Examples of asset categories measured at cost

Assets under construction

8.1 Investment property under construction is valued at fair value, where this can be measured reliably.

Infrastructure assets

8.2 Examples of infrastructure assets include:
- roads
- sea defences
- bridges
- permanent ways
- water drainage and
- street furniture.

Community assets

8.3 Community assets are described in the Code as ‘assets that the local authority intends to hold in perpetuity, that have no determinable useful life, and that may have restrictions on their disposal.’ If the asset is used for a specific operational purpose, it does not qualify as a community asset and should be valued accordingly.
8.4 Examples of community assets include:
- parks (but not a golf course within a park)
- historic buildings (but not if used for, say, a museum or office accommodation)
- works of art, museum exhibits and statues
- civic regalia
- cemeteries and crematoria (land only) and
- allotments (where there are restrictions on alternative uses).

8.5 The following questions can be used to test for community assets:
- Is the intent to hold the asset forever?
- Does the asset have an indeterminable useful life?
- Are there restrictions on disposal?

To qualify as a community asset, the answers for questions (1) and (2) have to be 'yes', while an affirmative answer to question (3) is not obligatory but a helpful contributory factor.
UK appendix 6 Examples of published references to valuation reports

1 Introduction

1.1 The following examples are intended to be illustrative only of the typical degree of detail required for published references to valuation reports. The valuer must have due regard to the requirements of VPS 3 paragraph 7(j), Restrictions on use, publication and distribution and produce a statement that reflects the scope and nature of the property valued.

2 Valuation by an external valuer

2.1 The company’s freehold and leasehold properties were valued on 31 December 2012 by an external valuer, Joe Smith, FRICS of Alpha Chartered Surveyors. The valuations were in accordance with the requirements of the RICS Valuation – Professional Standards 2012 and FRS 15 (and any other regulatory requirements).

2.2 The valuation of each property was on following bases of value and assumptions:

- owner-occupied property: valued to existing use value (EUV) assuming that the property would be sold as part of the continuing business
- investment property: valued to market value assuming that the property would be sold subject to any existing leases and
- surplus property and property held for development: valued to market value assuming that the property would be sold with vacant possession in its existing condition.

2.3 The valuer’s opinion of market value and EUV was primarily derived using (include as appropriate):

- comparable recent market transactions on arm’s length terms
- depreciated replacement cost approach, because the specialised nature of the asset means that there are no market transactions of this type of asset, except as part of the business or entity
- an estimate of the future potential net income generated by use of the property, because its specialised nature means that there is no market-based evidence available.

2.4 Similar comments may be appropriate where the valuation is of plant and equipment or mineral bearing land.
2.5 A statement regarding disclosures should be made in accordance with VPS 3 paragraph 7 and UKVS 4.3.

3 Valuation by an internal valuer

3.1 The statements will be the same as those for valuations by an external valuer, except for the following variations of the first sentence:

The company’s freehold and leasehold properties were valued by an internal valuer, Joe Smith FRICS, the company’s chief estates surveyor, as at 31 December 2012.

The company’s freehold and leasehold properties were valued as at 31 December 2012, by the directors in conjunction with the company’s own professionally qualified staff.

Where appropriate, at the end of the statement, the following variation may be included:

A representative sample of properties was also valued on the same basis by external valuer, ABC Chartered Surveyors, who confirmed that values proposed by the company’s professionally qualified staff are at level(s) consistent with its own figures.
UK appendix 7  FCA Listing Rules

RICS specification for reports for inclusion in prospectuses or shareholders circulars to be issued by UK companies

1  Introduction

1.1 This specification is supplementary to VPS 3, Valuation reports. It does not replace VPS 3, but provides guidance on the content of reports prepared for this purpose. Where the valuation is of a portfolio of properties, VPGA 8 is relevant.

1.2 The FCA Handbook allows valuations for inclusion in prospectuses or shareholder circulars to be in a condensed form in specified circumstances. However, a condensed report must still meet the requirements of VPS 3, Valuation reports, and published references to them. A condensed report must be distinguished from a publication statement under VPS 3 paragraph 7(j), Restrictions on use, publication and distribution.

1.3 The FCA Listing Rules can be found at www.fshandbook.info/FS/html/FCA/LR

2  Reports for inclusion in prospectuses

2.1 All UK-domiciled property companies seeking FCA approval, under the FCA Prospectus Rules for the publication of a prospectus, must include a property valuation report by an expert valuer in the prospectus. However, the report may be in a condensed form. Property companies are defined as those issuers whose principal activity is the purchase, holding and development of properties for letting and retention as an investment.

2.2 A condensed valuation report may also be included when the prospectus relates to a ‘property collective investment undertaking’, which is a collective investment undertaking whose investment object is the participation in the holding of property long term.

3  Reports for inclusion in circulars

3.1 When a UK-listed company proposes an acquisition or disposal of property, and the transaction is classified under the FCA Listing Rules as either a class 1 transaction (where the size of the transaction exceeds 25% of the value of the company) or a ‘related party’ transaction, the company must seek shareholder
approval. In either instance, it must include a property valuation report by an expert valuer in the circular to shareholders. The company decides the classification of the transaction, but full definitions may be found in the FCA Listing Rules.

3.2 A UK-listed company must also include a property valuation report where it makes significant reference to the value of property in a class 1 circular to shareholders.

4 Status of the valuer

4.1 The valuation report must be prepared by an independent expert. For this purpose an independent expert is an external valuer as defined in the Glossary.

4.2 The independent expert must disclose any material interest, if any, in the issuer. A material interest includes the following circumstances:

- ownership of securities issued by the issuer or any company belonging to the same group, or options to acquire or subscribe for securities of the issuer
- former employment of, or any form of compensation from, the issuer
- membership of any of the issuer’s bodies and
- any connections to the financial intermediaries involved in the offering or listing of the securities of the issuer.

4.3 It is the issuer’s responsibility to consider if the information provided will result in a material interest, taking into account the type of securities offered. The issuer is also responsible for clarifying that these securities have been taken into account, in order to fully describe the material interest (if any) of the expert, to the best of the issuer’s knowledge.

4.4 The valuer and the valuer’s staff must be aware of the Criminal Justice Act 1993, Part V – Insider dealing, and the valuer must ensure compliance with the law. In case of doubt, legal advice should be sought.

4.5 A valuer who attends meetings with clients and other advisers (such as lawyers, stockbrokers, accountants and investment bankers) should be aware of assuming any role which could be regarded as that of a ‘financial adviser’ within the provisions of the Financial Services and Markets Act 2000. If this were the case, the valuer must be a registered member of a professional regulatory organisation. Although the role of a valuer would not normally fall within the definition, an extended involvement could lead to this – for example, in providing profit forecasts or commenting on them. If valuers have any doubt about their position, they should take legal advice, preferably before attending any meeting.

5 Valuation requirements: the Prospectus Rules

5.1 Valuations for the FCA Prospectus Rules are to be on the same basis as adopted by the issuer for accounting purposes (either IFRS or UK GAAP).

5.2 Where the issuer is a property company resident in the UK, a valuation report must be included in the prospectus, but it can be in a condensed form only.

5.3 The effective valuation date can be up to one year prior to the date of publication of the prospectus, provided that the issuer affirms in the prospectus that
no material changes have occurred since the valuation date. If the valuer has previously provided a valuation for accounting purposes and the date of that valuation is within the time limit, the condensed report will relate to that valuation and no additional valuation is required.

5.4 Where the issuer cannot affirm that no material changes have occurred, the effective valuation date must be at the latest practical date. Where the material change relates to only part of the issuer’s portfolio, only that part needs be valued at the latest practical date.

5.5 Where the report to be published includes information considered by the issuer to be commercially sensitive, the issuer may decide to delay disclosure of that information, which is acceptable provided its omission will not mislead the public. In such cases the valuer may amend the report appropriately, but must make a reference to the omission and state that this has been done on the express instructions of the issuer.

6 Valuation requirements: the Listing Rules

6.1 The basis of value for the FCA Listing Rules is market value.

6.2 Where the valuation report refers to a portfolio of 60 or more properties, the valuation report to be included in the publication may be in a suitably condensed format.

6.3 The effective valuation date must be within 42 days of the date of the circular. The report is to be dated the same day as the circular is issued, or the same day as any other documents that will be incorporated.

7 Framework for condensed reports

7.1 A condensed report need not include descriptive details of the properties, but must include the minimum information required by VPS 3, Valuation reports, and UKVS 4, Regulated purpose valuations. The following framework adopts the minimum terms set out in VPS 3 but with comments specific to the preparation of reports under the Prospectus Rules and Listing Rules.

<table>
<thead>
<tr>
<th>Item</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Identification and status of valuer</td>
<td>The report must confirm the valuer is acting as an external valuer and as an independent expert under the rules. The statement that the valuer has the knowledge, skills and understanding to undertake the valuation competently should be made in this section. As this is a regulated purpose valuation, the disclosures required by UKVS 4.3 must be included.</td>
</tr>
<tr>
<td>(b) Identification of the client and any other intended users</td>
<td>The report must be addressed to the client, or its representatives.</td>
</tr>
</tbody>
</table>
(c) Purpose of the valuation
This may include a comment that the report is a condensed version prepared for the relevant rules.

(d) Identification of the asset or liability to be valued
A brief overview of the asset(s) being valued is required – i.e. the number of interests involved, whether freehold or leasehold, type (e.g. retail, industrial, leisure), location (e.g. throughout UK, in central London) and whether held as investment(s), for development or for owner occupation.

(e) Basis of value
For prospectuses the basis required is the same as required for inclusion in the company’s accounts. For circulars the basis is *market value*.

(f) Valuation date
This must be within one year of the publication date for a prospectus and 42 days for a circular.

(g) Extent of investigation
The report must record the date(s) and extent of the *inspection(s)* undertaken. Where a substantial number of properties are being valued, a generalised statement of these aspects is acceptable, provided that it is not misleading.

(h) Nature and source of information relied on by the valuer
A summary of the information relied on is acceptable, provided that it is not misleading. Valuers should also include any additional information that has been available to, or established by, them that they believe to be crucial to the reader’s ability to understand and benefit from the valuation.

(i) Assumptions and special assumptions
All *assumptions* must be stated together with any reservations that may be required (see VPS 4 paragraph 2, Assumptions). Where property is located in more than one state, any variation of *assumptions* in each state must be made clear.

*Special assumptions* (VPS 4 paragraph 3, Special assumptions) must be clearly stated and confirmed as agreed with the client.

Where the valuation reflects marketing constraints (VPS 4 paragraph 4, Valuations reflecting an actual or anticipated market constraint and forced sales), restricted information (VPS 3 paragraph 7(h)) or limited *inspection* (VPS 3 paragraph 7(g)), the report must include full particulars.

Any *departures* from the standards must be stated and explained (PS 1 paragraph 7, Departures).
<table>
<thead>
<tr>
<th>UK appendix 7  FCA Listing Rules</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(j) Restrictions on use, distribution or publication</strong></td>
</tr>
</tbody>
</table>
| As this condensed report will be published in its entirety, it will be appropriate to include consent for publication in the specific prospectus or circular in it, but otherwise to reserve the valuer's rights to it being reproduced or referred to in any other document. 
For prospectuses, the report should not include any disclaimer to the effect that liabilities to the *third parties* are excluded. 
For circulars, the report may include a disclaimer to the effect that liabilities to *third parties* are excluded but may not disclaim responsibility to the company, its directors or its shareholders. 
A statement that the report may not be used for any other purpose than that stated may be included, provided that the purpose of the valuation report is clearly stated in the report as being for inclusion in the issuer's prospectus. |
| **(k) Confirmation that the valuation has been undertaken in accordance with these standards** |
| Where the report is for inclusion in a prospectus and the company has adopted IFRS, confirmation is also required that the valuation accords with these standards and with International Valuation Standards. |
| **(l) Valuation approach and reasoning** |
| This is as VPS 3 paragraph 7(l), Valuation approach and reasoning. |
| **(m) Amount of the valuation or valuations.** |
| The valuations are to be summarised in the same categories determined under (d), identifying separately freeholds and leaseholds. Any negative values (liabilities) must be reported separately. 
The aggregate values and numbers of properties in each category are to be stated. Where the value of any individual property amounts to more than 5% of the aggregate valuation, the property must be specifically identified and the individual value disclosed. 
Where appropriate, state the currency that has been adopted. 
It may be appropriate to state that further details of individual properties are available for inspection, or on request, if this has been agreed with the client. |
Subject to any agreement that certain property information be kept confidential, the report should not omit information that would assist the reader to interpret the valuations. The following disclosures therefore must also be made, where appropriate:

- reports must include a statement about the extent to which the values are supported by market evidence, or are estimated using other valuation techniques (which shall be disclosed) because of the nature of the property, limited transactions or any combination of these factors
- where *special assumptions* have been made, alternative figures may be required to illustrate their effect and
- for property in the course of development, the *market value* will reflect the value of the completed property, assuming that it had been completed at the *valuation date*, less the anticipated costs to complete, including the costs of finance and other holding costs.

Statements must be also be made as to whether or not:

- any allowance has been made for liability for taxation that may arise on disposal, whether actual or notional
- the valuation reflects costs of acquisition, disposal or reorganisation.

| (n) Date of the valuation report | The *date of the report* is to be the same as the date of issue, or such other date that is the same as any other documentation to be published. |
UK appendix 8 Takeovers and mergers

1 Introduction

1.1 This appendix contains a summary of the asset valuation provisions set out in Rule 29 of the Takeover Code. According to this rule, the valuer is considered to be an adviser and must comply with the Code. Before accepting instructions, it is essential that the valuer checks the extant version of the Code to ensure that all its requirements are met (see www.thetakeoverpanel.org.uk).

1.2 All the valuer’s colleagues (professional, administrative and secretarial) who provide assistance may be considered to be advisers. Other partners and employees not involved are normally excluded.

1.3 A register of the holdings of securities that the valuer and colleagues have in the company, or companies, concerned must be maintained, including ‘nil’ returns and the holdings of spouses and dependent children. The valuer should advise the client of the totals or of any nil return.

1.4 No dealings in shares and other securities, or rights over these, may be made before or during the offer. The restrictions of the Criminal Justice Act 1993 apply, as does Rule 4, Restrictions on Dealings, of the Code. The valuer and any colleagues involved in a takeover or merger must observe the law, which also embraces spouses and dependent children. The rules also cover acquisitions and realisations of share holdings, and the valuer and colleagues must comply with them.

1.5 The valuer may consult the Executive of the Panel directly to seek advice. It is not necessary to do this through the company’s advisers. In fact, the valuer may prefer not to involve them, particularly if subject to pressure to do something that is not in accordance with professional and ethical standards and these standards.

2 Status of the valuer

2.1 The valuation must be provided by a named independent valuer. The Code states that an independent valuer means a corporate member of RICS who is an external valuer as defined in these standards, and who has no connection with other parties to the transaction.

2.2 The valuer must be able to demonstrate compliance with PS 2 paragraph 3, Member qualification, and with any legal or regulatory requirements that apply.

2.3 The Code contains various provisions relating to the independence of advisers. Where potential conflicts are identified it may not be possible to resolve them by isolating information or assigning different personnel to the transaction. ‘Chinese walls’ may not be regarded as adequate (see PS 2 paragraph 5, Maintaining strict
separation between advisers). Where doubt exists, the compliance unit, or a similar disinterested unit of the valuer’s firm, must consult the Panel. Otherwise, legal advice should be sought.

3 Basis of value

3.1 The basis of value will normally be market value as defined in VPS 4 paragraph 1.2, Market value. If the company’s accounts are prepared under UK Generally Accepted Accounting Principles (UK GAAP) with the consent of the Panel, the basis of value set out in UKVS 1.1 may be used.

3.2 The basis of value must be clearly stated in the valuation report. Only in exceptional circumstances should it be qualified, in which case the valuer must explain the meaning of the words used. Similarly, special assumptions (see VPS 4 paragraph 3, Special assumptions) should not normally be made in a valuation, but if assumptions are permitted by the Panel, they should be fully explained (see VPS 3 paragraph 7(i), Assumptions and special assumptions).

3.3 In the case of land currently being developed or with immediate development potential, in addition to giving the market value in the state as at the valuation date, the valuation should include:

(a) the value after the development has been completed
(b) the value after the development has been completed and let
(c) the estimated total cost, including carrying charges, of completing the development, and the anticipated dates of completion and of letting or occupation, and
(d) a statement whether planning consent has been obtained and, if so, the date thereof and the nature of any conditions attaching to the consent that affect the value.

4 Reporting the valuation

4.1 The effective date at which the assets were valued must be stated together with the professional qualifications and address of the valuer. If a valuation is not current, the valuer must state that a current valuation would not be materially different. If this statement cannot be made, the valuation must be updated.

4.2 The Code requires that the opinion of value must be contained in the offer document, and the valuation report must also be put on display (see VPS 3 paragraph 7(j), Restrictions on use, distribution or publication). Where the valuation report includes material that may be commercially sensitive, the Panel may allow publication in a summarised form.

4.3 In some exceptional cases, it will not be possible for a valuer to complete a full valuation of every property. The Panel may be prepared to regard the requirements of Rule 29 as met if the valuer carries out a valuation of a representative sample of properties and reports those valuations. In such case the directors must take sole responsibility for an estimate, based on the sample, to cover the remaining properties. This procedure will be available only where the portfolio as a whole is within the knowledge of the valuer, who must also certify the representative nature of
UK appendix 8  Takeovers and mergers

the sample. Where this is done, the document should distinguish between properties valued professionally and those where the directors have made estimates on the basis of the sample valuation. The document should also compare such estimates with book values.
UK appendix 9 Collective investment schemes

1 Introduction

1.1 This appendix provides information on the land and property valuation requirements in the FCA Collective Investment Schemes Sourcebook (COLL).

1.2 To avoid confusion, valuers should be aware that the sourcebook uses the term ‘scheme property’ in a very wide sense, which is not restricted to real estate. An ‘immovable’ is a freehold or leasehold interest in England and Wales, any interest or estate in or over land, or heritable right (including a long lease in Scotland) or, if not in either of those jurisdictions, an equivalent interest.

1.3 For more detailed information about collective investment schemes, the full text of the sourcebook is available at www.fca.org.uk and follow the links to the handbook. A guide on investment schemes is also available in the handbook at www.fshandbook.info/FS/html/handbook/COLL. This guide provides some general background material on the regulatory structure surrounding scheme regulation in the UK.

1.4 Qualified investor schemes are authorised funds that may only be sold or marketed to sophisticated investors. They have a more relaxed set of rules governing their operation than that for retail schemes, particularly regarding their investment powers. A qualified investor scheme is essentially a mixed asset type where different types of permitted asset may be included as part of the scheme property, depending on the investment objectives and policy of that scheme and any restrictions in the rules.

2 Basis of value

2.1 Any valuation by an appropriate valuer or a standing independent valuer must be on the basis of market value as defined in these standards and any special provisions within the instrument constituting the scheme.

3 The valuer

3.1 The COLL requirements for an appropriate valuer are given in the following extract.
UK appendix 9  Collective investment schemes

(7) An appropriate valuer must be a person who:
(a) has knowledge of and experience in the valuation of immovables of the relevant kind in the relevant area;
(b) is qualified to be a standing independent valuer of a non-UCITS\(^1\) retail scheme or is considered by the scheme's standing independent valuer to hold an equivalent qualification;
(c) is independent of the ICVC\(^2\), the depositary and each of the directors of the ICVC or of the authorised fund manager and depository of the AUT\(^3\) or ACS\(^4\); and
(d) has not engaged himself or any of his associates in relation to the finding of the immovable for the scheme or the finding of the scheme for the immovable.

COLL 5.6.18, © The Financial Conduct Authority

1 UCITS: undertakings for collective investment schemes in transferable securities
2 ICVC: investment company with variable capital
3 AUT: authorised unit trust
4 ACS: authorised contractual scheme

3.2 The COLL requirements for a standing independent valuer are given in the following extract:

5.6.20 (1) The following requirements apply in relation to the appointment of a valuer:
(a) the authorised fund manager must ensure that any immovables in the scheme property are valued by an appropriate valuer (standing independent valuer) appointed by the authorised fund manager; and
(b) the appointment must be made with the approval of the depositary at the outset and upon any vacancy.

(2) The standing independent valuer in (1) must be:
(a) for an AUT or ACS, independent of the authorised fund manager and depository; and
(b) for an ICVC, independent of the ICVC, the directors and the depositary.
(3) The following requirements apply in relation to the functions of the standing independent valuer:

(a) the authorised fund manager must ensure that the standing independent valuer values all the immovables held within the scheme property, on the basis of a full valuation with physical inspection (including, where the immovable is or includes a building, internal inspection), at least once a year;

(b) for the purposes of (a) any inspection in relation to adjacent properties of a similar nature may be limited to that of only one such representative property;

(c) the authorised fund manager must ensure that the standing independent valuer values the immovables, on the basis of a review of the last full valuation, at least once a month;

(d) if either the authorised fund manager or the depositary becomes aware of any matters that appear likely to:

(i) affect the outcome of the valuation of an immovable; or

(ii) cause the valuer to decide to value under (a) instead of under (c);

it must immediately inform the standing independent valuer of that matter;

(e) the authorised fund manager must use its best endeavours to ensure that any other affected person reports to the standing independent valuer immediately upon that person becoming aware of any matter within (d); and

(f) any valuation by the standing independent valuer must be undertaken in accordance with [VPS 4 paragraph 4, Valuations reflecting an actual or anticipated market constraint and forced sale of the RICS Valuation – Professional Standards 2014 (The Red Book)], or in the case of overseas immovables on an appropriate basis, but subject to COLL 6.3 (Valuation and pricing).

(4) In relation to an immovable:

(a) any valuation under COLL 6.3 (Valuation and pricing) has effect, until the next valuation under that rule, for the purposes of the value of immovables; and

(b) an agreement to transfer an immovable or an interest in an immovable is to be disregarded for the purpose of the valuation of the scheme property unless it reasonably appears to the authorised fund manager to be legally enforceable.

5.6.20A In considering whether a valuation of overseas immovables by the standing independent valuer is made on an appropriate basis for the purpose of COLL 5.6.20R(3)(f), the authorised fund manager should consider whether that valuation was made in accordance with internationally accepted valuation principles, procedures and definitions as set out in the International Valuation Standards published by the International Valuation Standards Committee.

COLL 5.6.20 and 5.6.20A, © The Financial Conduct Authority
UK appendix 10 RICS residential mortgage valuation specification

1 Introduction

1.1 This specification provides a standard approach to the provision of valuation advice to prospective lenders where the security offered is either:

(a) an individual residential property that is intended to be occupied, or is occupied, by the prospective borrower or

(b) an individual residential property purchased as a buy-to-let investment.

Where the instruction is to provide one valuation of two or more individual securities, the valuation approach will not be in accordance with this specification but should comply with PS 1, Compliance with standards and practice statements where a written valuation is provided, and PS 2, Ethics, competency, objectivity and disclosures.

1.2 It is recognised that although the report is provided to the lender there is established case law that the valuer may have a duty of care to the prospective purchaser, who may or may not be provided with a copy of the report, or a summary of its relevant recommendations.

1.3 It has been agreed with the Council of Mortgage Lenders (CML) and the Building Societies Association (BSA) that this specification is to be incorporated into the commissioning requests for valuation advice from members of those organisations throughout the UK.

1.4 The specification has been arranged under the following headings:

• application of the RICS Valuation – Professional Standards (the ‘Red Book’)
• inspection
• basis of value
• factors that may have a material impact on value
• assumptions and special assumptions
• the form of the valuation report and
• reporting factors that have a material impact on value.

1.5 The report will include the valuer’s opinion of value at the specified date, together with comments on the factors that may materially impact the value established during the inspection and any matter identified that is not in accordance with the standard assumptions.
2 Application of the Red Book

2.1 Valuers are reminded that the Red Book applies to the provision of valuation advice for residential mortgages. In addition to the general requirements of PS 1, Compliance with standards and practice statements where a written valuation is provided and PS 2, Ethics, competency, objectivity and disclosures, PS 2 paragraph 4, Independence, objectivity and conflict of interest will apply because the FCA requires that the 'property shall be valued by an independent valuer at or less than market value'. An independent valuer is defined as a 'person who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process'.

2.2 The role of the valuer is to advise the lender:
(a) on the nature of the property and any factors revealed during the inspection that are likely to materially affect its value
(b) the market value (and/or market rent if required), with specified assumptions or special assumptions and
(c) where there are serious cases of disrepair or obvious potential hazards revealed during the inspection that have a material impact on the value.

2.3 The valuer must not accept instructions to make recommendations as to the length of the mortgage term, or the amount to be advanced. In addition, advice must not be given as to a lender’s underwriting decisions, for example, whether the property is suitable for mortgage lending. These decisions are solely the responsibility of the lender.

2.4 When agreeing terms of engagement the valuer must comply with the requirements of VPS 1, Minimum terms of engagement. Reference to this specification will provide most of the information required under the minimum terms (a) to (l) of VPS 1, but specific mention must be made of:
• identification and status of the valuer (paragraph (a))
• restrictions on use, distribution or publication (paragraph (j))
• confirmation that the valuation will be undertaken in accordance with the IVS (paragraph (k)) and
• the additional requirements in paragraphs (m) to (o).

2.5 Some lenders may have standard terms of engagement that refer to this specification. The valuer must ensure that in confirming the terms, whether as a generic standing instruction or for an individual instruction, all the requirements within VPS 1, Minimum terms of engagement, are addressed. Where generic standing terms of engagement are in place, these must be assumed to apply in all subsequent cases, subject to any specific amendments that may be required.

2.6 Where a request incorporates special requirements – for instance a limited, or no, inspection or special assumptions, the valuer must clarify them and consider any potential impact on the fee before accepting the instruction.

2.7 In some cases, for instance, where the property is known to be exceptional; has extensive grounds; is of architectural or historical interest; is located in a conservation area; or is of unusual construction, consideration should be given as to whether the valuer has the appropriate knowledge and skills to undertake the
valuation competently on standard terms. If not, the instruction should be declined
(see PS 2, Ethics competency, objectivity and disclosures). Where it is
discovered on arrival at the property that it is exceptional, etc., or even includes
some commercial property element, consideration should be given to referring back
to the lender and further instructions sought.

2.8 In Scotland, due to time restrictions sometimes created by the traditional and
accepted procedures for buying residential property, it may be difficult to confirm the
terms of engagement prior to issuing the valuation report. In these circumstances
specific guidance has been issued by RICS Scotland (see UK appendix 12).

3 Inspection

3.1 The purpose of an inspection for a mortgage valuation is to provide a valuation
upon which the lender can base the terms of a loan, and to identify and report those
matters that may have a material effect on the value.

3.2 The valuer will inspect the property to be valued.

3.3 The visual inspection covers as much of the exterior and interior of the property
as is readily accessible without undue difficulty or risk to personal safety. Although
personal judgment has to be used, this inspection should include all of the property
that is visible when standing at ground level within the boundaries of the site and
adjacent public/communal areas, and when standing at the various floor levels.

3.4 More specifically, and subject to the assumptions set out in subsection 6, are
the following:

(a) Roof voids and underfloor voids are not to be inspected. Furniture and
effects are not to be moved, and floor coverings are not to be lifted. Cellars
and basements should be inspected where there is safe access.

(b) The availability of services, including green technologies, should be recorded
but are not tested.

(c) The inspection includes garaging, car parking, other outbuildings (excluding
leisure complexes) of permanent construction and any other structures
attached to the dwelling. If relevant, their impact on the value of the property
is to be noted.

(d) The valuer is not expected to comment on the size, condition or efficiency of
any leisure facility in the grounds of the property. However, comment may be
expected where:

(i) there is obvious evidence of serious disrepair

(ii) the siting of the installation (for example, of a swimming pool) is a
potential hazard to the dwelling, or poses a threat in other terms and

(iii) the installation covers an unacceptably large area in relation to the
confines imposed by site boundaries.

3.5 The land within the ownership should be inspected, subject to the comments in
paragraphs 2.6 and 2.7, and any material matters recorded and reported. This will
include any obvious access restrictions and easements.
Where there are locational factors that may impact value they should be recorded and reported. Certain problems, such as flooding, mining settlement, subsidence, woodworm, invasive vegetation, radon gas, mundic and other issues are particularly prevalent in certain districts. If appropriate, the valuer should make some reference to these defects, even if the subject property does not appear to be affected at the time of the inspection. Where appropriate, the valuer should advise that an environmental assessment or a mining report should be obtained.

The energy-efficiency rating provided within the Energy Performance Certificate (EPC) is to be considered, if it is available.

In Scotland the valuer is not required to read the Home Report documents unless carrying out the original Single Survey, in which case the valuer is not required to read the Property Questionnaire.

Where the property is a flat or maisonette, the following additional requirements will apply:

- The external inspection will be of the main building within which the flat or maisonette is located.
- The external inspection will include the primary communal access areas to the property and any communal areas on the floor on which the flat or maisonette is located.
- Where communal services are provided it may be assumed that the right to use these and have them maintained passes with the property, subject to an appropriate and reasonable service charge.
- The general standard of management and maintenance may have an impact on the service charge, and the possibility of the owner having to contribute to capital expenditure may have a substantial effect on the value. The valuer does not have to provide any estimates of such costs, but will draw attention to them in the report.

To be able to respond to a future enquiry, legible notes (which may include photographs) of the findings and, particularly, the limits of the inspection and the circumstances in which it was carried out must be made and retained. The notes should also include a record of any comparable transactions and/or valuations considered when arriving at the valuation.

In relation to inspections generally, regard should be had to the RICS guidance note, Surveying safely (2011).

The basis of value to be adopted is market value.

Where an existing property has, or has a reasonable prospect of obtaining, planning approval for future development, that value is to be excluded from the assessment of market value by way of a special assumption unless instructed otherwise by the lender.

Factors that may have a material impact on value

The inspection, and enquiries made, may reveal various factors that could have a material impact on the value.
These include:

- the tenure of the interest offered as security and, if known, the terms of any tenancies to which that interest is subject
- the location, age, type, accommodation, fixtures and features, and amenities of the property
- the apparent general state of, and liability for, repair, form of construction and apparent major defects, liability to subsidence, flooding and/or other risks
- any easements, servitudes, burdensome or restrictive covenants, and third party rights and
- any obligations relating to planning conditions, for instance Section 106 agreements or restrictions related to affordable housing conditions.

5.2 The valuation of a new-build property should be approached in the same way as any other valuation. There are, however, specific aspects of the new-build residential market that have led certain mortgage lenders to require an alternative approach to valuation. In all instances, the notified sale price must be treated with caution. The RICS guidance note, The valuation of individual new-build homes (2012), is relevant when valuing these types of property.

6 Assumptions and special assumptions

6.1 Considering the limited nature of an inspection for a mortgage valuation, the valuer is entitled to make reasonable assumptions with regard to the state of the property and other factors that may affect value.

6.2 Unless instructed otherwise the following assumptions and special assumptions may be made without verification:

(a) The property will be transferred with vacant possession.

(b) All required, valid planning permissions and statutory approvals for the buildings and for their use, including any extensions or alterations, have been obtained and complied with. It is not necessary for the valuer to make enquiries into town planning and other matters. These should be left to the lender’s or borrower’s legal advisers. Any obvious breach of planning control, however, should be reported. The lender should be advised of any obvious, recent and significant alterations and extensions, so that the lender’s legal adviser is alerted to the possible need to make enquiries. The valuer is not obliged to search for statutory notices, although the lender’s legal advisers may ask if any such matters that come to light during searches have a material effect on value. Consideration may have to be given to known, or suspected, planning restrictions or conditions. The valuer is under no duty to search, but may be called on for advice as to any material effect on value, if they are disclosed.

(c) In the case of a building that has not yet been constructed, the valuer will, unless instructed otherwise, provide a valuation on a special assumption that the development had been satisfactorily completed, as at the date of the inspection, in accordance with planning permission and other statutory requirements.

(d) No deleterious or hazardous materials have been used in the construction. However, if the limited inspection indicates that there are such materials, this must be reported and further instructions requested.
UK appendix 10  RICS residential mortgage valuation specification

(e) The site is not contaminated and is free from other environmental hazards. No enquiries regarding contamination or other environmental hazards are to be made but, if a problem is suspected, the valuer should recommend further investigation. The valuer will not carry out an asbestos inspection and will not be acting as an asbestos inspector in completing a mortgage valuation inspection of properties that may fall within the Control of Asbestos Regulations 2012.

(f) The property is not subject to any unusual or especially onerous restrictions, encumbrances or outgoings, and good title can be shown.

(g) The property and its value are unaffected by any matters that would be revealed by a local search (or their equivalent in Scotland and Northern Ireland), replies to the usual pre-contract enquiries or any statutory notice that may indicate that the property and its condition, use or intended use are, or will be, unlawful.

(h) An inspection of those parts that have not been inspected, or a survey inspection, would not reveal material defects or cause the valuer to alter the valuation materially.

(i) There is unrestricted access to the property, and the property is connected to, and has the right to use, the reported main services on normal terms.

(j) Sewers, main services and the roads giving access to the property have been adopted, and any lease provides rights of access and egress over all communal estate roadways, pathways, corridors, stairways and use of communal grounds, parking areas and other facilities.

(k) In the case of a newly constructed property, it has been built under a recognised builder’s warranty or insurance scheme approved by the lender, or has been supervised by a professional consultant capable of fully completing the CML Professional Consultant Certificate acceptable to the lender.

(l) There are no ongoing insurance claims or neighbour disputes.

6.3 Where the inspection reveals matters that affect any assumption or the value of the property, the details are to be included in the report together with, if appropriate, recommendations for further action to be taken.

6.4 Where the proposed security is part of a building comprising flats or maisonettes, the following assumptions will also be made, unless instructed to the contrary:

(a) The costs of repairs and maintenance to the building and grounds are shared equitably between the flats and maisonettes.

(b) There are suitable, enforceable covenants between all leaseholds, or through the landlord or the owner.

(c) There are no onerous liabilities outstanding.

(d) There are no substantial defects, or other matters requiring expenditure (in excess of the current amount or assumed amount of service charge payable on an annual basis), expected to result in charges to the leaseholder or owner of the subject property during the next five years, that are equivalent to 10% or more of the reported market value.
6.5 Where the dwelling is leasehold, and it is not possible to inspect the lease or
details have not been provided, the following assumptions will be made, unless
instructed to the contrary:

(a) The unexpired term of the lease is assumed to be 70 years, and no action is
being taken by any eligible party with a view to acquiring the freehold or
extending the lease term.

(b) There are no exceptionally onerous covenants upon the leaseholder.

(c) The lease cannot be determined, except on the grounds of a serious breach
of covenant in the existing lease agreement.

(d) If there are separate freeholders, head and/or other subhead leaseholders,
the terms and conditions of all the leases are in the same form and contain
the same terms and conditions.

(e) The lease terms are mutually enforceable against all parties concerned.

(f) There are no breaches of covenant or disputes between the various interests
concerned.

(g) The leases of all the properties in the building/development are materially
the same.

(h) The ground rent stated, or assumed, is not subject to unreasonable review
and is payable throughout the unexpired lease term.

(i) In the case of blocks of flats or maisonettes of over six dwellings, the
freeholder manages the property directly, or there is an appropriate
management structure in place.

(j) There is a dutyholder, as defined in the Control of Asbestos Regulations
2012, and there are in place an asbestos register and an effective
management plan, which does not require any immediate expenditure, pose
a significant risk to health, or breach the Health and Safety Executive (HSE)
requirements.

(k) Where the subject property forms part of a mixed residential or commercially
used block or development, there will be no significant changes in the
existing pattern of use.

(l) Where the property forms part of a development containing separate blocks
of dwellings, the lease terms of the property apply only to the block. There
will be no requirement to contribute towards costs relating to other parts of
the development, other than in respect of common roads, paths, communal
grounds and services.

(m) Where the property forms part of a larger development whose ownership
has since been divided, all necessary rights and reservations have been
reserved.

(n) There are no unusual restrictions on assignment or subletting of the property
for residential purposes.

(o) There are no outstanding claims or litigation concerning the lease of the
subject property or any others within the same development.

(p) Where the property benefits from additional facilities within the development,
the lease makes adequate provisions for the occupier to continue to enjoy
them without exceptional restriction, for the facilities to be maintained adequately and for there being no charges over and above the service charge for such use and maintenance.

6.6 In respect of insurance, the following assumptions will be made, unless instructed to the contrary:

(a) the property can be insured under all-risks cover for the current reinstatement cost and is available on normal terms
(b) there are no outstanding claims or disputes
(c) where individuals in a block make separate insurance arrangements, the leases make provision for mutual enforceability of insurance and repairing obligations and
(d) any landlord responsible for insurance is required to rebuild the property with the alterations that may be necessary to comply with current Building Regulations and planning requirements.

Reinstatement cost

6.7 An insurance reinstatement cost, often referred to as a ‘fire insurance valuation’, will not be provided unless specifically requested.

6.8 Where the lender requests that an insurance replacement cost be provided it shall be in accordance with Building Cost Information Service (BCIS) guidance. The rebuilding costs used refer to the expense of demolishing and clearing away the existing structure, and then rebuilding it to its existing design in modern materials, using modern techniques, to a standard equal to the existing property and in accordance with current Building Regulations and other statutory requirements. It excludes VAT, except on fees.

6.9 Where the building is not of modern materials, or is a protected building that is required to be reinstated exactly and is therefore outside the scope of BCIS guidance, the reinstatement cost should not be provided unless the valuer has expertise in that type of property. In these circumstances a professional cost assessment should be recommended.

6.10 Where the subject property is a flat or maisonette, the valuer should assess the reinstatement cost of that part of the total structure constituting the proposed security. It is the lender’s responsibility to enquire whether a management committee or the landlord arranges insurance for the building as a whole, and whether that cover is adequate.

6.11 Any exceptional risks likely to affect the premiums for insurance purposes should be reported. There is, however, no obligation for the valuer to seek out such factors. The duty is limited to factors that come to notice during the ordinary course of inspection.

7 The form of the valuation report

7.1 The lender will often provide a general valuation report format. Whatever format is used the information provided in the report should comply with VPS 3, Valuation
reports. It should be sufficient to enable the prospective lender to understand the nature of the security being offered, although unnecessary detail should be avoided.

7.2 The valuer’s duty is to prepare a report on the basis of the information or questions contained in the instructions received, unless there are obvious errors or inconsistencies.

7.3 If other assumptions are made in addition to those described in section 6 above, they must be explicitly stated in the report.

8 Reporting factors that have a material impact on value

8.1 In addition to reporting the value, an important part of the report is to identify those factors that may have materially impacted value, or may be expected to do so in the future. Where such factors are identified the valuer will recommend appropriate action.

8.2 If it is suspected that hidden defects exist that could have a material effect on the value of the property, the valuer should recommend more extensive investigation. It may be appropriate, in exceptional circumstances, to defer making a valuation until the results of the further investigations are known.

8.3 If it is not reasonably possible to carry out any substantial part of the inspection this should be stated.

8.4 The report should include reference to:
   (a) the form of construction
   (b) the existence of any obvious, recent and significant alterations and extensions
   (c) any obvious evidence of serious disrepair or potential hazard to the property, and any other matters likely to materially affect the value (although minor items of disrepair, poor design or lack of decoration that do not materially affect the value of the security do not need to be reported)
   (d) items that are not serious at the date of inspection, but could become so if left unattended and
   (e) other items of disrepair or poor design, or a lack of maintenance that may adversely affect the structure in the future and lead to a material effect on the value of the security.

8.5 Where there is a basic structural defect, such that renovation ceases to be possible or economic, a valuation should not be provided, subject to the lenders more specific reporting requirements.

8.6 Where the proposed security is part of a building comprising flats or maisonettes, the valuer should comment on:
   (a) any apparent deficiencies in the management and/or maintenance arrangements observed during the inspection that materially affect the value
   (b) the current amount of the annual service charges payable, if available and
   (c) any situation where the apparent sharing of drives, paths or other areas might materially affect the value of the subject property.
8.7 If the valuer’s inspection reveals anything that gives reason to suspect an encumbrance, for instance, easements and other rights pertaining to way, light and drainage, they must be reported even if the report is in the lender’s format and no provision is made on the form for such information to be provided.

8.8 If the inspection reveals the possibility that third parties have the right of occupation this must be reported in all cases.

8.9 Where the valuer does not have the necessary expertise to estimate any repair and maintenance costs and their impact on value, specialist advice should be obtained or the instruction declined. One example would be a property of architectural or historic interest, listed as such, or in a conservation area. Another would be a property of unusual construction, where any remediation of defects may require planning permission, or other consent. The repairs may also have to be to a standard that would not be detrimental to the property’s architectural or historic integrity, its future structural condition or the conservation of the building fabric.

**Treatment of incentives**

8.10 Sales incentives and the marketing of property, especially new-build homes, have become increasingly more innovative and sophisticated. Incentives can differ between development sites, between properties being sold and between the types of purchaser being attracted by the seller (owner-occupier or buy-to-let investor).

8.11 Where the property is a new-build, the valuer must obtain a copy of the developer’s Disclosure of Incentives Form. More detailed guidance on the treatment of incentives and how to report on their impact is contained in the RICS guidance note, *The valuation of individual new-build homes* (2012).

8.12 Where the property is a new-build, it is recommended that the valuer considers including a statement to the following effect:

‘It should be appreciated that the valuation provided is for the property as new. It may not be possible to obtain the valuation figure if the property is resold as second-hand, especially if comparable new property is on offer at the same time.’
UK appendix 11 Application of the RICS residential mortgage valuation specification to related purposes

1 Introduction

1.1 This appendix contains guidance on various matters related to residential mortgage valuation advice that are not dealt with in the residential mortgage specification. These are:

- re-inspections
- retyping reports and transcriptions
- further advances
- buy to let
- valuations without internal inspection and
- retrospective valuations.

1.2 Valuation advice may also be sought on a variety of other matters, such as mortgage rescue and accounts in arrears. Unless the instructions specify otherwise, the basis of value will be market value.

2 Re-inspections

2.1 A ‘re-inspection’ is a further visit to a property for which the valuer has previously provided a report where the lender has either imposed conditions, or made a retention.

2.2 The cases that may arise include:

- consideration of the release of money by way of stage payments applicable to the stage of construction reached
- whether the (new, or newly-converted or improved) property has been completed to the state assumed in the initial mortgage valuation report (where a mortgage offer has been made on this basis, but no advance has actually been made) and
- in circumstances where part of the advance has been retained until specified works have been undertaken, whether those works have apparently been completed as assumed in the initial valuation report, or as otherwise specified.
by the lender, to a standard satisfactory to justify lending on them and without significant adverse effects on the value of the property.

2.3 The valuer may be asked to advise whether the previous valuation report (which must always be available to the valuer) is still sufficiently accurate for the lender to assess the adequacy of the security, when deciding whether or not to release a retention or stage payment. In this case the valuer’s duty is to inspect only those parts of the property with which the lender is concerned. It is not the task of the valuer to inspect the whole property.

2.4 The lender must be advised if, during the re-inspection, the valuer:

- becomes aware of any material changes or factors additional to those in the previous report, which would materially affect the valuation of the proposed completed security
- becomes aware of any other factor that might materially affect the valuation
- is of the opinion that the valuation of the proposed completed security would be materially different from that previously reported
- considers that the property may have been affected adversely by the works carried out
- observes new defects and/or repair requirements and/or unsatisfactory workmanship and/or
- becomes aware that the problem originally causing the need to carry out the remedial works is now affecting another part of the structure, or that part of the structure which is the subject of the required inspection is suffering from a further defect.

However, there is no requirement to provide a revised valuation unless requested to do so.

2.5 A new figure for reinstatement insurance purposes is not to be provided, unless requested by the lender.

3 Retype reports and transcriptions

3.1 A ‘retype report’ is the generic name applied to a request for a ‘copy report’ or ‘transcription’, which is commonly requested by brokers and lenders. When receiving instructions from a third party (e.g. broker) to complete a retype, the valuer should be clear as to the acceptability of such reports by the lender whose report form is being completed. The lender’s requirements will usually be made clear in the lender’s panel contract and guidance. These requirements will always prevail over any contrary instructions from third parties, particularly in respect of retype acceptability, timescales, applicable valuation dates and valuation definitions.

3.2 Some requests for a retype report can lead to a potential conflict of interest, which should be considered in relation to the specific guidance in Table 1 (see paragraph 3.10) and generally in PS 2, Ethics, competency, objectivity and disclosures.

3.3 Retype reports can be categorised as either:

- a copy report – a duplicate copy of a previous report stating exactly the same facts with an inspection date, valuation date and valuation figure the same as for the original report or
a transcription report – the transcription of data, which was presented in a previous report, to another report format stating the same facts with an inspection date, valuation date and valuation figure.

3.4 There may be minor amendments to meet lender requirements for additional data that can be presented in the transcription report if it was collected during the original inspection. Where additional data is requested that would require another visit to the site, the valuer should negotiate the appropriate fee for the additional work.

3.5 Where the valuer is aware that the value of the property has reduced to a level materially below the valuation at the original inspection date, the valuer should initially decline instructions. In the absence of a contract or agreement to provide a copy report stating both the original and current valuation figures, the valuer should offer to provide a revaluation at an appropriate fee.

3.6 Where the lender’s requirements are for a valuation based on a different valuation definition from the original, the instructions should be declined. The valuer should then offer to provide a revaluation at an appropriate fee.

Retype reports in Scotland

3.7 After the introduction of the Home Report there is the option for the surveyor to provide a generic mortgage valuation report (MVR) in addition to the Single Survey. Buyers will be in the same position as before in having this prior to making an offer. A lender may request a valuation for mortgage purposes on its own report forms. This can be provided prior to purchase provided that:

- the valuer is an approved panel member for the lender
- the valuation in the MVR is replicated exactly in the retyped lender valuation and
- no additional information other than that which is in the Single Survey and MVR is provided.

3.8 If the valuer is unable to comply with these requirements, the instruction should be declined and the lender will be required to source a valuation from another panel member. However, if the valuation in the MVR is seen to be inappropriate at the date of the retype request due to changing market circumstances or the level of the offer from the prospective buyer, the valuer may seek the vendor’s permission to ‘refresh’ the Single Survey and MVR. This creates an updated version to be put into the public domain and then provides the opportunity for the valuer to provide a valuation to the lender. If the vendor does not give permission, the lender will need to source another valuation from a different panel member.

3.9 Where a lender requires a valuation for mortgage purposes after the applicant has made a commitment to purchase then the valuer, provided he or she is an approved panel member for the lender, can provide additional information, if appropriate, to the lender without the need to ‘refresh’ the Single Survey and the MVR. If the valuation is seen to be inappropriate at the date of the retype request and a refreshed Single Survey is not instructed, the lender would be required to source another valuation from a different panel member.

3.10 Table 1 provides an indication of the circumstances under which a request for a retype report may give rise to a conflict of interest. Further guidance on conflicts of interest is given in PS 2 paragraph 4, Independence, objectivity and conflict of interest.
Table 1

<table>
<thead>
<tr>
<th>Instruction source</th>
<th>Acceptable</th>
<th>Not acceptable (not applicable in Scotland)</th>
<th>Acceptable subject to conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lender</td>
<td>Different lender, same applicant: acceptable, as this is an accepted industry practice</td>
<td>Different lender, different applicant: not acceptable, as previous applicant and lender case may still be live</td>
<td>Same lender, different applicant: acceptable if applicant ‘related’ to previous applicant and change is administrative</td>
</tr>
<tr>
<td></td>
<td>Same lender, different applicant: acceptable, as most likely to be a full revaluation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intermediary</td>
<td>Same or different lender, same applicant: acceptable, as this is an accepted industry practice</td>
<td>Different lender, different applicant, or same lender, different applicant: not acceptable, as there’s no proof that original applicant has ceased interest, so potential conflict</td>
<td>Different intermediary, different lender, same applicant: can proceed</td>
</tr>
<tr>
<td>Applicant</td>
<td>Same applicant, different lender: acceptable, as applicant has instructed the transfer of information, therefore it is implicit that the valuer has the personal details. It should be stated within the report that the applicant has instructed the valuer.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4 Further advances

4.1 Where a property is already in mortgage to a lending institution, the lender may sometimes wish to consider whether a further advance, usually of a specified sum, can be made on the security of the property or the repayment of a loan rescheduled. The valuation may be of the property as it stands and/or with works proposed to it. The lender is expected to provide the valuer with the original report, or a copy, wherever possible.

4.2 The valuer’s remit is to provide a report on all of the following:

- the current market value of the property in its existing state
- the current market value in its future state, where defined works are contemplated on the special assumption that they have been satisfactorily completed
- where previously provided, a revised estimate obtained for insurance purposes
- any factors likely to affect its value materially and
changes in the accommodation or its amenities since the previous inspection report.

5 Buy to let

5.1 Buy-to-let valuations will encompass a number of different categories. The main three are:

Category 1: a single individual residential unit let to a single household on a single assured shorthold tenancy (AST) where it neither forms, nor is intended to form, part of a portfolio

Category 2: a single residential unit let on a single AST, but to individuals on a sharing basis up to a maximum of four individuals and

Category 3: licensable houses in multiple occupations (HMOs) and multiple units held on a single title. They will include categories of properties not capable of being valued on an assumption of owner occupation and/or by adopting a traditional comparable methodology. These will be valued only after confirmation of direct terms of engagement with the instructing lender and referring to the lender’s specific guidance.

5.2 The following comments apply to all categories:

(a) The valuer must be sufficiently experienced in the residential investment market and have a sound knowledge of the rentals in the locality.

(b) The valuer should be aware of the impact of rental incentives in respect of properties suitable for buy-to-let investment. Guaranteed rents that are above market rent and cashbacks in lieu of rental income for a number of years may have an effect on price. The valuer should consider these impacts and report accordingly.

(c) The lender may use either or both the market rent and the market value to determine the size and type of loan to be extended to the borrower. The market rent figure may therefore be critical in the underwriting of the loan and should not be viewed just as a guide or confirmation of the current or future rent passing.

(d) The valuer should fully research, document and retain comparable rental evidence and either decline to provide a market rent figure or clearly state limitations as to accuracy if there is insufficient or limited evidence.

(e) If the property is likely to incur higher than average maintenance costs due to its age/type, existing condition or intensity of occupation, this should be identified within the report, as the proportion of rent required for reinvestment will exceed normal levels and reduce net income accordingly. Excessive service charges and/or ground rents should also be considered in this regard, as they will similarly affect net income.

(f) Where the lender advises the valuer that the borrower intends to let a vacant property for residential purposes, the lender should also instruct on whether the valuer is to value the property:

(i) with vacant possession
5.3 Where market rent is to be provided it shall comply with VPS 4 paragraph 1.3, Market rent, on the special assumption that it is an unfurnished, six-month AST. This should be a sustainable rent and not one distorted by temporary factors of high demand, such as seasonal workers, holiday lets, asylum seekers or other special cases. A simple adoption of the current rent passing (if known) will not be appropriate where market conditions have changed since commencement of the existing tenancy.

5.4 Comparable evidence for market rent should be as robust as that obtained for market value.

5.5 The following paragraphs provide comments that apply to the specified categories.

**Category 1: Single assured shorthold tenancy**

5.6 Individual residential properties that fall into category 1 may be purchased with a view to the owner letting them as investments. Many lenders have specific loans designed for this buy-to-let market. As the security offered is essentially a property that would be in the residential owner-occupier market, it is appropriate that the valuation is in accordance with that market.

5.7 The valuer should be aware of the impact of incentives in respect of properties suitable for buy-to-let investment. Guaranteed rents that are above market rent and cashbacks in lieu of rental income for a number of years may affect the price. The valuer should consider these impacts and report accordingly. In some cases the lender may specifically request the valuer to give an opinion of the market rent on an AST under item f(ii) in paragraph 5.2.

5.8 In the case of item f(i) in paragraph 5.2, the valuer must include in the report a sentence stating that the lender has advised that the property is to be let and that this may adversely affect the valuation reported (if the valuer believes this to be the case). In the case of item f(iii) or (iii) in paragraph 5.2, the valuer must state in the report that a special assumption has been made that the property has been let on an AST on market terms, or such other stated terms as advised by the lender.

5.9 Many lenders use a standard pro-forma report for buy-to-let valuations. Where this is the case, the valuer does not need to comment on:

(a) the letting assumptions made and/or
(b) the possible adverse effect on the capital value of letting.

This applies where the pro-forma, lender’s terms of engagement or lender’s guidance manuals (or equivalent) already state the assumptions and/or special assumptions that the lender wishes the valuer to make in the preparation of the report.

5.10 In the event that the property is already let and is to be conveyed subject to the letting, the lender may request that a special assumption be made that the property is vacant. The current rent passing should not necessarily be confirmed as
the current *market rent*. The current *market rent* should be the figure that the valuer considers is the true value irrespective of whether the current rent passing is higher or lower.

5.11 Where the lender requires the valuation of more than one category 1 property for the same borrower, the valuation is to be on an ‘individual property basis’ and not as a parcel or portfolio of properties, unless otherwise instructed. In such case this specification does not apply, and the valuer should refer to VPGA 2, Valuations for secured lending, and VPGA 8, Valuations of portfolios, collections and groups of properties, unless covered in the following paragraphs.

*Category 2: Shared houses*

5.12 Where a property has been let to a group of tenants, typically a shared student house or as individual rooms, the *market value* may be assessed on a comparable basis. However, these properties may be located in areas comprising a high concentration of similar rented accommodation and limited owner occupation. In this situation, the comparables used to determine the valuation may come principally from transactions of other similar *investment property* (rather than owner-occupied property) in the locality.

5.13 The rental value assessment should only be provided at a ‘higher’ shared occupancy rate, where there is a proven sustainable demand in the area for this type of letting arrangement and the property is suitable for this form of letting.

*Category 3: Houses in multiple occupation/multi-unit properties*

5.14 For this specialist area of valuation, the valuer must have knowledge of, and experience in, the valuation of the more complex residential *investment property* in the particular locality.

5.15 Houses in multiple occupations (HMOs) comprise individual units that cannot be sold separately and have at least some shared facilities. If the property appears to be compliant with legislation/safety requirements having regard to the provisions of the *Housing Act 2004*, then it is reasonable to adopt the *income approach* method of valuation, assuming there is a continuing rental demand for this type of accommodation in the area. The valuation obtained should be logic checked against the tone of values for similar *investment property* in the vicinity.

5.16 The valuer should identify whether the property is subject to mandatory HMO licensing and if a copy of the licence has been seen.

5.17 The additional considerations for the category 3 scenarios include:

(a) management regulations for HMO
(b) potential mandatory or discretionary licensing schemes
(c) condition/fitness requirements, that is, Housing Health and Safety Rating System (HHSRS) and
(d) the possibility that planning consent will be required for the HMO usage, in addition to the usual local authority consents for the current property form and layout.
6 Valuations without internal inspection

6.1 The valuer may be asked for a valuation without the benefit of an internal inspection, and with or without the benefit of an earlier report. This may be called a ‘desk-top’, ‘drive-by’ or ‘pavement’ valuation, or an ‘external appraisal’, and may include reference to automated valuation models (AVM).

6.2 When an opinion is provided on this basis, it must be confirmed in writing, and the manner of valuation and the restrictions under which it is given clearly stated (see VPS 1.9(g), Extent of investigation). The lender must be informed that the value stated in such a fashion must not be disclosed to the borrower or any other party, unless required to do so by the FCA rules in Mortgages and home finance: conduct of business sourcebook (MCOB).

6.3 Many lenders use a standard pro-forma report for valuations without an internal inspection. Where this is the case, the valuer does not need to comment on:

- the manner of valuation
- the restrictions under which it is given
- the non-disclosure to the borrower and/or other third parties or
- where the pro-forma, lender’s terms of engagement or lender’s guidance manuals (or equivalent) already state the assumptions, restrictions and terms under which the valuer should prepare the report.

6.4 Where a desk-top opinion is sought without any form of inspection of the property itself, the valuer should exercise additional caution particularly as to the intended use of the valuation. It is likely to be used for a preliminary assessment prior to a more detailed investigation at a later date (and section 7 below may also apply). The valuer should ensure that the source of information and the rationale used in arriving at the desk-top valuation are documented and retained, given that there will be no site notes.

7 Retrospective valuations

7.1 A valuation may be provided at any historical date. However, a lender may be seeking a retrospective valuation as part of an internal process of reviewing a specific loan. It is therefore important that the valuer establishes the reason for the request before accepting the instruction.

7.2 Where an instruction is accepted, the terms of engagement must incorporate the following statements:

- The valuation will be in accordance with the residential mortgage specification as at the valuation date. Previous specifications are available from the RICS Library.

- Where inspection is not possible, or is expressly forbidden, a statement to that effect will be made.

- Because the valuation is based on restricted information, it is provided solely for the internal use of the lender. It is not to be used in any proceedings without the valuer’s consent, as the opinion may change if the valuer is later required to give evidence in formal proceedings.
UK appendix 11 Application of the RICS residential mortgage valuation specification to related purposes

- Where the lender decides to institute formal proceedings the valuer must be instructed to act as an expert witness and will follow the RICS mandatory standard, *Surveyors acting as expert witnesses* (2008).
UK appendix 12  RICS Scotland advice on issuing terms of engagement

1  Introduction

1.1 This appendix reproduces the advice issued by RICS Scotland in January 2006.

1.2 The advice in this appendix does not apply to the provision of services as part of a Home Report in Scotland. In such cases UKVS 3.6 will apply.

1.3 Paragraph 1.1 of the RICS Scotland advice refers to the Rules of Conduct and those standards that were applicable in 2006. As the Rules of Conduct 2007 do not refer to terms of engagement and the references in these standards have changed, this paragraph should be read as follows:

‘1.1 This advice should be read in conjunction with the RICS Valuation – Professional Standards, 2014. PS 2.7, Terms of engagement, requires the terms of engagement to be brought to the client’s attention and appropriately documented prior to the issue of the report.’

1.4 Similarly, all references to various ‘practice statements’, now termed professional standards, valuation practice statements or valuation standards, should be checked against their new numbering and location in this edition of the Red Book.

RICS Scotland advice on issuing terms of engagement (SRF/01/06)
1 Introduction
1.1 This advice should be read in conjunction with the Royal Institution of Chartered Surveyors (RICS) Appraisal and Valuation Standards (Fifth edition) (Red Book) Chapter 2 (Agreement of terms of engagement), PS 2.1 – Confirmation of terms of engagement. RICS Code of Conduct, Rule 8, provides that terms of engagement shall be sent promptly.
1.2 This advice reflects that due to time restrictions sometimes created by the traditional and accepted procedures for buying residential property in Scotland, it is often difficult to issue Terms of Engagement to clients, or those acting for clients, prior to the issuing of a valuation or survey report. The guidance contained in this advice aims to reflect best endeavours on behalf of the Chartered Surveyor, in their firm.
2 Best endeavours

2.1 Where it is possible, and reasonable time permits, these Terms of Engagement shall be issued to clients in accordance with the Red Book PS 2.1 – Confirmation of terms of engagement. Where this is not possible then the Chartered Surveyor, or their firm shall adhere to at least one of the following guiding principles:

2.1.1 A written copy of the standard Terms of Engagement shall be sent to the client, or their representative, within 24 hours of receipt of the instruction.

2.1.2 Where a Chartered Surveyor, or their firm, has a website openly accessible to the public, then their standard Terms of Engagement shall be posted therein and the client, or their representative, shall be directed to view the terms on the website.

2.1.3 Where practicable, the Terms of Engagement shall be emailed to the client, or their representative, within 24 hours of receipt of the instruction.

2.1.4 Where practicable, the Terms of Engagement shall be sent by fax to the client, or their representative, within 24 hours of receipt of the instruction.

2.1.5 It shall be deemed to be good practice for the Chartered Surveyor, or their firm, to furnish their standard Terms of Engagement with referring parties (e.g. local solicitors, lenders, etc., with their valuation commissions once received). A note of receipt of these terms should ideally be sought.

3 This advice is approved by the RICS Appraisal and Valuation Standards Board and RICS Scottish Residential Faculty Board.

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UK appendix 13 Valuation of registered social housing providers’ stock for secured lending purposes

1 Introduction

1.1 This appendix provides guidance on the additional matters that should be taken into account by valuers undertaking valuations for registered social housing providers’ stock for secured lending purposes. Its provisions also apply to valuations of their interests in property in shared ownership.

1.2 In this appendix references to the ‘client’ are to the lender, which will normally issue any valuation instructions. However, the provisions apply equally if a registered social housing provider requests a valuation for secured lending.

2 Identifying the property

2.1 The valuer first needs to agree with the client whether the stock is to be valued as a single portfolio, or in lots, which could be individual dwellings. If the stock is not to be valued as a single portfolio, the client must be made aware that the aggregate of the valuations provided may differ from the price that could be achieved if some or all of the properties were sold either as a portfolio, or if a large number were placed on the market concurrently for sale individually (see also VPGA 8, Valuations of portfolios, collections and groups of properties).

2.2 Particular care is necessary to establish the nature of the housing provider’s interest(s) to be valued. Restrictions and encumbrances (for example, Section 106 agreements, right to buy and nomination rights) are common. Planning consents may include restrictions on occupation or tenure. Obviously the valuation must reflect the terms of any shared ownership leases.

3 Extent of inspection

3.1 Where the stock to be valued comprises a large number of similar properties, or a number of estates or blocks, each of which comprises similar properties, the valuer must agree with the client whether every property will be inspected or, as is more usual, whether sample inspections should be completed. In such case, the valuer will assume that these are representative of those properties that have not been
inspected. The extent of each sample inspection (for example, internal and external, external only or front elevation only) must also be agreed.

3.2 Where the inspection is to be of a sample only, the extent of the sampling and the method of its selection must be agreed with the client. If the valuer subsequently considers that the extent of the inspection is not adequate for the purpose of the service, the client must be advised accordingly and further instructions agreed before reporting.

4 Basis of value

4.1 Market value will be subject to existing tenancies. Unless the client specifies to the contrary, a special assumption should not be made that dwellings vacant at the valuation date have been re-let to tenants in the registered social housing provider’s target group. Instead, they should be valued with vacant possession.

4.2 A valuation on the basis of market value should reflect any intention that the valuer considers a prospective purchaser would have to raise the rents. If the valuer expects to make this assumption, the potential impact of this on the value of the security should be drawn to the client’s attention.

4.3 Existing use value for social housing (EUV–SH) is defined in UKVS 1.13, Valuations for registered social housing providers. Its use is appropriate in secured lending valuations, as it assumes that the properties will continue to be let as social housing and that any vacant dwellings will be re-let to tenants in the registered social housing provider’s target group.

5 Calculations of worth

5.1 The client may also require the valuer to provide a calculation of worth on the assumption that the lender was in control of the security, following default by the borrower. In this case the client’s potential rights (for example, whether it will be entitled to sell vacant dwellings, or where tenants’ rights to buy exist), along with its willingness and ability to raise rents and sell dwellings that become vacant, will be relevant.

5.2 The client may also be interested in receiving, and hence will specify, a return that is to be adopted through the discount rate used in the calculation of worth. Special assumptions such as this must be stated in the report.

5.3 Where a calculation of worth is provided, an opinion of value on market value or EUV-SH should be provided concurrently.

6 Developments

6.1 Where the security of a proposed development (or a development in the course of construction) is being considered for lending purposes, it will normally be appropriate to provide both a valuation of the property in its current condition, and a further valuation on the special assumption that the development will be completed in accordance with the plans and specification provided. In establishing the current
value the valuer will need to determine what information is available on the anticipated development costs, and the extent to which these may be relied on by the valuer.

7 Reporting

7.1 The report should contain, in addition to those matters listed in VPS 3, Valuation reports, as many of the following additional matters as seem appropriate in the circumstances:

- a statement of the average rents being charged for each dwelling and tenancy type, and a comparison of these with the valuer’s assessment of the level of rents that could be obtained if the properties were let unfurnished on the open market
- a statement as to the existence of nomination rights
- an explanation if there is an exceptionally high number of vacant dwellings
- an appreciation of the strength of demand for the dwellings, both let at the level of rents charged, or to be charged, by the registered social housing provider and if offered for sale with vacant possession, along with any known factors likely to significantly affect these strengths
- a statement where the valuation(s) reported has been affected by the existence of an unimplemented planning permission for change of use or other development, or by the prospect of such consent(s) being available, with advice as to the amount(s) of the increase reported in consequence
- an opinion as to whether, over the period contemplated for the loan, material changes in the necessary level of expenditure, in real terms, are likely to be required
- the valuer’s opinion of the property as a lending security, including implications relating to the ability to realise the security in the event of default, bearing in mind the length (which will be stated) of the term of the loan contemplated by the client, and assuming that the borrower will maintain the property in a reasonable state of repair and
- a statement as to the valuation method(s) adopted, and an indication of the extent to which the valuer has been able to have regard to comparable market transactions. The yield, the principal inputs (where a discounted cash flow method is used), assumptions and the discount rate adopted must be stated.

8 Liaison with lenders

8.1 The British Bankers’ Association, the Council of Mortgage Lenders and RICS regard it as important that the lender and the valuer develop a close working relationship in respect of valuation and appraisal, especially in more complex cases, to ensure that the service provided by the valuer reflects the lender’s needs and that the lender fully understands the advice that is being given.
UK appendix 14 Affordable rent and market rent

1 Introduction

1.1 This appendix provides background information on the regulatory system in England related to affordable rent and guidance to the valuer on the application of the basis of market rent for this type of property. The additional requirements set out in paragraphs 3 to 5 are of mandatory application.

2 Background

2.1 Affordable rent is designed to:
• maximise the delivery of new social housing by making the best possible use of constrained public subsidy and the existing social housing stock and
• provide an offer that is more diverse for the range of people accessing social housing and an alternative to traditional social rent.

2.2 Affordable rent falls within the definition of social housing in section 68 of the Housing and Regeneration Act 2008 (and, in particular, the definition of low cost rental accommodation in section 69 of the Act). Affordable rent properties will therefore be subject to regulation by the Homes and Communities Agency (previously known as the Tenant Services Authority (TSA)) where they are provided by a registered provider. Current HCA regulations and archived TSA regulations are available on www.homesandcommunities.co.uk

3 Status of the valuer

3.1 The regulations neither specify that the valuer should be professionally qualified, nor require the valuation to be made by a valuer independent from the landlord. However, where the valuer is a member of RICS, attention is drawn to PS 1 paragraph 1, Mandatory application, where a written valuation is provided. Where the valuer is an employee of, or is in any way associated with, the registered provider, then details of such relationship are to be clearly stated in the report to comply with VPS 3 paragraph 7(a) Identification and status of valuer.

4 Basis of value and assumed tenancy terms

4.1 The regulations refer to ‘gross market value’. This term is taken to be the same as market rent as defined in VPS 4 paragraph 1.3, having regard to the following assumed tenancy terms:
• The tenancy is assumed to be a 12-month assured shorthold tenancy on market terms, unfurnished but with appliances, carpets and curtains, with an expected right for the tenant to ‘hold over’ or renew the tenancy.
• The rent is inclusive of any service charges (the assumption being that these are paid by the landlord). If this is not the case the rationale should be explained.
• As long as they do not conflict with the aforementioned assumptions the general tenancy terms should reflect those usually applied in the private sector.
• The condition of the property is only taken into account in so far as it impacts the rental value.

5 The property

5.1 The extent of the property being valued should be clearly stated.

5.2 Where the valuation is for a proposed new development, reference to the plans should be clearly stated within the report. The assumptions on the quality of specification, and compliance with planning approvals and development control requirements, should also be disclosed.

5.3 Where an existing property is being valued, a summary of the condition of the property should be included within the report to the extent that it impacts the rental value.

5.4 All assumptions about the property should be stated.

6 Method of valuation

6.1 The comparison method of valuation evidence is expected to be the most likely approach to be adopted, with evidence obtained from the private rented sector. Where other methods are adopted they are to be specified in the terms of engagement, together with confirmation that the client has no objection.

6.2 The method of valuation and justification for its use should be stated within the report.

6.3 Where the landlord owns a large number of properties, it is acceptable to provide valuations on a sample, or beacon, basis. In such cases the valuer must clearly identify the types of property within each sample or beacon.

7 Analysis of comparable market evidence

7.1 Details of comparable evidence should be included in the report, together with the evidence drawn from these cases.

7.2 Some market information is publicly available, but published and website database information must be used with caution and with the full knowledge of how and from where it is derived. While databases may be useful in providing a general background to values, they may not be sufficiently comprehensive by themselves to provide enough data for an accurate valuation.
7.3 Details of all comparable evidence, including any adjustments made to reflect
the differences between the terms of letting and the valuation requirements, should
be kept on file and sources of comparables noted in the valuation report.

7.4 The HCA’s comment on the difficulty in identifying comparables in certain
circumstances is stated in the 2011-2015 Affordable Homes – Framework at
paragraph 3.5:

‘Housing for vulnerable and older people often includes a range of services to
support the particular needs of the client group. When setting an Affordable
Rent, the gross market rent comparables should be based on similar types and
models of service provision. Where there are insufficient comparables for
similar types of provision in the local area, valuers should be requested to
identify comparables from other areas, and extrapolate their best view of the
gross market rent that would be applicable in the location in which the property
is situated.’

7.5 Where rental evidence of comparable types of property is not available from
within the immediate locality, then a wider market area should be used. The valuer
will need to use professional knowledge and judgment in order to apply the evidence
to the subject property. Comment should be made on similarities and variations in
the comparable market and how they affect the valuation. Sometimes evidence may
be completely lacking, in which case the valuer may be forced to consider an
alternative method of valuation, such as investment value or the rental relationship to
the capital value.

7.6 Comparables may be more difficult to identify in rural areas, or for specialist
supported housing being provided for a particular client group. They may also require
a wider market area of comparables, or an alternative supporting method of
valuation adopted to determine the market rental value with details provided within
the valuation report.

7.7 Output from an automated valuation model (AVM) may also be considered.
However, care should be taken to understand how that output relates to the valuation
requirements. Guidance on AVM is being developed and once published will be
available on www.rics.org/standards

7.8 Further guidance on comparable evidence can be found in the RICS information
10 RICS UK guidance notes

UKGN 1 Land and buildings apportionments for lease classification under IFRS

1 Introduction: the accounting principles

1.1 The purpose of this guidance note is to provide assistance to valuers on the various matters that arise from the application of IAS 17, Leases.

1.2 This guidance is written with specific reference to UK leasing practice and markets.

1.3 This guidance note was originally published as Valuation Information Paper 9 in 2006. Apart from revising the commentary on the classification of the land element of leases that arises from an amendment of IAS 17 in January 2010, there have been no fundamental changes to the original text.

1.4 It is common for items of property, plant and equipment used by a business to be leased rather than purchased outright, as this gives the entity (the term used for the business preparing the financial statements) lower entry costs and potentially greater flexibility. Leased assets are generally treated as belonging to the lessor, and therefore do not appear on the balance sheet of the lessee.

1.5 In some cases, however, the rent payable under a lease can be seen simply as payment by instalments for the purchase of the leased asset, including an interest charge. Such a lease is termed as a ‘finance lease’. In this situation, the underlying asset is classified as belonging to the lessee and appears on the balance sheet of the lessee as an asset, with the corresponding rent outgoings capitalised and shown as a liability.

1.6 Leases that are more of a temporary arrangement, where the rents can be best seen as a payment for a short term right to use the asset, are recognised as ‘operating leases’. These are accounted for as assets on the balance sheet of the lessor, and the lessee merely presents the periodic rental charge in the profit and loss statement, with future rent liabilities disclosed in the notes to the accounts.

1.7 This guidance note does not address in detail the accounting treatment of finance and operating leases. However, under an operating lease the annual rent charge is shown in the profit and loss statement. Under a finance lease, the rent is divided between an interest charge (shown in the profit and loss statement) and a
charge for the repayment of the capital. The lessee’s accounts will also usually show
an annual depreciation charge on the asset.

1.8 IFRS requires all leases to be accounted for in accordance with IAS 17, which
is not just concerned with land and buildings, but with all leased items such as plant
and equipment. The difficulties raised by leases of land and buildings are recognised,
and some guidance is given in the standard on how to deal with these asset types.

1.9 Land and buildings are usually traded in the market as a single unit – the land
supports the buildings and the buildings cannot be used independently of the land.
Leases in the UK are drawn up on this basis, and the valuation process does not
differentiate between the two elements. Nevertheless, IFRS treats these elements as
‘separable’ and a separate accounting treatment may be required. This might lead to
a requirement for separate valuations of the two elements and, more directly, an
apportionment of the rent payable between them.

1.10 A split of rentals is required for two reasons. First, it will help determine the
classification of the lease (as it relates to each element) as either a finance lease or
an operating lease. Where it has been classified as a finance lease, the split of
rentals will be used to calculate the amounts to be included in various parts of the
financial statements.

Table 1: Lease classification

<table>
<thead>
<tr>
<th>Party</th>
<th>Operating lease</th>
<th>Finance lease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lessor financial statements</td>
<td>The asset will be held on the balance sheet as (usually) an investment property.</td>
<td>A financial asset is recognised on the balance sheet as representing the right to receive lease payments and the entity’s interest in the residual value of the property.</td>
</tr>
<tr>
<td></td>
<td>Rental income is recognised in the income statement over the lease term, and depreciation may be charged against the asset.</td>
<td>Rental payments are allocated between the repayment of the financial asset and interest income (which is recognised in the income statement).</td>
</tr>
<tr>
<td>Lessee financial statements</td>
<td>The asset is not recognised on the balance sheet.</td>
<td>The asset is recognised on the balance sheet initially at an amount equal to the lower of its fair value or the present value of the minimum lease payments. A liability to make future payments, equal to the lower of the fair value of the asset or the present value of the minimum lease payments, is recognised on the balance sheet.</td>
</tr>
<tr>
<td></td>
<td>Lease payments paid are recognised in the income statement over the lease term.</td>
<td>The asset will be depreciated. Interest expense is recognised in the income statement.</td>
</tr>
</tbody>
</table>

UKGN 1 Land and buildings apportionments for lease classification under IFRS
1.11 It is the responsibility of company directors to determine lease classification, in consultation with their accounting advisers. The directors may ask valuers for advice ranging from advising on elements of the classification routines described in this guidance note to undertaking a full detailed quantitative test for lease classification, including the calculation of the amounts to be included in the financial statements. Valuers are advised only to provide these services if they have an adequate understanding of the accounting concepts involved.

1.12 As illustrated in Table 1, the classification of a lease for an asset (which would either be the land or the buildings in the case of real estate) can have a significant impact on what is present in the financial statements.

2 Accounting guidance

2.1 IAS 17 requires all leases to be classified as either a finance lease or an operating lease, depending on the substance of the transaction, and not by its legal form. A finance lease is defined as 'a lease that transfers substantially all the risks and rewards incidental to ownership' of the leased asset to the lessee (IAS 17, paragraph 4). An operating lease 'is a lease other than a finance lease'.

2.2 When a lease includes both land and buildings elements, an entity assesses the classification of each element as a finance lease or an operating lease by applying the tests outlined in paragraphs 2.6 and 2.7.

2.3 In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life. Consequently, most leases of land are normally classified as operating leases, unless the practical effect of the lease is to transfer the risks and rewards. This would apply if, for example, the lease is longer than 99 years or the lessee is expected to acquire title to the land (because it can be bought at a favourable price). In addition, if the land value is insignificant, there is no need to account for the land and buildings assets separately and the classification of the buildings will be paramount.

2.4 Therefore, under IAS 17 unless title to the land is expected to pass to the lessee, the lessee is not considered to receive 'substantially all the risks and rewards of ownership' of the land. This is a clear instruction within the standard, despite the fact that substantially all the value of the land might pass to the lessee at the inception of a long lease.

2.5 The classification of the buildings element is often less straightforward. However, in many cases it is possible to determine that the lease of the building is an operating lease at a qualitative level without performing detailed calculations. The underlying test is not financial (IAS 17 does not state any threshold apportionments of value), but depends on the transfer of risks and rewards having regard to the substance of the transaction, rather than the form of the lease contract.

2.6 IAS 17, paragraph 10, provides examples of situations that 'would normally' indicate that a lease is a finance lease. These are (in the order in which they appear in the standard):
UKGN 1  Land and buildings apportionments for lease classification under IFRS

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term;
(b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;
(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;
(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
(e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

IAS 17, paragraph 10

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2.7 In addition, the following circumstances are described as situations that could also indicate a finance lease:

(a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
(b) gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and
(c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

IAS 17, paragraph 11

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2.8 Paragraph 12 of IAS 17 states that the examples and indicators in paragraphs 10 and 11 (see paragraphs 2.6 and 2.7 above) are not always conclusive. ‘If it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership, the lease is classified as an operating lease.’

2.9 Most of these tests are primarily factual and objective, and should not be difficult to apply. The exceptions are 2.6(c) and (d).

2.10 With regard to 2.6(c), there is no definition of what is meant by ‘the major part of the asset’s economic life’. Some auditors interpret this to mean a lease term that is at least 75% of the asset’s remaining economic life at the inception of the lease, but the standard offers no further guidance. Building lives are a matter of judgment, so this test is unlikely to be conclusive in isolation. An appropriate test might be to ask whether the building would be redeveloped or re-let today if it currently was at
the age and in the condition predicted for the end of the lease term. If a refurbishment might be envisaged (perhaps retaining the structure and frame, but rebuilding the walls, roof and services), then the residual value should be estimated taking into account which elements are retained.

2.11 Under 2.6(d) there is similarly no definition of what is meant by ‘substantially all’ of the fair value. The company directors and their accounting advisers will need to interpret this test in the context of the advice provided to them by the valuer. In due course a certain percentage might become established practice. Certainly, if the value of the lease interest in the buildings comes close to 90% of the freehold value or more, then the lease would likely be classified as a finance lease, unless there is persuasive evidence to the contrary.

2.12 If the qualitative tests (excluding 2.6 (d), which is quantitative) indicate an operating lease and a preliminary (non-detailed) consideration of 2.6 (d) does not suggest otherwise, then no further analysis is required. If the qualitative tests are not conclusive, then separate valuations of the land and buildings under the lease, and an apportionment of the rent, will be required in order to carry out the test under 2.6(d) and to determine the figures to be included in the financial statements. The remainder of this guidance note will focus on this subject matter.

3 Definitions

3.1 Certain terms are used in IAS 17 for which definitions are not provided. Phrases that may seem familiar to valuers may have different meanings than expected. The following expressions (defined in IAS 17, paragraph 4, and reproduced in quotes) are used with the meanings provided in the following paragraphs. Valuers should refer to IAS 17 for the full list of definitions.

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3.2 Fair value is ‘the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction’. In the context of IAS 17, the fair value of the leased asset or interest will normally be its market value as defined in VPS 4 paragraph 1.2, Market value.

3.3 Asset normally refers to the property out of which the lease is created. In valuation terms, this would be the freehold in the land or the buildings. It is also referred to as the leased asset (which is not defined).

3.4 A lease is an ‘agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time’. It is the substance of the agreement that is important, not its legal form. An agreement can be a lease in accounting terms that would, however, not be considered a lease under UK law.

3.5 The inception of the lease is the ‘earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease’.
This would usually be the date when the heads of terms are agreed or the date of
the lease. The inception of the lease and the commencement of the lease term refer
to the original lessor and lessee’s situation, not that of the current parties if the lease
has been assigned. There may be practical difficulties in ascertaining some dates
that are many years after the event, but the date of the lease and the stated
commencement date are usually sufficient for lease analysis.

3.6 The **commencement of the lease term** is the ‘date from which the lessee is
entitled to exercise its right to use the leased asset’.

3.7 The **lease term** is the ‘non-cancellable period for which the lessee has
contracted to lease the asset together with any further terms for which the lessee
has the option to continue to lease the asset, with or without further payment, when
at the inception of the lease it is reasonably certain that the lessee will exercise the
option’.

3.8 **Contingent rent** is the ‘portion of the lease payments that is not fixed in amount
but is based on the future amount of a factor that changes other than with the
passage of time’ (for example, future changes in market rents, percentage of future
sales, amount of future use, future price indices, future market rates of interest).

3.9 **Minimum lease payments** are ‘the payments over the lease term that the
lessee is or can be required to make, excluding contingent rent, costs for services
and taxes to be paid by and reimbursed to the lessor, together with:

(a) for a lessee, any amounts guaranteed by the lessee or any party related to the
lessee [for example, another group company]; or

(b) for a lessor, any [amounts] guaranteed to the lessor by:

(i) the lessee;

(ii) a party related to the lessee; or

(iii) a third party unrelated to the lessor that is financially capable of
discharging the obligations under the guarantee.’

In addition, if the lessee has an option to purchase the asset at a price that makes it
reasonably certain at the inception of the lease that the option will be exercised, then
the minimum lease payments will be the rent payable up to the date when the option
can be exercised, plus the option payment. The ‘minimum lease payments’ include
any premium paid as consideration for the granting of the lease.

3.10 **Residual value** is the term used in IFRS for the value the asset will have at
the end of its useful life. Useful life is the period over which the entity currently
holding the asset expects to use it, which can be contrasted with economic life (see
paragraph 3.11). For valuations undertaken in the context of IAS 17, residual value is
considered to be the discounted reversion value of the leased asset – that is, the
estimated value of the leased asset at the end of the lease term discounted back to
the inception of the lease. (The terms ‘residual value’ and ‘reversion value’ are
virtually synonymous in the context of IAS 17. Where this guidance note refers to a
specific concept within IAS 17, the term ‘residual value’ is used. Where the
discussion is on more general valuation issues, the term ‘reversion’ is used.)

3.11 **Economic life** is (for land and buildings) ‘the period over which an asset is
expected to be economically usable by one or more users’. This is not necessarily
3.12 The interest rate implicit in the lease is
‘the discount rate that, at the inception of the lease, causes the aggregate present value of:
(a) the minimum lease payments and
(b) the unguaranteed residual value to be equal to the sum of
(i) the fair value of the leased asset and
(ii) any initial direct costs of the lessor.’
Residual value here refers to the leased asset, which is usually the buildings element of the freehold reversion value. The fair value of the leased asset would normally mean its market value.

3.13 The lessee’s incremental borrowing rate of interest is ‘the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.’

3.14 The terms land and buildings are not defined in IAS 17. These are familiar terms to valuers, but when used in an accounting context should not be interpreted too literally. IAS 17 assumes that all the features and qualities of a parcel of real property that contribute to its value can be grouped under two categories: ‘land’ and ‘buildings’. Further, there is the implicit assumption that the sum of the values of these categories equals the value of the parcel of real property. Value might be affected by many features, such as location, architectural merit, lease structure, covenant and sunk finance costs.

3.15 It is possible to construct arguments that value relies on matters other than ‘land’ and ‘buildings’, and that the sum of the parts does not necessarily add up to the whole, but they are not relevant to this discussion. IAS 17 instructs valuers to apportion the value of a leased asset into two parts, labelled ‘land’ and ‘buildings’, and therefore by definition the two combined will equate to the whole.

3.16 The ‘land’ category is best defined as those elements that contribute to the value of real property and do not depreciate or reduce in a systematic way over time or usage. ‘Buildings’ is best defined as everything else. ‘Land’ therefore has an indefinite value, while ‘buildings’ needs to be accounted for as a wasting asset. In practice, ‘buildings’ will include, for example, the physical structures on the land, plus the sunk finance costs, developer’s profit and perhaps the lease value, all of which will depreciate to zero if the land is cleared of all built structures. ‘Land’ will include the location factors, as well as the physical ability and the legal right to use and construct improvements on the site.

4 The process of lease classification

4.1 Land and buildings are considered separately for lease classification. Financial calculations are only required to assist in the classification process for borderline
leases. Subsequently, these calculations are used for producing the various figures required for reporting purposes if the lease of either element is determined to be a finance lease.

4.2 The lessor and lessee do not have to classify the lease in the same way. For example, if the lessor had the benefit of a guaranteed residual value from a party unrelated to the lessee, then this would affect the lessor’s lease classification, but not the lessee’s.

4.3 In terms of IFRS, the value of an asset comprising land and buildings that have been leased has four elements:
- the value within the lease of the buildings
- the value within the lease of the land
- the residual value of the buildings and
- the residual value of the land.

4.4 Although most UK leases are drawn up on the assumption that the buildings will be yielded up to the landlord at the end of the term in good repair and ready for re-letting, the reality is that some buildings are redeveloped rather than re-let. In financial terms, the lessor may not be concerned with the value of the buildings (as opposed to the value of the land as a development site) at the end of the term when agreeing to grant a lease. If the reversionary value of the buildings is not important at the inception of the lease, many accountants will consider that the buildings have been ‘bought’ by the lessee. This would create a finance lease, whatever the form of the lease and covenants.

4.5 Where there are rent reviews during the non-cancellable term and these rent reviews are expected to take effect, it might be perceived that the benefits of an increase in the value of the asset during the term still accrue to the lessor, indicating an operating lease. However, if the rent reviews are upwards only and the initial rent is set at a high enough figure and lasts for a long enough term, such that these rent payments alone could ‘pay for’ the buildings regardless of the contingent element, this would indicate a finance lease.

4.6 The valuer may be asked to carry out classification appraisals on long lease terms without unusual review provisions, where the economic life test might be passed and the effects of declaring a finance lease need to be considered.

4.7 The following information is needed from the valuer by those who prepare accounts regarding leases of land and buildings for classification under the test in paragraph 2.6(d), and to determine the asset and liability figures to be shown in the accounts:
- the freehold value of the asset that has been leased, split between the buildings and the land
- the value contained within the lease, again split between the buildings and the land
- the allocation of the minimum lease payments under the lease between the buildings and the land and
- the calculation of the interest rate implicit in the lease.
4.8 Table 2 illustrates the main steps the valuer will need to take. The figures are drawn from Example 1, section 13. Although this is not a finance lease, it is used to illustrate the method and how the calculations would be carried out as if it was a finance lease.

Table 2

<table>
<thead>
<tr>
<th>Process</th>
<th>Description</th>
<th>Land element</th>
<th>Buildings element</th>
<th>Total</th>
<th>Commentary</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Assess the freehold value of the land and buildings</td>
<td></td>
<td></td>
<td></td>
<td>2,500,000</td>
<td>Carry out a valuation of the investment See section 5</td>
</tr>
<tr>
<td>2. Apportion the freehold value between the value within the lease and the residual (reversion) value</td>
<td>Lease value</td>
<td></td>
<td>1,843,000</td>
<td>Deduct the present value of the freehold reversionary interest See section 6</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Residual value</td>
<td></td>
<td>657,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td></td>
<td>2,500,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Apportion the freehold value between the land and buildings</td>
<td></td>
<td>550,000</td>
<td>1,950,000</td>
<td>2,500,000</td>
<td>Deduct land value or buildings (DRC) value See section 7</td>
</tr>
<tr>
<td>4. Apportion the value of the buildings element between the residual value and the value within the lease</td>
<td>Within lease</td>
<td></td>
<td>1,640,000</td>
<td>Estimate the buildings residual value using expected depreciation, or from the current value of older buildings See section 8</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Residual value</td>
<td></td>
<td>310,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td></td>
<td>1,950,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Apportion the values under the lease</td>
<td></td>
<td>203,000</td>
<td>1,640,000</td>
<td>1,843,000</td>
<td>Deduct the value of the buildings within the lease</td>
</tr>
<tr>
<td>6. Apportion the minimum lease payments between the land and buildings</td>
<td></td>
<td>19,300</td>
<td>155,700</td>
<td>175,000</td>
<td>Apportionment in the ratio of step 5 values See section 10</td>
</tr>
<tr>
<td>(Alternative approach)</td>
<td>Sinking fund</td>
<td>32,700</td>
<td>116,000 + 26,300</td>
<td>175,000</td>
<td>Apportion in the ratio of step 3 values, but allowing for the depreciating nature of the buildings</td>
</tr>
<tr>
<td>7. Calculate the interest rate implicit in the lease</td>
<td>Freehold value</td>
<td></td>
<td>1,950,000</td>
<td>Work out the discount rate that, when applied to both the lease payments and the residual value, gives the present value of the leased asset See section 11</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Residual value</td>
<td></td>
<td>310,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Minimum lease payments</td>
<td></td>
<td>155,700</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Implicit interest rate</td>
<td></td>
<td>6.99%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
5 The value of the freehold interest

5.1 The value of the freehold interest is the *market value* of the property (land and buildings combined) as an investment, determined in the normal manner in accordance with *VPS 4 paragraph 1.2, Market value*.

5.2 Most leases will have been agreed as arm's length transactions, and therefore the *market value* of the asset at the inception of the lease can be readily determined. If a premium has been paid for a lease, this is to be included as part of the minimum lease payments. However, the valuer may consider that the *investment value* arising out of the lease is not the same as the *market value* (i.e. *fair value*) of the leased asset. If so, the valuer is advised to assess the true *fair value* of the asset so that the difference between the created *investment value*, or actual sale price, and the underlying *fair value* can be accounted for separately in the accounts. This might occur when, for example, there is a clear case of a *special purchaser* or through a sale and leaseback transaction that is known to be at a non-market rent.

5.3 This is borne out by the particular rules that apply to sale and leasebacks (IAS 17, paragraphs 58 to 66). Clearly these allow for the possibility that the money paid by the investor/lessee under a sale and leaseback may be in excess of the normal *market value* of the leased asset. In these cases, where there is a clear indication that a non-market price has been reached as a result of a sale and leaseback, the valuer will have to carry out the test outlined previously in paragraph 2.6(d). For this test, the valuer compares the sale and leaseback lease payments with the true *market value* of the asset, assuming a normal lease (having regard to the market at the time) and a *market rent*. When defining the difference between the sale and leaseback price and the true *market value*, the valuer might consider the following factors:

- **Yield**: sale and leasebacks may be arranged across a number of properties at the same time, giving the investor greater security by spreading the property risk. The yield may also be determined by the financial strength of the vendor/lessee. Either of these factors might alter the price paid above or below the true underlying asset value, especially if the price paid is an apportionment of a larger transaction. The valuer should apply a market yield having regard to the normal covenant expected for properties of a similar nature.

- **Rent**: the rent paid under a sale and leaseback transaction might be related to affordability rather than current *market rents*. The *market rent* is to be used when estimating the true *market value* of the asset.

- **Lease terms**: if the lease term is unusually long, or other covenants have been written into the lease that would not be considered normal in the marketplace and which have affected the price paid, then the price paid may need adjustment to reflect 'normal' lease terms in the prevailing market. For example, there might be a rent escalator provision linked to a financial index as opposed to *market rents*.

- **Lease incentives**: the *investment value* of a property at the inception of the lease might be affected by a rent-free period or other incentives that have been granted to the lessor. Such provisions would not usually apply to a sale and leaseback transaction, meaning the price paid might be raised.

5.4 The valuer needs to be sure that any atypical lease terms that have been identified have affected the price paid. Otherwise, there is no need to use an
alternative market value in the test outlined in paragraph 2.6(d). While the ‘true’ market value is required for lease classification, once the lease is classified this value is only used again if the lease is an operating lease. If a finance lease results, then the asset is not deemed to have changed hands and any excess amount of the sale proceeds over the carrying amount of the asset is deferred and amortised over the period of the lease (IAS 17, paragraph 59). Under an operating lease, any amounts above or below fair value (as opposed to carrying amount) have to be identified because these are treated separately in the accounts.

6 Residual value

6.1 The residual value of the property (the land and buildings combined) for the purposes of lease classification can be estimated using the freehold value of the property in the condition anticipated at the end of the lease term, but in the market prevalent at the inception of the lease, and then deferring this over the term certain of the lease. This will be the shorter of the lease term or the period to the first break (unless it is reasonably certain the break will not be exercised).

6.2 The suggested means of doing this is to apply the single rate years purchase (YP) for the lease term at the valuation yield to the minimum lease payments (usually the current rent payable), and deduct this from the freehold value. Mathematically what is left will be the part of the freehold value that is not dependent on the contractual rents payable under the lease.

6.3 Care is required if the current buildings are known to be a sub-optimum use of the land, so that the land reversion is inflated by the expectation of redevelopment. The valuer should make sure that all of this element of value is included in the residual, thus diminishing the value within the lease. These circumstances are unlikely at the inception of the lease and, in any event, suggest that the buildings will be held under a finance lease (see Example 8 in section 13).

6.4 Normally this residual value is split between the land and buildings elements at this stage, as shown in Table 2 (see paragraph 4.8). The lessor of a finance lease of buildings will show in its balance sheet a financial asset equal to the net investment in the lease (the discounted value of the lease payments plus the unguaranteed residual value). The land and buildings components of the residual value will therefore appear as different assets, and the valuer must distinguish between them accordingly. This apportionment is also required in order to calculate the interest rate implicit in the lease for the buildings element.

6.5 This apportionment could be done in one of two ways. The first is to estimate the remaining economic life of the buildings at the end of the lease term, and then apply this as a ratio to the current depreciated replacement cost (DRC). This is a simple and robust method that can be easily understood by the reader of the valuer’s report. An alternative is to estimate what the building might be worth if it was already at the age and in the condition expected at the end of the lease, but using the market conditions as at the lease inception date. For example, if the lease of a new property was for 40 years, the value of a comparable 40-year-old building today and the redevelopment value should be considered. Any margin between those two elements would become the residual value of the buildings.
7 Apportioning the values between land and buildings

7.1 All calculations are carried out as at the inception of the lease, as defined previously in section 3, Definitions.

7.2 The apportionment can be done by finding the value of the land and treating the remaining value as attributable to the buildings, or vice versa.

7.3 If the buildings are valued as the remainder after deducting the known value or a development appraisal (see paragraph 7.4) of the land, this presents few problems for the valuer. Frequently, however, evidence of land values is not available, but the situation will vary depending on local market practice and conditions.

7.4 If a development appraisal of the land is carried out using the existing development, in effect the calculation is the same as using the DRC of the buildings (see paragraphs 7.6 to 7.9). If the freehold value would be affected by a different development in highest and best use, this development value could be used provided it is treated only as part of the residual value (see paragraph 6.3). Again, the same result might be obtained more easily by taking the current development cost of the buildings and depreciating it heavily to reflect the expected redevelopment at the end of the lease term.

7.5 If the buildings have to be valued, this is usually done based on their DRC, which is not the same as the fire insurance reinstatement cost. Instead, the value required represents the remaining utility value of the buildings, having regard to their age and condition at the inception of the lease and current construction techniques, not simply their reinstatement cost. However, the initial stage of the process is similar.

7.6 The valuer first estimates the gross rebuilding cost of the buildings. As the valuer is concerned with value and utility rather than reinstatement, the costs should be for a modern equivalent structure of the same utility, rather than the reproduction costs. The value should take into account factors that add to the prestige and attractiveness of the building and therefore its value, but not necessarily seek to reproduce every feature in a like-for-like manner.

7.7 Professional and carrying (finance) costs should be added to the building costs and any non-recoverable tax. This is because these costs would have to be incurred when constructing the buildings and the value of these costs is lost once the building reaches the end of its economic life. They therefore attach to, and depreciate with, the buildings. Costs that need to be considered include:
   • professional fees
   • developer's profit (see paragraph 7.8)
   • interest charges
   • VAT and
   • acquisition costs.

7.8 The developer's profit is judgmental. It is believed that this item should be allowed for if, under the normal scheme of procurement for the asset, this cost would be incurred in the market at the inception of the lease. For example, if the asset is the supermarket unit in a shopping centre, it is not possible to construct this unit except as part of a larger scheme. This would involve a developer who would need a
return. In contrast, an owner-occupied and self-constructed building on leased land might not involve any third party developer. However, even in this situation there may have been internal costs that should be correctly capitalised to arrive at the true cost of procuring the building.

7.9 The gross building costs then need to be depreciated having regard to the situation and condition of the buildings at the inception of the lease. This should also reflect the difference between the modern equivalent building that has been costed and the remaining utility of the existing structures. A new building might not require any depreciation, while older buildings are usually depreciated having regard to their original estimated economic life, adjusted for maintenance and repairs, compared with their estimated remaining economic life.

8 Land and buildings residual values

8.1 This is the part of the process that is most likely to cause difficulties for valuers and their clients.

8.2 It might be assumed that if a direct valuation of the land is used, the same value could be used as the end of lease value and discounted to the inception of the lease. In practice, this is unlikely to produce the right figure because the yield rates used in valuations are growth implicit, and most of that growth will apply to the land, not the buildings. Therefore, at the end of the lease the land will have a value that reflects the then optimum development of the site, involving issues such as technological development, changing tenant requirements and revised planning restrictions. It is impossible to predict these changes, and so mathematically there is a good reason to adopt a lower discount rate for the land element if the current land value is used to calculate the residual value of the land at lease expiry, as compared with the buildings. Implicitly, the discount rate on the land would be lower than the valuation yield for the whole property. The difficulty is that there is unlikely to be any objective basis by which this revised discount rate can be calculated.

8.3 It is therefore simpler to estimate the residual value of the buildings by applying a depreciation adjustment to the value of the buildings at the inception of the lease, than to estimate the land residual value. While it might not be clear how long the economic life of the buildings might be, at least a reasoned estimate can be made, thus making the adopted figure more transparent and reliable.

8.4 The buildings residual value (in current market prices, as required by IAS 17) can be estimated using a straight-line depreciation over the expected economic life, and applying a depreciation factor proportionately to the relative durations of the lease term and the economic life. Alternatively, if the current value of an older building is known, the amount of depreciation can be calculated if it is assumed that all of the fall in value as the building ages should be attributed to the buildings.

8.5 In section 13, Examples 2 and 3 show how these calculations might be carried out.

9 Minimum lease payments

9.1 Minimum lease payments include only those rent payments that can be quantified absolutely at the inception of the lease, as well as any premiums or capital sums payable as part of the agreement.
9.2 Any increase in the rent payable following a review to market rental value is a contingent element and not included in the minimum lease payments. If the rent cannot reduce on review, then the initial rent is included until the end of the lease term or earlier expected date of determination. If there is an upward or downward review, then the entire rent after the review date is treated as contingent and is not included in the minimum lease payments. In practice, a lease with regular upward or downward rent reviews cannot be a finance lease because the lessor retains the risk of rental value changes. Minimum lease payments would not extend beyond a break clause unless it was reasonably certain the break would not be exercised.

10 Apportioning the minimum lease payments

10.1 IAS 17 states that ‘the minimum lease payments … are allocated between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in the land element and the buildings element’ (paragraph 16). The allocation of the minimum lease payments, simply by reference to the relative fair values of the land and buildings, would not reflect the fact that land often has an indefinite economic life and therefore would be expected to maintain its value beyond the lease term.

10.2 In contrast, the future economic benefits of a building are likely to be used up, at least to some extent, over the lease term. Therefore, it would be reasonable to expect that the lease payments relating to the building would be set at a level that would enable the lessor not only to make a return on initial investment, but also to recoup the value of the building used up over the term of the lease. IAS 17 confirms that the allocation of the minimum lease payments should be weighted to reflect their role in compensating the lessor, and not mechanically by reference to the relative fair values of the land and buildings (see IAS 17, ‘Basis for Conclusions’, BC9 to BC11).

10.3 The simplest way of achieving this weighted allocation of the minimum lease payments is to apportion the rent. This should not be done by reference to the freehold relativity of the land and buildings values, but by the ratio of the values within the lease. As the net present value of the buildings residual value has been reduced by applying a depreciation factor before discounting it, the result is that the buildings element in the lease has been increased, as compared with the proportion of the freehold value attributed to the buildings. Therefore, applying the leasehold value apportionment to the rent produces a realistic weighting to reflect the depreciating nature of the buildings.

10.4 Alternatively, the rent could be apportioned simply by reference to the ratio of the freehold values of the land and buildings, and then adding a sinking fund element to the buildings allocation that would explicitly allow for the wasting nature of the leased buildings. The term used would be to the expected lease termination date (either the full term or an earlier break date, if this is expected to be exercised). The sinking fund would be calculated to replace that element of the buildings value used up during the lease term. This would be the difference between the buildings freehold value at the inception of the lease and the undiscounted residual (reversion) value at the end of the term.
11 Discount rate [interest rate implicit in the lease]

11.1 The implicit interest rate can be calculated using discounted cash flow (DCF) techniques or by a formula in spreadsheet applications. The discount rate needs to be applied to both the minimum lease payments allocated to the buildings and the buildings residual value, such that the net present value of both elements equals the freehold value of the buildings at the inception of the lease.

11.2 IAS 17, paragraph 16, implies that the interest rate implicit in the lease (or the lessee’s incremental borrowing rate) can be applied to the allocated minimum lease payments to test whether the net present value equates to ‘substantially all’ of the fair value of the leased asset. These calculations reveal a certain circularity in the lease classification process because for leases of land and buildings (unless the lessee’s incremental borrowing rate is used), the interest rate will depend on the prior calculation of the residual value.

11.3 For high land value locations, such as a high street, the minimum lease payments could possibly equate to the freehold value of the buildings over relatively short terms, if a high enough proportion of the payments is allocated to the buildings (see Example 5 in section 13). In these situations, it is worth considering the payments apportioned to the land element to decide whether they, in fact, give a realistic return on the land element. If the land return is similar to the buildings return (see Examples 4 and 6 in section 13), then it is more likely that the buildings should be classified as held under a finance lease.

11.4 Once all the aforementioned values have been obtained, the company will decide on the lease classification and, if a finance lease is determined, on the allocation of the rent between the interest charge (in the profit and loss account) and the payment for the leased asset.

12 Listed buildings

12.1 UK planning law dictates that certain buildings are protected from development or substantial alteration through having a historic or architectural significance. There is a presumption in law that these buildings will be maintained and will effectively have an indefinite economic life. However, there are circumstances under which redevelopment is permitted.

12.2 Certain listed buildings (those of the greatest importance) can be treated as if they will never be redeveloped, and therefore a lease of such buildings, or part of them, will qualify as an operating lease. This applies for the same reason that the land element is usually an operating lease: the lease term is a temporary arrangement when compared with the economic life of the building.

12.3 Even when the listed building is considered not to be of particular importance, such that at least a partial redevelopment might be envisaged at some time in the future, it would be appropriate to assume a long remaining economic life at the inception of the lease that is at least the length of a new modern building. Only longer lease terms would pass the economic life test in paragraph 2.6(c).

12.4 When calculating the construction cost of listed buildings, the valuer should take into account the features of the building that gave rise to its listed status and
presume that those features and the materials used would have to be identical to the existing structure. It would not be appropriate to cost a modern equivalent building with the same utility. The depreciation factor applied will need careful consideration, and guidance can be found in UKGN 2, Depreciated replacement cost method of valuation for financial reporting.

12.5 Listed buildings where the features that gave rise to the listing are relatively unimportant in relation to the building as a whole (for example, the facade or certain rooms within the structure) are often redeveloped around these features. In these cases, it may not be appropriate to make significant changes to the lease classification considerations because the building is listed, especially if development work has already been carried out on the structure.

13 Examples

13.1 The following examples are intended to illustrate how the calculations might be performed and to address difficulties that might arise. All calculations for these examples are given together at the end of this guidance note.

13.2 Example 1

13.2.1 This is a provincial office building that is newly constructed and let under a 20-year upwards only, full repairing and insuring (FRI) lease. It was leased at £175,000 per annum with no rent-free period. The rent has been treated as the expected market rental value, and therefore the freehold value is calculated at £2.5 million using a standard YP approach. The buildings have an estimated rebuilding cost of £1,950,000, which includes fees and profit. While there is little doubt that this is not a finance lease under the economic life test, this example serves to illustrate the judgments that the valuer will be required to make.

13.2.2 In this example it is assumed that there are no readily available comparables that give a direct land value for the analysis, so the DRC of the buildings has been used to apportion the value between the land and buildings.

13.2.3 The building costs include fees, unrecoverable VAT and the developer’s profit. It is considered normal in the particular location for this property for developers or property companies to carry out developments and then sell them into the market. Although a company could self-develop a property, it is most unlikely for them to do this unless they have a particular property expertise. In that event, it might be appropriate to consider capitalising internal costs such as managers’ time, so the final figure might not be very different.

13.2.4 The residual value of the buildings at the end of the lease term has been estimated using simple straight-line depreciation.

13.2.5 The results show that even though the lease term is only for 20 years, 84% of the present value of the buildings element is included in the value of the lease. Using undiscounted values, this figure falls to 40%, reflecting the 30 years of continued economic life after expiry of the lease term anticipated at the inception of the lease.

13.2.6 The rent has then been apportioned in the same ratio as the land and buildings values under the lease, with 89% of the rent allocated to the buildings.
When compared with the freehold values, this gives a return of 8% on the freehold value of the buildings, but only 3.5% on the land. The discrepancy and relatively low returns again suggest this is an operating lease.

13.2.7 The interest rate implicit in the lease has been calculated to be exactly the same as the property yield (7%). This is as expected, because the calculations have all been predicated on the yield and no external adjustments (such as applying a known land value) have been made.

13.2.8 The alternative calculation shows the effect of using the freehold relativities for the rent apportionment, and then applying a sinking fund to recover the buildings value consumed over the term of the lease (£770,000). The calculations do not give quite the same figure, as the freehold analysis inevitably applies a higher land value and the calculation is sensitive to the sinking fund accrual rate. The discrepancy between the two approaches diminishes for longer lease terms (see Examples 4 and 6).

13.3 Example 2

13.3.1 This example is exactly the same as Example 1, but with the residual value taken from market evidence of the value of older buildings. The difference between the value of the new property and the 20-year-old property is £830,000. For the sake of simplicity, it is assumed that this entire diminution applies to the buildings. Therefore if the cost of construction today is £1,950,000 (including fees, profit and interest), then the value of the 20-year-old building will be £1,120,000 at today’s prices. The rest of the calculation is much the same as for Example 1.

13.4 Example 3

13.4.1 Again, this is very similar to Example 1, but with a known land value applied to calculate the buildings value at the inception of the lease. Therefore, there is no need to calculate the building costs, but the residual value of the land and buildings is still most easily calculated by applying a depreciation factor to the buildings value. The alternative is to use the estimated land value at the end of the lease term and discount this. However, this calculation is difficult because investments in land are purchased in the expectation of capital value growth in the land over the lease term. Therefore, either a rate of growth has to be assumed in the land value over the lease term, or the discount rate has to be reduced to reflect this. This leads to subjective adjustments that are best avoided.

13.5 Example 4

13.5.1 This is the same as Example 1, but with a much longer lease term. The rental return on the lease values is much higher than in Example 1 (especially on the land) and much closer to the implied return on the freehold values, but the interest rate implicit in the lease has not changed.

13.5.2 This example might be considered to create a finance lease on the buildings element because of the length of the lease term. However, if the lessee’s increment borrowing rate is applied and is higher than 7%, then the allocated minimum lease payments would not equate to ‘substantially all’ of the fair value of the buildings.
13.6  Example 5

13.6.1  This property is a high street shop, where the buildings cost is relatively low compared to the value of the freehold land and buildings. The relative returns on the land and buildings are similar to Example 4, despite the lease term being only 20 years. Mathematically, therefore, the value test in paragraph 2.6(d) will be ‘passed’ much earlier than for properties with a lower relative land value, leading to the possibility of a finance lease with shorter lease terms.

13.7  Example 6

13.7.1  This is the same as Example 5, but with a longer lease term. The implicit interest rate is again unchanged, but the return on the land and buildings elements has converged, as with Example 4.

13.8  Example 7

13.8.1  This is a detached restaurant in an edge-of-town retail and leisure park. It is a simple single-storey structure that can be built cheaply, but uncertainty over future rental movements means that the lessee has agreed to a compounded fixed rent escalator of 3.5% per annum.

13.8.2  As this is a fixed rent increase, these additional payments form part of the minimum lease payments for classification analysis. This has two notable effects:

- the interest rate implicit in the lease is much higher than in the earlier examples, which is a strong indication that the buildings lease could be classified as a finance lease
- the interest charges are implicitly higher than the rent payable for the early years of occupation.

13.8.3  This is an example of an atypical lease structure, which means the lessee does assume the risk of variations in the value of the leased asset. The rent does not change if the value of the property changes over the lease term. Therefore, provided the lease term is long enough, a finance lease is indicated for the buildings.

13.9  Example 8

13.9.1  This example is for an older industrial property already midway through its expected economic life and let for 20 years at £50,000. The rebuilding cost is similar to the current value of the building, but after allowing for depreciation at 50%, there is still a significant value on the land.

13.9.2  The remaining estimated economic life of the building at the inception of the lease is equal to the lease term, even though it is only for 20 years. The values and implicit interest rates also suggest that a finance lease has been created for the buildings. While this might appear illogical for an FRI lease, the original lessor and lessee are anticipating (at the inception of the lease) that the buildings will be redeveloped at the end of the lease term. Even though this might not happen, it would be reasonable to assume that the lessor is not relying on the buildings element having a significant residual value.
Example 1: DRC on buildings cost, using expected life of buildings

**Description**
Detached office building in provincial town

<table>
<thead>
<tr>
<th>Description</th>
<th>Value within the Lease</th>
<th>Residual value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tenure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lease date</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Term</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lease expiry date</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rent review date(s)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basis of rent review</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rent passing</td>
<td>£175,000</td>
<td></td>
</tr>
<tr>
<td>Effective term</td>
<td>19.75 years</td>
<td></td>
</tr>
<tr>
<td>Valuation</td>
<td>Rent passing</td>
<td>175,000</td>
</tr>
<tr>
<td></td>
<td>Yield</td>
<td>7.00%</td>
</tr>
<tr>
<td></td>
<td>Years purchase</td>
<td>14.29</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2,500,000 (rounded)</td>
</tr>
<tr>
<td>Usually at this stage, purchaser's costs would be deducted to arrive at a 'price' in exchange. However, in 'fair value' includes these costs, this step can be omitted.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Depreciated Replacement Cost of Building (used when no land values are available)</th>
<th>Freehold Value 2,500,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross internal area</td>
<td>1,950,000</td>
</tr>
<tr>
<td>Effective value construction cost</td>
<td>1,200.00 ($/m²)</td>
</tr>
<tr>
<td></td>
<td>Building cost</td>
</tr>
<tr>
<td></td>
<td>Add fees</td>
</tr>
<tr>
<td></td>
<td>Developer's profit</td>
</tr>
<tr>
<td></td>
<td>Acquisition fees</td>
</tr>
<tr>
<td></td>
<td>Capitalised interest</td>
</tr>
<tr>
<td></td>
<td>Non-recoverable VAT</td>
</tr>
<tr>
<td></td>
<td>Total Building cost (rounded)</td>
</tr>
<tr>
<td></td>
<td>Depreciation</td>
</tr>
<tr>
<td></td>
<td>Effective value of buildings</td>
</tr>
</tbody>
</table>

**Calculation of Buildings Residual Value (using interest rate implicit in the lease)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Value within the Lease</th>
<th>Residual value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciated Replacement Cost</td>
<td>Freehold Value 2,500,000</td>
<td></td>
</tr>
<tr>
<td>Current construction cost (as above)</td>
<td>1,950,000</td>
<td></td>
</tr>
<tr>
<td>Remaining economic life</td>
<td>19.75 years, being 50 years from completion</td>
<td></td>
</tr>
<tr>
<td>Less term</td>
<td>(19.75)</td>
<td></td>
</tr>
<tr>
<td>Remaining life at encl of lease</td>
<td>30.00</td>
<td></td>
</tr>
<tr>
<td>Buildings residual value (straight line approach)</td>
<td>1,180,000</td>
<td></td>
</tr>
<tr>
<td>Present value multiplier at JR implicit in lease</td>
<td>0.9632 rounded 6.9932% for 19.75 years</td>
<td></td>
</tr>
<tr>
<td>Present value of buildings residual value, say</td>
<td>310,000</td>
<td></td>
</tr>
<tr>
<td>Value under the lease</td>
<td>1,640,000</td>
<td></td>
</tr>
<tr>
<td>residual value as % of total</td>
<td>15.90% using net present value</td>
<td></td>
</tr>
<tr>
<td>implicit interest rate (buildings lease)</td>
<td>6.9990%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fair Value of Leasehold Assets</th>
<th>Percentage Split</th>
<th>Rent Allocation</th>
<th>Income Rate of Return on FH Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings element</td>
<td>1,640,000</td>
<td>88.99%</td>
<td>155,700</td>
</tr>
<tr>
<td>Land element</td>
<td>203,000</td>
<td>11.01%</td>
<td>19,300</td>
</tr>
<tr>
<td>Total</td>
<td>1,843,000</td>
<td></td>
<td>175,000</td>
</tr>
</tbody>
</table>
Example 1: DRC on buildings cost, using expected life of buildings (continued)

Breakdown of Net Present Values

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings value under lease</td>
<td>1,640,000</td>
</tr>
<tr>
<td>Land value under lease</td>
<td>205,000</td>
</tr>
<tr>
<td>Buildings residual (reversion) value</td>
<td>310,000</td>
</tr>
<tr>
<td>Land residual (reversion) value</td>
<td>347,000</td>
</tr>
<tr>
<td>Total</td>
<td>2,500,000</td>
</tr>
</tbody>
</table>

Apportionment of Value at Inception of Lease

<table>
<thead>
<tr>
<th>Description</th>
<th>£'000s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings value under lease</td>
<td>500</td>
</tr>
<tr>
<td>Land value under lease</td>
<td>294</td>
</tr>
<tr>
<td>Buildings residual (reversion) value</td>
<td>311</td>
</tr>
<tr>
<td>Land residual (reversion) value</td>
<td>346</td>
</tr>
<tr>
<td>Total</td>
<td>4,641</td>
</tr>
</tbody>
</table>

Alternative Approach – using freehold apportionment, but adjusted by a buildings sinking fund

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings value at start of term</td>
<td>1,950,000</td>
</tr>
<tr>
<td>Undiscounted buildings value at end of term</td>
<td>1,165,000</td>
</tr>
<tr>
<td>Buildings value consumed during term</td>
<td>770,000</td>
</tr>
<tr>
<td>Accumulation rate</td>
<td>4.00%</td>
</tr>
<tr>
<td>Effective Term</td>
<td>19.75%</td>
</tr>
<tr>
<td>Sinking Fund (rounded)</td>
<td>26,300</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair Value of Leasehold Assets</td>
<td></td>
</tr>
<tr>
<td>Direct Rent Allocation</td>
<td></td>
</tr>
<tr>
<td>Include Sinking Fund</td>
<td></td>
</tr>
<tr>
<td>Income Rate of Return on FH Value</td>
<td></td>
</tr>
<tr>
<td>Buildings element</td>
<td>1,960,000</td>
</tr>
<tr>
<td>Buildings sinking fund</td>
<td>136,500</td>
</tr>
<tr>
<td>Land element</td>
<td>550,000</td>
</tr>
<tr>
<td></td>
<td>2,640,000</td>
</tr>
<tr>
<td></td>
<td>176,900</td>
</tr>
<tr>
<td>Implicit Interest rate (buildings lease)</td>
<td>6.227%</td>
</tr>
</tbody>
</table>

Table of Components

<table>
<thead>
<tr>
<th>Description</th>
<th>Total</th>
<th>Land</th>
<th>Buildings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of Whole Leased Asset (including costs)</td>
<td>2,500,000</td>
<td>550,000</td>
<td>1,950,000</td>
</tr>
<tr>
<td>ELESS Residual Value</td>
<td>1,843,000</td>
<td>205,000</td>
<td>1,640,000</td>
</tr>
<tr>
<td>Value of the Lease Elements</td>
<td>1,843,000</td>
<td>205,000</td>
<td>1,640,000</td>
</tr>
<tr>
<td>Rent allocation, using values within the lease</td>
<td>175,000</td>
<td>19,400</td>
<td>155,700</td>
</tr>
<tr>
<td>Interest Rate Implicit in the Buildings Lease</td>
<td>7.000%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rental allocation, using FH values with sinking fund</td>
<td>175,000</td>
<td>32,700</td>
<td>162,400</td>
</tr>
<tr>
<td>Buildings sinking fund</td>
<td>26,300</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Rate Implicit in the Buildings Lease</td>
<td>6.227%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Example 2: DRC on buildings cost, using evidence of value for older buildings

Description: Detached office building in provincial town

Tenure: As per example 1

Valuation:
- As per example 1: 2,900,000

Residual Value:
- As per example 1: 657,000

Value of Old Asset Today:
- Market rent: 125,000
- Yield: 7.50%
- Diminution in Value: 830,000

Depreciated Replacement Cost of Building:
- As per Example 1: 1,950,000
- LESS: Diminution in value of 20 year old building: 830,000
- Effective value of building at end of lease: 1,120,000
- Depreciation: 42.56%
- Implied straight line life: 46.99 years

Calculation of Buildings Residual Value (using interest rate implicit in the lease):

<table>
<thead>
<tr>
<th>Description</th>
<th>Percentage</th>
<th>Rent Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings element</td>
<td>1,655,000</td>
<td>157,100</td>
</tr>
<tr>
<td>Land element</td>
<td>1,843,000</td>
<td>175,000</td>
</tr>
</tbody>
</table>

Implicit interest rate (buildings lease): 6.9934%

Alternative Approach – using freehold apportionment, but adjusted by a buildings sinking fund:

<table>
<thead>
<tr>
<th>Description</th>
<th>Percentage</th>
<th>Rent Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings value consumed during term</td>
<td>1,950,000</td>
<td>114,300</td>
</tr>
<tr>
<td>Accumulation rate</td>
<td>4.00%</td>
<td></td>
</tr>
<tr>
<td>Effective Term</td>
<td>19.75</td>
<td></td>
</tr>
<tr>
<td>Sinking Fund (rounded)</td>
<td>28,400</td>
<td></td>
</tr>
</tbody>
</table>

Implicit interest rate (buildings lease): 6.1553%
Example 3: Using current land values

<table>
<thead>
<tr>
<th>Description</th>
<th>Detached office building in provincial town</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tenure</td>
<td>As per example 1</td>
</tr>
<tr>
<td>Valuation</td>
<td>As per example 1, 2,500,000</td>
</tr>
<tr>
<td>Residual Value</td>
<td>As per example 1, 657,000</td>
</tr>
</tbody>
</table>

**Land and Building Values**

- **Land area**: 0.04 hectares
- **Price**: 13,750,000 per hectare
- **Value of land within freehold**: 550,000
- **Value of buildings within freehold**: 1,950,000

Having derived the buildings element in the freehold value, the calculations proceed as per example 1 – Calculation of Buildings Residual Value.
Example 4: Long lease with upwards only rent reviews

Description  Detached office building in provincial town

Tenure  As per example 1
Rent passing  £175,000
but with an effective term of  44.75 years

Valuation  As per example 1
2,590,000

Residual Value  £2,500,000
Value within the Lease  (2,579,000) The PV of £175,000 pa for 44.75 years, at 7%
The residual value  121,000 for both land and buildings

Depreciated Replacement Cost of Building (as before)  1,950,000 as per example 1
Effective value of buildings

Calculation of Buildings Residual Value
Current buildings value  1,950,000
Remaining economic life  49.75 years, being 50 years from completion
Less lease term  (44.75)
Remaining life at end of lease  5.00
Buildings residual value (straight line approach)  200,000 being £1,950,000 x (5/49.75), rounded
PV multiplier at IR (implicit in lease)  0.6485 6.998% for 44.75 years
Present value of buildings residual value  10,000
Value under the lease  1,940,000 being £1,950,000 less £10,000

<table>
<thead>
<tr>
<th>Fair Value of Leasehold Assets</th>
<th>Percentage of Rent Allocation</th>
<th>Income Rate of Return on FH Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings element 1,940,000</td>
<td>81.5% 142,700 7.32%</td>
<td></td>
</tr>
<tr>
<td>Land element 450,000</td>
<td>18.5% 32,300 5.87%</td>
<td></td>
</tr>
<tr>
<td>Total 2,390,000</td>
<td>175,000</td>
<td></td>
</tr>
</tbody>
</table>

Implicit interest rate (buildings lease)  6.9981%

Alternative Approach – using freehold apportionment, but adjusted by a buildings sinking fund
Buildings value at start of term  1,950,000
Undiscounted buildings value at end of term  200,000
Buildings value consumed during term  1,750,000 89.74%
 Accumulation rate  4.00%
 Effective Term  44.25
 Sinking Fund (rounded)  14,600

<table>
<thead>
<tr>
<th>Fair Value of Freehold Assets</th>
<th>Direct Rent Allocation</th>
<th>Include Sinking Fund</th>
<th>Income Rate of Return on FH Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings element 1,950,000</td>
<td>136,500 125,100 5.16%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buildings sinking fund</td>
<td></td>
<td>14,600</td>
<td></td>
</tr>
<tr>
<td>Land element 550,000</td>
<td>38,500 35,700 6.42%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total 2,500,000</td>
<td>175,000 173,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Implicit interest rate (buildings lease)  6.8277%
Example 5: Retail unit on institutional lease

Description
High street shop with upper parts in provincial town

Tenure
As per example 1, except
Rent passing £150,000
Effective term until 19.75 years

Valuation
Rent passing £100,000
Yield 6.00% per annum
Years purchase 16.67
1,670,000 (rounded)

Residual Value
Freehold Value £1,670,000
Value within the Lease £1,030,000
The PV of £130,000 per annum for 19.75 years, at 6.00% for both land and buildings
The residual value 530,000

Depreciated Replacement Cost of Building
Gross internal area 400.00
Effective value construction cost £1,000/sqm
Building cost 400,000
Add fees 12.50% 50,000
Developer’s profit 20.00% 90,000
Acquisition fees 2.00% 11,000
Capitalised interest 7.5% for 6 months 21,000
Non-recoverable VAT 48,213
Total building cost (rounded) 620,000
Depreciation 5.00% assuming new building 31,000
Effective value of buildings 620,000

Calculation of Buildings Residual Value
Current buildings value £620,000
Remaining economic life, say 49.75 years being 50 years from completion (19.75)
Remaining life at end of lease 20
Buildings residual value £130,000
PV multiplier at 6% implicit value £1.3158
Present value of buildings residual value £171,000
Value under the lease £1,030,000

Fair Value of Leasehold | Percentage | Rest | Income Rate of Return on FH Value
<table>
<thead>
<tr>
<th>Assets</th>
<th>Split</th>
<th>Allocation</th>
<th>Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings element</td>
<td>500,000</td>
<td>44.14%</td>
<td>44,200</td>
</tr>
<tr>
<td>Land element</td>
<td>630,000</td>
<td>55.86%</td>
<td>55,800</td>
</tr>
<tr>
<td>Total</td>
<td>1,130,000</td>
<td></td>
<td>100,000</td>
</tr>
</tbody>
</table>

Implicit interest rate (buildings lease) 6.0106%

Alternative Approach – using freehold apportionment, but adjusted by a buildings sinking fund
Buildings value at start of term £620,000
Undiscounted buildings value at end of term (370,000)
Buildings value consumed during term: 200,000 40.33%
Accumulation rate 4.00%
Effective Term 19.75
Sinking Fund (rounded) £8,500

Fair Value of Freehold | Direct Rent | Include Sinking | Income Rate of Return on FH Value
| Assets | Allocation | Fund |
|-------------------|-----------|---------|-----------------|
| Buildings element | 620,000 | 57,126 | 34,000 | 6.85% |
| Buildings sinking fund | | | 8,500 |
| Land element | 1,350,000 | 62,874 | 57,500 | 5.48% |
| Total | 1,970,000 | 160,000 | 160,000 |

Implicit interest rate (buildings lease) 5.6990%
Example 6: Retail unit on long lease

Description: High street shop with upper parts in provincial town.

Tenure: As per example 5
- Rent passing £100,000
- but with and effective term of 44.75 years

Valuation: As per example 5
- £1,670,000

Residual Value: £1,670,000

Value: Value within the Lease
- £1,548,000 (The PV of £1,000,000 pa for 44.75 years, at 6%,
- The residual value £126,000 rounded for both land and buildings)

Depreciated Replacement Cost of Building
- As per example 5
- £620,000

Calculation of Buildings Residual Value
- Current buildings value £620,000
- Remaining economic life 49.75 years
- Less lease term (44.75)
- Remaining life at end lease 5.00
- Buildings residual value £60,000 bringing £620,000 x (5/49.75)
- PV multiplier at IR implicit in lease 0.0736 rounded 6.0077% for 44.75 years
- Present value of buildings residual value £1,000
- Value under the lease £616,000 bringing £620,000 less £4,000

<table>
<thead>
<tr>
<th>Fair Value of Leasehold Assets</th>
<th>Percentage Split</th>
<th>Rent Allocation</th>
<th>Income Rate of Return on FH Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings element</td>
<td>616,000</td>
<td>39.90%</td>
<td>39,900</td>
</tr>
<tr>
<td>Land element</td>
<td>928,000</td>
<td>60.10%</td>
<td>60,100</td>
</tr>
<tr>
<td>Total</td>
<td>1,544,000</td>
<td>100.00%</td>
<td>100,000</td>
</tr>
</tbody>
</table>

Implicit interest rate (buildings lease) 6.0048%

Alternative Approach – using freehold apportionment, but adjusted by a buildings sinking fund

<table>
<thead>
<tr>
<th>Fair Value of Freehold Assets</th>
<th>Direct Rent Allocation</th>
<th>Include Sinking Fund</th>
<th>Income Rate of Return on FH Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings element</td>
<td>620,000</td>
<td>37,126</td>
<td>35,400</td>
</tr>
<tr>
<td>Buildings sinking fund</td>
<td></td>
<td></td>
<td>4,700</td>
</tr>
<tr>
<td>Land element</td>
<td>1,050,000</td>
<td>62,874</td>
<td>59,900</td>
</tr>
<tr>
<td>Total</td>
<td>1,670,000</td>
<td>100,000</td>
<td>100,000</td>
</tr>
</tbody>
</table>

Implicit interest rate (buildings lease) 6.0416%
Example 7: Long lease with fixed uplifts

Description: Detached single storey unit in retail park

<table>
<thead>
<tr>
<th>Tenure</th>
<th>Description</th>
<th>Date</th>
<th>Term</th>
<th>Lease expiry date</th>
<th>Rent review date(s)</th>
<th>Basis of rent review</th>
<th>Rent payment</th>
<th>Effective term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lease date</td>
<td></td>
<td>21-Jan-00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Term commencement</td>
<td></td>
<td>21-Oct-99</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Term</td>
<td></td>
<td>35.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lease expiry date</td>
<td></td>
<td>21-Oct-34</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rent review date(s)</td>
<td></td>
<td>21-Oct-04</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basis of rent review</td>
<td></td>
<td>3.5% per annum</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rent payment</td>
<td></td>
<td>£100,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Effective term</td>
<td></td>
<td>34.75 years</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Valuation

Rent passing: £100,000
Yield: 6.00%
Years purchase: 16.67

1,670,000 (rounded)

Residual Value

Freehold Value: £1,447,000
Value within the Lease: £223,000

The residual value: £223,000

Average Contractual Rent
(minimum lease payments)

<table>
<thead>
<tr>
<th>Period</th>
<th>Rent</th>
<th>PV at 6.3321%</th>
<th>NPV</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.75</td>
<td>75,000</td>
<td>0.94</td>
<td>70,651</td>
</tr>
<tr>
<td>1.75</td>
<td>100,000</td>
<td>0.87</td>
<td>86,931</td>
</tr>
<tr>
<td>2.75</td>
<td>100,000</td>
<td>0.80</td>
<td>80,245</td>
</tr>
<tr>
<td>3.75</td>
<td>100,000</td>
<td>0.74</td>
<td>74,073</td>
</tr>
<tr>
<td>4.75</td>
<td>100,000</td>
<td>0.68</td>
<td>68,576</td>
</tr>
<tr>
<td>5.75</td>
<td>115,927</td>
<td>0.63</td>
<td>73,170</td>
</tr>
<tr>
<td>6.75</td>
<td>115,927</td>
<td>0.58</td>
<td>67,543</td>
</tr>
<tr>
<td>7.75</td>
<td>115,927</td>
<td>0.54</td>
<td>62,384</td>
</tr>
<tr>
<td>8.75</td>
<td>115,927</td>
<td>0.50</td>
<td>57,552</td>
</tr>
<tr>
<td>9.75</td>
<td>115,927</td>
<td>0.46</td>
<td>53,126</td>
</tr>
<tr>
<td>10.75</td>
<td>134,392</td>
<td>0.42</td>
<td>58,850</td>
</tr>
<tr>
<td>11.75</td>
<td>134,392</td>
<td>0.39</td>
<td>54,748</td>
</tr>
<tr>
<td>12.75</td>
<td>134,392</td>
<td>0.36</td>
<td>48,442</td>
</tr>
<tr>
<td>13.75</td>
<td>134,392</td>
<td>0.33</td>
<td>44,716</td>
</tr>
<tr>
<td>14.75</td>
<td>134,392</td>
<td>0.31</td>
<td>41,277</td>
</tr>
<tr>
<td>15.75</td>
<td>134,392</td>
<td>0.28</td>
<td>37,171</td>
</tr>
<tr>
<td>16.75</td>
<td>134,392</td>
<td>0.26</td>
<td>33,474</td>
</tr>
<tr>
<td>17.75</td>
<td>155,927</td>
<td>0.24</td>
<td>30,071</td>
</tr>
<tr>
<td>18.75</td>
<td>155,927</td>
<td>0.22</td>
<td>26,918</td>
</tr>
<tr>
<td>19.75</td>
<td>155,927</td>
<td>0.21</td>
<td>23,980</td>
</tr>
<tr>
<td>20.75</td>
<td>180,611</td>
<td>0.19</td>
<td>21,319</td>
</tr>
<tr>
<td>21.75</td>
<td>180,611</td>
<td>0.18</td>
<td>18,860</td>
</tr>
<tr>
<td>22.75</td>
<td>180,611</td>
<td>0.16</td>
<td>16,580</td>
</tr>
<tr>
<td>23.75</td>
<td>180,611</td>
<td>0.15</td>
<td>14,494</td>
</tr>
<tr>
<td>24.75</td>
<td>180,611</td>
<td>0.14</td>
<td>12,588</td>
</tr>
<tr>
<td>25.75</td>
<td>209,378</td>
<td>0.13</td>
<td>10,865</td>
</tr>
<tr>
<td>26.75</td>
<td>209,378</td>
<td>0.12</td>
<td>9,264</td>
</tr>
<tr>
<td>27.75</td>
<td>209,378</td>
<td>0.11</td>
<td>7,771</td>
</tr>
<tr>
<td>28.75</td>
<td>209,378</td>
<td>0.10</td>
<td>6,380</td>
</tr>
<tr>
<td>29.75</td>
<td>209,378</td>
<td>0.09</td>
<td>5,089</td>
</tr>
<tr>
<td>30.75</td>
<td>242,276</td>
<td>0.09</td>
<td>3,918</td>
</tr>
<tr>
<td>31.75</td>
<td>242,276</td>
<td>0.08</td>
<td>2,849</td>
</tr>
<tr>
<td>32.75</td>
<td>242,276</td>
<td>0.07</td>
<td>1,880</td>
</tr>
<tr>
<td>33.75</td>
<td>242,276</td>
<td>0.06</td>
<td>1,020</td>
</tr>
<tr>
<td>34.75</td>
<td>242,276</td>
<td>0.06</td>
<td>1,042</td>
</tr>
</tbody>
</table>

Average: 0.3286
Implied rental equivalent: 128,469
Example 7: Long lease with fixed uplifts (continued)

Depreciated Replacement Cost of Building (used when no land values are available)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Internal area</td>
<td>750,000</td>
</tr>
<tr>
<td>Effective value construction cost</td>
<td>800,000 £/m²</td>
</tr>
<tr>
<td>Building cost</td>
<td>600,000</td>
</tr>
<tr>
<td>Add fees</td>
<td>12,500</td>
</tr>
<tr>
<td>Developer's profit</td>
<td>20,000</td>
</tr>
<tr>
<td>Acquisition fees</td>
<td>2,000</td>
</tr>
<tr>
<td>Capitalised interest</td>
<td>7.5% for 6 months</td>
</tr>
<tr>
<td>Non-recoverable VAT</td>
<td>72,275</td>
</tr>
<tr>
<td>Total building cost (rounded)</td>
<td>930,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>0.00% assuming a new building</td>
</tr>
<tr>
<td>Effective value of building</td>
<td>930,000</td>
</tr>
</tbody>
</table>

Calculation of Buildings Residual Value (using interest rate implicit in the lease)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciated Replacement Cost</td>
<td>930,000</td>
</tr>
<tr>
<td>Remaining economic life</td>
<td>40.00 years</td>
</tr>
<tr>
<td>Less lease term (34.75)</td>
<td></td>
</tr>
<tr>
<td>Remaining life at end of lease</td>
<td>5.25</td>
</tr>
<tr>
<td>Buildings residual value (straight line approach)</td>
<td>120,000</td>
</tr>
<tr>
<td>Present value multiplier at UR implicit in lease</td>
<td>0.620</td>
</tr>
<tr>
<td>Present value of buildings residual value, say</td>
<td>7,000</td>
</tr>
<tr>
<td>Value under the lease</td>
<td>923,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pair Value of Leasold Assets</th>
<th>Percentage of Split</th>
<th>Rent Allocation</th>
<th>Income Rate of Return on FH Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings element</td>
<td>923,000</td>
<td>65.79%</td>
<td>81,947</td>
</tr>
<tr>
<td>Land element</td>
<td>554,000</td>
<td>36.31%</td>
<td>46,522</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,477,000</strong></td>
<td></td>
<td><strong>128,469</strong></td>
</tr>
</tbody>
</table>

Implicit interest rate (buildings lease) | 8.3321%

Alternative Approach – using freehold apportionment, but adjusted by a buildings sinking fund

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings value at start of term</td>
<td>930,000</td>
</tr>
<tr>
<td>Undiscounted buildings value at end of term</td>
<td>(120,000)</td>
</tr>
<tr>
<td>Buildings value consumed during term</td>
<td>810,000</td>
</tr>
<tr>
<td>Accumulation rate</td>
<td>6.00%</td>
</tr>
<tr>
<td>Effective Term</td>
<td>34.75</td>
</tr>
<tr>
<td>Sinking Fund (rounded)</td>
<td>11,100</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pair Value of Freesold Assets</th>
<th>Direct Rent Allocation</th>
<th>Include Sinking Fund</th>
<th>Income Rate of Return on FH Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings element</td>
<td>930,000</td>
<td>71,543</td>
<td>65,400</td>
</tr>
<tr>
<td>Buildings sinking fund</td>
<td></td>
<td></td>
<td>11,100</td>
</tr>
<tr>
<td>Land element</td>
<td>740,000</td>
<td>56,266</td>
<td>51,969</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,670,000</strong></td>
<td><strong>128,669</strong></td>
<td><strong>128,669</strong></td>
</tr>
</tbody>
</table>

Implicit interest rate (buildings lease) | 7.6711%
Example 8: Old industrial building

Description
Aging single storey industrial unit

Tenure
Lease terms as per example 1
Rent passing £30,000
Effective term 19.75 years

Valuation
Rent passing 50,000
Yield 8.00%
Years purchase 12.50

Value from above
630,000

Value within the Lease
488,000
The PV of £50,000 per 19.75 years at 8%
The residual value 142,000
for both land and buildings

Depreciated Replacement Cost of Buildings
Gross internal area 1,000.00
Effective value construction cost 350.00 £/m²
Building cost 350,000
Addi fees 12,909 44,000
Developer’s profit 20.09% 79,000
Acquisition fees 2.09% 9,000
Capitalised interest 7.5% for 6 months 18,000
Non-recoverable VAT 42,175
Total building cost (rounded) 540,000
Depreciation 50,000
Effective value of building 270,000

Calculation of Buildings Residual Value
Current buildings value 270,000
Remaining economic life 25.00 years, being 50 years from completion:
Less lease term (19.75)
Remaining life at end of lease 5.25
Buildings residual value 60,000
PV multiplier at IR implicit in lease 0.2188, rounded 7.9985% for 19.75 years
Present value of buildings residual value 13,000
Value under IR lease 257,000
Being £270,000 less £13,000

<table>
<thead>
<tr>
<th>Fair Value of Leasehold</th>
<th>Percentage</th>
<th>Rent</th>
<th>Income Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>Allocation</td>
<td>FH Value</td>
<td></td>
</tr>
<tr>
<td>Buildings element</td>
<td>257,000</td>
<td>52.69%</td>
<td>26,300</td>
</tr>
<tr>
<td>Land element</td>
<td>231,000</td>
<td>47.34%</td>
<td>23,700</td>
</tr>
<tr>
<td>Total</td>
<td>488,000</td>
<td>100%</td>
<td>49,000</td>
</tr>
</tbody>
</table>

Implicit interest rate (buildings lease) 7.9985%

Alternative Approach – using freehold apportionment, but adjusted by buildings sinking fund
Buildings value at start of term 270,000
Undiscounted buildings value at end of term (60,000)
Buildings value consumed during term: 210,000
Accumulation rate 0.09%
Effective Term 19.75
Sinking Fund (rounded) 7,200

<table>
<thead>
<tr>
<th>Fair Value of Freehold</th>
<th>Direct Rent</th>
<th>Include Sinking</th>
<th>Income Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>Allocation</td>
<td>Fund</td>
<td>FH Value</td>
</tr>
<tr>
<td>Buildings element</td>
<td>270,000</td>
<td>21,429</td>
<td>18,500</td>
</tr>
<tr>
<td>Buildings sinking fund</td>
<td></td>
<td></td>
<td>7,200</td>
</tr>
<tr>
<td>Land element</td>
<td>360,000</td>
<td>28,571</td>
<td>24,500</td>
</tr>
<tr>
<td>Total</td>
<td>630,000</td>
<td>50,000</td>
<td>50,000</td>
</tr>
</tbody>
</table>

Implicit interest rate (buildings lease) 7.6313%
UKGN 2 Depreciated replacement cost method of valuation for financial reporting

1 Introduction

1.1 The purpose of this guidance note is to provide information on the use of the depreciated replacement cost (DRC) approach. The ‘cost approach’ and DRC are regarded as synonymous terms; both are in common use around the world to describe a method of valuation of all types of assets. This guidance note also highlights the reporting requirements outlined in these valuation standards that are particularly relevant when the DRC method has been used.

1.2 It is important to understand that the word ‘depreciation’ is used in a different context for valuation than for financial reporting. In a DRC valuation, ‘depreciation’ refers to the reduction, or writing down, of the cost of a modern equivalent asset to reflect the obsolescence and relative disabilities affecting the actual asset. In financial reporting, ‘depreciation’ accounting refers to a charge made against an entity’s income to reflect the consumption of an asset over a particular accounting period. These are distinct usages of the word, and there is no direct correlation between the methods used to assess depreciation in each case.

1.3 The intention of this guidance is to provide guidelines that better ensure:

- client involvement and understanding
- that valuations are appropriate to the needs of both public and private sector clients
- transparency and
- year-on-year consistency in asset valuation approach, including where there is a change of valuer.

1.4 Section 13 contains a list that will assist the valuer in checking that all the matters to be considered within this guidance have been addressed.

1.5 Where DRC is used for valuations in the public sector, there may be specific requirements within the rules governing those valuations that amend specific parts of this guidance, for instance, the date at which the building is assumed to be available. Such specific requirements take precedence over this guidance note.
2 Definition of depreciated replacement cost

2.1 There are three principal valuation approaches that are generally recognised internationally:

• direct market comparison
• income approach and
• cost approach.

These approaches may all be used to assess different bases of value, including market value.

2.2 This guidance note focuses on the use of DRC to derive market value. When used to assess market value the objective is to establish the price that would be paid between a willing buyer and willing seller acting at arm’s length. Therefore when considering comparative costs and depreciation adjustments, the valuer must have regard to the evidence of the market (in so far as is practicable), not only the circumstances of the current owner.

2.3 DRC is a form of cost approach that is defined in the Glossary as:

the current cost of replacing an asset with its modern equivalent asset less deductions for physical deterioration and all relevant forms of obsolescence and optimisation.

2.4 The DRC approach is based on the economic theory of substitution. Like the other valuation approaches listed in paragraph 2.1, it involves comparing the asset being valued with another. However, DRC is normally used in situations where there is no directly comparable alternative. The comparison therefore has to be made with a hypothetical substitute, also described as the modern equivalent asset. The underlying theory is that the potential buyer (described in the market value definition) in the exchange would not pay any more to acquire the asset being valued than the cost of acquiring an equivalent new one. The technique involves assessing all the costs of providing a modern equivalent asset using pricing at the valuation date.

2.5 In order to assess the price that the buyer would bid for the actual asset, depreciation adjustments have to be made to the gross replacement cost to reflect the differences between it and the modern equivalent. These differences can reflect factors such as the comparative age or remaining economic life, the comparative running costs and the comparative efficiency and functionality of the actual asset.

2.6 This guidance note discusses factors that may need to be taken into account in assessing both the cost of a modern equivalent asset and the depreciation adjustments applied to the actual asset.

3 When depreciated replacement cost is used

3.1 DRC is used where there is no active market for the asset being valued – that is, where there is no useful or relevant evidence of recent sales transactions due to the specialised nature of the asset.

3.2 Although the DRC method may be used for the valuation of different types of specialised asset, particular complications arise when applying the DRC method to specialised property, which is defined in the Glossary as:
a property that is rarely, if ever, sold in the market, except by way of a sale of the business or entity of which it is part, due to the uniqueness arising from its specialised nature and design, its configuration, size, location or otherwise.

This definition is broad and can apply to properties or assets that may be of conventional construction, but become specialised by virtue of being of a size or in a location where no relevant or reliable evidence of sales involving similar property.

3.3 However, DRC is often referred to as a method of last resort and is only to be relied on if it is impractical to produce a reliable valuation using other methods. The classification of an asset as specialised should not automatically lead to the conclusion that a DRC valuation must be adopted. If sufficient direct market evidence exists, it still may be possible to undertake a valuation of the specialised property using the sales comparison and/or the income capitalisation approach.

3.4 For certain types of specialised asset that are associated with an identifiable and dedicated cash flow, the income (or 'profits test') approach may be more appropriate. The use of DRC may not be preferred but may be used as a cross-check to establish whether the return on capital is realistic.

3.5 The market for assets will change over time. Assets that might previously have been classified as having no market may have an active market that has recently emerged. For example, within the healthcare and leisure sectors, evidence of market transactions is growing. Therefore, before adopting the DRC method the valuer will need to be satisfied that there are no transactions involving similar buildings in similar use that could provide sufficient evidence to use a sales comparison approach.

3.6 The value of a specialised property (or a specialised plant and equipment asset) is intrinsically linked to its use. If there is no demand in the market for the use for which the property is designed, then the specialised features will either be of no value or will have a detrimental effect on value as they represent an encumbrance. It is therefore important to establish the entity’s intentions when valuing for inclusion in a financial statement. If the specialised property is not to be retained for the delivery of a product or service because there is no longer demand for it, it follows that the use of DRC would be inappropriate. No hypothetical buyer would consider procuring a modern equivalent asset if this would immediately be redundant. Such surplus property is valued having regard to its potential for alternative use, with due allowance for any costs associated in achieving that alternative use.

3.7 Some buildings (or specialised plant and equipment assets) have a conventional basic design that is superficially similar to other buildings that are regularly bought and sold in the market, but on closer inspection have specialised features or extensive adaptations designed to meet the requirements of the actual occupier. Typical examples, which may be purpose built or adapted, include an office building with enhanced security features such as thickened walls, toughened glazing and extra stand-off land, or an industrial building with structural alterations to accommodate a particular production process.

3.8 Where the entity has significantly adapted an existing asset to its requirements, it may elect to treat the cost of specialised adaptations as a separate item in its financial statements. In such a case, the valuer would need to value the interest in the asset on the special assumption that the adaptations do not exist. If detrimental
3.9 If the entity does not treat the costs of specialised adaptations separately, the latter will then be valued as part of the property interest. The valuer will have to decide whether the adaptations are sufficiently extensive for the property to meet the definition of a *specialised property*. The valuer will also have to decide whether there is no other reliable method of assessing the *market value* plus adaptation, before using the *DRC* method. In respect of *real property* this decision will reflect the market in the locality. In one location there may be sales evidence of other similarly adapted buildings, thus using the *DRC* method would be inappropriate. However, the same building in another location may properly be valued using the *DRC* method because there is no remotely comparable property bought and sold in that location.

3.10 The *DRC* method is not suitable for use in valuations of *real property* for loan security. This is due to the specialised nature of assets that are normally valued using *DRC*, and because the method assumes that there is a continuing demand for the use of the asset. Exceptionally, in rare cases, it may be used to support a valuation for loan security arrived at using a different approach.

### 4 Valuer qualifications

4.1 It is fundamental that *DRC* is recognised as a valuation to which the *valuation standards* apply, and not a cost estimation exercise. Each valuation to which the standards apply must be prepared by, or under the supervision of, an appropriately qualified valuer.

4.2 The valuer’s task includes consideration of the key elements of a market transaction involving the specialised asset. The specialised knowledge required in order to properly undertake a *DRC* valuation includes:

- an understanding of the asset, its function and its environment
- knowledge of the specification that would be required for an equivalent asset in the current market, and the cost of acquiring or procuring that asset
- sufficient knowledge of the asset and its marketplace to determine the remaining physical and economic life of the asset and
- sufficient knowledge of the sector in question to assess functional, technical or economic obsolescence.

4.3 Although a single valuer may not have all the knowledge or skills required, the *valuation standards* accept that these can be met in aggregate by more than one valuer. *PS 2 paragraph 3, Member qualification*, requires that if the valuer proposes to employ another *firm* to provide valuation advice, as opposed to providing information to assist the valuer in preparing his or her own valuation, the client’s approval must be obtained.

### 5 Settling the terms of engagement

5.1 The discussion of the *terms of engagement* provides an essential link between the valuer and the client that will help to establish whether the use of the *DRC* method is appropriate.
5.2 **VPS 1, Minimum terms of engagement**, stipulates certain matters that must be addressed by the *terms of engagement*. The following particular points may need more detailed attention:

- the subject of the valuation
- the interest to be valued
- the type of property and how it is used, or classified, by the client
- the extent of the valuer’s investigations and
- the nature and source of information to be relied upon by the valuer.

5.3 If the asset is specialised it may be necessary to define what is to be included in the valuation. The identification of assets that are classified as part of the property interest and those that are classified as plant and equipment is often unclear in a *specialised property*. Many specialised assets comprise separately identifiable components, and the valuer will need to discuss with the client whether it is appropriate to value these as separate items, or to what degree it would be appropriate to regard them as aggregated into a single asset, and valued accordingly. The entity’s accounting policies may influence this decision.

5.4 The valuer will need to establish how the entity uses the asset and confirm that there is an intention to continue that use. For a *specialised property* it may be necessary to establish the extent of the land occupied by the specialised improvements and distinguish this from land that is properly classified as either surplus or in conventional use.

5.5 With specialised assets the valuer may have to place greater reliance on information provided by the client, or its other advisers, than would be the case with more conventional assets. This information can include information of the cost, design features and performance of the asset. Since the asset is specialised it follows that detailed knowledge of these matters may be outside the knowledge and expertise that could normally be expected of a valuer in that sector. It may be important to discuss and agree the extent to which the valuer may rely on such information provided by the client or, if further specialist input is to be obtained by the valuer, the source and cost of that further advice.

5.6 Where the valuer has not provided an earlier valuation it is recommended that the client be asked to provide a copy of any previous report. The information in that report will enable the valuer to establish the approach taken and assist the client in reconciling any significant valuation differences that may arise.

5.7 It is essential that the valuer maintains accurate and comprehensive records of discussions with the client and the reasons for the conclusions reached.

### 6 Assessing replacement cost

6.1 The general principle is that the costs reflect those of a modern equivalent asset. Although the actual or estimated cost of reproducing the actual asset may be relevant in this assessment, there will be many cases, especially with old or obsolete assets, where this information is irrelevant.

6.2 The principle can be illustrated by considering the value of an item of machinery that is a few years old. If technological advances mean that the same output can...
now be achieved with a smaller and more efficient machine, the actual machine
would not be replaced. The modern equivalent is defined by its comparative
performance and output, not its physical characteristics.

6.3 In assessing the cost of the replacement asset, due account has to be taken of
all the costs that would be incurred by a potential buyer on the valuation date. These
could include the costs of delivery, transportation, installation, commissioning and
any unrecoverable duties or taxes. Quite often a specialised asset will have to be
especially commissioned, so design and other fees may also be incurred.

6.4 When considering specialised property, the current gross replacement cost of
the asset is assessed. This comprises the cost of replacing the land plus the cost of
replacing the improvements to the land. For the latter, the approach is to assess the
cost of their replacement with a modern equivalent and then make depreciation
adjustments to reflect the differences between it and the actual asset when
compared with a modern equivalent. Costs that may be expected to be incurred in
replacing the asset include:
• setting up costs, where appropriate, such as planning fees and site
  preparation works
• professional fees related to the project
• a contingency allowance, if appropriate and
• finance costs, taking into account the likely pattern of payment.

Once the gross replacement cost has been derived, the depreciation factors are
applied as a further and separate calculation.

6.5 The asset being valued may take a considerable period, often years, to replace.
In assessing the replacement cost of the modern equivalent asset, based on current
prices, the prospect for cost fluctuation and related issues that may occur over such
a prolonged period may be taken into account.

7 The site value of a specialised property

7.1 Although the ultimate objective of the DRC method is to produce a valuation of
the actual property in its actual location, the initial stage of estimating the gross
replacement cost has to reflect the cost of a site suitable for a modern equivalent
facility. Often this will be a site of a similar size and in a similar location to the actual
site. However, if the actual site is clearly one that a prudent buyer would no longer
consider appropriate because it would be commercially wasteful or would be an
inappropriate use of resources, the modern equivalent site is assumed to have the
appropriate characteristics. The fundamental principle is that the hypothetical buyer
for a modern equivalent asset would purchase the least expensive site that would be
suitable and appropriate for its proposed operations.

7.2 The property being valued may be located in a situation that would now be
considered unnecessarily expensive. This may be due to changes in the way in
which the service provided is delivered, or to changes in the market for the product it
produces. An example could be a hospital that was originally constructed in the
centre of a city that might now be better situated in the suburbs because of changes
in the transport infrastructure or the migration of the population it served. Another
example could be where a specialised industrial facility was originally located close to a source of raw materials that are now imported, thus rendering the original location irrelevant.

7.3 Other factors need to be considered in addition to establishing the location of the modern equivalent site. The modern equivalent asset may not require a site as extensive as the actual site. In this respect land is no different to any other asset. If 2 hectares are now sufficient to provide the same service, the modern equivalent site will be 2 hectares, even if the actual site is 4 hectares.

7.4 There may also be geographical limitations on where the modern equivalent site might be located, imposed by physical or practical considerations. For example, a specialist industrial operation may require a site located next or close to a dock if material has to be imported by sea. A local authority may have an obligation to provide a service within a particular geographical locality, even though cheaper sites may be available elsewhere.

7.5 Sites of specialised properties often include areas of vacant land. This may be held for possible future expansion, as a safety or security cordon, or may simply be surplus. The valuer will need to enquire as to the purpose of any vacant land at the actual property in order to assess whether this would be a necessary feature of the notional replacement site. If not then it is not reflected in the DRC calculation, although its value would need to be considered separately. Surplus land is normally reported as a separate asset as it needs to be identified and treated separately in the financial statements.

7.6 Once the extent and location of the site that would be necessary to create the modern equivalent asset has been identified, the next step is to estimate what it would cost to acquire that site in the market at the valuation date. Because many specialised properties will be sui generis uses under planning legislation, there can be practical difficulties in determining from what planning use it is appropriate to draw the sales comparison. In the case of a specialised industrial property, it would usually be appropriate to assume that land with an industrial planning consent (or where such permission could be anticipated) would provide the best comparable evidence. Likewise for the site of a specialised administration building in a town centre, sites for office use would provide the most appropriate comparables.

7.7 The actual use of the property may be so specialised that it may be impossible to categorise it in general market terms. In such cases the valuer has to determine what other uses the property can offer to a buyer of an alternative site for the specialised use to make it competitive in the market. This may be a range of uses that prevail in the locality of the actual site, but for the reasons discussed earlier, this may not be appropriate if the modern equivalent site would be located elsewhere. In that case, it is the range of uses in that locality that would be considered.

7.8 In the public sector, particular issues can arise with specialised property that provides a service to a defined local community, such as schools, libraries and health centres. One characteristic of such property is that the service requirement may be attached to a tightly defined geographical area, which limits the availability of alternative sites.

7.9 The valuer may need to decide and agree with the entity on the possible locations for the current defined service requirement. This might mean competing against other users, but where land could be made available by using statutory
powers, this might indicate the appropriate approach to the valuation. The overriding objective is for the valuer to establish the lowest amount that a prudent purchaser would pay to acquire a site for an equivalent development in a relevant location at the valuation date.

7.10 A particular problem that arises with schools, within either the public or private sector, is when they have playing fields within the curtilage. This land will be considered separately from the land on which the buildings are constructed, as no prudent purchaser would buy land with consent for residential or commercial development for use as a playing field. The potential on the existing site is not relevant in the DRC calculation, as the purchaser of the equivalent asset would acquire land for which playing field use would be the only permitted form of development. There are many examples of schools, universities and private businesses that have their main facilities within a town, but have their associated playing fields in an out-of-town location that is outside the permitted development boundary.

7.11 In some circumstances the actual site may be leasehold. The consideration of the land value will therefore reflect the terms of the existing lease.

7.12 Incidental costs, such as fees and carrying costs, are restricted to those costs associated with the normal acquisition and development of land.

8 Calculating the cost of the buildings and site improvements of a specialised property

8.1 When valuing a specialised property it is often difficult to distinguish between what may be classified as a building or structure and what may be classified as plant. In the specialised industrial sector, many structures effectively only provide support and weather protection for process plant – if the plant was removed then the ‘building’ would not exist. In such cases there has to be discussion with the entity as to whether a distinction needs to be made between buildings and plant and, if so, what items fall under each heading.

8.2 Because of the diverse nature of the buildings, structures and plant that may form part of a specialised property, the term ‘site improvement’ refers to all additions to the land. These are buildings, structures or some modifications to land of a permanent nature, involving expenditures of labour and capital, and they are intended to enhance the value or utility of the property. Improvements have differing patterns of use and economic lives.

8.3 Site improvements will include all site works associated with the development, including services, fencing, paving and any other items of a permanent nature that support the specialised use. The following paragraphs provide guidance on calculating the cost of buildings and site improvements. Although they refer specifically to buildings, the same principles apply to all improvements.

8.4 In order to assess the cost of a modern equivalent building, the valuer needs first to establish the size and specification that the hypothetical buyer would ideally require at the valuation date in order to provide the same level of productive output or an equivalent service. If the actual building is old, it will usually be the case that a new building could be smaller but still provide the same level of service. For
example, a modern building will often be able to offer more efficient space, as it can provide open plan or clear span areas that have a greater capacity than an older building with fragmented accommodation and a poor net to gross floor area.

8.5 Having established the size of the notional building to be costed, the valuer may need to determine an appropriate specification for the building. It cannot be assumed that this would be the same as the actual building, especially if it is not new. The design and construction of a modern equivalent may differ from the existing building because features of the latter are now unsuitable or just irrelevant for the needs of the entity. In other cases, the existing materials may still be suitable but are simply unavailable, or only available at a cost that would be uneconomic. Care has to be taken to consider the service that is being provided within the building, and to price for a specification that would be compatible with the service potential of the subject building.

8.6 For example, the specification that would be appropriate for a high security government department (for example, a defence weapons establishment) will be different from that appropriate for a specialised, but not security-sensitive, use. Similarly the specification required for a general care, private sector hospital will be different from that for a specialised, high-dependency unit within public sector provision.

**Historic buildings**

8.7 Historic buildings can present particular valuation difficulties. The principle that the cost is based on a modern equivalent asset still applies, but there may be situations where the only way that a replacement asset could provide equivalent service potential would be if it reproduced the actual building. However, reproduction will be very rare. In most cases the fact that the entity currently occupies a historic building is incidental to the service provided and would be totally irrelevant when specifying a modern equivalent.

8.8 Only where the historic nature of the building itself creates an intrinsic part of the benefit or service potential of the asset would it be correct to reflect the cost of reproducing the actual asset in the cost of the modern equivalent. An example could be an art gallery housed in a building that itself is as important as the exhibits it contains in attracting visitors. Another example provided in International Public Sector Accounting Standard 17 (IPSAS 17, *Property, Plant, and Equipment*, paragraph 47), published by the International Federation of Accountants (IFAC), is of a parliament building that may be reproduced rather than replaced with an alternative because of its significance to the community. In cases where it would not be possible to reproduce the actual building, it may be appropriate to assess the cost of constructing a building with a similarly distinctive design and high specification.

8.9 Some historic or heritage assets may be impossible to replace because a modern reproduction could never recreate the historic significance of the asset. The decision of whether or not a historic asset is to be capitalised is a matter for the entity, although the valuer may be asked to comment upon the practicability or otherwise of valuing the asset.
Sources of cost information

8.10 Having determined the nature, size and specification of the modern equivalent building and all other necessary improvements, the cost of providing these may be assessed by reference to published building cost data. However, published construction price data may be of limited assistance where the replacement building or structure is highly specialised. Instead, the valuer may have to rely on actual costs involved in the creation of the current asset, or discuss with the entity the need to commission specialist cost advice.

8.11 If the valuer has access to the actual costs incurred in constructing the asset, those costs may need adjustment to reflect differences between these costs and those that would be incurred in constructing the modern equivalent.

8.12 The most obvious of these differences is the date on which the price is fixed. The cost of the modern equivalent will reflect the cost that would be incurred if the works were commissioned on the valuation date. Various cost indices are published for construction and engineering work that show typical historic price fluctuations, and they can be used to adjust historic cost data to the valuation date.

8.13 Other factors that may result in the cost of creating the actual asset to differ from that of a notional replacement include:

• Site preparation: work may have been undertaken to prepare the actual site for development that would not be necessary for the assumed equivalent site. For example, costs actually incurred in levelling a site or providing services to the site boundary may already be reflected in the cost of acquiring an equivalent site in the market if the available evidence was for level, serviced land.

• Phasing of work: a large site may have been developed in phases, whereas the cost of the modern equivalent reflects the cost that would be incurred in replacing the whole asset at the valuation date as a single contract. This could create economies of scale and reduce contract overheads, for example, on preliminaries work.

• Optimal working conditions: if the cost of the equivalent site is based on a site that is assumed to be free of any difficulties or constraints on development, then any additional costs incurred because of abnormal conditions on the actual site are ignored.

• Contract variations: any additional costs incurred in constructing the actual building caused by design or specification changes during the progress of the contract are ignored.

• Planning changes: when the actual asset was constructed it may have had deemed planning consent. As the planning legislation has changed, the cost of obtaining consent for a modern equivalent may need to be taken into account.

Two other related factors are the additional cost of footings for heavy machinery (where specialised plant and equipment is required) and additional costs arising from extending an existing property.

8.14 Incidental costs, such as fees and carrying costs, are to be restricted to those costs associated with the assumed procurement of the building. Allowance for VAT is made only where this is an irrecoverable cost. Although it would not normally be
appropriate to make an addition to the cost to reflect developer’s profit (because the purchaser is deemed to be procuring the building for owner occupation), it may be appropriate to add for management time if this were a significant cost that would be incurred in constructing a modern equivalent.

8.15 The entity may require the valuer to provide an estimate of the cost of components within the actual building for depreciation accounting as part of the valuation instruction (see paragraph 1.4). These costs are not to be confused with the cost of creating an equivalent component in the modern equivalent building, but are intended to reflect a realistic allocation of the end value attributed to the building in exactly the same way as if the asset had been valued using a sales comparison or income approach.

9 Assessing depreciation

9.1 Having established the replacement cost of a modern equivalent asset, it is then necessary to adjust or depreciate it to reflect differences between this modern equivalent and the actual asset being valued. The underlying principle is that the hypothetical buyer has the option of procuring either the modern equivalent or the actual asset. If the modern equivalent provides the ideal facility for the buyer, the price paid for the actual asset is expected to reflect all the disadvantages that it suffers in comparison.

9.2 Applying depreciation is primarily a process of replicating how the market would view the asset. Depreciation rates and estimates of the future economic life of an asset are influenced by market trends and/or the entity’s intentions. The valuer is recommended to identify these trends and intentions, and to be capable of using them to support the depreciation rates applied. The application of DRC should replicate the deductive process of a potential buyer with a limited market for reference.

9.3 Three principal types of depreciation allowance, or obsolescence, may be identified as:

- physical deterioration
- functional obsolescence and
- external obsolescence.

Physical deterioration

9.4 This is the result of wear and tear over the years, which may be combined with a lack of maintenance. The valuer compares the decline in value of an asset of a similar age with the value of new assets in the same market.

9.5 The asset is valued in its existing condition, with the valuer fully taking into account any physical deterioration arising from a lack of maintenance or other causes, and the recognition that a lack of adequate maintenance can accelerate the rate of depreciation. Thus, depreciation caused by inadequate maintenance is to be reflected in the allowance made, just as a deduction for disrepair would be made from a valuation based on sales comparison. Physical deterioration is frequently measured by reference to the anticipated physical life of the asset.
9.6 The physical deterioration of the asset is to be viewed not in absolute terms, but within context. In some markets and for some types of asset, a degree of physical deterioration will not adversely affect the value, while in other cases it will. It would be inappropriate to determine the effect of physical deterioration on value depreciation only in purely mechanistic terms.

**Functional obsolescence**

9.7 Functional obsolescence arises where the design or specification of the asset no longer fulfils the function for which it was originally designed. An example would be a building that was designed with specific features to accommodate a process that is no longer carried out. In some cases functional obsolescence is absolute, i.e. the asset is no longer fit for purpose. In other cases the asset will still be capable of use, but at a lower level of efficiency than the modern equivalent, or may be capable of modification to bring it up to a current specification. The depreciation adjustment will reflect either the cost of upgrading or, if this is not possible, the financial consequences of the reduced efficiency compared with the modern equivalent.

9.8 Functional obsolescence may also arise because of advances in technology. A machine may be capable of replacement with a smaller, cheaper equivalent that provides a similar output, or a modern building may be more efficient because of superior insulation and modern services.

9.9 The modern equivalent asset may be cheaper to recreate than the current asset, and so the replacement cost already reflects that of an ‘optimised’ asset, thus making further adjustment under this heading unnecessary. An example would be where the modern equivalent reflects a smaller building because there is no need for it to reflect historic or redundant features that exist in the actual building. Further depreciation to account for these features would be double counting.

9.10 There will be situations where the asset being valued is too small, as technological advances now make it possible to achieve economies of scale. An example would be an aircraft terminal, designed to cater for a maximum number of passengers per plane, which is now too small to handle larger modern planes.

9.11 Another cause of functional obsolescence is legislative change. In the industrial sector an existing plant may be incapable of meeting current environmental regulations, or in some cases the product it was built to produce is now illegal. In the service sector, the need for occupiers to comply with current regulations on health and safety or disabled access may also give rise to differing degrees of functional obsolescence.

**Economic obsolescence**

9.12 This arises from the impact of changing economic conditions on the demand for goods or services produced by the asset. However, care has to be taken to distinguish these factors that are due to economic conditions, from factors that are specific to the entity. Any writing down of a valuation derived solely from the DRC approach to reflect the profitability of the business is a matter for the occupier.

9.13 A common example of economic obsolescence is where over-capacity in a particular market reduces the demand and therefore value for the actual asset, regardless of how modern or efficient it may be. In the industrial sector, falling
commodity prices have seen periods when excess market capacity has made the production of commodities such as oil or steel uneconomic. During such periods, this would have had a significant impact on the demand and therefore on the value of specialised facilities used to produce these products. In these particular examples, the cyclical nature of the markets might mean that a purchaser might be willing to buy and hold the facility in anticipation of a return to profitability, but the price would need to reflect the risks involved.

Measuring obsolescence

9.14 The three principal categories of obsolescence identified are not the only reasons why it may be necessary to adjust the cost of the modern equivalent asset in order to establish the value of the actual asset. Depreciation rates may be all encompassing or analysed separately. The three main headings simply illustrate common reasons for the actual asset being worth less than the modern equivalent. Frequently it will be not be possible to identify a separate adjustment under each category; in other cases, the distinction between the categories may be blurred. It is important to ensure that separate consideration of depreciation under each heading does not result in double counting.

9.15 There will be cases where obsolescence is total. Examples include:

- **Physical obsolescence**: if the cost of repairing, reconditioning or refurbishing the actual asset to render it useable has exceeded the cost of a modern equivalent, the asset would have no value.

- **Functional obsolescence**: the introduction of new technology may render obsolete a relatively new asset with an otherwise long anticipated life, with the result that there would be no demand for it other than any value for salvage or an alternative use.

- **Economic obsolescence**: if demand for the product or service provided by the asset has collapsed and is not expected to recover, there would be no demand for the asset other than for any salvage value or alternative use.

9.16 Total obsolescence is often clear from the outset of the instruction, and the asset in question is classified accordingly as surplus or redundant by the entity. However, if the valuer concludes that an asset is completely obsolete during the course of the valuation exercise, this matter should be discussed with the entity before proceeding, as reclassification as surplus will indicate that a different valuation approach is required.

9.17 It follows that the DRC method is normally used where obsolescence is only partial. Although the actual asset may not be in the same condition, as efficient or as technically advanced as a modern equivalent, it may still have a useful remaining life and will therefore have a value for that use. Assessing the remaining life of the asset is therefore an important aspect of the DRC method.

Asset life

9.18 The depreciation that will affect an asset when compared with its modern equivalent will depend on its anticipated remaining life. An asset that is expected to have a remaining life of 20 years will be worth a higher percentage of a new replacement than one with an expected life of five years. The remaining life can
depend on physical or economic factors, or a combination of both. The physical life is how long the asset could be used for any purpose, ignoring any potential for refurbishment or reconstruction. The economic life is how long a succession of owners could use the asset for its designed purpose. The remaining life for valuation purposes will be the lower of the physical life and economic life where these do not coincide.

9.19 The life of the asset (and its pattern of depreciation) determined as part of the DRC valuation is not necessarily based on the same criteria as the estimate of the ‘useful life’ or ‘future useful economic life’, or in the public sector ‘service delivery lifespan’ and attendant depreciation, which has to be determined by the entity for depreciation accounting (the latter two tasks are not to be confused).

9.20 In assessing the remaining life, it may be assumed that routine servicing and repairs are undertaken, but the possibility of materially extending the life of the asset by significant refurbishment or the replacement of components is disregarded.

9.21 For some classes of asset a regular pattern of depreciation can be determined over the whole life of an asset, although the value will reflect the remaining life available at the valuation date. Where this is the case, the percentage of the current replacement cost remaining at the valuation date may be estimated using a ‘straight-line’, ‘reducing balance’ or an ‘S-curve’ method. These are described in the following paragraphs.

9.22 It will be helpful to discuss with the client how the entity deals with depreciation in its financial statements and how the valuer’s approach may differ.

**Straight-line**

9.23 The straight-line basis tends to be the most commonly adopted method for calculating depreciation of buildings because of its simplicity and relative ease of application. Straight-line depreciation assumes the same amount is allocated for depreciation for each year of the estimated life.

9.24 The weakness of this method is the very simplistic assumption of the uniform erosion of the asset’s value over its total life, compared with the equivalent replacement asset. The assumption is clearly correct at two points in the life – the beginning and the end – but it would be entirely fortuitous if it were correct at any intermediate point, which is when a valuation is most likely to take place. However, this effect may be mitigated by frequent valuations.

**Reducing balance**

9.25 The reducing balance method of depreciation assumes a constant percentage rate of depreciation from the reducing base. The reduction of the balance at the end of each period by a fixed proportion of itself creates a sagging depreciating value curve over the life of the asset. This method effectively ‘compounds’ the total depreciation. This may match reasonable expectations of declining value over time better than the straight-line method.

**S-curve**

9.26 The S-curve is recommended where sufficient data is available for the valuer to be confident that the curve represents the likely reality. In some cases it presents
the most realistic representation of an asset's depreciation by assuming that
depreciation is at a low rate in the early years, then accelerates in the middle years
and reduces again in the final years. However, some assets, such as plant, may
have a different depreciation pattern (high at first rather than low).

9.27 Although it is normally accepted that the S-curve realistically represents the
pattern of depreciation over the life of most assets, the percentage for any given year
will depend on decisions made as to the rates of depreciation at different times and
when these change. In the absence of empirical evidence in support of these inputs,
the exact pattern of the curve may depend on subjective inputs and may be no more
relevant than the other methods discussed.

9.28 The chart in Figure 1 compares the patterns of each of the methods where it
is assumed that an asset has an original cost of £100,000, which reduces to a value
of £1,000 over 20 years. Two types of S-curve are shown to illustrate the possible
range of differences, as it is recognised that the pattern of depreciation will differ
between, for example, buildings and plant and equipment.

![Figure 1: Comparison of depreciation methods](attachment:image)

9.29 The three methods outlined are all in common use. Of these, the straight-line
approach has the advantage of simplicity. However, it does not represent the way in
which asset values are normally reflected in the marketplace. The reducing balance
method may also be open to similar criticism that it does not reflect market
perceptions. The S-curve attempts a surrogate for market behaviour and is
appropriate where there is empirical evidence available.

9.30 Other forms of depreciation curves are available, and where they are used by
a particular market the valuer is expected to reflect them. In making adjustments for
depreciation and obsolescence the valuer is advised to rely on professional
knowledge, judgment and market experience, and to take due account of the nature
of the asset and the type of use to which it is put.

10 Other considerations

10.1 It is not normally appropriate to make any deduction for depreciation from the
cost of acquiring a modern equivalent site in the market, because freehold land
rarely depreciates. When valuing *specialised property* the normal practice is to
assess the cost of the improvements separately, assess the appropriate depreciation
and then add this to the cost of replacing the land in order to arrive at the final
valuation.
10.2 Where a specialised property has many buildings or structures, some may have a longer anticipated life than others. Although it may be appropriate to adopt different rates of depreciation for different structures in making the valuation, care has to be taken not to lose sight of the objective of the exercise, which is to establish the value of the whole of the defined specialised property. It would therefore be inappropriate to assign a substantially longer life to an individual building or component than the anticipated life of the whole of the defined property.

10.3 If individual buildings are identified as having potential for an alternative use beyond the anticipated life of the overall specialised property, this may be separately reported and based on a different valuation method, but should not be reflected in the DRC calculations. The objective of the DRC approach is to establish how valuable the specialised property is in comparison with a modern equivalent. The modern equivalent cannot be assumed to be exactly alike with the same alternative potential; it is purely the utility of the asset for the current use that is being assessed as part of the DRC calculation.

10.4 There will be situations where the valuer can readily identify that the site of a specialised property could be redeveloped for an alternative, and more valuable, use if the current use was to be discontinued. In assessing the cost of the equivalent replacement site as part of the DRC calculation, this potential has to be disregarded for the simple reason that the hypothetical buyer would not buy a site to construct the specialised facilities if it had to compete with more valuable uses. In most cases, the potential of the actual site will have been identified using a sales comparison, not a DRC approach. However, the fact that this potential is irrelevant to the DRC process does not mean that it is irrelevant to the entity. In these circumstances UKVS 1.16.3 requires the valuer to report the value based on the alternative use. Further discussion on this can be found in section 9.

11 Final reconciliation

11.1 The DRC calculation usually involves the consideration of many separate elements, and an essential final step is for the valuer to ensure that the resulting mathematical conclusion is consistent with the underlying valuation objective – that is, to establish the price that would be paid in an exchange between a willing seller and willing buyer in an arm’s length transaction.

11.2 The valuer is advised to ‘stand back and look’ at the overall conclusion, taking particular care to check that the process of adjusting for depreciation has not resulted in any factor being either double counted or ignored. An attribute of the actual asset may be identified that has not been reflected in the process of depreciating by comparison with the hypothetical modern equivalent. In the case of a specialised property this could include an adjustment for any additional value in the land in its current location, which could lead to a buyer of the specialised facility for its continued use to bid more for this property than it would for a modern equivalent with no such potential.

12 Reporting

12.1 The report must comply with VPS 3, Valuation reports. The matters that have to be covered in all valuation reports are listed in VPS 3 paragraph 7, Report.
content, while UKVS 1.16.1 and UKVS 1.16.2 impose additional requirements when the DRC approach is used. A summary is given in the following paragraphs.

**12.2** A statement that the DRC method has been used is necessary (see VPS 3.7(l)). If the valuation is being undertaken for inclusion in accounts prepared under International Financial Reporting Standards (IFRS), the value is reported as being on the basis of market value. However, in order to comply with VPS 3.7(l), a statement is required explaining that because of the specialised nature of property, the value is estimated using a DRC method and is not based on the evidence of sales of similar assets in the market. This statement matches a requirement in International Accounting Standards (IAS) 16 for the entity to include a similar statement in the published accounts.

**12.3** For assets held in the private sector, to comply with UKVS 1.16.1, a statement that the valuation is subject to the adequate profitability of the business paying due regard to the total assets employed must be included.

**12.4** For assets held in the public sector, to comply with UKVS 1.16.2(a) statement that the valuation is subject to the prospect and viability of the continued occupation and use must be included. If the valuer was readily able to identify that the asset has a higher value for an alternative use, this must be reported in accordance with UKVS 1.16.3(a) as the market value, together with a statement that the value for alternative use takes no account of matters such as business closure or disruption and any associated costs that would be incurred. This is most likely to arise in connection with a specialised property, where the land may have a higher value for redevelopment than the DRC value.

**12.5** If the valuer considers that the value of the asset would be materially lower if the business ceased, the report must also contain a statement to this effect (see UKVS 1.16.3(b). The valuation standards do not require the valuer to provide an actual figure for this purpose. If the entity wishes to establish the impact of possible closure of a specialised facility on the value of the assets employed, it may commission valuations to reflect the ‘break-up’, salvage or alternative use value of the asset. This would be a separate exercise and not part of the DRC valuation for inclusion in the financial statements. Any valuations provided would need to be on the special assumption that the entity had ceased operations (see VPS 4 paragraph 3, Special assumptions).

**13 Checklist**

This checklist is intended to provide the valuer with a simple way of confirming that all the matters discussed in this guidance note have been considered.

Where large numbers of properties are to be valued it may be helpful for a separate list and a schedule to be prepared for groups of properties. The schedule could indicate against each entry the matters that have been discussed and agreed.

It may be helpful to attach such a schedule to the report so that any reader will be fully aware of the approach taken. This will also help ensure that consistency is achieved when a revaluation is undertaken.
### UKGN 2  Depreciated replacement cost method of valuation for financial reporting

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Ensure file contains all relevant information on the decisions taken during the *DRC* process.
UKGN 3 Valuations for capital gains tax, inheritance tax and stamp duty land tax

1 Introduction

1.1 Valuations for capital gains tax (CGT), inheritance tax (IHT) and stamp duty land tax (SDLT) purposes are based on a statutory definition of ‘market value’, which is similar to the definition used in these standards. However, the statutory definition has been the subject of interpretation by the Upper Tribunal (Lands Chamber). Members should be aware of these differences between the definitions, so that HM Revenue and Customs (HMRC) will not be able to challenge their valuations as being made on an incorrect basis.

1.2 This guidance note deals solely with the statutory basis of ‘market value’ for CGT (including corporation tax on capital gains), IHT and SDLT, and does not cover valuations that may be required for income tax or corporation tax (such as capital allowances). The valuation approach in this guidance note is the one that would likely be adopted by HMRC for VAT purposes.

1.3 CGT, IHT and SDLT are complex taxes and members should take care to understand the background to the event triggering a potential tax liability before proceeding.

1.4 Further information is available on the HMRC website (www.hmrc.gov.uk), which gives access to the HMRC’s internal guidance manuals, and the Valuation Office Agency (VOA) website (www.voa.gov.uk), which gives access to the instructions to district valuers.

1.5 Valuations, which will include apportionments in appropriate cases, for tax purposes are based on the concept of a hypothetical sale for which a statutory definition is required. The statutory definition and interpretation of market value for tax purposes is not exactly the same as the definition of market value used in these standards. While the differences are not always significant, difficulties arise frequently enough to warrant some basic introduction for general practitioners who may encounter such issues only on rare occasions.

1.6 This guidance note is based on interpretations arising from cases that have been determined by the Upper Tribunal (Lands Chamber) or higher courts on appeals made by taxpayers against tax assessments based on the value of property. It is recognised that there may be circumstances where the client wishes to challenge an aspect of the tax calculation, including the interpretation of the statutory basis or the method of valuation. If the valuer is instructed to give valuations on specified assumptions that differ from those in this guidance note, the procedures in VPS 3 paragraph 7(i), Assumptions and special assumptions must be followed.
2 Background

2.1 CGT, IHT and SDLT are included in self-assessment procedures where the taxpayer is responsible for calculating the appropriate amount of tax based on the valuations provided by the valuer.

2.2 In the case of individual taxpayers, partnerships and trusts, any CGT calculation will be included in the tax return for the tax year in which the transaction requiring the tax application took place.

2.3 Large companies, on the other hand, pay their corporation tax on any capital gains in advance, by quarterly instalments based on a prediction of their results for that tax year. A large company is one that does not fall in the category of a small or medium sized enterprise (SME) as defined by the European Commission. Its definition of an SME is an enterprise that employs fewer than 250 persons and either a turnover of less than €50 million or a balance sheet total of less than €43 million.

2.4 Special provisions apply for groups of companies. Any large company taxpayer with a significant property portfolio is faced with the problem that property transactions may generate large gains or losses that can distort a tax charge. The exact amount of those gains or losses may be dependent on the valuation provided.

2.5 In IHT cases the personal representatives are required to submit an IHT account that identifies all ‘appropriate’ property and its value.

2.6 The valuations used by taxpayers in their tax computations are subject to examination by district valuers on behalf of the HMRC. It is therefore imperative that any valuation used in those tax calculations has been calculated on the statutory basis using best practice.

2.7 If, following discussion with a district valuer, a different valuation or apportionment is agreed or determined and results in a materially different tax bill, a taxpayer could be faced with a claim for interest and, in some cases, additional penalties. Where the taxpayer has paid too much tax, the HMRC may pay interest, although the taxpayer is still worse off because the interest rates are less favourable than commercial rates.

2.8 It is therefore of great importance, when preparing a valuation for taxation purposes, to apply the statutory rules appropriately and to have a proper understanding of the basis of market value for taxation purposes.

3 Basis of value


3.2 These definitions are written in similar terms and broadly define market value as:

‘the price which the property might reasonably be expected to fetch if sold in the open market at that time, but that price must not be assumed to be reduced on the grounds that the whole property is to be placed on the market at one and the same time.’
3.3 The current statutory definitions for CGT, IHT and SDLT are similar to those used in earlier tax acts. Over the years, case law has established that, in arriving at market value, the following assumptions must be made:

- the sale is a hypothetical sale
- the vendor is a hypothetical, prudent and willing party to the transaction
- the purchaser is a hypothetical, prudent and willing party to the transaction (unless considered a special purchaser)
- for the purposes of the hypothetical sale, the vendor would divide the property to be valued into whatever natural lots would achieve the best overall price
- all preliminary arrangements necessary for the sale to take place have been carried out prior to the valuation date
- the property is offered for sale on the open market by whichever method of sale will achieve the best price
- there is adequate publicity or advertisement before the sale takes place so that it is brought to the attention of all likely purchasers and
- the valuation should reflect the bid of any special purchaser in the market (provided that purchaser is willing and able to purchase).

3.4 Clients will often request a valuation for ‘probate purposes’, when they actually need a valuation for IHT purposes. When confirming instructions and in the report, the valuer must make it clear that although the valuation is required as part of the procedure for obtaining a ‘grant of probate’, the basis of value will be in accordance with the statutory definition. Valuers should therefore avoid using the term ‘probate value’.

4 Analysis of the definition

4.1 The definition of open market value for the basis of value for CGT or for tax purposes may be broken up into elements that have been defined in case law.

‘The price …’

4.2 In Duke of Buccleuch v IRC (1967) the price that the property might reasonably be expected to fetch was defined as the gross sale price for the property without deducting any selling costs.

4.3 Furthermore, in Ellesmere v IRC (1918) the price was held to mean the best possible price that would be obtainable in the open market, if the property was sold in such a manner (and subject to such conditions) as might reasonably be calculated to obtain for the vendor the best price for the property.

4.4 However, it should not be assumed that the best price is automatically the highest possible price that could be achieved. What is required, in valuation terms, is an estimate of the price that could be realised under the reasonably competitive conditions of an open market on a particular date.

‘… the property …’

4.5 In Duke of Buccleuch v IRC it was held that the reference to ‘the property’ was not a reference to the whole estate being valued, but meant any part of the estate that was proper to treat as a unit for valuation purposes. Similarly, in Ellesmere v
IRC, it was held that the market price was a price based on the separate values of the various parts. It was also indicated that the price must be estimated on the basis that the properties were sold in whatever lot(s) would realise the best price.

4.6 In IRC v Gray (Executor of Lady Fox deced.) (1994) it was held that the property must be valued as it actually existed, even if, in reality, a vendor would most likely have made some changes or improvements before putting it on the market. Although this case referred to variations in the way in which the property was held by the parties (rather than physical works), it identified the general principle of valuing the property as it stands at the valuation date.

4.7 As a consequence, in preparing any taxation valuation, it is important to have proper regard to the most viable lotting of the property (or properties) to be valued, in order to maximise the overall price. This is effectively a notional marketing exercise, commonly referred to as ‘prudent lotting’.

‘… if sold …’

4.8 The statutory definitions of market value are concerned with a hypothetical sale, not an actual one. As originally held in IRC v Crossman (1937), and confirmed unanimously in Duke of Buccleuch v IRC and in Lynall v IRC (1972), in arriving at the value, it is irrelevant to consider what would have been the circumstances attending an actual sale.

4.9 The price that the property would have actually realised in the open market, or the potential impossibility of putting the property on the market at the valuation date, is also irrelevant. In other words, one does not have to assume that the property actually had to be sold, as a hypothetical market must be assumed, as at the valuation date.

4.10 In IRC v Gray (Executor of Lady Fox deced.) it was said that the property must be assumed to have been capable of sale in the open market, even if it was in fact inherently unassignable or held subject to restrictions on sale. The relevant question is what a purchaser would have paid to enjoy whatever rights were attached to the property at the relevant date, assuming a hypothetical sale.

‘… in the open market …’

4.11 In Lynall v IRC it was held that the property must be valued on the basis of a hypothetical sale between a hypothetical willing vendor (not the actual owner of the property in question) and a hypothetical willing purchaser. The hypothesis used was that potentially no one was excluded from buying (the hypothetical purchaser thus potentially including even the actual owner).

4.12 The statutory definitions refer to ‘the open market’ and not ‘an open market’. This has been interpreted to mean a real market made up of real people. In Lynall v IRC the open market was regarded as a blend of reality and hypothesis. It was held that the conditions under which the hypothetical sale is deemed to take place should be built on a foundation of reality as far as is possible. However, it was deemed even more important not to defeat the intentions of statute by an undue concern for reality in what is essentially a hypothetical situation.

4.13 Case law has further refined the components of the open market definition and, in particular, those parties assumed to be active in it. In Lynall v IRC it was held that the statute implied that there had been adequate publicity or advertisement
before the sale, and that steps had been taken (before the sale) to enable a variety
of persons, institutions or financial groups to consider what offers they would be
prepared to make.

4.14 However, in IRC v Gray (Executor of Lady Fox decd.) it was said that it could
not be emphasised too strongly that although the sale is hypothetical, there is
nothing hypothetical about the open market in which it is supposed to have taken
place. The hypothetical sale envisaged (in order to ascertain the market value for
taxation purposes) presupposes a willing vendor and a willing purchaser.

‘... at that time ...’

4.15 This is defined by statute for the purposes of the valuation exercise in question
(for example, in a CGT case it might be 31 March 1982). The assumption regarding
the definition of the date is that all the preliminary arrangements have been made
prior to the valuation date so that a hypothetical sale can take place at the statutory
point in time. The objective is to ascertain the value of the asset at the prescribed
time (and not at any other time), and this can only be achieved by assuming that all
preliminary arrangements have been made beforehand.

5 Further interpretation

5.1 As part of the consideration of the definition of market value for tax purposes,
the courts have also given guidance on other terms which, although not appearing in
the statutory definition, are used in the interpretation.

5.2 A willing vendor or willing seller is one who is prepared to sell, provided that
a fair price is obtained. It does not mean a vendor who is prepared to sell at any
price and on any terms. In short, the hypothetical vendor is assumed to be a
reasonable and prudent person.

5.3 A willing purchaser presupposes that the open market includes everyone who
has the will and the money to buy. It has been said that the buyer, like the vendor or
seller in paragraph 5.2, must be a person of reasonable prudence.

5.4 A special purchaser is one who has a particular interest in acquiring a
property. The case of IRC v Clay (1914) effectively established that where there is a
known purchaser in the market who is willing to buy at a considerably higher price
than anyone else, then the value of the asset for tax purposes is represented by the
higher price the special purchaser is willing to pay, or by a close approximation to
this.

5.5 In Walton v IRC (1995) it was held that it was a question of fact – to be decided
by evidence – whether or not there were any special purchasers in the market and
what price they would be prepared to pay.

6 Methods of valuation

6.1 Methods of valuation are not predetermined by statute or by case law.
Transaction evidence may reflect the application of a variety of valuation methods,
but that does not affect the comparability of the price realised in each case. In
practical terms, property assets are valued or appraised by whichever ‘method’ is
most appropriate. Special classes and categories of asset will be valued in different
ways because of how 'the market' values them. A presumption of the *Lynall* case is that the vendor, when advertising the property, makes such information available to purchasers of that type of asset as they would expect to receive, or to be able to access, in a normal market transaction.

### 7 Special cases

7.1 Special situations, such as the valuation for taxation purposes of interests in land that are rarely (undivided shares) or never (unassignable agricultural tenancies) sold in the real world, or apportionments for part-disposal calculations, are beyond the scope of this guidance note. Those involved in such matters should study the relevant HMRC and VOA manuals and other guidance. Further help may be obtained from the RICS Valuation Professional Group (valuation@rics.org).

### 8 Case references

8.1 The relevant cases referred to in this guidance note are:

- *Duke of Buccleuch v IRC* [1967] 1 AC 506
- *Ellesmere v IRC* [1918] 2 KB 735
- *IRC v Clay* [1914] 3 KB 466
- *IRC v Crossman* [1937] AC 26
- *IRC v Gray (Executor of Lady Fox decd.)* [1994] STC 360
- *Lynall v IRC* [1972] AC 680, HL (This case was heard in a range of courts between 1969 and 1972); see also *Attorney-General for Ireland v Jameson* [1905] 2 IR 218
UKGN 4 Inspections and material considerations

1 Introduction

1.1 VPS 2, Inspections and investigations, paragraph 3 refers to settling the terms of engagement and notes that "the degree of on-site investigation that is appropriate will vary, depending on the nature of the property, the purpose of the valuation and the terms of engagement agreed with the client."

1.2 Unless expressly stated to the contrary in the terms of engagement, the valuer has an obligation to investigate, consider and report on any material feature that affects a property or its surroundings and could have an impact on value, even if it is not included in this guidance note.

1.3 Although many issues affect the value of a property interest, the degree to which these matters may be addressed by the valuer will often depend on the purpose of the valuation and the extent of enquiries that would normally be associated with such a valuation. It is acceptable for the valuer to agree with the client that either no investigation of these matters will be undertaken, or that specific assumptions can be made, providing that this takes account of VPS 1 paragraph 2(g), Extent of investigation.

1.4 The topics referred to, and the information sources provided, are for guidance only. They should not be regarded as a comprehensive list of all matters that may need to be investigated or reflected in every situation.

1.5 While many information sources are property specific, others are not and only give generalised information relating to a wider area. The valuer will need to take care in considering the potential impact on the specific property and, where appropriate, make clear the limitations of the information relied on in the report.

1.6 Increasingly under UK legislation, a risk assessment is to be undertaken by a designated competent person who will identify the appropriate action to be taken to counter a potential property hazard. Valuers are not expected to be competent to assess these risks, but are recommended to familiarise themselves with those matters that commonly affect value in the sector or locality in which they practise. Where these are likely to be a factor, valuers will need to discuss with clients whether the matters identified should be subject to an investigation by appropriate specialists, or whether the value is to be reported on the basis of a specific assumption about the level of risk.

1.7 In most cases the risk arising from a particular hazard reflects a combination of the physical features of the property and the manner in which the property is used by the occupier. Care is to be taken to distinguish between any work that may be required because of the specific way in which a particular occupier uses a property and work that would have to be undertaken by any potential buyer in the market.
1.8 Where expert reports have been obtained, the valuer is to consider their effect on the valuation. It is important that the valuer does not offer any explanation or interpretation of such reports in the absence of any personal expertise in the subject.

2 Contamination and environmental matters

2.1 Depending on the scope and purpose of the valuation the valuer will agree, in the terms of engagement, the extent to which contamination and environmental matters are to be investigated or commented on in the report (see VPS 1 paragraph 2(g), Extent of investigation, and VPS 2, Inspections and investigations).

2.2 The RICS guidance note, Contamination, the environment and sustainability: their implications for chartered surveyors (2010), contains detailed guidance on various issues related to environmental and sustainability. The use of the relevant property observation checklist provided in that guidance note is recommended.

3 Hazardous or deleterious materials

3.1 It is estimated that asbestos, in some form, is present in 1.5 million buildings in the UK, as its use was common until the mid-1980s.

3.2 The Control of Asbestos Regulations 2012 require non-domestic property to have management plans in place. In any building where asbestos is present, the cost of maintenance, alteration and repair can be significantly increased because of the need to take appropriate precautions under the regulations, and this can affect value. It is therefore recommended that all valuers develop an awareness of the types of buildings and construction likely to contain asbestos.

3.3 Depending on the purpose of the valuation, the valuer may have to alert the client of the need to identify or discover:

- the dutyholder
- the asbestos register and
- if any management plan is in place, following any specialist asbestos survey.

Valuers are not qualified to interpret or validate the content of any asbestos register, or asbestos management plan, unless they have been specially trained, for example, accredited by National Individual Asbestos Certification Scheme (NIACS).

3.4 The RICS guidance note, Asbestos and its implications for members and their clients (2011), has been especially prepared for non-specialist surveyors. Its purpose is to assist them in identifying potential problems and knowing when to recommend the appointment of an expert.

3.5 There may be various materials used in the construction of buildings that may be deleterious, for instance, high alumina concrete and calcium chloride cement and, in Devon and Cornwall, mundic. The identification of these requires specialist knowledge, but for more information members are referred to the following RICS guidance notes, available to RICS members on www.rics.org:

- Building surveys and technical due diligence of commercial property (2010)
- Building surveys of residential property (2004)
4 Disability discrimination

4.1 The Equality Act 2010, which came into effect 1 October 2010, largely replaced the Disability Discrimination Act 2005 as well as consolidated numerous other anti-discriminatory laws. With regard to disability, the Act imposes a duty on employers and businesses offering a service to the public to make reasonable changes to practices and procedures to enable disabled people to do their jobs. In addition, employers and businesses must remove or alter any feature that makes it impossible, or unreasonably difficult, for a disabled person to make use of the services provided.

4.2 Disability has a wide definition; valuers should be aware of the potential liability on building owners or occupiers to comply with the Act and its possible impact on the value of the property interest. However, the duty of compliance rests with the occupier. Although physical changes to a property may enable a particular occupier to comply with the Act, so may changes in the way it conducts its business. For further information, the Department for Work and Pensions provides extensive advice on the application of the legislation (visit www.dwp.gov.uk).

5 Fire safety law

5.1 The Regulatory Reform (Fire Safety) Order 2005 (SI 2005/1541) requires the ‘responsible person’ to make a suitable and sufficient assessment of the risks, and to identify the fire precautions required to comply with the Order. The Order applies to all non-domestic property.

5.2 Such fire precautions may include adaptation of the building and installation of fire safety equipment, but in all cases they must include: signage, fire safety action plans, staff training, identifying dutyholders and routine maintenance/monitoring via signed and dated checklists.

5.3 For further information the RICS publication, The New Fire Safety Legislation 2006: A Practical Guide (2007), written for construction and property management professionals, outlines their duties under fire safety legislation. Detailed information on the regulations and fire safety in general is available from www.fire.org.uk

6 Energy Performance Certificates

6.1 In England and Wales the government has implemented the European Energy Performance of Buildings Directive requiring Energy Performance Certificates (EPC) to be made available for all properties, residential and commercial, when bought sold or rented.

6.2 For commercial properties the duty was introduced progressively from 6 April 2008, according to the floor area of the building. From 1 October 2008 an EPC must
be made available by the ‘relevant person’ whenever a non-domestic building is constructed, sold or rented out, subject to certain exemptions. EPCs are valid for ten years.

6.3 The valuer should be aware that the ‘relevant person’ (such as a prospective landlord or a tenant making an assignment of, or subletting, a non-domestic building) is responsible for making an EPC available free of charge to the prospective buyer, tenant or assignee. Landlords are required to cooperate in providing an EPC if their tenant decides to assign or sublet the premises that are subject to common heating or air conditioning services. More information can be found on the Communities and Local Government website at www.gov.uk/government/policies/improving-the-energy-efficiency-of-buildings-and-using-planning-to-protect-the-environment

6.4 In Scotland the Scottish government via the Scottish Building Standards (SBS) Agency is responsible for the implementation of the directive. Generally, all public buildings over 1000m² will need to display an EPC, even if they are not being sold or leased. The implementation date for non-domestic EPCs in Scotland when leased or sold was 4 January 2009.

6.5 Domestic (residential) properties that are marketed for sale in Scotland after 1 December 2008 are required to provide an energy report as part of the Home Report (this will generate an EPC). All rented dwellings are also required to have an EPC from 4 January 2009 when they change occupants, although existing tenancies are not affected. An EPC will be valid for ten years. More information can be found on the Scottish government website at www.scotland.gov.uk/Topics/Built-Environment/Building/Building-standards
UKGN 5 Local authority disposal of land for less than best consideration

1. Introduction

1.1 This guidance note applies only to local authorities in England and Wales.

1.2 Local authorities have wide land disposal powers under sections 123 and 127 of the Local Government Act 1972 and section 233 of the Town and Country Planning Act 1990. However, they are required to seek specific consent from the secretary of state where the consideration is less than the best that can reasonably be obtained.

1.3 In England, the Local Government Act 1972: General Disposal Consent (England) 2003 removes the requirement for authorities to seek specific consent from the secretary of state for any disposal of land where the difference between the unrestricted value of the interest to be disposed of, and the consideration accepted (the ‘undervalue’), is £2 million or less.

1.4 The detailed valuation requirements are set out in the Technical Appendix to the Consent, which specifically incorporates this guidance note and the definition of market value in VPS 4 paragraph 1.2, Market value.

1.5 In Wales, the Local Government Act 1972: General Disposal Consent (Wales) 2003 removes the requirement for authorities to seek specific consent from the National Assembly for Wales for any disposal of land where the difference between the unrestricted value of the interest to be disposed of, and the consideration accepted (the ‘undervalue’), is £2 million or less.

1.6 The circular accompanying the 2003 Consent provides that the valuer shall have regard to the guidance on local authority disposals of land at an undervalue in these standards.

1.7 The local authority decides whether any proposed disposal requires specific consent, as the secretary of state and the National Assembly for Wales have no statutory powers to advise in any particular case. The valuer may be asked to provide a valuation so that the local authority may consider whether or not an application for consent is necessary, or to support a submission for a specific consent. For either request, valuation must be provided in England following the advice in the Technical Appendix and in Wales following the advice in paragraph 4 of the circular.

1.8 In Scotland, the consent regime is provided by section 74 of the Local Government (Scotland) Act 1973. However, this section was amended by section 11 of the Local Government in Scotland Act 2003, so that the current ministerial consent regime can be replaced by regulations issued by Scottish ministers. No regulations have yet been made.
2 Bases of valuation

2.1 The consent requires the valuer to provide the following figures (details of which are given in the proceeding paragraphs):
   - unrestricted value
   - restricted value and
   - the value of voluntary conditions.

2.2 Unrestricted value

2.2.1 This is the best price that is reasonably obtainable for the property. It is the market value of the land, as defined in VPS 4 paragraph 1.2, Market value, except that it should take into account any additional amount that is, or might reasonably be expected to be, available from a purchaser with a special interest. It should also ignore the reduction in value caused by any voluntary condition imposed by the local authority.

2.2.2 In general terms, unrestricted value is intended to be the amount that would be received for disposal of the property where the principal aim was to maximise the value of the receipt. Apart from the inclusion of bids from a purchaser with a special interest, it is defined in the same way as market value. For example, the valuer must take account of any uses that might be permitted by the local planning authority if these would be reflected by the market, and not only a use (or uses) intended by the parties to the proposed disposal.

2.2.3 The valuer should assume that the freehold disposal is made, or the lease is granted, on terms that are intended to maximise the consideration. For example, where unrestricted value is based on the hypothetical grant of a lease, at a rack rent or ground rent, with or without a premium, the valuer should assume that the lease would contain those covenants normally included in such a lease by a prudent landlord. The valuer should also assume that the lease would not include unusual or onerous covenants that would reduce the consideration, unless these had to be included as a matter of law.

2.3 Restricted value

2.3.1 This is the market value of the property having regard to the terms of the proposed transaction. It is defined in the same way as unrestricted value, except that it should take into account the effect on value of any voluntary condition.

2.3.2 Where the local authority has invited tenders and is comparing bids, the restricted value is normally the amount offered by the local authority’s preferred transferee. Otherwise it is normally the proposed purchase price.

2.4 The value of any voluntary conditions

2.4.1 Sales may be subject to voluntary conditions. These are any term or condition of the proposed transaction that the local authority chooses to impose. Voluntary conditions do not include any term or condition that the local authority is obliged to impose, for example, as a matter of statute or a condition that runs with the land.
They also do not include any term or condition relating to a matter that is a discretionary, rather than a statutory, duty of the local authority.

2.4.2 Their value is the total of the capital values of voluntary conditions imposed by the local authority as terms of the disposal, or under agreements linked to the disposal, that produce a direct or indirect benefit to the local authority that can be assessed in monetary terms. It is not the reduction in value (if any) caused by the imposition of voluntary conditions, and any adverse effect these may have on value must not be included in this figure.

2.4.3 The proposed disposal, or an agreement linked with it, may give rise to non-property benefits to the local authority. For example, these might include operational savings, or income generated as a result of the transaction where the local authority has an associated statutory duty. The monetary value of these benefits to the local authority should be included in the value of voluntary conditions in the valuer’s report.

2.4.4 The valuer will often be able to assess the value of a voluntary condition of disposal to the local authority. However, there may be cases where a question arises about the status, in law, of such value (whether or not it is capable of forming part of the consideration). In such cases, the local authority may need to seek legal advice as to whether the value of the voluntary condition is such that it may form part, or all, of the consideration the local authority proposes to accept. Conversely, there may also be cases where a term or condition of disposal is, in law, capable of forming part, or all, of the proposed consideration, but it has no quantifiable value to the local authority, or its value is nil.

2.4.5 Where the valuer is not qualified to assess the value of any benefits (for example, of share options) the report should make clear the extent to which the valuer accepts liability for the figures. Where the valuer does not accept full responsibility, the report should make clear who was responsible for assessment of the remainder, and copies of any valuations or advice received from accountants or other professional advisers should be annexed.

3 Leasehold disposals

3.1 The valuer is required to assess the unrestricted value in capital terms. The unrestricted value should be assessed by valuing the authority’s interest after the lease had been granted, plus any premium payable for its grant. In other words, it will be the value of the right to receive the rent and any other payments under the lease, plus the value of the reversion when the lease expires.

4 Options

4.1 Where a disposal involves the grant of an option, the valuer must consider both the payment for the option and the consideration that might be received, were it to be exercised as either, neither or both may involve a discount. Paragraphs 19 to 21 of the technical appendix to the Consent provide more detailed guidance on the treatment of options.
5 Discount

5.1 This is the amount by which the value of the actual consideration is less than that of the best consideration reasonably obtainable. It is given by the formula:

\[\text{unrestricted value} - (\text{restricted value} + \text{value of conditions}).\]

Otherwise, where the value of the consideration for the disposal differs from the restricted value, it is given by this formula:

\[\text{unrestricted value} - (\text{value of consideration} + \text{value of conditions}).\]

5.2 The secretary of state must be aware of cases where the proposed consideration is more or less than the value of the interest to be disposed of, subject to the proposed voluntary conditions, so that this can be taken into account when reaching the decision. Accordingly, where the value of the consideration differs from the restricted value, both figures must be given.

6 Purpose of the valuation

6.1 Along with stating the purpose of the valuation, the valuer must provide a summary of the proposed transaction, noting the key terms and any restrictions to be imposed by the local authority. Where the local authority proposes to grant a lease, a copy of the draft lease should be attached to the report. Where this is impracticable, a copy of any heads of terms agreed or a summary of the key terms of the proposed lease should be provided.

7 Assumptions as to planning

7.1 Where there is no detailed scheme, the valuer should make reasonable assumptions about the form of the development. This should include a note of the existing use(s), current planning consents and use(s) likely to be permitted with regard to the development plan. Where the unrestricted value has been based on an assumed planning use other than that for which the property has been sold, a detailed explanation of the planning assumptions made is required.

8 Tenure

8.1 This must include a note identifying the local authority’s tenure and giving details of the purpose(s) for which the land is held (which is normally for the purposes of the power under which it was acquired, or taken on lease, unless it has since been formally appropriated). It must also include a summary of the details of any leases, or encumbrances such as easements, to which the land is subject.

9 Valuations

9.1 The unrestricted and restricted values, together with the value of conditions, should be given. Where any of these is nil this should be expressly stated.
9.2 Where the value of a scheme is less than the development cost (that is, there is
‘negative development value’), the advice in paragraph 23 of the technical appendix
to the Consent should be followed.

9.3 Where the value of land may be affected by the availability of grants, the advice
in paragraph 24 of the technical appendix to the Consent should be followed.

9.4 The valuation date should not be more than six months before the submission
of the application to the secretary of state.

10 Description

10.1 The report must include a written description of the site and buildings, the
location and surroundings. A plan, to which the secretary of state will refer if giving
consent and which is sufficiently accurate to identify the land, is also to be provided.

11 Existence of a special purchaser

11.1 The effect on value of the existence of a purchaser with a special interest
should be described.

12 The report

12.1 The report must be signed by a ‘qualified valuer’ (a member of RICS).
UKGN 6 Analysis of commercial lease transactions

1 Introduction

1.1 In the period before the major commercial property crash in 1990 in the UK, rental valuation was relatively straightforward. The vast majority of institutional grade properties were let on 20 or 25-year terms, had upwards only market rent reviews and were let on Full Repairing and Insuring (FRI) terms. Hence, defining and assessing rental values was relatively straightforward using the comparable method underpinned with a good supply of comparable property lettings on standard lease terms. Rental value variations were largely based on location and physical differences, although differences between rents provable at a third party rent determination and those achievable in new lettings were being monitored by some market participants.

1.2 The situation changed in the period after the 1990 property market crash. Successive reports by the University of Reading in relation to monitoring the Commercial Leases Code of Practice (DETR, 2000; ODPM, 2005), supported in the last 10 years by the BPF/IPD Annual Lease Review (e.g. BPF/IPD, 2012), detail the increasing variation in lease terms in the UK and the increasing importance since 1990 of incentives within new lettings, such as rent-free periods and capital contributions by landlords. It is these developments that have created additional difficulties in assessing rental levels. In essence, the inclusion of incentives within a letting means that the rent negotiated between the parties cannot be taken at face value as a signal of the rental value of the subject property. This, in turn, causes issues for asset valuation in general and for two specific major applications of valuation method; rent review and property performance measurement.

1.3 Whatever the purpose, the valuer may be required to establish the market rent of the subject property. Market rent is defined in VPS 4 paragraph 1.3, Market rent. This definition suggests that the market rent should be assessed as the current letting value of the vacant property based ‘on appropriate lease terms’. The supporting text is more specific:

‘Valuers must therefore take care to set out clearly the principal lease terms that are assumed when providing an opinion of market rent. If it is the market norm for lettings to include a payment or concession by one party to the other as an incentive to enter into a lease, and this is reflected in the general level of rents agreed, the market rent should also be expressed on this basis. The nature of the incentive assumed must be stated by the valuer, along with the assumed lease terms.’

1.4 The definition suggests that, where it is normal in a particular market environment to grant incentives to tenants, the market rent is subject to these
incentives and so the market rent to be identified under the RICS definition is a headline, face or contract rental value. Headline, face or contract rent is defined below but, in summary, represents the rental value that is paid, or would be paid, subject to a stated or assumed set of lease incentives.

1.5 However, in the case of a rent review, the rent review clause usually contains its own definition, which takes precedence over the market rent definition in VPS 4 paragraph 1.3, Market rent. In the case of lease renewals under the Landlord and Tenant Act 1954, the Act and case law will also take precedence over this definition. In UK practice, occasionally this will be the headline rental value, but in many cases an effective rental value will be required at a rent review.

1.6 This guidance note addresses the valuation issues that have arisen from these recent market changes and provides some guidance to valuers on the analysis of transactions subject to lease incentives. It describes the different incentives and explains some of the different approaches that can be used to help determine the effective rental value. This is the rent that the property would have let at in the market place had no incentives to let been given to the tenant. Although the best evidence of rental levels in the market is new lettings, they are most likely to include incentives. This guidance note explores some of the factors that the valuer may need to consider when assessing the impact of such incentives on the rent agreed and its analysis.

1.7 One of the major factors in any market is market knowledge. Openness, transparency and a willingness to share information benefit the market as a whole and are to be encouraged. However, due to commercial sensitivities, lettings of commercial property can be subject to confidentiality clauses, meaning that the available information may be limited. As assumptions may have to be made, it is very important that valuers are closely involved with, and aware of, the workings of the particular market and use their experience of the market when approaching comparable transactions. They should consider the circumstances of these types of transaction, understand the transaction being analysed and identify the true incentive, before adopting a mathematical approach.

1.8 There is no single correct approach to analysis and, as illustrated in the examples (see section 7 below), no ‘right’ answer. Methods may vary depending on the circumstances of individual cases and market practices in different areas and sectors. Changing markets may mean that the approach adopted previously may not be appropriate several years later. Different approaches may also be suitable for the different reasons why an effective rent is being sought; for example consistency of approach through time may be an important element where effective rental values are being used to construct a rental value index for performance measurement approaches. However, whatever the purpose, the underlying principles are the same.

1.9 The following terms are used in this guidance note:

- **Incentive:** this term embraces any form of incentive, inducement or concession made by either party. The most common examples are capital payments and rent-free periods (subject to paragraph 4.1.3 for fitting-out periods).

- **Headline rent:** this is the actual contracted periodic rental payment under the lease that becomes payable after all the initial incentives or concessions in the letting have ended. It is sometimes referred to as the ‘face rent’ or ‘contract rent’.

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Effective rent: this is the rent that would be agreed between the parties for a letting of the premises on the relevant terms and conditions, but without incentives forming part of the transaction. In some circumstances, such as where a large premium has been paid to secure the property and part of it is considered to be a rental equivalent, the effective rent could be higher than the headline rent. The effective rent is sometimes referred to as the equivalent rent.

2 Motivation of the parties

2.1 The terms upon which prospective landlords and tenants will enter into a commercial lease are influenced by the general and local state of the market at the time that the terms are negotiated.

2.2 The parties may also be influenced by their respective individual objectives, economic circumstances, accounting practices or tax positions even though these are not directly related to the value of the property.

2.3 The motivations for parties offering or accepting incentives will differ with each transaction. A tenant accepting an incentive may have different motivations from the landlord offering them. Moreover, the two parties to a transaction may put different interpretations on their agreement.

2.4 Aside from market conditions and the negotiating strength of the parties, the reasons for, and influences upon, the agreement of incentives include, among others, the following:

• Investor landlords generally seek to hold the property for a combination of rental income and capital growth. They will seek to maintain or achieve a given level of rent and/or length of lease to secure an income stream from a good tenant covenant for a period that will maximise capital value.

• Incentives may be given to facilitate funding, possibly at a more favourable funding rate. The achievement of higher headline rents may be an important factor.

• If the lessor is itself a tenant, its motivation may be different from an investor landlord as it will normally be aiming to mitigate or eliminate its continuing liabilities rather than maximising capital value.

• The taxation, grant and capital allowance positions of the parties may be factors.

• The strength or weakness of the tenant’s covenant may be a consideration.

• The actual terms, frequency and nature of rent reviews and the assumptions made at future rent reviews may have an impact.

• They may ease cash flow for either party. For the tenant, a rent-free period, coupled with a higher subsequent rent, is effectively an unsecured loan from the landlord.

3 Impact of break clauses, rent reviews and lease length on write-off period

3.1 In certain markets the amount of an incentive is directly proportionate to the length of tenant commitment, with larger incentives being payable if the tenant...
commits to a longer lease. There may also be variations in the preferences of landlords and tenants as to the length of leases. The length of the lease, the timing and type of any rent review and the presence of break clauses all impact on the length of time that the incentive impacts on the lease income.

3.2 Break clauses may have a critical impact on any analysis depending on whether there is a reasonable possibility that they will be exercised and the terms on which they are capable of being exercised. Break clauses may have a bearing upon any write-off period with the assumption that, if a headline rent is above the effective rent at the time of the break, the break may be more likely to be exercised.

3.3 However, not all break clauses are exercised in these circumstances so it is not necessarily correct to assume that all tenants might be expected to operate a break clause (especially if there is a penalty for its operation). Exercising the break changes the period for the write-off of fitting-out costs to a shorter one than initially envisaged, which may in turn have to be reflected in an adjustment to the tenant’s accounts. The effect of the notice period and the tenant’s need to secure alternative premises may also be factors. If alternative premises are secured first, there could be an element of double overheads. Landlord’s break clauses, on the other hand, are unlikely to be operated if the rent passing still exceeds the effective rent, unless other pressures dictate. However, a break may be capable of being used by the tenant to negotiate a downward review, so extinguishing the impact of any incentive over the later part of the lease.

3.4 This explains the importance of the rent review to any consideration of the length of time that any incentive has an impact. A rent review clause that allows a downward review to an effective rental value automatically extinguishes the impact of any incentive at that point. In these circumstances, the rent at review would be the same regardless of whether a headline rent or an effective rent had been agreed at the beginning of the lease. If, however, an upwards only rent review to effective rental value is in place, the impact of the review will only have been extinguished if the level of effective rental value had grown to or above the level of headline rent at the date of the review. The same test applies for any subsequent reviews in the lease. For any given package of lease incentives, it is only possible to determine the write-off period by assuming a future level of rental growth over the lease period. Therefore, a logical decision on write-off period can only be made in the context of an explicit cash flow analysis. If a conventional valuation approach is applied, there is no fundamental basis for that decision.

3.5 However, in the context of UK rent review negotiations, this decision has been based in the motivation of the parties within a conventional valuation framework. A write-off period to the end of the lease is preferred by landlords as it produces a higher effective rental value level from any headline rent and incentives package than if that same headline rent and package is written off to the first review only. The lower effective rental value determined when the incentives are written off to the first review only is obviously preferred by tenants (see section 5, Analysing the transaction). If a rent review negotiation cannot be resolved between the parties, third party determination is used and each of the parties can object to any particular arbitrator or expert. Arbitrator/experts would tend to adopt a compromise position, which is for the incentives to be written off over a compromise period between the first rent review and the lease term.

3.6 The more rational argument for the determination of write-off period is that, if a very low effective rent is determined by writing off to the first review, it is less likely to
be able to grow to headline rent by the first review; which means it does last beyond the first review. Conversely, if a high effective rent is determined by writing it off over the whole length of the lease, it is much more likely to grow to the headline rent over the period to the first review; suggesting the impact does not extend past the rent review. Unless the incentives packages are small in the case of tenants or the anticipated growth over the whole term of the lease is very low in the case of landlords, both extreme positions tend to be self-defeating. Only in an explicit cash flow context can the write-off period be modelled effectively.

4 Types of incentives

4.1 Rent-free periods

4.1.1 A rent-free period may occur at the beginning of the lease or at any time during the currency of the lease term. Occasionally, the tenant is required to pay rent for an initial period as evidence of its commitment to the lease, with the free period commencing at some future date.

4.1.2 Rent-free periods may reflect:

- the time required to fit out the property to suit the tenant’s needs
- agreement by the tenant to carry out repairs, or improve the property, which may benefit the landlord
- commitment from the tenant to pay a higher rent so the landlord maintains rental levels as high as possible or
- acceptance of specific liabilities or restrictions under the lease.

4.1.3 The principle of granting a rent-free period to reflect the time required for fitting out the property to suit the tenant’s reasonable needs is common practice in many markets. Therefore it may not normally be regarded as an incentive. It represents a balance between the landlord’s need to secure an income from as early a date as possible and the tenant’s need not to have a rent liability until the property can be occupied.

4.1.4 What is considered a reasonable length of time for the fitting out will vary according to the extent of the works, the size of the property in question and local market practice. Where specialist fitting out is involved, the time taken may go beyond a normal fitting-out period and an element may not be considered to be part of the reasonable fitting-out period.

4.1.5 In some circumstances, usually by the grant of a licence or following an agreement for a lease, the fitting-out period may begin before the formal commencement of the lease.

4.1.6 Assistance by the landlord with the costs of fitting out (in contrast to the rent-free period to reflect the time taken for the works) may take the form of capital payments to the tenant, or the provision of physical works by the landlord.

4.1.7 When fitting-out works or improvements are carried out as a condition of the grant of the lease, they are effectively a premium payable by the tenant. It is necessary to establish whether such improvements can be reflected in the rent at review.
4.2 Premiums and other capital payments

4.2.1 Consideration of premiums requires care because they rarely show a consistent pattern. A premium could be made up from several elements, which are necessary to establish so that only those elements that are appropriate to be reflected in an adjustment are identified. The timing of payments also needs to be considered, particularly where they are close to new lettings, reviews or renewals.

4.2.2 A payment by the landlord to the tenant is not necessarily an incentive as it may relate to other issues, such as taking on repairing obligations.

4.2.3 A payment by the landlord for the cost of works that improve the property in a way that enhances its rental value may not be an incentive, but merely a change in the nature of the property being let. Premiums can also be cash payments to the tenants at the commencement of (or at any time throughout) the lease term, or they can be payments in kind, such as subsidies or equipment, or tenants’ removal/relocation costs.

4.2.4 A premium paid by the incoming tenant to the landlord, or an existing tenant on an assignment of a lease, may reflect the fact that the passing rent is below the current net effective rent. The value of improvements, goodwill, a need to be in a particular location or building or the assignee being a special purchaser may also be considered in this premium. In addition, the premium may account for special modification of the lease terms tailored for that tenant's particular trading circumstances, or even the benefit of restrictive covenants on other tenants in a development.

4.2.5 The assessment of the true capital cost of these benefits to both landlords and tenants can be problematic, and there may be differing interpretations which include the following:

- The landlord may argue that the whole of the premium represents capitalised profit rent, or it is common in prime locations to find new lettings significantly above reviews or lease renewals.
- The tenant may argue that:
  - treating premiums as capitalised profit rent may result in high figures that cannot be justified by other market evidence
  - its payment of a premium is solely to obtain occupation that is not related to rental value or
  - an occupier may be prepared to pay a premium, but would not pay an equivalent amount as rent because of its particular accounting practices.

4.2.6 The validity of these arguments requires careful review to establish what proportion (if any) of the premium should be considered to be paid in lieu of rent.

4.3 Stepped rents, rent capping and fixed rent on reviews

4.3.1 Stepped rents and fixed rents are common in sale and leaseback transactions. In these circumstances they are not an incentive but a reflection of the price of the capital raised by the lessee. However, in an open market letting, these features can be used as incentives and may influence the headline rent.
4.3.2 The period over which rents may be stepped is usually, but not always, within the period to the first rent review. Rents may be capped to a maximum or minimum level, or a range, and may also be linked to factors not directly property related.

4.4 Lease surrenders or take-backs

4.4.1 The landlord may agree to accept the tenant's ongoing liabilities, either partially or in their entirety, in respect of the previous or other premises of the tenant.

4.4.2 The calculation of the benefits to a tenant may consider not only the projected void costs in any existing leases surrendered or assigned, but also the costs of disposal (including legal and agency fees, and any necessary incentives) and any accrued dilapidations or other liabilities.

4.4.3 The landlord may be influenced by its ability or wish to redevelop or refurbish the premises taken back.

4.4.4 Another example might be marriage value (or synergistic value) accruing to the landlord by taking back the premises. This might influence the valuer to make an upwards adjustment of the rent, rather than discounting it.

4.5 Other incentives

4.5.1 The parties may agree to incentives that may reflect circumstances particular to the letting, such as concessions in the lease covenants and service charge caps.

4.5.2 The assessment of these incentives may not be straightforward due to the difficulty in obtaining full details of the amounts involved and assessing the real benefits to the tenant.

5 Analysing the transaction

5.1 Methods of analysis

5.1.1 The purpose of the analysis is to establish the effective rent, having regard to the package of incentives incorporated into the specific transaction.

5.1.2 There are three different types of method normally applied to this analysis.

(a) The first method does not take into account the timing of cash flows and simply sets the total income and expenditure from the actual lease, including any incentives, against an equivalent lease that assumes no incentives to let had been granted. The method does not anticipate any change to the cash flow over time regardless of whether there are rent reviews in the lease.

(b) The second method adopts a similar ‘conventional’ approach to future rental value change during the lease but adopts a time value of money discounting approach to the problem. This requires a discount rate that may be either some form of target return rate or a capitalisation rate or a combination of both.

(c) The third method is an explicit discounted cash flow approach requiring both a target return rate and a rental growth rate as inputs.
5.1.3 Section 7 of this guidance note sets out two examples to illustrate how these methods work; one with rent reviews within the lease and one without.

- Example 1 is a short lease with a rent-free period, no reviews and a small amount of capital payment.
- Example 2 is a longer lease with upwards only rent reviews, a longer rent-free period and a larger capital payment.

All the examples and discussion assume that any rent reviews are upwards only and that the lease term is assumed to be the end of the lease or the period to the first break clause, if one exists.

5.1.4 There are a number of issues concerning the methods. The three issues that apply to all of the methods are:

- the treatment of comparables
- the approach to any rent-free period for fitting out of the premises and
- the individual circumstances of the parties.

5.2 Treatment of comparables

5.2.1 There are two primary approaches to the treatment of comparables in common use in the UK:

(a) devalue each comparable to an effective rent and then apply all of them to arrive at one net effective rent for the subject premises, after making appropriate adjustments for differences (for example, in lease length) that might cause the appropriate scale of the incentives, and hence the effective rent, to differ or

(b) use the comparable evidence to find the market package (that is, headline rent and incentives) that would be likely to be agreed in the marketplace for the subject premises, and then adjust that transaction to reflect the assumed lease terms. Having arrived at the market package applicable to the subject premises, the effective rent is then calculated.

5.3 Rent-free periods for fitting out

5.3.1 The valuer may need to decide if the effective rent is to be calculated including or excluding a rent-free period during which the fitting-out works took place.

5.3.2 For general valuation purposes, the logical approach to the valuation would be that the tenant needs to occupy for a period to fit out, and therefore the rent-free period would start at the beginning of the lease and the total rent-free period would include both fitting-out and incentive periods. The effective rent lease would have just the fitting-out period.

5.3.3 For lease renewals, the legislation (in England and Wales, the Landlord and Tenant Act 1954) and associated case law will be relevant in all cases, although the Act is silent on fitting-out assumptions in its definition of rental value.

5.3.4 In the case of rent reviews, the lease wording should be checked carefully. There are two possible approaches. The first is to assume that under the hypothetical 'net effective rent deal', the tenant would receive a rent-free period equal
to the fitting-out period only. An alternative approach is to assume that the fit-out took place before the start of the lease term and it is quite common in UK rent reviews to have this assumption written into the rent review clause.

5.3.5 This difference can be accommodated within all the methods set out in all the methods set out in the examples. The basic approach of this note is to assume that the fit-out period is part of the lease term; however, Example 1 in section 7 of this guidance note illustrates the alternative approach.

5.4 Accounting and tax

5.4.1 It is arguable that the tax and accounting implications of the incentives, from both the landlord and tenant’s point of view, should be taken into account in the analysis. However, in market valuation generally, these are not taken into account as market rents should be priced by competition in the market and not by the personal tax circumstances of individual parties. These may influence the amount a landlord and tenant could afford to pay but these personal advantages or disadvantages do not normally flow into market prices unless they are available to all, in which case they should be picked up within the comparable information.

5.5 Write-off periods and discount rates

5.5.1 There are three major issues concerning the application of methods to the analysis of effective rental values from headline rents which do not impact equally on each method. These are the choice of write-off period, the choice of any discount rate required and the choice of any growth rate. Section 5.1.2 identifies which methods need which inputs. In summary the cash flow approach requires a choice of discount rate and growth rate. Method 1 does not require the choice of a discount rate or growth rate but does require a choice of a write-off period. Method 2 requires a write-off period to be chosen and a discount rate.

5.5.2 The use of a capitalisation rate as a discount rate implies change in the future cash flow. It may be assumed that, where some changes to rent are expected, the capitalisation rate could be used in the calculations.

5.5.3 However, there are some interesting contradictions with this assumption that are related to the issue of the write-off period. Effective rents could grow rapidly enough such that the headline rent is superseded at the first review. However, it is also possible that it would not, with the result that the headline level of rent persists as the passing rent beyond the first review date (assuming an upwards only rent review clause). In the latter case, it would be appropriate to discount the effective rent within method 2 at the capitalisation rate where the effective rent is assumed to last beyond the review date. If the write-off period is to the first review only, the effective rent is fixed for the duration of the calculation and so a target rate of return would be more appropriate.

5.5.4 Yet the headline rent is a fixed rent so a growth implicit capitalisation rate would not be appropriate to discount that income flow. Where the write-off period extends beyond the rent review, an assumption is being made that the headline rent, underpinned by an upwards only clause, remains above the effective rental value at the review date. So, even where the write-off period extends beyond the first review,
it is still appropriate to discount it at the target rate. It may therefore be appropriate to discount the headline rent at a target rate and the effective rent at a capitalisation rate.

5.5.5 Method 3 has no such ambiguities. It is based on an explicit cash flow, so all cash flows are discounted at the target rate of return. The choice of target rate is not simple and is discussed in the RICS guidance note, "Discounted cash flow for commercial property investments" (2010).

5.5.6 As each method requires a different set of inputs, the choice of each of these inputs has a very different impact on the outcome. The various outcomes to Examples 1 and 2 are set out below in Table 1 and range between effective rents of £64,632 and £73,684 for Example 1 and between £10,465 and £74,576 for Example 2. The huge range in Example 2 is primarily caused by the different write-off periods adopted.

5.5.7 IPF (2013) (Innovation in Public Finance Conference) examines a greater range of different inputs and finds variation in the other inputs as well as the write-off period – low capitalisation rates and high growth rates should lead to shorter write-off periods while low growth rates and higher capitalisation rates tend to favour longer write-off periods. More obviously, lower levels of incentives should be written off over shorter periods. IPF (2013) also found that using a compromise write-off period in methods 1 and 2 reconciles more closely with a more sophisticated cash flow approach across a range of capitalisation rates, target rates and write-off periods than where these methods are applied using either rent review or full lease term as the write-off period.

Table 1: Range of solutions to the various methods

<table>
<thead>
<tr>
<th>Example</th>
<th>Method 1</th>
<th>Method 2 Capitalisation rate</th>
<th>Method 2 Target rate</th>
<th>Method 2 Target rate and capitalisation rate</th>
<th>Method 3 DCF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Example 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Write off to lease end</td>
<td>£73,684</td>
<td>£69,724</td>
<td>£68,365</td>
<td>£64,632</td>
<td>£68,365</td>
</tr>
<tr>
<td>Example 2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Write off to rent review</td>
<td>£21,053</td>
<td>£13,581</td>
<td>£11,078</td>
<td>£10,465</td>
<td></td>
</tr>
<tr>
<td>Write off to lease end</td>
<td>£74,576</td>
<td>£63,764</td>
<td>£59,875</td>
<td>£52,605</td>
<td></td>
</tr>
<tr>
<td>Write off half way between rent review and lease end</td>
<td>£61,538</td>
<td>£51,792</td>
<td>£48,409</td>
<td>£44,008</td>
<td>£55,3041</td>
</tr>
</tbody>
</table>

Note 1: The DCF method does not require a compromise write-off period, it selects the correct one for the growth assumptions made.
6 Conclusion

6.1 The effective rental value depends on the terms of the lease as well as the usual location and building characteristics. When providing an estimate of market rent, valuers must take care to set out clearly the principal lease terms that are assumed, as well as any other payments or concessions by one party to the other as an incentive to enter into the lease (see VPS 4 paragraph 1.3, Market rent).

6.2 There are occasions when it is necessary to amend the details of the actual letting in order to calculate the effective rent assuming no incentives had been given. These could include clarifying rental evidence in rental negotiations at rent review, as well as developing consistent bases for the construction of rental value indices through time, and identifying the market value or investment value of both let and vacant properties.

6.3 There are a number of methods of analysing contract, face or headline rents in order to determine the level of effective rent for any individual transaction. The choice of method is for the valuer to determine in the light of the individual circumstances. This choice may vary on account of the type and quality of property. It may also vary according to the role of the rental analysis; for example, at the time of writing there is an industry consultation taking place in the UK to identify a consistent method of analysing rental transactions for performance measurement purposes. In this case, consistency of application of technique may be more important than applying the best method to each individual circumstance.

6.4 Different applications of three methods of analysis have been identified in section 7 of this guidance note, ranging from simple addition of the benefits of the individual leases through conventional cash flow, to more explicit cash flow approaches. The examples are not exhaustive and the methods not inclusive of all possible approaches. In addition, the methods are not mutually exclusive of each other and some or all can be used by valuers to support their valuation.

6.5 There are a number of important issues to consider when determining effective rental values.

(a) First, the write-off period can be determined objectively but it does require some explicit assumptions on the future behaviour of the cash flows from the different leases being compared.

(b) Second, valuations require the choice of a discount rate and this can be based on the capitalisation rate or on a target rate of return. These choices can be side-stepped but only by applying a technique that ignores discounting; and discounting is the cornerstone of modern valuation practice.

Variations in these inputs will have varying effects on the different methods and will create some valuation uncertainty. This is normal in all valuations and it is for the valuer to determine the appropriate method for the different circumstances.

7 Examples of the analysis of incentives

This section illustrates and compares the results of analysing two transactions using the methods outlined in section 5, Analysing the transaction. They do not
recommend or endorse any particular approach. To illustrate the principles, the examples are highly simplified and thus cannot be used as a model approach to the analysis of a specific lease.

**Discount rates and growth rates**

In all of the examples, the following discount rates and growth rates have been assumed:

- equivalent yield: 6.0% (the investment capitalisation rate)
- target internal rate of return (IRR): 8.0% (investors’ typical target IRR)
- growth rate 2% (a simplified implied rate from the target and capitalisation rate).

**Cash flow in arrears or advance**

In methods 2 and 3, where a DCF concept is adopted, the calculations are presented using a DCF shortcut approach employing years purchase (YP) and present value factors. The YP factors are on an annually in arrears basis to reflect general market practice and the analysis of capitalisation rates, which are often also based on these assumptions. However, YP quarterly in advance or a YP for any other period can easily be substituted into the calculations illustrated.

**Example 1**

A short lease with a rent-free period, no reviews and an amount of capital payment. Headline rent £100,000 pa, capital payment £50,000, lease 5 years, rent free 1 year of which fitting-out period 3 months.

| Headline rent | £100,000 pa |
| Lease length | 5 years |
| Capital payment | £50,000 |
| Capitalisation rate | 6% |
| Target rate | 8% |
| Assumed growth rate | 2% |
| Rent-free period | 1.00 year |
| Fitting-out period | 0.25 years |
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Method 1: Straight line

<table>
<thead>
<tr>
<th>Description</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000 pa</td>
</tr>
<tr>
<td>Lease length</td>
<td>5 years</td>
</tr>
<tr>
<td>Capital payment</td>
<td>£50,000</td>
</tr>
<tr>
<td>Capitalisation rate</td>
<td>6%</td>
</tr>
<tr>
<td>Target rate</td>
<td>8%</td>
</tr>
<tr>
<td>Assumed growth rate</td>
<td>2%</td>
</tr>
<tr>
<td>Rent-free period</td>
<td>1.00 year</td>
</tr>
<tr>
<td>Fitting-out period</td>
<td>0.25 years</td>
</tr>
</tbody>
</table>

Method 1

<table>
<thead>
<tr>
<th>Description</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000</td>
</tr>
<tr>
<td>Received for (yrs)</td>
<td>4.00 years</td>
</tr>
<tr>
<td>Capital value of headline rent</td>
<td>£400,000</td>
</tr>
<tr>
<td>Less capital payment</td>
<td>£50,000</td>
</tr>
<tr>
<td>Capital value of inducements</td>
<td>£350,000</td>
</tr>
<tr>
<td>Spread over/divide by (yrs)</td>
<td>4.75 years</td>
</tr>
<tr>
<td>Effective rent</td>
<td>£73,684</td>
</tr>
</tbody>
</table>

Method 2: Time value of money

Method 2 (using target rate)

<table>
<thead>
<tr>
<th>Description</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000</td>
</tr>
<tr>
<td>YP @ target rate for 4.00 yrs</td>
<td>3.3121</td>
</tr>
<tr>
<td>PV £1 @ target rate for 1.00 yr</td>
<td>0.9259</td>
</tr>
<tr>
<td>Capital value of headline rent</td>
<td>£306,678</td>
</tr>
<tr>
<td>Less capital payment</td>
<td>£50,000</td>
</tr>
<tr>
<td>Capital value of inducements</td>
<td>£256,678</td>
</tr>
<tr>
<td>Divide YP @ target rate for 4.75 yrs</td>
<td>3.8274</td>
</tr>
<tr>
<td>PV £1 @ target rate for 0.25 yrs</td>
<td>0.9809</td>
</tr>
<tr>
<td>Deferred YP</td>
<td>3.7545</td>
</tr>
<tr>
<td>Effective rent</td>
<td>£68,365</td>
</tr>
</tbody>
</table>
**Method 2 (using capitalisation rate)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000</td>
</tr>
<tr>
<td>YP @ capitalisation rate for 4.00 yrs</td>
<td>3.4651</td>
</tr>
<tr>
<td>PV £1 @ capitalisation rate for 1.00 yr</td>
<td>0.9434</td>
</tr>
<tr>
<td>Capital value of headline rent</td>
<td>£326,897</td>
</tr>
<tr>
<td>Less capital payment</td>
<td>£50,000</td>
</tr>
<tr>
<td></td>
<td>£276,897</td>
</tr>
<tr>
<td>Divide YP @ capitalisation rate for 4.75 yrs</td>
<td>4.0296</td>
</tr>
<tr>
<td>PV £1 @ capitalisation rate for 0.25 yrs</td>
<td>0.9855</td>
</tr>
<tr>
<td>Deferred YP</td>
<td>3.9713</td>
</tr>
<tr>
<td>Effective rent</td>
<td>£69,724</td>
</tr>
</tbody>
</table>

**Method 2 (Headline rent target rate, effective rent rate)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000</td>
</tr>
<tr>
<td>YP @ target rate for 4.00 yrs</td>
<td>3.3121</td>
</tr>
<tr>
<td>PV £1 @ target rate for 1.00 yr</td>
<td>0.9259</td>
</tr>
<tr>
<td>Capital value of headline rent</td>
<td>£306,678</td>
</tr>
<tr>
<td>Less capital payment</td>
<td>£50,000</td>
</tr>
<tr>
<td></td>
<td>£256,678</td>
</tr>
<tr>
<td>Divide YP @ capitalisation rate for 4.75 yrs</td>
<td>4.0296</td>
</tr>
<tr>
<td>PV £1 @ capitalisation rate for 0.25 yrs</td>
<td>0.9855</td>
</tr>
<tr>
<td>Deferred YP</td>
<td>3.9713</td>
</tr>
<tr>
<td>Effective rent</td>
<td>£64,632</td>
</tr>
</tbody>
</table>

**Method 3: Cash flow**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000</td>
</tr>
<tr>
<td>YP @ discount rate for 4.00 yrs</td>
<td>3.3121</td>
</tr>
<tr>
<td>PV £1 @ discount rate for 1.00 yr</td>
<td>0.9259</td>
</tr>
<tr>
<td>Capital value of headline rent</td>
<td>£306,678</td>
</tr>
<tr>
<td>Less capital payment</td>
<td>£50,000</td>
</tr>
<tr>
<td>Capital value of inducements</td>
<td>£256,678</td>
</tr>
<tr>
<td>Divide YP @ discount rate for 4.75 yrs</td>
<td>3.8274</td>
</tr>
<tr>
<td>PV £1 @ discount rate for 0.25 yrs</td>
<td>0.9809</td>
</tr>
<tr>
<td>Deferred YP</td>
<td>3.7545</td>
</tr>
<tr>
<td>Effective rent</td>
<td>£68,365</td>
</tr>
</tbody>
</table>
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Example 1 using an alternative fit-out assumption

Method 2: Using capitalisation rate and assuming rent review clause suggests fit-out period before the start of the lease

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000</td>
</tr>
<tr>
<td>YP @ capitalisation rate for 4.25¹ yrs</td>
<td>3.6560</td>
</tr>
<tr>
<td>PV £1 @ capitalisation rate for 0.75 yrs</td>
<td>0.9572</td>
</tr>
<tr>
<td>Capital value of headline rent</td>
<td>£349,969</td>
</tr>
<tr>
<td>Less capital payment</td>
<td>£50,000</td>
</tr>
<tr>
<td></td>
<td>£299,969</td>
</tr>
<tr>
<td>Divide YP @ capitalisation rate for 5¹ yrs</td>
<td>4.2124</td>
</tr>
<tr>
<td>Effective rent</td>
<td>£71,212</td>
</tr>
</tbody>
</table>

Note¹: The incentive is still 0.75 years of the one year total rent free but the fit-out period is assumed to be outside of the lease term and so the headline rent period is 4.25 years and the effective rent write-off period is the full 5 years.

Example 2

A longer lease with upwards only rent reviews, a longer rent free and capital payment. Headline rent £100,000, rent free 3 years, capital payment £100,000, lease 15 years with 5-year upwards only reviews.

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000 pa</td>
</tr>
<tr>
<td>Lease length</td>
<td>15 years</td>
</tr>
<tr>
<td>Rent review</td>
<td>5 years</td>
</tr>
<tr>
<td>Capital payment</td>
<td>£100,000</td>
</tr>
<tr>
<td>Capitalisation rate</td>
<td>6%</td>
</tr>
<tr>
<td>Target rate</td>
<td>8%</td>
</tr>
<tr>
<td>Assumed growth rate</td>
<td>2%</td>
</tr>
<tr>
<td>Rent-free period</td>
<td>3.00 years</td>
</tr>
<tr>
<td>Fitting-out period</td>
<td>0.25 years</td>
</tr>
</tbody>
</table>
Method 1: Straight line

**Method 1 (write off full lease period – 15 years)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000</td>
</tr>
<tr>
<td>Received for (yrs)</td>
<td>12.00</td>
</tr>
<tr>
<td>Capital value of headline rent</td>
<td>£1,200,000</td>
</tr>
<tr>
<td>Less capital payment</td>
<td>£100,000</td>
</tr>
<tr>
<td>Capital value of inducements</td>
<td>£1,100,000</td>
</tr>
<tr>
<td>Spread over/divide by (yrs)</td>
<td>14.75</td>
</tr>
<tr>
<td>Effective rent</td>
<td>£74,576</td>
</tr>
</tbody>
</table>

**Method 1 (write off to rent review – 5 years)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000</td>
</tr>
<tr>
<td>Received for (yrs)</td>
<td>2.00</td>
</tr>
<tr>
<td>Capital value of headline rent</td>
<td>£200,000</td>
</tr>
<tr>
<td>Less capital payment</td>
<td>£100,000</td>
</tr>
<tr>
<td>Capital value of inducements</td>
<td>£100,000</td>
</tr>
<tr>
<td>Spread over/divide by (yrs)</td>
<td>4.75</td>
</tr>
<tr>
<td>Effective rent</td>
<td>£21,053</td>
</tr>
</tbody>
</table>

**Method 1 (write off over compromise period – 10 years)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000</td>
</tr>
<tr>
<td>Received for (yrs)</td>
<td>7.00</td>
</tr>
<tr>
<td>Capital value of headline rent</td>
<td>£700,000</td>
</tr>
<tr>
<td>Less capital payment</td>
<td>£100,000</td>
</tr>
<tr>
<td>Capital value of inducements</td>
<td>£600,000</td>
</tr>
<tr>
<td>Spread over/divide by (yrs)</td>
<td>9.75</td>
</tr>
<tr>
<td>Effective rent</td>
<td>£61,538</td>
</tr>
</tbody>
</table>
Method 2: Time value of money

Method 2 (capitalisation rate write off full lease period – 15 years)

<table>
<thead>
<tr>
<th>Description</th>
<th>Calculation</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000 pa</td>
<td></td>
</tr>
<tr>
<td>YP 12 years x PV 3 yrs @ 6%</td>
<td>7.0392</td>
<td></td>
</tr>
<tr>
<td>Value of headline rent</td>
<td>£703,924</td>
<td></td>
</tr>
<tr>
<td>Less capital payment</td>
<td>£100,000</td>
<td></td>
</tr>
<tr>
<td>Value of headline lease</td>
<td>£603,924</td>
<td></td>
</tr>
<tr>
<td>Divide by YP 14.75 yrs x PV 0.25 yrs @ 6%</td>
<td>9.4712</td>
<td></td>
</tr>
<tr>
<td>Effective rent</td>
<td>£63,764</td>
<td></td>
</tr>
</tbody>
</table>

Method 2 (capitalisation rate write off over rent review period – 5 years)

<table>
<thead>
<tr>
<th>Description</th>
<th>Calculation</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000 pa</td>
<td></td>
</tr>
<tr>
<td>YP 2 years x PV 3 yrs @ 6%</td>
<td>1.5394</td>
<td></td>
</tr>
<tr>
<td>Value of headline rent</td>
<td>£153,935</td>
<td></td>
</tr>
<tr>
<td>Less capital payment</td>
<td>£100,000</td>
<td></td>
</tr>
<tr>
<td>Value of headline lease</td>
<td>£53,935</td>
<td></td>
</tr>
<tr>
<td>Divide by YP 4.75 yrs x PV 0.25 yrs @ 6%</td>
<td>3.9713</td>
<td></td>
</tr>
<tr>
<td>Effective rent</td>
<td>£13,581</td>
<td></td>
</tr>
</tbody>
</table>

Method 2 (capitalisation rate write off over compromise period – 10 years)

<table>
<thead>
<tr>
<th>Description</th>
<th>Calculation</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000 pa</td>
<td></td>
</tr>
<tr>
<td>YP 7 years x PV 3 yrs @ 6%</td>
<td>4.6871</td>
<td></td>
</tr>
<tr>
<td>Value of headline rent</td>
<td>£468,708</td>
<td></td>
</tr>
<tr>
<td>Less capital payment</td>
<td>£100,000</td>
<td></td>
</tr>
<tr>
<td>Value of headline lease</td>
<td>£368,708</td>
<td></td>
</tr>
<tr>
<td>Divide by YP 9.75 yrs x PV 0.25 yrs @ 6%</td>
<td>7.1191</td>
<td></td>
</tr>
<tr>
<td>Effective rent</td>
<td>£51,792</td>
<td></td>
</tr>
</tbody>
</table>

Method 2 (target rate – as above at 8%)

<table>
<thead>
<tr>
<th>Description</th>
<th>Calculation</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effective rent over whole lease period</td>
<td></td>
<td>£59,875</td>
</tr>
<tr>
<td>Effective rent over rent review period</td>
<td></td>
<td>£11,070</td>
</tr>
<tr>
<td>Effective rent over compromise period</td>
<td></td>
<td>£48,409</td>
</tr>
</tbody>
</table>
Method 2 (Headline rent target rate 8%, effective rent capitalisation rate 6%)

| Effective rent over whole lease period | £52,605 |
| Effective rent over rent review period | £10,465 |
| Effective rent over compromise period | £44,008 |

Method 3: Cash flow

| Headline rent | £100,000 pa |
| YP 12 years x PV 3 yrs @ 8% | 5.9824 |
| Value of headline rent | £598,238 |
| Less capital payment | £100,000 |
| Net value of headline lease | £498,238 |

Value of effective rent

| YP 5 years x PV 0.25 yrs @ 8% | 3.7545 |
| Value of first term | £3,7545x |

Reversion to future rental value @ 2% pa

| YP 5 years @ 8% x PV 5 years @ 8% | £3,0002x |
| Value of 1st reversionary rent | £3,0002x |

Reversion to future rental value @ 2% pa

| YP 5 years @ 8% x PV 10 years @ 8% | £2,2544x |
| Value of 2nd reversionary rent | £2,2544x |
| Value of effective rent | 9,0091x |

Effective rent = value of HR divide by value of ER = £498,238/9,00091 = £55,304 pa

Effective rent at first review = £55,304 x (1.02)⁵ = £61,060 pa

Effective rent at second review = £61,060 x (1.02)⁵ = £67,415 pa

The result illustrates that the impact of the incentive spreads over the whole of the lease term but that the impact diminishes over time assuming positive growth. Had the level of incentives and/or the target rate and growth rate used suggested that the effective rental value had overtaken the headline rent at either of the rent reviews, the calculation would need to be redone using a 10-year write-off period only or even a write off to the first review. Example 3 illustrates such a situation and is assessed by a cash flow approach only.
**Example 3**

The same lease as in Example 2 with no capital payment and a shorter rent-free period of 1 year.

<table>
<thead>
<tr>
<th>Description</th>
<th>Values</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Headline rent</strong></td>
<td>£100,000</td>
</tr>
<tr>
<td><strong>Lease length</strong></td>
<td>15 years</td>
</tr>
<tr>
<td><strong>Rent review</strong></td>
<td>5 years</td>
</tr>
<tr>
<td><strong>Capitalisation rate</strong></td>
<td>6%</td>
</tr>
<tr>
<td><strong>Target rate</strong></td>
<td>8%</td>
</tr>
<tr>
<td><strong>Assumed growth rate</strong></td>
<td>2%</td>
</tr>
<tr>
<td><strong>Rent free</strong></td>
<td>1.00 year</td>
</tr>
<tr>
<td><strong>Fitting out</strong></td>
<td>0.25 years</td>
</tr>
</tbody>
</table>

**Method 3: Cash flow assuming full term**

<table>
<thead>
<tr>
<th>Calculation</th>
<th>Values</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000 pa</td>
</tr>
<tr>
<td>YP 14 years x PV 1 yrs @ 8%</td>
<td>7.6336</td>
</tr>
<tr>
<td>Value of headline rent</td>
<td>£763,355</td>
</tr>
<tr>
<td>Value of effective rent</td>
<td>£x</td>
</tr>
<tr>
<td>YP 5 years x PV 0.25 yrs @ 8%</td>
<td>3.7545</td>
</tr>
<tr>
<td>Value of first term</td>
<td>£3.7545x</td>
</tr>
<tr>
<td>Reversion to future rental value @ 2% pa</td>
<td>£1.1041x</td>
</tr>
<tr>
<td>YP 5 years @ 8% x PV 5 years @ 8%</td>
<td>2.7174</td>
</tr>
<tr>
<td>Value of 1st reversionary rent</td>
<td>£3.0002x</td>
</tr>
<tr>
<td>Reversion to future rental value @ 2% pa</td>
<td>£1.219x</td>
</tr>
<tr>
<td>YP 5 years @ 8% x PV 10 years @ 8%</td>
<td>1.8494</td>
</tr>
<tr>
<td>Value of 2nd reversionary rent</td>
<td>£2.2544x</td>
</tr>
<tr>
<td>Value of effective rent</td>
<td>9.0091x</td>
</tr>
<tr>
<td>Effective rent = value of HR divide by value of ER</td>
<td>£763,355/9.0091</td>
</tr>
<tr>
<td>Effective rent (x) =</td>
<td>£84,732 pa</td>
</tr>
<tr>
<td>Effective rent at first review</td>
<td>£93,550 pa</td>
</tr>
<tr>
<td>Effective rent at second review</td>
<td>£103,207 pa</td>
</tr>
</tbody>
</table>
If the growth projection within the calculation suggests that headline rent will be overtaken by the effective rental value at the second review, the calculation needs re-working under that assumption of a 10-year write-off period.

Method 3: Cash flow assuming 10-year write-off period

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline rent</td>
<td>£100,000 pa</td>
</tr>
<tr>
<td>YP 9 years x PV 1 yr @ 8%</td>
<td>5.7842</td>
</tr>
<tr>
<td>Value of headline rent</td>
<td>£578,416</td>
</tr>
<tr>
<td>Value of effective rent</td>
<td>£x</td>
</tr>
<tr>
<td>YP 5 years x PV 0.25 yrs @ 8%</td>
<td>3.7545</td>
</tr>
<tr>
<td>Value of first term</td>
<td>£3.7545x</td>
</tr>
<tr>
<td>Reversion to future rental value @ 2% pa</td>
<td>£1.1041x</td>
</tr>
<tr>
<td>YP 5 years @ 8% x PV 5 years @ 8%</td>
<td>2.7174</td>
</tr>
<tr>
<td>Value of 1st reversionary rent</td>
<td>£3.0002x</td>
</tr>
<tr>
<td>Value of effective rent</td>
<td>6.75471x</td>
</tr>
<tr>
<td>Effective rent = value of HR divide by value of ER</td>
<td>£578,416/6.75471x</td>
</tr>
</tbody>
</table>

Effective rent (x) = £85,632 pa
Effective rent at first review = £85,632 x (1.02)^5 = £94,544
Effective rent at second review = £94,544 x (1.02)^5 = £104,384 pa

Headline rent is predicted to be extinguished by the second review in year 10, as the rent of the headline rent lease will be reviewed upwards to the same rent as if the property had been let at an effective rental value of £85,632 per annum.
UKGN 7 Valuations for charities

1 Introduction

1.1 There are various statutory provisions that apply to charities. These include:
- the Companies Act 2006
- the Charities Acts 2006 and 2011
- the Trusts of Land and Appointment of Trustees Act 1996 and
- the Trustee Act 2000.

1.2 In addition, the Charity Commission publishes various booklets giving advice on specific topics that are available on its website (www.charitycommission.gov.uk/detailed-guidance/land-and-property/). Booklets CC33, Acquiring Land, and CC28, Sales, leases, transfers or mortgages, together with their operational guidance, are particularly useful. Where charities are producing financial statements, they will follow the Charity Commission’s statement of recommended practice (SORP), which broadly follows FRS 15 (see UKVS 1.1, Basis of value).

1.3 This guidance, which is based on CC28 and CC33, provides further information for valuers who are requested to provide valuations for acquisitions and disposals by charities. Members who require more information about the powers of trustees or any other matter related to charities should seek advice from the charity’s own professional advisers.

2 Acquisitions

2.1 Where trustees propose to acquire land, there is no requirement for them to obtain professional advice, unless such a requirement is in the trust deed. However, the Charity Commission strongly recommends that they obtain a report from a ‘qualified surveyor’ (as defined in CC33 and given in paragraph 2.2) who is acting solely for the trustees. Where the proposed transaction requires the trustees to obtain an order of the Charity Commission before acquiring land (for example, acquiring land other than freehold land, buying land from one of the trustees or where there is no power to acquire land), it is anticipated that the Commission will expect such an application to be accompanied by a surveyor’s report.

2.2 A ‘qualified surveyor’ is defined in CC33 as ‘a fellow or professional associate of the Royal Institution of Chartered Surveyors (RICS)’. Pending any review of this publication, the reference with regard to RICS may be read as referring to any ‘member’ of RICS, as defined in the Rules of Conduct.
2.3 When considering the purchase of land, the trustees must take all reasonable steps to ensure that, among other matters:

- the property is suitable for its intended use and, in particular, is not subject to any legal or planning restrictions or conditions that might conflict with that use, or with which it may be difficult for the trustees to comply
- any necessary planning permission is obtained
- the price or rent is fair compared with similar properties on the market and
- when acquiring a lease, they understand the obligations to which they will be subject under the lease and ensure that the terms of the lease are fair and reasonable.

2.4 Basis of value

2.4.1 Although there is no basis of value specified in the guidance, the presumption is that it will be market value or market rent.

2.4.2 There may be circumstances where a charity is in a special position – for instance, where it has the benefit of certain tax exemptions or is a special purchaser – and therefore may be able to justify paying more than market value. Such circumstances, which are assessments of worth, are not to be reflected in the valuation but should be referred to in the general advice as to what the trustees should offer to pay or bid at auction.

2.5 Matters to be included in the report

2.5.1 The valuer will comply with the general requirements of VPS 3, Valuation reports, having regard to the commission’s recommendation to include the following:

- a description of the land
- details of any planning permission needed
- a valuation of the land
- advice on the price that the trustees ought to offer to pay, or the maximum bid they ought to make at auction
- a description of any repairs or alterations the trustees would need to make and their estimated cost
- a positive recommendation (with reasons) that it is in the interests of the charity to purchase the land and
- anything else the surveyor thinks is relevant, including a description of any restrictive or other covenants to which the land is subject.

3 Disposals

3.1 Where a charity wishes to dispose of an interest in land exceeding a term of seven years, a report must be obtained from a ‘qualified surveyor’ (section 119 of the Charities Act 2011).

3.2 For these purposes, a ‘qualified surveyor’ is a member of RICS. The member must also be reasonably believed by the trustees of the charity to have ability in, and experience of, the valuation of land of the particular kind and in the particular area in question.
Matters to be included in the report

3.3 The report must include a range of information laid down in the Charities (Qualified Surveyors' Reports) Regulations 1992 (SI 1992/2980), as summarised in the following paragraphs.

3.4 A description of the relevant land and its location, by reference to a plan if convenient, is to include:
   - the measurements of the relevant land
   - its current use
   - the number of buildings (if any) included in the relevant land
   - the measurements of any such buildings and
   - the number of rooms in any such buildings and their measurements.

3.5 Details of whether the relevant land, or any part of it, is leased by or from the charity trustees should be included and, if it is, so should details of:
   - the length of the lease and the period of this which is outstanding
   - the rent payable under the lease
   - any service charge payable
   - the provisions in the lease for any review of the rent payable under it, or any service charge payable
   - the liability under the lease for repairs and dilapidations and
   - any other provision in the lease that, in the opinion of the surveyor, affects the value of the relevant land.

3.6 The report should contain information on whether the relevant land is subject to the burden, or enjoys the benefit, of any easement or restrictive covenant. In addition it should inform if the land is subject to any annual or other periodic sum charged on, or issuing out of, the land, except rent reserved by a lease or tenancy.

3.7 Information on any buildings included in the relevant land and whether they are in good repair should be commented on. If not, the surveyor should give advice on:
   - whether or not it would be in the best interests of the charity for repairs to be carried out prior to the proposed disposition
   - what those repairs, if any, should be and
   - the estimated cost of those repairs.

3.8 Advice should be given on whether it would be in the best interests of the charity to alter any buildings included in the relevant land prior to disposition (because, for example, adaptations to the buildings for their current use will not command the best market price on the proposed disposition). An estimate of the outlay required for any alterations should be suggested.

3.9 Advice should be given on the manner of disposing of the relevant land so that the terms on which it is disposed of are the best that can reasonably be obtained for the charity, including:
   - where appropriate, a recommendation that the land should be divided for the purposes of the disposition
the period for, and the manner in which, the proposed disposition should be advertised (unless the surveyor’s advice is that it would not be in the interests of the charity to advertise the proposed disposition)

where advised that it would not be in the best interests of the charity to advertise the proposed disposition, the reasons for that advice (for example, that the proposed disposition is the renewal of a lease to someone who enjoys statutory protection, or belief that a special purchaser will pay considerably more than the market price for it) and

any view the surveyor may have on the desirability or otherwise of delaying the proposed disposition and, if it is reasonable to believe that such delay is desirable, what the period of that delay should be.

3.10 The report should include the surveyor’s opinion of:

- the current value of the relevant land, taking account of its current state of repair and current circumstances (such as the presence of a tenant who enjoys statutory protection), or, where the proposed disposition is a lease, the rent that could be obtained in its current state
- the value of the relevant land, or what the rent under the proposed disposition would be if advice under paragraph 3.7 has been given and followed; or where an opinion expressed under paragraph 3.8 has been acted on; or if both such advice and opinions had been acted on
- the increase in the value of the relevant land or rent if a recommendation made under paragraph 3.9 had been followed
- the amount by which the price that could be obtained by not advertising exceeds the price that could be obtained if the proposed disposition were advertised (where the advice is that it would not be in the best interests of the charity to advertise the proposed disposition because it is believed a higher price can be obtained by not doing so) or
- where a delay is advised in the proposed disposition under paragraph 3.9, the amount by which the surveyor believes the price that could be obtained due to such a delay exceeds the price that could be obtained without it.

3.11 In cases where it is relevant, and the surveyor feels competent to do so, advice should be given on whether VAT can be charged on the proposed disposition, and the effect it would have on the valuations given in paragraph 3.10. In cases where either the surveyor does not feel able to give such advice, or believes that such advice is not relevant, a statement should be made to that effect.

3.12 The surveyor may be of the opinion that the proposed disposition is not in the best interests of the charity because it does not make the best use of the relevant land. If so, the reasons for this opinion, together with advice on the type of disposition that would constitute the best use of the land are to be given. For example, this would include any relevant advice on the prospect of buying out a sitting tenant, or of succeeding in an application for a change in the use of the land under the laws relating to town and country planning or similar.
Other RICS publications

Other RICS publications that may have a relevance to valuation may be obtained from the RICS website at www.rics.org/guidance. They include the following mandatory practice statement, guidance notes and valuation information papers.

**Practice statement [mandatory]**

*Surveyors acting as expert witnesses, 3rd edition (2008)*

**Guidance notes**

*Asbestos and its implications for members and their clients (2011)*

*Auctioneers selling real estate (2013)*

*Boundaries (2009)*

*Capital and rental valuation of public houses, bars, restaurants and nightclubs in England and Wales (2010)*

*Cash flow forecasting (Global edition) (2012)*

*Conflicts of interest (2012)*

*Contamination, the environment and sustainability: implications for chartered surveyors and their clients (2010)*

*Discounted cash flow for commercial property investments (2010)*

*Financial viability in planning (2012)*


*Mineral-bearing land and waste management sites (2011)*

*Real Estate Agency and Brokerage Standards (2011)*

*Surveying safely (2011)*

*Sustainability and commercial property valuation (2013)*

*Valuation of data centres (2011)*

*Valuations for financial statements under UK GAAP (2011)*

*Valuation of individual new-build homes (2012)*

*Valuation of land for affordable housing (2010)*

*Valuation of land for affordable housing – Scotland (2013)*

*Valuation of medical centre and surgery premises. (2010)*
Other RICS publications

Valuation of rural property (2011)
Valuation of trees for amenity and related non-timber uses (2010)
Valuation of woodlands (2010)

Information papers

Capital and rental valuation of fuel stations (2012)
Capital and rental valuation of hotels in the UK (2012)
Comparable evidence in property valuation (2012)
Farm stocktaking valuations (2012)
Japanese Knotweed and residential property (2012)
Valuation of renewable energy installations (2012)
Valuation of independent healthcare properties in the UK (2012)

Valuation information papers [all currently under review]

VIP 12: Valuation of development land (2008)

European publications

EUGN 1: European Union directives and regulations relevant to valuation (2013)
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