

EUROPEAN VALUATION STANDARDS 2012 SEVENTH EDITION

The European Group of Valuers' Associations



EUROPEAN VALUATION STANDARDS

2012

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Preface



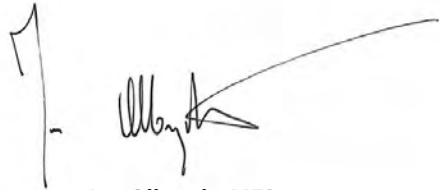
It is often stated that real estate is not EU policy. This is largely true and good as housing policy and property law are not the EU's competence. There is a strong local aspect to much regulation of property which must indeed be as close to citizens as possible, often below the national level. And yet, for very important reasons, real estate is also at the heart of European politics and it is extremely timely that European Valuation Standards have made our work and our goals part of the substance of valuation practice.

Across the Union, real estate markets, closely dependent on bank finance, have all been affected by the crisis and in some areas have been part of the systemic problem. The European Parliament has been at the forefront of the wave of EU legislation designed to make it far more difficult for such cascading market failures to happen again. Valuation is clearly a key component of property market safety and security, and it is therefore to be welcomed that European Valuation Standards comprise specific applications on valuation issues raised by the Services Directive and the Alternative Investment Fund Managers Directive.

Land and buildings are also the single most important stake in the sustainability debate, buildings alone accounting for 36% of EU carbon footprint and land use being another key climate factor. Land and buildings are the matrix of EU policy on soil protection, flood management, water saving, environmental liability, environmental impact assessment, strategic environmental assessment, renewables and energy efficiency. But EU legislation cannot achieve its goals without proper take-up, and efficient transposition of EU Directives into national law is only part of this. Increasingly, it is important to ensure authentic understanding and 'ownership' of EU policy goals by citizens. Here too, it is commendable that European Valuation Standards contain a specific application helping valuers help their clients to make the most out of the opportunities offered by the Energy Performance of Buildings Directive.

I preside over the European Parliament's Urban Intergroup, a purpose of which is to monitor and discuss the impact of EU policies on the urban environment so that parliamentarians, European Commission officials and civil society are more conscious of

the interrelations, impacts and trade-offs between different policies. European citizens would benefit from such a holistic view and I therefore welcome the section of European Valuation Standards giving a comprehensive survey of the relevant EU legislation that applies to property.

A handwritten signature in black ink, consisting of a large, stylized 'J' followed by a series of loops and a long, sweeping horizontal stroke that extends to the right.

Jan Olbrycht MEP
President, URBAN Intergroup
European Parliament

Introduction

Like its previous editions, this book is intended to serve the needs of valuers that are members of the 45 valuers' associations from 26 countries representing the membership of TEGoVA. To aid transparency and to assist clients in their understanding of the framework of these standards, an online version is also available at the TEGoVA website (www.tegova.org).

A singularity of EVS has always been to highlight the origins in EU law of concepts as basic to the profession as 'market value' and 'mortgage lending value'; or the EU definition of 'asset valuer' for state aid rules, or again, under the Capital Requirements Directive, the concepts of 'independent valuer' and valuation reporting for the purposes of monitoring and reporting the values of property used as collateral. But EVS 2012 takes coverage and understanding of the EU's influence on property and valuation to another level.

Besides the inevitable updating and associated rewriting, this edition goes beyond the provision of standards and their application. Divided into three parts, this book contains European Valuation Standards and their application in Part I, European Union legislation pertinent to property valuation in Part II and a series of technical documents in Part III.

This, the seventh edition of European Valuation Standards replaces the previous edition with effect from 1 June 2012.

Part IA - European Valuation Standards

Some of the substantive changes to EVS1 – EVS5 are described in the paragraphs that follow.

The definition of "Market Value" in EVS1 is the same as that used in both EVS 2009 and the Capital Requirements Directive save that it now refers more broadly to the "asset" rather than the "property" and uses the phrase "valuation date" rather than "date of valuation" as the latter has proved to cause some international confusion. These changes do not affect its interpretation for property. The definition of "Market Rent" continues to refer to a "property" as it concerns the rent for a leasehold interest. Some "Assumptions" and "Special Assumptions" that may be made in forming an opinion of Market Value are set out and confirmation is provided that "Forced Sale Value" is not a basis of valuation,

though once all the relevant constraints are identified it may be seen as a market value assessment on the special assumption of a stated but limited period for marketing the property. Clarification of the concept of "highest and best use" is provided in a considerable commentary explaining that in essence it is the use that is permitted at the valuation date that offers the highest value based on reasonable expectations.

As the application of "Fair Value" is used in two particular but distinct contexts, two separate definitions are provided in EVS2. A "General Definition" to be used as a basis of valuation for real estate as between specific participants in an actual or potential transaction is set to reflect the fact that the result may often produce a value that differs from the market value of a property. A definition "For Accounting Purposes" follows; specifically adopted as a term under International Financial Reporting Standards for which, albeit with slightly looser assumptions than the full definition of Market Value, the same figure as Market Value may often result.

In EVS3 all "Qualified Valuers" and their representative professional or technical organisations are now required to adhere to the TEGoVA Code of Ethics and Conduct, as provided within Part III of this book.

EVS4 considers the procedural steps to be followed in preparing a valuation report. Detailed terms of engagement that must be agreed in writing with the client prior to submission of any valuation report are provided, stressing that these are minimum terms. Apart from the benefits to the valuer of a clear and concise record which has been prepared and agreed in advance of the assignment, this new requirement ensures that the client and the client's professional advisers know what to expect and are able to judge whether what they receive is what they wanted and expected.

As a "Valuation Report" must adequately report all matters set out within the terms of engagement, EVS5 now states that these terms should virtually mirror the headings of the report, and provides additional requirements, including provision of a description of the valuation methodology and analysis utilised in forming the opinion of value.

Part IB - European Valuation Applications

EVS 2012 contains eight valuation applications, three more than the previous edition. All of the applications included within EVS 2009 have either been updated or replaced, with the scope of each application being clearly set out.

The new applications address specific qualities and skills needed by valuers for cross-border valuation, EU valuation rules for hedge funds including real estate funds, and the

specific valuation challenges of the Energy Performance of Buildings Directive.

EVA6 - Cross-border valuation

The EU Treaties and the Services Directive guarantee the freedom of valuers to provide services anywhere in the Union, but they contain nothing on the particular skills and qualities required by valuers operating outside of the home country. EVA6 provides guidance to the valuer carrying out a valuation in a member state other than his own. It complements the Services Directive by covering the experience, competence and reporting requirements required when undertaking a cross-border valuation. The application covers qualifications, professional experience and market knowledge, terms of engagement, compliance with local rules, conflicts of interest, ethics, insurance and the report.

EVA7 - Property Valuation under the Alternative Investment Fund Managers Directive

The crisis has led to considerable toughening of supervisory and regulatory control over financial markets and a massive shift of that control from the national to the EU level. One result is the new Alternative Investment Fund Managers Directive covering, inter alia, real estate fund managers, and containing a detailed valuation article. EVA7 reviews the Directive's requirements concerning the independence of the valuer, professional registration requirements, the criteria concerning the procedures for the proper valuation of the assets, the professional guarantees the valuer must be able to furnish to effectively perform the valuation function, and the frequency of valuation.

EVA8 - Property Valuation and Energy Efficiency

Another important sphere of EU influence is action against climate warming. As buildings account for 40% of the entire European carbon footprint, it is not surprising that the EU has produced extremely coercive legislation on the energy performance of buildings. EVA8 provides guidance on all valuation-relevant aspects of the Energy Performance of Buildings Directive, including how best to advise clients on whether any renovation required by the building being valued is sufficient in scale to trigger the upgrading of the building's minimum energy performance required by the Directive in the event of 'major renovation'. Further advice is given to assist in providing an objective assessment as to what effect, if any, the rating and recommendations ensuing from the Directive-required energy performance certificate have on the valuer's reporting of his opinion as to the value of the property.

Part II: General knowledge of EU property and valuation policy

There is a new Part II “European Union Legislation and Property Valuation”, separate from the standards and applications, giving valuers for the first time a comprehensive overview of EU legislation as it applies to property and intended to offer general assistance to valuers in their professional capacity. It is explained that, although the EU does not regulate housing, property law or the relations between landlord and tenant, its general economic and social provisions directly impact property. In particular, this section demonstrates how the thirty-year effort to complete the EU Internal Market has also led to an ‘Internal Market for Real Estate’, where free movement of capital underpins the freedom to buy and sell property throughout the Union without obstacle while freedom to provide services with or without establishment has ensured free circulation of the valuation profession.

Specific EU Internal Market provisions on the valuation of property are examined including valuation of property for company accounts, financial institutions and state aid rules as well as an overview of Internal Market taxation legislation including VAT and property. This is followed by a review of property and valuation aspects of EU health and safety policy, energy policy, environment policy including such property and valuation-relevant fields as environmental and strategic impact assessments, water, and environmental liability for contaminated land, pollution, asbestos, biodiversity and conservation. The Common Agricultural Policy is also reviewed, as access to and limitations on CAP payments are relevant to both capital values and rents of relevant property.

Part III: Technical Documents

This section consists of 11 separate chapters. TEGoVA codes relating to ethics and conduct and measurement of distance, area and volume are included, together with summaries of TEGoVA’s “Minimum Education Requirements” and “Recognised European Valuer Scheme”. Three Information Papers relating to sustainability and valuation, the apportionment of value between land and buildings and certification of valuers are also set out. The final chapters provide a “Classification of TEGoVA’s Technical Documents”, an updated valuers guide to “Property and Market Rating” that enables a standardised and objective risk assessment of properties; a copy of the European Mortgage Federation’s “Profile for Risk Related Criteria for Valuations” and, finally, a glossary.

The need for brevity prevents any comprehensive review of these documents, though specific reference is provided to the “TEGoVA Code of Ethics and Conduct” and the Information Paper relating to “Sustainability and Valuation”.

TEGoVA Code of Ethics and Conduct

Whenever the spotlight is turned on the valuation profession issues relating to the ethical behaviour of valuers are highlighted. To address this TEGoVA has approved a code that all member associations are required to adopt as a minimum requirement. This code encompasses personal responsibility, corporate responsibility and responsibility to the profession. The core values embedded in the Code include fairness, a proper professional respect for others and for standards, responsibility and trustworthiness. Its core requirements include acting with integrity, recognising personal interests and maintaining competence. Such professional standards extend beyond the requirements of law, entailing a balance between transparency, openness, client confidentiality and external communication with clients, stakeholders and anyone to whom an established duty of care is owed. These principles reinforce the need for professionalism, accountability and client focus.

Information Paper - Sustainability and Valuation

The twin pressures of economics and public policy have led to greater attention being paid to a range of resource issues, many embracing the concept of sustainability. It can be expected that both regulation and market sentiment will make the issues of environmental performance and sustainability increasingly important to those concerned with property and buildings and so, where relevant, to valuation. The information provided within this chapter is both broad and comprehensive embracing corporate social responsibility, environmental management systems, "green buildings", "green leases" and "green rating tools". Sustainability is considered mostly in respect of the environmental terms that are salient in today's discussions, together with other practical issues of adaptability and flexibility of the property and the space and facilities it offers to retain the ability to remain useful without major change.

And finally ...

The publication of EVS 2012 is the culmination of a journey that started immediately after the last edition was published. The quest for excellence has energised members from many member associations and the endless work of the European Valuation Standards Board (EVSb) has in itself resulted from feedback, commentary, queries and requests for additional information and guidance. It is hoped that the product of this work achieves its aim of enabling the advancement of the valuation profession Trans-Europe, where valuations produced in accordance with these standards provide a consistent quality that can be relied upon – a common benchmark for investors, the financial industry, clients and valuers throughout the European Union and beyond.

TEGoVA is indebted to the members of the EVSB and to Michael MacBrien, Gabriela Cuper and Francois Isnard of the TEGoVA secretariat for their respective roles in the production and publication of this book. Whereas he would not wish to be distinguished from other members of the EVSB, special thanks go to Jeremy Moody for finding the time to demonstrate his drafting skills, to be a major contributor of text and to share his wisdom.

A handwritten signature in black ink, appearing to read 'J. Hockey', with a stylized, cursive script.

John Hockey
Chairman, EVS Board
May 2012

PART 1

EUROPEAN VALUATION STANDARDS AND APPLICATIONS

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Part 1A

European Valuation Standards

EVS1 Market Value

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

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

EVS2 Valuation Bases Other than Market Value

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

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

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

EVS3 The Qualified Valuer

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

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

The valuer must be able to show professional skill, knowledge and competence appropriate to the type and scale of valuation and must disclose any factor which could compromise an objective assessment.

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

EVS4 The Valuation Process

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

The valuation must be researched, prepared and presented in writing to a professional standard.

EVS5 Reporting the Valuation

The valuation must be presented in clear written form to a professional standard, transparent as to the instruction, purpose, basis, method, conclusion and prospective use of the valuation.

EVS1

Market Value

1. **Introduction**
2. **Scope**
3. **TEGoVA's Approved Definition of Market Value**
4. **Definitions of Market Value in EU Legislation**
5. **Commentary**

EUROPEAN VALUATION STANDARD 1

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

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

1. Introduction

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

1.2 The “market value” of an asset is understood to mean its “current value in the market, saleable value” (*Oxford English Dictionary*) irrespective of actual parties. For a valuation, that means the date for which the opinion of value is applicable.

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

2. Scope

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

2.2 This Standard specifically considers the application of Market Value to:

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

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

2.4 The definition of Market Value approved by TEGoVA at paragraph 3.1 is built on the range of assumptions explored in Section 5.

3. TEGoVA's Approved Definition of Market Value

3.1 Unless otherwise directed by legislation (see below), “market value” means:

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

3.2 As in EVS 2009, TEGoVA recommends that its definition of Market Value, practically identical to that in Directive 2006/48/EC, be used as the basic definition and interpreted in accordance with the commentary in Section 5 below, save where legislation specifically requires otherwise.

3.3 As a corollary and applying the definition of Market Value to leasehold interests, the TEGoVA approved definition of “*market rent*”, usually expressed as an annual figure, is:

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

4. Definitions of Market Value in EU Legislation

4.1 There are several definitions of Market Value within EU legislation, each provided for specific purpose – EU law does not provide a general definition. After analysis

and consideration of the legal cases and other rulings arising under these provisions (especially the 1997 State Aid rules (see 4.3.1 below) as the relevant regulation that has been most closely analysed in practical situations by EU institutions) these definitions are perceived to be entirely consistent in practice with that set out in EVS1.

4.2 The Capital Requirements Directive Definition

4.2.1 European Union legislation has defined Market Value for the purposes of assessing the value of real estate as collateral for a lending institution, in essence as part of implementing the Basel 2 Agreement. *Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions (recast)* at paragraph 63 in 1.5.1(a) [Real Estate Collateral] of Part 3 of Annexe VIII, Credit Risk Mitigation. The definition reads:

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

4.2.2 *The Capital Requirements Directive* is currently under review and is expected to be replaced by an EU Regulation on prudential requirements for credit institutions and investment firms, transposing Basel III into European law. Hence, the cited numbering of Articles will change.

4.2.3 The definition is invoked for the purposes of Articles 84 to 89 of the Directive which under the heading of its Title V (Principles and Technical Instruments for Prudential Supervision and Disclosure), Chapter 2 (Technical instruments of prudential supervision), Section 3 (Minimum own funds requirements for credit risk) provides as sub-section 2, the EU’s legal framework for the Internal Ratings Based (IRB) Approach. Article 76 provides that this Approach may be used to calculate an institution’s “risk weighted exposure amount” that it has to match with a minimum level of its own funds under Article 75. Under Article 91, this IRB Approach can also be relevant to credit risk mitigation. Thus, where a credit institution lends on the basis of property, these rules are of significant importance both to the amount of capital it needs to hold in its balance sheet and for its management of credit risk.

4.2.4 This definition is immediately followed in the same paragraph of the Capital Requirements Directive by the provision that “The market value shall be documented in a transparent and clear manner.” This is seen as a procedural requirement for the purposes of the directive rather than a factor helping determine the market value of any property and is thus addressed below in EVS5.

4.3 The State Aid Communication and the Insurance Accounts Directive definition

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

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

and states that for these purposes:

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

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

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

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

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

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

"For the purposes of this Directive, 'open market value' shall mean the full amount

that, in order to obtain the goods or services in question at that time, a customer at the same marketing stage at which the supply of goods or services takes place, would have to pay, under conditions of fair competition, to a supplier at arm's length within the territory of the Member State in which the supply is subject to tax."

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

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

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

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

5. Commentary

5.1 The advantage of the definition used in EVS1 over other available EU definitions is that it more clearly sets out the key concepts involved, namely:

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

This commentary takes each phrase of the definition in turn and explores its meaning in seeking the market value of real property.

5.2 The definition in EVS1:

- is the same as that used in both EVS 2009 and the Capital Requirements Directive of 2006 save that it now refers more broadly to the "asset" rather than the "property" and uses the phrase "valuation date" rather than "date of valuation" as the latter has proved to cause some international confusion. These changes do not affect its interpretation for property;
- while differing in its drafting from the new definition in IVS 2011, does not differ

in its substance for the valuation of real property. IVS refers to the value of “an asset or liability” (but also deems “asset” to include “liability”) while EVS1, with its focus on property, refers just to the value of “the asset” since “liability” is seen to be more relevant to accounting concepts. IVS 2011 has also replaced “wherein” to read “where ” but nothing of significance is seen to turn on either point.

- is consistent with most definitions of Market Value in European countries, and
- can be taken as setting a basic definition of Market Value that is available for general application.

The same points essentially apply to the TEGoVA approved definition of “Market Rent” in 3.3 above. As this concerns the rent for a leasehold interest EVS1, like IVS, continues to refer to a “property”. Developed from the definition in EVS1, there are minor differences of expression in this definition from that used in IVS 2011 but again nothing of significance is seen to turn on these.

5.3 The Result

5.3.1 *“The estimated amount ...”* - This refers to a price expressed in terms of money (normally in the local currency), payable for the asset in an arm’s length market transaction. Market Value is measured as the most probable price reasonably obtainable in the market at the valuation date in keeping with the Market Value definition. It is the best price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer.

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

5.3.3 Special Value is considered with related issues under EVS2 – ‘Valuation Bases Other Than Market Value’.

5.3.4 The application in practice of the 1997 EU State Aid rules may potentially have regard to special value, whether specific marriage value or otherwise.

5.4 The Real Property Being Valued

5.4.1 *“... an asset ...”* - This is where the property itself with its legal, physical, economic and other attributes is to be analysed with all its actual opportunities and difficulties. This is introduced into the definition of Market Rent at 3.3 above by the need to consider the terms of any tenancy agreement.

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

5.4.3 The market value of an asset reflects the full potential of that asset so far as it is recognised by the market place. It may thus take account of the possible uses of the asset that may be unlocked by changes affecting it, whether new development control permissions, relevant infrastructure, market developments or other possibilities.

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

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

5.4.6 The concept of **highest and best use** is met in a number of countries and some valuers in Europe may be asked to value a property on the assumption of its highest and best use. In essence, that is the use that is permitted at the valuation date that offers the highest value based on reasonable expectations. On analysis, that excludes the hope value that the market might place on a property's potential opportunities that are not currently available. While it is an assessment of the property as it is on the valuation date it is not an assessment of the best use that the market might at that date reasonably envisage could be possible for it.

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

"the use of an asset that maximises its productivity and is possible, legally permissible and financially feasible." (International Valuation Standards 2011, p. 22)

and

"the reasonably probable and legal use of property, that is physically possible, appropriately supported, and financially feasible, and that results in the highest value." (The Appraisal Institute of Canada)

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

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

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

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

5.4.11 Unless instructed otherwise, it is the valuer’s task to determine the market value of the land or property in accordance with the full analysis of market value in EVS1. The hypothetical seller will accept no less for his property and the hypothetical buyer will not want to offer more than he would pay for an equivalent asset of similar usefulness to him. As each point of the definition of highest and best use (except the requirement for evidence) places some constraint on the definition of market value, the highest and best use assumption will not necessarily be the same as market value, albeit that it might be higher than existing use value. The most obvious common point of difference lies in the exclusion of potential permissions or other future opportunities for which the market might express hope value and in doing so judge the prospects, risks

and costs of that future opportunity.

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

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

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

State Aid Communication II.1.(b)

5.5 The Transaction

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

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

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

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

5.6 The Valuation Date

5.6.1 “... *on the valuation date* ...” - This requires that the estimated Market Value be time-specific to a given date and this is normally the date on which the hypothetical sale is deemed to take place and is usually, therefore, different from the date the valuation is actually prepared. As markets and market conditions may change, the estimated value may be incorrect or inappropriate at another time. The valuation amount will

reflect the actual market state and circumstances at the effective valuation date, not at a past or future date. The valuation date and the date of the valuation report may differ, but the latter cannot precede the former. The definition also assumes simultaneous exchange and completion of the contract for sale without any variation in price that might otherwise be made in a Market Value transaction.

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

5.6.3 The phrases 'date of valuation' and 'valuation date' are used to refer to the date at which the valuation is assessed or determined (and for which the evidence supporting it is to be relevant) rather than the, usually later, date when the valuation is prepared and considered with the valuation report then completed for the client. The completion of the valuation report will never be earlier than the valuation date as it would then be contemplating circumstances that have not happened and may not and for which important evidence may yet be found.

5.6.4 The valuation date will not be later than the date of the Report. By providing that the hypothetical exchange of contracts is deemed to take place on the valuation date, this ensures that the valuation is informed by those factors that would have been in the expectations of the parties as to value at that point in time. However, national regulation might require that, in specific circumstances, the valuation date may coincide with a later reference date for the purposes of assessing the quality and situation of the property (e.g. public compensation schemes).

5.7 The Parties - Hypothetical, Willing and Competitive

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

5.7.2 This buyer is also one who purchases in accordance with the realities of the current market and with current market expectations, rather than on an imaginary or hypothetical market, which cannot be demonstrated or anticipated to exist. The assumed buyer would not pay a higher price than that which the market requires him to pay. The present owner of the asset is included among those who constitute the market.

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

5.7.4 The State Aid rules refer to an "arm's length buyer" unconnected with and independent of the seller.

5.7.5 *“... and a willing seller ...”* - Again, this is a hypothetical seller, rather than the actual owner and is to be assumed to be neither an over-eager nor a forced seller who is prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in the current market. The willing seller is motivated to sell the asset at market terms for the best price obtainable in the open market after proper marketing, whatever that price might be. The factual circumstances of the actual owner are not part of this consideration because the ‘willing seller’ is a hypothetical owner.

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

5.7.7 Market Value is thus independent of and uninfluenced by the objectives of the client instructing the valuation.

5.7.8 *“... in an arm’s length transaction ...”* - An arm’s length transaction is one between parties who do not have a particular or special relationship (for example, parent and subsidiary companies, or landlord and tenant) which may make the price level uncharacteristic of the market or make it inflated, because of an element of special value. The Market Value transaction is presumed to be between unrelated parties, each acting independently.

5.8 The Marketing

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

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

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

II.1.(a), 1st paragraph

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

“such offers should also be made known through agents addressing clients on a

Europe-wide or international scale”.

II.1.(a), 2nd paragraph

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

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

5.9 The Parties’ Consideration of the Matter

5.9.1 *“... wherein the parties had each acted knowledgeably ...”* - This presumes that both the willing buyer and willing seller are reasonably well informed about the nature and characteristics of the property, its actual and potential uses, and the state of the market at the valuation date.

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

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

5.9.4 *“... and without compulsion ...”* - This establishes that each party is motivated to undertake the transaction, but is neither forced nor unduly coerced to complete it.

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

5.10.1 Assumptions

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

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

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

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

- (i) A detailed report on title that sets out any encumbrances, restrictions or liabilities that may affect the value of the property may not be available. In such a case, the valuer would have to assume the position he considers most likely, also stating that he accepts no responsibility or liability for the true interpretation of the legal title.
- (ii) The extent of the inspection should be clearly set out in the report, consistent with the nature of the instruction and type of property. It may be necessary to make the assumption that while any obvious defects have been noted; other defects may exist requiring a more detailed survey or the appointment of experts to report on their findings. This may be followed by comment that

the opinion of value stated is based on the condition as reported and that any additional defects that exist may require the figures to be amended.

- (iii) Assumptions may be needed with regard to the necessary statutory consents for the current buildings and use together with reference to any policies or proposals by statutory bodies that could impact positively or adversely on the value.
- (iv) The competence of the valuer to report on any potential risk of contamination or the presence of hazardous substances will need to be considered. It may be necessary to make assumptions in providing an opinion of value that either no such risks exist or that the valuer will rely on information prepared by specialist consultants.
- (v) The valuer may, on occasion, need to assume that all mains services provided are operational and sufficient for the intended use.
- (vi) It may be necessary to make an assumption as to whether the property has not, or will not be expected to flood or whether other environmental matters may bear on the opinion of value.
- (vii) Where the property is let, it may be necessary to assume that detailed enquiries about the financial status of tenants would not reveal matters that might affect the valuation.
- (viii) The valuer may need to assume that there are no planning or highway proposals that might involve the use of any statutory powers or otherwise directly affect the property.
- (ix) The valuer may need to assume that items of plant and equipment normally considered to be part of the service installations to a building would pass with the property.
- (x) The assumptions required where a valuation without an inspection is required are considered in EVS4 at 6.4.

5.10.2 Special Assumptions

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

5.10.2.2 This may often be to inform the client about the effect of changed circumstances on the valuation. Examples of this include where the valuer is instructed

to make special assumptions as to the value of the property:

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

Forced sale value is an example of a market value on a special assumption as to the period for marketing.

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

5.10.2.4 Where special assumptions are to be made they should be recorded in the terms of engagement and in the valuation report (see also EVS4 at 5.9).

5.10.3 Alternative Use Value

5.10.3.1 **Definition** - This means the market value of the property without presuming the continuation of its present use.

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

5.10.3.3 This basis may also be relevant where a depreciated replacement cost valuation has been undertaken.

5.10.4 Forced Sale Value

5.10.4.1 **Definition** - A sum that could be obtained for the property where, for whatever reason, the seller is under constraint requiring the disposal of the property.

5.10.4.2 **Commentary** - The need for a valuation may arise where the seller is under compulsion to sell, is desperate to sell or a strict time limit is otherwise imposed. This might most obviously arise where the period in which the property is to be sold is too short to allow the proper marketing needed to be confident of the best bids. More generally, potential buyers may be aware that the seller is under constraint and so moderate their bids from those they may otherwise have offered. The nature of these specific constraints determines the situation in which the hypothetical transfer takes place – without those constraints, it would simply be Market Value.

5.10.4.3 Forced Sale Value is not a basis of valuation. Once all the relevant constraints are identified it may be seen as a Market Value assessment on the Special Assumption

of a stated but limited period for marketing the property. Thus, the valuer should not undertake a valuation on a forced sale basis but rather on a market value basis on stated specific special assumptions relevant to the case in hand.

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

5.11 Other Matters

5.11.1 *Documentation* - While Market Value exists independently of documentation, a professional valuation under this standard should be properly recorded in writing in a way that is transparent and clear to the client in accordance with EVS4 and to anyone else who might reasonably seek to rely on it or appraise it.

5.11.2 The definition of Market Value should be recorded in both the terms of engagement and the valuation report.

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

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

5.11.5 However, the position on this may vary (perhaps especially for accounting purposes) with different national legislation. In certain circumstances EU law also takes a different approach. Article 49(5) of *Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings states that:*

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

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

EVS2

Valuation Bases Other than Market Value

- 1. Introduction**
- 2. Scope**
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- 4. Fair Value**
- 5. Special Value**
- 6. Investment Value or Worth**
- 7. Mortgage Lending Value**
- 8. Insurable Value**
- 9. Depreciated Replacement Cost**

EUROPEAN VALUATION STANDARD 2

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

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

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

1. Introduction

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

2. Scope

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

3. Basis of Value

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

3.2 Commentary

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

3.2.2 In the event that none of the bases in EVS 2012 are suitable for the completion of an instruction, a clear and transparent definition of the basis used must be expressly stated, and the valuer should explain the reason for deviating from a recognised basis. If the resultant valuation does not reflect a sum that would equate to a valuation prepared on the basis of Market Value, this should be stated. Any assumptions or special assumptions used should be set out in the valuation report.

3.2.3 By contrast, a basis of valuation (or a valuation approach) is a methodology that can be used to determine a valuation from the available evidence. The income, cost and depreciated replacement value approaches are thus, in principle, methods to achieve a valuation and not bases of value.

4. Fair Value

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

- (i) **A General Definition** - Fair Value may generally be used as a basis of valuation for real estate as between specific participants in an actual or potential transaction, rather than assuming the wider marketplace of possible bidders. As such, it may often result in a different value to the market value of a property. For this purpose it is defined as:

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

This definition has regard to general market transactions where an opinion of Fair Value would not be expected to be the same as an opinion provided to Market Value.

- (ii) **For Accounting Purposes** - Fair Value is specifically adopted as a term under International Financial Reporting Standards for which, albeit with slightly looser assumptions than the full definition of Market Value, it may often give the same result as Market Value. This is more closely reviewed in EVA1. For this purpose, it is defined as:

“The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing market participants at the measurement date” (International Accounting Standards Board (IASB), International Financial Reporting Standards (IFRS) 13, par. 1).

This new definition was introduced by IFRS 13 Fair Value Measurement in May 2011 and will supersede the former definition provided by IAS 16 from 1 January 2013. Until this date, Fair Value is defined as “the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm’s length transaction” (IAS 16, par. 6).

4.2 Commentary

4.2.1 As a basis of value, Fair Value is less specific and exacting in its assumptions than Market Value. In particular, there is no requirement to expose the property to the open market. There are many situations where it will be used to address the value of a property.

4.2.2 The Fair Value of a non-financial asset like real estate takes into account a market participant’s ability to generate economic benefits by using the asset in its highest and best use, that is the use of the asset that is physically possible, legally permissible and financially feasible at the valuation date (see EVS5 4.6-10 above). In this non-financial context, Fair Value is likely to differ from a valuation prepared in accordance with the definition of Market Value (see EVS1). This may be because it is assessed as between specific participants, such as landlord and tenant.

4.2.3 In respect of financial reporting (see EVA1), Fair Value is a recognised and permissible basis of valuation which accords with International Financial Reporting Standards (IFRS), subject to additional conditions, though any figures reported will frequently be indistinguishable from Market Value. However, a company's auditors may want to exclude the effect of any development potential that does not yet have planning permission in which case the Fair Value of a property could differ, perhaps on occasion substantially, from its Market Value. Where IFRS excludes hope value, its Fair Value may resemble Market Value as assessed on the highest and best use assumption.

4.2.4 The U.S. Financial Accounting Standards Board (FASB) emphasised in its Accounting Standards Update N° 2011-04 published in May 2011 that, in order to achieve common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS, "fair value is a market-based measurement, not an entity-specific measurement". Its objective is "to estimate the price at which an orderly transaction to sell the asset would take place between market participants at the measurement date under current market conditions" (FASB, Topic 820-10-05-1B). Fair Value is measured using the assumptions that market participants would use when pricing the asset (FASB, 820-10-05-1C).

4.2.5 One important consequence of the less specific assumptions of Fair Value is that it allows recognition of the individual value a property may have to one bidder. That is considered in the concept of Special Value.

5. Special Value

5.1 Definitions

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

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

5.2 Commentary

5.2.1 Where particular qualities or characteristics of a property are valued by one acquiring party at a level above that which would represent Market Value, that party may be described as a Special Purchaser and any figures reported that equate to a sum representing that purchaser's opinion of value would represent a Special Value.

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

5.3 Synergistic Value or Marriage Value

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

5.3.2 It is defined as “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” (IVSC, 2011, p.12).

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

5.3.4 This might often be found where the acquisition of a property, often a neighbouring one, unlocks extra value for the purchaser. It may be relevant to transactions between landlord and tenant. However, where a property offers synergistic value opportunities to several potential bidders (as by offering any of them greater scale of operation) then that may more usually be a function of Market Value.

6. Investment Value or Worth

6.1 Definition - “Investment Value is the value of an asset to the owner or a prospective owner for individual investment or operational objectives” (IVSC, 2011, p.12).

6.2 Commentary

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

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

6.2.2 The application of this definition is discussed in EVA5.

7. Mortgage Lending Value

7.1 Definition - The value of the property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property. Speculative elements shall not be taken into account in the assessment of the Mortgage Lending Value.

7.2 Commentary

7.2.1 The above definition was incorporated in Directive 2006/48/EC (the Capital Requirements Directive) at Annexe VIII, paragraph 64 in the context of real estate collateral for the capital requirement and credit risk management of credit institutions. This Directive will be replaced in 2012 by a new Regulation on prudential requirements for credit institutions and investment firms transposing the Basel III Accord into European law. The draft Regulation was published on 20 July 2011 (COM (2011) 452 final) and the Mortgage Lending Value definition is included in its Article 4 par. 51.

7.2.2 Both the Directive and the forthcoming EU Regulation recognise real estate as a security or as risk mitigating collateral inducing a lower risk weight, i.e. lower capital requirements to be allocated by credit institutions. The Directive and the draft Regulation stipulate that:

“the property shall be valued by an independent valuer at or less than the market value. In those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions the property may instead be valued by an independent valuer at or less than the mortgage lending value” (Annex VIII, Part 3, paragraph 62 of the Directive and Article 224 of the draft Regulation).

7.2.3 Both Directive 2006/48/EC and the draft Regulation expressly require property valuations to be carried out by an independent valuer.

7.2.4 The concept of Mortgage Lending Value (MLV) is of particular value in some European countries in the context of long term lending programmes. It is a value-at-risk approach to manage the risk exposure of credit institutions taking into account special safety requirements. It is understood by banking supervisors as a risk management tool. In contrast, the concept of Market Value is universally understood as representing a spot value, a market assessment of value at a given point in time (see EVS1 and EVA2).

8. Insurable Value

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

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

8.3 The application and assessment of this basis of valuation is discussed in EVA4, Assessment of Insurable Value.

9. Depreciated Replacement Cost

9.1 Depreciated Replacement Cost (DRC) is recognised as a method to address Market Value in the absence of better evidence.

9.2 Definition - Depreciated Replacement Cost is the current cost of replacing an existing asset with a notional modern equivalent asset, making appropriate adjustments for physical, functional and technical obsolescence.

9.3 Commentary

9.3.1 Depreciated Replacement Cost, also known as the Contractor's Method, can be used to give a value to properties for which there are no relevant direct market comparisons, by referring to a wider range of evidence from the market. These may often be properties with non-conforming, unusual or distinctive attributes, either in terms of construction, orientation, location or other spatial characteristics.

9.3.2 In some countries it is recognised as a basis of value; though it is generally regarded as an approach to valuation leading to Market Value. The theoretical underpinning, namely that the relationship between cost and value can be correlated, is not a safe proposition as cost is only one factor in determining supply and demand and it cannot be assumed that costs have been incurred wisely or successfully. Accordingly, this method should only be used where an absence of demand or comparable evidence prevents an alternative method being used, or for valuations required in respect of matters relating to national taxation.

9.3.3 The valuer is required to provide a considered opinion of the Market Value of the land and buildings in their existing use to which is added the hypothetical cost of providing a similar property and relevant site works. Deductions are made from this gross sum to account for matters that would influence the value of any existing property, compared to any replacement property. Allowance is made for factors including depreciation, age, condition, and economic and functional obsolescence.

9.3.4 The application of this method will require, inter alia, a practical knowledge of current building control regulations, current building costs and relevant health and safety regulations.

9.3.5 The choice of depreciation rate is a valuation judgment.

9.3.6 In Germany, this method may be called the Asset Value method under which the valuer makes a final adjustment, reflecting his professional view of what would be the outcome of a transaction on the hypothetical terms, which results in Market Value.

EVS3

The Qualified Valuer

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

EUROPEAN VALUATION STANDARD 3

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

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

The valuer must be able to show professional skill, knowledge and competence appropriate to the type and scale of valuation and must disclose any factor which could compromise an objective assessment.

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

1. Introduction

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

2. Scope

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

3. General

3.1 A valuation should be prepared by a Qualified Valuer and meet the requirements of a professional service. Such a person will commonly be an individual but, on occasions and in some countries, a valuation may be made by a company with a legal personality in which case the relevant work should be undertaken by suitably qualified individuals retained by that company.

3.2 The valuer must be able to show professional skill, knowledge and competence appropriate to the type and scale of valuation and must disclose any factor which could compromise an objective assessment.

3.3 The terms and conditions for the valuer's instruction should be agreed before undertaking the valuation and set out clearly in writing before the valuation is reported (see EVS4 for further guidance).

3.4 **Valuations** which are to be in the public domain or which will be relied on by **third parties** are frequently subject to statute or regulation. There are often specific requirements that a valuer must meet in order to be deemed suitable to provide a truly objective and independent view. However, there are no specific criteria for most valuations, and the onus is on valuers to ensure that they are aware of potential conflicts of interest.

4. The Qualified Valuer

4.1 **Definition - A Qualified Valuer (including valuers working for valuation**

companies) who is responsible for preparing and supervising valuations, bearing liability for them as included in financial statements and for other authorised purposes, shall be a person of good reputation, who can demonstrate:

- (i) either:
 - a university degree, post graduate diploma; or other recognised academic or vocational certification relevant to asset valuation that meets TEGoVA Minimum Educational Requirements (MER); and having at least two years' professional experience in property valuation and having maintained and enhanced his professional knowledge through a relevant programme of continuing education; or
 - long term relevant experience; or
 - having undertaken at least twenty written real property valuations within the last two years; or otherwise satisfied the requirements of TEGoVA's Recognised European Valuer Scheme (see the TEGoVA website);
- (ii) sufficient local knowledge and experience in valuing real property in the location and category of the subject property or, having disclosed the insufficiency to the client before accepting the assignment, having obtained assistance from competent and knowledgeable person(s);
- (iii) where required by national legislation or regulations, any required licence to practise as a valuer or membership of a professional association;
- (iv) compliance with all legal, regulatory, ethical and contractual requirements related to the valuation;
- (v) that he will at all times maintain the highest standards of honesty and integrity and conduct his activities in a manner not detrimental to clients, the public, the profession, or his respective national professional valuation body. It is mandatory for all Qualified Valuers and their representative professional or technical organisations to adhere to an ethical code that is as stringent as the TEGoVA Code of Ethics and Conduct;
- (vi) professional indemnity insurance appropriate to the valuation work undertaken (unless the Member Association does not require it and it is not commercially available for the country in which the valuer works).

4.2 European Definition of an Asset Valuer for State Aid Rules

4.2.1 The 1997 Commission rules provide a definition of an "asset valuer" for the purposes of valuations undertaken for those rules (*Commission Communication on State aid elements in sales of land and buildings by public authorities* (OJ C 209, 10/07/1997, p0003-

0005 – 31997Y0710 and extended to EFTA countries by EFTA Surveillance Authority Decision No 275/99/COL of 17 November 1999 introducing guidelines on State aid elements in sales of land and buildings by public authorities and amending for the 20th time the Procedural and Substantive Rules in the field of State aid.)

4.2.2 Under these 1997 Rules, the valuer is to be

“a person of good repute who:

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

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

“a member of a recognized professional body concerned with the valuation of land and buildings and either:

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

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

State Aid Communication II.2.(a)

4.3 National Legislation - Several European states have specific certification systems to qualify valuers under national legislation or regulation. Certification schemes are discussed in more detail below in the Information Paper on this in Part 3. European Standard EN45013, the European Standard for Bodies operating Certification of Personnel, was issued in 1990. The European Accreditation's Multilateral Recognition Agreement assists the mutual recognition of qualifications. For a qualification to be approved under this standard it must require training, compliance with professional ethics, monitoring of compliance with standards and periodic re-certification. The qualification and knowledge requirements for valuers are then defined at national level by the relevant certification body. In 2006, EN45013 became a world standard, ISO/IEC 17024.

4.4 Recognised European Valuer (REV) - TEGoVA has developed the Recognised European Valuer (REV) scheme to enable individual valuers, through their professional associations, to have an enhanced status, over and above TEGoVA's Minimum Educational Requirements, to assure clients, especially from other countries,

of their valuation expertise. The REV scheme is summarised in the Information Paper in Part 3 and its more detailed requirements are set out on the TEGoVA website.

4.5 TEGoVA's Minimum Educational Requirements (MER) - As part of its education strategy of supporting standards of professional competence, TEGoVA sets Minimum Educational Requirements (MER) for its Member Associations to require of their qualified members so that they apply to every valuer elected to practice after 1 January 2003. TEGoVA's Minimum Education Requirements are summarised in the Information Paper in Part 3 and set out in detail on the TEGoVA website. Many member associations demand more stringent qualifications.

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

5. Commentary

5.1 General - Valuers must ensure that they meet the requirements of the instruction with professional standards of knowledge, competence and independence. It follows that a valuer who is asked to undertake an instruction must make initial enquiries of the client as to the nature of the instruction and purpose of the valuation. The valuer must be able to meet both the requirements of the client and the rules, legislation and codes of conduct relevant to the task.

5.2 Conflicts of Interest

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

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

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

5.3 Independence of the Valuer

5.3.1 While the valuer must always be objective and professional in his appraisal and assessment of value, in many cases it will be necessary and professional for the valuer (and where appropriate any valuation company) to show that he is independent of any party interested in the outcome of the valuation. Any such connection, other potential conflict of interest or other threat to the valuer's independence and objectivity, should be disclosed in writing to the client and recorded in the valuation report.

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

5.3.3 There are various circumstances where the relationship with the client or another party makes it imperative that the valuer be, and be seen to be, not only competent to act, but also independent, and without any undisclosed potential conflicts of interest which are actual or possible and which can be foreseen at the time when the instructions are accepted.

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

5.3.5 EU Definitions - Directive 2006/48/EC, in considering the monitoring of the values of property used as collateral for credit institutions, defines an "independent valuer" at Annexe VIII, Part 2, 1.4, paragraph 8(b) as:

"a person who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process."

5.3.6 The 1997 State Aid rules provide that "The valuer should be independent in the carrying out of his tasks" (for the full text see 4.2.2 above).

5.4 The Valuer's Liability

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

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

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

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

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

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

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

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

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

EVS4

The Valuation Process

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

EUROPEAN VALUATION STANDARD 4

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

The valuation must be researched, prepared and presented in writing to a professional standard.

1. Introduction

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

2. Scope

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

3. Terms of Engagement

Detailed terms of engagement should be recorded in writing. In respect of lending, other financial or receivership instructions, terms must be agreed in writing before the valuation is submitted to the instructing client. It is best practice to obtain the client's written agreement to the terms of engagement before submitting any valuation.

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

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

5. Commentary

5.1 Valuers have an absolute responsibility to ensure:

- (i) that they are, and can be seen to be, competent, qualified and not debarred by reason of any actual, potential or perceived conflicts of interest or have otherwise declared, and taken steps to remedy, any real or apparent deficiency so that they may carry out the proposed assignment;
- (ii) that their appointment is clearly set out in unambiguous wording, covering all heads of terms that are relevant to the instruction and corresponding to the client's needs and the requirements of statute, regulation, deemed fiduciary responsibility and professional ethics; the appointment should be explicitly agreed by both parties prior to acceptance of new or repeated instructions; and

- (iii) that any departure from the Standards that is required by the client is unambiguously expressed in the letter of instruction and the Valuation Report. Additionally, it is important to ensure that any such departure is not likely to mislead or confuse the user of the Report because of the qualifications imposed or assumptions made.

5.2 The valuer should establish the client's needs and requirements with precision as a matter of good business practice. The agreed written terms of engagement should be included as an appendix to the report. Terms must include reference to:

- the client's identity, specifying a corporate or personal identity;
- the purpose of the valuation and the importance of restricting the use of the valuation to the stated purpose;
- the precise extent of the property/interest being valued with reference to a plan or other fixed object;
- the basis or bases of value;
- a specific valuation date, not "as of the date of valuation";
- any previous involvement with the property or the parties involved;
- the status of the valuer, clarifying whether acting in an external and independent capacity, specifying a corporate or personal identity; or as an internal valuer;
- all assumptions and special assumptions that will be made in preparing the report;
- the scope and extent of investigations that will be undertaken and any verification that will be required by the client or his representatives, together with confirmation of the valuer's competence to undertake the instruction;
- reliance placed on information provided by the client, the client's representatives or third parties;
- any restriction placed on publication of part or all of the valuation produced;
- the extent to which a duty of care will be provided, stating any exclusions as to parties or matters as determined by the valuer or requirements of insurers;
- compliance, where appropriate, with European Valuation Standards, 7th edition; and
- the basis of fee to be charged, as determined by the valuer or prescribed by third parties or statute.

Matters arising following the submission of terms of engagement that require amendment to the terms submitted must be recorded in writing to avoid misunderstanding and consequential dispute.

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

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

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

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

5.7 Valuations which are Inconsistent with the Standards - Where a valuer is asked to carry out a valuation on a basis that is inconsistent with, or in contravention of, the Standards, the valuer must advise the client at the beginning of the assignment that the Report will be qualified to reflect the departure from the Standards.

5.8 Valuations Carried Out with Limited Information - A situation may arise where there is limited information, inadequate inspection opportunities, or restricted time available to the valuer. In some cases the Report may be required for the internal purposes of the management, in others the Report may be required in relation to a takeover or merger where time is of the essence. In such cases, the valuer must ensure that the Report will not be published by arriving at an agreement at the beginning of the assignment.

5.9 Valuations for which Special Assumptions are Necessary - A valuer may need to make special assumptions or be required by the client to value on the basis of special assumptions. Such situations could include:

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

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

5.10 Exceptionally, it may be appropriate and expedient to sanction publication of valuations containing appropriate qualifications in instances where the limited circumstances set out below apply:

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

6. Supporting the Valuation

6.1 A professional valuation relies on the valuer appraising the subject property in its context, researching and verifying all matters with a bearing on the value of the property. The quality of the valuation will, in part, rely on the quality of the information used to prepare it and so the valuer will need to verify any sources and the date of that information. Market conditions relevant to the subject property should also be reviewed as, where soundly appraised, these form part of the basis on which decisions may be made.

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

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

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

certificate as factors which could significantly affect the property's value may not have been identified.

6.5 Consideration should also be given to establishing relevant financial, legal and regulatory points regarding the property, including Energy Performance Certificates required by Directive 2010/31/EU on the energy performance of buildings and other factors arising under environmental regulation.

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

6.7 Where the valuer is aware of market uncertainty, volatility or other issues putting the value at risk, these should be considered and reported in the assessment.

7. Valuation Reviews

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

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

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

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

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

valuer should clarify with the client, in the conditions of engagement, whether or not he may do so. It must be made clear in the Report whether or not discussions with the original valuer have taken place.

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

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

EVS5

Reporting the Valuation

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

EUROPEAN VALUATION STANDARD 5

The valuation must be presented in clear written form to a professional standard, transparent as to the instruction, purpose, basis, method, conclusion and prospective use of the valuation.

1. Introduction

The valuation, as determined by the valuer, must be clearly and effectively conveyed to the client. The Valuation Report will be the document on which the client will rely in taking decisions, making it important that it be exact both as to what it says and as to the qualifications to which it is subject.

2. Scope

This Standard reviews the Valuation Report in which the valuer advises the client of the value determined.

3. Valuation Reporting - Definitions

3.1 Having defined both Market Value and Mortgage Lending Value, Capital Requirements Directive 2006/48/EC provides in the next sentence of the same paragraphs that:

“The market value shall be documented in a transparent and clear manner.”

and

“The mortgage lending value shall be documented in a transparent and clear manner.”

3.2 That is done in the Valuation Report or, occasionally, a Valuation Certificate.

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

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

4. The Valuation Report or Certificate

4.1 General

4.1.1 A valuation report must be in writing, prepared and presented in a reliable and comprehensible manner for the users and clients. This is required by the definition of Market Value in EVS1 and is appropriate to all other bases of valuation, giving certainty between valuer and client.

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

4.1.3 The Valuation Report must provide a clear and unequivocal opinion as to value, as at the valuation date (see EVS1 5.6.3 above) with sufficient detail to ensure all matters agreed with the client in the terms and conditions of engagement and all other key areas are covered and that no misunderstanding of the real situation of the property can be construed.

4.1.4 The Report or Certificate must be objective. Decisions may be made and finances committed or withdrawn on the strength of it. The valuer must not be influenced by pressure brought by the client or a third party to produce a particular result in terms of the valuation or any other associated advice. In appropriate cases the valuer must refuse to act where his reputation for objectivity is likely to be put at risk. Where the valuer has been instructed despite a conflict of interest that conflict should be stated with a record that it was notified to the client.

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

4.2 Contents of a Valuation Report

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

4.2.2 A Valuation Report must adequately report all matters set out within the terms of engagement (see EVS4, 5.2).

4.2.3 A Valuation Report should generally include:

- the instructions for the assignment;
- the valuer's qualifications;
- the basis and purpose of the valuation;
- the valuation date (see EVS1 5.6.3 above);
- a description of the property, including a note as to the basis on which areas have been measured;
- a summary of the legal context (tenure, tenancies, development control, etc);
- a commentary on the market for the property;
- a description of the valuation methodology and analysis;
- any assumptions that have been made;
- any limitations on the report;

leading to and concluding with the opinion as to the value of the property, including, where appropriate, details of comparables used. It may also explain the analytical processes undertaken in carrying out the valuation, and present the supporting information.

4.2.4 Valuations for commercial secured lending and other asset types need to take into account additional or alternative requirements of the lender including reference to the suitability of the subject property for the intended loan. Where the terms of the loan have not been disclosed the valuer should provide an opinion based on normal lending terms having regard, as appropriate, to the profile for risk-related criteria for valuations published by the European Mortgage Federation (see Part 3 below).

4.2.5 Assumptions and special assumptions relating to secured lending valuations, as recorded within the terms of engagement, will usually require reference to (inter alia):

- the existing permitted use, any planning permission or potential planning consent for an alternative use, including any potential or actual impact on value at the specified valuation date;
- any marriage, special or synergistic value that exists and, where present, whether such value is available to the borrower and, if necessary, to the lender on taking possession;
- market conditions at the specified valuation date and whether any valuation uncertainty relating to low volumes of reliable comparable evidence, marked volatility or other specified factors had been taken into account or ignored in reaching an opinion of value; and
- any recent or proposed changes to the property, the immediate or local environment or legislation that might have an impact on value, and where such an impact is reported, the extent of that impact. Matters that might be included within this category include potential or actual contamination, deleterious materials or title.

4.2.6 The report will need to include additional relevant material where the property

is, or is to be, held as an investment (see EVA5), fully equipped as a trading entity or the subject or potential for actual development, refurbishment or retro-fitting.

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

4.2.8 Where the market for the property being valued is affected by uncertainty and this is relevant to the valuation, the valuer should proceed with caution and comment on the issue to the client.

4.2.9 The valuer may wish to consider and state the period after which the valuation will be deemed to have expired. This may be particularly important in times when values are volatile. This may be specified by national legislation in some countries or by the requirements of the contract.

4.2.10 It is recommended that all valuation reports include a statement to the effect that the Qualified Valuer responsible for the valuation to the client has conformed to the requirements of these European Valuation Standards and the extent and reasons for any departure or why any key part of the valuation process has been omitted.

4.3 Valuation Certificate

4.3.1 The valuer may be asked to issue a valuation certificate, providing the valuer's summary conclusion as to the value of the property as at the valuation date (see EVS1.5.6.3). The certificate may be a separate document or incorporated within the valuation report, of which it may be a summary.

4.3.2 Exceptionally, in countries where legislation or practice determines that a valuer must certify the amount of the valuation of the property, that will usually be by a short letter the contents of which will include:

- the client's name and address;
- details of the property;
- the valuation date;
- the purpose of the instruction;
- the date of the Certificate;
- any assumptions upon which the valuation is based;
- the name, address and qualifications of the valuer.

4.3.3 The same basic requirements are made of that certificate or letter as are made of a valuation report. It must be objective, unambiguous and clearly written in terms which a person with no knowledge of the property or of valuations can understand. It must not mislead or create a false impression. It must meet the client's instructions. It

should state and have regard to the purpose of the valuation and the use that the client proposes to make of the valuation.

4.4 Draft Reports

There may be circumstances where it is appropriate to provide an advance draft of a valuation or an update in abbreviated form that does not comply with this European Valuation Standard. In such cases the existence of, and reference to, a future detailed report or an earlier comprehensive certificate must be made.

4.5 Value Added Tax

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

Part 1B

European Valuation Applications

EVA1 Valuation for the Purpose of Financial Reporting

EVA2 Valuation for Lending Purposes

EVA3 Property Valuation for Securitisation Purposes

EVA4 Assessment of Insurable Value

EVA5 Application of Investment Value (Worth) for Individual Investors

EVA6 Cross-border Valuation

EVA7 Property Valuation in the Context of the Alternative Investment Fund Managers Directive

EVA8 Property Valuation and Energy Efficiency

EVA1

Valuation for the Purpose of Financial Reporting

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

1. Introduction

1.1 In order to achieve consistency and comparability of financial reporting, the European Union has, over a period of more than 25 years, developed a set of accounting rules laid down in *Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings*.

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

1.3 The EU has since introduced most of the International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) through subsequent Commission Regulations, the latest consolidated text having been published as *Commission Regulation (EC) N° 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) 1606/2002*.

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

- IAS 2: Inventories
- IAS 11: Construction Contracts
- IAS 16: Property, Plant and Equipment
- IAS 17: Leases
- IAS 40: Investment Property
- IAS 41: Agriculture
- IFRS 6: Exploration for and Evaluation of Mineral Resources

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

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

2. Scope

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

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

3. Framework for the Preparation and Presentation of Financial Statements (extract from IFRS technical summaries as issued at 1 January 2011)

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

3.2 *Qualitative characteristics* determine the usefulness of information in financial statements. They are understandability, relevance, reliability and comparability.

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

- (i) An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
- (ii) A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
- (iii) Equity is the residual interest in the assets of the entity after deducting all its liabilities.

Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the balance sheet and income statement. This involves the selection of the particular base of measurement.

4. Classification of Assets

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

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

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

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

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

Investment property shall be recognised as an asset when:

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

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

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

4.6 Leases - The objective of IAS 17 is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures to apply in relation to leases.

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

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

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

5. The Selection of Consistent Bases of Valuation

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

- the *Cost Model*: after recognition as an asset, “an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses” (IAS 16.28); and
- the *Fair Value Model*: relying on the price at which the property could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction (IAS 40). IFRS 13 Fair Value Measurement will provide a new definition which is applicable from 1 January 2013 (see below paragraph 6.1 Fair Value Measurement).

5.2 The three most relevant International Accounting Standards applicable to property valuation for accounting purposes are IAS 16 (owner occupied property, plant and equipment), IAS 17 (leases) and IAS 40 (investment property). The following commentary will focus on these three Standards.

5.3 IAS 16 - Property, Plant and Equipment

5.3.1 *Measurement at recognition* - An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost. This cost is the cash price of the item equivalent at the recognition date and includes its purchase price, import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

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

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

5.4 IAS 17 - Leases

5.4.1 At the commencement of the lease term, lessees shall recognise finance leases as assets and liabilities at the lower of the fair value of the asset and the present value of the minimum lease payments (IAS 17.20). The depreciation policy for assets held under finance leases should be consistent with that of owned assets. If there is no reasonable certainty that the lessee will obtain ownership at the end of the lease, the asset should be depreciated over the shorter of the lease term or the life of the asset (IAS 17.27).

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

5.5 IAS 40 - Investment Property

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

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

5.6 IAS 41 - Agriculture - Many farm businesses will be below the thresholds at which the use of IAS is mandatory. Where IAS 41 applies, it does not introduce any new principles for the valuation of land used for agriculture, horticulture, floriculture, aquaculture or forestry. Thus, IAS 16 or IAS 40 should be followed as required by the circumstances. It affects the treatment of growing plants that are physically attached to the land and are managed for their produce or for transformation into further plants. Whether they are annual crops such as wheat or potatoes, multi-annual crops such as fruit bushes, orchards and vines or long term crops such as forestry, they are classed as biological assets and are to be assessed at their fair value reduced by the estimated costs of selling them separately from the land. This is thus different from the ordinary treatment of stocks on a cost basis under IAS 2. IAS 41 recognises that this may be a difficult task and commends various options to tackle this including an income basis or apportionment of the prices achieved for land sold with growing crops. Where fair value cannot be measured reliably, a cost basis may be used. Where, for example, with amenity woodland, growing plants are not managed for their biological potential they are not taken into account.

6. Fair Value

6.1 Fair Value Measurement Project

6.1.1 In September 2005, the IASB added the Fair Value Measurement Project to its agenda. The global financial crisis emphasised the importance of having common fair value measurement and disclosure requirements. Therefore in June 2010, as a convergence project with the US-American Financial Accounting Standards Board (FASB) both standard setters published their exposure drafts. The goals of this project were to reduce complexity and to improve consistency in the application of fair value measurement principles by having a single set of requirements for all fair value measurements.

6.1.2 On 12 May 2011, the IASB issued IFRS 13, Fair Value Measurement. IFRS 13 will be relevant for IAS 16, IAS 40 and IAS 41. Yet, this standard has not been endorsed in the European Union. It is expected to be endorsed in the 3rd quarter of 2012. For this reason, all standards that are relevant for property's fair value measurement will be subsequently addressed.

6.2 IAS 16 - Property, Plant and Equipment - Under IAS 16, the commentary as to fair value is as follows (valid until 31 December 2012):

- "The fair value of land and buildings is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers." (IAS 16.32);
- "If there is no market-based evidence for Fair Value because of the specialised nature of the item of property ... and the item is rarely sold, except as part of a continuing business, an entity may need to estimate fair value using an income or a depreciated replacement cost approach." (IAS 16.33).

6.3 IAS 40 - Investment Property - Under IAS 40, the Fair Value of a property is to reflect market conditions at the end of the reporting period (IAS 40.38). The best evidence of fair value is given by current prices in an active market for similar property in the same location and condition and subject to similar lease and other contracts (IAS 40.45).

6.4 In the absence of current prices in an active market, a valuer is to consider information from a variety of sources, including:

- (i) current prices in an active market for properties of different nature, condition or location (or subject to different lease terms or other contracts), adjusted to reflect those differences;

- (ii) recent prices of similar properties in less active markets, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices; and
- (iii) discounted cash flow projections based on reliable estimates of future cash flows, supported by the terms of any existing lease and other contracts and (when possible) by external evidence such as current market rents for similar properties in the same location and condition, and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows (IAS 40.46).

Costs of sale should not be deducted but can be reported separately.

6.5 IFRS 13 - Fair Value Measurement

6.5.1 On 12 May 2011, the IASB issued IFRS 13 Fair Value Measurement which is effective from 1 January 2013. The Standard provides a clarifying definition of fair value and further guidance for measuring fair value. It also improves transparency by enhancing detailed disclosures about fair value measurement derived using models. It must be clear that this standard provides an answer only to the question 'how to measure' and not to the question 'what to measure'.

6.5.2. The fair value of an asset or liability is defined as *the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (IFRS 13.9)*. In comparison to the standards mentioned above, this definition refers to the so-called exit price of an asset under current market conditions. Additionally, fair value is measured using the price in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability (IFRS 13.15). In case of non-financial assets, a fair value measurement takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use (IFRS 13.27).

6.5.3 IFRS 13 sets out three valuation techniques: market approach, cost approach and income approach (IFRS 13.62). The market approach is used where market prices are available. The income approach is used where directly identifiable cash flows are available (e.g. discounted cash flow). The cost approach is used where identical market prices do not exist, prices need to be adjusted or income is not directly produced (e.g. replacement cost). In some cases, a single valuation technique will be appropriate, whereas in others multiple valuation techniques will be appropriate (IFRS 13.63). Valuation techniques should be applied with the aim to choose the most appropriate

technique in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs (IFRS 13:67).

6.5.4 IFRS 13 provides a 'fair value hierarchy' categorising the inputs used in valuation techniques into three levels. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs (IFRS 13.72), an active market being defined as a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis (IFRS 13 Appendix A).

- Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date (IFRS 13.76).
- Level 2 inputs are inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly (IFRS 13.81).
- Level 3 inputs are unobservable inputs for the asset or liability (IFRS 13.86).

Selecting a valuation technique and its inputs leads to Fair Value.

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

6.6 In common with the IVSC (IVS 2011, IVS 300, G2), TEGoVA considers that the fair value requirement is, in principle, met by the valuer adopting Market Value (EVS1), but Fair Value and Market Value are not synonymous, particularly in circumstances where Market Value is not readily identifiable or where specific characteristics of an asset translate into a special value for the party involved.

7. Apportionment between Land and Buildings

An apportionment of value between the land and the buildings on it may be required to allow a proper accounting to be made for depreciation, and thus for the purpose of the preparation of financial statements. This technical task should be distinguished from valuation. EU Directives and international and national accounting standards all require an apportionment for depreciation purposes. National rules might prevail in certain circumstances. Further guidance on this is given in the Technical Document, Information Paper - Apportionment of Value between Land and Buildings, in Part 3.

8. Disclosure Provisions

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

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

More detail on the contents of the Valuation Report is contained in EVS5.

EVA2

Valuation for Lending Purposes

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

1. Introduction

1.1 Lending institutions rely on sound valuations not simply for obvious reasons of commercial prudence in lending but also under the rules following the Basel II & III agreements governing their credit structures (as applied to credit institutions in the EU by Capital Requirements Directive 2006/48 and the forthcoming European Regulation on prudential requirements for credit institutions and investment firms, transposing Basel III into European law).

1.2 These two factors mean that the valuation of property for lending purposes carries a high degree of fiduciary responsibility. It must take account of, among other factors:

- the purpose of valuation;
- the basis required by the client;
- the objective assessment of property-specific risk factors linked to the structure and the duration of the proposed loan facility;
- potential future market demand for the subject property and be clear in its reporting of the valuation date, the market context and net cash flows.

1.3 Where financing arrangements are secured on specific property, valuers are typically asked to prepare the valuation on the basis of Market Value (see EVS1). In some countries an assessment of Mortgage Lending Value (see EVS2) may be required.

2. Scope

2.1 This Application applies to all circumstances in which valuers are required to advise or report to institutions and others lending money on the basis of property

valuations and where the objective of the valuation relates to loans, mortgages or debentures.

2.2 EVA2 applies to valuations prepared prior to, and in contemplation of, a new loan, a renewal or an additional loan. It also applies in analogous cases where a secured lender is considering whether to repossess or appoint a receiver in case of default and/or instructions on disposal of a property are being formulated.

2.3 The valuer must be competent to give advice on comparative property and sector-related risks if this is required. It is generally the role of the lender to assess risk as it relates to the financial status of the borrower or in the context of the overall geographical, sector, and client bias. A valuer may, however, be consulted on any of these matters because of his specialist knowledge. More detail about the qualification of the valuer is contained in EVS3.

2.4 As far as the valuation is concerned, these matters relate to, and depend on, the type of property on which the loan is to be secured, the property's geographical or sector context, client bias and, particularly, on the effects of liquidation procedures in the country in which the property is located.

3. Commentary on Land and Property Categories

3.1 The five different categories are:

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

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

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

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

3.4 Development Properties

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

3.4.2 Development properties present a number of problems for valuers; reliance on a feasibility analysis is advised. The volatility of development values following changes in any of the underlying assumptions of rent, yield, cost and timing must be explained to the lender, as part of the risk assessment. It is advisable to make the methods of valuation explicit, and to ensure that cash flow, discounted cash flow, residual valuations, and assessment by comparison are all, as relevant, shown clearly with appropriate explanatory notes.

3.5 Properties normally valued on the basis of their trading potential

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

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

3.5.3 Lenders are expecting valuers to assess the marketability of the property and/or its suitability for third party use. In certain cases, an assessment on the basis of Alternative Use Value or Forced Sale Value may be required. Where such operational properties are being developed or redeveloped with borrowed money, the time to obtain all necessary permits and licences and to build up a sustainable level of trade and commercial risks must be assessed, and the lender advised of the dynamics of the industry.

3.6 *Wasting Assets* - In some jurisdictions, wasting assets may not be used as security for loans. Where this asset class is permitted as security, special problems are associated with valuation. As a result, mineral producing properties and other wasting assets are not an asset class favoured by lenders. Where a loan is proposed, particular attention needs to be drawn to the duration and financial profile of the loan, including interest and capital repayment dates, as they relate to the life of the wasting asset and the planned programme for its extraction or productive use.

4. Usual Bases of Value

4.1 Market Value, as the paramount basis of value, has been considered in detail in EVS1 with the definition adopted by TEGoVA and other definitions where provided in EU legislation.

4.2 Mortgage Lending Value as defined in EU legislation has been considered with a brief commentary in EVS2. It should be noted that, as stated in EVS2, such valuations do not meet the definition of Market Value. The application of Mortgage Lending Value is considered in more detail hereunder (par. 5).

4.3 In any circumstances where a valuer is requested to provide valuations on a basis other than Market Value, the valuer should proceed only if that valuation is not in breach of local laws or regulations and will not otherwise be misleading. Under such circumstances it is customary for valuers to include an opinion of Market Value or other appropriate information as to the extent to which a value on an alternative basis may differ from Market Value.

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

5. Application of Mortgage Lending Value

5.1 Mortgage Lending Value has a particular relevance as an approved basis for assessing the collateral value of real property for credit institutions. It should provide an assessment of the *long term sustainable* value of the security, available to guide internal banking decisions in the credit decision process on such matters as loan-to-value ratio, amortisation structure, loan duration, funding or risk management. Mortgage Lending Value is a basis for assessing whether a mortgaged property provides sufficient collateral to secure a loan over a long period. Alternatively, lenders may address this directly by their choice of the appropriate loan-to-value ratio.

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

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

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

5.5 Mortgage Lending Value can be used as a risk management measure in a number of ways in the context of:

- lending secured by real estate;
- capital requirements for credit institutions as detailed in the EU supervisory framework;
- funding of mortgage loans through Covered Bonds secured by real estate as the cover assets;
- the development of capital market products converting real estate and real estate collateral into tradable assets (e.g. mortgage backed securities as discussed in EVA3).

5.6 The concept of Mortgage Lending Value is defined by legislation both by the EU (see EVS2 above) and, in some countries, by national law and rules.

5.7 The assessment of Mortgage Lending Value can, subject to the type of property and any specific legal, historic or other features of the market where the property is located, follow appropriate use of the three internationally recognised valuation methods on which market value may be assessed:

- sales comparison approach;
- income capitalisation approach;
- cost approach.

5.8 Mortgage Lending Value differs from Market Value in that it is not a 'spot value' but serves to express prudent expectations as to value over the longer term. This requires a number of steps to exclude short-term market volatility or temporary market trends. The valuer should address the following key issues when determining the Mortgage Lending Value of a property:

- (i) The future marketability and saleability of the property has to be assessed carefully and prudently. The underlying time perspective goes beyond the short-term market and covers a long-term period.
- (ii) As a principle, the long-term sustainable aspects of the property such as the quality of the location, construction and layout.
- (iii) The income stream of the property used in this valuation should be no more than the sustainable net rental income that the type of property which is the subject of the valuation usually produces over time in the specific local market, excluding any actual over-rented element and other additional unusual or extraordinary cash flows. This means assessing the sustainable yield on the basis of a judgement of past and current long-term market trends and not taking any uncertain elements of possible future income growth into account.
- (iv) The choice of capitalisation rates is also to be based on long-term market trends and exclude all short-term expectations regarding the return on investment. It should consider the sustainable income-producing capacity of the property, multi-purpose or appropriate alternative uses as well as the future marketability of the property.
- (v) The valuer must fully deduct administration costs and allow for obsolescence, reinvestment, annual maintenance, the risk of voids, a tenant not meeting his obligations and other risks to the rent.
- (vi) The sustainability of the comparative values through the application of appropriate discounts where necessary if the Mortgage Lending Value is derived using comparables or the depreciated replacement cost approach.
- (vii) Mortgage Lending Value is generally based on the current use of the property. The Mortgage Lending Value should only be calculated on the basis of a better alternative use under certain circumstances, such as where there is a proven intention to renovate or change the use of the property. Essentially speculative or transient uses are excluded.
- (viii) Further requirements, for example, with respect to compliance with national standards, transparency, content and comprehensibility of the valuation, complement the legal framework for the calculation of Mortgage Lending Value.

5.9 Some of these principles require further commentary:

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

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

6. Forced Sales and Liquidation Sales

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

6.2 In a falling or distressed market, owners may not be willing sellers and may be obliged to accept a price considered to be less than Market Value (see EVS1) due to constraints imposed upon them. Such constraints may reflect the characteristics of the property or circumstances of the owner and must be clearly indicated in the report.

6.3 Figures reported should be stated to be subject to specific special assumptions which should be agreed in writing and included within the terms of engagement (see EVS4). The result should be a Market Value, but on the basis of the special assumptions cited. The figures reported will only be valid as at the valuation date due to potential changes in market conditions.

6.4 Forced sale value is not a basis of valuation and should not be used, unless clearly instructed to do so.

EVA3

Property Valuation for Securitisation Purposes

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

Note - For further reading see Part 3, "European Property and Market Rating: A Valuer's Guide"

1. Introduction

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

1.2 The creator of the securities benefits from the removal of property-related assets from its balance sheet. This helps to improve its financial ratios, enhance its return on capital and achieve compliance with risk-based capital standards (such as the Basel Accords, Capital Requirements Directive 2006/48 and national regulations).

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

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

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

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

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

2. Scope

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

2.2 The valuations relevant to REITs, property trusts and property unit trusts are considered in EVA1, *Valuation for the Purpose of Financial Reporting*, and EVA5 *Application of Investment Value (Worth) for Individual Investors*.

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

3. Definitions

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

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

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

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

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

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

3.5 **Market Value is defined in EVS1.**

3.6 **Mortgage Lending Value is defined in EVS2.**

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

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

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

4. Statement of the Application

4.1 Where the valuation will be used to secure a loan on a property or a portfolio of properties intended to back a securitised instrument, this will normally be on the basis of the *market value* of the property. In some jurisdictions, the *mortgage lending value* may also be used.

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

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

4.3 TEGoVA recommends valuers to undertake their task in two stages: the conventional valuation of the real property, and an assessment of the specific property risk profile. Where a portfolio of properties is being assessed, the valuation and risk assessment should relate to the whole portfolio.

5. Commentary

5.1 The *first step* is to consider the individual underlying properties. The valuer should determine the Market Value (and/or the Mortgage Lending Value) at the point when the mortgage is granted on the individual property, following EVA1 and EVA2. If such an assessment was not carried out when that initial mortgage was agreed, this must be done for each property at the point when the mortgage loans are being sold to the special purpose vehicle. Individual credit rating agencies may impose special conditions, which must be factored into the valuation and the advice provided.

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

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

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

5.5 Valuation of portfolios of mortgages on residential properties held by private investors should be undertaken by analysing groups of properties with a similar nature ("cluster analysis") on the basis of the age of the properties, similar income streams, location or other features. The values of the individual properties within a cluster can

be examined by a simplified method (such as a desk-top valuation), taking into account those factors most likely to influence values. If there has not been a previous valuation of the properties, they should be assessed at this stage. The valuations of the individual properties are then summarised as the value of the cluster, for which a risk assessment is also completed. Finally, the values of the individual clusters are used to derive the net asset value for the entire portfolio, which will also be risk-assessed.

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

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

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

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

EVA4

Assessment of Insurable Value

1. **Introduction**
2. **Scope**
3. **Definitions**
4. **Recommendations**
5. **Assessment Methodology**
6. **Other Issues**

Caution - EVA4 considers the assessment of the value of buildings for insurance cover against damage or destruction and applies where this is the primary purpose of the value to be provided under the instruction (see paragraph 1.6). It does not consider the other insurances that may be needed against other risks arising from that damage or destruction or the associated disruption of business or those other insurances commonly handled by those managing property.

1. Introduction

1.1 An insurance contract is a business contract. As such, it is a legally binding agreement between the parties, with the insurer being paid premiums to indemnify the insured against losses up to a defined amount or amounts arising out of a specified risk or risks. The basis of cover rests on the terms of contract.

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

1.3 The maximum liability of an insurer is the sum insured, even though this may not represent a full indemnity. In the event of a total loss the insurers would only pay out, as a maximum, the amount insured. It is thus important to consider that amount carefully and regularly.

1.4 In the event of a partial loss (as where only part of a building is destroyed), insurers will conventionally only pay out, as a maximum, an amount that reflected the sum insured as a percentage of the proper insurable value. This is known as average or an average clause.

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

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

1.7 An assessment may also be required in connection with loss adjustment following a claim on an existing policy and also of any damages associated with the cause of the claim. The reinstatement criteria may be defined in the insurance contract. While the framework of this EVA is generally relevant to loss adjustment, the requirements set out in EVS3 regarding appropriate expertise apply to this specialist work.

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

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

2. Scope

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

3. Definitions

3.1 The 'insurable value' of a property means the sum stated in the insurance contract applying to that property as the liability of the insurer should damage and financial loss be caused to the insured by a risk specified in the insurance contract occurring to that property. When instructed to provide an insurable value, the valuer is to determine the figure that will provide appropriate insurance cover for the property. This is a matter which may not only be relevant to the insured and the insurer but also to others such as someone with a loan secured on the property.

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

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

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

3.5 Rebuilding, repair and restoration within the context of reinstatement means replacement by methods or with materials that satisfy current building, fire and other regulations or legislation.

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

3.7 On this basis, Insurable Value will take account of the total cost of rebuilding together with additional factors as appropriate. For insurance cover restricted to buildings ('buildings only'), the figure should exclude all items of plant and machinery, trade fixtures and other materials that do not form an integral part of the structure but will usually be covered by other insurances held by the occupier or other relevant person.

3.8 The figure should include an estimate of the cost of demolition, site clearance, shoring and propping-up, together with all professional and statutory fees that will be incurred in the reconstruction.

3.9 If either the valuer is instructed to use Depreciated Replacement Cost or it is appropriate to do so, then the valuer should assess the new replacement cost and then

deduct an allowance for ageing and wear and tear of the structure. This cover equates to the replacement of the building as it is, not for its replacement with a new building.

4. Recommendations

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

4.2 Exclusion from cover does not remove the responsibility to report any matters that might impact on any decision of the insurer. Matters that might be excluded from cover (though still to be considered in any assessment) or for which cover may be specifically limited under the contract, include:

- asbestos and other deleterious materials;
- damage from flooding, especially if the premises are situated within a flood plain and may have suffered flooding in the past;
- potential storm damage to fencing;
- the condition of all roofing as insurers might exclude storm damage where the standard is poor;
- fire damage may be excluded if the electrical system has not been certified or if there is insufficient fire protection (e.g. extinguishers);
- for premises with sprinkler systems, water damage could be excluded unless sprinkler leakage cover is purchased;
- in areas prone to subsidence problems, subsidence cover may be excluded;
- earthquakes can be an excluded risk in some areas;
- loss of rent, alternative accommodation and associated risks.

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

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

4.5 In respect of apartment buildings, unit owners have a financial interest in the entire building, as well as the building elements within their unit. Whilst a unit owner should not need to insure the entire building, insurers of an individual unit require an adequate level of indemnity. Local regulation or tradition may determine the extent of cover required beyond the assessment of insurable value of the specified unit of accommodation. It is recommended that details of the insurance policy be reviewed

to ensure that cover is provided in accordance with the requirements of the insurer. It is also recommended that valuers make enquires relating to any specific requirements of insurers where flooding of any block of property may impact on the individual unit, irrespective of whether the fabric of any unit is affected by flooding.

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

5. Assessment Methodology

5.1 Building areas are often calculated by determining the gross internal area for commercial and industrial buildings and gross external area for residential property. In some countries building areas are calculated on a gross external basis, irrespective of use. Guides are published that provide typical building costs for each different form of construction. A valuer must ensure that the basis of measurement undertaken is consistent with the basis adopted by authors of any recognised guide and the practice adopted in the country concerned.

5.2 The conventional purpose of insurance cover is to make good the loss caused by damage. An assessment of Insurable Value should be based on the full cost of replacement, rather than Market Value or any other basis, unless the valuer is specifically instructed otherwise in which case the report should make clear that the value given is not an assessment of the cost of reinstatement.

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

5.4 The cost of construction will often be substantially more than the actual cost of a recently completed building on a cleared site. The new build cost would reflect the fact that the site was clear of buildings and the contractor could employ efficient site construction methods. Where it is a case of rebuilding, the site may often be constrained by other buildings already on site and other surrounding buildings which have since been developed. Any building attached to another property may need to be supported temporarily and protected from the weather.

5.5 The valuer must undertake an assessment and provide an adequate description of:

- the location and use of both the subject property and adjacent property;
- the accommodation, number of floors, services, and access;
- internal and external facilities including a record of construction detail, dimensions, fittings and use, supported by a comprehensive photographic record. Specific regard should be made to materials or features not commonly found in similar property or where the replacement costs would be higher than normally incurred;
- relevant planning permissions, licences and approvals;
- the condition of the property, including an assessment of any deterioration arising from damage, age, defects or overdue repairs;
- the specification of reconstruction costs together with necessary additional costs associated with reinstatement;
- the possible requirement to increase the assessed costs where the insured would be liable for, but unable to recover, input VAT charges;

5.6 The cause of a claim for total reinstatement may be a catastrophic fire or explosion. Provision therefore needs to be made for the cost of demolition of the existing structure as well as any work needed to protect adjacent and adjoining buildings. Depending on the nature or extent of the damage, the demolition process may be more dangerous than might otherwise be the case and in extreme cases the foundations may also require removal.

5.7 Provision needs to be made for the cost of removing any rubble and other waste material from site prior to rebuilding. Costs associated with depositing in landfill or waste sites have increased substantially over recent years, particularly in respect of deleterious or contaminated materials.

5.8 Costs associated with improving the energy performance of a qualifying building require consideration. Energy Performance of Buildings Directive 2010/31/EU requires improved energy performance in the event of “major renovations”, defined as: “those where the total cost of the renovation related to the building shell and/or energy installations such as heating, hot water supply, air-conditioning, ventilation and lighting is higher than 25% of the value of the building, excluding the value of the land upon which the building is situated, or those where more than 25% of the building shell undergoes renovation”.

5.9 Architect’s, surveyor’s, engineer’s and other relevant fees all need to be taken into account, together with fees and costs associated with planning permission and building regulation approval.

6. Other Issues

6.1 In certain specialised cases, it may be necessary to envisage that, in the event of total loss, it would be unrealistic or perhaps unnecessary or uneconomic to rebuild the structure as it existed. This might arise most commonly where the insured property had been constructed using materials that would not now be used or by methods or to standards that are now outmoded. An example would be a building built with traditional materials and designed to accommodate out-dated processes. In such instances, there may be no need to rebuild the structure as it was and it may be cheaper and more appropriate for rebuilding to meet the current and foreseeable requirements at the time of assessment with contemporary methods, materials and standards. The valuer may be asked to provide a valuation based on the concept of Depreciated Replacement Cost.

6.2 The Cost Approach (or the Contractor's Method) is used to assess the new replacement cost and the depreciated replacement cost (see EVS2).

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

6.4 Underlying land does not need to be valued unless it is subject to an identified risk covered by the insurance policy (for example, flooding, contamination or a mudslide).

6.5 Any assessment of insurable value of listed or heritage buildings requires specialist knowledge of construction detail, appropriate replacement costs and requirements of a government agency or planning authority. Unless the valuer is recognised as a specialist in this area, any assessment should not be completed without assistance from an expert in the type and design of the subject property. Where assistance is obtained, the client must be advised, and agree to the appointment.

EVA5

Application of Investment Value (Worth) for Individual Investors

1. **Introduction**
2. **Scope**
3. **Definitions**
4. **Commentary**
5. **Method of Analysis**

1. **Introduction**

EVA5 applies to assessment of the maximum price that an investor might pay to purchase a property, taking account of the benefits the specific investor will receive by holding it and his operational objectives.

2. **Scope**

This Application considers the basis of value and method of analysis used to assess the investment value (worth) of a property for an individual investor.

3. **Definitions**

3.1 All bases of valuation in EVA5 are defined in EVS2 (Valuation Bases other than Market Value).

3.2 *Useful Life of a Property*: The period during which the property will be capable of effective use for its purpose.

4. **Commentary**

4.1 **Basis of Value** - These valuations must be made under the basis of Worth or Investment Value (see EVS2). The valuation report, prepared in accordance with

EVS5, must state this and make clear that it is prepared only for that investor (with his requirements and assumptions) and not for the assurance of third parties.

4.2 Information - The valuer needs to obtain the following information from the investor:

- any specific characteristics of his enterprise or investment portfolio that will have any influence on the future cash flows generated by the real property that is being valued;
- the investor's investment criteria (such as a target rate of return or the duration of the investment);
- lease contracts;
- expected budgets for financial performance;
- licences;
- land register and cadastral documents;
- maintenance costs;

and, also, usually from others, information as to:

- market data related to the property;
- interest rates and expected changes;
- potential for disposal of the property;
- legal and development control issues affecting the property;
- current and prospective inflation.

4.3 Categories of Property

4.3.1 Investment properties can be assessed in three categories:

- properties held as investments for their performance as an asset for generating income and/or capital gains;
- properties which are in the course of development;
- properties held for future development.

4.3.2 Properties held as investments will normally include those where construction work has been completed and which are owned for the purpose of letting, producing a rental income which is negotiated at arm's length with third parties. Sometimes, they may be held to produce an income from its direct use by the investor.

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

4.3.4 Properties held for future development will include those acquired with the intention of redevelopment at some future date (with or without any other properties which have not yet been acquired) and which are not in either of the other two categories.

5. Method of Analysis

5.1 To assess Worth or Investment Value, the valuer would usually use the Discounted Cash Flow method or equivalent techniques. On occasion, the residual method may be appropriate.

5.2 Cash flows and costs are to be estimated over the period that the investor is expected to hold the property, taking into account all factors that could affect them. Having assessed the income and costs with the risks for both during the period when the property is to be held by the investor, the final item in the cash flow will be:

- for buildings held for leasing to third parties or for the investor's own use, the investor's expected receipt on the final sale of the property; or
- if the property is to be held by the investor until the end of its useful life, an assessment of the future market value, less selling costs, of the underlying land at that date where there are sound reasons (rather than unsubstantiated expectation) to suppose that changes in circumstances will lead to a change in its value in the market place; or
- if the property is to be sold by the investor before the end of its useful life, an assessment of its expected market value at the date of the future sale less selling costs.

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

5.4 The discount rate applied to future income and costs will be that chosen by the investor, reflecting his requirements.

EVA6

Cross-border Valuation

1. **Introduction**
2. **Scope**
3. **Qualification of Valuers**
4. **Professional Experience and Market Knowledge**
5. **Terms of Engagement**
6. **Compliance with Local Rules**
7. **Independence and Conflicts of Interest**
8. **Ethics**
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1. Introduction

1.1 With the globalisation of finance, opening world markets and the developing Single Market in the EU, clients are increasingly looking for property valuations across national borders. TEGoVA's Recognised European Valuer (REV) scheme assists clients and their valuers to identify qualified practising valuers in other countries who can be instructed to do this work. Equally, valuers themselves may have experience in valuing in other countries and be instructed to do this, perhaps most often where specific property markets now cross national borders. The different market circumstances, legislation and practice of each country mean that particular care should be taken when undertaking a valuation in another country.

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

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

1.4 EVA6 sets out the basic requirements with which valuers should comply if they intend to carry out property valuations in countries other than their own. These requirements are based on:

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

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

2. Scope

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

3. Qualification of Valuers

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

3.2 Holding specific relevant qualifications from recognised professional bodies and long term professional experience may further demonstrate these skills to clients.

4. Professional Experience and Market Knowledge

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

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

4.2 Valuers are required to secure and expand their knowledge of the host country property markets and property valuation by regular participation in professional development programmes organised by host country professional bodies or other qualified and recognised providers.

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

5. Terms of Engagement

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

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

6. Compliance with Local Rules

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

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

7. Independence and Conflicts of Interest

In order to avoid any conflict of interest and to uphold their professional objectivity, valuers must maintain strict professional independence of their clients in undertaking the work, so as to fulfil their professional responsibility, regardless of the valuers' personal situation.

8. Ethics

Valuers shall comply with the TEGoVA Code of Ethics and Conduct as required by their professional valuation association.

9. Insurance

Valuers are responsible for taking out and maintaining professional indemnity insurance sufficient for their potential liabilities to their clients and third parties in all countries in which they operate.

10. The Report

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

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

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

EVA7

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

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

1. Introduction

1.1 As a consequence of the financial crisis, the European Union adopted Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers providing regulation and oversight of entities engaged in the management and administration of alternative investment funds (AIFM). The Directive establishes a harmonized EU framework for monitoring and supervising the risk that AIFM pose to their investors, counterparties, other financial market participants and to financial stability.

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

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

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

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

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

1.7 The European Commission will adopt, on the basis of advice provided by the European Securities and Markets Authority (ESMA), measures specifying:

- the criteria concerning valuation procedures and the calculation of the net asset value per unit;
- the professional guarantees external valuers must be able to provide in order to perform the valuation function;
- the frequency of valuations carried out by open-ended AIFs.

1.8 ESMA delivered its advice on 16 November 2011.

2. Scope

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

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

3. Definitions

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

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

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

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

3.5 “*Net asset value*” is defined in EVA3 at 3.4 as a measure of the aggregate current value of assets, less all liabilities.

4. Statement of the Application

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

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

4.3 Valuations should normally be carried out on the basis of the Market Value of each property. If a valuer is instructed to value a real estate portfolio, each single property of the portfolio should be valued individually. Departures from European Valuation Standards should be recognized in the valuation report.

5. Commentary

5.1 General

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

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

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

5.2 Internal or External Valuation

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

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

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

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

- (i) is subject to mandatory professional registration recognized by law or to legal or regulatory provisions or rules of professional conduct;
- (ii) is requested to provide sufficient professional guarantees to be able to perform effectively the valuation function;
- (iii) shall not delegate the valuation function to another party.

5.2.5 In line with ESMA's advice the professional guarantees to be furnished should contain evidence of the external valuer's qualification and capability to perform the valuation with:

- (i) sufficient personnel and technical resources;
- (ii) adequate procedures safeguarding proper and independent valuation;
- (iii) adequate knowledge and understanding.

5.2.6 The valuer's liability is enshrined in the Directive. Article 19 par. 10 stipulates that the external valuer is liable to the AIFM for any losses suffered by the AIFM as a result of the external valuer's negligence or intentional failure to perform its tasks (see EVS3 for further guidance).

5.2.7 Valuers should be aware of the AIFM's obligation to notify their appointment to the competent authorities of their home Member State (Article 19 N°7 of the Directive). Member States can refuse the appointment and request the nomination of another valuer.

5.3 Valuation Frequency and Review of Individual Values

5.3.1 Although the Directive states the principle that non-financial assets have to be valued at least once a year, it is specified that the valuation of such assets of open-ended funds shall also be carried out at a frequency which is both appropriate to the assets and to its issuance and redemption frequency (see Article 19 N° 3 of the Directive).

5.3.2 This enables open-ended real estate funds to apply tailor-made regimes and increase the valuation frequency if relevant. This applies when the last determined value is no longer fair and/or proper. It is the valuer's task to consult the AIFM's internal policy and procedures for this purpose.

5.3.3 In the case of closed-ended funds, valuations shall also be carried out in case of an increase or decrease of the AIF's capital (Article 19 par. 3). In addition, individual asset values must be reviewed when evidence arises that they are no longer appropriate. This could be the case in volatile as well as in illiquid markets. The AIFM is required to hold systems suitable to process the validation of the AIF's asset values.

EVA8

Property Valuation and Energy Efficiency

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

1. Introduction

1.1 Energy is often one of the most significant costs of occupying property and one that has generally been increasing in recent years. The requirements of heating, lighting and, increasingly, air conditioning combine with the demands of services, from cooking to lifts, and the energy needs of the processes for which the building is used. Potential purchasers and tenants are usually interested, at least as a matter of practicality, in the availability and cost of suitable energy for their needs. Some may wish to demonstrate particular levels of efficiency or that the energy comes from renewable sources.

1.2 Buildings are held to account for 36 per cent of CO₂ emissions in the European Union and so energy concerns are now a major factor driving legislation affecting property. Both the EU and individual countries hope to influence property occupiers to change their behaviour, reduce consumption, improve efficiency and make greater use of renewable energy sources. In this, buildings distinctively have a much longer life cycle than equipment or systems. Many properties, particularly houses, are more than a century old and most of the housing stock in 2050 exists now.

1.3 Directive 2010/31/EU on the Energy Performance of Buildings develops the approach of its predecessor 2002/91. Its Preamble notes that:

“The sector is expanding, which is bound to increase its energy consumption” and so states that

“reduction in energy consumption and the use of energy from renewable sources in the buildings sector constitute important measures needed to reduce the Union’s energy dependency and greenhouse gas emissions”. (Recital 3)

“It is necessary to lay down more concrete actions with a view to achieving the great unrealised potential for energy savings in buildings and reducing the large differences between Member States’ results in this sector.” (Recital 7)

1.4 The professional valuer is to report his opinion as to the value of the property under his instructions to the client on the basis of the evidence available to him. That will include the evidence of values from the market place. That is essential to the concept of “market value”. Energy costs and efficiency will be one part of this matrix and so one of many issues for the valuer.

2. Scope

This Application applies to consideration of energy efficiency issues in the valuation of property and particularly to the effect of the measures to be taken by EU member states under Energy Performance of Buildings Directive 2010/31/EU. The Commentary here is based on the Directive. Valuers should be aware that while member states are bound to implement the Directive they are free to set higher standards.

3. Definitions

3.1 The definitions cited here are, unless otherwise stated, drawn from Energy Performance of Buildings Directive 2010/31/EU (referred to hereafter as “the Directive”).

3.2 “*building*’ means a roofed construction having walls, for which energy is used to condition the indoor climate;” (Article 2(1))

Note - This definition excludes a number of structures that might normally be referred to as buildings, particularly those where no effort is made to heat or cool them, from the energy performance standards and Energy Performance Certificate (EPC) regimes.

3.3 “*energy performance certificate*’ means a certificate recognised by a Member State or by a legal person designated by it, which indicates the energy performance of a building or building unit, calculated according to a methodology adopted in accordance with Article 3;” (Article 2(12))

3.4 “*energy performance of a building*’ means the calculated or measured amount of energy needed to meet the energy demand associated with a typical use of the building, which includes, inter alia, energy used for heating, cooling, ventilation, hot water and lighting;” (Article 2(4)).

3.5 “*nearly zero-energy building*’ means a building that has very high energy performance as determined in accordance with Annex 1. The nearly zero or very low amount of energy required should be covered to a very significant extent by energy from renewable sources, including energy from renewable sources produced on site or nearby;” (Article 2(2)).

3.6 “*technical building system*’ means technical equipment for the heating, cooling, ventilation, hot water, lighting or for a combination thereof, of a building or building unit;” (Article 2(3)).

4. Statement of the Application

4.1 The professional valuer is to report his opinion as to the value of the property under his instructions to the client on the basis of the evidence available to him. The energy efficiency of a building may be relevant to a property’s value but with the associated energy costs will be only one part of this assessment.

4.2 Where a valuation is being prepared in a context to which construction, sale, or lease to a new tenant is relevant, then the EPC rating and any salient recommendations it may make should be reported and, as the valuer judges appropriate, taken into account in the valuation.

4.3 In particular

- when considering a property with an energy performance certificate, the valuer will take account of the rating and recommendations so far as relevant, reflecting market circumstances, in providing his opinion as to the value of the property on a recognised basis of valuation;
- when asked to advise on or assist with the determination of whether works constitute a “major renovation” in a member state that has adopted the option based on cost and value, the valuer when so instructed should:
 - (i) judge whether the renovation required by the building is sufficient to trigger any upgrading of the building’s required minimum energy performance as a consequence;
 - (ii) according to the valuer’s skills and instructions, estimate, obtain a reputable estimate or advise the client to obtain an estimate for the cost of that upgrading so that the client may make an informed decision.

5. Commentary

5.1 General

5.1.1 Among its measures most relevant to valuations of property, the Directive requires member states to establish:

- integrated energy performance standards, based on both the thermal characteristics of each building and its renewable energy systems, to be:
 - set by each member state for all buildings; and
 - enforced not only for new buildings and but also for existing buildings subject to a “major renovation”; and
- energy performance certificates (EPCs).

Alongside those, it requires that by 2021 all new buildings meet a “nearly zero-energy use” requirement and imposes a regime for the regular inspection of larger heating and air conditioning systems with resulting recommendations.

5.1.2 The valuer will need to understand the provisions applying in the member state where the property is situated.

5.2 New Buildings - Nearly Zero-Energy

5.2.1 “Member States shall ensure that:

- a. by 31 December 2020, all new buildings are nearly zero-energy buildings; and
- b. after 31 December 2018, new buildings occupied and owned by public authorities are nearly zero-energy buildings.”

Article 9(1)

5.2.2 This is a strict obligation although Article 9(6) allows member states not to apply it in “specific and justifiable” cases where the cost-benefit analysis over the economic cycle of the building in question is negative.

5.3 Existing Buildings and “Major Renovation”

5.3.1 While energy performance standards are to be set for existing buildings, the Directive does not require their enforcement save when this is triggered by a “major renovation”.

5.3.2 “Major renovations” - The Preamble points out that “Major renovations of existing buildings, regardless of their size, provide an opportunity to take cost-effective measures to enhance energy performance.” (Recital 16).

5.3.3 “Member States shall take the necessary measures to ensure that when buildings undergo major renovation, the energy performance of the building or the renovated part thereof is upgraded in order to meet minimum energy performance requirements ...” (Article 7).

5.3.4 A valuer could be instructed by a client concerned as to whether proposed works amount to a “major renovation” with the consequent requirement under the Directive to meet current energy performance standards. The Directive sets out two options from which each member state is to select its tests to determine whether works are a “major renovation”:

“major renovation” means the renovation of a building where:

- a. the total cost of the renovation relating to the building envelope or the technical building systems is higher than 25% of the value of the building, excluding the value of the land upon which the building is situated; or
 - b. more than 25% of the surface of the building envelope undergoes renovation.
- Member States may choose to apply option (a) or (b).” (Article 2(10)).

5.3.5 Where a valuer is required to advise on this he should know which option has been chosen in the relevant member state.

5.3.6 It may be a matter of interpretation in the light of the facts of any case whether an extension amounts to a renovation (which in the absence of any further definition, is assumed to be limited to its usual meaning).

5.3.7 For option (a), the Directive does not specify the basis on which “value” is to be assessed – by default, it is assumed to be “market value” assessed in accordance with EVS1 unless there is good reason to adopt another basis (though the Directive’s Recital 16 does refer to both its “actuarial value” and the cost of reconstruction as possible bases). The tenure of the building does not seem to be relevant to this assessment. It is a comparison of the cost of the proposed work with the value of the building, having excluded the value of the land under the building. The test does not ask for an apportionment of value but the exclusion of the value of the land. That would mean that in most cases, this test appears to require two valuations for any building that would ordinarily be sold with its underlying land:

- one of the building as it would be sold with the land;
- another of the underlying land without the building (likely to be with the benefit of any development value).

The resulting net figure is then to be compared with the cost of the proposed works. As cost is a different concept from value, especially for the adaptation of buildings, this test may often require the upgrading of the energy performance of the building where the value added by the work is less than 25 per cent of the apportioned value of the building.

5.3.8 Option (b) appears to require an assessment of:

- the total external area of the building, including its walls and roofs; and
- how much of that area would be subject to the renovation.

This might mean that a purely internal renovation would not be caught by option (b) but be caught by option (a).

5.3.9 If the renovation proves to be “major” under the test adopted by the member state, the Directive gives each member state the freedom to decide whether it is the whole building or just the renovated part of it that is to be upgraded to minimum energy performance standards. The valuer should be aware of the local rules pertaining to this.

5.3.10 As option (a) turns on value, where this option is selected by the member state, the valuer when so instructed should:

- (i) judge whether the renovation required by the building is sufficient to trigger any upgrading of the building’s required minimum energy performance as a consequence;
- (ii) according to the valuer’s skills and instructions, estimate, obtain a reputable estimate or advise the client to obtain an estimate for the cost of that upgrading so that the client may make an informed decision.

5.4 Energy Performance Certificates (EPCs)

5.4.1 An EPC is to record an assessment by an approved inspector of the energy efficiency of a building using a standard rating basis and making comparisons and advisory recommendations for its improvement. The rating will summarise in one letter or number the building’s thermal characteristics and the extent of the building’s reliance on energy from renewable sources, following Energy from Renewable Sources Directive 2009/28/EC. An EPC cannot be valid for more than ten years. Certificates issued under the previous 2002 Directive remain valid. The reported efficiency rating is to be shown in advertisements marketing the property and the EPC is to be given to the prospective purchaser or tenant.

5.4.2 Having a valid EPC is a legal requirement for the construction, sale, or lease to a new tenant of most buildings and for all buildings occupied by public authorities with a useful floor area of over 500m². “The energy performance certificate or a copy thereof is shown to the prospective new tenant or buyer and handed over to the buyer or new tenant.” (Article 12(2)).

5.4.3 The policy purpose of the EPC in informing the property market is described in the Directive's Recital:

"The prospective buyer and tenant of a building or building unit should, in the energy performance certificate, be given correct information about the energy performance of the building and practical advice on improving such performance ... The energy performance certificate should also provide information about the actual impact of heating and cooling on the energy needs of the building, on its primary energy consumption and on its carbon dioxide emissions." (Recital 22).

5.4.4 Is an EPC Needed? - When considering a building as part of valuing a property the valuer may usually wish to determine whether an EPC is required for it and, if so, that a valid one has been obtained.

5.4.5 Subject to the exceptions noted below, an EPC is mandatory for:

- Buildings that are:
 - constructed
 - to be sold
 - to be rented to a new tenant
- Buildings occupied by a public authority and frequently visited by the public. The minimum size of 500m² is reduced to 250m² from 9th July 2015.

Member states may defer the application of EPCs to single building units (such as flats in a building) that are rented out until 31st December 2015.

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

5.4.7 Buildings Not Needing EPCs - With the Directive's definition of a building, an EPC is not required for buildings where no effort is made to alter the climate. These are outside the EPC regime. These might include some storage and many agricultural buildings.

5.4.8 Member states are also free to exempt the following categories of buildings from the obligation to issue an EPC:

- a. buildings officially protected as part of a designated environment or because of their special architectural or historical merit, in so far as compliance with certain minimum energy performance requirements would unacceptably alter their character or appearance;

Note - This exclusion is only as far as compliance would change the character or appearance of the building as perhaps where a historic building's appearance would be altered by double glazing or external insulation.

- b. buildings used as places of worship and for religious activities;

Note - Buildings used for religious activities might include such places as monasteries and facilities for ritual purification. It would not appear to matter that such buildings may also have other uses.

- c. temporary buildings with a time of use of two years or less, industrial sites, workshops and non-residential agricultural buildings with low energy demand and non-residential agricultural buildings which are in use by a sector covered by a national sectoral agreement on energy performance;

Note - This exclusion appears to come in three parts:

- Temporary buildings might include those used on construction sites and for specific events as well as those on temporary planning permissions.
- It appears that the "low energy demand" exclusion not only applies to non-residential agricultural buildings but also qualifies industrial sites and workshops. "Low energy demand" is not defined in the Directive. Some member states may do so.
- Sectoral agreements on energy performance covering agricultural buildings are most likely to apply to pigs, poultry and some horticultural enterprises.

- d. residential buildings which are used or intended to be used for either less than four months of the year or, alternatively, for a limited annual time of use and with an expected energy consumption of less than 25% of what would be the result of all-year use;

Note - This is most likely to cover seasonal housing, whether for holidays or work.

- e. stand-alone buildings with a total useful floor area of less than 50 m².

5.4.9 When valuing a building which might fall into one of these categories, the valuer should, where relevant, check whether it is exempted from the energy performance certification (and also the renovation requirements discussed above) in the jurisdiction in question.

5.4.10 Using an EPC - The Directive does not create a common format for the EPC throughout the EU. EPCs vary between member states, and sometimes within them. The Directive does instruct the European Commission to adopt a voluntary EU certification scheme for non-residential buildings (Article 11(9)). Valuers may thus see EPCs in different national formats as well as those under the voluntary common EU scheme.

5.4.11 Where a valuation is on the basis of market value (see EVS1) or relevant for the purposes of sale or lease to a new tenant of a qualifying building, it should take account of a valid current EPC. These circumstances would usually include a valuation for secured lending as the mortgagee is also commonly interested in the disposal value

of a property. The weight, if any, given to the EPC will be a matter for the professional skill of the valuer. It may be that in some countries there will in time be additional requirements for or liabilities on the sale or letting of properties with a poor EPC rating.

5.4.12 The valuer should see the EPC (recording its supplier, registration reference, reported energy rating and expiry date) and establish that it is a current one for the purposes of the instructed valuation. The relevance of an EPC may be affected by any changes to the building since it was issued.

5.4.13 Where an EPC is required, the reported efficiency rating may have an impact on value. The valuer is to judge that from his knowledge of the market place.

5.4.14 The valuer should advise the client where an EPC is not available or trustworthy and assess the situation for his report as seems appropriate in the circumstances and available knowledge.

5.4.15 The potential for buildings to have their energy efficiency upgraded by “retro-fitting” may be recognised in their market value. Equally, where that work would be more expensive, its potential cost may depress values. In such circumstances, the valuer may judge the significance and impact of the recommendations made by the EPC to improve the efficiency of the building.

5.4.16 It will be for the valuer’s professional judgment to determine whether and how anything more than the fact of the EPC is reported in the valuation.

5.4.17 Any significant recommendations in reports on technical building systems may also be taken into account where relevant.

5.4.18 The valuer may on occasion be instructed to assist the client in obtaining maximum value from the EPC. The valuer should only do so if it is within his professional competence. If the valuer undertakes this task, its purpose is to use the analysis of the EPC to help the client in forming a judgment on his possible approaches to the issues raised. Common key points in this may include:

- the energy rating reported for the building (on a scale either from A to G or 0 to 100);
- the annual energy demand;
- the cost of that annual energy use;
- comparison with current relevant standards;
- the condition of the technical systems in the building;
- the efficiency improvement measures recommended by the EPC
- with their associated costs and returns; and
- any other value that may be achievable by a different rating if, according to any national rules, it makes it possible to sell or let a property more easily.

5.4.19 The valuer will take account of the rating and recommendations so far as relevant, reflecting market circumstances, in providing his opinion as to the value of the property on a recognised basis of valuation.

PART 2

EUROPEAN UNION LEGISLATION AND PROPERTY VALUATION

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Caution – This text is prepared as a brief, general review of EU legislation as it may apply to property. It is intended to offer general assistance to valuers in their professional capacity – not in any other role, including the ownership of property – and is based on an understanding of the law as at January 2012.

It cannot be exhaustive or dwell on specialist areas. Where an issue is relevant to a valuation, the valuer should seek further specific and better information on appropriate points.

In particular, it is a review of EU legislation, mainly by Directive which means that Member States will generally have used their own legislation to implement it. It is thus likely that there will be local features of significance as well as interactions with other domestic law.

1. General Introduction

1.1 European Union (EU) legislation has an increasingly important impact on the use, management, associated costs and development opportunities of property and so on its value. In some cases, it makes specific provisions to that valuation.

1.2 While the founding treaties of the EU do not touch on property law or land tenure, a sensitive area left to member states, their general economic provisions have an impact on property. Thus, from a relatively early stage EU law on company accounting bore on the valuation of property for the financial accounts of relevant companies. This has been developed for lending institutions by successive Capital Requirements Directives.

1.3 Similarly, while real estate, being 'immovable', is not subject to EU law ensuring the free movement of goods within the European Union, the EU Treaty and legislation do ensure the free movement of capital and so the ability to buy or sell property anywhere in the EU.

1.4 Again, while housing policy is not covered, the EU is active in legislating in a growing number of policy areas that affect property markets and professions. These include energy efficiency, environmental protection, discrimination by landlords, unfair contract terms, regulation of retail services including shopping centre development, work site safety, construction products, construction and building-related cartels, state aid to social housing companies competing for middle-income tenants, mortgage credit, capital requirements for mortgage lending, financial market reform, reduced rates of VAT on renovation and repair of housing, and money laundering. Just some of these are reviewed in this chapter.

1.5 While taxation is also left to member states, EU directives provide a common framework for Value Added Tax. This has a specific regime for interests in property based on their exemption and the ability to waive it. This affects transactions and has consequences for those who cannot fully recover VAT.

1.6 The EU's State Aid rules have increasingly regulated public bodies in all manner of activities to limit distortions in the market place. These include rules for the valuation of property.

1.7 Over the last three decades, two particular areas of EU policy have developed enormously in ways that affect property:

- the Internal Market programme
- environmental policy.

Throughout this period the Common Agricultural Policy has had an effect on rural property.

1.8 The Internal Market programme for the free movement of goods and services, labour and capital throughout the European Economic Area (the EEA; that is, the EU with Iceland, Liechtenstein and Norway). Its legislation is supervised by the European Court of Justice (ECJ) and decided cases show how this programme can drive changes in areas of policy otherwise apparently outside the EU's formal competence – as, for example, the *Jäger* (C-256/06 [2008]) case has led to changes in the treatment of property for taxation by both Germany and the United Kingdom so that domestic tax legislation was no longer an impediment to the free movement of capital.

1.9 The Treaty of Rome had from the beginning sought to promote a single market in goods and services, labour and capital. This underlay the legislative emphasis on harmonisation of standards and rules to enable fair competition, less distorted by national action.

1.10 The concept was developed radically by the Internal Market programme under the Single European Act of 1987 giving a powerful stimulus to intra-Community trade and allowed new economic patterns to be created across national borders.

1.11 The substantive creation of the Single Market (now the Internal Market) has had an impact on property markets, both in terms of the demand for property and the availability of finance for property. In turn, this has affected matters relevant to valuations. Its spirit and rules also influence legislation bearing on property.

1.12 The substantial removal of borders between member states for the free movement of capital has reshaped patterns of demand for all real property, both commercial and residential.

1.13 Cross-border property investment has increased sharply from insignificant levels in the mid-nineties and, even after the financial crisis and the accompanying general decline in investment, stood at €36.2 billion in 2010 (€21.4 billion intra-EU and a further €14.8 billion from outside the EU; Source: DTZ Research). While initially the preserve of large, often listed, property investment companies and funds concentrating

on prime assets in capital cities it has developed to involve smaller property companies investing in niche markets as well.

1.14 In implementing the Internal Market policy, the Services Directive (Directive 2006/123 on services in the internal market) was the formal instrument for opening the EU market for services. This includes valuation services, so that they can be provided in other member states. However, most 'cross-border' valuation work is done by *local* valuers with their specialist knowledge servicing *foreign* investors, i.e. it is the foreign investor who provides the cross-border element, rather than the valuer. These investors operating often for the first time in an unfamiliar market are in particular need of local valuers qualified to a recognised European standard. In this context, TEGoVA's Recognised European Valuer (REV) scheme also gives a ready means for those who need valuation services in another country to identify qualified practising valuers to provide valuations in that other state.

1.15 The increasing importance of the EU in driving **environmental policy and the response to climate change** is affecting policy on resource protection, energy issues, water, pollution (including for example asbestos) and bio-diversity. Much of this affects property. Section 5 below reviews the main regimes as they may be relevant to property but there are provisions that will apply to individual sectors and arise from the control of particular chemicals or issues which may be pertinent to specific properties.

1.16 At first, this was driven by concerns to ensure a safe environment, stimulated by incidents such as the exposure in 1976 of the population of Seveso and neighbouring settlements near Milan to dioxins following an incident at a chemical manufacturing plant. This concern was evidenced by, for example, drinking water legislation. Increasingly, now, property is seen not only to pose key problems of consumption and inefficiency to be tackled in these areas but perhaps also to offer solutions in terms of land management, climate change mitigation and renewable energy.

1.17 Policy on the protection of species of flora and fauna can affect both the potential for and costs of development. The classification of land for nature conservation and for subsidy purposes also has an influence on valuation of relevant property.

1.18 From almost the earliest days of the European Union, the **Common Agricultural Policy** has affected much rural property. At first, this influence was indirect through intervention in the market for produce, supporting prices, but it has since developed both as a support policy that has increasingly been available through a defined relationship with and use of specific land and with rural development policy.

1.19 Throughout, the impact of legislation on property is generally twofold:

- where it applies to activity on an area or site specific basis, creating opportunities or imposing limitations according to location; and

- where it applies to property or activities closely associated with its ownership, occupation or use.

1.20 The European Union's emerging role in economic policy may have a larger influence on the property market. The developing framework for EU/Eurozone Economic Governance involves procedures to co-ordinate national economic and budgetary policies, so influencing the wider macro-economic background. More specifically, Commission proposals include increasing the taxation of property, especially higher value property, to ease the taxation of labour. Measures could include moving the taxation of housing from transactions to a recurrent basis, and reviewing the tax deductibility of mortgage interest payments. Volatility in house prices is seen as an issue for a number of member states and those in the Eurozone could be fined if they do not address it.

The Nature of EU Legislation

1.21 Much of this common framework and increasing influence is not directly evident to many who are active in their local marketplaces.

1.22 Most of the EU legislation reviewed here has been made by Directives which require member states to implement them by their own legislation. Once a Directive is agreed it is, for member states, "binding as to the result to be achieved". The force of this was shown in the ECJ decision in *Commission v UK (C-337/89 [1992])* finding that compliance with the Drinking Water Directive was an absolute obligation – it was not sufficient to take all practical steps. Where a Directive prescribes an outcome, such as a particular quality of water, that outcome has to be achieved (*Commission v UK (C-56/90 [1993])* on the Bathing Waters Directive). The effect of a Directive will, thus, depend on how it is drafted. Determining whether a member state has complied with a more general "framework" Directive which does not specify outcomes so closely may turn more on the approach it has taken (see *Commission v Italy (C-365/97 [2003])* – the San Rocco Valley case).

1.23 Further, the ECJ ruled in *Marleasing SA v La Comercial Internacional de Alimentación (C-106/89 [1991])* that national legislation must be interpreted to suit the purpose of the directive:

"in applying national law, whether the provisions in question were adopted before or after the directive, the national court called upon to interpret it is required to do so, as far as possible, in the light of the wording and the purpose of the directive in order to achieve the result pursued by the latter."

1.24 While EU Regulations apply directly in member states, they are frequently covered by domestic legislation. Sometimes this is for the purposes of effective

implementation, supplying further operational matters.

1.25 In some cases, the European requirements will interact with other existing domestic regimes or be implemented alongside other domestic measures.

1.26 Although much EU legislation is applied through national laws, that does not detract from the key place of the EU as the source of much that affects the valuation of property. This role, one that has grown and seems likely to develop substantially, needs to be understood clearly.

1.27 Where an EU Directive or Regulation is relevant to the valuation of a property, the valuer will need to refer to and understand the appropriate national or local detailed provisions implementing the underlying EU legislation. With the range and scale of EU legislation, this text cannot be exhaustive in its review of the Directives and Regulations that may affect the valuation of specific properties but outlines the major areas that may more commonly be met.

2. The EU Internal Market

A. Internal Market - Provisions on the Valuation of Property

A.1 Valuation of Property for Company Accounts

2.1 The requirements of European legislation in valuing property for reporting in company accounts have been referred to in Part I at EVA1.

2.2 Directive 78/660 applying to the annual accounts of public companies (but not financial institutions and insurance companies) outlined the basic requirements of the recognition of assets. These were originally to be valued on the basis of the cost at which they were purchased or produced. The valuer is to report the method he has used. Any different approach driven by national law was to be disclosed.

2.3 That approach was:

- extended to consolidated accounts by Directive 83/349;
- applied to banks and other financial institutions by Directive 86/635;
- applied to insurance undertakings by Directive 91/674.

2.4 In the case of insurance undertakings, current value could under 91/674 be assessed on the basis of "market value" defined as

"... the price at which land and buildings could be sold under private contract between a willing seller and an arm's length buyer on the valuation date, it being assumed that the property is publicly exposed to the market, that market

conditions permit orderly disposal and that a normal period, having regard to the nature of property, is available for the negotiation of sale."

This is discussed at EVS1 4.3 above.

2.5 These directives have since been amended a number of times (see Legislation section below) with the more significant being:

- Directive 2001/65 for public companies and banks allowing valuations to be at "fair value"
- Regulation 2909/2000 providing that for the accounting of non-financial fixed assets:

"The market value of an asset shall be the price which a buyer would be prepared to pay for it, having due regard to its condition and location and on the assumption that it could continue to be used."
- Regulations 1606/2002 and 1725/2003 provide that from 2005 all consolidated accounts of listed companies must be prepared in accordance with international accounting standards. These are not only International Accounting Standards (IAS) but also International Financial Reporting Standards (IFRS) and Standing Interpretations of these.
- Directive 2003/51 amended the four main Directives above and allowed "fair value" generally as a basis of valuation.

2.6 The concept of "fair value" is reviewed at EVS2. It can have a different meaning for accountants to that understood by valuers.

Legislation

Fourth Directive on the annual accounts of certain types of companies 78/660

Seventh Directive on consolidated accounts 83/349

- These Directives are amended by Directives for:
 - The exemptions for small and medium sized companies and publication of accounts in ecus 90/604
 - The extension of company types 90/605
 - Statutory audits of annual accounts and consolidated accounts 2006/43 amended by 2008/30

Directive on the annual accounts and consolidated accounts of banks and other financial institutions 86/635

- Amended by Commission Recommendation 2000/408 – Disclosure of information on financial instruments and other items

Directive amending Directives 78/660/EEC, 83/349/EEC and 86/335/EEC with regard to the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions - 2001/65

Directive on the annual accounts and consolidated accounts for insurance undertakings 91/674

Directive amending Directives 78/660/EEC, 83/349/EEC, 86/335/EEC and 91/674/EEC with regard to the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions 2003/51

Regulation 2000/2909 on the accounting management of non-financial fixed assets

Regulation 2002/1606 on the application of international accounting standards

Regulation 2003/1725 adopting certain accounting standards in accordance with 1606/2002

A.2 Valuation of Property for Financial Institutions

Credit Institutions

2.7 The international Basel agreements in seeking to impose a prudent framework for banking require lending institutions to hold capital and set out how this is to be calculated. The amount needed is assessed with a ratio for each class of available capital according to its nature. They thus make specific provision for the approach to setting values for this purpose on property on which lending has been secured.

2.8 The EU has also addressed these issues in successive Capital Requirements Directives, most recently Directive 2006/48 as amended (and now being recast). This has been considered at EVS1 4.2 in Part I above.

2.9 This regulates credit institutions and so provides the framework for their operation in the internal market. It applies the requirements of the Basel agreements. Given the stress that that places on the valuation of assets:

- it provides the definitions of “market value” set out in EVS1 at 4.2.1 and of “mortgage lending value” set out in EVS2 at 7, both in Part I above.
- it defines an “independent valuer” – see EVS3 5.3.5 in Part I above.

2.10 In some roles, valuers may find TEGoVA's Property and Market Rating to be a helpful tool (see Part 3 below).

Legislation

Directive on the taking up and pursuit of the business of credit institutions 2006/48/EC Amended by Directives 2007/18/EC, 2007/44/EC, 2007/64/EC and 2008/24/EC

Directive on the capital adequacy of investment firms and credit institutions 2006/49

Other Institutions

2.11 The new Alternative Investment Funds Directive introduces rules for the valuation of assets held by hedge funds (including real estate funds) and other similar institutions. These are to be assessed on a net asset value basis, discussed in EVA7 in Part 1 above.

Legislation

Alternative Investment Fund Managers Directive 2011/61

A.3 Valuation of Property for State Aid Rules

2.12 EU policy is to promote an open internal market. To this end, it has sought to regulate the extent to which governments and public bodies can use subsidy, both express and implied, as a protectionist tool, distorting the free operation of that market. The State Aid rules have been a major part of this policy, providing a legal framework in which such actions in member states can be regulated, approved or forbidden. Effective throughout the EEA, they have been used to regulate the valuation of property, the methods for disposing of property and the management of state owned or subsidised property.

2.13 State Subsidy for Social Housing - That last point is illustrated by the Commission's intervention in both the Netherlands and Sweden to limit the ability of social or municipal housing providers to offer state subsidised unused properties for rent on the open market and so compete unfairly with the private sector for tenants – seen as using state subsidy to invest in commercial property.

2.14 Under the Commission Decision of 14th July 2005, the Dutch state may only subsidise housing bodies that cater for socially disadvantaged households and, as a result, the Dutch government set a €37,000 income cap on households entitled to social housing. As the Dutch social housing companies had also been using excess state aid capital to invest in commercial property, the Commission also decided that any commercial exploitation of public service activities must take place under market conditions.

2.15 In Sweden, under the 'utility value' system, private sector rents were effectively set at the levels of comparable municipal flats, yet only the municipal housing companies were receiving state aid and they were competing with the private sector for the same tenants. Informal action by the Commission under the State Aid rules brought the system to an end in 2011. (Source: European Property Federation)

2.16 Valuation of Public Property - EU State Aid rules also provide a basis on which public property is to be valued for disposal so that no question of a state aid is seen to arise, whether by being sold at an undervalue or to favoured buyers. These rules are discussed at EVS1 4.3 and through its section 5 in Part I above.

2.17 The rules use the same definition of "Market Value" as Directive 91/674 (accounts for insurance undertakings):

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

2.18 They define the qualifications of an asset valuer suitable for this purpose – see EVS3 4.2 and 5.3.6 in Part I above.

Legislation

Commission Communication 97/C 209/03 on State Aid Elements in the sale of land and buildings by public authorities.

B. Internal Market - Taxation Legislation

B.1 Value Added Tax (VAT) and Property

2.19 VAT, a tax on the value added in the supply of goods and services, is a fundamental aspect of the operation of the EU and its adoption is a key part of the accession process for new member states. It is the one tax administered on a national basis by member states for which the EU expressly provides a common framework albeit that it does not operate as an EU-wide tax. That framework of EU legislation provides a common underlying structure for the way VAT is applied, its exemptions and the rates, though the detail of its implementation within this framework varies between member states. Disputes over VAT are ultimately referred to the European Court of Justice whose decisions (alongside the Directives and Regulations) govern what member states can do.

2.20 Property is often the second or third largest cost for a business; buying or selling a property may be the largest transaction a business makes. While salaries and finance are not subject to VAT, where VAT is levied on a transaction in property it can be a significant factor in several ways:

- while most businesses can fully recover VAT on qualifying inputs it is still a pressure on cash flow;
- where a party to a transaction is not registered for VAT it cannot recover it on inputs. Aside from consumers that is often also a factor for financial and other businesses whose outputs are deemed to be exempt;
- it is a complex area of legislation with much case law, making it important to understand how VAT will treat each transaction. As the volume of case law shows, this is not always possible, adding to the uncertainty and potential risk in some situations.

2.21 VAT was first instituted by directive in 1967 (Directive 67/227). The current EU legislation is the Seventh VAT Directive 2006/112 though many of the ECJ cases referred to here were decided under its predecessor, the Sixth Directive 77/388.

2.22 The Directive contains specific provisions as to the identification of value where this is needed (see EVS1 4.4 in Part I above).

2.23 The VAT Directive makes specific provision for interests in property, through exemptions and reduced rates.

2.24 Exemptions - The exemption of sales, leases and other equivalent transactions in property from VAT is provided for by Article 135(1) at:

- (j) the supply of a building or parts thereof, and of the land on which it stands, other than the supply referred to in point (a) of Article 12(1);
- (k) the supply of land which has not been built on other than the supply of building land as referred to in point (b) of Article 12(1);
- (l) the leasing or letting of immovable property.

The equivalent provision of the Sixth Directive was at Article 13(B). While the references to Article 12 exclude new buildings from the exemption (making them taxable), Article 371 gives a “transitional” right to member states to retain exemption from VAT for new buildings and building land for the time being and Article 370 allows the retention of taxation of other buildings – position upheld by the ECJ in *Norbury Developments Ltd* (C-136/97).

2.25 Under Article 137 the exemptions given by Article 135(1)(j) to (k) can be waived if the member state provides for this and the taxpayer then makes the necessary election. Where that exemption is waived VAT will be chargeable on the supply of property by sale, lease or equivalent transactions, including the surrender and assignment of leases. Where a business makes both VATable and exempt supplies it falls under the partial exemption rules in calculating the VAT that it can recover on its inputs.

2.26 It may be difficult in some situations concerning property to assess whether the transaction involves a single supply or separate supplies with possibly different VAT treatments. Tests for determining this were laid down by the ECJ in *Card Protection Plan* (C-349/96 [1999]):

- is there a single service whose economic purpose would make it artificial to split?
- is the essential feature of transaction a single supply?
- are some elements ancillary to the main purpose of the supply? They will be ancillary if they do not constitute a separate purpose for the customer but rather a means of better enjoying the service supplied.

Where there is a single supply involving land and the land predominates, the whole transaction may be exempt but, if the sale or lease of land is found on these tests to be ancillary to a taxable supply, it may be treated in accordance with the VAT status of that supply.

2.27 Reduced Rates for Works to Property - Directive 2009/47/EC amended the Sixth VAT Directive to allow member states the freedom to adopt reduced VAT rates (as low as 5 per cent) on a small number of items, including “renovation and repair of private

dwellings, excluding materials which account for a significant part of the value of the service supplied". (Article 106 and Annex IV (2) of the Seventh Directive).

2.28 This is an option which each member state can take up or not. Valuers should be acquainted with the rate in the state in which they are carrying out the valuation.

2.29 As an exception to the formal architecture of the Sixth Directive, its Article 110 allows member states to retain those exemptions or reduced rates that they were applying on 1st January 1991. In at least some member states, these may relate to property or works on property while the Directive also makes a limited number of specific national exceptions.

2.30 Property Valuation and VAT - The valuer should understand or seek instruction on the VAT status of the property being valued where this is relevant. Is it exempt or has the exemption been waived? If it is subject to tax what rate of VAT would apply to transactions? With the significant rates of VAT applicable in many countries, failing to recognise the impact of VAT, especially in markets where some buyers are not able to recover it fully or at all, could prejudice the valuation.

VAT and the Supply of Land and Buildings

2.31 A supply naturally includes a clear disposal but Article 15(2) also allows member states to treat the following as a supply of goods:

- (a) certain interests in immovable property;
- (b) rights in rem giving the holder thereof a right of use over immovable property;
- (c) shares or the equivalent to shares giving the holder thereof de jure or de facto rights of ownership or possession over immovable property or part thereof."

2.32 Meaning of "land" and "buildings" There are differences between member states as to whether buildings can be owned independently of the land under them. In this context, "land" is undefined but appears not to include buildings as they are given their own exemption. However, the exemption of Article 135(1)(k) for the supply of buildings does include the land on which they stand. Article 12(2) defines a "building" to be "any structure fixed to or in the ground".

VAT and Leases

2.33 Article 135(1)(l) (previously 13(B)(b) of the Sixth Directive) requires member states to exempt the "leasing or letting of immovable property" under conditions that they are to determine. As this is an important distinction in tax treatment of property it has led to a number of ECJ cases.

2.34 What is a Letting for EU Law? Consistent with the *Marleasing* ruling, ECJ decisions are clear that this is a concept to be analysed under European Union law, not the varied national property legislation of member states. This can be particularly problematic in an area as individual between members states as land law.

2.35 Some light may be cast on the meaning of “leasing or letting” by the four exceptions in Article 135(2) to the exemption of Article 135(1)(l):

- (a) the provision of hotel accommodation in the hotel sector and in sectors with a similar function including holiday camps and camping sites;
- (b) the letting of premises and sites for parking vehicles;
- (c) lettings of permanently installed equipment and machinery; and
- (d) hire of safes.

These are liable to VAT. While they may not extend the exemption, member states are allowed to add further exclusions from it even to the point where the ECJ approved Spain making all leasing and letting taxable except for residential property (*Miguel Amengual Far v Juan Amengual Far* (C-12/98)). As these exceptions would, from their context, otherwise fall within the “leasing or letting of immoveable property” they have been found to offer assistance in interpreting that phrase, as discussed below.

2.36 The ECJ noted in *Stichting Goed Wonen* (C-326/99 [2001]) that the recital to the Sixth Directive stated the aim of collecting the Community’s resources in a uniform manner in all member states: “exemptions must constitute independent concepts of Community law”. The Advocate General’s Opinion in *Maierhofer v Finanz Augsburg-Land* (C-315/00 [2003]) was that these exemptions should “have their own meanings which must in principle be independent of the civil law concepts of individual member states”. In particular, he said that “the term used to specify the exemption in Article 13B(b) must be given a Community definition”.

2.37 In *Breitsohl* (C-400/98), the ECJ commented in passing that: “the concept of ... land cannot be defined by reference to the national law applicable to the main proceedings, given the purpose of the Sixth Directive, which is aimed at determining the basis of VAT in a uniform manner according to Community rules. Such a concept which contributes to determining the persons who may be regarded by Member States as taxable persons by virtue of Article 4(3)(a) of the Directive, must therefore be interpreted in a uniform manner in all Member States.”

This case concluded that the exemption or option to tax would apply to land and the buildings on it together – they could not be treated separately.

2.38 Is the property immoveable? In *Maierhofer* prefabricated buildings had been bolted onto a concreted area of land and then leased for use as temporary housing for asylum seekers. The buildings could be dismantled by eight persons in ten days and then re-erected elsewhere. The Advocate General held that these buildings were

securely fixed to the ground. The final ECJ judgment itself said:

“The answer to the Question must therefore be that the letting of a building constructed from prefabricated components fixed to or in the ground in such a way that they cannot be either easily dismantled or easily moved constitutes a letting of immoveable property for the purposes of Article 13B(b) of the Sixth Directive, even if the building is to be removed at the end of the lease and re-used on another site.”

The terms of the lease were not decisive in this. *Maierhofer's* facts were distinguished from those of *EC Commission v France* C-60/96 [1999] where caravans, tents, mobile homes and light framed structures were held to be moveable. In the Dutch case, *Coffeeshop Siberie* (C-158/98), the Advocate General felt that the renting of a table in a coffee shop for the sale of narcotic drugs did not amount to the letting of immovable property.

2.39 A consequence of *Maierhofer* is that the leasing of fixtures, if on particular facts held to be a separate supply, may be exempt.

2.40 What is a “Leasing or Letting”? In *EC Commission v United Kingdom* (C-359/97 [2000]), the ECJ noted that but for specific exclusions

“... the wording of article 13B(b) ... does not shed any light on the scope of the terms ‘leasing or letting of immovable property’. The definition of ‘letting of immovable property’ under that provision is certainly wider in some respects than that enshrined in various national laws. For instance the article lists, in order to exclude it from the exemption, a contract for a hotel room ... which in view of the overriding importance of the services provided by the hotelier and the control he retains over the use of the premises by patrons, is not considered in some national laws, to be a contract to let.”

2.41 The Advocate General's Opinion in *Lubbock Fine*, stated:

“In my view, a letting for the purposes of Community law includes a lease, a licence, ‘un bail’ or a ‘convention d’occupation précaire.’”

That is clearly not an exhaustive list and, in practice, case law continues to develop the concept as successive ECJ decisions have considered possible tests.

2.42 While the member state's land law is relevant in understanding what rights have been conferred, it is irrelevant to the interpretation of how the VAT system then applies to those rights. Also irrelevant are:

- any artificial presentation of the transaction – the issue is its essential purpose;
- the duration of the supply (length of the lease or letting);
- whether it includes the land on which the immoveable property stands (*Maierhofer*).

“Leasing or letting” must not be by a person to himself (*Seeling* (C-269/00)).

2.43 The interpretation of this exemption from the VAT system was closely considered by the ECJ in *EC Commission v United Kingdom* (C-359/97 [2000]) which, with the parallel case C-358/97 involving Ireland, concerned the VAT status of road tolls (illustrating the potential breadth of the topic). It affirmed that, especially as this concerned a potential exemption from taxation, the Directive was to be interpreted strictly.

2.44 It first observed that the duration of the supply does not matter in interpreting this exemption:

“transactions as short lived as the use of a hotel room for a single night or the letting of sites for parking vehicles fall *prima facie* within the definition of leasing or letting.”

It further said that exclusive possession was not required:

“the terms ‘leasing’ and ‘letting’ ... do not imply a right of exclusive occupation or a fixed duration for the right to use the goods in question. Any other interpretation is incompatible with article 13B(b)(2) ... from which it is clear that the letting of sites for parking vehicles is *prima facie* leasing or letting within the meaning of that provision. A contract of that type does not imply exclusive use of the car park or even of a particular space in the car park.”

In that case, a “leasing or letting” was understood to require an agreement on duration and that the duration should be reflected in the price charged.

2.45 The ECJ took a stronger line on exclusive possession in *Stichting Goed Wonen* and began to develop the test of “leasing or letting” as a passive activity not generating value added. However, if property is made available to a taxable person it is then within the economic system contributing to the production of goods and services whose cost is passed on in their price. The Dutch association had been right to charge VAT on the grant of a 10 year usufructuary right for a housing complex. The usufruct was accepted as:

“conferring on the person concerned, for an agreed period and for payment, the right to occupy property as if that person were the owner and to exclude any other person from enjoyment of such a right”.

In economic terms, it has common characteristics with letting and so member states could treat it as such, irrespective of its separate legal nature.

2.46 However, this approach was revised by the ECJ in *Belgian State v Temco Europe SA* (C-284/03 [2005]). Temco provided space to businesses sharing premises, with no set duration and rent partly linked to turnover and staff numbers. As in *Stockholm Lindopark* (C-150/99) (see below), the ECJ decision emphasised the criterion of passivity as “leasing or letting” agreements:

“have as their essential object the making available, in a passive manner, of premises or part of buildings in return for payment linked to the passage of time.”

The absence of exclusivity and of an agreed term was not fatal. In making this change

of stance, it explained that:

- exclusivity could be shared and only need be available against “all other persons not permitted by law or by the contract to exercise a right over the property.”
- previous decisions had considered duration in distinguishing letting from industrial and commercial activity which saw the provision of a service rather than “simply the making available of property” “an activity simply linked to the passage of time and not generating any significant added value”.

2.47 The ECJ has since followed this approach in *Fonden Marselisborg Lystbådehavn* (C-428/02) where agreements for mooring and storing boats were accepted as an exempt “leasing or letting” even though when the boat was away from the mooring for more than a day it was then offered to visitors without reimbursement, as

“such occasional use does not cause harm to the lessee, it cannot be regarded as altering the relationship ...”.

2.48 What is the main character of the supply? For VAT law purposes, the issue was to establish the character of the main supply. For this, the ECJ distinguishes activities that are essentially the supply of services rather than simply making property available.

2.49 In *Mirror Group plc* (C-409/98 [2001]), the Advocate General said:

“In my view, this idea that the characteristics of the lease or let must predominate in a contract in order for it to come within the exemption is highly irrelevant for our purposes. It would exclude from the exemption contracts which, while sharing a number of features with contracts of leasing or letting, are primarily concerned with the supply of services incidental to the occupation of the property ... In order to identify the key features of a contract, however, we must go beyond an abstract or purely formal analysis. It is necessary to find the contract’s economic purpose, that is the precise way in which the performance satisfies the interests of the parties. In other words we must identify the element which the legal traditions of various European countries term the cause of the contract and understand as the economic purpose, calculated to realise the parties’ respective interests, lying at the heart of the contract. In the case of a lease ... this consists in the transfer by one party to another of an exclusive right to enjoy immovable property for an agreed period.”

He concluded stressing the importance of the duration of the right to use the immovable property.

2.50 In *Stockholm Lindopark* a Swedish development company ran a golf course for the exclusive use of businesses which were able to offer staff and clients an opportunity to play golf. The ECJ decided that:

- the activity of running a golf course generally entails not only the passive activity of making the course available but also a number of commercial activities and

continuing maintenance. Letting a golf course is unlikely to be the main service supplied on the facts;

- permission to use the course is likely to be restricted both as to purpose and period of use. The period of enjoyment of immovable property is an essential element of a lease.

2.51 In *Sinclair Collis* (C-275/01), the ECJ found that the commercial objective of installing cigarette machines in another person's licensed premises was to sell cigarettes. While the agreement excluded competitors, it could not be the "leasing or letting" of immovable property, however much the machines were fixed to the premises as only limited rights of possession or control were granted.

Payments concerning Tenancies between Landlords, Tenants and Assignees

2.52 For a payment to be exempt it must be for an exempt supply. Where a tenant makes a payment to take a lease it will be exempt, whether it is of rent or a premium. Variations of a lease may usually be exempt.

2.53 Service charges will only be exempt if they are ancillary to an exempt supply of property and supplied by the landlord rather than a third party.

2.54 Reverse Payments - For a reverse payment to be exempt, it must not only be shown that it is for a supply but that the supply is of land. VAT is due on the supply of goods or services, not on a payment. If a supply is identified, it is then a question of analysis whether that supply falls within the exemptions of Article 135. The leading ECJ cases are *Mirror Group plc* and *Cantor Fitzgerald International* (C-108/99 [2001]) overturning an earlier decision in *Lubbock Fine* (C-63/92 [1994]).

2.55 Where:

- a landlord pays a tenant to take a tenancy, it may be that there is no supply by the tenant or it may be liable to VAT – see *Mirror Group plc*, as perhaps where the payment is for building works;
- the tenant pays the landlord to accept the surrender of a tenancy, that may be liable to VAT;
- an outgoing tenant pays the assignee for taking the tenancy, that may well be a VATable supply by the incoming tenant – see *Cantor Fitzgerald*.

Other VAT Issues Relevant to Property

2.56 Transfer of a Going Concern - Article 19 of the Directive allows that a member state can consider that the transfer of "a totality of assets" is not a supply of goods but that instead the new owner is simply treated as the successor of the transferor.

This allows the purchase of a business to be effected without VAT applying.

2.57 Capital Goods Scheme - The Directive's Articles 187 to 191 can apply to durable goods, such as buildings or substantial work on them, spreading the recovery of input tax over several years.

Legislation

Seventh VAT Directive 2006/112

Directive 2009/47 amending Directive 2006/112 as regards reduced rates of value added tax

3. Health and Safety

3.1 The European Union's legislation on health and safety at work may have effects on the use of a property and so its value. Substantial limitations on use or development potential can be imposed by the legislation on hazardous activities.

3.2 Hazardous Activities - Member states are required to adopt land use planning strategies around sites of hazardous activity under Council Directive 96/82/EC on the control of major accident hazards. This is known as the Seveso II Directive from its origin as a response to the release of dioxins in an accident at a chemical plant near Seveso. It was amended in 1997 and then extended by Directive 2003/105/EC following industrial accidents at Toulouse, Baia Mare and Enschede. The aim is to "ensure that the objectives of preventing major accidents and limiting the consequences of such accidents are taken into account in their land-use policies and/or other relevant policies". The measures which should be taken to achieve these objectives include controls on new developments in the vicinity of existing hazardous installations and on the siting of new hazardous installations. The 2003 extensions covered risks arising from storage and processing activities in mining, from pyrotechnic and explosive substances and from the storage of ammonium nitrate and ammonium nitrate based fertilizers.

3.3 Such land use planning strategies can restrict the use of land close to major industrial sites such as chemical plants and oil refineries, but their scope can extend much further. In the United Kingdom, for example, they can affect the land along the line of a high pressure gas pipeline. Such restrictions on development potential can affect value and may require valuations for compensation or mitigation.

3.4 A review of the Seveso II Directive has recently been concluded and a new Directive is proposed to replace it by June 2015. The main proposals are further public access to information and increasing standards for inspections.

Legislation

Directive on Major Accident Hazards of Certain Industrial Activities 96/82 (Seveso II

Directive)
Directive 2003/105.

4. Energy

4.1 Much of the EU's energy policy is now devoted to achieving a very substantial reduction in the emission of greenhouse gases from energy. The essential thrusts of the policy are that:

- energy should come from sources that do not make a net contribution to those gases and so a very strong emphasis on renewable sources of energy;
- energy for heat and transport should come increasingly from electricity;
- energy efficiency should be increased.

4.2 This is being tackled by an array of instruments which will have both direct and indirect effects on property and its use, from the Energy Performance of Buildings Directive to the Large Combustion Plant Directive which will see parts of the EU lose more than a third of their existing generation capacity by 2020, aside from any ordinary obsolescence.

4.3 The current target set by the Directive on Energy from Renewable Sources (2009/28/EC) is for the EU to supply 20 per cent of its overall energy needs from renewable sources by 2020. By 31 December 2014, member states must require the use of minimum levels of energy from renewable sources in new buildings and in existing buildings that are subject to major renovation. There is a parallel target for greenhouse gas emissions to be reduced by 20 per cent from 1990 levels by 2020 – with the possibility of this increasing to 30 per cent if non-EU countries co-operate.

4.4 The pressure imposed by these targets is shown by the November 2010 Commission Communication (COM(2010) 639): Energy 2020, A strategy for competitive, sustainable and secure energy. Its title reflects the goals set for energy policy by the Lisbon Treaty but the paper notes "Europe's energy systems are adapting too slowly, while the scale of the challenges grows" and expresses concern that the EU may not meet all its 2020 energy goals:

"Time is short. Thus, the Commission will present most of the proposals to achieve the 2020 goals in the coming 18 months. Discussion, adoption and implantation will be needed quickly. In this way, the EU will be better able to put in place the building blocks of the 2020 outcome – standards, rules, regulations, plans, projects, financial and human resources, technology markets, social expectations, etc. – and prepare Europe's citizens for the challenges ahead."

4.5 This will all have implications for property whether as the location for renewable generation or improving the efficiency of its use of energy. If the costs of

property together with transport and other key factors change markedly, that may influence users' and investors' decisions as to the nature and location of property.

4.6 Energy Efficiency - There is a clear concern to improve the efficiency with which energy is used so that the greatest benefit is achieved for the least use of resources and so contain the likely increases in energy demand. Both efficiency and greenhouse gas issues can be tackled by carbon pricing through mechanisms like the EU's Emissions Trading System, making the use of fossil fuels to generate energy relatively more expensive. Equally, energy conservation has a key part to play and this is particularly significant for buildings.

4.7 The best known EU measure in this regard is the Energy Performance of Buildings Directive of 2002 now replaced by the recast Directive of 2010. It applies to buildings, with their technical systems, rather than the operations within them.

4.8 One of its prime objects is to improve market awareness of energy inefficiency and cost. Its predecessor set in place the system of Energy Performance Certificates (EPCs), giving each premises an energy efficiency rating on a relatively standard system. These are required for the sale or lease to a new tenant of a wide range of buildings, essentially almost all residential, commercial and public sector buildings and most other buildings unless they are "low energy demand".

4.9 The new Directive builds on this to require that, by 9 January 2013, advertisements marketing a property for sale or rent show the building's energy rating and requiring prominent display of the EPC in buildings over 500m² that are frequently visited by the public.

4.10 Under the Directive, new buildings must be "nearly zero energy" by 31 December 2020 (after 31 December 2018 for buildings occupied and owned by public authorities) – a demanding goal reinforcing other trends in policy to increase the energy efficiency requirements of national building standards. It does not enforce standards for existing buildings except where a renovation qualifies as a "major renovation", in which case it requires compliance with energy performance standards. It imposes a regime of inspections for heating and air conditioning systems.

4.11 This Directive is discussed in more detail at EVA8.

Legislation

Energy from Renewable Sources Directive 2009/28

Energy Performance of Buildings Directive 2010/31

5. Environment

5.1 General

5.1.1 Valuations and Environmental Issues - The professional valuation of a property can only reflect the actual market as it exists on the valuation date with its balance of supply and demand, hopes and concerns and the information the market thinks relevant reduced to a single figure. Legislation and policy relevant to the property is part of that matrix of circumstance but cannot necessarily drive it. Valuations cannot get ahead of the market.

5.1.2 Environmental regulation can impose large costs on property and business owners and users making it important to understand the potential for its impact in any particular situation and so its consequence for property values. These concerns will be shared by lenders. They need to be considered in lettings.

5.1.3 Growth of Environmental Legislation by the European Union - The original Treaty of Rome of 1957 made no mention of the environment. As environmental issues became more significant in the early 1970s, the first official EU reference to them was a declaration made by the then six heads of state in October 1972. That heralded the first of six Action Programmes for the Environment, setting out broad policy objectives. The current, sixth, Programme covers the period 2002 to 2012 and has four "key environmental priorities": climate change, nature and biodiversity, environment with health and quality of life, and natural resources and wastes.

5.1.4 Case law and then treaties have progressively extended the activity of the European Union in environmental policy on the basis that many issues see both causes and effects extending beyond the reach of individual countries. In the years from 1973 to 1986, EU environmental law steadily developed for water, waste and then air pollution before being given a further impetus by the Seveso incident. In particular, the EU's role was confirmed by the Single European Act 1987 (as since amended) and applied by the ECJ in its constitutional interpretations, as in, for example, the *Titanium Dioxide* case (C-300/89 [1991]), tending to run ahead of formal constitutional change. In 1989 a separate Environment Directorate was created in the Commission and the creation of a European Environment Agency was agreed in 1990 which, operational from 1993, is to produce a report on the state of the European environment every three years. The EU not only agrees specific legislation but frames general environmental policies. A "Sustainable Development Strategy" was agreed in 2001.

5.1.5 This is a large, diverse, complex and developing area with considerable consequences for property. Each piece of EU legislation is likely to have a body of case law and, especially for Directives, is likely to be masked and sometimes extended by national implementing regulations. There will often be much associated subsequent amending and related EU legislation for each.

5.1.6 The first significant EU intervention for nature conservation was the Wild Birds Directive of 1979 setting an approach to conservation policy later broadened by the Habitats Directive. Those conservation interests were then applied more broadly through the Environmental Impact Assessment Directive, bearing first on major development proposals but now a significant issue for much development.

5.1.7 The Single European Act 1987 was the first formal confirmation of the EU's role in environmental policy, previously unclear. The ECJ decisions in *Titanium Dioxide* [1991] and *Wallonian Waste* (C-2/90 [1993]) elaborated this position which has since been consolidated and reinforced by the 1997 Treaty of Amsterdam at Articles 95 and 174 to 176. Article 174(2) simply states:

"Community policy on the environment shall aim at a high level of protection taking into account the diversity of situations in the various regions of the Community. It shall be based on the precautionary principle and on the principles that preventive action should be taken, that environmental damage should as priority be rectified at source and that the polluter should pay."

Since the Treaty of Amsterdam, Article 6 of the Treaty states:

"Environmental protection requirements must be integrated into the definition and implementation of the Community policies and activities referred to in Article 3, in particular with a view to promoting sustainable development".

The effect is that environmental protection is now an integral part of the framework of EU legislation and that, alongside the precautionary and the "polluter pays" principles, "sustainable development" has been affirmed as a core principle (and is also mentioned in the amended Article 2 of the Treaty on European Union). Articles 95 and 176 allow member states to impose more stringent requirements.

5.1.8 Environmental protection is not an overriding objective. The ECJ's Advocate General commented in *R v Secretary of State for the Environment Transport and the Regions, ex p First Corporate Shipping Limited* (C-371/98 [2000]) that the reference to "sustainable development" in the Preamble to the Treaty does not mean that;

"the interests of the environment must necessarily and systematically prevail over the interests defended in the context of the other policies pursued by the Community in accordance with Article 3 of the EC Treaty."

It is a political matter of reconciling competing interests at the EU level. This has been more recently affirmed by the Advocate General in *Austria v Parliament/Council* (C 161/04 [2006]):

"Although this provision is drafted in imperative terms ... it cannot be regarded as laying down a standard according to which in defining Community policies environmental protection must always be taken to be the prevalent interest. Such an interpretation would unacceptably restrict the discretionary powers of the Community institutions and the Community legislature. At most it is to be regarded as an obligation on the part of Community institutions to take due

account of ecological interests in policy areas outside that of environmental protection *stricto sensu*. It is only where ecological interests manifestly have not been taken into account or where they have been completely disregarded that Article 6 EC may serve as the standard for reviewing the validity of Community legislation."

5.1.9 Climate Change Measures - The European Union is increasingly focussing on measures to mitigate climate change. In part, this is through legislation on energy issues (see Section 4 above) but also more directly through limitations on greenhouse gas emissions. Buildings are said to be responsible for some 40 per cent of emissions while land management can either aggravate or ameliorate the issue. The Emissions Trading System and other measures may affect the economics of some businesses. More generally, many property owners and occupiers may find it important to consider the commercial issues arising from carbon reduction schemes when appraising property: does it offer easy opportunities to assist or is it expensive to adapt?

5.2 Environmental Impact Assessments and Strategic Environmental Assessments

5.2.1 In general, the EU has intervened relatively little in spatial planning policy but rather in ways that affect decisions on specific proposals. Its most general intervention in development control is through the Environmental Impact Assessment Directive, first enacted in 1985, revised in 1997 and applying to specified classes of development proposals.

5.2.2 The object is to ensure a systematic account, an environmental impact assessment, of a development's likely effects on the environment and so consideration of measures that would avoid significant adverse effects. This relies on a structured approach using expert reports to assist those making development control decisions.

5.2.3 The ECJ decision *Commission v Ireland* (C-215/06) suggests that a member state is not entitled to grant a development consent retrospectively for a scheme for which no EIA had been submitted without a new EIA being provided. That could be a significant issue for the assessment of some properties.

5.2.4 In 2001, the Strategic Environmental Assessment Directive extended the need for environmental assessment to plans or programmes setting the framework for future development consents for agriculture, forestry, fisheries, energy, industry, transport, waste management, water management, telecommunications, tourism and development control. This applies to projects listed in Annex I or II of the 1985 EIA Directive and to any plan requiring an assessment under the 1992 Habitats Directive.

Legislation

Environmental Impact Assessment Directive 97/11

Assessment of the Effects of Certain Plans and Programmes on the Environment

Directive 2001/42

(commonly called the Strategic Environmental Assessment Directive)

5.3 Water

5.3.1 Most water issues naturally fall into three categories:

- water quality – pollution in various forms
- water scarcity – shortage
- water quantity – flooding risk

EU policy has generally focused on water quality but the wide-reaching Water Framework Directive now implicitly touches on scarcity and the new Floods Directive requires action on flooding risk. The ecological role of water bodies is recognised in nature conservation legislation, sometimes imposing a significant constraint on development.

5.3.2 The first EU legislation on water quality was the Surface Water for Drinking Directive of 1975 and it has steadily broadened since 1990. The most powerful piece of general legislation is the Water Framework Directive of 2000, due to be fully implemented by 2015 with the prospect of member states being fined for breaches of standards.

5.3.3 Water pollution issues can be divided into point source ones (as with a specific sewage pipe, factory outlet or local incident) and diffuse pollution arising from the background environment. General pollution legislation can be effective in limiting the potential for point source pollution and penalising incidents. The Water Framework Directive tackles the much harder problems of diffuse pollution from a background of contaminants which may be anything from soil, fertilisers, sprays for weeds or pests, animal wastes and urban run-off to naturally occurring chemicals and bacteria.

5.3.4 The Dangerous Substances Directive of 1976 required member states to control prescribed substances from entering sewers and has been reinforced by later directives on discharges into sewers. The terms of licences to discharge may add or limit the value of affected premises.

5.3.5 The first Groundwater Directive was introduced in 1980 to require member states to take measures to prevent the pollution of groundwater by a wide range of substances whose discharge is either to be prevented or controlled, subject to their toxicity. It is to be repealed in 2013 by the Water Framework Directive and a new Groundwater Directive was enacted in 2006 to take its place in due course.

5.3.6 The Nitrates Directive was introduced in 1991 to reduce water pollution arising from nitrates from agricultural sources and preventing further such pollution. It requires member states to designate nitrate vulnerable zones within which “good agricultural practice” is to be imposed, limiting the application rates for nitrogenous fertilisers and requiring storage of manures and slurries. Surface waters and groundwater aquifers in

the zones are to be monitored as is the eutrophic state of fresh surface waters, estuarial and coastal waters.

5.3.7 The Urban Waste Water Directive of 1991 requires that discharges of industrial waste water to sewage or treatment plants must be subject to prior regulation and so any necessary pre-treatment to reduce its pollution potential and use collecting systems designed and maintained in accordance with the “best technical knowledge not entailing excessive expenditure”. This applies to a plant measured by its “population equivalent” (pe), a measure of the organic biodegradable load imposed by the effluent. More stringent standards apply to “sensitive” areas.

5.3.8 The Water Framework Directive applies to surface waters (lakes, reservoirs, rivers, canals estuaries and waters up to one nautical mile from the shore) and groundwater. Its aims are:

- to prevent further deterioration of waters, and to protect and enhance aquatic eco-systems;
- to promote sustainable water use based upon long-term protection of available water resources;
- to reduce discharges, emissions and losses of priority substances, and to cease or phase out discharges, emissions and losses of priority hazardous substances into aquatic environment. Priority substances are governed by both the Directive and the Environmental Quality Standards Directive;
- to reduce and prevent groundwater pollution;
- to contribute to mitigating the effects of floods and droughts.

It requires strategic management plans for each river basin to show how the objectives for its water bodies are to be met, addressing both point source and diffuse pollution. Member states are to deliver good surface water status in terms of both chemical composition and ecology and ensure groundwater’s chemical status and quantity (so that it is not depleted by the long run rate of abstraction). These standards are not precisely defined but are to be delivered by 22 December 2015, especially in areas designated under other EU legislation, but can otherwise be delayed to 2021 or 2027.

5.3.9 As a framework directive, there are several “daughter” directives to assist its implementation. Those already enacted are:

- Dangerous Substances Directive 2006/11 – an interim measure
- Groundwater Directive 2006/118

with others to follow including the Environmental Quality Standards Directive, listing and setting limits for priority substances and requiring an inventory of emissions, discharges and losses for each river basin.

5.3.10 The Floods Directive establishes a framework for the assessment and management of inland and coastal flooding risks. Member states are obliged to carry out an assessment for each river basin, prepare flood hazard and risk maps and set out

flood management plans. The identification of a site as at risk from flooding will have consequences for affected property both from the practical fact of any actual flooding but also from the impact of that identification on the availability or cost of insurance. In some cases, flood control measures will require land to be flooded to protect other property by managing water flow – with effects on values.

Legislation

Surface Water for Drinking Directive 75/440

Water Pollution by Discharges of Dangerous Substances Directive 76/464

Groundwater Directive 1980

Nitrates from Agricultural Sources Directive 91/676

Directive on Urban Waste Water Treatment 91/271

Water Framework Directive 2000/60

Dangerous Substances Directive 2006/11

Groundwater Directive 2006/118

Floods Directive 2007/60

Environmental Quality Standards Directive 2008/105

5.4 Contaminated Land and Environmental Liability

5.4.1 The 2004 Directive on Environmental Liability with regard to the prevention and remedying of environmental damage (as amended) will be relevant to property transactions where there is pollution or contamination that affects land, designated conservation sites and groundwater.

5.4.2 Applying the “polluter pays” principle, a person may be liable under the Directive if considered an “operator”. The operator of an activity listed in the Directive’s Annexe III is strictly liable for measures to prevent or remedy damage to land, groundwater, surface water, coastal waters, and protected species and natural habitats. The Annexe invokes the Integrated Pollution Prevention and Control Directive and the Waste Framework Directive. For activities outside Annexe III, the operator is liable for measures to prevent damage to protected species and natural habitats, provided he is negligent or at fault in this.

5.4.3 There is environmental damage to:

- land when there is a significant risk of human health being affected by contamination due to the introduction of “substances, preparations, organisms or micro-organisms”. The operator who damaged the land must remove that significant risk;
- water if there is a significant adverse effect on the ecological, chemical or quantitative status of water or its ecological potential;
- protected species or natural habitats if there is significant adverse effect on

reaching or maintaining a favourable conservation status.

For both water and protected species or habitats the operator who caused the damage is liable for:

- primary remediation, restoring the subject to its condition before being damaged;
- complementary remediation where this is not possible; and
- compensatory remediation by providing other improvements to compensate for interim losses between the damage and its restoration.

5.4.4 Waste - Land contamination issues will also interact with the developing EU regimes governing waste, intended to drive both the reduction of waste and an increase in recycling. The main present legislation is the Waste Framework Directive 2008 which specifically excludes:

- "land (in situ) including unexcavated contaminated soil and buildings permanently connected with land" (Article 2(1)(b)); and
- "uncontaminated soil and other naturally occurring material excavated in the course of construction activities where it is certain that the material will be used for the purposes of construction in its natural state on the site from which it was excavated" (Article 2 (1)(c))."

Otherwise, waste is to be recovered or disposed of without endangering human health, without using processes or methods which would harm the environment and particularly without:

- risk to water, air, soil, plants or animals;
- causing nuisance through noise and odours;
- adversely affecting the countryside or places of special interest.

The policy is implemented by environmental permitting regulations, the preparation of development plans, and regimes for a duty of care. The Directive is supported by the Landfill Directive, the Waste Incineration Directive and Integrated Pollution Prevention and Control Directive.

Legislation

Environmental Liability Directive 2004/35

Waste Legislation

Landfill Directive 99/31

Waste Incineration Directive 2000/76

Integrated Pollution Prevention and Control Directive 2008/1

Waste Framework Directive 2008/98

5.5 Pollution

5.5.1 The central Directive for this subject is the Integrated Pollution Prevention and Control Directive applying to operations with significant potential for pollution.

5.5.2 Compliance with standards will be important for such businesses and so a major factor in their approach to property.

5.5.3 The water legislation reviewed above considered both point source and diffuse pollution of water.

5.5.4 Several directives bear directly on air pollution and so on emissions from various classes of industrial and other plants, all requiring member states to set controls on the air pollution from individual plants. These mean that a valuer addressing such a property needs to understand how far it is compliant and the practical consequences of any shortcomings as they may affect a valuation.

Legislation

Integrated Pollution Prevention and Control Directive 2008/1

Air pollution legislation relevant to property

Framework Directive on Emissions from Industrial Plants 84/360

Large Combustion Plants Directive 88/609

Municipal Waste Incinerators Directive 89/369

Ambient Air Quality Assessment and Management Directive 96/62

Solvent Emissions Directive 1999/13

Waste Incineration Directive 2000/76

Large Combustion Plant Directive 2001/80

5.6 Asbestos and Other Substances

5.6.1 The Control of Asbestos Directive has a significant impact on the management of many buildings constructed in the twentieth century when asbestos was a cheap and effective building material used in roofing sheets, as panels and in other ways. The Directive followed the association of some forms of asbestos with cancer and:

- requires a survey of the asbestos present in any building; and
- imposes standards for its removal and disposal.

This can add substantially to the costs of building work on a property or the remediation and development of a site and so may affect its value.

5.6.2 Assessment will require specialist knowledge. It is normal for valuation reports to contain exclusions regarding asbestos, recommend the commissioning of a specialist report and otherwise assume that asbestos is present.

Legislation

Control of Asbestos Directive 87/217

5.7 Bio-diversity and Conservation

5.7.1 Nature conservation was one of the first significant areas of EU activity in environmental policy, sometimes superimposed on earlier national provisions. It has now generated a structure to designate many sites to protect them for their value in this regard by stating what is not permitted on them. It can therefore impose significant hurdles for the development or change of use of property affected by conservation interests. However, there may be opportunities for grants or annual payments under management agreements, subject to state aid rules. As the conservation interests are likely to be site specific they will have a bearing on the value of the site. In addition to international and national schemes for designating sites, EU Directives require the designation of sites:

- The Directive on the Conservation of Natural Habitats and of Wild Flora and Fauna (the Habitats Directive) requires member states to designate Special Areas of Conservation (SACs - the network of these is called Natura 2000) to maintain or restore natural habitats and species of wild flora and fauna of Community interest. It also implements the 1979 Bern Convention on the Conservation of European Wildlife and Habitats as EU law.
- The Directive on Conservation of Wild Birds requires the designation of Special Protection Areas (SPAs) on the basis of the ornithological criteria in the Directive (*European Commission v Netherlands* C 3/96 [1999]) to ensure the survival and conservation of certain species.

There are also a number of sites of European Union importance designated by the Commission on the nomination of member states.

5.7.2 Member states are then to “take appropriate steps to avoid the deterioration of the sites and significant disturbance of the species for which the areas have been designated” (Article 6(2), Habitats Directive).

5.7.3 The ECJ has interpreted these directives strictly, both for initial designation of sites and their subsequent protection in decisions on such areas as Leybucht Dykes (*Commission v Germany* (C-57/89 [1991]), Santoña Marshes (*Commission v Spain* (C-355/90 [1993]), and Lappel Bank (*R v Secretary of State for the Environment, ex p Royal Society for the Protection of Birds* (C-44/95 [1997])). Designation is an objective issue to which economic criteria are not relevant (*R v Secretary of State for the Environment Transport and the Regions, ex parte First Corporate Shipping Limited* C-371/98 [2001]). The ECJ has rejected considering the effect of the Common Agricultural Policy (*Commission v France* (C-96/98 [2000])) or the effect of an outstanding public consultation and state ownership (*Commission v France* (C-166/97 [1999])).

5.7.4 Once a site is designated, the Member State is then to protect it and the species for which it was designated. However, development proposals may be allowed after due consideration and where they will not adversely affect the integrity of the

site. The Directive was amended after the Leybucht Dykes decisions so that where there is no alternative solution to damaging a designated site, it may be reduced in extent “for imperative reasons of public interest, including those of a social or economic nature”. However, the Member State must then take compensatory measures to ensure the overall coherence of Natura 2000, an objective that requires more than simple mitigation. That may mean:

- recreating a habitat on a new or enlarged site to be incorporated into Natura 2000;
- improving a habitat on part of the site or another Natura 2000 site proportional to the loss due to the project;
- proposing a new site;

with that new measure to be operational when the Natura 2000 site is damaged. As many Natura 2000 sites involve wetland, this can be a particular constraint on the development of, for example, coastal sites as may be desired by ports or power stations. The requirement for compensatory measures for lost tidal flats was a significant feature of the development of Cardiff Bay as part of the city.

5.7.5 Annexes II and IV of the Habitats Directive list several hundred species of animal and plants that are to be protected. Equivalent protection for bird species is provided under the Wild Birds Directive. This protection is frequently relevant to the potential development of property as it requires that the impact on these species be assessed which can take time and be expensive. Where that impact is significant, it that may be taken into account in decisions about whether consent for development should be granted and, if so, on what conditions. The presence of protected species can also influence the management of property.

Legislation

Wild Birds Directive 79/409

Habitats Directive 92/43

6. The Common Agricultural Policy

6.1 The Common Agricultural Policy (CAP) has been a major feature of the EU since 1963 and still accounts for over 40 per cent of its budget, providing significant support to those who qualify for payment. With changing policy needs, budgetary constraints and the demands of world trade talks, it has slowly adapted from a regime based on support for product prices through intervention in the market – mainly for temperate products such as cereals, milk and beef – and so tending to support the sale and rental value of land naturally used for those products. Milk quotas were introduced in 1984 to limit the cost of the dairy regime and major general reforms were agreed in 1992 (MacSharry Reforms) and 2003 (the Single Payment Scheme). Following minor changes to the 2003 reforms, especially in 2008 (the Health Check), discussions have now started

on the shape of the “CAP post-2013” alongside the review of the EU’s budget for the years 2014 to 2020. The Commission published draft regulations for this in October 2011.

6.2 The long reform process has also seen the use of some of the CAP budget for “rural development” purposes, variously support for hard pressed areas, agri-environment schemes and measures to strengthen or diversify the rural economy. Member states have taken differing approaches and emphases in implementing this while the allocation of funds to each country varies widely.

6.3 It is noteworthy that CAP legislation is by Regulation, and not Directive, though issues of national implementation usually still require additional domestic legislation.

6.4 The present policy, ahead of decisions on the CAP post-2013, is divided into two “pillars”:

- Pillar 1 essentially comprises the annual direct payments to farmers (currently the Single Payment Scheme introduced from 2005) and market management measures. The Single Payment is a payment to qualifying farmers in respect of area of qualifying agricultural land they have at their “disposal” on the claim date. It is subject to penalties for breaches of cross-compliance rules which impose legal obligations and minimum land management requirements. Meeting world trade commitments, the payment does not depend on the type or volume of current agricultural production – it is “decoupled” (though some member states have used limited powers to retain parts of the previous coupled arable and livestock schemes). There are two types of the scheme:
 - Those states that have joined the EU more recently, especially in central Europe and having no such history of subsidy, operate a Single Area Payment Scheme simply based on the qualifying land declared each year. This is paid at standard rates, usually much less than is paid for historic reasons in the EU-15.
 - In the EU-15, the SPS is paid on the basis of a system of transferable entitlements (expressed in hectares) largely allocated on the basis of the areas used for previous subsidy at payment values based on the claimant’s previous history. That means that the importance of the system varies between countries according to their historic commitment to cereals, cattle and dairying. To yield the payment, entitlements must be matched each year against an equivalent area of qualifying land in the same payment area as the entitlements were created. In England and Germany payment values are being phased to standard rates; CAP reform proposals would see that change made in the remainder of the EU-15.

The land at “disposal” test that qualifies land for a claim has been considered by the ECJ in *Landkreis Bad Dürkheim* (C61/09) finding that the claimant must be an

autonomous farmer on the land and be substantially able to deliver the cross compliance requirements. With the varied property laws of member states that was not expressed in land tenure terms.

- Pillar 2 is the Rural Development Regulation. This offers support, often on a longer term or multi-annual basis, in wide variety of ways of which those usually most relevant to the assessment of property are for:
 - Less Favoured Areas (LFAs) which are defined areas of usually difficult or adverse terrain seen as challenging to farm but often of social, cultural or landscape significance. These payments have variously been made on the basis of the numbers of qualifying animals, the area involved or, sometimes now, for agri-environment commitments.
 - Agri-environment schemes which are usually commitments binding the land for periods of five (sometimes ten) years. The claimant should have management control of the land.

6.5 These schemes and their administration are not only important to those involved but often complex for both farmer and the official payment agencies and vary significantly between (and sometimes within) member states. Access to and limitations on payments may be relevant to both capital values and rents of relevant property.

Legislation

Single Payment Scheme Regulation - Council Regulation (EC) 73/2009

Rural Development Regulation 1698/2005

SCHEDULE OF EU LEGISLATION

Valuation of Property for Company Accounts

Fourth Directive on the annual accounts of certain types of companies 78/660

Seventh Directive on consolidated accounts 83/349

These Directives are amended by Directives for:

- The exemptions for small and medium sized companies and publication of accounts in ecus 90/604
- The extension of company types 90/605
- Statutory audits of annual accounts and consolidated accounts 2006/43 amended by 2008/30

Directive on the annual accounts and consolidated accounts of banks and other financial institutions 86/635

Amended by Commission Recommendation 2000/408 - Disclosure of information on financial instruments and other items

Directive amending Directives 78/660, 83/349 and 86/335 with regard to the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions - 2001/65

Directive on the annual accounts and consolidated accounts for insurance undertakings 91/674

Directive amending Directives 78/660, 83/349, 86/335 and 91/674 with regard to the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions 2003/51

Regulation 2000/2909 on the accounting management of non-financial fixed assets

Regulation 2002/1606 on the application of international accounting standards

Regulation 2003/1725 adopting certain accounting standards in accordance with 2002/1606

Valuation of Property for Financial Institutions

Directive on the taking up and pursuit of the business of credit institutions 2006/48

Amended by Directives 2007/18, 2007/44, 2007/64 and 2008/24

Directive on the capital adequacy of investment firms and credit institutions 2006/49

Alternative Investment Fund Managers Directive 2011/61

Valuation of Property for State Aid Rules

Commission Communication 97/C 209/03 on State Aid Elements in the sale of land and buildings by public authorities.

Value Added Tax and Property

Seventh VAT Directive 2006/112

Directive 2009/47 amending Directive 2006/112 as regards reduced rates of value added tax

Health and Safety

Directive on Major Accident Hazards of Certain Industrial Activities 96/82 (Seveso II Directive)

Directive 2003/105

Energy

Energy from Renewable Sources Directive 2009/28

Energy Performance of Buildings Directive 2010/31

Environmental Impact Assessments and Strategic Impact Assessments

Environmental Impact Assessment Directive 97/11

Assessment of the Effects of Certain Plans and Programmes on the Environment 2001/42 (commonly called the Strategic Environmental Assessment Directive)

Water

Surface Water for Drinking Directive 75/440

Water Pollution by Discharges of Dangerous Substances Directive 76/464

Groundwater Directive 1980

Nitrates from Agricultural Sources Directive 91/676

Directive on Urban Waste Water Treatment 91/271

Water Framework Directive 2000/60

Dangerous Substances Directive 2006/11

Groundwater Directive 2006/118

Floods Directive 2007/60

Environmental Quality Standards Directive 2008/105

Contaminated Land, Environmental Liability and Waste

Landfill Directive 99/31

Waste Incineration Directive 2000/76

Environmental Liability Directive 2004/35

Integrated Pollution Prevention and Control Directive 2008/1

Waste Framework Directive 2008/98

Pollution

Integrated Pollution Prevention and Control Directive 2008/1

Air Pollution

Framework Directive on Emissions from Industrial Plants 84/360

Large Combustion Plants Directive 88/609

Municipal Waste Incinerators Directive 89/369

Ambient Air Quality Assessment and Management Directive 96/62

Solvent Emissions Directive 1999/13

Waste Incineration Directive 2000/76

Large Combustion Plant Directive 2001/80

Asbestos

The Control of Asbestos Directive 87/217

Biodiversity and Conservation

Wild Birds Directive 79/409

Habitats Directive 92/43

Common Agricultural Policy

The Single Payment Scheme Regulation - Council Regulation 73/2009

Rural Development Regulation 1698/2005

PART 3

OTHER TECHNICAL DOCUMENTS

TEGoVA's Code of Ethics and Conduct

Summary of TEGoVA's Minimum Educational Requirements

Summary of TEGoVA's Recognised European Valuer (REV) Scheme

Information Paper - Sustainability and Valuation

Code of Measurement of Distance, Area and Volume

Information Paper - Apportionment of Value between Land and Buildings

Information Paper - Certification of Valuers

European Property and Market Rating: A Valuer's Guide

European Mortgage Federation Profile for Risk Related Criteria for Valuations

TEGoVA's Code of Ethics and Conduct

1. Introduction

1.1 Clients expect a valuation to be prepared by a professional, qualified valuer who:

- adheres to a prescribed code of conduct;
- behaves ethically;
- is transparent in handling all aspects of the instruction from its inception through to completion. Among other matters, this will include the provision of detailed terms of engagement that
 - cover valuation assumptions
 - confirm that no conflict of interest exists,
 - confirm that the valuation report will correspond to the client's needs as advised together with the requirements of statute, regulation and the valuer's fiduciary duty.

1.2 The client also expects the valuer to conduct himself appropriately and ethically, so that he takes the correct actions, has the confidence to follow them through and deal with their consequences and outcomes, doing so with integrity in the production of a competent, professional valuation.

1.3 EVS4 makes specific reference to the requirement for the detailed terms of the valuer's engagement, covering valuation assumptions, responsibilities of the valuer, and the fee basis, to be recorded in writing (at its section 3). That Standard also requires the valuer to report his status, clarifying whether he is acting in an external and independent capacity, specifying a corporate or personal personality; or as an internal valuer (para.5.2). EVS5 stipulates the need for openness, stating that opinions of value must be set out in a transparent and clear manner (at 3.1); while EVS3 states as 4.1(iv):

"Valuers will at all times maintain the highest standards of honesty and integrity and conduct their activities in a manner not detrimental to their clients, the public, their profession, or their respective national professional valuation body. It is mandatory for all Qualified Valuers and their representative professional or technical organisations to adhere to an ethical code that is as stringent as the TEGoVA Code of Ethics."

2. Scope

2.1 This Code encompasses personal responsibility, corporate responsibility and responsibility to the profession. The core values embedded in the Code include fairness, a proper professional respect for others and for standards, responsibility

and trustworthiness. Its core requirements include acting with integrity, recognising personal interests and maintaining competence. Such professional standards extend beyond the requirements of law, entailing a balance between transparency, openness, client confidentiality and external communication with clients, stakeholders and anyone to whom an established duty of care is owed. These principles reinforce the need for professionalism, accountability and client focus.

2.2 It is for the valuer's national professional body to outline and maintain these professional values through its rules, management and accountability structures and as necessary, disciplinary procedures. It is that body that has responsibility to monitor and enforce compliance and determine what action is taken as a result of any known or perceived activity that is inconsistent with the requirements of a Qualified Valuer. Monitoring an individual valuer's compliance with this Code of Ethics and Conduct is the responsibility of the relevant national professional valuation body, not TEGoVA, and any perceived or actual violation of this Code should be reported to that body.

2.3 This Code is not intended to restrict legal and reasonable business competition, but compliance does require clarity in respect of the extent of services and the responsibilities provided by the valuer.

3. Definitions

3.1 A **valuer** may be an individual person, a practice, firm, other corporate body or a company with legal personality undertaking or assisting with a valuation. .

3.2 A qualified valuer is a valuer who meets the standards of reputation, education and experience set out in EVS3, particularly its paragraph 4.1.

3.3 A valuer may be a contributor to a valuation report. Responsibility for the report is to be borne by a qualified valuer.

3.4 A national professional valuation body is an association, institution or other body that is a member association of TEGoVA.

4. TEGoVA's Code of Ethics and Conduct

- a Valuers are required to comply with all appropriate laws and regulations of the countries in which they operate.
- b Valuers must act with integrity at all times to safeguard the trust in which they are held by colleagues, employers, clients and anyone to whom a duty of care is owed.

- c Valuers must maintain a level of professional knowledge and technical skill consistent with the expectation and requirements of the national professional valuation body of the valuer in respect of all legal, regulatory, ethical and contractual requirements. Valuers should not accept instructions outside their expertise.
- d Valuers who have access to privileged or confidential information must not use or disclose that information to achieve personal gain for themselves or others.
- e Terms and conditions of every valuation instruction must be agreed and set out clearly in writing before the valuation is reported.
- f Valuers must not offer, promise, give, demand or accept an unethical advantage or bribe in order to obtain, retain or give business or other advantage.
- g A valuer shall not accept, directly or indirectly, any rebate, fee, commission, discount or other benefit, monetary or otherwise, which could reasonably be seen as a conflict with the interests of the client or employer unless the client or employer is first notified in writing of the activity or potential conflict of interest, and expressly consents to such representation. If an activity would result in a conflict between the interests of the employer and the interests of the client, then the interests of the client shall take precedence.
- h A valuer has a duty to provide the national professional valuation body with any significant factual information that reasonably suggests that another member of that body may have violated its Code of Ethics.

5. Commentary

5.1 TEGoVA requires every member association to set, monitor and enforce requirements that are at least equivalent to and consistent with the requirements of this Code unless prohibited from complying with part of the Code by law or regulation.

5.2 To assist compliance, the member association should provide appropriate resources for training and ensure continual professional development.

Summary of TEGoVA's Minimum Educational Requirements

1. Introduction

1.1 TEGoVA requires each Member Association to set educational standards for its members that are at least as demanding as the Minimum Educational Requirements (MER) set by TEGoVA. MER were first introduced by TEGoVA in January 2003 as a basic requirement for every valuer elected to practice by a member association. Many Member Associations have more stringent educational requirements.

1.2 TEGoVA regularly reviews and updates the MER to support the development of professional standards among its members and so for those who require their services. The latest revision was adopted by the General Assembly of TEGoVA at its meeting in November 2010.

1.3 MER requirements are equivalent to and consistent with the EU's Second Diploma Directive relating to the Mutual Recognition of Professional Qualifications (92/51/EEC). In applying MER, Member Associations in countries outside the EU must adopt the requirements of the Second Directive and develop a syllabus that matches the criteria of the Directive.

1.4 Professional services delivered by valuers across Europe vary considerably and many will be specialists in particular sectors. Some geographical areas will be affected by factors that do not apply elsewhere. Thus, the knowledge they require will vary. However, the essential disciplines of valuation will be fundamental to their work and so are central to the MER syllabus. Member Associations develop their educational requirements in line with the Directive and the MER syllabus, though national variations will take account of differing legislation, tax regimes and client requirements. Valuations in, for example, forestry or agriculture may be more prevalent in some countries or for some associations while different types of commercial activity may prevail in others. The Member Association is charged with the responsibility to interpret the MER to ensure consistency with the professional demands of its members.

1.5 The globalisation of real estate markets, continuing European integration, together with an improved free flow of services across the EU and rising client expectations are the drivers for change in the breadth and depth of knowledge expected of real estate professionals. The industry is now not only focussed on transaction-orientated business but now also demands the delivery of added value with valuers asked for strategic consultancy with appropriate knowledge in all areas of business, the built environment, corporate governance and corporate social responsibility.

1.6 TEGoVA provides additional and separate guidance in respect of its Recognised European Valuer (REV) scheme (see next section). Valuers who have achieved this status are subject to additional requirements including continuing professional development.

1.7 The subject areas within the MER are grouped into three levels of knowledge expected of the valuer:

- (a) understanding,
- (b) general knowledge, and
- (c) in-depth knowledge.

2 Outline of Syllabus

2.1 Valuers require an **understanding** of:

| | |
|--|--|
| <ul style="list-style-type: none"> • Principles of Economic Theory • Practical Economics for Real Estate | <ul style="list-style-type: none"> • Business and Finance |
|--|--|

2.2 Valuers require a **general knowledge** of:

| | |
|---|--|
| <ul style="list-style-type: none"> • Marketing Real Estate • Energy Efficiency, Environmental and Resource Protection | <ul style="list-style-type: none"> • Buildings and Construction |
|---|--|

2.3 Valuers require an **in-depth knowledge** of:

| | |
|--|---|
| <ul style="list-style-type: none"> • Law Relevant to Property* • Professional Practice • Valuation • Government Policies and Land Use* | <ul style="list-style-type: none"> • Valuation under Statute* • Valuation Standards * |
|--|---|

* Denotes in-depth knowledge required relative to the country or sector of practice

Summary of TEGoVA's Recognised European Valuer (REV) Scheme

1. TEGoVA's Recognised European Valuer Scheme is designed to assist the valuation profession in Europe by identifying skilled valuers for clients, particularly from other countries but also in their own country. The status TEGoVA '**Recognised European Valuer**' with the designation **REV** can be awarded to individual practising valuers, as evidence of a pan-European indicator of ability and experience to assure clients of their valuation proficiency.
2. Application for REV status is open to qualified practising valuers who meet the required standards and belong to an authorised Full or Associate TEGoVA Member Association (TMA) or by an individual valuer of a valuation company which itself is a member of a TMA. Applications have to be made by a valuer direct to a home country TMA that is approved to award recognition in accordance with the terms and conditions agreed with TEGoVA.
3. The process of attaining REV status is divided into two stages. First is the granting of awarding status to the TMA by TEGoVA. The second stage the certification of the individual by the approved TMA.
4. To attain the first stage of awarding status from TEGoVA, a Member Association must demonstrate that it will have in place an effective quality system to ensure that individual applicants meet the requirement of the scheme as regards education, ethics, experience and lifelong learning.
5. The second stage is the assessment of an individual practising valuer by the approved Member Association in order to ascertain if the applicant meets the required TEGoVA standards, and where successful, the granting of consent to use of the designatory letters REV (Recognised European Valuer).
6. Recognition of competence is granted in the name of TEGoVA by the Member Association in the form of a certificate signed jointly by the Chairman of TEGoVA and the Chairman/President of the Member Association.
7. The applicant who has been granted Recognised European Valuer status is permitted to use this title and the designation REV after his/her name for a period of 5 years after which time the valuer must seek renewal of REV status.
8. Full details of the scheme are available from the TEGoVA Secretariat; E-mail: info@tegoval.org or from the Website: www.tegoval.org

Information Paper

Sustainability and Valuation

- 1. Introduction**
- 2. Sustainability and Property Users**
- 3. Developing “Green” Standards for Property**
- 4. Valuation and Sustainability**

1. Introduction

1.1 The twin pressures of economics and public policy have led to greater attention being paid to a range of resource issues, covered by the concept of sustainability. It can be expected that both regulation and market sentiment will make these issues of environmental performance and sustainability increasingly important to those concerned with property and buildings and so, where relevant, to valuation. Indeed, many larger corporate clients and those with ethical concerns look to meet rising standards with regard to sustainability and expect similar standards from those with whom they deal. They are likely to raise the matter when seeking valuation advice.

1.2 It is very clear that these issues are evolving, with new ones, such as those related to climate change, coming to the fore. The emphases between them will change as legislation and market sentiment develop. While they may often still be externalities in economic terms, not influencing values, regulation (including taxation) is likely to increase the impact of these issues. Thus, while the market may often not have taken significant account of many of these issues to date, it seems increasingly likely that it will. As specific issues crystallise and become understood so they become part of standard practice. It may be inevitable that much discussion of sustainability as a concept focuses on those issues that have not yet crystallised including some that may not do so.

1.3 As an example, energy issues are becoming more salient, driven by cost, resource issues and now climate change concerns. The introduction of gradually strengthening regulation (such as the EU Energy Performance of Buildings Directive with its Energy Performance Certificates (EPCs) and other tools) for new and existing building stock will eventually lead to more sensitivity concerning a building's energy performance and efficiency. This means that labelling and certification systems using independent information will be used more often, regulations on energy codes will

become stricter and subsidies and tax relief might be available when building energy-efficient houses – due to the internalisation of negative external effects. It may well be that concerns over water scarcity and quality will follow a similar path.

1.4 Many of the issues covered by sustainability involve a long term perspective, such as expectations as to energy prices or handling environmental risk, while the necessary specific information may often be uncertain and the analytical tools still developing. However, those limitations do not make the questions unimportant.

1.5 Valuers must act within the limits of their professional skills. This will usually mean that they will need to call on relevant expertise, certification and reports as to a property's sustainability rather than prepare them personally. This follows existing practice regarding environmental issues such as the assessment of contamination, asbestos, flood risk or soil erosion for which valuers need to be able to understand what the specialist reports might mean and judge what weight to give to them. Valuers can only value on the basis of the market as it is, not hypothesise about the future. This information paper is offered to assist valuers' awareness of and sensitivity to these issues and so their understanding of markets as they evolve.

1.6 Sustainability - At a general level, sustainability is the capacity to endure. While this paper focuses on the environmental aspects of sustainability, it also has economic and social dimensions and many of the issues of economic sustainability may already be material to valuations. Indeed, economic concepts such as sustainable rental income or sustainable cash flow long pre-date the current uses of the word.

1.7 As pressures on resources and natural systems have grown, so attention has focused on the extent to which this capacity can be protected by intervention and management. The focus on environmental constraints has led to one definition of sustainability as improving the quality of human life while living within the carrying capacity of supporting eco-systems.

1.8 Sustainable Development - That approach already implies the problems of reconciling sustainability with any action or change. The concept of "sustainable development" was promoted by the World Commission on Environment and Development (the Brundtland Commission) which reported in 1987. It has since been a key component in many policy discussions on economic, social and environmental issues. In its report, *Our Common Future*, the Brundtland Commission defined it as:

"development which meets the needs of current generations without compromising the ability of future generations to meet their own needs."

The Commission's proposals were approved by the United Nations Conference on Environment and Development at Rio de Janeiro in 1992 leading to both national and international attention, including the United Nations Commission for Sustainable Development.

1.9 It has proved to be an enduring, broad but vague, portmanteau concept. Its formulation does not arbitrate between economic, environmental and social objectives where they conflict. Indeed, as the emphasis between these objectives will vary between parties and situations as well as over time, this very fluidity may assist its general acceptability, if not its robustness. No more precise definition has emerged and it will have different practical connotations for different people, in different contexts and over time.

1.10 With the developing momentum of such policy discussions, sustainable development may be best understood as a process rather than a defined end, that process currently being increasingly influenced by concerns over climate change and resources.

1.11 A variety of tools and concepts have evolved to consider environmental issues for property, including Life Cycle Assessment, Cradle to Cradle, Ecological Footprint Analysis and green buildings. In varying ways, they consider the impact of development on the environment and ecological systems over time, with greater efficiency in the use of resources and less degradation of the environment, developing resilience and adaptability and with concerns about social equity. These are measured through a growing range of audits, procedures and indicators all trying to capture aspects of the larger concept and influence decisions and so increasingly bearing on the use and development of land, property and buildings. This is not only through public policy and regulation but also by market perceptions and the demands of investors, businesses and their customers.

1.12 One challenge in analysing this is to understand for each case whether addressing sustainability adds or subtracts value. It can be seen as a cost and a restriction. Equally, economic opportunities can be seen in green growth with its accompanying technical innovation, while meeting standards may protect or enhance value.

1.13 At the larger level, it has been conventional to see economic growth as a challenge to environmental concerns but there is evidence (sometimes summarised in the Environmental Kuznets Curve) that higher levels of economic development can see reduced environmental degradation, perhaps partly as resources are then available to tackle the issues that are then of increasing concern and also as the nature of economic activity changes as do the techniques used. This transition with rising economic activity appears to reduce local externalities first, with more dispersed externalities being addressed at higher income levels. As techniques to reduce degradation are developed so it becomes easier for others to adopt them. Equally, the growing scale of economic activity represents a challenge. Increasing knowledge, sophistication and scientific advance open up new challenges – few would have been troubled by CO₂ emissions thirty years ago.

1.14 As the concepts become clearer in practice and guidance develops so it is likely to create intangible assets which will themselves need valuation where they can be separated from the underlying asset.

1.15 One international forum for discussing the valuation issues associated with the sustainability debate is the Vancouver Accord: “a commitment by valuation standards organizations globally to begin the process to embed sustainability into valuation and appraisals.” Those developing discussions are likely to inform the valuation profession.

1.16 Eco-System Valuation - There is a growing body of work, particularly for economic and environmental policy, to put values on such resource and environmental issues as:

- pollution, energy and materials;
- environmental protection and resource management;
- natural resource assets;
- valuation of non-market flows and environmentally adjusted aggregates.

Others have adapted this for topics such as fishing, water and agriculture.

1.17 This approach, commonly developed independently from an economics background, tends to identify values that can be on very different assumptions from those required by the valuation profession's standards. The resulting assessments, commonly reflecting externalities and often very sensitive to changes in assumptions, may or may not be useful for public policy, according to the realism of their assumptions and rigour of their analysis, but will not be either a market value or a fair value. Conceivably, they could represent a measure of Worth (see EVS2) applicable to the policy makers concerned but not of wider relevance. Understanding and perhaps reconciling the differences between the two approaches may be increasingly necessary as eco-system valuations develop. In practice, eco-system valuations may be of greater relevance in comparing options than in identifying absolute values.

2. Sustainability and Property Users

2.1 The sustainability movement is now increasingly driven by concern over climate change and so focuses on energy and carbon issues. This bears on all aspects of a firm's business including its property and buildings. This leads to the use of new terms such as “green building” and “sustainable building”.

2.2 Owners and occupiers of property may have a variety of motives for considering sustainability in general or specific aspects of it, such as energy efficiency, in particular. These may range from personal commitment to cost-cutting, from complying with regulation to seeing it as an advantage with customers.

2.3 With the increasing prominence of climate change as a source of policy concern, the association of buildings with some 40 per cent of energy consumption makes property a particular focus of attention and comment. Nonetheless, energy costs may only form some 1 per cent of some businesses' operating costs, while staff costs may account for as much as 85 per cent of the operating costs of an office tenant. Such ratios have limited the impact of energy issues on rents and values. It could equally suggest that the aspects of the building that influence the working environment may have a perhaps unrecognised importance. Where tenants are willing to pay higher rents for compliant properties then that will assist values, but they may only do so if they see benefits in occupying a green building. In practice, attitudes may vary over the economic cycle.

2.4 For those owners and businesses that make purely commercial judgements, the necessary investment has to show an acceptable return. It may be that investment in improving building equipment (such as heating, ventilation, air conditioning or for chilling) may not appear justified by the financial benefits of the improved energy efficiency or the market premium of that property. Green leases (see 3.3 below) are a means to try to reconcile the common imbalance of interests between landlords and tenants in these matters.

2.5 As businesses choose or are increasingly expected to operate in ways more sensitive to these issues, their owners and customers may tend to demand more relevant credentials to prove this. For larger businesses, such credentials might include:

- demonstrations of Corporate Social Responsibility (CSR)
- a Carbon Reduction Commitment (CRC)
- accreditation according with ISO 14001 – the international standard for environmental management systems or EMAS, the EU-wide Eco Management and Audit Scheme.

A tangible example of such commitment by either party may be the use of "green leases".

2.6 Corporate Social Responsibility (CSR) describes companies' voluntary choice to integrate the consideration of social and environmental issues into their daily business to demonstrate ethical behaviour and improve social conditions. This may include considering:

- inputs, such as raw materials, energy, water;
- processes, such as environmentally friendly production; and
- publicity, such as community relations.

The more developed policies will cover property occupation and investment and so may have an effect on both capital and rental values.

2.7 While voluntary, an increasing number of companies accept CSR as an element in business plans and annual company statements. In some cases, it may be seen as a proxy for quality and management. It may be that the largest companies will be legally

required to report on these matters. In some countries, the law already regulates the presentation of non-financial performance indicators.

2.8 A CSR policy may be driven by a company's strategic plan, its corporate risk strategy, the needs for grants and funding or pressure from investors, customers and others. A clear statement of the company's rationale will be needed for any appraisal of its impact.

2.9 Some companies encompass the ecological, social and economic aspects of sustainability in the concept of the "Triple Bottom Line", analysing and reporting performance under each heading. This is, of necessity, a permanently evolving approach and indeed sustainability could be extended to consider technical and functional quality.

2.10 Responsible Property Investment (RPI) is a framework for investors to maximise the positive effects and minimise the negative effect of property ownership, management and development on society and the natural environment. The UNEP Finance Initiative has set out Principles for Responsible Investment to incorporate environmental, social and corporate governance (ESG) issues into company policies and practice, offering a series of toolkits for this. Its declaration requires companies to look to their "investment service providers (...) to integrate ESG factors into evolving research and analysis". Recognising the constraint of a tenant's legal possession, it sees the investor's role as particularly critical for construction, refurbishment, management of common space and the opportunities given by lease termination - at each point having more control over sustainability issues than when an investor in equities (including REITs). The responsible investor should engage with its tenants to manage the environmental and social impact of a property, albeit that few historic leases have many clauses relevant to sustainability issues.

2.11 When considering investment, properties might be screened for:

- the location – sustainability grounds might point to those with better public transport or on brownfield sites;
- physical characteristics – do the buildings meet environment standards such as BREEAM, LEED, Green Star or CASBEE (see 3.2 below)? This may limit the choice of investments, potentially constraining portfolio diversification and, by focusing demand on such properties, affecting their prices and so their returns;
- tenants – perhaps by their business activity.

The data to support such screening is often limited and partial, in some markets there may be almost none.

2.12 An alternative approach is to seek out properties that are best in their class. However, this will also rely on recognised certification and rating systems, such as

BREEAM or EPCs. While this may help identify properties whose value is better protected for the future it will tend to be available only for new properties and in the case of EPCs, for existing buildings being sold or rented out.

2.13 Environmental Management Systems (EMS) offer tools for businesses to consider sustainability issues by seeking continuous improvement on the basis of the four stages of planning: what is to be done, do it, check that it was done, and act to make improvements, considering impact on the environment and the activity that causes that change. It may assist businesses in looking at cost savings, managing legal, financial and reputational risks (including the identification of prospective legal requirements), marketing opportunities and the expectations of stakeholders. It can start from reviewing the current position (as a baseline) which may show that much has already been done without having thought of it as “environmental” and then developing an environmental policy to drive the future process.

2.14 ISO 14001 sets standards for these by which businesses can then be audited. These cover five aspects or stages:

- environmental policy;
- planning of action;
- implementation and operation of project;
- checking and corrective action;
- management review.

2.15 The Eco Management and Audit Scheme (EMAS) offers a European standard that is voluntary but once adopted is subject to mandatory auditing (unlike ISO 14001). As some of its requirements are supported by legislation it may be more demanding than ISO 14001 to which it is essentially similar. A business is to identify its direct and indirect environmental impacts and assess their significance. Internal audits must cover the management of the issue, performance in doing so and compliance and there is an external audit on a three year cycle.

2.16 Life Cycle Costs - A judgment on the sustainability of a property may focus on its whole life cycle together with its associated externalities. Where the valuation employs the income method, cost and income must be analysed and reduced to a present value. Life Cycle Cost Analysis (LCCA) calculates the present value of all costs for the whole remaining life of a building, including construction, operation, maintenance and end-of-life costs.

2.17 Some European countries have national standards and guidelines for carrying out LCCA while the international standard is ISO 15686-5 Buildings and constructed assets - Service life planning - Part 5: Maintenance and life cycle costing set the frame. However, ISO 15686-5, does not prescribe a common format for this analysis, allowing different approaches in practice.

3. Developing “Green” Standards for Property

3.1 “Green Buildings”

3.1.1 A “green” or “sustainable building” uses resources such as energy, water, materials and land more efficiently than buildings constructed to existing minimum standards, producing less waste and fewer emissions and potentially offering a better internal working environment. As sustainability expects that the needs of the present should not compromise the ability of future generations to meet their own needs, green buildings should also take social, ecological and environmental issues into account. That broader definition includes external effects and the impact across generations.

3.1.2 The RICS has defined (2008 Valuation Standards) a green building as a property that

“displays characteristics that minimise environmental impact through all parts of the building’s life-cycle and focuses on improved health for its occupiers, optimise utility for their owners and occupiers and the wider public, whilst minimising the use of natural resources and environmental impact”.

3.1.3 The American Society of Heating, Refrigerating and Air-Conditioning Engineers (ASHRAE), in conjunction with the Illuminating Engineering Society of North America (IES) and the U.S. Green Building Council (USGBC) published a standard for the design of high-performance green buildings in February 2010. Standard 189.1, *Standard for the Design of High-Performance Green Buildings Except Low-Rise Residential Buildings*, states:

“a high performance green building is a building designed, constructed and capable of being operated in a manner that increases environmental performance and economic value over time, seeks to establish an indoor environmental performance that supports the health of occupants, and enhances satisfaction and productivity of occupants through integration of environmental-preferable building materials, and water-efficient and energy efficient systems.”

3.1.4 These definitions show that the concept of sustainability is far from precise when applied to buildings which themselves vary enormously in design, construction and use while different users will have their own concerns which may change over time.

3.1.5 The following may serve as a general checklist:

- location – where relevant, is it accessible by public transport as well as private means?;
- the existing land use of a site for development – there may be such issues as contamination or water management;
- the risks to a building’s location from such threats as flooding or earthquakes or those caused by its siting and design (as with flooding from hard surfaces);
- the design and layout of building, covering issues from its expected life to

- its energy management, including materials (source, recycling, type, life) and resource efficiency;
- its quality as a working environment and so its impact on occupiers' health and efficiency, which can include ventilation and lighting;
- energy efficiency and sourcing;
- water efficiency;
- waste management;
- how resilient is it to potentially rising costs of energy, water and waste management?

3.2 Certification of Buildings and Green Rating Tools

3.2.1 A number of approaches have been launched for rating buildings against defined environmental standards, some statutory and others voluntary, offering standardised assessment and certification for green and energy-efficient buildings. There are around 30 voluntary rating systems worldwide that try to meet the conceptual complexity of the term "sustainability". Perhaps inevitably, they are overwhelmingly focused on new or heavily renovated buildings.

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

- BREEAM (Building Research Establishment Environmental Assessment Method) which scores the performance of a building for eight criteria (energy, transport, pollution, land use and ecology, health and welfare, and management) whose scores are then totalled and rated. It provides different regimes for different uses such as industrial, retail, or schools. A new building may be first assessed at the design stage (with an interim certificate) and after construction. It can also apply to renovations. There are four pass grades.
- LEED (Leadership in Energy and Environmental Design) set by the US Green Building Council (USGBC) applies to new buildings and renovations scoring them out of 100 points, again with four final levels of certification. The main scheme's criteria for assessment are sustainable sites, water efficiency, energy and atmosphere, materials and resources, and indoor environmental quality together with scores for innovation in design and regional priority. The USGBC issued data in 2008 to show that buildings compliant with its LEED standards showed:
 - 8-9 per cent lower operating costs
 - 3.5 per cent higher occupancy rates
 - 3 per cent higher rents
 - a 6.6 per cent higher return on investment
 - a 7.5 per cent increase in market value

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

3.2.3 Other standards noted internationally are DGNB in Germany, CASBEE in Japan, Green Star and NABERS in Australia. Individual countries may have their own domestic standards or codes. Each scheme varies in what and how it assesses and all are regularly revised. Their appraisal methods often tend to be prescriptive rather applying underlying principles to form assessments.

3.2.4 There are few bases for assessing existing buildings. EPCs offer a prescriptive approach to energy ratings in the EU, while the US Building Owners and Managers Association has developed Go Green.

3.2.5 All approaches tend to be applied differently in different countries, so that even EPCs vary between EU member states, posing issues for international understanding and appraisal in comparing information. (*Note* - the Energy Performance of Buildings Directive of 2010 instructs the European Commission to adopt a voluntary EU certification scheme for non-residential buildings (Article 11(9) and work is expected to be completed in 2012 (see EVA8)).

3.2.6 Policies and expectations for sustainability continue to change and develop. Thus, mandatory standards for new buildings imposed through development control or building regulations systems may well increasingly focus on ever more demanding low energy or passive house standards and the use of renewables as well as more general sustainability criteria. In some areas, these regular requirements may either replace voluntary green building rating tools or encourage them to set still higher standards. The Energy Performance of Buildings Directive provides for new buildings to be to “near-zero energy” standards by 2018 (public buildings) and 2020 (private buildings) (see EVA8).

3.3 “Green Leases”

3.3.1 There is growing discussion of the concept of “green leases” which may again have an impact on the valuation of some properties. Still in their infancy and perhaps most developed in Australia, there is no precise definition of green leases that is widely accepted in the market.

3.3.2 Discussion of green leases has arisen in response to the common imbalance of interest between landlord and tenant in environmental issues. Capital investment, sometimes with long pay back periods, is often required to improve a property's performance. Landlords and investors may often be reluctant to incur that cost without an appropriate return while tenants can be cautious about investing in a property they do not own, indeed may only hold for the balance of a short lease. The green lease, which may in practice only be agreed between parties interested in the issues for their own commercial or personal reasons, endeavours to tackle identified sustainability concerns between them and meet rising legal standards.

3.3.3 In general, a green lease refers to a lease of a sustainable/energy-efficient property on terms that promote sustainability. Those terms, widely varying in practice, may often relate to green or energy-efficient standards, operational controlling and audit procedures related to energy performance measurements. Some landlords have granted green leases with just a few basic green obligations, such as co-operation on energy-saving initiatives, provision of information on energy, water and waste, the use of sustainable materials, and prohibitions on harming the building's energy performance – "Light Green Leases". At the other end of the spectrum there may be provisions setting targets for the use of energy, waste and water, including separate metering, reports, rent review assumptions, alterations, and reinstatement – "Dark Green Leases". They may cover such topics as waste disposal or the avoidance of volatile organic chemicals in cleaning materials. The leases may include incentive and penalty clauses based on agreed upon service and energy performance levels which may affect the rent or be considered as improvements or dilapidations on termination of the tenancy.

3.3.4 The Australian Government has published a series of model green lease schedules for different types of tenancy, requiring the tenant to operate the property efficiently and extract the greatest environmental benefit from it in ways such as using the most efficient equipment, fittings, lights and heating systems with an Energy Management Plan and a framework for reporting and auditing subject to penalties. Precedents are now available in other jurisdictions, such as the United Kingdom. They may make provision for a range of subjects to be, addressed between the landlord and the tenant including:

- the landlord providing the tenant with a handbook to energy and environmental operation of the property;
- energy efficiency targets – maintaining and improving EPC ratings with any failure exposing the party responsible to financial penalties;
- if the landlord fails to meet agreed commitments to improve energy efficiency there may be rent rebates;
- the tenant is to ensure that energy consumption is efficient and provide the landlord with full data on energy and water use;
- the landlord and the tenant produce Energy and Sustainability Performance Reports;
- alterations which materially reduce the environmental performance of the property may be prohibited absolutely;
- as the tenant may be the best person to make alterations to improve the environmental efficiency of the property, there can be provisions allowing him to leave them at the end of the lease with the landlord waiving dilapidations on them;
- a reduction in the EPC rating may be considered a dilapidation;
- service charges – where a property has several tenants the landlord may reserve the power to weight and re-weight the service charge to reflect

the tenants' relative environmental performance which can then be a comparable factor at a rent review;

- a property with several occupiers may have a management committee including the landlord.

3.3.5 Where considering a green lease, it is prudent to make a record of condition using an energy and environmental audit to establish a baseline from which to judge the issues and commitments of the lease.

4. Valuation and Sustainability

4.1 The valuer can only provide his opinion of value on the basis of evidence and so reflecting the experience of the marketplace. That opinion cannot state that something should have a value, just that it has a value assessed from a judgment of the available data. That opinion is to be so supported and prepared so that, within the limits of the available evidence, the client can rely on it for the purpose for which the valuation was instructed.

4.2 There can be no general rule as to any typical pattern of premiums or discounts accounting for environmental issues. Even where such issues are significant in the marketplace, much will turn on factors such as the state of the market, transparency of information, location, sector, exposure to environmental risk in the region, and consumer awareness.

4.3 Markets may in time differentiate between the values of properties on environmental grounds. Thus, it may be that highly energy-efficient buildings with low energy consumption or properties with a recognised green certification may begin to attract an additional value in some markets. While this may apply for a while, it may then be that as the market begins to expect such standards or regulation requires them, that premium is replaced by a discount for other properties. Such changes will be phenomena of the market place and there cannot be any general rule for the impact of these issues on property values, rents and yields.

4.4 The issues on which the concept of sustainability focuses may or may not be relevant to that opinion, according to the nature of the asset, the relevant circumstances and the behaviour of prospective buyers. Thus, their relevance may turn on several factors including the extent to which the issues:

- are not externalities but relevant to the price someone will pay
- are of interest as incentives or deterrents to buyers.

In essence, it is a question of how far the evidence shows that a willing, knowledgeable and prudent bidder will take them into account when considering the price or rent of a

property. Corporate buyers of commercial property may view these issues in a different way from someone buying a house to live in.

4.5 This may also be influenced by market circumstances. Where there is a strong market with a limited supply of buildings, the market may not particularly distinguish between properties on sustainability grounds. However, as these issues come to matter to buyers and occupiers and as more properties meeting recognised sustainability criteria are available so the market may differentiate on this point, perhaps especially when market sentiment is weak.

4.6 There may be particular classes of bidders to whom sustainability issues may be more important. Most obviously these will include those for whom the ethical aspects matter more, whether out of personal conviction or under the rules of a specific investment fund. Some may be temperamentally interested in innovation – “early adopters”.

4.7 Others may see them as criteria relevant to potential future movements in values. They may think that properties meeting particular standards are more likely to rise in value or that properties failing to meet them are at greater risk of standing at a discount to a future market. Only the future will prove whether they were right or wrong, whether about the future reactions of markets or the specific criteria they have selected. Where such purchasers have chosen the right criteria and markets prove to move as they expect, then they may outperform the general market whether by buying advantageous properties or selling ones at greater risk from environmental factors. Markets may, of course, move in unforeseen directions or regard other factors as relevant.

4.8 One way of analysing this behaviour is to observe that those parties are approaching their decisions on the basis of Worth (also known as Investment Value – see EVS2 and EVA5) in assessing the value of a property to them for their own objectives. Where the Worth of the property to them on their criteria is markedly greater than its Market Value, they may see an opportunity.

4.9 When considering properties that are to be let, sustainability issues will be more relevant if they encourage tenants to pay higher rents or the market to see them as more secure income streams. The former will depend on the usefulness of such properties to tenants, over and above other properties – tenants will rarely have an interest in the future capital value of the property. There may be relevant differences in energy or other costs; they may offer more attractive working environments for staff; they may help the tenant project its favoured image to its own customers. Some of this will inevitably overlap with the likelihood that the most sustainability-compliant buildings will be those built most recently, so also meeting other contemporary standards and be less likely to need refurbishment in the near future. Less compliant

properties may need to incur the greater costs of adaptation in “retro-fitting” to meet rising standards as and when this may be required, whether by market expectations or as legislation develops or stand at a discount to more compliant properties.

4.10 Should such an approach become more widely adopted by parties in the market place in respect of particular criteria then it would over time influence market values. However, if the criteria in question do not become more widely used, they would remain factors for only a limited number of individual players with less or no influence over market values.

4.11 These issues can become more difficult where a building is in several different occupations where the owner and occupiers may all have differing obligations, interests and objectives.

4.12 Where markets do move towards a greater appreciation of sustainability, whether just, say, for energy or a wider range of issues, then it will be relevant to the assessment of market value. In practice, analysing this may often not be a matter of general sustainability, but of appraising the role of specific issues (such as energy) which may interact with operational costs or be currently salient issues in the market place.

4.13 Many may say they will pay a premium for meeting certain general standards such as BREEAM, but this may be less evident from actual behaviour. It can be hard to tell from market evidence of actual transactions where traditional factors may often appear to explain the outcome.

4.14 Conversely, as legislation, market sentiment and perhaps taxation increasingly enforce sustainability issues, so the costs of compliance and improvement for many existing properties or more complex development proposals (such as some urban regeneration schemes) may adversely affect their values.

4.15 **“Green Value”** - The concept of “green value” is sometimes invoked. Just as there are various green building definitions, there is no commonly accepted definition of “green value”. At one level, it can just mean that the “sustainable” qualities of buildings and properties may be reflected in their value.

4.16 More specifically, green value is the extra value a green building may have when compared with an ordinary building. However, while this may offer a useful shorthand, especially for comparison, such green value does not exist on its own but is one integral part of the property’s overall market value and is separate only as a theoretical construct.

4.17 **Approaches** - While ever greater attention is being focused on sustainability issues, it is often noted that they may often not be reflected in market values. As any

one issue becomes of general concern to buyers, so it just becomes part of the general matrix of factors underlying market value. The effect may of course not be that of a premium over other properties, but that less compliant properties may be at a discount.

4.18 Sustainability, energy efficiency and green features can only be reflected in the valuation where this is supported by observable market evidence. There is no reason to assume that meeting or failing to meet any aspect of sustainability will generally see a premium or discount in the property's value. The impact of a feature may vary over time, between different sectors, uses or regions.

4.19 All existing valuation methods – mainly income, direct value comparison and replacement cost – are suitable for the valuation of sustainable buildings. Comparable transactions are the best proof of the market's willingness to pay for certain building features.

4.20 In some markets, the valuer may try to apply advanced statistical methods to identify green value as part of his analysis. This may depend on the quality and range of available data. The use of multiple regression analysis may persuade more sophisticated clients. Contingent valuation, hedonic pricing or even cost-benefit analysis may offer approaches but these can risk producing results that are uncertain, unduly sensitive to changing assumptions, with large ranges and that are not obviously supported by the market place.

4.21 Discounted Cash Flow (DCF) can be a way of taking into account and comparing differing profiles of operating and refurbishment costs.

4.22 One practical problem is that sustainability issues do not exist in isolation but, as noted above, will overlap with other factors. For example, energy efficiency may be a virtue, a cost saving, allow a higher quality of working environment and be an aspect of a modern building which, as such, has lower maintenance costs, less need of refurbishment and may be in a more attractive location.

4.23 As a practical profession, valuation turns on observation and appraisal. In present circumstances, considering sustainability issues in relation to a property requires careful analysis. It may only rarely be that sustainability issues as a generality will be relevant, but more often that specific issues and particularly, specific standards will be of concern. Standards, certification and rating regimes can summarise and encapsulate information on, say, energy in ways that the market may more easily take into account. It thus becomes more important to know how to:

- identify, describe and assess the relevant characteristics of properties;
- interpret and judge assessments of them;
- consider whether they are already taken into account so far as they are relevant to value;

- select the appropriate way to take any remaining points into account without double counting.

4.24 Once relevant factors are identified and appraised in this way they can, in principle, be taken into account for valuations in just the same way as any other specific factors. They do not require new valuation methods but rather calm, practical assessment under the terms of the valuation basis instructed. They will need to be covered in the valuation report to the extent and in the manner that is appropriate.

4.25 The extent to which the report refers to sustainability will be a matter of judgement in the circumstances. This will in part reflect the extent to which sustainability issues are relevant to the value and in part the interests of the client. These two points come together where a client interested in sustainability issues instructs a valuation on the basis of Worth.

4.26 Any recognised certification or rating awarded to the property should usually be reported.

4.27 Towards Checklists - Where sustainability issues are relevant to the valuation, the valuer will have to collect appropriate information, appraise it and take it into account in his report, either as aspects within the usual structure of his report or as separate sections, with or without appendices, according to the case. The diversity of properties and the developing nature of sustainability combine to mean that no general check list can be exhaustive but it may, according to the property, be relevant to consider some or all of the following non-exhaustive lists of points.

4.28 Alongside the usual description of the property, factors to consider might include:

- construction materials;
- any contamination of properties such as brownfield sites for development;
- risks of natural disasters such as flooding, earthquakes, or avalanches;
- compliance with relevant building standards;
- insulation and related features, its special features (such as heat bridges or type of windows) and continuity in terms of durability, regional and legislative building standards;
- nature and complexity of building services;
- age and quality (efficiency) of the equipment in the building for heating, cooling and other purposes and so the feasibility of maintaining or replacing specific building components (such as an oil-fired heating system compared with an alternative system that may reduce overall operating costs);
- energy efficiency, EPC ratings and recommended measures for improving it, energy sources (renewable?) and net energy demand;
- water efficiency, especially in locations with scarce water supplies, using grey

water, recycling of water, rainwater harvesting, etc.;

- operating expenses;
- floor area in terms of usability, adaptability and cost effectiveness;
- impact on users' productivity and wellbeing;
- likely timing and cost of refurbishment;
- market attitudes towards sustainability and willingness to pay for green features;
- requirements of legislation;
- possible financial support;
- relevant certifications or ratings;
- terms of leases (green-leases).

4.29 Reviewing the property more generally:

- does it meet best practice?
- can deficiencies be remedied economically?
- how does it compare to other buildings in the area of search?
- do sustainability issues affect the demand from potential tenants? And the rents they will pay?
- do they affect the yields that other investors will seek?
- what are its running costs and the likely timing and scale of any refurbishment costs?

4.30 While this paper has considered sustainability largely on the environmental terms that are salient in today's discussions, other practical issues of adaptability and flexibility of the property and the space and facilities it offers may also be aspects of its ability to remain useful without major change. Where larger areas of land are involved, as with agriculture or for development, other relevant issues may include bio-diversity and diffuse pollution. Where an Environmental Impact Assessment is required, that will require a review of many sustainability issues.

Code of Measurement of Distance, Area and Volume

Note – *This Code does not define how different types of property are to be measured as this will depend on the local market. It sets out what is meant by a particular measurement basis and the types of property and valuation for which it may usually be employed.*

- 1. Introduction**
- 2. Scope**
- 3. General Definitions**
- 4. Building Measurements in Practice**
- 5. Further Reading**

1. Introduction

1.1 Recent research by the European Council of Construction Economists (CEEC) showed that while all European countries use similar bases for measuring floor areas in buildings, the way these components are grouped and coded differs vastly between various countries. This means that comparisons between various types of areas are often highly misleading.

1.2 This document acknowledges that at present it is impossible to generalize cross-border rules for the measurement of property into a common code. It is therefore a guide to the bases and methods used in measuring properties for the purposes of valuation.

1.3 This document acknowledges that at present it is impossible to generalize cross-border rules and general practice for measurement of areas and space. The contents of this document are therefore intended as a guide solely for the purpose of the valuation of real estate properties.

1.4 The approaches described in this paper have been informed by Euronorm 15221-6 published by CEN (Comité Européen de Normalisation - The European Committee for Standardization) in 2011 in the context of facilities management. There are other codes and some of these are noted in this paper's final section on further reading.

2. Scope

2.1 This Code covers the measurement of distance, area and volume of land and buildings as a guide for valuers in Europe as many European countries currently use different rules and definitions for assessing these, such as the floor areas of buildings. This makes it difficult to compare and interpret data between different countries in a way that is accurate or useful for valuers or clients. This has wider consequences for comparisons that may be made by many other decision-makers, such as planners and architects, economists and investors, owners and tenants, politicians and administrators.

2.2 This Code sets out definitions for many commonly used measurements and notes some types of property and valuation where they may usually be employed, so that they can be understood and so be used to give results that are comparable between countries and so assist property valuation and assist benchmarking between comparable properties in different countries.

2.3 This Code does not define how different types of property are to be measured in detail as this will depend on local conditions, standards and regulations. Valuation reports should, where relevant, clearly state and explain the bases of measurements used and identify any unusual bases or deviations from the approaches described in this paper.

3. General Definitions

3.1 Measurements will usually be made and recorded using the metric system, though not always with Systeme International units. However, individual countries and sectors may conventionally use imperial or local measurements commonly adopted in national practice or in keeping with market practice.

3.2 Subject to any legal provisions or instructions from the client, the choice of units and the number of decimal places used will be a practical matter for the valuer to determine in the circumstances of the property and the needs that a client may be expected to have.

3.3 Units

- Distances are measures of length in one dimension and should be expressed in metres (m).
- Areas are measures in two dimensions and should be expressed in square metres (m²) though markets such as the United Kingdom office market will use square feet (ft²).
- Larger areas, rural properties, and older buildings commonly have irregular

shapes. Care should be taken to measure such areas accurately, perhaps by a land survey, or the use of digital maps. The areas can be expressed in hectares, though the United Kingdom commonly uses acres and some sectors in other countries may have their own conventional measures.

- Volumes are measures in three dimensions and should be expressed in cubic metres (m³).

3.4 Distance

- Gross length is measured as the horizontal distance between either the outer faces of exterior walls or between the centres of interior walls. The choice of basis should be stated.
- Net length is measured as the horizontal distance between the inner faces of exterior walls, disregarding internal structural components such as pillars or buttresses that are not complete walls.
- Gross height is measured as the vertical distance between the top of a finished floor and
 - the top of the finished floor of a room situated above it, or
 - the top of the roof structure above it.
- Net height is measured as the vertical distance between the top of a finished floor and the bottom of a ceiling, floor or roof situated above it, disregarding internal structural components that are not complete walls.
- Free height is measured as the vertical distance between the top of a finished floor and the underside of a suspended ceiling above it.

Areas and Volumes

- Gross areas are determined by using gross lengths.
- Net areas are determined by using net lengths.
- Gross volumes are determined by using gross lengths.
- Net volumes are determined by using net lengths.

3.5 Property Boundaries and Plot Areas

- Plot area is the area of the property within its boundaries. This may be referenced by government agencies (such as a Land Registry, Cadastral or local authority) measured as from a horizontal plan. Plot area can then as appropriate be divided into the built area and the un-built area:
 - Built area is the part of the plot area which is covered by buildings in their finished state both above and below ground.
 - Unbuilt area is the remaining part of the plot area which is not classified as built area.

3.6 Identifying External Boundaries - Valuers should be careful to establish that they have an accurate understanding of the boundaries of the property. It is important to establish whether and which boundary features belong to the property

and so be certain of the line of the boundary with adjacent properties. This also applies to party walls between buildings.

3.7 The area of the property as documented for the valuer may not be the correct one. Older documentation may be obsolete.

3.8 Land may, for example, have been subject to compulsory purchase or subdivided. Property areas may also change when boundaries alter as a result of agreements between neighbouring parties who may not always formally register their agreement.

3.9 Boundaries such as woodland edges, tree lines, hedges and rivers may not prove to be precise descriptions and can change over the years. Fences and other markers may be incorrectly placed or have been moved and consequently the GPS measurements used in preparing digital maps may not represent the true position.

3.10 Where boundaries are not precisely recorded or are in dispute, there may be local practices and interpretations which may offer presumptions for identifying the boundary.

3.11 Measuring Boundaries - The historic method for surveying land is the Metes (direction and distance) and Bounds (reference points) system. Land is measured and identified by describing its boundaries as agreed between interested parties who walked the perimeter of a property and established or recorded landmarks along it. Those Bounds might be stones, trees, tree lines, hedges, ditches, rivers, streams and creeks, corners of other properties or artificial survey points. Metes describe the direction from one reference point to the next and the distance between them.

3.12 The methods for recording boundaries and measuring the areas within them have since developed substantially from measuring distances and angles to global positioning and electronic mapping. In each case, the measurement will only be as good as the limitations of the method used – even the global positioning systems available for commercial use work to certain tolerances and may be affected by military or other considerations.

3.13 The internet now offers many opportunities to view property, whether from the air or the street. This can be a useful tool, perhaps especially for a preliminary or a general view. However, the pictures may be dated and the property could have changed since they were taken. There are particular problems in taking measurements from such services and these should not be relied upon.

3.14 Where working from any form of records, as for desk top valuation, the data as to measurements will only be as at the date they were recorded and will be subject not only to changes that may have occurred since but to any omissions or errors in their collection.

3.15 While the accuracy of measurement has greatly improved, the property boundaries on which they depend may be uncertain and disputes over them give rise to many court cases throughout Europe.

3.16 The valuer should cite the source (and its date) for the property area reported in his valuation.

3.17 In some cases, the value of the land can be influenced by the topography of the land which may give it a greater or lesser usable area - sloping and undulating farmland may offer a larger croppable area than flat land.

3.18 Classification of Types of Plot Areas

a) natural landscape:

- forests
- greens including individual plants
- planted areas
- agricultural land which may be further divided by its use, quality or other characteristics including its qualification under the specific rules of subsidy schemes
- natural expanses of water
- other natural landscapes (sand, rocks)
- land neighbouring or on the foreshore of tidal waters

b) paved areas:

- paths for pedestrians or cyclists
- roads for light and heavy vehicles
- parking areas including internal roads
- sports fields and playgrounds including sport greens and swimming pools
- railways

c) structural units:

- walls and other internal boundary features
- protection systems (against noise and light)
- ramps, stairs, steps
- bridges, catwalks
- canopies, shelters, pergolas
- water basins, fountains

d) technical units:

- water supply
- waste water
- gas supply

- heating and cooling services
- earth heat exchanger
- other technical units

Specific Definitions of Building Areas

3.19 Site area is the part(s) of the plot area used for one or more buildings or intended for their construction.

3.20 The Building Envelope (BEA) is the plan of the part of the site area that is physically occupied by the building both above and below ground, using its maximum dimensions.

3.21 The Building Footprint (BFA) is the plan of the part of the site area that is physically occupied by the building above ground level, using its maximum dimensions.

3.22 Gross External Area (also called Gross Floor Area (GFA)) is the area within the outside of the exterior walls of the building envelope and so includes the thickness of the perimeter wall of the building ("extra muros").

3.23 In France, **Surface Hors Œuvre Nette (SHON)** is broadly the GFA after deducting the area of vertical circulation voids, such as stairwells and lift shafts. It is used for development control purposes and administrative consents.

3.24 Exterior Construction Area (ECA) is the area of the perimeter walls themselves.

3.25 Gross Internal Area (also called Internal Floor Area (IFA)) is the Gross External Area after deducting the Exterior Construction Area ("intra muros"). Thus, $GIA = GFA - ECA$.

3.26 Interior Construction Area (ICA) is the area of the internal structural components of the building within the perimeter walls, so recording the area taken up by load bearing columns and supporting walls.

3.27 Net Floor Area (NFA) (also called the Effective Floor Area or the Rentable Floor Area) is the Internal Floor Area (IFA) after deducting the Interior Construction Area (ICA). Thus, $NFA = IFA - ICA$

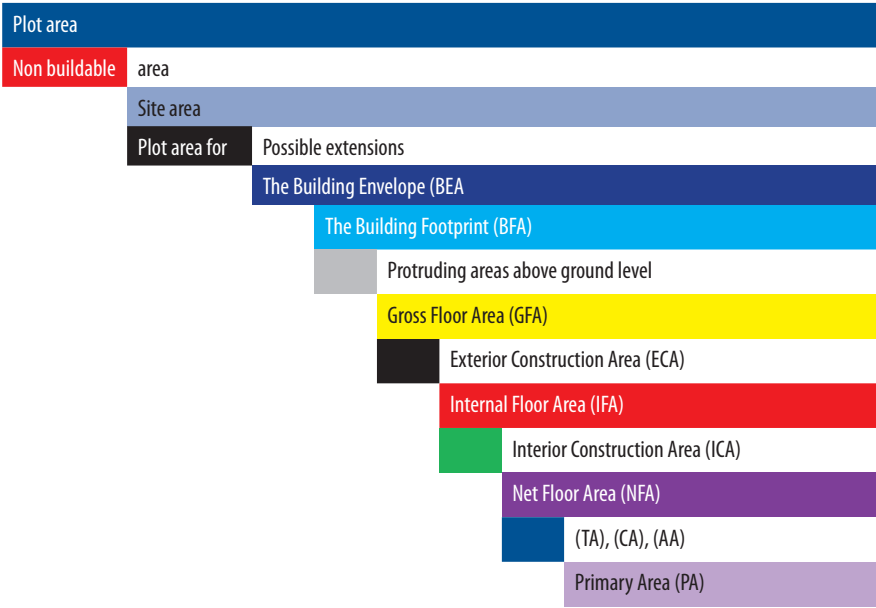
3.28 Areas for Technical Services (TA), Circulation (CA), Amenities (AA) etc are the areas common to all users, measured as net floor area.

3.29 Primary Area (PA) is the portion of the Net Floor Area (NFA) used for

supporting the core business needs and work processes, for example TA - Technical Area, CA - Circulation Area, AA - Amenity Area.

3.30 In France, **Surface Loi Carrez** is the Primary Area for residential property but excluding areas where there is less than 1.8 metres headroom. When used for offices, it includes lavatories which are exclusive to the particular occupier. Countries may differ as to whether such facilities are included in the letting area or not.

Figure 1 - Illustration of the various types of areas and their relationship



4. Building Measurements in Practice

4.1 These measurements will be of all available space in a building on each relevant storey meeting the definition in question.

4.2 Gross Floor Area (GFA)

- (a) Each floor should be measured to include the outside faces and projections of the enclosing wall. The full thickness of the building's perimeter wall is included in this measurement. Non-functional areas such as large open areas (without a floor) should not be included - if such areas are to be included their area must be specified.

- (b) The measurement should include areas occupied by:
 - internal walls, partitions, columns, stairwells, lifts, escalators, air (or other) vertical ducts
 - lift motor rooms, central heating or air-conditioning (ventilation) plant rooms, fuel tank rooms, electricity transformer and/or low tension rooms, corridors and other circulation areas, all sanitary areas
 - open-sided covered areas, ramps, enclosed parking areas, storage rooms, archive rooms (basement)

4.3 Internal Floor Area (IFA)

- (a) The IFA of each floor should be calculated between the internal surfaces of external building walls. The IFA is the Gross Floor Area (GFA) after deducting the Exterior Construction Area (ECA).
- (b) Measurements are to be taken at a specified height above the floor. Where ceilings are sloping the valuer should explain how he has measured the area. Guidance has been given on this by the Building Owners and Managers Association International (BOMA)

4.4 Net Floor Area (NFA)

This is the usable area offered by all floors within a building on the following bases:

- (a) Each floor should be measured at all levels between internal surfaces of external building walls. The NFA is the Internal Floor Area (IFA) after deducting the Interior Construction Area (ICA).
- (b) Measurements are to be taken at a specified height above the floor. Where ceilings are sloping, the rules for measurement must be specified.
- (c) The following areas of each floor are to be excluded from the calculation:
 - internal structural walls
 - vertical ventilation, wiring or pipe ducts and structural columns (generally only excluding items larger than one square metre in area but there may be differing practices between countries)
 - staircases and lift wells
 - lift motor rooms, tank rooms, (other than those used for processes), transformer rooms, high and low tension areas
 - space occupied by permanent air-conditioning, heating or cooling apparatus and surface mounted ducting which makes the space unusable, having regard to the purpose for which it is said to be used. This does not apply to apparatus installed by or on behalf of the tenant or used in the building for special purposes, such as computer operation, processing or manufacturing.

In calculating this area for office buildings, the following areas of each floor should be excluded:

- (a) those areas set aside for the provision of facilities or services to the building not for the exclusive use of occupants of the building
- (b) areas set aside as public space for thoroughfares and not used exclusively by occupants of the building. (Note: additional common areas that may be created by the subdivision of a single floor to accommodate more than one tenant are to be included in the calculations)
- (c) those parts of buildings such as entrance halls, landings and balconies which are used in common with other occupants. In some cases, these parts may be apportioned between the building's occupants.

Figure 2 - Illustration of Bases for Measuring Areas of Buildings

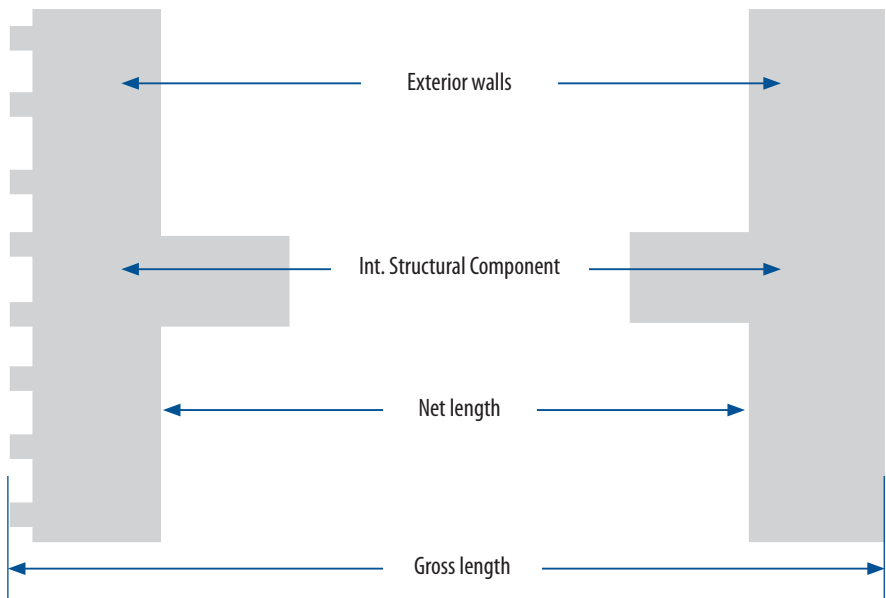
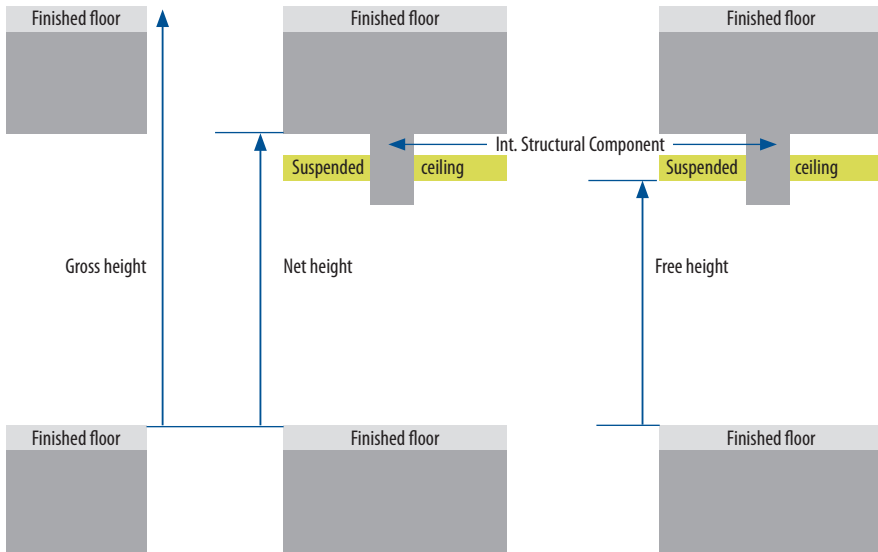


Figure 3 - Illustration of Bases for Measuring Heights of Buildings

Zoning

4.5 For some properties, particularly in the retail sector, the area within stated depths from the building's frontage may be a significant factor for a valuation. Typically, the area nearest the frontage may be described as Zone A and have the highest value per unit of area – for retail, this may offer the greatest density of sales. The areas at growing depths beyond that (Zones B, C and so on) will each have a value, usually given as a proportion of the Zone A figure and commonly reducing with growing distance from the frontage (depth). This offers both a means of appraising the commercial utility of the subject building and of analysing comparables.

4.6 Discussion of zoning may refer to the Built Depth, measuring the depth of the building back from its commercial frontage onto a thoroughfare within which the relevant zones are established.

4.7 It is important that the same zone depths be used in the analysis of comparable properties and in the valuation of the subject property. The depths used may vary between countries and by types of property but, for example, 6 metre depths are often used in the United Kingdom.

Special Provisions

4.8 Where relevant, the room height should be reported. The measurement procedures used for rooms with sloping ceilings should be reported.

4.9 Mezzanine areas, temporary or permanent, should be reported as well as the free height above and below.

4.10 Areas for special purposes such as areas and heights designed for special sized pallets and likewise, should also be reported

4.11 The height to a building's eaves or of the entrances is a key measurement for buildings used for vehicles or machinery in such sectors as transport, warehousing or agriculture.

Applications of Specific Measurement Bases

4.12 Gross Floor Area (GFA)

- Building costs (also for Insurance Valuation purposes)
- Site coverage
- Planning
- Zoning

4.13 Internal Floor Area (IFA)

- Building cost estimation
- Industrial building, shop and warehouse agency
- Valuation practice

4.14 Net Floor Area (NFA)

- Agency and valuation practice
- Service charge apportionment

4.15 Building Footprint

- Land usage

4.16 Building Envelope

- Land usage

5. Further reading

- ASTM (formally known as the American Society for Testing and Materials) - E 1836/E 1836M-09e1 - Standard Practice for Building Floor Area Measurement for Facilities Management
NB This Practice Paper was developed for use in the United States. It gives guidance in Annex A1 on office buildings but is specifically disappplied for use

in lease negotiations for which people are referred to the American National Standard published by the American National Standards Institute as ANSI/BOMA Z65.1-2010 (the BOMA Standard).

- BOMA (Building Owners and Managers Association International) - Six standards for floor measurement:
 - *Office Buildings: Standard Methods of Measurement (ANSI/BOMA Z65.1 – 2010) E-Book*
 - *Retail Buildings: Standard Method of Measurement E-Book (ANSI/BOMA Z65.5-2010)*
 - *Multi-Unit Residential Buildings: Standard Methods of Measurement (ANSI/BOMA Z65.4-2010) E-Book*
 - *Gross Areas of a Building: Standard Methods of Measurement (ANSI/BOMA Z65.3 – 2009) E-Book*
 - *Industrial Buildings: Standard Methods of Measurement (ANSI/BOMA Z65.2– 2009) E-Book*
 - *Mixed Use Properties: Standard Methods of Measurement E-Book*

CEN (Comité Européen de Normalisation - European Committee for Standardization) - EN 15221-6 - *Space and Area Measurement in Facility Management* - published on 19 October 2011 (national members of CEN are to publish this new version by April 2012 and withdraw previous standards within two years)

- IPD (Investment Property Databank) - Space Code
- ISO 9836 - *Performance Standards in Building - Definition and Calculation of Area and Space Indicators*
- Standards prepared for use, whether optional or mandatory, in specific countries, for example:
 - Germany = DIN 277 and GIF Mietflächenrichtlinie für gewerblichen Raum (MF-G)
 - Norway
 - Areas and Volumes of Buildings (Norsk Standard NS 3940:2007 Arealvolumberegning av bygninger)
 - Guidelines for the measurement of areas for residential properties for the Valuation Profession (Takstbransjens Retningslinjer ved Arealmåling av Boliger - 2009)
 - Spain - Asociación Profesional de Sociedades de Valoración (ATASA). "Estándar ATASA de Medición de Superficies de Inmuebles". ATASA. Madrid, 2011.
 - United Kingdom - RICS *Code of Measuring Practice*

Information Paper

Apportionment of Value between Land and Buildings

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

1. Introduction

1.1 Valuers often encounter situations where the value of a property has to be apportioned between its different components. In particular, EVA1, Valuation for the Purpose of Financial Reporting, makes reference to apportionment.

1.2 This information paper reviews the assessment of apportionment between land and buildings on land which cannot usually be marketed separately. This is thus a distinct topic from the valuation of undivided shares in a property. Apportionment may also on occasion involve equipment and machinery or intangibles.

2. Scope

2.1 The purpose of the current information paper is to analyse the valuer's approach to this apportionment of a property's value. This may be required for financial reporting purposes, the classification of a lease under IFRS, or taxation. Values may also need to be apportioned for some rent reviews or to apply agreements between parties. EU Directives and international and national accounting standards all require an apportionment for depreciation purposes.

2.2 Common terms used in the apportionment of the value established for a property between land and buildings on the land are:

- replacement cost (new replacement cost or indexed new replacement cost);
- depreciation;
- depreciated replacement cost;
- the useful life;

and these are defined below. However, their use must depend on the sound judgment

of the valuer both as to the method adopted and as to whether any further adjustments are required to achieve an answer that genuinely reflects a proper allocation of the value between the components in the circumstances of the property.

3. Definitions

3.1 Some of the approaches to apportioning the value of a property between the land and buildings on that land rely on the concept of the building's replacement cost. The various definitions of replacement cost are based on the most common use of the building, calculating the cost of rebuilding, as for insurance purposes. Excepting Depreciated Replacement Cost, this may not always mean the replacement of the building exactly as it is but rather the appropriate contemporary building for its purpose, of the dimensions necessary for that purpose and built with the materials and techniques and to the standards expected today.

3.2 Replacement Cost of a building is the cost to replace it so that it can fulfil the functions for which it is used. It may be assessed as either the New Replacement Cost or the Indexed Replacement Cost. It will include the fees associated with the construction.

3.3 New Replacement Cost ("New for Old") - The new replacement cost of the physical structures using the reconstruction costs as at the valuation date. This will be based on the current technical standards for building with fresh materials. Changed building standards may require the replacement structure to be more costly than a simple replacement of the old one (EVA4).

3.4 The present building may be less useful or efficient than a modern one. Thus, where the age, design or type of construction of a building mean that it would not ordinarily be re-built as it stands, the valuer may instead assess the cost of a modern substitute building. The purposes for which the building is needed may now require a different scale or configuration of structures or a different provision for services as may be needed, say, for IT. The old building might have higher ceilings, an awkward layout or ornamentation or other features that would not be replicated in a new building. Where such a modern equivalent building is assumed, it is to be of a quality, specification and with the services that would be required for the current use of the building.

3.5 Indexed New Replacement Cost - This adjusts the new replacement cost by recognised construction indices. (EVA4).

3.6 Depreciated Replacement Cost - This corresponds to the new replacement cost but after allowing for ageing and wear and tear of the structure. This cover only allows for the replacement of the building as it is, not for its replacement with a new building. (EVA4)

3.7 Depreciation is defined as the measure of the wearing out, consumption or other loss of value of a fixed asset whether from use, passage of time or obsolescence arising from technological or market changes.

3.8 Useful life is the period during which the building will be capable of economic use for its purpose.

3.9 Excess Land (or surplus land) is land within the property that is not essential to the operational purposes of buildings. In many cases, that may be after a view is taken of the modern equivalent buildings on which replacement cost would be assessed rather than the buildings as they stand. That may change the area of excess land or, indeed, create some.

4. Commentary

4.1 Apportionment of value between the components of a property is not a valuation. The outcome of the apportionment should not be taken as corresponding to the market value of the components.

4.2 In respect of apportionment, the valuer's judgment and selected methodology will determine the adjustments necessary to provide a realistic and justifiable opinion of apportionment.

4.3 The starting point for apportionment is commonly either:

- the market value of the property established by appropriate use of the three internationally recognized valuation methods; or
- the price of the transaction.

4.4 In some jurisdictions there may be policies for apportionment for certain classes of property established by legislation, government agencies or local practice. Where such apportionment policies are in place, they must, or as appropriate, may be adopted. The valuer may need to explain or justify the method used.

4.5 Where the requirement is to apportion value between land and buildings on that land, the apportionment process should usually have regard to one of the following procedures:

- (a) deducting the value of the land for its existing use at the relevant date from the value or price of the property;
- (b) deducting the depreciated replacement cost of the buildings at the relevant date from the value or price of the property.

It may also be possible to proceed by a component analysis of comparable properties and comparable land for which there is good evidence. Even though derived from

market values, this will result in a comparative assessment of the components, not a market value for each.

4.6 Where the depreciated replacement cost of a building is used, the value to be applied may vary according to whether any consideration has been given to its possible economic obsolescence. This issue may have a larger effect on the apportionment as, for example, where a factory might now be constructed as a smaller building to achieve the same output with modern machinery so needing less land and releasing land to be excess or surplus land (see 4.8 below).

4.7 The Land - The component of the property that is the land is considered to be the bare land in an undeveloped state but with planning permission for construction and use of the buildings. The services that exist are assumed to be available for connection but all built improvements such as roads, fences, paved areas and other site works are excluded as they have to be depreciated. The valuation will thus reflect the advantages and disadvantages of the site and its location. It should not include any development potential over and above that required for the buildings being considered.

4.8 “Excess land” or “surplus land” is not included for the apportionment. Excess land, if there is any, should be identified and then valued separately on a market value basis with any development potential that it may have.

4.9 Apportionment in Practice - The use of either procedure depends on the relevance and consistency of available information. It is unlikely that the two methods, even where supported by good evidence, will give the same result, as they involve different concepts and the value of the whole property may differ from the sum of its separate parts. Even if only one method is used, the valuer will then use his professional judgment to justify the selection and application of the apportionment procedure used and any subsequent adjustment in reaching his final figures.

4.10 If the value ascribed to the building component under the procedure in 4.5(a) is higher than the replacement cost of the building when adjusted for physical deterioration and the apportionment is required for depreciation purposes, it is recommended that the valuer thoroughly analyse the value he has found. It is possible that this value includes the benefit of intangible assets or personal property. It may be relevant that intangibles will be subject to depreciation or annual impairment testing and that the useful lives of intangible components often differ from the useful lives of buildings.

4.11 The procedure 4.5(b) is more usually used:

- (a) where there is little or no evidence of values for relevant land;
- (b) under jurisdictions that apply a building tax to the book value of the building;
- (c) when dealing with property where there are other owners in the building

- and where rights of common interest might exist;
- (d) when applying the procedure in 4.5(a) results in a value of the building that also includes intangible assets or personal property, which may limit the value of the figure so deduced.

4.12 A component valuation analysis of properties comparable to the building and the land on which it sits may assist the identification of the apportioned value of each constituent part. This is a method of analysis in comparing properties, not to be confused with valuation of the subject property divided into lots. The analysis of the other properties should be in terms suitable to the subject property to ease the sustainable identification of the value of such points as:

- the comparable potential of the land, undeveloped but serviced;
- the nature and scale of the buildings;
- the relative benefits and disadvantages;
- scale and location.

The valuer should use a consistent approach throughout. The principle is that the apportionment must follow the analysis which simply affords a means of comparison. The components are not available for separate marketing and so are unlikely to have the values that that would achieve. The task here is to analyse the values of the comparables by their components and then work from those values (which may sometimes appear low in isolation) to appraise the subject holding: "As you analyse, so you should value."

4.13 On occasion, the valuer is required to apportion the value of a portfolio of properties between land and the buildings on the land. One approach to this is to establish the appropriate apportionment for a representative sample of properties and then extrapolate that to the larger portfolio so far as the properties in it are comparable. This sample-based approach should not be applied unthinkingly to properties in the portfolio that do not have buildings or differ significantly from the sample.

4.14 Some valuations for IFRS purposes may require the apportioned value of the building to be further apportioned between elements with different useful lives and so depreciation rates (sometimes called "componentisation"). With the clear limitations on proper apportionment of the value of the entire property the valuer is recommended, unless specifically instructed, to approach this in a practical manner, only identifying those significant features that differ greatly in character. Excessive subdivision is likely to lead to implausible values of little assistance to the client or other advisers and yield results that may necessarily differ substantially between valuations according to the assumptions and interpretations applied.

4.15 It is particularly important to prepare and retain accurate notes on the assessment of the apportionment. Where it is prepared for accounting purposes, as for public sector clients, it is likely to be audited while those records will also make it easier to interpret the figures for any subsequent apportionment.

Information Paper

Certification of Valuers

1. Valuation practice in a number of European countries is based on personal certification schemes designed to secure and/or enhance the professional qualification of valuers. The relevant European rule (Euronorm EN 45013) was recently merged with the International Standard ISO/IEC 17024. Its objective is to achieve and promote a globally accepted benchmark for organisations operating certification of persons (certification bodies). Certification of persons is one means of providing assurance that the certified persons meet the requirement of the certification scheme. Confidence in the respective certification scheme is achieved by means of a globally accepted process of assessment, subsequent supervision and periodic re-assessments of the competence of certified persons.
2. The Standard specifies requirements which ensure that certification bodies operating certification schemes for persons (e.g. valuers) operate in a consistent, comparable and reliable manner. These requirements have to be considered as minimum requirements and therefore may have to be supplemented in response to additional demonstrated market need/desire or specific government requirements.
3. Certification bodies have to pass the accreditation according to ISO/IEC 17024 through an accreditation body from their own or another European country. The national accreditation body must be a member of the Multilateral Agreement Certification (EA); however, it does not necessarily have to be the accreditation body of the certification body's home country.

Minimum Requirements

4. ISO/IEC 17024 addresses the structure and governance of the certification body, the characteristics of the certification programme, the information required to be available to applicants and the recertification initiatives of the certifying body. More precisely, a certification body has to comply with a certain number of requirements in order to be accredited and must set a certain number of minimum educational and professional requirements for its candidates. The precise level of knowledge and professional skills are to be defined by the national certification body.
5. At valuer's level, the demonstration of personal competence includes education, knowledge, skills and experience requirements that a certified person needs and would be expected to meet.

Admission Requirements

6. In order to be accredited, a national certification body has to comply with the requirements of a national accreditation body; in particular, it has to produce a quality management handbook.

7. National certification bodies generally require applicants to fulfil the following minimum requirements:

- relevant university degrees and professional experience in property valuation;
- a missing university degree might be compensated by a longer period of professional experience in the property business and/or in property valuation;
- submission of property valuations (valuation reports) covering different types of properties.

Certification Examination

8. Examination must be independent and be a valid test of competence. National certification bodies require from their candidates:

- a written examination during which at least one complete valuation is prepared; and
- an oral examination of the candidate (individually or in a group of candidates).

Examination Curriculum

9. Any certification body must produce an examination curriculum generally covering the following subjects:

- national property market and/or European property markets (basics);
- national valuation methods and/or European valuation methods (basics);
- basic technical knowledge and building economics;
- land register (if it exists in the country concerned);
- economics/business management;
- mathematics/statistics;
- systems of the major valuer organisations, training etc. (national and international (Europe));
- relevant legal framework.

Professional Ethics

10. Certification bodies generally require their certified valuers to observe and comply with professional ethics, covering among others:

- Discretion/Confidence – valuers are obliged to treat all documents and

information with discretion and to use the information exclusively for the valuation that is being prepared.

- Objectivity – valuers are obliged to prepare valuations in an unbiased and objective manner to the best of their knowledge and belief.
- Impartiality/Independence – the fact that a valuer is gainfully employed does not automatically exclude impartiality and independence. It has to be guaranteed that valuers are not subject to directives with regard to the technical content of their statements.
- Technical Competence and Respectability – valuers are obliged to accept only those instructions for which they have the required technical skills, competence, and experience.

Monitoring and Continuing Professional Development (CPD)

11. During the validity period of the certificate, certified valuers are constantly monitored. In principle, certification bodies oblige their certified valuers to undergo every year a pre-defined continuing professional development. In addition, they require the submission of valuation reports in order to verify their compliance with the set quality standards.

Maximum Validity of Certificates / Recertification

12. Certificates issued by certification bodies do not have unlimited validity. The validity of certificates is limited to a certain number of years, generally to five years.

13. Before the expiry of the certificate, the valuer has to undergo a recertification process. Admission to recertification requires a positive assessment of the certified valuer during the monitoring process, i.e. proof of annual CPD and positive assessment of valuation services rendered. Recertification is based on an oral examination.

Auditing

14. Certification bodies are continuously supervised by the competent accreditation body. Supervision generally covers the following subjects:

- amendments made to certification documents;
- reliability of the certification process;
- quality of the examination;
- qualification of examiners.

European Property and Market Rating: A Valuer's Guide

- 1. Introduction**
- 2. Definitions**
- 3. Rating System**
- 4. Rating of Developments**
- 5. Rating Templates**

1. Introduction

1.1 In the increasingly risk sensitive environment driven by the Basel Committee on Banking Supervision and the European institutions, rating systems have significantly increased in importance not only for capital market investors but also in the context of banking supervision. A rating is commonly defined as an evaluation or an assessment of something in terms of quality, quantity or a combination of both.

1.2 Rating tools were initially developed by rating agencies for risk assessment purposes on behalf of issuers of securities on capital markets. Since the introduction of the Basel Accords, external and internal bank rating systems also play a pivotal role in banking supervision. More recently, rating systems also spread out to other sectors like real estate.

1.3 In 2004, TEGoVA developed Property and Market Rating (PaM) for assessing the quality of real estate. PaM enables a standardised and objective risk assessment of properties, identifies risks and reveals opportunities. This tool not only provides transparency as to property risks but can also be used for a number of other purposes such as real estate portfolio analysis and controlling, risk assessment of property portfolios for securitisation purposes or the analysis of real estate investment decisions. As PaM shows the profile of “risk and opportunities” of properties, it is particularly well suited as a portfolio management tool measuring the risk exposure of financial services providers or real estate investors. By this means, it also contributes to a high level of transparency in property valuation.

1.4 Since 2004, climate change and sustainability issues have become increasingly relevant for the real estate industry and consequently for the valuation profession. Valuers are expected to assess the impact of sustainability issues on the value of properties.

PaM can reflect these issues through the sub-criterion 'ecological sustainability' in the property criteria class, but does not provide a new specific 'sustainability' or 'green value' criteria class. Advice is provided on how to take sustainability issues into consideration through the underlying measurement standards at national level.

1.5 Property and Market Rating has been designed to achieve standardised measurements of the quality of properties in their relevant markets. This approach is based on the market value of the property.

2. Definitions

2.1 Rating Definition for Completed Properties

2.1.1 Property and Market rating is a standardised procedure to show the sustainable quality of a property in its relevant market. That quality is judged by the medium-term sales prospects at a price that would be agreed between parties with access to all property and market information. Thus, PaM is future-oriented.

2.2 Rating Definition for Developments

2.2.1 The rating of project developments is a standardised procedure to show the quality of a project in its relevant market taking into account the sustainable quality of a hypothetically completed property and the development risks and opportunities. That quality is judged by the sales prospects for the project on the rating date at an adequate price between professionals with access to all property and market information.

2.2.2 Since the circumstances of such a property will continually change during the process of development (status of building permits, construction progress, selling situation, etc.), its sales prospects can only be determined as per the rating date.

3. Rating System

3.1 Rating Scale

3.1.1 Property and Market rating follows the pattern used by rating agencies and the internal rating scales of banks. It consists of 10 grades, with 1 representing an excellent rating, 5 an average one and 10 a disastrous one. A rating below 5 represents opportunities; a rating above 5 represents risks.

3.1.2 PaM differentiates between four types of property: residential property, retail property, office properties and warehousing, distribution and production properties.

3.2 Criteria Classes

3.2.1 The essential features influencing the sustainable quality of a property are divided into the following four criteria classes: market, location, property and quality of the property cash flow.

3.2.2 Each criteria class consists of several sub-criteria that are weighted according to their influence on the medium-term sales prospects of the individual property in its relevant market. Examples of objective or measurable sub-criteria are purchase power figures or space efficiency. Subjective sub-criteria are, for example, the quality of the architecture or location of the plot of land. The weighting of each sub-criterion might differ with the property type assessed.

3.3 Measuring Standards

3.3.1 While the measurable sub-criteria are easy to assess on the basis of a standardised comparison, it is crucial for the reliability of PaM that valuers share a common understanding of the rating of the subjective sub-criteria. In order to achieve this, measuring standards must be defined at national level for each of the sub-criteria, differentiated by property types. The present Guide does not include such measuring standards. These standards must determine the standard representing the average for each criterion in the relevant market, so allowing assessment of whether the property in question is better or worse than that average.

3.3.2 Sustainability issues do not exist in isolation, but overlap with many other factors. Although being recognised in the sub-criterion 'ecological sustainability' within the 'Property' criteria class, sustainability issues have also an impact on the quality of the working environment, the location and the property market itself. This explains why PaM does not provide a separate criteria class 'sustainability'.

3.3.3 Instead, valuers are to consider sustainability issues within the underlying measurement standards where they play a role. For example, environmental issues have to be assessed in the 'Market' criteria class through the sub-criterion class 'acts of God'. Sustainability issues have an impact on the sub-criterion 'socio-demographic development'. Sustainable aspects have also to be considered in the 'Location' criteria class through the sub-criteria 'transportation infrastructure' and 'local supply facilities'. Two other important areas where sustainability is of concern are 'usability by third parties' and 'recoverable or non-recoverable expenses' of the criteria class 'Quality of the cash flow'. Future market developments will further shape the impact of sustainability on measuring standards as well as on benchmarking.

4. Rating of Developments

4.1 Criteria Classes for Developments

4.1.1 To arrive at a rating for a development project, all the above mentioned criteria classes have to be rated as if the property had been completed. The assessment has to concentrate on the sales prospects of the hypothetically completed property, because that is the conclusion of the development project for those who have invested in it.

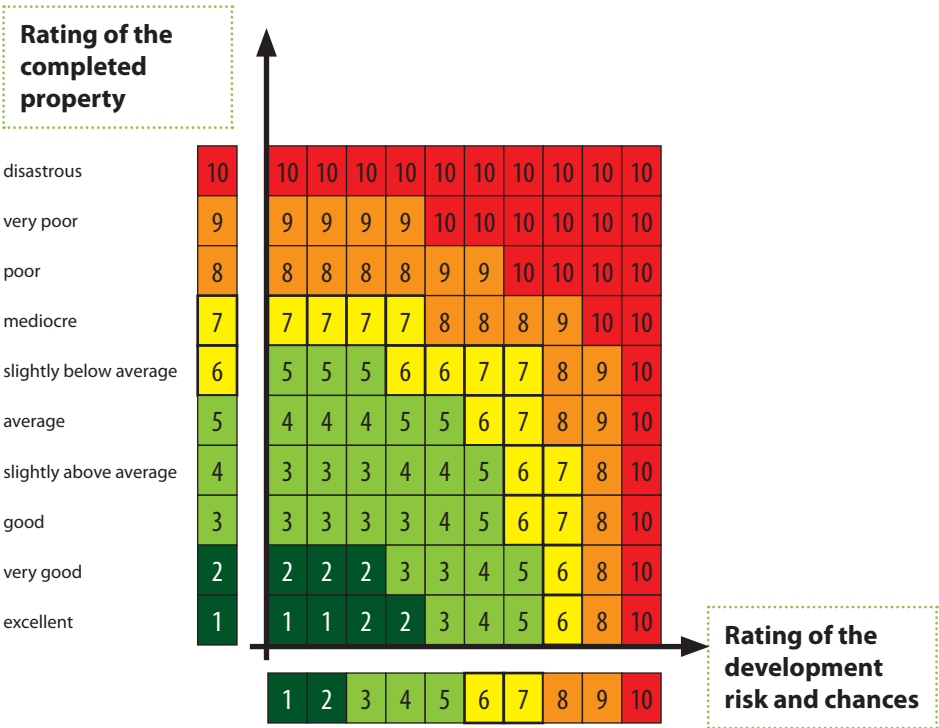
4.1.2 However, a specific fifth criteria class must be added to assess the development risks and opportunities inherent in the project. In this context, the “project” means the planning, construction, and marketing of a building (commercial and residential use) on a plot of land within existing building regulations. It does not include the development of unplanned plots of land without development permission.

5th Criteria Class “Development risks and chances of a development project”

| Sub-criteria | Weighting | |
|--|---------------|------------------|
| | Sub-criterion | Criteria class |
| 5.1 Letting and selling | 60 % | see matrix below |
| 5.2 Planning and permits | 15 % | |
| 5.3 Construction and costs | 25 % | |
| Result of the development risks and chances rating | 100 % | |

4.2 Sales Prospects of a Project

The rating of the sales prospects of the project at the rating date is to be determined using the attached matrix that takes into account all possible combinations of the rating for the hypothetically completed property and the rating for the risks and chances of the development.



5. Rating Templates

5.1 The attached rating templates set out the full range of criteria classes with their sub-criteria for all four property types and show the weight accorded to each sub-criterion both in its criteria class and its share in the overall rating.

5.2 It would not reflect the market, if a very poor rating of one sub-criterion was only included in the result according to its weighting. Instead that very poor rating must be reflected in the assessment given to the whole criteria class. Thus, a rating of 10 for one sub-criterion will lead to its entire criteria class being rated at 10.

5.3 Retail Properties

1. Criteria Class “Market” (national and regional)

| Sub-criteria | Weighting | | |
|---|---------------|-----------------------|------------------------------------|
| | Sub-criterion | national/ regional | Criteria class |
| 1.1 national | | | |
| 1.1.1 Acts of God | 5 % | 30 % | Criteria class 1 20 % |
| 1.1.2 Socio-demographic development | 20 % | | |
| 1.1.3 Overall economic development and international attractiveness | 20 % | | |
| 1.1.4 Political, legal, taxation and monetary conditions | 15 % | | |
| 1.1.5 Property market: retail | 40 % | | |
| 1.2 regional | | | |
| 1.2.1 Acts of God | 5 % | 70 % | |
| 1.2.2 Socio-demographic development | 25 % | | |
| 1.2.3 Economic situation and attractiveness | 25 % | | |
| 1.2.4 Property market: retail | 45 % | | |
| Result for the market rating | | 100 % | |

2. Criteria Class “Location” - Retail

| Sub-criteria | Weighting | |
|---|---------------|------------------------------|
| | Sub-criterion | Criteria class |
| 2.1 Suitability of the micro location for the property type and target occupiers | 30 % | Criteria class 2 30 % |
| 2.2 Image of the quarter and the location | 20 % | |
| 2.3 Quality of transportation infrastructure of the plot and quarter | 15 % | |
| 2.4 Quality of local supply facilities of the plot and quarter for target occupiers | 15 % | |
| 2.5 Acts of God | 20 % | |
| Result for the location rating | 100 % | |

3. Criteria Class “Property” - Retail

| Sub-criteria | Weighting | |
|---|---------------|------------------------------|
| | Sub-criterion | Criteria class |
| 3.1 Architecture / type of construction | 20 % | Criteria class 3 20 % |
| 3.2 Fitout | 10 % | |
| 3.3 Structural condition | 15 % | |
| 3.4 Plot situation | 25 % | |
| 3.5 Ecological sustainability | 10 % | |
| 3.6 Profitability of the building concept | 20 % | |
| Result for the property rating | 100 % | |

4. Criteria Class “Quality of the property cash flow” - Retail

| Sub-criteria | Weighting | |
|---|---------------|------------------------------|
| | Sub-criterion | Criteria class |
| 4.1 Tenant / occupier situation | 20 % | Criteria class 4 30 % |
| 4.2 Rental growth potential / value growth potential | 30 % | |
| 4.3 Letting prospects | 20 % | |
| 4.4 Vacancy / letting situation | 10 % | |
| 4.5 Recoverable and non-recoverable operating expenses | 10 % | |
| 4.6 Usability by third parties | 10 % | |
| Result for the rating of the quality of the property cash flow | 100 % | |

5.4 Residential Properties

1. Criteria Class “Market” (national and regional) - Residential

| Sub-criteria | Weighting | | |
|---|---------------|-----------------------|------------------------------------|
| | Sub-criterion | national/ regional | Criteria class |
| 1.1 national | | | |
| 1.1.1 Acts of God | 5 % | | |
| 1.1.2 Socio-demographic development | 30 % | 20 % | Criteria class 1 20 % |
| 1.1.3 Overall economic development and international attractiveness | 15 % | | |
| 1.1.4 Political, legal, taxation and monetary conditions | 10 % | | |
| 1.1.5 Property market: residential | 40 % | | |
| 1.1.5 Property market: retail | 40 % | | |
| 1.2 regional | | | |
| 1.2.1 Acts of God | 5 % | 80 % | |
| 1.2.2 Socio-demographic development | 35 % | | |
| 1.2.3 Economic situation and attractiveness | 15 % | | |
| 1.2.4 Property market: residential | 45 % | | |
| Result for the market rating | | 100 % | |

2. Criteria Class “Location” - Residential

| Sub-criteria | Weighting | |
|---|---------------|------------------------------|
| | Sub-criterion | Criteria class |
| 2.1 Suitability of the micro location for the property type and target occupiers | 30 % | Criteria class 2 30 % |
| 2.2 Image of the quarter and the location | 20 % | |
| 2.3 Quality of transportation infrastructure of the plot and quarter | 15 % | |
| 2.4 Quality of local supply facilities of the plot and quarter for target occupiers | 15 % | |
| 2.5 Acts of God | 20 % | |
| Result for the location rating | 100 % | |

3. Criteria Class “Property” - Residential

| Sub-criteria | Weighting | |
|---|---------------|------------------------------|
| | Sub-criterion | Criteria class |
| 3.1 Architecture / type of construction | 20 % | Criteria class 3 20 % |
| 3.2 Fitout | 10 % | |
| 3.3 Structural condition | 15 % | |
| 3.4 Plot situation | 25 % | |
| 3.5 Ecological sustainability | 10 % | |
| 3.6 Profitability of the building concept | 20 % | |
| Result for the property rating | 100 % | |

4. Criteria Class “Quality of the property cash flow” - Residential

| Sub-criteria | Weighting | |
|---|---------------|------------------------------|
| | Sub-criterion | Criteria class |
| 4.1 Tenant / occupier situation | 20 % | Criteria class 4 30 % |
| 4.2 Rental growth potential / value growth potential | 30 % | |
| 4.3 Letting prospects / fungibility | 20 % | |
| 4.4 Vacancy / letting situation | 10 % | |
| 4.5 Recoverable and non-recoverable operating expenses | 10 % | |
| 4.6 Usability by third parties | 10 % | |
| Result for the rating of the quality of the property cash flow | 100 % | |

5.5 Office Properties

1. Criteria Class “Market” (national and regional) - Office

| Sub-criteria | Weighting | | | |
|---|---------------|-----------------------|------------------------------------|--|
| | Sub-criterion | national/ regional | Criteria class | |
| 1.1 national | | | | |
| 1.1.1 Acts of God | 5 % | | | |
| 1.1.2 Socio-demographic development | 10 % | 30 % | Criteria class 1 20 % | |
| 1.1.3 Overall economic development and international attractiveness | 30 % | | | |
| 1.1.4 Political, legal, taxation and monetary conditions | 15 % | | | |
| 1.1.5 Property market: office | 40 % | | | |
| 1.1.5 Property market: retail | 40 % | | | |
| 1.2 regional | | | | |
| 1.2.1 Acts of God | 5 % | 70 % | | |
| 1.2.2 Socio-demographic development | 15 % | | | |
| 1.2.3 Economic situation and attractiveness | 35 % | | | |
| 1.2.4 Property market: office | 45 % | | | |
| Result for the market rating | | 100 % | | |

2. Criteria Class “Location” - Office

| Sub-criteria | Weighting | |
|---|---------------|------------------------------|
| | Sub-criterion | Criteria class |
| 2.1 Suitability of the micro location for the property type and target occupiers | 25 % | Criteria class 2 30 % |
| 2.2 Image of the quarter (office district) and the location | 15 % | |
| 2.3 Quality of transportation infrastructure of the plot and quarter | 25 % | |
| 2.4 Quality of local supply facilities of the plot and quarter for target occupiers | 15 % | |
| 2.5 Acts of God | 20 % | |
| Result for the location rating | 100 % | |

3. Criteria Class “Property” - Office

| Sub-criteria | Weighting | |
|---|---------------|------------------------------|
| | Sub-criterion | Criteria class |
| 3.1 Architecture / type of construction | 20 % | Criteria class 3 20 % |
| 3.2 Fitout | 10 % | |
| 3.3 Structural condition | 15 % | |
| 3.4 Plot situation | 25 % | |
| 3.5 Ecological sustainability | 10 % | |
| 3.6 Profitability of the building concept | 20 % | |
| Result for the property rating | 100 % | |

4. Criteria Class “Quality of the property cash flow” - Office

| Sub-criteria | Weighting | |
|---|---------------|------------------------------|
| | Sub-criterion | Criteria class |
| 4.1 Tenant / occupier situation | 20 % | Criteria class 4 30 % |
| 4.2 Rental growth potential / value growth potential | 30 % | |
| 4.3 Letting prospects | 20 % | |
| 4.4 Vacancy / letting situation | 10 % | |
| 4.5 Recoverable and non-recoverable operating expenses | 10 % | |
| 4.6 Usability by third parties | 10 % | |
| Result for the rating of the quality of the property cash flow | 100 % | |

5.6 Warehousing, Distribution, and Production Properties

1. Criteria Class “Market” (national and regional) - Warehousing, distribution, and production

| Sub-criteria | Weighting | | | |
|---|---------------|-----------------------|------------------------------------|--|
| | Sub-criterion | national/ regional | Criteria class | |
| 1.1 national | | | | |
| 1.1.1 Acts of God | 5 % | | | |
| 1.1.2 Socio-demographic development | 15 % | 30 % | Criteria class 1 20 % | |
| 1.1.3 Overall economic development and international attractiveness | 25 % | | | |
| 1.1.4 Political, legal, taxation and monetary conditions | 15 % | | | |
| 1.1.5 Property market: warehousing, distribution, and production | 40 % | | | |
| 1.2 regional | | | | |
| 1.2.1 Acts of God | 5 % | 70 % | | |
| 1.2.2 Socio-demographic development | 20 % | | | |
| 1.2.3 Economic situation and attractiveness | 30 % | | | |
| 1.2.4 Property market: warehousing, distribution, and production | 45 % | | | |
| Result for the market rating | | 100 % | | |

2. Criteria Class “Location” - Warehousing, distribution, and production

| Sub-criteria | Weighting | |
|--|---------------|------------------------------|
| | Sub-criterion | Criteria class |
| 2.1 Suitability of the micro location for the property type and target occupiers | 10 % | Criteria class 2 40 % |
| 2.2 Use-relevant conditions (regulations, decrees, etc.) | 25 % | |
| 2.3 Quality of transportation infrastructure of the plot and quarter | 40 % | |
| 2.4 Economic situation | 20 % | |
| 2.5 Acts of God | 5 % | |
| Result for the location rating | 100 % | |

3. Criteria Class “Property” - Warehousing, distribution and production

| Sub-criteria | Weighting | |
|---|---------------|------------------------------|
| | Sub-criterion | Criteria class |
| 3.1 Architecture / type of construction | 10 % | Criteria class 3 20 % |
| 3.2 Fitout | 10 % | |
| 3.3 Structural condition | 20 % | |
| 3.4 Plot situation | 25 % | |
| 3.5 Ecological sustainability | 10 % | |
| 3.6 Profitability of the building concept | 25 % | |
| Result for the property rating | 100 % | |

4. Criteria Class “Quality of the property cash flow” - Warehousing, distribution and production

| Sub-criteria | Weighting | |
|---|---------------|------------------------------|
| | Sub-criterion | Criteria class |
| 4.1 Tenant / occupier situation | 20 % | Criteria class 4 20 % |
| 4.2 Rental growth potential / value growth potential | 25 % | |
| 4.3 Letting prospects | 25 % | |
| 4.4 Vacancy / letting situation | 10 % | |
| 4.5 Recoverable and non-recoverable operating expenses | 10 % | |
| 4.6 Usability by third parties | 10 % | |
| Result for the rating of the quality of the property cash flow | 100 % | |

European Mortgage Federation

Profile for Risk Related Criteria for Valuations

Recommendation - Profile on Risk Related Criteria for Valuations

Introduction

The European Mortgage Federation recommends that certain risk related criteria (see attached risk profile) should be used when preparing and interpreting property valuations for lending purposes. These criteria relate to valuations using mortgage lending value or market value and can be considered independently of the valuation approach. In addition, there are other criteria that can be considered by professionals in assessing risks such as partnership risks and financial risks.

The risk profile can be used by lenders to obtain additional information that would improve their recognition and management of risk. The profile is intended to enhance the quality of valuations by covering what could be of interest to mortgage lenders.

Rationale for a risk profile

The risk profile builds on the findings of the EMF Comparative Study on the Valuation of Property for Lending Purposes in the European Union, now in its 6th edition, especially with respect to the use of valuations nationally and cross-border together with the relevant regulation and/or self regulation. Property valuation is increasingly recognised as a core criterion for the optimal measurement and management of credit risk by mortgage lenders especially with respect to the risk sensitive approach of Basel II and the Capital Requirements Directive.

In this respect, the risk profile can be seen as a tool to manage and reduce risk. It should prove useful in improving the quality of valuations and increasing the credibility of valuation with supervisors.

Valuation and lending practices

In a number of Member States, the valuation of property is a different, albeit complementary, act from risk assessment in the granting of a loan. For instance, an independent valuation company may undertake the former while the latter is done internally within the lender. This reflects the different valuation traditions in the European Union. In some Member States valuation is internal to the lender and

is an integral part of the risk management process. In others the valuation profession operates independently from the lender.

In the latter case, valuers do not have information about the financial arrangements or about the borrower. For example, the loan to value ratio comes under the heading 'financial risks'. The valuer should not take into account loan to value when determining the value. However, credit officers do have such information which they can use along with the valuation report. Therefore, the valuer when making a valuation for lending purposes should take into account market and location risks, construction related property risks, the quality of tenants and leases as well as fiscal and legal risks. The credit officer, when considering a mortgage loan application, should also take into account other risks such as financial risks.

Different valuation approaches

The profile is not linked to a specific valuation approach (e.g. comparative, income etc). This enables users of valuations from another valuation tradition to use the profile to assist the interpretation of any kind of valuation report. Where a valuation is carried out using the market value one could signal that the valuation has been carried out at the top of the cycle and may not be sustainable. It may not be possible to purchase/sell a property at this price. Where a valuation is carried out using the mortgage lending value one could signal that this is the sustainable value.

Profile of Risk Related Criteria for Valuations All Types of Property

A valuation of property for lending purposes should reflect the following risk criteria:

1. Market Risks

- Timing (present market conditions)
- Market cycles
- Market volatility / stability / liquidity
- Demand and supply
- Economic stability of the market
- Market structures
- Attractiveness of regional markets
- Investor or owner occupier driven market
- Behaviour of the market participants
- Demographic trends
- Labour supply
- Other investment opportunities

2. Location Risks

- Planning and development of the immediate neighbourhood and the greater surroundings (micro & macro)
- Development of the region, the city and the district
- Competition: micro-trends of the local economy / other alternative investment opportunities at local level
- Suitability of the location for investment, revenues and increases in values
- Infrastructure
- Public utilities / local supply
- Attractiveness of the location for companies

3. Construction related property risks

- Physical / architectural issues / quality of the property (fitting out, age etc.)
- Maintenance requirements
- Economic efficiency
- Environmental efficiency
- Marketability and appropriateness for third party users
- Flexibility for other types of use
- Contamination / polluted land
- Reconstruction cost

4. Tenants / Leases

- Strength of tenants
- Reputation of tenants
- Cash flow risks
- Strength of investor

5. Fiscal risks

- Current tax situation
- Potential positive / negative changes
- Local tax regime
- Regional incentives

6. Legal risks

- Ownership
- Planning permission
- Country specific lease structures
- Subsidies
- Efficiency of enforcement (repossession) and forced sale
- Liability for contamination

Classification of TEGoVA's Technical Documents

1. Introduction

This classification aims to constitute a catalogue of designations for the different types of *technical documents* issued by TEGoVA.

2. Scope

This classification will apply to all documents prepared by TEGoVA in the technical field, both for internal use and in relationship with its Members. However, where appropriate, some *technical documents* might also be circulated beyond TEGoVA's membership.

3. Definitions

3.1 TEGoVA Technical Document. A written piece of work, prepared or supported by TEGoVA, dealing with any matter related to valuation, presenting standards, guidance, information or a position in order to improve the quality of the valuation work, based on results consolidated through science, technology and experience.

3.2 TEGoVA Standard. A *TEGoVA technical document* stating the Europe-wide generally accepted concepts, definitions and requirements applicable to the basic elements of valuation work. *TEGoVA standards* shall be approved by the General Assembly.

3.3 TEGoVA Application. A *TEGoVA technical document* containing the implementation of *TEGoVA standards* into specific valuation purposes. *TEGoVA applications* shall be approved by the TEGoVA Board.

3.4 TEGoVA Guidance Note. A *TEGoVA technical document*, based on *standards* and *applications*, providing advice about specific aspects, such as valuation methodologies, scenarios, procedures or property types, which are of importance across Europe. *TEGoVA guidance notes* shall be approved by the TEGoVA Board.

3.5 TEGoVA Information Paper. A *TEGoVA technical document* providing information on valuation matters. *TEGoVA information papers* shall be approved by the TEGoVA Board.

3.6 TEGoVA Code. A systematic collection of rules, methods or principles produced by TEGoVA. *TEGoVA codes* shall be approved by the TEGoVA Board.

3.7 TEGoVA Position Paper. A *TEGoVA technical document* addressing and giving an opinion about a valuation issue, including consultation responses. *TEGoVA position papers* shall be approved by the TEGoVA Board.

3.8 European Valuation Standards (EVS). A set of *TEGoVA technical documents*, periodically updated, including all *TEGoVA standards*, as well as *applications, guidance notes* and *information papers* as agreed.

4. Contents

4.1 Wherever feasible, TEGoVA technical documents shall have the following structure:

1. Introduction
2. Scope
3. Definitions
4. Content
5. Any other provisions

4.2 Prior to approval, TEGoVA technical documents shall go through some or all of the following phases:

- EVSB internal draft(s)
- EVSB consultation draft(s) for corresponding members
- TEGoVA Board consultation draft(s)
- TEGoVA Membership consultation draft(s)
- Restricted exposure draft(s)
- Open exposure draft(s)
- Proposed TEGoVA technical document
- Approved version

5. Final provision

This classification has been approved by TEGoVA's General Assembly. Any amendments shall be proposed by the Board of Directors as requested by the EVSB.

Glossary

Alternative Use Value

The market value of the property without presuming the continuation of its present use.

Asset Value Method - see **Depreciated Replacement Cost****Assumption**

A fact or condition about the property assumed by the valuer (whether instructed or otherwise) which he does not or cannot know or reasonably ascertain.

Basis of Value

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

Depreciated Replacement Cost (DRC) - (also known as the **Contractor's Method** and in Germany, as the **Asset Value Method**)

The current cost of replacing an existing asset with a notional modern equivalent asset, making appropriate adjustments for physical, functional and technical obsolescence.

Directive

EU legislative instrument. It is binding as to the result to be achieved, but leaves to the national authorities the choice of form and methods.

Fair Value (General)

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

Fair Value (For Accounting Purposes)

"The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing market participants at the measurement date" (International Accounting Standards Board (IASB), International Financial Reporting Standards (IFRS) 13, par. 1.

Forced Sale Value

The value that could be obtained for the property where, for whatever reason, the seller is under constraint requiring the disposal of the property.

Future Value - see **Hope Value**

Highest and Best Use

The use that is permitted at the valuation date that offers the highest value based on reasonable expectations.

Hope Value (also Future Value)

The value that, as at the valuation date, the marketplace will offer for the potential for the property to have a higher value arising from a potential change in the circumstances of the property.

Insurable Value

"The sum stated in the insurance contract applying to that property as the liability of the insurer should damage and financial loss be caused to the insured by a risk specified in the insurance contract occurring to that property." When instructed to provide an insurable value, the valuer is to determine the figure that will provide appropriate insurance cover for the property. This a matter which may not only be relevant to the insured and the insurer but also to others such as someone with a loan secured on the property.

Investment Value (also called Worth)

"The value of an asset to the owner or a prospective owner for individual investment or operational objectives" (IVSC, 2011, p.12).

Market Rent

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

Market Value

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

Marriage Value - see **Synergistic Value**

Mortgage Lending Value

"The value of the property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property. Speculative elements shall not be taken into account in the assessment of the mortgage lending value."

Regulation

EU legislative instrument. It is binding in its entirety and directly applicable in all Member States.

Special Assumption

A fact or circumstance about the property that the valuer has assumed or is instructed to assume that is different from those that are verifiable at the valuation date.

Special Purchaser

A purchaser who can optimise the usefulness of an asset compared to other market participants and whose opinion of price equates to a Special Value.

Special Value

An opinion of value that incorporates consideration of characteristics that have a particular value to a Special Purchaser.

Synergistic Value (also known as 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. (IVSC, 2011, p.12)

Valuation Date

The date to which the opinion of value applies (and for which the evidence supporting it is to be relevant) which cannot be later than the date when the valuation report is completed.

Valuation Report

A document detailing the scope, key assumptions, valuation methods, and conclusions of an assignment.

Worth - see **Investment Value**

Membership of the European Valuation Standards Board

John Hockey - Chairman

INSTITUTE OF REVENUES RATING AND VALUATION (IRRV) (UK)

Leandro S. Escobar Torres

ASOCIACIÓN PROFESIONAL DE SOCIEDADES DE VALORACIÓN (ATASA)

Professional Association of Valuation Companies of Spain

Wolfgang Kälberer

VERBAND DEUTSCHER PFANDBRIEFBANKEN e.V. (vdp)

Association of German Pfandbrief Banks

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NORGES TAKSERINGSFORBUND (NTF)

Norwegian Surveyors and Valuers Association

Jeremy Moody

CENTRAL ASSOCIATION OF AGRICULTURAL VALUERS (CAAV) UK

Adrian Vascu

ASOCIATIA NATIONALA A EVALUATORILOR DIN ROMANIA (ANEVAR)

National Association of Romanian Valuers

Membership of TEGoVA

Albania

- SHOQERIA E VLERESUESVE TE PASURIVE TE PALUAJTSHME (SVP)
The Albanian Society of Real Property Valuers

Austria

- VERBAND ÖSTERREICHISCHER IMMOBILIENSACHVERSTÄNDIGER
Austrian Association of Real Estate Experts (ARE)

Belgium

- FÉDÉRATION ROYALE DU NOTARIAT BELGE (FRNB)-KONINKLIJKE FEDERATIE VAN HET BELGISCH NOTARIAAT (KFBN)
Royal Federation of Belgian Notaries

Bulgaria

- КАМАРА НА НЕЗАВИСИМИТЕ ОЦЕНИТЕЛИ В БЪЛГАРИЯ (КНОБ)
Chamber of Independent Appraisers in Bulgaria (CIAB)

Czech Republic

- ČESKÁ KOMORA ODHADCU MAJETKU (ČKOM)
The Czech Chamber of Appraisers (CCA)

Denmark

- DANSK EJENDOMSMAEGLERFORENING (DE)
The Danish Association of Chartered Estate Agents

France

- ASSOCIATION FRANCAISE DES SOCIÉTÉS D'EXPERTISE IMMOBILIÈRE (AFREXIM)
French Association of Property Valuation Companies
- CHAMBRE DES EXPERTS IMMOBILIERS DE FRANCE (CEIF-FNAIM)
Chamber of the Real Estate Valuers of France
- CONFÉDÉRATION DES EXPERTS FONCIERS (CEF)
Confederation of Land Valuers

- CONSEIL SUPÉRIEUR DU NOTARIAT (CSN)
High Council for the Notarial Profession
- INSTITUT FRANCAIS DE L'EXPERTISE IMMOBILIÈRE (IFEI)
French Institute of Real Estate Valuation
- SYNDICAT NATIONAL DES PROFESSIONNELS IMMOBILIERS (SNPI)
National Association of Real Estate Professionals

Germany

- BUND DER ÖFFENTLICH BESTELLTEN VERMESSUNGSINGENIEURE e.V. (BDVI)
German Association of Publicly Appointed Surveyors
- BUNDESVERBAND ÖFFENTLICH BESTELLTER UND VEREIDIGTER SOWIE QUALIFIZIERTER SACHVERSTÄNDIGER (BVS)
Association of Publicly Certified and Qualified Experts
- HYPZERT GMBH
Certification Body
- INGENIEURBÜRO WESELMANN GmbH
Ship Valuation Company
- IMMOBILIENVERBAND DEUTSCHLAND IVD BUNDESVERBAND DER IMMOBILIENBERATER, MAKLER, VERWALTER UND SACHSVERSTÄNDIGEN e.V. (IVD)
German Real Estate Professional Association
- VERBAND DEUTSCHER PFANDBRIEFBANKEN e.V. (vdp)
Association of German Pfandbrief Banks
- BUNDESVERBAND ÖFFENTLICHER BANKEN DEUTSCHLANDS e. V. (VÖB)
Association of German Public Sector Banks

Greece

- ΣΩΜΑ ΟΡΚΩΤΩΝ ΕΚΤΙΜΗΤΩΝ (ΣΟΕ)
Body of Sworn-in Valuers of Greece (SOE)
- ΣΥΛΛΟΓΟΣ ΕΚΤΙΜΗΤΩΝ ΕΛΛΑΔΟΣ (ΣΕΚΕ)
Association of Greek Valuers (AVAG)

Hungary

- MAGYAR INGATLANSZÖVETSÉG (MAISZ)
Hungarian Real Estate Association (HREA)

Italy

- CONSIGLIO NAZIONALE GEOMETRI E GEOMETRI LAUREATI (CNGGL)
National Council of Surveyors

- CRIF CERTIFICATION SERVICES (CCS)
Certification Body
- ASSOCIAZIONE GEOMETRI VALUTATORI ESPERTI (GEOVAL)
Association of Expert Valuers
- ISTITUTO ITALIANO di VALUTAZIONE IMMOBILIARE (IsIVI)
Italian Institute for Real Estate Valuation

Kazakhstan

- ҚАЗАҚСТАННЫҢ КӘСІБИ БАҒАЛАУШЫЛАРЫНЫҢ ПАЛ ТАСЫ (ҚКБП)
ПАЛАТА ПРОФЕССИОНАЛЬНЫХ ОЦЕНЩИКОВ КАЗАХСТАНА (ППОК)
The Chamber of Professional Appraisers of Kazakhstan (CPA)

Kosovo

- SHOQATES SE VLERESUESVE TE KOSOVES (SHVK)
Kosovo Appraisers Association (KAA)

Latvia

- LATVIJAS IPASUMU VERTETAJU ASOCIACIJA (LIVA)
Latvian Association of Property Appraisers

Lithuania

- LIETUVOS TURTO VERTINTOJU ASOCIACIJA (LTVA)
Lithuanian Association of Property Valuers

Norway

- NORGES TAKSERINGSFORBUND (NTF)
Norwegian Surveyors and Valuers Association

Poland

- POLSKA FEDERACJA STOWARZYSZEŃ RZECZOZNAWCÓW MAJĄTKOWYCH
The Polish Federation of Valuers' Associations (PFVA)

Portugal

- ASSOCIAÇÃO PROFISSIONAL DAS SOCIEDADES DE AVALIAÇÃO (ASAVAL)
Professional Association of Valuation Companies of Portugal

Romania

- ASOCIATIA NATIONALA A EVALUATORILOR DIN ROMANIA (ANEVAR)
National Association of Romanian Valuers

Russian Federation

- РОССИЙСКОЕ ОБЩЕСТВО ОЦЕНЩИКОВ (РОО)
Russian Society of Appraisers (RSA)
- ПАРТНЕРСТВО РОССИЙСКОГО ОБЩЕСТВА ОЦЕНЩИКОВ (ПРОО)
Partnership of the Russian Society of Appraisers (PRSA)
- РОССИЙСКАЯ КОЛЛЕГИЯ ОЦЕНЩИКОВ (РКО)
Russian Board of Appraisers (RBA)

Serbia

- NACIONALDO UDRUZENJE PROCENITELJA SRBIJE (NUPS)
National Association of Valuers of Serbia (NAVS)
- UDRUZENJE SUDSKIH VESTAKA D.O.O. BEOGRADA (USVB)
Association of Court Experts L.T.D. Belgrade

Slovakia

- SLOVENSKÁ ASOCIÁCIA EKONOMICKÝCH ZNALCOV (SAEZ)
Slovak Association of Economic Appraisers

Spain

- ASOCIACIÓN PROFESIONAL DE SOCIEDADES DE VALORACIÓN (ATASA)
Professional Association of Valuation Companies of Spain

Sweden

- ASPECT/SFF
The Swedish Society of Real Estate Valuation

United Arab Emirates

- دائرة الأراضي و الأملاك - مركز التقييم العقاري
Dubai Land Department (TAQYEEM)

United Kingdom

- CENTRAL ASSOCIATION OF AGRICULTURAL VALUERS (CAAV)
- INSTITUTE OF REVENUES RATING AND VALUATION (IRRV)

United States

- APPRAISAL INSTITUTE (AI)

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NOTES

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EUROPEAN VALUATION STANDARDS 2012 SEVENTH EDITION

The European Group of Valuers' Associations (TEGoVA) is the European umbrella organisation of 46 national associations of valuers or valuation companies from 27 countries, uniting valuation professionals, either self employed or working for property consultancies, private and public sector companies, investment funds, banks and government departments.

It sets European standards for valuation practice, education and qualification as well as for corporate governance and for ethics for valuers through its European Valuation Standards, Minimum Educational Requirements and Recognised European Valuer scheme. It speaks with a common voice on valuation to European legislators and policy makers.

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