EUROPEAN VALUATION STANDARDS

10TH EDITION — 2025

DRAFT KEY PARTS FOR DECISION BY THE TEGOVA GENERAL ASSEMBLY, BUCHAREST, 11 MAY 2024

Tenth edition ISBN ...

The EVSB Chairman's introduction to this draft

Dear Colleagues,

This document is a draft of the key parts of EVS 2025 for your comment or approval in Bucharest. The entire Blue Book has been reviewed and refined, but the main novelties are, by order of appearance (excepting EVIP 1):

- ***EVS 6 Valuation and Energy Efficiency:*** It has been adapted to the radical new renovation requirements ensuing from European Green Deal legislation and whilst EVS 6 in the current Blue Book instructs valuers to take account of energy efficiency and consider its impact on market value in the event of legal renovation trigger points or deadlines, the Commentary in EVS 2025 shows the valuer how to do so.

- ***Asking prices in Methodology section 6 and in EVIP 1 on Valuation in Non-transparent Markets:*** EVS 2020 legitimated the use of asking prices in non-transparent markets; EVS 2025 contains more detail.

- ***In Methodology, section 9 on the residual method*** has been clarified with specific terminology from the relevant literature and now includes the alternative discounted cash flow method for valuing development property.

- ***EVGN 1 on Applying European Valuation Standards in Wartime Circumstances:*** No substantive changes compared to the original work published in December 2022 (so no special presentation in Bucharest)

- ***EVGN 2 on Valuation for Mortgage Lending – Prudently Conservative Valuation Criteria:*** EVS 2025 interprets this and the linked 'property value', both being completely new concepts that will now co-exist with market value under the revised Capital Requirements Regulation. No substantive changes compared to the original work published in March 2023, but there will still be a presentation due to the radical consequences for valuation practice.

- ***EVGN 3. II on Valuation Report for Office Property:*** In comparison to the existing report for residential property: more physical characteristics of the property to be described; description of health and safety features; more detail on tenancies given the frequent use of the income approach; zoning for physical risks and transition risks ensuing from energy efficiency regulation; judgment of the impact of the tenancy situation, the expectation of vacancy and estimated capex.

- ***EVGN 4 on Valuation of Agricultural Property:*** The return of agricultural valuation for the first time since EVS 2003 due to high interest. Includes climate change, technology and data, and an EVS Agricultural Valuation Report.

- ***Minimum Educational Requirements:*** Previous scale 'understanding', 'general knowledge' and 'in-depth knowledge' consolidated to 'general knowledge' and 'in-

depth knowledge'; simplification of curricula explanations; removal of marketing; higher emphasis on sustainability and on statistics.

EVSB members will review all of the above at the General Assembly with opening to the floor after each item and several topics will also be presented at the valuation conference the day before.

NB: For the first time at this stage, we have had TEGOVA's designers put this work into something resembling the elegant format of the final version, but please note that we have not completed the long process of eliminating typos and other presentational deficiencies.

With kind regards,

Cédric Perrière REV MRICS
Chairman, EVSB

I. European Valuation Standards

I. European Valuation Standards

EVS Summary

EVS 1 Market Value

Valuers must use the following definition of Market Value corresponding to the definition in Regulation (EU) No 575/2013 (the Capital Requirements Regulation):

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

For the purpose of interpretation of 'arm's length transaction', TEGOVA has a universally usable common guidance-definition:

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

Valuers must use the following definition of Market Rent:

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

EVS 2 Valuation Bases Other than Market Value

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

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

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

EVS 3 The Qualified Valuer

Each valuation carried out in accordance with these Standards must be undertaken by a Qualified Valuer.

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

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

EVS 4 The Valuation Process

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

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

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

EVS 5 Reporting the Valuation

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

EVS 6 Valuation and Energy Efficiency

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

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

EVS 1 **Market Value**

Valuers must use the following definition of Market Value corresponding to the definition in Regulation (EU) No 575/2013 (the Capital Requirements Regulation):

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

For the purpose of interpretation of 'arm's length transaction', TEGOVA has a universally usable common guidance-definition:

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

Valuers must use the following definition of Market Rent:

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

1. **Introduction**
2. **Scope**
3. **European Valuation Standard 1 — Definitions of Market Value and Market Rent**
4. **Commentary**
5. **Assumptions**
6. **Special assumptions, including alternative use value and forced sale value**
7. **Other matters**

1. Introduction

1.1. Market Value is a key concept in establishing an informed expectation as to the price for something. The nature of the market in which that value is determined will differ according to the subject of the transaction while market conditions will vary with the changing balance of supply and demand, changing knowledge, fashion, rules, expectations, credit conditions, hopes of profit and other circumstances.

1.2. 'Value' does not mean the actual sum that may prove to be paid in a given transaction between specific parties. At an individual level, the value of an asset, such as a property, to a person will reflect its usefulness to her/him when judged against the person's resources and opportunities. In the context of a market with competing parties, it is rather an estimate of the amount that could reasonably be expected to be paid, the most probable price in market conditions at the date of valuation. While the property in question may have different values for different individuals who may be in the market, its Market Value is the estimate of the price in the present market on assumptions that are deliberately neutral to achieve a standard basis of assessment for both buyers and sellers.

1.3. These assumptions are explored in Section 4 below.

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

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

2. Scope

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

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

- **Real estate and related property rights** which are less homogenous as an asset class and for which such instant, liquid and reported market conditions rarely exist but for which Market Values often need to be identified
- **That are marketable**, that is to say legally and physically saleable
- It does so for assessing both the value that would be expected to be paid for ownership of a property and the rent that might be paid to take the property on a lease

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

2.4. The definitions of Market Value and Market Rent at paragraphs 3.1 and 3.4 rely on the range of assumptions explored in Section 4.

3. European Valuation Standard 1 — Definition of Market Value

3.1. The Definition in Regulation (EU) No 575/2013 (the Capital Requirements Regulation)

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

For the purpose of interpretation of 'arm's length transaction', TEGOVA has a universally usable common guidance-definition:

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

3.2. TEGOVA's definition of Market Value is to be interpreted in accordance with the commentary in Section 4 below.

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

3.4. "Market Rent"

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

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

3.6. This definition of Market Rent, derived from and consistent with the definition of Market Value, is to be used as the basic definition and interpreted in accordance with the commentary in Section 4 below.

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

4. Commentary

4.1. General

4.1.1. This section sets out the key concepts involved, namely:

- The result
- The real property being valued
- The transaction
- The date of valuation
- The nature of the hypothetical parties as willing and at arm's length
- The necessary marketing
- The consideration of the market by the parties

4.2. The result

4.2.1. *"The estimated amount ..."* — This refers to a price expressed in terms of money (normally in the local currency), payable for the property excluding local or national applied taxes in a transaction between parties acting independently of each other. Market Value is measured as the most probable price reasonably obtainable in the market at the date of valuation on the assumptions of the Market Value definition. It is the best price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer.

4.2.2. This estimate specifically excludes an estimated price inflated or deflated by any special terms or circumstances such as financing which are not typical, sale and leaseback arrangements, special

considerations or concessions granted by anyone associated with the sale, or any elements of Special Value.

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

4.2.4. Special value is considered with related issues under EVS 2 — Valuation Bases Other Than Market Value.

4.3. The real property being valued

4.3.1. *"... a property ..."* — This is where the property itself, which can be any legal interest in real estate, with its legal, physical, economic and other attributes, is to be analysed with all its actual opportunities and difficulties.

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

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

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

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

4.3.4.2. **'Physically possible'** — There can be a reasonably probable and

legal use which offers the highest value for the property, but is inoperable if, for instance, poor soil quality means that the foundations could not bear the size of the construction envisaged.

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

4.3.4.4. **'Legal or likely to become so'** — Potential buyers perceive that:

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

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

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

4.4. The transaction

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

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

4.4.3. The use of *"should"* conveys that sense of reasonable expectation. The valuer must not make unrealistic assumptions about market conditions

or assume a level of Market Value above that which is reasonably obtainable.

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

4.4.5. The hypothetical sale is by *"private contract"* and so is the subject of negotiation.

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

4.5. The date of valuation

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

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

4.5.3. The phrase *"date of valuation"* (and also *"valuation date"*) is used to refer to the date for which the valuation is determined and for which the opinion of valuation applies (and for which the evidence supporting it is to be relevant) rather than the, usually later, date when the valuation is prepared and considered, with the valuation report then being completed for the client. The completion of the valuation report will never be earlier than the date of valuation, as it would then be contemplating circumstances that have not happened and for which important evidence may

yet be found. The report should record both the date of valuation and the date on which the report was completed.

4.5.4. The date of valuation will not be later than the date of the valuation report. By providing that the hypothetical binding agreement of the terms of the transaction is deemed to take place on the date of valuation, this ensures that the valuation is informed by those factors that would have been in the expectations of the parties as to value at that point in time.

4.6. The parties — Hypothetical, willing and at arm's length

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

4.6.2. The same provision applies to Market Rent, presuming a hypothetical would-be tenant.

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

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

4.6.5. *"... 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.

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

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

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

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

4.7. The marketing

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

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

4.8. The parties' consideration of the matter

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

4.8.2. The parties will thus appraise what might reasonably be foreseen as at that date. This involves knowledge not just of the property but also of the market and therefore the evidence (including such comparables as may be available) on which to judge the value of the property.

4.8.3. *"... prudently ..."* — Each party is presumed to act in their own self-interest with that knowledge, and prudently to seek the best price for their

respective positions in the transaction. Prudence is assessed by referring to the state of the market at the date of valuation, not with the benefit of hindsight at some later date. It is not necessarily imprudent for a seller to sell property in a market with falling prices which are lower than previous market levels. In such cases, as for other transactions in markets with changing prices, the prudent person will act in accordance with the best market information available at the time.

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

5. Assumptions

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

5.2. The valuation instruction may require the valuer to make an assumption, as, for example, on the time allowed for marketing in the context of a forced sale valuation *(see 4.10.7 below)*. The valuer may have to make certain assumptions in order to complete the valuation effectively, often in the absence of particular information. In either case those assumptions should be clearly stated in the valuation report.

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

5.4. The following is an indicative, non-exhaustive, list of items that may be reported as matters where assumptions have been made in arriving at an opinion of value:

- A detailed report on title that sets out any encumbrances, restrictions or liabilities that may affect the value of the property may not be available. In such case, valuers would have to assume the position they consider most likely, also stating that they accept no responsibility or liability for the true interpretation of the legal title.
- The extent of the inspection should be clearly set out in the report, consistent with the nature of the instruction and the type of property. It may be necessary to make the assumption that, while any obvious defects have been noted; other defects may exist which could require a more detailed survey or the appointment of specific experts. That might be followed by a comment that the opinion of value stated is based on the condition as reported and so any additional defects that exist may require the figures to be amended.
- Assumptions may be needed with regard to the necessary statutory consents for the current buildings and their use together with reference to any policies or proposals by statutory bodies that could impact value positively or adversely.
- Risk of contamination or of the presence of hazardous substances: It may be necessary to make assumptions that no such risks exist.
- The valuer may, on occasion, need to assume that all mains services provided are operational and sufficient for the intended use.
- It may be necessary to make an assumption as to whether the property has not been flooded, or will not be expected to flood or whether other environmental matters may bear on the opinion of value.
- Where the property is let and to be valued as such, it may be necessary to assume that detailed enquiries about the financial status of tenants would not reveal matters that might affect the valuation.
- The valuer may assume (for instance, in hotel valuations) that items of plant and equipment normally considered to be part of the service installations to a building would pass with the property.

The assumptions required where a valuation without an inspection is instructed are considered in EVS 4 at 6.2.3.

6. Special assumptions, including alternative use value and forced sale value

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

6.2. This, to be stated in the valuation report, is to inform the client as to the valuation in those different circumstances. Examples of this include

where the valuer is instructed to make special assumptions as to the value of the property:

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

6.3. Two particular examples are considered below:

- Alternative use value
- Forced sale value

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

6.5. Where special assumptions are made, they must be presented in the valuation report. If they are known before the valuation assignment, they are to be included in the terms of engagement as well. *(see also EVS 4 at 5.8)*.

6.6. Alternative use value

6.6.1. **Definition** — The value of the property under a use other than the present one.

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

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

6.7. Forced sale value

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

6.7.2. **Commentary** — Forced sale value is a Market Value on a special assumption as to the conditions for marketing. The need for a valuation may arise where the seller is under compulsion to sell, is

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

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

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

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

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

7. Other matters

7.1. **Documentation** —A professional valuation under this standard should be properly recorded in writing in a way that is transparent and clear to the client and to anyone else who might reasonably seek to rely on it or

appraise it in accordance with EVS 4.

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

7.3. **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 reported as a sum in addition to the Market Value. These factors may influence the value but are not part of it.

7.4. 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.

7.5. 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."

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

EVS 2 Valuation Bases Other than Market Value

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

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

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

1. **Introduction**
2. **Scope**
3. **Basis of value**
4. **Fair value**
5. **Special value**
6. **Investment value**
7. **Mortgage lending value**
8. **Insurable value**
9. **Values for local and national taxation purposes**
10. **Values for compulsory purchase and/or compensation**

1. Introduction

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

2. Scope

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

3. Basis of value

3.1. Definition — A statement of fundamental principles to be used in finding a value.

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 are suitable for the completion of an instruction, a clear and transparent definition of the basis used must be expressly stated, and the valuer must explain the reason for deviating from a recognised basis. The valuation report should state that the resultant value could be different from Market Value.

3.2.3. Any assumptions or special assumptions used must be set out in the valuation report.

4. Fair value

4.1. Fair value for purposes other than financial reporting

4.1.1. Definition — Fair value may generally be used as a basis of valuation for real estate as between specific, identified participants in an actual or potential transaction, rather than assuming the wider market place of possible bidders. As such, it may often result in a different value to the

Market Value of a property. For this purpose it is defined as:

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

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

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

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

4.1.1.3. In some jurisdictions the expression *"fair rent"* may have other meanings, determined by legislation or regulation.

4.1.2. Commentary

4.1.2.1. The key concept of the definition of fair value for purposes other than financial reporting involves the following:

- The amount
- The property
- The transaction
- The nature of the identified market participants
- Other relevant matters

4.1.2.2. ***"The amount that would be received … or paid …"*** refers to a fair price (expressed in terms of money), payable for the property (asset and liabilities) in a transaction between two identified parties taking account of their respective interests and the advantages and disadvantages to the buyer of acquiring the property.

4.1.2.3. ***"… to sell a property"*** means the property including certain assets and liabilities, which is the subject of transaction. In some cases the property may be transferred as a group of assets, without liabilities, as in a bankruptcy process or litigation.

4.1.2.4. ***"… in an orderly transaction"*** — This requires enough time for both parties to collect all relevant facts and information necessary to obtain appropriate knowledge and understanding of the subject property and specific circumstances, and be capable of

making a decision considering their individual interests and motivation.

4.1.2.5. ***"... between identified market participants"*** — This assumes a specific, known buyer and seller, where both parties are not always motivated and willing, as in litigation where one party is usually compelled to undertake the transaction. Both parties will make their decision having in mind their personal interests, knowledge, objectives, understanding and consideration of specific circumstances. The position and interest of the specific buyer and specific seller may be different from that of market participants under general market conditions, and therefore, the fair value may be different from Market Value.

4.1.2.6. Fair value is particularly pertinent in situations where, for whatever reason, it could be envisaged that the real buyer might pay a different amount than the Market Value.

4.1.2.7. Fair value therefore allows recognition of the individual value a property may have to one particular bidder.

4.2. Fair value for financial reporting

4**.2.1.** Fair value is specifically adopted as a term under International Financial Reporting Standards for which, albeit with slightly less detailed assumptions than the full definition of Market Value, it may often give the same result as Market Value. This is more closely reviewed in EVGN 2. For this purpose, it is defined as:

"The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

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

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

4.2.1.2. 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 property in its highest and best use, that is, the most valuable use of the property that is physically possible, legally permissible and financially feasible at the date of valuation. In this non-financial context, Fair value may differ from a valuation prepared in accordance with the definition of Market Value *(see EVS 1 for Market Value and EVGN 2.8 for a discussion of possible differences between Fair Value and Market Value)*.

4.2.2. Commentary

4.2.2.1. In respect of financial reporting under IFRS 13 *(see EVGN 2)*, fair value is a required basis of valuation, defined as in 4.1 above. While the definition differs from that of Market Value, being less detailed in its assumptions about prior exposure to the market, the value reported will be indistinguishable from Market Value.

4.2.2.2. The determination of fair value is discussed in greater detail in EVGN 2, Fair Value for Financial Reporting. It should be noted that, since the publication of IFRS 13, it is now clear that fair value is intended to be an estimate of the sale price (or "exit price") that could be achieved. Fair value must be estimated from the point of view of actors in the market. Any special value to the existing owner is to be disregarded if actors in the market would not be expected to bid for that extra value.

4.2.2.3. Fair value will generally be determined on the basis of the property's highest and best use as defined by IFRS 13, that is, the most valuable use of the property that is physically possible, legally permissible and financially feasible at the date of valuation. Despite different wording, the IFRS 13 and EVS definitions of HABU have the same meaning.

5. Special value

5.1. Definitions

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

5.1.2. A **special purchaser** is an individual for whom the property has a higher value than for other market participants.

5.2. Commentary

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

5.2.2. Special value can sometimes be associated with elements of going concern value. The valuer must ensure that such criteria are distinguished from Market Value, making clear any special assumptions made.

5.3. Synergistic value (known in some countries as marriage value)

5.3.1. This is a particular class of special value that valuers will commonly meet.

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

5.3.3. **Commentary** —Terms of engagement and valuation reports must clearly specify where such value is required or will be provided and that such value may differ from the Market Value of the property.

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

6. Investment value

6.1. Definitions

6.1.1. This is the value of a property to an owner or prospective buyer, calculated on the basis of the individual's investment criteria. Every prospective buyer will individually calculate the investment value of a property. That value may often be quite different from a Market Value.

6.1.2. Investment value is most often used for the purposes of decisions on the acquisition, management, development, disposal or other actions in respect of a property investment.

6.2. Commentary

6.2.1. This subjective concept relates a specific property to a specific investor, group of investors, or entity with identifiable investment objectives and/or criteria. As valuations prepared on this basis determine what an individual buyer may be prepared to bid, they are not a measure of the overall judgment of the market on the property. Thus, they would not be

expected to be consistent with or equivalent to valuations prepared on any other basis, including Market Value. Such valuations are to determine the value of a property for a specific individual investor with her/his own actual concerns, rather than a hypothetical party.

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

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

6.2.4. This basis of value is used to assess the investment value of a property for a known individual investor. This process is to be distinguished from the determination of Market Value: whereas Market Value is the best price that would be reasonably expected in the market, taking account of all the various types of likely bidders, investment value is the maximum price that a known individual bidder would offer, on the basis of her/his specific investment requirements.

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

- Any specific characteristics of client's business or property portfolio that might have an influence on the future cash flows generated by the subject property;
- The client's investment, purchase or rental criteria (such as a target rate of return or the hold period).

6.2.6. **Reporting** — The valuation report, prepared in accordance with EVS 5, must state that the basis of value adopted is investment value and that the Market Value may be different.

6.2.7. It must make clear that it is prepared only for the particular client to whom it is addressed, that it contains specific requirements and assumptions relating solely to that client and that it is not to be relied on by any third parties.

6.2.8. The report must record the criteria required and the information provided by the client.

7. Mortgage lending value

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

7.1.1. The definition of MLV varies between countries and even within them due to differing practices of financial institutions. Valuers using MLV must state which definition and/or legislation they are using.

7.2. Commentary

7.2.1. The above definition is incorporated in Regulation (EU) N° 575/2013 on prudential requirements for credit institutions and investment firms (Capital Requirements Regulation (CRR)).

7.2.2. In the CRR, immovable property providing collateral for covered bonds may "be valued at or at less than the Market Value, or in those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions, the mortgage lending value of that property ..." *(see also EVGN 1)*.

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

7.2.4. Reporting — The valuation report, prepared in accordance with EVS 5, must state that the basis of value adopted is MLV and that the Market Value may be different.

8. Insurable value

8.1. Definition

8.1.1. Insurable value is the cost of replacing the damaged property.

8.2. Commentary

8.2.1. The insurable value should include, inter alia, any appropriate additional values including, inter alia, fees for architects, engineers and service providers, planning permissions, licenses and approvals. Except if instructed otherwise, plant and machinery and any other material that do not form an integral part of the structure should be exempted (as they are usually covered by another insurance).

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

8.2.3. In reporting an insurable value, the valuer should state the replacement basis on which it has been assessed, that other insurable bases of cover may be available, and that the building regulations applicable at the time of any rebuilding might require a higher expenditure.

9. Value for local and national taxation purposes

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

10. Values for compulsory purchase and/or compensation

Where property or rights over property are compulsorily acquired under statutory powers, it is usual for the owner (and the occupiers, if any) to receive appropriate compensation payments. While compensation for loss of property is often based on Market Value, this principle may be modified or supplemented by national or local law and legal precedent. As such, it is inappropriate to seek to treat this subject further in EVS.

EVS 3 The Qualified Valuer

Each valuation carried out in accordance with these Standards must be undertaken by a qualified valuer.

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

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

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

1. Introduction

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

2. Scope

This Standard requires that the valuation report be undertaken by a qualified valuer. All valuers contributing to a report must have sufficient expertise and work to professional standards and, where considering valuation issues, must meet the requirements of this Standard.

3. General

3.1. A valuation must be undertaken by a qualified valuer delivering the professional knowledge, skills, and competence and ability to give an objective opinion consistent with the requirements of EVS including the European Valuers' Code of Conduct.

3.2. When expertise beyond the valuer's competence is required, 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.

3.3. 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 opinion of value. However, there are no specific statutory or regulatory criteria for most valuations and it will therefore be for valuers to satisfy themselves that they possess the requisite skills, knowledge, competence and independence for each instruction undertaken.

3.4. In all cases the onus is on valuers to ensure that they are aware of potential conflicts of interest and can meet the requirement of independence *(see Code of Conduct).*

4. The Qualified Valuer

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

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

- A relevant university degree, or post graduate qualification; or
- Other recognised academic or vocational qualification relevant to property valuation that meets TEGOVA's Minimum Educational Requirements (MER) and having at least two years' professional experience in property valuation; or
- Long term relevant professional experience.
- Maintainence and enhancement of professional knowledge through a relevant programme of continuing education.
- Sufficient experience in valuing real property in the location and category of the subject property or, having disclosed the insufficiency to the client before accepting the assignment, that they have obtained suitable assistance from competent and knowledgeable person(s);
- Where required by home country national legislation or regulations, any required licence to practise as a valuer or membership of a professional association;
- Compliance with all legal, regulatory, ethical and contractual requirements related to the valuation;
- Adherence to the TEGOVA European Valuers' Code of Conduct or to another equally stringent ethical code;
- The holding of professional indemnity insurance appropriate to the valuation work undertaken (unless the Member Association does not require it);

4.3. **Enhanced** They have maintained and enhanced their professional knowledge through a relevant programme of continuing education.**competence** — Qualified valuers reach this level when they can demonstrate enhanced skills by:

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

(see Part V of these Standards and the TEGOVA website)

4.4. **Recognised European Valuer (REV)** — TEGOVA has developed the Recognised European Valuer (REV) programme to enable individual valuers, through their professional associations, to have an enhanced status, over and above TEGOVA's Minimum Educational Requirements, to assure clients of their valuation expertise.

4.5. **TEGOVA Residential Valuer (TRV)** — The TEGOVA Residential Valuer programme enables recognition of qualification, knowledge and professional experience for individual valuers undertaking residential valuations. Attainment of this recognition can assist in ensuring that *"internal and external appraisers conducting property valuations are professionally competent and sufficiently independent from the credit underwriting process so that they can provide an*

impartial and objective valuation ..." (Directive 2014/17/EU, Art. 19(2), "The Mortgage Credit Directive").

4.6. **TEGOVA's Minimum Educational Requirements (MER)** — As part of its education strategy of supporting standards of professional competence, TEGOVA sets Minimum Educational Requirements (MER) for its Member Associations to require of their qualified members so that they apply to every valuer elected to practice after 1 January 2003.

4.7. REV, TRV and MER are summarised in Part V and set out in detail on the TEGOVA website,

4.8. **Continuing professional development** — Qualified valuers must maintain their expertise by keeping up to date with all relevant developments, whether legislative, technical or otherwise, affecting instructions to be undertaken so that they continue to have the commercial and professional expertise for the preparation and provision of valuations.

5. Commentary

5.1. General

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

5.2. Independence of the valuer and conflicts of interest

5.2.1. There are various circumstances where the relationship with the client or another party makes it imperative that the valuer be, and be seen to be, not only competent to act, but also independent, and without any undisclosed potential conflicts of interest which are actual or possible and which can be foreseen at the time when the instructions are accepted. Any connection, other potential conflict of interest or other threat to the valuer's independence and objectivity, must be disclosed in writing to the client and recorded in the valuation report.

5.2.2. The requirements for valuers in terms of professional objectivity mean that they must be aware of anything that could be perceived as a conflict

of interest.

5.2.3. If such a conflict exists, then it must be disclosed in writing to the client who may then choose whether or not to confirm the appointment In the event of confirmation, the circumstances of the conflict must be clearly stated in the valuation report.

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

5.2.5. 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. EU law on valuer competence and independence

5.3.1. **Directive** 2014/17/EU ("The Mortgage Credit Directive") states in its Article 19(2) that:

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

5.4. The valuer's liability

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

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

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

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

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

5.4.6. As professionals, valuers' fundamental duty is to their clients. Any limitations on their liability should not be at the expense of the professionalism of the valuation.

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

EVS 4 The Valuation Process

The first stop of the valuation process is that the terms of engagement and the basis on which the valuation will be undertaken must be set out in writing and agreed.

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

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

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

1. Introduction

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

2. Scope

This Standard considers the procedural steps followed in preparing the valuation report.

Starting with terms of engagement, it continues with the appraisal and inspection of the property and then reviews the valuation report and retention of data. Finally, it discusses what may be considered when a valuer is instructed to review an existing valuation.

3. Terms of engagement

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

3.2. Detailed terms of engagement must be agreed in writing at the start of the valuation process.

3.3. Terms of engagement as agreed may require subsequent amendment. Any amendments must be recorded in writing to avoid misunderstanding and consequential dispute.

3.4. Terms of engagement must be in line with client requirements, recent legislation, requirements of the valuer's professional association and the latest edition of EVS.

3.5. Failure to issue written terms will result in non-compliance with EVS. It may also result in an inadequate defence to any legal action relating to fees, negligence or performance.

3.6. Where valuations of a similar nature, such as lending valuations, are regularly provided to the same client and the valuer has previously provided terms of engagement, the valuer must confirm in writing that these terms continue to apply unless otherwise agreed with the client. The client must be notified

promptly in writing of any subsequent amendments.

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

- The client's identity and that of any other intended users
- The purpose of the valuation
- The property being valued
- The ownership
- The basis or bases of value
- A specific date of valuation
- Declaration that no conflict of interest exists. Declaration of any previous involvement with the property or the parties involved
- The identity and status of the valuer
- Assumptions, special assumptions and departures from EVS
- The scope and extent of investigations
- Reliance placed on information provided by the client, the client's representatives or third parties
- Any restriction placed on publication
- The extent to which a duty of care will be provided
- Compliance with European Valuation Standards
- The fee for valuation services
- Basic disclaimer
- Timetable for work

(see table under 5.10)

4. Liaison with client's advisers, auditors and others

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

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

5. Commentary

5.1. Valuers have a responsibility to ensure that they are, and can be seen to be, competent, qualified and not subject to conflicts of interest or have declared,

and taken steps to remedy, any real or apparent deficiency so that they may carry out the proposed assignment.

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

5.3. A clear and concise record prepared and agreed in advance of the assignment also ensures that clients and their professional advisers know what to expect and are able to judge whether what they receive is what they wanted.

5.4. **Sub-contracted valuations** — Prior approval must be obtained from the client where work is sub-contracted to other specialist valuers or where substantial third party professional assistance is necessary. This approval must be recorded in writing from the client and disclosed in the terms of engagement.

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

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

5.7. **Valuations carried out with limited information or where special assumptions are necessary** — A situation may arise where there is limited information, inadequate inspection opportunities, or restricted time available to the valuer. For example, in some cases the Report may be required for the internal purposes of the management, in others the Report may be required in relation to a takeover or merger where time is of the essence. In such cases, the valuer must ensure that the terms of engagement agreed confirm that the valuation will be conducted with such limitations and the Report shall clearly explain the specific limitations.

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

- Assuming vacant possession when the property is tenanted
- Valuing on the basis of an assumed planning consent which differs from the actual consent

- Assumptions to provide a basis for the valuation of fire-damaged property
- Special assumptions when valuing trading property

In such circumstances it is essential that the terms of engagement state clearly that the Valuation Report, and any publication based on it, will set out in clear terms the instructions relating to the valuation, the purpose and context of the valuation, the extent to which enquiries have been restricted, the special 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 any departure from these Standards.

5.9. Comment on Minimum Terms of Engagement

Terms	Details
The client's identity	
The purpose of the valuation	The valuer must declare that the valuation only relates to the specific purpose stated.
The property being valued	The address must be stated as well as any specific information enabling exact identification of the property. The following must be considered: • Where the boundaries of the property being valued are undefined, reference to a plan or other fixed object may be required; • Where fixtures, fittings, plant or machinery are present in a property, specify what will be assumed to remain with the property; • Where a property is being valued subject to a tenancy, it is possible that improvements undertaken by tenants will be disregarded upon renewal or review of a lease. This may have an impact on value.
The ownership	If more than one legal interest or legal estate exist, specify which is/are being valued.
The basis or bases of value	The basis or bases of value that will be reported must be specified. A basis of value recognised in EVS should be used unless the client, professional body or regulation require something else, in which case the different basis of value must be specified.
A specific date of valuation	
Conflicts of interest	Declaration that no conflict of interest exists.

	Declaration of any previous involvement with the property or the parties involved *(see EVS 3.5.2)*
The identity and status of the valuer	State that the valuer is acting in an external and independent capacity. Compliance with the valuer's professional association's and with TEGOVA's European Code of Conduct must be confirmed. The qualifications and designations of the valuer should be set out.
Assumptions, special assumptions and departures from EVS	All assumptions and special assumptions required by the client in preparing the valuation or Valuation Report must be specified. Reference must be made to any departures from EVS, setting out the reasoning and justification for departure. *(see EVS 1)*
The scope and extent of investigations	The scope and extent of the investigations must be clearly set out. The extent of the inspection (internal and external) must be mentioned.
Reliance placed on information provided by the client	If the client has supplied information relating to the property or if the valuer is advised by the client to obtain information from a specified third party, then the terms must state that the valuer will rely upon this information and will not seek to verify the accuracy of the information provided. The valuer does not accept liability where the client has withheld information or given incorrect information.
Any restriction placed on publication	If any restrictions regarding publication, reproduction, public reference or circulation of the valuation report are agreed, they must be stated.

The extent to which a duty of care will be provided	The specific identity of the parties to whom a duty of care is owed should be set out. It may be appropriate to specify that no responsibility or duty of care will be offered to any other parties.
Compliance with European Valuation Standards	Where the valuation has been rendered compliant with EVS, reference must be given with the title European Valuation Standards.
The basis of fee and other costs to be charged	All relevant fees and other costs to be borne by the client should be specified. If expenses are to be charged, the basis of that charge should be included. Figures quoted should state where they are exclusive of VAT or other taxes. Where the client is not registered for VAT (such as a private individual) the total fee including VAT should be stated.
Basic disclaimer	
Timetable for work	

6. Supporting the valuation

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

6.2. **Property inspection** — As part of obtaining personal knowledge of the property, the report-signing valuer or a named and qualified person mandated by the report-signing valuer must make her/his own visual inspection of it. This will include the interior of the buildings, the locality and the environment to record all matters which appear relevant to the value of the property.

6.2.1. The valuation report must contain the following inspection information:

- Date of inspection
- Information to be received and examined: list of documents and other information originating from third parties e.g. cadastral information, surfaces, current occupancy, leases, etc., including origin of data and supporting evidence
- Confirmation that the inspection was made by the valuer or by a suitably qualified person under the valuer's responsibility
- The name and qualifications of the person who physically inspected the property
- Responsibility for the inspection falls to the valuer signing the report
- The extent of the inspection carried out

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

6.2.3. The nature and scale of the property inspection(s) will depend on the purpose of the valuation and the basis agreed with the client. There may be circumstances, such as the provision of a portfolio valuation, where it is appropriate to restrict the inspection(s), for example, to the exterior and locality only or a desktop valuation.

6.2.4. Lack of inspection or a restricted inspection must be recorded in the valuation report, as factors which could significantly affect the property's value may not have been identified.

6.3. Consideration must be given to identifying relevant financial, legal and regulatory factors regarding the property.

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

6.6. Figures reported must be supported, not just stated. The valuation is the culmination of the valuer's investigations and research that demonstrates her/his skill in collating data from various sources, using that information efficiently and providing a considered opinion.

6.7. The contents of a valuation report will be determined by the purpose and agreed terms. EVS 5 addresses valuation reporting.

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

7. Valuation review

7.1. A valuation review is an assessment of the report of another valuer taking the form of a valuation review report.

7.2. In EVS it is not:

- A check of the overall accuracy of a portfolio of valuations *(see EVGN 1)* on the basis of a representative sample of properties including the main findings of the assumptions and checks performed
- The review performed by banks according to Article 208 paragraph 3 point b) of Regulation (EU) n. 575/2013 ("the Capital Requirements Regulation")[1] which EVS interprets as meaning a 'revaluation'

7.3. The **review objectives** and the requirements to be met by the reviewing valuer are to:

- Provide an assessment of the compliance of the valuation work under review with European Valuation Standards
- Examine the documents relied on and assess their proper and accurate use
- Identify any nonconformities and their impact on the conclusions

Note — The objective is not to provide a new valuation figure, as that would require a new valuation.

7.4. Apart from the elements needed to achieve the review objectives, **the valuation review report shall state at least**:

- The identity of the client and other intended users
- The intended purpose of the review, and intended use of the review results
- The professional independence requirements based on which the reviewing valuer shall express an unbiased opinion with no influence from any third party

[1] (b) the property valuation is reviewed when information available to institutions indicates that the value of the property may have declined materially relative to general market prices and that review is carried out by a valuer who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process. For loans exceeding EUR 3 million or 5 % of the own funds of an institution, the property valuation shall be reviewed by such valuer at least every three years.

- Whether or not discussions with the original valuer have taken place
- The assumptions and special assumptions in the valuation review

7.5. The **scope of the review work** must be clearly stated, in a manner that must not be misleading to either the contracting parties or any independent competent third party having legitimate access to the contract that covers the scope of work.

7.6. The **review report** must be clearly presented and must contain sufficient information so as to provide clarity to the client and the intended users about the review results.

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

- A qualified valuer, as defined in EVS 3
- Independent from the valuer who originally performed the valuation

7.8. If the reviewing valuer does not have all the information available for the original valuation, this must be clearly stated.

EVS 5 Reporting the Valuation

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

1. **Introduction**

2. **Scope**

3. **Valuation Report — Definition**

4. **The Valuation Report**

1. Introduction

The valuation must be clearly and effectively conveyed to the client. The valuation report will be the document on which the client will rely in taking decisions. It must therefore be precise, transparent and understandable to the client.

2. Scope

This Standard deals with the valuation report in which the valuer informs the client of the value determined.

3. Valuation Report — Definition

The **valuation report** is the comprehensive communication of the valuer's professional judgement of value to the client. It is a document detailing the scope, key assumptions, valuation methods, and conclusions of an assignment. The report provides a professional opinion of value supported by a recognised basis or bases of valuation within the framework of European Valuation Standards.

4. The Valuation Report

4.1. General

4.1.1. A valuation report must be in writing, prepared and presented in a reliable and comprehensible manner for the users and clients.

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

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

4.1.4. The report must be written in terms which a person with no knowledge of the property or of valuations can understand.

4.1.5. . As decisions may be made and finances committed or withdrawn on the strength of it, If the valuer has strong opinions on the strengths or weaknesses of the property should be reasoned and substantiated in a

way that will enable the reader to understand the conclusions reached.

4.1.6. If the valuer has been instructed despite an actual or potential conflict of interest, that conflict must be stated with a record that it was notified to the client and with details of the measures taken to ensure that the conflict did not adversely affect the valuer's opinion.

4.2. Content of a valuation report

4.2.1. A valuation report must adequately report all matters set out within the terms of engagement *(see EVS 4, section 3).*

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

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

4.2.4. The report must include material relevant to the property that is, or is to be, held as an investment, fully equipped as a trading entity or the subject or potential for actual development, refurbishment or retrofitting or other specific purpose.

4.2.5. Valuers must state whether in undertaking the valuation they have become aware of matters that could affect the figures reported. Such matters might include potential contamination on or near the subject property, the presence of deleterious materials or issues over title.

4.2.6. Where the market for the property being valued is affected by unusual uncertainty and this is relevant to the valuation, the valuer must comment on the issue in the report.

4.2.7. All valuation reports must include a statement that the valuer has conformed to the requirements of these European Valuation Standards. The valuer must state the extent of, and reasons for, any departure from the standards and state why any key part of the valuation process has been

omitted.

EVS 6 Valuation and Energy Efficiency

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

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

Preliminary notice: The rules laid down in the EU Directives must be transposed into national law with Member States retaining some room for manoeuvre concerning the detail. Therefore, valuers will need to complete the information in this Standard with knowledge of the requirements specific to their country of practice. In particular, valuers will need to identify the segments of the national building stock prioritised for renovation and the deadlines or inflection points for renovation as well as the energy performance certificate classes the renovations need to reach. This information will be readily available from the authorities as it must all be reported to the European Commission in good time.

1. Introduction

1.1. The European Green Deal is a package of binding EU legislation for the complete decarbonisation of the EU by 2050 and a 55% reduction in GHG emissions by 2030.

1.2. A number of these EU laws target the building stock, the largest energy consumer (40%) and GHG emitter (36%). The key laws are Directive (EU) 2024/XXX on the energy performance of buildings and Directive (EU) 2023/1791 of 13 September 2023 on energy efficiency: for the first time, there are direct energy efficiency renovation obligations that are no longer contingent on the owner's sovereign decision to undertake a major renovation. See 4.4. Minimum energy performance standards

1.3. The deadlines for the initial building and renovation obligations are so close (2030, 2033 and 2035) that they will cause a rapid transformation of real estate markets and Market Values.

1.4. Valuers in some Member States will need to heed national legislation with stricter obligations than the minima stipulated in EU law. Valuers may also find markets where there is discrimination between more or less energy efficient properties reflected in price.

2. Scope

This Standard covers the changes to the property market stemming from the Energy Performance of Buildings Directive and the Energy Efficiency Directive and the consequent EVS requirements for the estimation of Market Value.

3. European Valuation Standard 6 – Valuation and Energy Efficiency

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

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

4. The key building and renovation requirements under the Energy Performance of Buildings Directive

4.1. In terms of impacts on Market Value, the cornerstones of the Energy Performance of Buildings Directive are:

- Minimum energy performance standards and trajectories for progressive renovation
- All new buildings to be zero-emission2 as of 01.01.2030
- Deployment of solar energy installations in buildings
- Partially harmonised and more prevalent energy performance certificates

4.2. Minimum energy performance standards and trajectories for progressive renovation

4.2.1. Non-residential

a) The 16% worst-performing buildings must be renovated by 2030
b) The 25% worst-performing buildings must be renovated by 2033

4.2.1.1. **Individual buildings can be exempted** in light of the expected future use of the building, serious hardship or an unfavourable cost-benefit assessment as long as the exemption criteria are precise, stringent and ensure equal treatment between buildings, but any exemptions will have to be compensated by equivalent energy performance requirements in other parts of the non-residential building stock.

4.2.1.2. In cases where the overall renovation necessary to achieve the energy performance thresholds has an **unfavourable cost-benefit assessment** for a given building, Member States shall require that, for that give building, at least those individual renovation measures with a favourable cost-benefit assessment are implemented.

4.2.2. Residential

4.2.2.1. As compared to 2020, the average primary energy use in kWh(m.2y) of the whole residential building stock must decrease by:

a) At least 16% by 2030

[2] 'Zero-emission building' means a building requiring zero or a very low amount of energy, producing zero on-site carbon emissions from fossil fuels and producing zero or a very low amount of operational greenhouse gas emissions (more detail in the Directive).

b) At least 20-22% by 2035

4.2.2.2. Member States shall ensure that at least 55% of the decrease of the average primary energy use is achieved through the renovation of worst-performing residential buildings.

4.2.2.3. Member States shall not disproportionately exempt rental dwellings.

4.2.3. For all buildings, the effort does not stop at 2033 or 2035. The Directive provides that **national building renovation plans** will contain roadmaps with nationally established targets for 2030, 2040 and 2050 as regards the annual energy renovation rate and measurable progress indicators to transform existing buildings into zero-emission buildings by 2050. The plans will be drafted and submitted to the European Commission for assessment every five years.

4.2.4. Member States may decide not to apply the minimum energy performance standards to the following categories of buildings:

a) Buildings officially protected as part of a designated environment or because of their special architectural or historical merit, or other heritage buildings, in so far as compliance with the standards would unacceptably alter their character or appearance, or if their renovation is not technically or economically feasible
b) Buildings used as places of worship and for religious activities
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 used by a sector covered by a national sectoral agreement on energy performance
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
e) Stand-alone buildings with a total useful floor area of less than 50 m2
f) Buildings owned by the armed forces or central government and serving national defence purposes, apert fromsingle living quarters or office buildings for the armed forces and other staff employed by national defence authorities

4.3. All new buildings to be zero-emission as of 01.01.2030 (public buildings as of 01.01.2028)

4.3.1. Member States can choose not to apply this to buildings for which building permit applications were submitted before 01.01.2030.

Note – Under the previous Directive, since 2021 new buildings have had to be nearly zero-energy.

4.4. Deployment of solar energy installations in buildings

4.4.1. This obligation applies:

a) By 31 December 2026, to all new public and non-residential buildings with a useful floor area over 250 m^2
b) By 31 December 2027, to all existing public buildings with a useful floor area larger than 2000 m^2
c) By 31 December 2028, to all existing public buildings with a useful floor area larger than 750 m^2
d) By 31 December 2030,to all existing public buildings with a useful floor area larger than 250 m^2
e) By 31 December 2027, to existing non-residential buildings with a useful floor area larger than 500 m^2, where the building undergoes a major renovation[3] or an action that requires an administrative permit for building renovations, works on the roof or the installation of a technical building system
f) By December 2029, to all new residential buildings
g) By 31 December 2029, to all new roofed carparks physically adjacent to buildings

4.5. Partially harmonised and more prevalent energy performance certificates (EPCs)

4.5.1. Across the EU, EPC class 'A' will mean a zero-emission building and 'G' will correspond to the very worst-performing buildings in the national building stock.

4.5.2 EPCs are set to become more prevalent. Previously only required when buildings or building units were constructed, sold or rented out to a new tenant, they must now also be produced after major renovation or renewal of the rental contract.

4.5.2.1. Higher prevalence of EPCs is crucial, because:

- Member States are to check compliance by individual buildings with the renovation requirements they have set under the Directive on the basis of EPCs.

[3] 'Major renovation' means, according to Member State choice, either
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

- The EPC's class and renovation information will underpin valuers' incorporation of energy efficiency renovation into the estimation of Market Value, especially as the EPC must contain an evaluation of the cost-effectiveness of the certificate's renovation recommendations based on **a preliminary cost forecast**. If the preliminary cost forecast is close to the date of valuation, the valuer may be able to rely on it for the residual valuation if the information in the EPC is judged to be of sufficient quality.

5. The exemplary role of public bodies' buildings under the Energy Efficiency Directive

5.1. Each Member State shall ensure that at least 3% of the total floor area of heated and/or cooled buildings owned by public bodies[4] is renovated every year to at least be transformed into nearly zero-energy buildings[5] or zero-emission buildings.

5.2. Where public bodies occupy a building that they do not own, they shall negotiate with the owner, in particular when reaching a trigger point such as:

- Renewal of rental
- Change of use
- Significant repair or maintenance work

with the aim of establishing contractual clauses for the building to become a nearly zero-energy building.

6. Commentary

6.1. Existing buildings

6.1.1. If there is no statutory deadline or trigger point affecting legal rights of use or disposal of the subject building unless it is at a certain EPC class, for example, prohibition from selling, renting, donating or converting the building unless it is a certain EPC class, and if there is a sufficient number of sales transactions or listings involving similar properties not facing a statutory deadline, the valuer can determine the Market Value of the subject property using the comparative method. This approach can reflect the Market Value on the date of valuation without requiring an estimate of the renovation costs.

[4] At all levels of public ownership: central, regional, municipal

[5] 'Nearly zero-energy building' means a building where the nearly zero or very low amount of energy is covered to a very significant extent by energy from renewable resources, including energy from renewable resources produced on-site or nearby (more detail in the Directive).

6.1.2. If there is a statutory deadline or trigger point affecting legal rights of use or disposal of the subject building unless it is at a certain EPC class, the valuer should in most circumstances use the residual method to determine the Market Value, proceeding as follows:

a) Compare the building's EPC class with the class required by law at the next trigger point for that specific building.
b) Estimate the Market Value of the property on the special assumption that at the date of valuation it has been renovated to the required EPC class by comparing with similar properties at that EPC class.
c) Using the residual method, from the above end value obtain and deduct the cost of renovating to the required EPC class.
d) If appropriate, having regard to the scale of renovation and market practice, deduct other costs such as the cost of financing, professional fees and a developer's profit.

6.2. New buildings

6.2.1. In this new context of imminent zero-emission new buildings, valuers must determine from the market evidence whether less energy efficient buildings completed, projected to be completed before 2030 or for which building permit applications were submitted before 01.01.2030 have a different market value.

6.2.1.1. Zero-emission buildings are harmonised at EPC class 'A' (see 4.3.). New buildings exempted from the class 'A' obligation (see 4.3.1.) still fall under the previous Directive's obligation to be near-zero energy. It is safe to presume that in the modified EPC scales ensuing from transposition of the Directive into national law, near-zero energy buildings will be EPC class 'B'.

6.2.1.2. When valuing a 'B' class new building the valuer may follow the procedure for existing buildings in 6.1. Note, however that there may be little regulatory/market pressure to differentiate between 'B' and 'A' because:

a) A new building will not be renovated for a long time and no legislation is going to require renovation to 'A' in the near future; and
b) There will be little likelihood of EU or national grants for such cases as all such financial aid is expected to go to the worst performing building stock.

6.3. Public bodies' buildings

6.3.1. The obligations of the Energy Performance of Buildings Directive apply to all buildings, public and private. The Energy Efficiency Directive's provisions on renovating 3% of the public building stock per year to at least near zero-energy level are additional to these.

6.3.2. In valuing a public body's building, valuers must ascertain:

- Whether the building is for sale or rent on the private market. If so, it ceases to be a government building for the purposes of energy efficiency regulation and is subjected to the standard requirements under 4.2. and to the requirements of this Standard under 6.1. If not, 6.3.2.1. or 6.3.2.2. applies and Market Value is estimated on the special assumption that the building stays in government hands and is renovated to B class.
- Whether the building is prioritised by the government for inclusion in the 3%
- Whether the government building is rented from a private landlord

6.3.2.1. For a building prioritised for inclusion in the annual 3%, valuers must:

- Compare the building's EPC class – or, in its absence, the valuer's best estimate of the likely EPC class - with the class equating with 'near zero-energy'6
- Estimate the Market Value of the property after renovation to the 'near zero-energy' EPC class
- Proceed as in section 6.1.2 (c)

6.3.2.2. For a building not prioritised for inclusion in the 3%, and which is rented from a private landlord, valuers must:

- Check for any of the trigger points listed in section 5.2.
- Compare the building's EPC class[7] with the class equating with 'near zero-energy'
- Estimate the Market Value of the property after renovation to the 'near zero-energy' EPC class
- Proceed as in section 6.1.2 (c)

[6] Most likely 'B' class, as under the Energy Performance of Buildings Directive, 'A' is harmonised in all member states at 'zero-emission'.
[7] Public buildings are much more likely to have an EPC if they are rented.

II. Valuation Methodology

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

1. Introduction

1.1. Technically speaking, **methodology** is a system of methods used in a particular area of study or activity.

1.2. In valuation, the term **methodology** is used to describe the process by which a valuer undertakes the valuation of the property. Thus, for a given valuation, methodology includes the selection by the valuer of the approach or approaches to be applied, the choice of method(s) and the use of models or techniques in order to interpret the valuation inputs and reach conclusions based on them.

1.3. There is a hierarchy of definitions; Approaches, Methods and Models. An approach is the first level in a hierarchy of definitions. The three recognised approaches are Market, Income and Cost *(see section 4 below)*. All of these are based on the underlying economic principles of price formation and the choice of approach will vary depending on the purpose and nature of the valuation. Each of these principal valuation approaches includes different detailed methods of application and within these methods, there are different models. Some models are quantitative in nature, others more qualitative but all are techniques that allocate value to the component characteristics of a property.

1.4. EVS 2020 does not impose any specific valuation methodology, as (unless there is applicable regulation) they are a matter for the professional judgement of the valuer in each case, according to the nature of the property and the context and purpose of the valuation. In addition, methodology can be expected to evolve in the future as a result of many influences, including market behaviour and advances in calculation and analytical tools/methods — it would be inappropriate to attempt to restrict future evolution by insisting on valuers retaining certain of today's recognised methods/models.

1.5. However, valuation methodology is implicit in valuation standards, and it is for that reason that this section on valuation methodology has been prepared. Standardised valuation methods facilitate transparency and comprehension by readers of Valuation Reports; up to date valuation standards in turn reinforce good practice in, and the accuracy of, valuations.

2. Scope

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

3. Definitions

3.1. **Basis of value** — A statement of the fundamental assumptions for undertaking a valuation for a defined purpose.

3.2. **Valuation approach** — The fundamental way in which, having regard to the available evidence, the valuer considers how to determine the value of the subject property.

3.3. **Valuation method** — The particular procedure, based on one or more valuation approaches, used by the valuer to arrive at an estimate of value.

3.4. **Valuation model** — A specific technique of data treatment conducted within a valuation method.

4. Valuation approaches

4.1. In order to perform a valuation founded on the relevant basis of value, one or more valuation approaches will be used.

4.2. Valuation methodology is based fundamentally on the workings of a free market economy. Thus, an understanding and subsequent modelling of the dynamics of the price mechanism of supply and demand that influences market pricing is essential. All valuation methods need to reflect the economic fundamentals of the real world.

4.3. Although there are certain differences in application and greater differences in nomenclature, there are, in fact, only three basic approaches for valuing land and buildings: the market (or comparative), the income and the cost approaches.

4.4. Within the three basic approaches of valuation, there are a number of valuation methods that are used, depending on how property pricing practice developed in a particular market. These methods will be used for one or more of the three basic approaches, as appropriate for the valuation based on the kind of property, the available data, the purpose of the valuation, the nature of the client, the local legal framework, etc.

4.5. In the **Market Approach**, the valuation is produced by comparing the property with the evidence obtained from market transactions that fulfil the criteria for the relevant basis of value and property type.

4.6. The **Income Approach** is for the valuation of all property where its value is found by capitalising or discounting the estimated future income to be

derived from the property, whether this income is rent or whether it is income generated by the business that is carried out on the property. In some countries, the form of income approach whereby the actual or potential rental flow is analysed and capitalised is treated as a sub-division of the market approach; in those countries, what would be widely understood as the income approach is reserved for valuations based on the accounts of the enterprise operating on the property.

4.7. The **Cost Approach** provides an indication of value based on the economic principle that a buyer will pay no more for a property than the cost to obtain a property of equal utility, whether by purchase or by construction, including the cost of sufficient land to enable that construction. It will often be necessary to make an allowance for obsolescence of the property compared with a brand new equivalent one.

5. General observations

5.1. **The importance of analysing the property and the market** — Before describing the most relevant methods and models in detail, it is necessary to stress the importance of analysing the market and the market evidence in detail before deciding which method or methods should be used to carry out the valuation. The examination, investigation and analysis of the available market evidence is one of the most important parts of the valuation process.

5.2. **'Looking behind' the evidence** — It is important to try to find out what matters had a particular influence on the respective parties and influenced them in arriving at the end result of the transaction that is being analysed. It is only when this process has been carried out that a realistic analysis of the evidence can be attempted.

5.3. **Relevant factors** — The valuer will investigate where the bulk of the market evidence is to be found, and this will depend on, for example: the nature of the local market; the type of property to be valued and its condition; the demographics of the immediate and wider locality; the financial climate at the time of the transactions; the date of comparable transactions; or the business or activity carried out on the premises. This process enables the valuer to determine which market transactions are the most relevant and to give due weight to each piece of relevant evidence.

5.4. **The type of property to be valued** is the second important factor, for on this, together with the locality, the decision will largely rest as to the valuation method to be adopted. While market-based comparison of transaction values may be natural for many types of property in many areas, certain common factors that tend to occur in most markets may prompt other approaches.

5.5. For example, in the case of the office market, in many countries there will tend to be more evidence of rental transactions than there is of sales. In view of this, and as this is an asset class that is traditionally attractive to investors, the income approach can be adopted and yields can be established from the comparison of sales data. In contrast, for highly specialised properties, such as an oil refinery or a chemical or steel works, the type of property is so specialised that there is generally no market, capital or rental, so the cost approach is usually adopted for many valuation purposes.

5.6. Prospective buyers or tenants may be willing to pay an additional sum for a location along a tree-lined street or with a view overlooking a lake, irrespective of the type of property. There is also growing evidence in some locations that 'green features' in some or all types of property may add value. As sustainability indicators may impact value, the valuer will have to include sustainability issues when analysing evidence. For example many banks today have a preference for lending in respect of green certified commercial properties and this has manifested itself in terms of lower discount rates and higher Market Values or putting other properties at discounted values.

5.7. The property should usually be distinguished from the business that may be using it.

5.8. **The relevant local market** — It is important to examine in some detail the nature of the local market — what types of property are represented there and whether the market for the property to be valued is predominately an owner-occupier market or a rental market. This last factor can be important in deciding what sort of comparable evidence to look for and whether the comparison approach or an income method is likely to be preferred.

5.9. A standard part of the valuer's work is identifying the most valuable locations and the local factors that can affect not only the actual value, but also the methods that might be used to arrive at the value. Proximity to particular business or transport hubs is a typical factor to be taken into account.

5.10. It may be that the property is located in a sub-market that has its own pricing practices, or variations on standard ones. In that case, the valuer will generally want to ensure that the methodology used takes this into account.

5.11. **The analysis of evidence, an essential rule** — When it comes to analysing the evidence, there are a number of processes to be gone through but whatever method is used, the end result is usually the same in essence: a unit of value is derived from the evidence and is used to value the property or properties in question.

5.12. This unit of value will often either be a capital value per square metre or a

Rental Value per square metre. In the case of hotels, it could be a value per bedroom or, in the case of petrol filling stations, it could be a value per thousand litres of throughput (these are relatively crude *"shortcut"* approaches which are sometimes used as approximations in the absence of detailed financial models, or as a check against other valuation procedures). In the case of land, it could be a price per square metre or a price per hectare or, for development land, a price per square metre of building that could be erected on the site. For specific properties (for example a castle or feet-in-the-water property), a global value of a property could also be a relevant 'unit value'. All valuations are ultimately based on an understanding and comparison of previous transactions in the market.

6. The Comparative Method

6.1. The Comparative Method is regarded as the preferred method to arrive at Market Value as it provides the most direct link to the actual market transactions.

6.2. Ideally the Comparative Method assesses Market Value through an analysis of prices obtained from sales or lettings of properties similar to the subject property followed by adjustment of the unit values to take account of differences between the comparable properties and the subject property. However, valuers should also have regard to other relevant market information and data upon which they may need to place greater reliance particularly in those markets or situations where information about transactions is either unreliable or simply not available.

6.3. Asking prices are not a tangible result of the forces of supply and demand and are therefore not a fully reliable source of information about the market situation. First and foremost, they reflect the expectations of the supply side of the market. Through comparison with transaction prices, however, they are helpful in identifying the phase of the market cycle. Crucially, by considering the market cycle and its degree of liquidity a valuer experienced in a given market can judge the relationship between offer prices and the likely sale prices of a property and therefore, in the absence of other reliable price data, the use of offer price information is important and desirable.

6.4. Valuers must give a brief explanation of the judgment supporting the discount or premium applied.

See EVIP 1, Valuing in Non-transparent Markets.

6.5. The prices from the comparable transactions are usually related to one or more units of comparison, such as the size of the property or the expected annual net operating income. Depending on property type and the data available, different units of comparison are used. It is important that the units of comparison be defined and measured in the same way for all the properties

within a particular class.

6.6. Judgments have to be made about the relative merits of the property and the comparable properties so that adjustments for differences can be made to the price of each comparable property to obtain an estimated price appropriate for the property being valued. The more dissimilar the comparable properties are to the subject property, the less reliable is the value resulting from the comparative method.

6.7. There are a number of factors to be considered when examining the reliability of the evidence obtained in respect of comparable properties:

- Their location as compared with the location of the property to be valued;
- The time factor, i.e., the time that has passed between the transaction in respect of the comparable property and the date of valuation. The valuer needs to decide how far back in time the comparable transactions should be accepted and what adjustments need to be made. Market conditions clearly change with time, and in some circumstances even quite recent transactions may no longer be good indicators of market conditions at the valuation date. Generally speaking, the most recent transactions are considered to provide the best comparable evidence;
- The degree of obsolescence of buildings and their fittings — Physical, technical and economic;
- The financial and reputational strength of the tenant, the percentage of the property occupied or vacant and the net to gross area ratio (in the case of investment properties);
- The number of comparable transactions is another important question and valuers will need to decide what they deem to be an acceptable number. This is a matter of judgment and could vary, for example, according to the purpose of the valuation;
- It is important to take into consideration that there may be considerable differences between the properties that have already been sold or let and the property that is to be valued. The Comparative Method should only be considered when there are properties with characteristics that are reasonably comparable to the subject property, although it may sometimes be necessary to accept as comparable, properties that are not really ideal in this respect. This is because some evidence is better than no evidence at all. However, in such a situation it may be advisable to look at another valuation method in order to check the result produced by the use of the comparative method.

6.8. As mentioned earlier, it is important that the unit of comparison be the same for all the comparable properties and the subject property (for example, if gross internal area is the unit of comparison, it must be measured in the same way for each property). Definitions of how the various types of area are

measured can be found in the European Code of Measurement in Part V.

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

7. The Income Approach, methods and models

7.1. In general terms, the Income Approach is a form of investment analysis. It is based on a property's capacity to generate net benefits (i.e. usually monetary benefits) and the conversion of these benefits into a present value. The benefits may simply be regarded as the net operating income. In the valuation of properties based on operating profits (such as hotels), the valuer will often work on the basis of EBITDA (earnings before interest, tax, depreciation and amortisation).

7.2. To estimate a Market Value, the procedure starts from the conditions on the actual market. This means that all data and assumptions must be market-derived. If the purpose is to estimate an investment value (i.e. the value that the property may have for a particular identified purchaser), the calculation starts from the situation of an individual investor.

7.3. When applied to investment properties, all methods based on the Income Approach will be grounded on the interaction of the following elements:

- Current and expected future net income;
- The timing of future events that can be expected to affect the net income;
- The way in which potential buyers would account for this interaction of money flows over time — this is taken into account by the choice of yield or discount rate.

7.4. The income method used within the Income Approach can be divided into two types of model:

- Traditional income growth-implicit models, known as **Capitalisation methods**, including direct capitalisation, term and reversion, layer (hardcore and top slice) and growth-implicit discounted cash flow models; and
- Income growth-explicit models usually known as **Discounted Cash Flow (DCF)**. The main feature of the growth-explicit discounted cash flow method (explicit DCF) is that anticipated growth in income and costs is explicitly incorporated into the model by the valuer.

7.5. It is important, when carrying out a valuation, to ensure that there is no double counting for inflation in rents, Rental Values and cost items. Thus, when a valuer is using a capitalisation model, the rate of return adopted will normally implicitly reflect the anticipated increase in Rental Value. It would therefore be wrong to then make a separate provision for rental growth in the cash flow. Conversely, in an explicit DCF model the valuer will usually want to explicitly include anticipated future growth in rents, in which case the discount rate adopted will generally be higher, in order to reflect the risk involved in predicting future income growth. The same applies to any cost items included in the valuation — future inflation of costs should not be included in a growth-implicit model, whereas it will be taken into account in a growth-explicit model.

7.6. **Capitalisation methods** — Traditional capitalisation methods can be broken down into two types:

- **Perpetual models** where the Market Rent is, for the purpose of the implicit model, considered to be the same forever (all growth and future sales are captured in the yield);
- **Reversionary models** where in today's terms the rent passing is below or above the Market Rent that will be received at a future reversion to Market Rent.

7.7. **Perpetual capitalisation** — Direct capitalisation involves converting income expectancy into an indication of value by applying an appropriate yield to the estimated income (most often net rental income or net operating income). The income that is capitalised is the expected income for one year (usually for the first year of calculation). Since direct capitalisation usually involves perpetual capitalisation of the first year's income for the subject property, this model does not reflect any potential future variation in rental income, unless an adjustment is made to the yield to reflect this.

7.8. Capitalisation is a market based model which relies on strong evidence of Market Rents and market yields (capitalisation rates). It relies on an active and liquid property market, both for investment and for lease, and requires sound analysis of property sales and property leases.

7.9. Capitalisation, in established markets, is usually applied in the valuation of

investment properties for which purchasers customarily base the price on a certain multiplier (inverse of capitalisation rate) of the rental income. These almost liquid properties are usually fully or almost fully leased at Market Rent or expected to be leased at Market Rent. However, in more challenging or emerging markets, where there is a scarcity of comparable evidence, it becomes difficult to derive a capitalisation rate from market analysis and the valuer has to resort to other, alternative methods of establishing the capitalisation rate or resort to alternative valuation models including discounted cash flow under which net annual rental income is set out explicitly over a typical 5 to 10 year cash flow period. The latter *"explicit"* model differs from *"implicit"* capitalisation which usually involves the capitalisation of today's net Market Rental income by means of a so called *"all risks yield"* which reflects the market's future risk and growth expectations. Capitalisation may be undertaken by means of a very simple mathematical model albeit in certain cases it may be more complex.

7.10. If at the date of valuation, property is leased at a Market Rent it can be assumed that this income is perpetual (i.e. income assumed to be constant at Market Rent) and, if it is possible to derive capitalisation rates from market transactions, **direct capitalisation** is applied based on the formula: capital value equals net operating income divided by the capitalisation rate. Thus direct capitalisation involves converting income expectancy into an indication of Market Value by applying an appropriate yield to the estimated income (most often net rental income or net operating income). The income that is capitalised is the expected income for one year (usually for the first year of calculation). This model does not reflect any potential future variation in rental income, unless an adjustment is made to the yield to reflect this. The capitalisation rate (all risks yield) reflects all of the market's perceived expectations about risks, expectations of positive benefits (in the form of income growth or growth in capital value) and other expectations of investors in the market. It includes the market's perception of rental growth and/or capital growth of the property. The better the location and quality of the property, the lower the risk perceived by investors who are therefore more willing to buy a property at a lower capitalisation rate.

7.11. **Reversionary models** — If at the date of valuation the rent paid differs from the Market Rent, then account must be taken of the actual rent and how long it will be paid until reversion to Market Rent, usually at the end of a lease and at rent review. In such case the valuer reflects projected changes in net income at certain defined future events, particularly at the end of a lease, rent review, or when major capital expenditure may be required. There are three models for dealing with such situations:

- **Term and Reversion** divides the cash flow vertically, and is usually applied when the term rent is below Market Rent (under-rented property);
- **The Layer Model** divides the cash flow horizontally, and is usually applied when term rent is above Market Rent (over-rented property);

- **Growth Implicit Discounted Cash Flow**, is a more sophisticated form of the term and reversion method typically presented in the form of a 5 to 10 year cash flow and a terminal value, both discounted at a so called **Equivalent yield**, being the single discount rate which, when applied to all income flows, results in a present value equal to the capital value of the investment. It is in the internal rate of return that the cash flow changes are allowed for implicitly. The income flows reflect current, actual and Market Rents and costs.

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

7.13. The capitalisation rate includes both the recovery of the original capital invested and expectations of capital appreciation, which allows an investor to overcome risk relating to the time value of money (money invested today has more purchasing power than the same amount of money in the future), risks relating to liquidity (time needed to dispose of property at some point in the future, uncertainty of sales price), tenant risk, lease agreement risk, risk inherent to the property itself and location, legal risk, taxation risk, legislation risk, and other risks as well as uncertainties related to the macro and micro economy, politics, demography and more.

7.14. The valuer will wish to take account of a number of factors when choosing the rate to be adopted, including:

- The location of the property, taking account of any likely future changes that may make it more or less desirable to tenants and/or buyers;
- The physical aspects of the property — Construction, quality of finishes, etc.;
- The nature, length and review patterns of leases;

- The obligations of the respective parties to any leases;
- Local and national law and regulation that might affect the potential for rents to increase or decrease during or at the end of the leases;
- The financial and reputational strength of the tenants.

7.15. Valuers will apply the same criteria to their analysis of comparable investment sales, adjusting the adopted yield to take account of the relative strengths or weaknesses of the subject property. Sale prices must be analysed on a consistent basis and valuers should have all details about the relevant sales and lease transactions.

7.16. Valuers may also rely with caution on market studies published by reputable agencies and market analysts. In some markets, whilst there may be a general lack of investment transactions, there is nevertheless some evidence of transactions in respect of prime commercial properties. Given that a hierarchical pattern of yields can nowadays be discerned across property sectors in Europe and within countries, valuers may also consider deriving a capitalisation rate having regard to yields reflected in known transactions and adjusting such yields in the valuation of the subject property for differences in location, sector, quality and other value-significant factors.

7.17. **Income from real estate** — The basis for calculating the income from real estate is the rental revenue it generates. Rental income also includes income from advertising boards, mobile phone antennas, ATMs, car parks etc.

7.18. The valuation is based on the income from the property accounted for annually, customarily assuming for ease of calculation and market analysis that it is obtained at the end of the year notwithstanding that in most cases income is received monthly or quarterly in advance.

7.19. The direct capitalisation method entails the use of current rents derived from the analysis of actual rents being paid on the market.

7.20. Typically, an analysis of rent paid for most buildings is done on the basis of Net Internal Floor Area or Gross Internal Floor Area, depending on the type of the property. It is very important that a valuer understand which area is specified in the lease.

7.21. The valuer must analyse all current occupational lease agreements and pay attention to value-significant factors including:

- Length of lease;
- Area under lease;
- Agreed rent;
- Responsibilities and liabilities of each contractual party;

- Any incentives;
- Fixed rent or inflation-indexed rent;
- Break clauses.

7.22. If it is customary in a particular local market to express gross monthly rents in lease agreements, valuers must deduct all expenses which relate to the operation of the building and arrive at a net operating income. Such expenses can be categorised under insurance, management, maintenance, taxes and repairs.

7.23. **Rent consistency** — Whichever capitalisation method is used, valuers should be careful to follow market practice as regards capitalising net rents or gross rents. For example, if the yields obtained from comparable transactions are based on gross rents, valuers will under-estimate the value if they apply the same levels of yields to net rents.

7.24. **Transactional costs** — Transactional costs are not reflected when assessing Market Value. However, when giving investment advice, valuers may be requested to estimate the return on total capital invested, and to express a value net of those costs.

7.25. **Discounting models** — Discounting models are based on present value calculations of expected income or cash flow projected over a specific calculation period. Unlike the capitalisation models,(which imply a future sale but don't explicitly express its date), a reversionary value is normally calculated and discounted at the end of a notional hold period. Consequently, a time horizon, projected cash flow and reversionary value have to be determined. To calculate present value, the estimated income or cash flow has to be discounted and a discount rate has to be determined.

7.26. **Explicit Discounted Cash Flow** (explicit DCF) is a discounting method that has gained popularity over the past decades, and is now widely used among valuers and investors. The model is based on the premise that the value of the property is equal to the sum of the present value of all future cash flows. The process of adding the present value for each future cash inflow and the present value of the resale price at the end of the period is called discounted cash flow analysis.

7.27. The conventional model for assessing the Market Value of commercial properties is direct capitalisation or derivatives thereof (term and reversion or layer techniques). However, because it is grounded on comparison and the exclusive use of market data at the date of valuation, without any explicit forecasts of market expectations, the explicit DCF model — once predominantly used for project feasibility analysis and estimation of investment value — is today also widely applied. The explicit DCF model requires the valuer to forecast the

cash flow based on market expectations and to discount it at a rate (target rate of return) expected by investors in the market.

7.28. Whichever model is used, valuers must be sure that it reflects the behaviour of market participants. It is always better to use comparable evidence generated from market transactions whenever possible with application of a pricing technique that is commonly used by market participants.

7.29. In the assessment of investment value, the valuer is advised of the forecasted cash flow (which may differ from market expectations) and the discount rate by the client. They should reflect the opportunity cost of investment capital and the perceived risk.

7.30. In assessing the Market Value by means of an explicit DCF model, it is difficult for the valuer to find a market-supported discount rate or any other key variables in the cash flow. Such a valuation can be very subjective. Thus, valuers have to make some reasonable assumptions in order to construct the most likely cash flow and to calculate the discount rate which they believe a typical buyer of the subject property would apply. The valuer will estimate the most probable rent over the investment holding period, based on in-depth analysis of past and current market conditions ensuring that the past is not simply extended into the future. In valuing investment property by means of the explicit discounted cash flow model, the valuer will seek to discount the projected cash flows by means of a so called **Target Yield** (also known as an Equated Yield). This is the discount rate applied to the cash flow projected during the life of the investment and to the reversionary or exit value at the end of the hold period. Under such scenario, income projections reflect expected future rental changes. The calculation reflects the valuer's views about Market Rental growth or decline. It is an expected Internal Rate of Return where cash flows are allowed for explicitly.

7.31. **The hold period** — Cash flows are estimated over a certain period during which the hypothetical buyer will own the property before finally selling it. In many cases a period of 10 years is adopted, largely because that period works well with lease patterns generally observed in many markets. There is no particular rule as to how long the hold period should be, although it is generally considered that it should be sufficiently long to allow for all leases to expire and for subsequent renewals or re-lettings. In some countries there might be statutory requirements in relation to specific valuation purposes requiring cash flows to be forecasted over the whole economic life of the building. This could reflect several market cycles within the holding period.

7.32. **Growth-explicit cash flows** — As stated above, in an explicit DCF valuation, valuers will wish to make their assumptions as explicit as possible, countering the criticism of capitalisation models that *"it's all in the yield"*. This will include estimating the future upward or downward movements of rents, lease

indexation clauses, and future inflation of costs that have been built into the cash flow.

7.33. **Assumptions at lease end** — Since one of the principles of the explicit DCF method is that assumptions should be made explicit, valuers will generally be expected to make it clear whether they have assumed that tenants will renew the lease, or leave and be replaced by new tenants. Some models allow for a weighted approach, allowing the valuer to adjust the weighting according to the circumstances of the property and even those of each tenant.

7.34. **The discount rate(s)** — All in-flows and out-flows in the cash flow model, including the projected future sale price, are discounted using discount rates. From a theoretical point of view, different rates should be used in one model to reflect the different levels of risks corresponding to the different in- and out-flows, but most frequently they are summarised in one single discount rate. As such, the discount rate is a key element of the DCF method. The discount rate is intended to reflect the hypothetical buyer's assessment of the risk inherent in the property.

7.35. The discount rate should be consistent with the cash (or profit) flows estimated in the model, i.e. it must be based on the same assumptions in terms of timing, inflation, costs, financing and taxes. The discount rate chosen should not reflect risks for which the future cash flow estimates have been adjusted.

7.36. Valuers should choose the discount rate in the light of the general level of risk inherent in the model — if the assumptions are generally optimistic, it would be appropriate to choose a somewhat higher discount rate, whereas cautious assumptions would call for a lower discount rate.

7.37. Individual rates reflecting the motivations of the individual investor or requirements of alternative investments are used when estimating an investment value for a particular investor.

7.38. Ideally, the valuer would have evidence of discount rates adopted by purchasers when bidding for comparable properties that have been sold recently. Unfortunately, such information is available in very few countries and markets.

7.39. Alternatively, where valuers have sufficiently detailed information of a recently sold comparable property, they can carry out their own analysis on a DCF basis and deduce the discount rate that way.

7.40. Where neither of those is possible, valuers often determine the discount rate by alternative analysis, the most common of which include:

- Adding risk premiums to a *"risk-free"* investment yield, such as long-term government bond yields;
- Applying a property yield, adjusted to reflect the fact that income growth has been made explicit in the cash flow;
- Estimating the weighted average cost of capital of a typical buyer of such a property.

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

7.41. **Reversionary value at the end of the hold period** — The DCF model assumes a sale at the end of the hold period. The value of the property at the end of the hold period is usually assessed by means of implicit direct capitalisation of the net income at the end of the last year of the hold period. This value is included in the income stream of the property over the hold period, and discounted to the present value. Alternatively, depending on the type of the property, the reversionary value can be obtained using a comparative method.

7.42. Typically, investors either assume the capitalisation rate at the end of the hold period (exit yield/future capitalisation rate) to be equal to the capitalisation rate prevailing at the date of valuation, or they assume a capitalisation rate on exit that is higher than the current capitalisation rate to account for the uncertainty of future cash flows expected to be received by the property over the hold period and because of the depreciation of the building over the hold period.

7.43. A valuer can also use historical capitalisation rate data in respect of the property type and market under consideration, applying personal knowledge of the local marketplace.

7.44. **Cash in-flows and out-flows** — Under the growth explicit DCF model, the valuer should make assumptions as explicitly as possible, given that the alternative direct capitalisation method suffers the criticism of including *"all in the capitalisation rate"*.

7.45. This will include forecasting future upward or downward movements of rents due to any lease indexation clauses, potential future growth in Rental Values and future operating cost inflation.

7.46. Income and operating cost information can be obtained from either primary or secondary sources. Primary sources are property owners and those who manage the property, accountants and real estate agencies. Secondary sources are selected published professional articles. Valuers must be critical towards all published professional articles when relying on them as reflecting market activity. They should also critically review the historical performance

of the property itself. The income and expense forecasts should also reflect aspects of the property which may not fall within a typical range published in professional articles.

7.47. Cash flow is usually designated in the currency in which the income is contracted.

7.48. Valuers should begin their analysis with a review of current or hypothetical lease terms typical for the type of the property in the local market.

7.49. It is important to identify who under the lease agreement is responsible for paying operational expenses.

7.50. The valuer should give special attention to the following issues in the lease agreement:

- Lease extension option and under what conditions;
- Terms of any rental indexation;
- Rent renewal clauses;
- Possibility of termination of the lease by the tenant;
- Tenant's investment in the property;
- Restrictions against allowing competing tenants.

Based on thorough analysis of:

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

7.51. The valuer should estimate:

- **The Potential Gross Income (PGI)** — The total revenue that can be derived from the property, being fully leased;
- **Effective Gross Income (EGI)** — This is derived from PGI making allowance for the loss due to both the current and an expected vacancy rate in the property and loss due to the possibility of not collecting rents over the lease period;
- The **Net Operating Income (NOI)** of the property should be assessed by subtracting from the EGI all operating costs which fall on the lessor. Operating costs include both fixed and variable costs:
- Fixed costs are all costs necessary to maintain the normal operation of the property and to achieve the expected revenue;
- Variable costs depend on the occupancy rate of property and include costs of management, administration, utilities, cleaning/maintenance, and security.

7.52. Special attention should be paid not to include expenses such as corporate taxes, income taxes, loan/debt servicing and accounting depreciation. After subtracting the operating costs, the valuer should also subtract the estimated budget for necessary long lasting renewal works and short term repairs.

7.53. Finally, it should be noted that explicit DCF is a highly complicated model relying on predictions of the future fluctuation of a large number of economic and property market indicators. The results of a DCF should therefore be treated with caution and it is recommended that the resulting values be checked against other market indicators, such as yields and prices per square metre and perhaps also against values obtained using other methods.

7.54. **Models based on the accounts of the current or a theoretical occupier** — In some countries, the term Income Approach refers to valuations based on the accounts of the enterprise that is operating on the property. EVS consider that as a specific Accounts Method within the Income Approach.

7.55. This method is essentially used for market or investment valuations of properties designed and adapted for a particular use and for which comparable sales are not frequently available, and the valuation is made by reference to the gross turnover that can be generated by business activity in the property. In many countries, explicit discounted cash flow models are preferred to the conventional accounts model but the principles behind it are essentially the same.

7.56. Typical cases where these methods are suitable are found in the leisure industry, such as leisure centres, sports stadia for professional sports, theatres, hotels, restaurants and clubs, and also, in some cases, in the valuation of forests and certain agricultural properties.

7.57. In assessing the reliability of actual income to the enterprise, care should be exercised to ensure that elements of over-trading peculiar to a particular occupier are properly adjusted. It is the expected normal income, often termed **Fair Maintainable Trade**, which the valuer should be seeking, which avoids special circumstances that might distort value. Care should also be exercised in looking at the content of income streams because it is the subject property that is being valued and not the business. Value that is accruing to a particular brand over another may require adjustments, as might significant income earned by the enterprise away from the property.

8. The Cost Approach

8.1. The Cost Approach provides an indication of value based on the economic principle that a buyer will pay no more for a property than the cost to obtain a property of equal utility, whether by purchase or by construction, including

the cost of sufficient land to enable that construction. It will often be necessary to make an allowance for obsolescence of the subject property compared with a brand new equivalent one.

8.2. The cost approach is most commonly used to estimate the replacement value of specialised properties and other properties that are very seldom, if ever, sold or let in the market. This means that the cost approach is generally only ever used when a lack of market activity precludes the use of the comparative method and when the properties to be valued are not suited for valuation by the income approach. There are, however, circumstances where it is used as a principal market-related procedure, particularly where there are significant data available to enhance the accuracy of the procedure.

8.3. Because cost and Market Value are usually more closely related when properties are new, use of the cost approach is easier when estimating the Market Value of new or relatively new constructions, but even so, the cost approach should not be adopted for this type of property unless there is a total absence of market evidence, or in the situations alluded to above. Indeed, in some cases the rental, occupational or investment markets may have changed considerably between the date when the construction cost was fixed and the date of final completion of the project, in which case the value obtained by the cost approach may no longer be a reliable measure of the Market Value. Using the cost approach for older properties can cause difficulties because of a lack of market data, both for construction costs and for depreciation, although this can also be true for certain newer properties.

8.4. Opinion varies across Europe as to the extent to which the Cost Approach can give a reliable indication of Market Value. It would appear that the countries that are against the use of this approach tend to be the ones where the market is more transparent and where more rental, yield and price evidence is therefore available. In addition, where markets are more volatile there is resistance against using cost as an indicator of value, as building costs react more slowly to cyclical changes than do market prices and rents. In contrast, the Cost Approach is often more widely used in markets that are less transparent and/or less volatile.

8.5. Use of the Cost Approach will therefore vary across Europe and from market to market. In some countries, the Cost Approach is used where there is market evidence but, as the cost approach is not a market-driven model, it should not be looked on as a primary valuation model.

8.6. **Depreciated Replacement Cost (DRC)** — In its traditional form, DRC is a cost-based method of arriving at a value for real estate assets which are normally never exposed to the market.

8.7. The reasons why such assets might not be exposed to the market are many

and varied, but will normally be because the real estate is operated for an unusual use, with sales rarely or never taking place for that use. One of the areas of common application in valuation using DRC is in public sector assets which, in providing a service to a local or wider community, are rarely, if ever, traded.

8.8. It might also be the case that there may be a lack of transactions or Market Value and as such, a comparables-based approach is not available. In the absence of a transaction market, it might be useful to contemplate an income approach to a valuation, but again this may not be appropriate, particularly in the absence of any profit motive of the entity to be valued. The DRC remains as a valid method in the absence of other methodologies.

8.9. Where an historic use ceases and the asset is traded as surplus or redundant, unless a similar use is forecast, the DRC valuation is unlikely to represent any proxy for sale proceeds. As a cost-based valuation, a DRC may not be reliable as net realisable value.

8.10. One of the primary uses of the DRC methodology is for financial statements, where a corporate entity is involved and in the case of public sector occupiers, often used as a device for ascertaining the monetary worth of the benefits of occupation.

8.11. The concept of 'value to the owner' is of note. The traditional use of DRC required the directors of a company (where a DRC was being transposed into financial statements) to certify that the entity was, at the date of the entry, a going concern. In the case of public sector property where there is often a lack of profit motive, the authority in owner-occupation was required to state that such use would continue for the foreseeable future.

8.12. Those requirements still hold good and from that, it is evident that the value is of greatest significance to the user of the asset rather than any third party and underlines the 'value in use' to the owner/occupier.

8.13. A DRC valuation is not a development appraisal, a residual valuation or an insurable amount. Common elements to an assessment of value for these purposes exist within a DRC approach, but only as to elements of it.

8.14. The DRC approach does not envisage actual redevelopment, actual expenditure on accrued repairs, actual remediation of any type of obsolescence, but seeks to measure where that current entity sits in value terms in relation to a modern equivalent property. The *"depreciation"* amount in a DRC reflects all of these reductions, losses or impairments over the modern option.

8.15. The primary question in DRC analysis of existing buildings is their future

economic performance.

8.16. The valuer is not suggesting improvements or necessarily deciding how long a property would benefit from an improvement. That would be a feasibility study or a development appraisal. In a DRC, the valuer sees how far removed the existing property is from the modern improved or replaced equivalent. Actual expenditure is not envisaged.

8.17. If the application of the method is to derive a figure to assess potential disposal proceeds, the method may not prove reliable as a proxy for disposal proceeds.

8.18. A valuation for alternative use is not a DRC and is more likely to be a *"Development Appraisal"*.

8.19. The definition of Cost Approach:

"A valuation approach which provides an indication of value based on the economic principle that a buyer will pay no more for a property than the cost to obtain a property of equal utility, whether by purchase or by construction, including the cost of sufficient land to enable that construction. It will often be necessary to make an allowance for obsolescence of the subject property compared with a brand new equivalent one."

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

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

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

8.23. This was particularly evident in those markets that saw the biggest collapse. Greece is an interesting example; faced with little or no active transactions for most commercial property, those involved in administering companies, loans, banks, and others still needed some reliable method of assessing

current value. In Greece, the DRC method evolved out of necessity to form, in effect, the *"going concern value"*. In other words, the sign-off historically provided by the Directors was replaced by the perception that the use or similar use by a third party would be financially viable and therefore a DRC was a default valuation methodology. This welcome modernisation of the traditional DRC approach has brought real transaction evidence into the DRC equation.

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

8.25. For many years, DRC was often regarded as the method of last resort for valuers, when there really is no evidence for a valid comparative approach or income and expenditure for whatever reason are not relevant to the asset being valued. For a long period, values were expressed in *"DRC and not in Market Value"*.

8.26. Consultancy firms and worldwide accounting standards started to influence the DRC approach and there was an interim period when properties were valued at Market Value (DRC).

8.27. The modern use is just Market Value. This, interestingly, carries dangers, because to the uninitiated, there is the perception that a property could be bought and sold for the DRC figure. The justification for the label Market Value is that like-users would trade a property between themselves at a DRC derived figure. For example, one hospital could be transferred to a different health authority provider and DRC would be the Market Value for both parties. This, of course, is where few, if any, of these assets are traded in their current use.

8.28. **Cost and value** — One of the fundamental problems for all cost-based valuations is that cost does not necessarily equal value. For new properties, there may be less of a problem, but the valuer still needs to exercise extreme caution in adopting actual build costs of an asset on the assumption that the entity funding it got value for money. Issues surrounding the choice to be made by the valuer in assessing building costs are many, but it is certainly the case that an actual new build cost should not automatically be the DRC valuation in year one, without further enquiry.

8.29. **The use of DRC** — DRC having been more widely used than perhaps historically justified, it is necessary for the valuer to step back and ask some pertinent questions.

8.30. In Germany, Greece and Italy, the DRC is widely used. As the basis of reduction remains subject to the financial viability of the entity, banks and lending institutions in the absence of any other option, have adopted a DRC approach in lending decisions.

8.31. In the UK, by contrast, banks, as a policy, will not lend against a DRC figure as they regard it as wholly inappropriate. In the UK, if there is a loan default, the bank will seek to realise the asset. In most cases, this will be a sale of either the property or the corporate entity in default of the loan where the entity has collapsed. That may mean the asset will be used in the future for a different use and the DRC 'existing use test' will fail. UK banks do not accept that a sale price is likely to be derived from a DRC approach and are therefore not willing to use a DRC as collateral.

8.32. A good example of why banks in some countries reject this approach might be a football stadium valued on a DRC. Often expensive to build, its use is heavily restricted to a stadium. In a town with one football club, if the club closes, what is the value of the stadium?

8.33. The banks will look at Market Value which conventionally is for a different use, often a housing development site (dependent on location and local planning laws).

8.34. The banks could not recover the loan from the sale as a stadium so they measure the collateral on a market comparison basis, which by the nature of DRC will most likely be for another use.

8.35. **Terms of engagement** — The application of a DRC approach involves the client to a potentially greater degree than other methods of valuation and the valuer will need detailed instructions.

8.36. Fundamental to the use of the DRC is an understanding with the client of how the valuation is to be used and for what purpose.

8.37. **Financial statements** — If the DRC valuation is to be used for accounting or financial statements, then this needs clarification as to what is included. For example, a user may have many extensive bespoke alterations to a property that are already being reflected in company accounts, and to include these in a DRC valuation may be double-counting.

8.38. Many specialised properties will contain plant and machinery, and in some uses, the property altogether may be largely described as plant and machinery. Again, care is required that these assets are not already reflected in other parts of a financial statement.

8.39. **Componentisation** — A modern request for financial statements is componentisation, which also includes property assets valued under a DRC approach. Taking the component parts of a building needs some care and thought, because individual parts such as walls, a roof, etc., may have defined costs but do not normally exist in isolation of each other. If under componentisation, different depreciation allowances are made, the valuer will need to decide how that relates to the whole. For example, if an assumption is made that the wall cladding will last 30 years and a roof 50 years, the valuer might assume that the whole will become unusable at 30 years rather than part at 30 and part at 50. Assumptions made and applied need to be explained to the client and set out within any reported value on DRC. **Componentisation is a separate exercise to the determination of the DRC overall value. The DRC figure can be a starting point for a componentisation exercise.**

8.40. **Going Concern/Continued Use** — In the case of a business entity occupying a property to be valued using DRC, it will be necessary for the valuer to obtain confirmation from the client that the entity is profitable, is a going concern, and realistically likely to continue in that form. A written assurance from a Director of the company using the property is of additional comfort to the valuer here.

8.41. In the public sector, where there are potentially no receipts, profit or profit motive, it is normally necessary to ascertain from the user that the service offered from the property is liable to continue and that a suitable demand for the service exists.

8.42. The valuer will need to establish with the client how the asset is used and will continue to be used. With these more specialised assets, valuers will need to place greater reliance on information provided by the client or other professional advisers than they might ordinarily expect with less specialised assets. Detailed reporting is essential to give credibility to the DRC approach and it is recommended that detailed record keeping be maintained on each of these valuations.

8.43. **The building costs** — Valuers should keep in mind that they are seeking to derive a figure for an asset that already exists, not one yet to be built. Therefore, how a new build is to be funded, with what interest rate and by whom, is not a relevant feature. However, if a structure has been built using third party grants or state or EU funding, then the question should be posed as to whether an entity would actually build without subsidy.

8.44. Grants have been shown to enable larger buildings to be erected than might otherwise be the case, perhaps on a presumption of future additional demand. In the public and private sectors, these types of structure can also, in some cases, be subject to a degree of architectural excess.

8.45. In a DRC, the valuer is tasked with identifying the cost to replace an asset with a modern equivalent of equal utility but usually the modern replacement utility where there are no abnormal building costs and not excessively expensive. That is not to say that grants should be deducted from build cost. The valuer should enquire as to what would be prudent to provide assuming there is no grant. Where it is not financially feasible to build without a grant, this might lead to special assumptions which need very careful explanation in the Valuation Report.

(see also 'Impairment of Value', supra)

8.46. **Replacement** is the cost to replace a structure with a substitute structure of at least equal utility using current standards of materials and design. A current acceptable utility may exceed the historic utility requirements of the use and may have evolved to adopt more modern requirements.

8.47. If an asset is new, the actual cost might be the relevant figure to adopt in assessing the build cost. In adopting this figure, the valuer would need to be satisfied that there was no excessive expenditure, or feature of the construction that is not relevant to the economic purpose of the property.

8.48. Enquiry as to how the build cost was agreed is also necessary. The valuer should not assume that the actual build achieved value for money. That needs to be tested.

8.49. **Sources of information for building costs** — In most countries, there are indices available based on simple contracts. With these, a price for building different structures in different uses can be identified at least to a range. The more specialised the site, the greater the likelihood that any sample contracts will be fewer. Specialist cost consultants may need to be consulted if a modern equivalent cost cannot be ascertained in any other way.

8.50. **Included in building costs:**

- **Fees and other costs** — To build a new entity as an equivalent modern asset, there will be professional fees. These should be identified and added to the cost of construction.

8.51. **Not included in building costs:**

- **Demolition** — For a DRC, it is not proposed to actually replace the asset — merely to identify the gap between the modern equivalent and the existing. Accordingly, the existing asset will not be demolished as part of the valuation and demolition costs should not be included;

- **Finance** — DRC is not a residual valuation or feasibility study. The property is assumed to already exist, so long term funding is not a consideration. Short term construction finance can however be considered as a cost providing a modern equivalent substitute;
- **Period of construction** — Most valuers assume a cost at date of valuation. An asset, however, may take months or years to build and costs may escalate during the actual build programme. This is irrelevant. The valuer is making a comparison at the date of valuation between an existing asset and a replacement asset that has by assumption been built using today's costs and values. There should be no addition or allowances for a build period. It is assumed the property is there at the valuation date.

8.52. **The Modern Equivalent Asset of Equal Utility** — One of the more difficult areas in presenting a DRC approval to a client is the concept of a modern equivalent asset which underpins the whole approach.

8.53. Taking the modern equivalent at its extreme, the valuer is entitled to consider a new structure of a different size in a different location to deliver the modern requirement of the business. It is against this background that the *"deficiencies"* of the current asset are depreciated. In order to do this, the valuer will need to have a fairly detailed understanding of the functions required and currently performed, including, where necessary, the most appropriate modern technical solution in asset provision. The valuer is most unlikely to be an expert in any of these solutions and will need to rely on the client or industry experts to understand what the best solution for a modern equivalent would be at the date of valuation.

8.54. If the valuer is to seek guidance beyond the client, then the scope, source and cost of that data need to be discussed and agreed with the client as the data might be both commercially sensitive and expensive.

8.55. **Modern equivalent** — Measuring depreciation for DRC is a difficult science, and the problem is exacerbated with a modern equivalent, as the comparison may not be like-for-like. Indeed, the modern equivalent may have radically different life span, cost in use, use of certain materials, design features, and/or performance standards.

8.56. The further away in concept the modern equivalent is from the existing, the greater the difficulty in making a comparison and potentially the much larger depreciation figure attaching to the existing structure(s).

8.57. **Depreciation and obsolescence**

8.58. In the context of a DRC depreciation, the valuer ascertains the size of the gap

between the modern equivalent replacement and the existing asset.

8.59. **Depreciation** is an opinion of a structure's lower value due to any cause in relation to its replacement or reproduction cost.

8.60. **The fact that the asset may have been depreciated to a figure in accounting terms is not relevant to the consideration of depreciation under a DRC.**

8.61. Broadly, there are three main types of DRC depreciation:

- Physical deterioration;
- Functional (and/or technical) obsolescence;
- Economic/external obsolescence.

8.62. All three types of depreciation may have an impact on value.

8.63. **Physical deterioration** is loss in value associated with the passage of time and use (combination of use, effect of aging process, structural defects).

8.64. Most types of property physically deteriorate with use and, depending on the type of property and use, the rate of depreciation may be materially different.

8.65. The effect of physical deterioration may be more important for some uses than others as the usability of the asset may become affected more readily. By way of example, some new structures have been designed with a life of probably as little as 20-25 years. At Year 10, the property is therefore halfway through its design life, whilst a period structure, though potentially requiring more regular repair and refurbishment, may have a much longer life span.

8.66. For DRC, the asset is valued in its existing condition. The valuer will need to take into account disrepair which may have accelerated physical deterioration.

8.67. **Valuers should be less interested in the expectations of the physical life of the building than in the expected economic life.**

8.68. **Economic life** is the period in which the building can provide economic benefits to the owner, generally shorter than the physical life. The remaining economic life is the time in which the building will still contribute to the total value of the property and is a matter of professional judgment.

8.69. The ultimate test for physical deterioration is for the valuer to consider the anticipated economic life of the asset, having regard to the constituent parts and the rate at which they will deteriorate.

8.70. **Functional (and technical) obsolescence** is lack of functional adequacy and/or utility.

8.71. **Depreciation caused by functional obsolescence** is the loss in value due to reduced utility or desirability of all or part of the building, because industry or modern use requirements have changed over time. This could apply to all types of property. The most obvious might be industrial processes but it can also be relevant to other classes of property valued on DRC. For example, leisure properties with the wrong mix of uses for the current requirements. Hotels with the wrong number of rooms or ancillary accommodation to be currently viable or even offices (where valued on DRC) that no longer meet modern user specifications.

8.72. Even a new building can be functionally obsolescent by the time of building completion.

8.73. Particularly in specialised manufacturing processes, it is likely that historic specification no longer fulfils the modern requirement of that industry and may also cease to efficiently deliver its original design function.

8.74. The result can be dramatic in that a structure might actually be no longer fit for purpose at all, or in other cases may still be used but at a lower than optimum efficiency.

8.75. It may also affect newly built commercial properties when there is a rapid change of users' requirements.

8.76. The depreciation adopted by the valuer needs to reflect the cost of bringing the original asset into line with a modern equivalent of equal utility or if not possible, reflect the consequence of a continued operation at lower efficiency. If the entire structure is no longer fit for purpose, the value of the structure itself as opposed to the land may be nil.

8.77. A very common problem is **technical obsolescence**, usually where economies of scale have been made, machines are quicker, smaller and have redefined different space and quality of space in which to operate. Technical or functional obsolescence can also be driven by legislative change. Environmental regulations, waste production and disposal may all feature in an industrial setting and for all sectors, health and safety, together with disabled access, requirements may give rise to differing degrees of technical obsolescence.

8.78. **Economic/external obsolescence** is loss in value due to influences outside the property. It is the type of depreciation that is not inherent to the building itself, but rather to factors that influence the way the building is used.

8.79. **Economic obsolescence** occurs where a market for an output has declined, altered or disappeared and there is surplus capacity. That would apply to all types of situation, not just industrial processes. Schools, for example, may have insufficient 'places' for pupils during a high birth rate period, but beyond, may express a large amount of surplus accommodation. That is a structural change in the market.

8.80. Logistics have moved to a 'just in time' delivery pattern which may mean less on-site storage of warehouse stock with redundant buildings but larger off-site logistics facilities, not necessarily in the same ownership.

8.81. The valuer will need to take a wide view of the 'economy' in which the entity operates including the general sentiment towards a particular use, whether it is stable, declining or growing. These are difficult for a valuer to quantify.

8.82. Some common features requiring a valuer's adjustment might be:

- Physical capacity versus requirements;
- Labour availability versus requirements;
- Working capital availability versus requirements;
- Location of current-day customers for the products or use versus location of the provision;
- Energy availability versus requirements;
- Potential legislative controls against emissions.

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

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

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

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

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

8.87. Depreciation is not a constant, either across industry and service providers or

on a year-on-year basis.

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

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

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

8.91. These assumptions need careful consideration by the valuer and, ideally, agreement with the client as to the appropriate approach to be adopted.

8.92. More complex models of depreciation have suggested an 'S' curve, where depreciation is low in its early years, accelerates over time and then levels out when it is relatively old. Or equally it may quickly deteriorate from new, level out in mid-life span and accelerate again towards the end of economic life.

8.93. There may be a great deal of logic to the 'S' curve approach. However, accurate measurement of the *"S"* — and where an asset is on that timeline and on the valuation date — may be problematic for the valuer simply due to lack of data. To that extent, a straight line approach may be simpler to present and understand, relying less on actual data. By definition, however, the simplistic approach is likely to be more theoretical than actual.

8.94. There will be cases where, in measuring depreciation, the obsolescence is total:

8.94.1. Physical obsolescence

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

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

8.94.2. Functional/technical obsolescence

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

In calculating a DRC, no expenditure is envisaged. The valuer is valuing at the date of valuation, if functional obsolescence can be rectified by the provision of more modern facilities. The cost of that revised facility may assist the valuer in arriving at the level of depreciation. Retrofitting existing facilities may cost more than a modern replacement and still have a shorter economic life. Care is required by the valuer in such a comparison.

8.94.3. Economic obsolescence

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

8.95. If the analysis of the existing buildings reveals significant functional/technical or economic obsolescence, they can be assigned nil value. The land may still carry a positive value.

8.96. **Alternative use** — A DRC can rarely be performed in a vacuum and alternative use may feature at different times during the application of a DRC approach.

8.97. A particular location, or asset (or both) may become, over time, more useful or valuable in an alternative use than for its original purpose. In location terms, that may be driven by development in the locality, or by town planning regulations for other uses in an area. The client's historic use may be environmentally damaging to neighbours, making it non-conforming.

8.98. Equally, redundant industrial buildings have been converted to leisure space, residential and museum uses often at greater value than the historic DRC on industrial use might suggest.

8.99. In cases where the use of DRC would be considered wholly inappropriate for measurement of collateral for bank lending, the alternative use is often adopted for the purpose of underpinning any lending decision.

8.100. Remaining economic life — Under a DRC approach, a valuer has to decide what the likely remaining economic life is, having taken into account the three types of depreciation likely to be present.

8.101. For economic life, consideration beyond the current user or client is required in order to judge how long any industry or service provider would make use of it, not just the individual client. It is the remaining economic life at the date of valuation that is relevant. Further planned refurbishments should not be taken into account at the date of valuation.

8.102. There may be guidance on the lifespan of certain assets or constituent parts obtainable from industry specialists. These data scores should be explained and detailed in the Valuation Report.

8.103. When considering a component approach to lifespan, care should be exercised with any averaging procedure as, if a component is scheduled to fail after a given lifespan, giving the component an apparently longer lifespan by averaging with other components of a longer lifespan will be inappropriate. It may be that some adjustment is required, but any fundamental component part of a structure which affects economic viability usually needs to be considered in the light of the component with the shortest predicted lifespan.

8.104. As stated, accounting depreciation and valuer depreciation are not necessarily the same measure.

8.105. Land value — When considering a DRC approach, it is not normal to make any depreciation from the cost of acquiring a modern equivalent site in the market because land in ownership rarely depreciates. The value of the land is therefore added to the depreciated asset values without depreciation adjustment.

8.106. The purpose of a DRC is to establish the cost of providing a modern equivalent which includes the site. It may be the case that in order to acquire a site in a certain locality, a higher price may have to be paid if the predominant use in the locality is a higher value use and the alternative site in question is also fit for that predominant use. In these circumstances, it is the cost of an equivalent site somewhere else that should be adopted. The value of the land for an alternative site should be brought to the attention of the client. Some clients may make their own policy assumptions to be included in the valuer's instructions.

8.107. If all land that is suitable for alternative operational purposes is land that has a higher alternative use value, then that value may need to be adopted, subject to detailed explanation of the assumptions made.

8.108. Such an approach can lead to value of the land element appearing disproportionate to the value of the structure. Detailed explanation will be necessary.

8.109. If due to a change in planning conditions, the existing land is potentially available for a much more valuable use, this should be reported to the client. Care should be taken in adopting a value for the land in alternative use even if a bid for another use would need to be made to secure the site for the current less valuable use. In a DRC, because the method allows the valuer to consider a site elsewhere, that may be of less cost than the current site with any new planning definition. That alternative site might be preferable for adoption as a modern substitute as opposed to importing a higher land value to the current site.

8.110. Land value apportionment — In some countries, DRC is being used to arrive at the land value of a property, i.e. that element that is not depreciated for accounting purposes. This is not a true DRC. The land value is apportioned from the total using a cost-based approach but it is not a DRC valuation.

8.111. Problems with land value in specialised use — The main reason for adopting a DRC approach towards an asset valuation is a lack of transaction or market evidence on which to base any other consideration of value.

8.112. A cost-based approach to valuation of an asset structure is achievable, but it leaves the problem of the land. By the very nature of a specialised use, there are little or no transactions, so transactions in land for such use will also be extremely rare or non-existent. The variable will therefore be land in another use. If higher value uses are likely to be permitted, the purchase of the land for the DRC purpose may have to compete with the higher value uses of the acquired site. That may distort the overall value. For green field or existing land bought at low value, this is rarely a problem, but in more urban areas where there may be competing land uses, this will increase the value.

8.113. In extreme cases, where a use requires specialist licensing, for example for environmental emissions, it may be that the choice of locations is severely restricted on that basis. In these circumstances, the purchase may need to be made at a premium value to secure the site.

8.114. These considerations need to be explained by the valuer in each instance.

8.115. Where no evidence of land transactions exists or can be of any assistance, some valuers have resorted to a percentage of build cost as the land value

element. That is not recommended, as it has no real basis. Any such methodological choice would need to be justified and explained.

8.116. **Final adjustments** — The DRC calculation draws together many elements, most of which are capable of significant adjustment by the valuer in individual circumstances.

8.117. The measurement of obsolescence for depreciation purposes is not a uniform view against a type of property of a certain age and the measurement adopted could be different for similar properties in different locations. The difference is sometimes material. Valuers are required to look at the answer and ask whether it is credible against their knowledge. When the work is completed, the valuer is obliged to look at the end result and consider its sense by way of a credibility check.

8.118. Herein lies a further problem. As a cost-based approach, this last stage is often described as *"stand back and look"*. Any adjustment at this stage is based on the judgment of the valuer that the result of the DRC is somehow wrong. We already know there are no market comparables which is why a DRC approach has been adopted, and we are faced with a defence that the valuer is 'uncomfortable' with the assigned DRC result and wishes to adjust it.

8.119. That judgment may be borne out of extensive knowledge and experience and may, on those grounds alone, be perfectly sound for a qualified valuer to do. Nonetheless, the judgment calls underpinning final adjustments need to be founded in logic and assumptions applied, all of which must be explained and annotated in the Report.

8.120. **Impairment of value** — Subsidies impact DRC reporting. For example, in Greece, currently a subsidy exists for the construction of new hotels in some areas. Arguably, with that subsidy at the time of writing being 40%, the modern equivalent will only ever cost a sector investor 60% of the modern equivalent replacement cost. Accordingly, unless an existing structure has greater than 40% depreciation in a DRC approach, the resultant figure will exceed the substitute value.

8.121. This market intervention should be regarded as a final adjustment on a special assumption which will affect only those properties in that use class that attract the subsidy and for as long as the subsidy endures.

8.122. The effect is an impairment of value. It will only apply against properties where such a subsidy would be available either geographically or by type in any jurisdiction.

8.123. The concept of impairment limited to those individual or unusual

circumstances should be carefully reported as the *"impairment"* against all properties subjected to a DRC in the same use or category and in locations where such subsidy is made.

8.124. If at the final stage the valuer decides to make adjustments and these changes do not have any other basis than just an opinion, then that should also be stated.

8.125. Reporting — The DRC approach is a complex methodology with a great number of elements requiring major assumptions and often relying on third party technical considerations.

8.126. Accordingly, it is not unusual for DRC opinions from different valuers to vary on the same asset. That underlines the need for a comprehensive report at each stage of the process.

8.127. The DRC approach is based on the assumption that the entity will continue as a going concern or as a service provision as in the public sector.

8.128. If these circumstances change, the DRC may no longer be valid. The consideration of alternative values is not strictly within the remit of a DRC approach, however, alternatives need to be considered for site values and potentially for replacement locations, so consideration of alternatives may be at least partly inherent.

8.129. If an alternative is likely to give a materially different valuation outcome, it is good practice that this factor be noted even if not formally reported.

9. The residual methods

9.1. **The classic residual method, sometimes called the 'static residual method'**, is used to arrive at the value of vacant land ripe for development, development in progress or of land and building/s with the potential for redevelopment or refurbishment. It assumes that the process of development, redevelopment or refurbishment is a business and, by adopting this assumption, it is possible to assess the Market Value of land or land and buildings in their existing form, reflecting development potential as a part of that process. The residual method is often also applied to measuring the feasibility of real estate development projects.

9.1.1. This method is simple in concept but needs great skill and experience in application, as what appear to be minor changes to the assumptions made in carrying out the valuation can have major effects on the final answer.

9.1.2. It comprises the estimation of the **'gross development value'** of the site or the buildings in a developed or redeveloped form, either by comparison or by the investment method. The valuer must take great care in applying the available evidence to establish the gross development value. The 'gross development value' is not a future value but the value of the property on the assumption that the development has been completed at the date of valuation. Thus it reflects market conditions as at date of valuation.

9.1.3. The valuer must deduct from this 'gross development value' all costs that will be incurred in putting the property into the form that will command that value. These costs will include demolition of any existing buildings, design costs, infrastructure works, construction costs, professional fees, agency fees, costs required for the development to proceed and the costs of financing the development.

9.1.4. It is common for a property development to be financed from external sources such as a bank loan. However, often a developer, will borrow only part of the necessary amount and provide the rest as equity. In such circumstances the residual calculation should nevertheless reflect the 'opportunity cost' or forgone interest on the equity invested by the 'willing buyer'. This also applies to the financing, whether by bank loan or equity, of the cost of acquiring the property.

9.1.5. A so called **'developer's profit'** must also be deducted from the gross development value. This is an allowance for the risk of undertaking the development. Developer's profit will either be expressed as a percentage of costs employed in a project, or a percentage of the gross development value, and percentages adopted will vary, depending on a variety of factors linked mainly to the risk inherent in the project and the letting and sale of the completed properties.

9.1.6. When valuing a property in the course of development the valuer should adopt a developer's profit as a percentage of the remaining costs still to be incurred by the 'willing buyer' in order to complete the development. As development works progress the percentage applied to remaining costs to arrive at the developer's profit may also diminish to reflect the reduced risk of a development nearing completion. It should be noted that the remaining costs of completing a development to a 'willing buyer' may be different to those budgeted by the existing owner of the property. Alternatively, developer's profit may be adopted as a percentage of Gross Development Value. As the latter figure is typically stable over the construction period, (unless market conditions change) and does not change in line with the progress of development works, a valuer should manually adjust such percentage to reflect diminishing level of risk of a development approaching completion.

9.1.7. Given that under the market value definition the valuer should assume a

hypothetical sale of the property, all costs should be calculated from the 'willing buyer's" perspective at the date of valuation. Any existing contractual obligations between the current owner and contractors should be ignored.

9.1.8. After deducting all the development costs and the developer's profit from the gross development value, the result is the residual value. The acquisition costs and the financial costs that result from the possession of the land during the construction period (costs of the property purchase loan or opportunity costs)should be deducted from the residual value to determine the Market Value of the property, so taking account of the time cost of money.

9.1.9. As a valuation by means of residual method is sensitive to even minor changes in the assumptions employed in the valuation process, the valuer should test the result by at least benchmarking the obtained unit value with any known market data or by calculating the assessed market value as a proportion of the gross development value. In most markets, experienced valuers with good local knowledge will be aware of such proportions in order to gage the accuracy of the residual calculation. Typically the better the location of the property, the higher the percentage.

9.1.10 The analysis and judgments in the valuation must be explained in the report.

9.2. The alternative discounted cash flow method for valuing development property, sometimes called the 'dynamic residual method' is more explicit compared to the traditional (static) method in terms of timing of incomes and costs. This method also enables quantification of the internal rate of return. Inputs on the cost side are largely the same as for the traditional method including construction costs, professional and agency fees, the costs of financing the development and, if not reflected in the internal rate of return, developer's profit.

10. Using more than one valuation method

10.1. In some countries, it is normal practice, or even a legal obligation for some valuation purposes in some instances, to value a property using two or more different methods, which therefore give a number of different resulting values. The valuer then considers the various results and makes a professional judgement as to the value to report. In contrast, in other countries the valuer is expected to use just one single method.

10.2. No general rule can be set as to whether the use of a single method or several methods leads to a more accurate and reliable valuation. However, where valuers have used only a single method it is recommended that they at least check their conclusions against other market indicators, if they exist. For example, where a property has been valued using a method within the Income

Approach, the valuer will often want to compare the resulting value per square metre with prices observed on the market for similar properties at the valuation date.

10.3. In some instances, valuers prepare valuations using two or more different methods, then apply mathematical weightings to the two or more resulting values to obtain a weighted value, which is then reported as the Market Value. Such an approach should be used with caution — there may be merit in it if the weightings are chosen for each individual property according to the valuer's own view of the relative reliability of the values that result from each of the various methods. However, it may be dangerous to apply standard weightings to a series of valuations or to a whole portfolio of properties, as such an approach precludes any consideration of the reliability of the various methods on a property-by-property basis.

11. The final check

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

EVGN 1 Applying European Valuation Standards in Wartime Circumstances

This Guidance was originally designed at the request of the State Property Fund of Ukraine (SPFU) , was drafted by the European Valuation Standards Board working with TEGOVA's Ukrainian members the Ukrainian Association of Bank Valuation Specialists and the Ukrainian Society of Appraisers, and was delivered to the SPFU on 20 December 2022.

Though designed for the context of the Russian invasion of Ukraine, the Guidance is valid for wartime circumstances generally.

CONTENTS

1. Scope

1.1 This Guidance applies to:

- the assessment of war damage to individual properties and businesses, as is being undertaken by valuers for clients
- the assessment of the costs of post-war reconstruction.

2. Application of EVS to War Damage

2.1 The circumstances of war do not disapply European Valuation Standards but rather pose particular and challenging circumstances. They are not a casualty of war. It is, though, important to understand how they provide support for professional valuations in such extreme circumstances, which may vary from property still being under hostile occupation, through total destruction and significant damage to looting.

2.2 In the circumstances of armed conflict, occupation, war damage and their aftermath, the valuer assessing the loss to a business may very often find that the information available is limited and incomplete, not of the quality that would usually be found for the same assets in a conventional peacetime situation. It may prove necessary to rely more on evidence that would normally be of lesser weight in the hierarchy of evidence, yet may be of better quality than is available for the direct evidence that would ordinarily be preferred. This is an extreme version of the problem that can be encountered in valuing assets that are rarely found or have very limited markets.

2.3 EVS 1.5.3 states that:

"The valuer must undertake inspections and investigation to the extent necessary in to produce a professional valuation for the purpose instructed."

and continues to discuss in general terms the position where the information available is limited or restricted, as may often the be case in the context of war. The valuer's task is still to form an independent, objective and professional opinion as to the value by:

- gathering the available evidence
- applying professional skill and experience to the evidence available
- making reasonable assumptions as seems required or instructed

and then recognising in the report the limitations on the certainty to be attached to the valuation. In such an unusually challenging position, the valuer should be able to form an opinion as to value and then sign the report stating that opinion.

2.4 With the various possible uses of the report and the potential for the valuer to be called as an expert witness in an assessment review, tribunal or court, the report should clearly explain the position with relevant evidence so that a third party can understand from it:

- what has been valued, with details of the property and the damage or other loss
- how the loss arose from the war
- how the opinion as to value was formed.

2.5 Regard may be had to the principles set out in the *Joint Declaration on Post-Crisis Assessments and Recovery Planning* agreed by the European Commission, the United Nations Development Group and the World Bank on 25th September 2008.

2.6 The valuer is not determining any compensation or payment but is providing a professional and objective view on which a claim for compensation or payment may be based. The valuation might be scrutinised or challenged as part of the process by which the claim is determined, whether by a court, a tribunal, a commission or other body. The valuer may need to explain the expert opinion in that process, perhaps under hostile challenge.

3. The Valuer

3.1 The valuer is to be suitably skilled, competent, experienced and objective (EVS 3.1) and qualified (EVS 3.2) complying with the European Valuers' Code of Conduct (EVS 3.3.1).

3.2 Even more than ordinarily, the expectation of objectivity is critical in appraising the damage, how it arose and is properly valued. The very demanding context of such a war and the natural desires of clients are likely to test that quality but it is a quality that is essential to the preparation of claims that will be sustained under review or challenge.

3.3 That prospect of challenge reinforces the need to be aware of any conflicts of interest and disclose them (EVS 3.5.2).

3.4 It is recognised that many valuers will have been in miliary service rather than valuation work for a period of time and, once available again, will need to familiarise themselves with the circumstances.

3.5 Clear terms of engagement of the valuer by the client are required by EVS (EVS 4.3) and should record the instruction. Where the owner of the property is dead, incapacitated, absent, or abroad or the client is claiming inheritance, the valuer should establish that the instruction is from someone able to act

for the owner – and the extent to which they can provide records that will assist. It is understood that good title to the property is to be assumed by the valuer.

3.6 Instructions might also come from state or local authorities where they have the authority to require a valuation. Any commission or other body established to determine compensation might choose to instruct a valuer to assist work.

4. The Valuation Process

4.1 The requirements of EVS 4.6, Supporting the Valuation, are affirmed but will need pragmatic interpretation according to the circumstances of the property in question.

4.2 **Defining the Property and/or Assets to be Valued –** This needs to be defined for the valuation to be undertaken. The nature of subject may then guide the approach to the valuation; for example, whether it is a business that was a going concern or the underlying real estate with or without other assets.

4.3 The property may have been lost (as by being removed, remaining under Russian occupation or movable goods looted), destroyed or damaged. There may be associated losses, such as loss of profits. Types of possible claims are illustrated in the Appendix drawn from the experience of the post-invasion and occupation claims made to the United Nations Compensation Commission for Kuwait. For the purposes of Ukrainian law, the *Resolution of the Cabinet of Ministers of Ukraine of 26th March 2022 No 380* sets out the kinds of initial information required for each of these categories of lost, destroyed and damaged property.

4.4 **Inspection – Wherever** possible, the property should be visited for an inspection. Even where the property has been badly damaged, this will help develop an informed view of the property involved in its context and so also of the appropriateness of the available evidence and submissions that may then be considered.

4.5 There will be circumstances in which this is not possible – as where the property is still under occupation – or it is unreasonable to inspect it on site, perhaps because of unexploded ordnance. Where it is not reasonable to enter into one or more buildings, it may be possible to undertake an external inspection.

4.6 In either case and especially for very large or complex properties, such as farms or factory complexes an aerial inspection may assist or be a substitute, as by using:

- drones as part of an inspection, able to go where it might be impossible or too dangerous to visit physically
- satellite imagery to an appropriate resolution.

The video or photographic records from this should be securely dated.

4.7 Evidence of the Property to be Valued – All available evidence, including records and photographs, should be gathered, to said understanding of:

- the property as it had been
- the loss or damage it has sustained
- how that directly arose from the war

This may often also concern plant, machinery stocks and other goods that may have been lost or damaged.

4.8 Particular weight should be given to contemporary evidence and what may be available as objective documents or from independent third parties, rather than solely from the uncorroborated testimony of the client.

4.9 For business losses, the business' pre-war and post-war accounts with stocktakings and associated papers would assist any claims based on the loss of stock or of profits.

4.10 **Evidence of the Relevant Market and Costs –** The valuer will hold or be gathering evidence of relevant comparables and, as necessary, costs to sustain the valuation, after appropriate adjustments.

4.11 In the Ukrainian context, the evidence is to be relevant as the case may be to:

- 23rd February 2022
- 20th February 2014

as the day immediately preceding the start of the war for the area in question, even though values may have changed subsequently.

4.12 **Methodologies** – The circumstances of war may mean that the evidence for the valuation is more imperfect than is ordinarily met, with the possibility of only limited comparables. With the challenges that this poses for valuers, the nature of the available evidence may guide the choice of methodology, sometimes perhaps prompting the use of an alternative method that might ordinarily be less favoured but for which there is better evidence. That places more stress on cross-checking between the results from methodologies and applying the final sense check as to whether the value found is realistic.

4.13 Part II of EVS 2025 considers valuation methodologies with the conventional

approaches to market value of applying and adjusting evidence from other transactions, whether capital values (comparables) or yields (the income approach). It also considers working from costs with the issues that this approach also raises. These three approaches, together with methods and models are described. There will be strains in applying each to the varying circumstances and properties to be met in war. With the valuer expected to form a professional and objective opinion as to value that may have to be presented not only in the national court but also in an international one, this Guidance Note offers an overview of the potential advantages and inadequacies of each approach:

4.14 **The Comparative Approach –** Assuming that valuations are to be assessed as at 23rd February 2022 (20th February 2014 in some cases) as the day before the Russian invasion, much will depend on the extent and quality of the data base of transactions held by or available to the valuer and, so far as is appropriate and available to valuers, the SPFU. Paragraph 6.2 of EVS 2025 Part II, Valuation Methodology, allows that it may be necessary to have regard to other evidence. Where such valuations have been derived using Automated Valuation Models (AVM), in reliance on knowledge of asking prices or the secondary evidence of valuation reports, care should be taken to understand how remote the figures given are from real evidence of actual market behaviour when making adjustments to arrive at market value. Similar care will be needed where it appears that reported transactions values may be inaccurate. The task is to find the best evidence for a professional opinion as to value on the basis of the definition of market value.

4.15 Alongside such evidence from more direct comparables, the valuer may consider general data on market movements, including indexes, and then other sources of information so far can be shown to be relevant and appropriate. The extent of the use made of each of these categories and the opinion of their reliability should be disclosed in the report. It should be remembered that the valuation could be subject to challenge in court.

4.16 It might also be that, in areas of prolonged conflict before the 2022 invasion, there could be little such evidence available. That and similar points will be matters to be judged in relevant cases.

4.17 **The Income Approach –** In normal circumstances, this would be the typical method of valuing properties commonly held for their income, often properties in commercial use, and also businesses. Guidelines should be developed to help the valuer construct cash flows at the date of valuation, looking to the future disregarding the Russian invasion. Again, the quality of valuations will be dependent on market reports and analysis immediately before the invasion.

4.18 **The Cost Approach –** Normally this would be an approach of last resort used

in the absence of any relevant market evidence. Cost and value are different concepts.

4.19 However, in the context of the many varieties of war damage and a purpose of restitution, the cost of making a damaged property good may often be the practical answer to put an affected party in the same position as they were before the damage. While such a cost might exceed market value, market value might not achieve restitution. That might be where there are no comparable replacement properties available, whether because there are no useable properties or there is no market. Such losses might also include the work of de-mining, remedying contamination and a reflection of residual risks.

4.20 In the context of a claim for loss, it would be usual to use a depreciated replacement cost approach, as reviewed in EVS 2025 at Section 8 of Part II, Valuation Methodology, so taking account of the actual age, condition and remaining period of economic life of the property, among any other relevant factors.

4.21 **Compensation for What Was Lost –** Especially where a costs-based approach is adopted, care must be taken to understand the property as it was so that the assessment is of compensation for loss, not a provision for improving the property beyond what would have been required by contemporary legal standards or what would be efficient in the marketplace, in mitigating loss. With the need to recognise depreciation, some properties or assets might already have been depreciated to a greater or lesser extent or be less useful than they once were, even obsolete for their purpose.

4.22 **Overview –** This framework and the guidance that may be developed under it are offered to support the valuer facing the challenges that will be met in particular cases. More detailed Ukrainian guidance, drafted with an awareness of Ukrainian law, practice and conditions could assist considerably. However, with the valuer's task of forming a professional and objective option as to value, there will be a risk in making that guidance too prescriptive to the point where it requires an answer that is not right for an individual property or business. The guidance would benefit from a recognition that it should evolve as practical experience is gained of war damage assessments. While Ukrainian courts might give particular regard to guidance developed in Ukraine and understand its context, once a case reaches an international court such a valuation based on Ukrainian guidance could be closely scrutinised. The valuer being cross-examined by a hostile party will need to be able to show that the valuation was professional and objective and not artificially distorted by the guidance.

5. The Valuation Report

5.1 The valuation report (as defined at EVS 5.3 and more generally described at EVS 5.4) must set matters out clearly and here particularly:

- describing the property as it was
- recording the loss or damage
- stating how it arose from the war
- stating the value
- explain how that value has been assessed, with the data used and the sources of that data, the results of analysis of the reliability and sufficiency of that data and any assumptions or special assumptions that had been made
- providing any necessary explanation of uncertainty as to that value, whether overall or in respect of any particular element of claim
- in each case with reference to the relevant evidence.

5.2 Again, EVS 5.4.1.5 stresses the importance of objectivity in the report.

5.3 EVS 5.4.2.6 recognises that properties may be affected by unusual uncertainty. The explanation of uncertainty, likely to be qualitative with reasons rather than quantitative, may assist anyone reviewing the valuation to understand whether:

- the effect of the uncertainty is of a material scale in the light of the reported damage
- the opinion is reasonable in the circumstances.

6. Beyond the Valuation – Additional Items of Claim

6.1 The valuation will assess the value lost. The fact of the damage imposed on the claimant imposes a further cost, that of the preparing and advancing the claim. It is conventional that the reasonable costs of a property owner's reasonable defence of property rights against statutory action are met by the body imposing on the property. These should be part of claimant's claim arising from military aggression.

6.2 **Interest –** The valuation for war damage will give the loss that was suffered as at the date of the invasion. Even if settled now, eight months would have passed; eight and half years for the older cases. It might be years yet before claims are settled and properties and businesses made good. That makes it important for interest to be due in addition on the sum finally awarded.

6.3 Whichever date is used, interest should then accumulate on a compound basis at a rate that reflects the circumstances. Purely to illustrate the point and the selection of a rate in circumstances a decade ago, the International Court of Justice determined in *Diallo (Republic of Guinea v Democratic Republic of*

Congo), 19th June 2012 that:

"Nevertheless, considering that the award of post-judgment interest is consistent with the practice of other international courts and tribunals, the Court decides that, should payment be delayed, post-judgment interest on the principal sum due will accrue as from 1 September 2012 at an annual rate of 6 per cent. This rate has been fixed taking into account the prevailing interest rates on the international market and the importance of prompt compliance. The Court recalls that the sum awarded to Guinea in the exercise of diplomatic protection of Mr. Diallo is intended to provide reparation for the latter's injury."

6.4 While that determination followed much practice with interest only accruing from the date of the determination, it would be more just for it to apply to the sum finally determined but from the original valuation date as the date of the loss.

7. The Cost of Post-War Reconstruction

7.1 This second issue being considered is a very different question as it is very clearly an assessment of cost of building anew. This is not a task of assessing compensation, reparation or restitution. Achieving better properties may be exactly what is in mind; the Ukrainian Government's policy is to "Build Back Better" and has referred to the standards expected by the EU, including Directive (EU) 2024/XXX on the energy performance of buildings, its minimum energy performance standards and trajectories for progressive renovation and its energy performance certificate. This assessment is not a market value at all but one of costs assessed to a specification, including construction costs with fees and required payments as well as any land acquisition and finance costs that might be necessary. In EVS terms, this is most similar to EVGN 6, *Cost Assessment for Insurance Purposes* (notably at 3.4, 4.4 and 4.5) save that liability as a result of armed aggression is of a non-contractual nature.

7.2 Unless recognised elsewhere, any costs for necessary demolition, the removal of explosives, decontamination, remediation and the management of residual risks would be part of this.

7.3 It would typically be appropriate to compare the resulting assessment with the market value of the reconstructed property, whether to avoid excessive costs or to indicate that an alternative, cheaper answer existed. That might, according to the needs of the business, be in a different but acceptable or more useful location but meeting the required improved standards.

7.4 This assessment can only be as at the date it is made even though the actual work will be at an unknown post-War date. That suggests that, where such an

assessment is required, in reality it would be more practical for it to be prepared in conjunction with the valuation of loss, making efficient use of the inspection and appraisal, perhaps even as two distinct parts of one report. Recognising that, for reasons offered below, such assessment is likely to prove to be an underestimate, it would in these circumstances still be the most secure basis for early presentation and subsequent revision, whether by an index or other means. Leaving this work until later would reduce its usefulness.

7.5 While assessing cost might appear more straightforward, the challenges here include:

- the experience of post-War reconstruction elsewhere is that there will be a period, even years, before it starts and, naturally taking time, many years before it is complete and so in which costs and values are likely to change
- the difference between what work is needed for immediate recovery and what for longer term reconstruction
- partially damaged properties, for which the principles for "major renovation" should be followed (see EVGN 6 at 4.6)
- the post-War economy and patterns of development may be very different to those pre-War, as where some areas become much less central to economic activity and new areas more so; people will now live in different places and pursue new lines of business
- determining the standard that is to be expected for reconstruction; using the example of energy efficiency of buildings, is the standard to be that of a pre-War standard or the EPC class required under the Energy Performance of Buildings Directive?
- the requirements that reconstruction at such a scale will make on contractors, equipment, materials and all else involved are likely to drive substantial increases in costs, both when initially estimated and as the work continues
- the initial works of remediation, decontamination, explosives clearance and demolition seem likely to have a particular and significant cost in their own while being a factor in the timescale for the later work of reconstruction.

7.6 The issue is the specification to which reconstruction is to be done. Beyond that is the question of how it is to be controlled so that it is not only done properly but economically and efficiently. There will be a cost in the planning and supervision for that.

ILLUSTRATION

A Property under Occupation when the Valuation is Made

As of the date when the damage was assessed and when the valuation report was issued, it was impossible for the valuer to carry out a physical inspection of the property and the assets at the location shown on the attached map and described above.

Their location is in an area occupied on those dates by the Russian Federation as a result of its armed aggression against Ukraine which began on 24th February, 2022, in accordance with the Decree of the President of Ukraine dated February 24, 2022 No. 64/2022, On the Introduction of Martial Law in Ukraine.

The claimant lost physical control over its property and assets at this location on ...., ceasing business.

Note *– Satellite imagery may be available, especially to demonstrate damage and its scale.*

The date of determining the amount of losses is 23rd February 2022 as the day before the armed aggression commenced. It was also the last day of the company's control over the assets and so the last opportunity for the company's employees to provide information about the technical condition and characteristics of the property and assets there.

The following documentary information and evidence about the technical condition and technical characteristics of the property and assets has been provided by the company:

[LIST WHAT THE CLIENT HAS PROVIDED]

As of the date of the assessment, the valuer is unable to undertake a physical check of the information provided by the claimant but as it appears internally consistent it is considered a reasonable basis for this valuation. However, the valuer, being unable to verify it, does not accept responsibility for its reliability, a responsibility which lies with the claimant.

Note *– There may be other information in accounts, other material and on the internet that may be given whatever weight is appropriate.*

This valuation is made on the basis that the claimant has lost control of the property and assets in an area of military occupation and sustained fighting. It therefore assumes their physical destruction with the loss of business that was operated from them.

This valuation should be reviewed and as necessary revised should the claimant recover possession of the property and assets when their condition and usefulness might be reassessed.

ANNEX

SOME POTENTIAL MATTERS TO BE VALUED

Notes

This is a non-exhaustive list drawn from the experience of compensation claims by business under the UN scheme following Iraq's invasion and occupation of Kuwait.

While the claim may include the costs of preparing it, including the cost of the valuation, they are not part of the valuation and neither is any interest that might be claimed.

Real estate - whether for destruction, damage and loss of utility, having regard to its previous age and condition and other factors.

Different types of property may pose particular questions.

Tangible property – including:

- moveable assets
- stocks and inventories
- plant and machinery
- vehicles
- cash

All requiring evidence of their existence, the claimant's ownership, their nature and the loss or damage.

Lost profits – generally assessed from accounts before and after the war with a view to be taken on the relevant period and appropriate rates, looking across the business activities of the claimant.

Issues over cancelled letters of credit were considered under lost profits.

The Panel had to consider some situations where a claimant business, such as a car dealership, with losses from the invasion and occupation then had exceptional post-war profits, as from sharply increased car sales to those had lost cars in the war.

Bad debts – for debts that were recoverable immediately before the invasion and became uncollectable because of it.

Costs of restarting business – in some cases, this might not be a loss of profits claim but is a matter of evidence.

Business contracts frustrated by the war and invasion – contract might have failed, been terminated or repudiated in the circumstances, with profit lost (for a period to be identified) and costs potentially incurred.

EVGN 2 Valuation for Mortgage Lending – Prudently Conservative Valuation Criteria

1. Introduction
2. Scope
3. Commentary

1. Introduction

1.1. Basel III is an internationally agreed set of measures developed by the Basel Committee on Banking Supervision in response to the financial crisis of 2007-09. The measures aim to strengthen the regulation, supervision and risk management of banks. One of these is the creation of 'prudently conservative valuation criteria'.

1.2. The European Union has transposed this Basel III measure into EU law via the latest revision of Regulation (EU) No 575/2013, Regulation (EU) … (the Capital Requirements Regulation (CRR)). An EU Regulation is directly applicable in all member states without national transposition legislation and, like all EU law, has primacy over national law. Banks must therefore ensure that their mortgage valuations adhere to these criteria under the control of the European and national banking supervisory authorities.

1.3. Under the revised CRR, valuation based on prudently conservative valuation criteria becomes the first-ever harmonised EU valuation basis for mortgage lending as the choice previously afforded to member states between Market Value and mortgage lending value (MLV) is now restricted to a derogation allowed for valuation of property collateralising covered bonds. This because:

- Valuation on the basis of Market Value is severely constrained and subsumed into the requirement to apply prudently conservative valuation criteria (see below).
- MLV is no longer an option for mortgage lending valuation generally, having been deleted from the relevant article (Article 229(1); see below). Its place in the Regulation is now restricted to Article 129 "Exposures in the form of covered bonds" where the default is also valuation based on prudently conservative valuation criteria but where member states may derogate by allowing immovable property providing collateral for covered bonds "to be valued at or at less than the Market Value, or in those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions, the mortgage lending value of that property without applying the limits set out in Article 208(3), point (b)[8]." (Article 129(3)).

NB: The difference in practice is marginal, given that traditionally MLV is largely applied in member states with covered bond cultures.

1.5. The CRR provides no guidance on how its new provision on prudently

[8] Article 208(3)(b): 'The value of the property shall not exceed the average value measured for that property or for a comparable property over the last three years in case of commercial immovable property, and over the last six years in case of residential property. Modifications made to the property that improve the energy efficiency of the building or housing unit shall be considered as unequivocally increasing its value.';

conservative valuation criteria is to be interpreted by practicing valuers, hence this Guidance Note.

2. Scope

2.1. The CRR lays down that in valuation according to 'prudently conservative valuation criteria', "the value excludes expectations on price increases". This Guidance Note addresses the issues arising from this in the contexts of:

- Valuation under the income approach
- Using the direct capitalisation model
- Valuations carried out by means of a DCF model
- Treatment of rental increases
- And the developer's profit in the residual method of valuation

2.2. The second CRR requirement for appraisal according to 'prudently conservative valuation criteria' is that "the value is adjusted to take into account the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan". Here the Guidance Note highlights issues of:

- Assessing the sustainability of the value over the life of the loan
- The impact of oversupply of a particular type of property on prices and value
- The impact on future value of declining population of a given locality and other negative factors changing the surroundings of the real estate

3. Commentary

3.1. Article 4 (74a) CRR 'property value' means the value of immovable property determined in accordance with Article 229 (1)

3.2. Article 229 (1) CRR: The valuation of immovable property shall meet all of the following requirements:

a) the value shall be appraised independently from an institution's mortgage acquisition, loan processing and loan decision process by an independent valuer who possesses the necessary qualifications, ability and experience to execute a valuation;

b) the value is appraised using prudently conservative valuation criteria which meet all of the following requirements:

1. the value excludes expectations on price increases;
2. the value is adjusted to take into account the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan;

c) the value is not higher than a market value for the immovable property where such market value can be determined. The value of the collateral shall reflect the results of the monitoring required under Article 208(3) and take account of any prior claims on the immovable property.';

3.3. Article 229 of Regulation 575/2013 on prudential requirements for credit institutions and investment firms is titled 'Valuation rules for recognised collateral other than financial collateral'.

3.4. Sub-paragraph (a) of paragraph 1 of Article 229 sets out the requirements to be met by the valuer of the property so that the valuation may be relied upon for mortgage loan purposes. Reference to a "valuer" indicates the need for a valuation performed by a physical person and not merely the result generated by an automated valuation model (AVM), albeit this does not exclude the possibility of the use of an AVM as a tool to assist the valuer with the necessary qualifications, skills and experience.

3.5. Reference to necessary qualifications suggests the need for a valuer to satisfy any legal requirements to practise as a valuer in an EU Member State. In the absence of such legal regulation, the valuer's qualification should be in accordance with prevailing market practice in the Member State concerned. The valuer should in such a case possess the qualifications that real estate valuers are typically expected to possess by participants in the relevant property market.

3.6. Article 229 emphasises the requirement that both the valuer and the valuation be independent of the mortgage loan application and decision-making processes. Thus, a valuer performing a real estate valuation for bank loan purposes can be neither involved nor interested in the outcome of the loan decision making process. Any valuer employed by a company involved in the loan decision making process must also be disqualified.

3.7. Article 229(1) a) b) and c) refer to the 'value' of the property, which is clearly distinguished from the 'market value' of the property in c). Whilst these are not identical concepts, the valuation methodology described in European Valuation Standards 2020, Section II – Valuation Methodology is applicable to the assessment of both types of value.

3.8. Paragraph (b) requires the use of ***"prudently conservative valuation criteria"*** **as follows:**

i) the value excludes expectations on price increases;

3.8.1. This exclusion relates to asking prices quoted in the property market or forecasts at the date of valuation but which may be higher than supported by market evidence immediately prior to the valuation date. The valuer should therefore not reflect any such expectation of an increase

in sale prices in the future. This does not, however, preclude the possibility of the valuer having regard to increasing prices, in a comparative approach valuation, as observed between the dates of recorded sales transactions of comparable properties and the date of valuation. However, such rising trends should not be forecast beyond the valuation date.

3.9. **Under the income approach**, the valuer will be aware that sale prices of properties generating or capable of generating an income are influenced mainly by the level of such income and yields, the latter reflecting investment risk. All other things being equal, an increase in income generally results in an increase in price. A similar effect is produced by a fall in market yield at a sustained level of income. However, changes in these two factors can cancel each other out (fully or partially) in their effect on a sale price. They may also exacerbate each other's effect leading to higher sale prices as in the case of a rising incomes and falling yields. For this reason, valuers adopting an income approach should consider the overall impact of all their valuation assumptions in order to be able to assess whether those assumptions are leading to the inclusion in the valuation of an expectation of future increases in property sales prices beyond such expectations based on market evidence immediately before the date of valuation. It should be recognised that an income approach valuation by its very nature does reflect the market's expectation of future rental and capital growth. Provided therefore a valuation does not reflect assumptions which are even more optimistic than supported by market evidence at the date of valuation a valuer can safely assume that his valuation meets the exclusion of sub-paragraph i) above.

3.10. In using the direct capitalisation model, the valuer assumes a level of income equal to the level obtainable for the property at the valuation date. This level will not of course be expected to remain constant over time in the future. Therefore, the risk of it falling or the expectation of it rising is reflected in the so called All Risks Yield. As this rate is most often derived from market analysis, it represents the perception of the risk of declining value or expectations of increases common amongst market participants. In arriving at the 'value' of the property the valuers should however ensure that their derived capitalisation rate (all risks yield) is indeed supported by the prevailing market sentiment and not over optimistic in anticipation of higher market prices in the future.

3.11. The situation is somewhat more complicated in the case of valuations carried out by means of a discounted cash flow (DCF) model whether in the form of an implicit or explicit cash flow. In both these cases, the expectation of market participants of future rent increases may be reflected in the valuation during the cash flow period. In an implicit cash flow, this will generally mimic a simple capitalisation approach by applying an 'All Risks Equivalent Yield'. In an explicit cash flow, expected future rental growth is reflected in the cash flow projection. In the latter case, attention should be paid to the interrelationships

between the individual valuation assumptions but again, in arriving at the 'value' of the property, valuers should ensure that their projected cash flows, discount rates and exit yields are supported by the prevailing market sentiment and not over optimistic in anticipation of higher market prices in the future.

3.12. Treatment **of rent increases**

3.12.1. When applying the income approach, the valuer should furthermore pay particular attention to any contracted indexation of rents or other income generated by the property, being another factor shaping the value of the property and sale prices. Since rental indexation is an element of the legal status of the property it should, in principle, be excluded from consideration of its possible impact on the expectation of price increases in the valuation. That said, a certain element of forecasting of the level of indexation over the remaining term of a lease will be needed. In eliminating the undesirable inclusion in the valuation of the expectation of an increase in the sale price of the property as a result of such indexation, the valuer may decide to adopt a future indexation at a level lower than (a) the inflation target of the relevant central bank or (b) the current level of the given index (if it is lower than the inflation target of the central bank).

3.12.2. A separate issue is the possible assumption in a projected cash flow of the rental indexation at the end of the term of the leases.

3.12.3. When projecting future rental increases at the end of lease terms, the elimination of the assumption of an increase in the sale price of the property in the market may be required. Again, the valuer should consider such an assumption holistically together with the other valuation assumptions made to assess, as described above, whether such a set of assumptions does not indirectly lead to the inclusion of an expectation of price growth in the valuation.

3.13. The developer's profit in the residual method of valuation

3.13.1. In the case of a residual method of valuation, it should be noted that the developer's profit taken into account in the valuation reflects the level of risk of running a given construction project. Part of the risk of this type of project is related to the risk of a decrease or the expectation of an increase in the Gross Development Value of the completed development between the date of the valuation and the date of the actual completion of the development. An example of this is the sale prices of apartments, which may vary in a local market between the date the valuation and the date of completion. If there is an expectation that the sales prices of the apartments will be higher in the future, thereby translating

into a higher value of the completed residential development, market participants may, at the valuation date, commonly accept a level of developer's profit that is lower than would be the case in the absence of expected increases in the prices of the apartments in the future. In such a situation in order to exclude *expectations on price increases* a valuer should consider the justification for increasing the level of developer's profit assumed in the valuation above that typically observed in the market on the valuation date.

ii) the value is adjusted to take into account the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan;

3.14. The second of the prudent valuation criteria refers to *"market price*". This should be understood as the Market Value. This criterion requires an adjustment to be made to the estimated '*value*' to reflect any risk that this *'market price'* may be significantly higher than the value that would be sustainable over the life of the loan. However there appears to be no need for the valuer to prove that the '*market price'* will indeed be significantly higher.

3.1.5. What is important is the identification of the risk of this occurring, as indicated by the words *"may be significantly higher*". The required adjustment is mandatory if it is not possible to exclude such risk. This is likely to be difficult in most cases. "Significance" cannot be defined as a precise percentage as it should be interpreted in accordance with specific market circumstances, property types and locations. Ultimately any '*adjustment'* made to the *'value'* is reliant solely on the well-argued expert opinion of the valuer based on her/his knowledge of the local market. Subparagraph ii) does not impose upon the valuer the need for a valuation which is separate from the assessment of "value" but an arithmetical '*adjustment'* to the latter.

3.16. For the purposes of analysing whether the prudent valuation criterion under this sub-paragraph is met, the valuer should be advised by the lending institution on **the length of the loan period**. It should be noted that, in most cases, as the term of the loan increases, the risk of changes in the value of the property occurring over time increases, hence the sustainable value of the property may be lower in the case of longer-term loans.

3.17. In a comparative approach valuation, an assessment of the risk that the current 'market price'9 of a property may be significantly higher than the value that would be sustainable over the life of the loan may be based on an analysis of the market in the context of its cyclicality. If the market price/value of the property was estimated when the market was at the peak of the market cycle, there is likely to be a risk that the price will be significantly higher than the value that could be sustained over the term of the loan. By contrast, if the

[9] EVS interprets 'market price' as meaning 'market value'.

market price/value was estimated when the market was at the bottom of the market cycle, there is probably little such risk.

3.18. Apart from the analysis of where the market is in the cycle, all other known factors should be taken into account in the assessment of the described risk. In particular, the oversupply of a particular type of property may lead to a decrease in prices in the future and thus to a decrease in the value of the assessed property in the future.

3.19. Other factors of this type may be, for example, the impacts of energy efficiency regulation by which a regulatory obligation to renovate a building to a higher level of energy efficiency by a fixed date or at a certain inflection point creates an unavoidable major cost that impacts Market Value (see EVS 6 Valuation and Energy Efficiency), or the declining population of a given locality observed on the local market, which may translate into a weaker demand for residential real estate in the future and thus a decline in the value of the property being appraised. This group of factors also includes all negative factors changing the surroundings of the real estate, e.g. construction of a burdensome industrial plant in the neighbourhood, which may reduce the attractiveness and value of the assessed property in the future. The catalogue of such factors to be considered when performing a valuation is open-ended and may vary significantly depending on the local market or the type of property being valued. However, it is certainly crucial that the valuer have an understanding of the local market and analyse it for the purposes of the valuation being carried out. This analysis may be carried out personally by the valuer. However, it should also be considered reasonable to use reliable studies from reputable firms and research centres specialising in market analysis.

3.20. Pursuant to paragraph (c) of Article 229(1), if a market value can be determined for a property, the 'value' of the property described above must not exceed that market value. In order to comply with this condition, valuers should always assess both the *"value"* of the property and its "*market value*".

EVGN 3 EVS Valuation Reports

I. **The EVS Valuation Report for Residential Property**

II. **The EVS Valuation Report for Office Property**

I. THE EVS Valuation Report for Residential Property

A. BASIC ELEMENTS OF THE INSTRUCTION

A.1. The property

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

A.2. The client

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

A.3. The valuer

8. Identification of the valuer **— When the valuation instruction is given to a company, the individual valuer conducting the report must be identified.**
9. **The qualifications of the valuer** *(EVS 3)*
10. **The status of the independent valuer (external or internal)**
11. **Confirmation that the valuer has the experience and market knowledge necessary to value the property**
12. Confirmation that there are no conflicts of interest **— Where conflicts exist, the report must state that these were brought to the client's attention and**

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

13. Use of specialist valuers or advisers **— Where the signing valuer has used the services of third party specialists, they must be identified.**

A.4. The scope of work

---

14. **The purpose of the valuation (mortgage loan and other banking use, sale/purchase, taxation, renovation, extension, etc.)**
15. **Basis of value instructed including full relevant EVS definition (e.g. Market Value) and reference to the appropriate EVS or to the law or regulation that defines the basis of the valuation**
16. **The legal interest in the property being valued (freehold/outright ownership, leasehold or other, ownership percentage, etc.)**
17. **Investigations carried out**

A.5. The available information

---

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

A.6. The inspection

---

22. **The scope of the inspection to be carried out. Purely visual with no coverage of hidden defects**
23. **Date of inspection**
24. **Confirmation that the inspection was made by the valuer or by a suitably qualified person under the valuer's responsibility**
25. **The name and qualifications of the person who physically inspected the property and the extent of the inspections carried out must be stated. If the inspection has been less complete than usually required for this type of valuation, this must be stated.**

26. Responsibility for the inspection **— Falls to the valuer signing the Report** *(identified above under A.3.8)*.

27. **The extent of the property that it was possible to inspect**

B. DESCRIPTION

B.1. The location

28. **Relevant neighbourhood characteristics Identification of prevalent uses and building types**

29. **Availability of public transportation, road accessibility and presence of infrastructure**

30. **Identification and description of the geographical area relevant to the property being valued (relevant maps and photographs must be included as annexes)**

31. **Valuer's opinion of the market characteristics that tend to influence property value in the identified area**

B.2. The property

32. **Site analysis:**
    - Distance from the city centre and/or the main business district, major regional cities, major transportation services (airport, railway, bus station), access to the property (adequate access from the main roads, etc.) and any other relevant information (proximity to employment, schools, shopping areas, etc.)
    - Description of the land plot on which property is built (size, shape, topography and local infrastructure)

33. **Description of the physical characteristics of the property (architecture, built-in furniture and equipment, the energy performance certificate's rating, view, luminosity, state of repair, attractiveness and character, etc.) must include photographs as annexes.**

34. **Comment on the physical characteristics as to quality, both in isolation and relative to the average neighbourhood quality**

B.3. The legal situation

35. Ownership and tenure **— Including comment on any covenants, third party rights over the property, restrictions or obligations that could have an**

effect on value

36. Tenancies **— Information on the main lease terms, the amounts of current rents and any provisions for them to vary during the remaining life of the lease.**

37. Town planning and development control **— Information about the current zoning in the relevant development plan(s), allowed uses, forest fire, earthquake, flood risk, etc.**

38. **Judgment of the impact of the legal situation on the value**

C. VALUATION

C.1. The methodology

39. **Description of valuation approaches and methods used**

40. Explanation of the choice of key assumptions **with reference to the comparables listed**

C.2. The selection criteria for relevant market data

41. **The criteria chosen for selections of comparables (market area, size, type, etc.) must be clearly stated and consistent with the property's characteristics.**

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

C.3. The analysis of the market data

43. **Description of each comparable (photographs may be included as annexes, chosen as appropriate in terms of confidentiality and privacy)**

44. Adjustments to the values of comparable properties with accompanying commentary **— The valuer must provide appropriate comment reflecting the logic and reasoning for the adjustments provided.**

C.4. Valuation

45. **Final calculation supporting the opinion of Market Value and/or other basis**

of value as instructed in the scope of work.

D. CONCLUSION

46. **The reported value must be clearly and unambiguously stated, together with confirmation that sufficient investigation has been undertaken to justify it.**
47. **Confirmation of value**
48. **Date of valuation**
49. **If a special assumption is being made, the valuer must clearly state that the opinion of value has been derived under that special assumption**
50. **A statement as to whether transaction costs such as VAT, fees, etc. are or are not included in the reported value**
51. Currency **— The reported value must state the currency that has been used for the valuation. If the value is reported in a currency other than the currency of the country in which the property is situated, the report must state the conversion rate used.**
52. **Statement of compliance with the General Data Protection Regulation (GDPR)**
53. **Statement of compliance with EVS**
54. **State "Disclaimers in Annex"**
55. **The valuation report must be signed and dated by the valuer** *(identified above under A.3.8)***.**

E. ANNEXES

56. Graphs, maps, disclaimers, photos

II. THE EVS Valuation Report for OFFICE Property

A. BASIC ELEMENTS OF THE INSTRUCTION

A.1. The property

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

A.2. The client

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

A.3. The valuer

8. **Identification of the valuer — When the valuation instruction is given to a company, the individual valuer conducting the report must be identified.**
9. **The qualifications of the valuer (EVS 3)**
10. **The status of the independent valuer (external or internal)**
11. **Confirmation that the valuer has the experience and market knowledge necessary to value the property**
12. **Confirmation that there are no conflicts of interest — Where conflicts exist, the report must state that these were brought to the client's**

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

13. **Use of specialist valuers or advisers — Where the signing valuer has used the services of third party specialists, they must be identified.**

A.4. The scope of work

---

14. **The purpose of the valuation (mortgage loan and other banking use, sale/purchase, taxation, renovation, extension, etc.)**
15. **Basis of value instructed including full relevant EVS definition (e.g. Market Value) and reference to the appropriate EVS or to the law or regulation that defines the basis of the valuation**
16. **The legal interest in the property being valued (freehold/outright ownership, leasehold or other, ownership percentage, etc.)**
17. **Investigations carried out**

A.5. The available information

---

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

A.6. The inspection

---

22. **The scope of the inspection to be carried out. Purely visual with no coverage of hidden defects**
23. **Date of inspection**
24. **Confirmation that the inspection was made by the valuer or by a suitably qualified person under the valuer's responsibility**
25. **The name and qualifications of the person who physically inspected the property and the extent of the inspections carried out must be stated. If the inspection has been less complete than usually required for this type of valuation, this must be stated.**

26. **Responsibility for the inspection falls to the valuer signing the Report (identified above under A.3.8).**

27. **The extent of the property that it was possible to inspect**

B.DESCRIPTION

B.1. The location

28. **Relevant neighbourhood characteristics, identification of prevalent uses and building types**

29. **Availability of public transportation, road accessibility and presence of infrastructure**

30. **Identification and description of the geographical area relevant to the property being valued (relevant maps and photographs must be included as annexes)**

31. **Valuer's opinion of the market characteristics that tend to influence property value in the identified area**

B.2. The property

32. **Site analysis:**

    a. Distance from the city centre and/or the main business district, major regional cities, major transportation services (airport, railway, bus station), access to the property (adequate access from the main roads, underground, bicycle paths, etc.) and any other relevant information

    b. Description of the land plot on which property is built (size, shape, topography and local infrastructure)

33. **Description of the physical characteristics of the property (surfaces, architecture, layout, built-in furniture and equipment, accessibility, the energy performance certificate's rating ,and the green building certifications, use/production of renewable energy, view, luminosity, time of construction and state of repair, attractiveness and character, etc.).**

34. **Description of the health and safety conditions of the property (for example, fire protection, air quality, temperature control systems, noise management system, lighting, presence of spaces dedicated to movement and physical activity, connectivity, comfort of the workspaces, etc.)**

35. **Comment on the physical characteristics and the health and safety conditions as to quality, independently and relative to the neighbourhood**

36. **Photographs to be included as suitable**

B.3. The legal situation

37. **Ownership and tenure — Including comment on any covenants, third party rights over the property, restrictions or obligations that could have an effect on value**

38. **Tenancies — Information on the main lease terms (duration, renewal requirements, break options), the amounts of passive and current rents and any provisions for them to vary during the remaining life of the lease and any other conditions (maintenance, insurance, capex, etc).**

39. **Town planning and development control — Information about the current zoning in the relevant development plan(s), allowed uses and building renovations and modifications, and related permits**

40. **Zoning for physical risks (forest fire, earthquake, flood, etc.) and transition risks ensuing from energy efficiency regulation.**

41. **Judgment of the impact of the tenancy situation, the expectation of vacancy and estimated capex**

42. **Judgment of the impact of the legal situation on the value**

C. VALUATION

C.1. The methodology

43. Description of valuation approaches and methods used

C.1.1 The income method

44. Explanation of the choice of key assumptions with reference to the income growth models (Capitalisation and Discounted Cash Flow)

C.1.1.1 The selection criteria for relevant market data

45. The criteria chosen for selections of rent comparables (for example, market area, size, type, energy performance rating, state of repair, etc.) must be clearly stated and consistent with the property's characteristics.

46. Information on comparable properties (redacted as appropriate for confidentiality and privacy) and other market data must be clearly set out together with the source of such information

47. Information on the main market data affecting lease (for example, inflation, risk free rates, property taxes, management costs, etc.)

C.1.1.2. The analysis of the market data

48. Description of each comparable (photographs may be included, chosen as appropriate in terms of confidentiality and privacy)

49. Adjustments to the values of comparable properties with accompanying commentary — The valuer must provide appropriate comment reflecting the logic and reasoning for the adjustments provided.

50. Justification of capitalisation rate, discount rate and cap-out rate used.

C.1.2 The comparative method

51. Explanation of the choice of key assumptions with reference to the comparables listed

C.1.2.1. The selection criteria for relevant market data

52. The criteria chosen for selections of comparables (for example, market area, size, type, energy performance rating, state of repair, etc.) must be clearly stated and consistent with the property's characteristics.

53. **Information on comparable properties (redacted as appropriate for confidentiality and privacy) and other market data must be clearly set out together with the source of such information.**

C.1.2.2. The analysis of the market data

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

C.2. Valuation

56. **Final calculation supporting the opinion of Market Value and/or other basis of value as instructed in the scope of work.**

D. CONCLUSION

57. **The reported value must be clearly and unambiguously stated, together with confirmation that sufficient investigation has been undertaken to justify the opinion of value reported.**
58. **Statement of Market Value and/or other basis of value as instructed in the scope of work.**
59. **Date of valuation**
60. **If a special assumption is being made, the valuer must clearly state that the opinion of value has been derived under that special assumption.**
61. **A statement as to whether transaction costs such as VAT, fees, etc. are or are not included in the reported value**
62. **Currency — The reported value must state the currency that has been used for the valuation. If the value is reported in a currency other than the currency of the country in which the property is situated, the report must state the conversion rate used.**
63. **Statement of compliance with the General Data Protection Regulation (GDPR)**
64. **Statement of compliance with EVS**
65. **State "Disclaimers in Annex"**
66. **The valuation report must be signed and dated by the valuer (identified above under A.3.8).**

E. ANNEXES

67. **Graphs, maps, disclaimers, photos**

EVGN 4 VALUATION OF AGRICULTURAL PROPERTY

The hard copy and electronic versions of the Blue Book will not contain parts 5-8, only a reference/link to the full Guidance Note on the TEGOVA website.

CONTENTS

1. Introduction

All European countries have agricultural and rural property but its nature and uses with associated legislative frameworks and markets can vary greatly between them and so affect valuations. Rural property is typically the property sector most influenced by very different national and local historical and cultural factors and so prevailing custom and practice. Even the Member States of the European Union with its Common Agricultural Policy are now seeing much more divergence as the CAP becomes a looser framework while countries outside the EU have their own differing approaches. There are differing levels of interaction with markets for residential, environmental, forestry, sporting, amenity and other uses. There may then be other calls on land from development from minerals and environmental purposes to renewable energy and leisure. This variety makes it important for the valuer to understand the assets to be valued in their context.

This Guidance Note applies to agriculture and forestry because some countries have the same valuation rules for both. However, it should be noted that other countries have separate and different rules for forestry valuation.

Regardless of the diverse definitions in national legislations, there is a consensus that rurality can no longer be defined solely according to agricultural activities. Rural land is associated with various typologies of areas based on different quantifiable criteria such as demography, employment, accessibility, and other statistical categories.

For most European countries since the 1990s, the analysis of demographic and economic data related to rural areas indicates a decline in agriculture in both economic and demographic terms.

That means that this Guidance Note considers general principles whose application will vary between countries for reasons that may be hard for someone outside the specific market to discern readily. With that caution, markets in agricultural land can be seen to lie at points along several possible spectrums, as to whether:

- there is an active market in the sale and letting of farmland
- there is greater or lesser national legislative intervention in land ownership, transactions and lettings
- the market is transparent or not as to transactions and prices
- the business of food production (and other activity) depends on the land itself as a factor of production or depends on high investment in production facilities on the land when the value may lie more in the business than the land as premises
- the market value of land just reflects its food production potential or is influenced by a wider range of factors.

The structures for landownership, occupation and use of agricultural and related land will vary with national or local history as between:

- when and where agriculture came to be seen more as a business and mechanised
- different regimes for the inheritance of landownership
- past patterns of radical political change and land reform
- the level of official intervention in land transfers, there often being more political concern about rural land than other property
- legislative intervention in the arrangements for letting farmland
- those areas that saw the collectivisation of agriculture with the differing ways in which that legacy has been handled.

Changing global circumstances are bringing new factors into agriculture and so the valuation of its property, including:

- the unfolding of climate change with its impact, the measures taken to mitigate it and how land-based businesses in global supply chains adapt to increasingly volatile and extreme weather conditions both at home and abroad
- growing constraints on the availability of water for farming and so the need for its optimal management, especially where it is critical to the farming use of the land
- with many inputs such as fertilisers in global supply chains and much produce being sold into them, changes in and disruption of world markets have an influence as do the changing tastes of consumers around the world
- the rapid development of new technologies for farming, from the use of big data and drones to robotics and other automation
- the growing expectations of environmental management in farming and of rural land to reduce its wider impact on such issues as water quality, flooding, air quality, biodiversity and climate change while also developing new techniques to work within growing economic and regulatory limitations on the use of crop protection products.

In many cases, regulatory permissions impose a key constraint relevant to the value of land such that a secure permission may add to the value of land and lack of it might diminish that value.

An important and widespread example is where the farming enterprise depends on having access to water and being able to retain that access on a useful and sustainable basis in the future. If official permission is needed to take water or to store water in reservoirs for use when needed, the limits of the available permissions and their security once granted are relevant to the valuation.

While these permissions are typically site-specific, the example of water shows they can themselves sometimes be tradeable. Indeed, European agriculture has

a wider history of production controls being transferable to a greater or lesser extent according to the national jurisdiction and markets.

Equally, environmental restrictions and designations may affect the value of land subject to them. In particular markets, these might make the land more attractive to some buyers (especially the more environmentally-minded) but they might, more generally, be seen as restrictive (especially to more commercial farmers).

Some areas have particular recognition as or reputation for particular production which can create a brand value or protection. Land within some French wine *appellations* can have a higher value than apparently similar land just outside. More generally, some areas have the infrastructure and downstream processing to support contracts and value in what elsewhere would be just commodity production.

2. Application of European Valuation Standards

Whichever the country and whatever the nature of its market for agricultural property, valuations are to be conducted according to European Valuation Standards unless national or local laws provide otherwise.

Market value is the default basis for valuation in the absence of other instruction or statutory requirement. It is to be assessed in accordance with its definition and commentary in EVS 1 and take into account the relevant range of factors in the minds of market participants . There are particular challenges for this in countries or areas where the agricultural property market is illiquid or lacks transparency .

Similarly, a rental valuation is to be on the default basis of market rent in the absence of other instruction or statutory requirement. Market rent is to be assessed in accordance with its definition and commentary in EVS 1. With agricultural property typically rented for economic reasons, it is more likely that rents reflect the economics of production having regard to supply and demand for the land and the quality of potential tenants.

However, there may be national legislation prescribing the basis on which the rent for agricultural or forestry land is to be reviewed.

The methodologies for assessing these values will necessarily vary according to the circumstances and available evidence. Subject to statutory instructions and local circumstances, agricultural valuations often rely on an analysis of the evidence of sale prices of comparable properties , especially in more transparent and liquid markets.

Understanding the specific features of agricultural land valuation requires consideration of the impact of multiple factors arising from economic, demographic, political, technological and natural characteristics of the environment and land use.

The valuation of agricultural property and the factors affecting it can be considered at different levels:

1) Factors affecting the suitability of land for land use, i.e. determining the quality and category of land. This draws attention to factors influencing land use such as climate, hydrology, topography, soils, land cover and vegetation needs, and the need for data availability on present land use and management.

2) Factors determining the mechanism of action of the agricultural property market (demand, supply and price) and impacting directly on the market value of agricultural land. This includes analysis of the impact of prices of agricultural products and inputs, location of land, production infrastructure, degree of fragmentation of estates, inflation, expectations of future land price changes, transaction costs, etc.

3) Factors affecting the efficiency of the agricultural property market. Most often, an efficient agricultural property market is associated with easy access to the system that the agricultural property market represents and with smooth market transactions. These conditions are possible if the necessary legal, institutional and financial frameworks are in place and adequate regulatory and fiscal policies are implemented.

Unless instructed otherwise, the valuer should consider the highest and best use of the land (HABU), so as to ascertain the feasibility of another type of use (for example: the subdivision of the land following an urban/suburban expansion, the switch from annual to multiannual crops, etc.). Thus the valuer should have regard to potential changes of use if such changes are physically possible, reasonably probable, legal or likely to become so and resulting in the highest value of the property at the date of valuation (EVS 1, paragraphs 4.3.4 and 4.3.5.). The valuer must indicate the time within which the HABU of the land could be achieved. If the valuation is for secured lending, it may be subject to Article 229 of the Capital Requirements Regulation requiring a “property value based on prudently conservative valuation criteria. Where other bases of value are required, such as investment value or fair value, they are to be assessed under the provisions of EVS 2.

The valuation of agricultural property is a specialist area requiring a close understanding of often complex, intricate and locally varied markets in specific contexts, to be undertaken by valuers knowledgeable and proficient in these markets, meeting the requirements of EVS 3.

The process of valuation and reporting should follow the requirements of EVS 4 and 5.

A template for an agricultural valuation report is offered in the Appendix.

3. Valuation Methodology

The same methodological approaches as apply generally to real estate (See EVS Section II on Valuation Methodology) apply to valuation of agricultural properties:

- Market Approach – Comparative Method
- Income Approach – Direct Capitalisation or Discounted Cash Flow (DCF)
- Cost Approach – Replacement Cost Method

with the Residual Method cutting across and incorporating all the various approaches. The choice will be driven by the nature of the property, the national or local market and the possible willing buyers.

Over time and in different areas, there will be differing balances between farming and non-farming buyers. With the locational nature of land, farmers may be particularly driven to buy neighbouring land when it is available rather than land beyond easy reach. Larger, equipped and free-standing units may attract a wider range of buyers. While buyers might generally be private individuals and families, traditional institutions and charities, now increasingly environmental ones, can be active.

However, in some areas, larger investment funds and corporate agri-businesses operations will have a role, especially where large units, including ones that can be irrigated at scale, meeting their criteria can be bought or rented, requiring an understanding of their approaches to property. They will look for a level of professional in valuation that incorporates these approaches, which can overlap with those for business valuation.

Nevertheless, more technical approaches based solely on production-generated income analyses are unlikely to reflect market prices in most areas, so that where income analysis is used it should be cross checked by comparative market analysis.

Market Approach - Comparative Method

As with real estate generally, the market approach to valuation of agricultural properties should be based on the comparative method.

Almost all agricultural property will usually be valued by comparison relying on appraisals of the property in question and knowledge of the marketplace in which it sits and of sources of information.

When a market is active and therefore the real estate data necessary for the valuation is available, the comparative method is the most direct, probative and documented method for valuing a property. The comparables should be drawn from properties similar to the one being valued, .

In the valuation of agricultural property , the comparative method seeks to assess the market value or market rent of a property by means of a comparison between the property being valued and a set of similar, recently contracted comparable properties with a known price or rent falling within the same market segment.

The evidence of the identified comparables should be considered and adjusted for their differences from the property being valued on factors known to be relevant in the market. Among many points, these might include:

- area, smaller parcels often having a higher unit value
- quality and nature of the land
- houses, buildings, facilities such as irrigation and other fixed equipment
- access to contracts, designations and markets
- limitations on use from environmental designation to soil depth and field size
- events since the comparable transaction was agreed.

Income Approach

This method is of greatest relevance for markets that view agricultural property predominantly for its income generating potential or when the property generates income from a lease agreement.

Sometimes the land simply underlies the business upon which it is conducted, rather than being an integral part of agricultural production. Where the value of the property is driven more by the business, often in higher value production with significant investment in facilities on the premises or with access to particular markets, an income approach may be more appropriate. This requires care in selecting the appropriate discount rate(s). The extent to which the business opportunity, including relevant contracts, is transferrable with the property may often be a critical factor.

The income approach may also be used, at least as a cross check, for land under perennial crops such as orchards and vineyards, or glasshouses. It can also have a direct application for valuing perennial crops for business purposes without reference to the land, when it it might be used for market value and for an individual client's investment value.

In some markets, an income approach might also be naturally adopted where large areas of agricultural property are available and viewed solely in terms of commercial production.

Some markets may be too limited or opaque for the comparative approach to be feasible with any reliability, requiring consideration of the most appropriate approach to assess the market value. In such situations, it is common to use an income approach based on the income derived from the business. The context requires care in validating the result and the means used to achieve it as a figure that could be expected to be achieved in a transaction.

The income approach requires an analysis of the potential for a property to generate monetary benefits and for converting these benefits into a capital value through the application of an appropriate discount rate. A distinction relevant to

the rate used is made between working from rents, as property income, and from profits, as business income.

The Methodology Section 7, sets out the different methods and models commonly applied under the Income Approach. Thus, both capitalisation methods (perpetual and reversionary models) and discounting models (Explicit Discounted Cash Flow) as well as models based on the accounts of the current or a theoretical occupier are described in some detail.

The income from agricultural property is either derived by the owner from letting or based on the production cycle for the intended farming enterprise. In the latter case the cash flow from agricultural property results from both the production cycle and the market cycle for products. The valuer must consider the impact of these cycles on revenues and costs.

An over-reliance on solely technical use of yield analysis is, in most countries, often unlikely to give market value, usually needing a final review for the credibility of the opinion as to value. It is also commonly subject to the risks inherent where yields are low (often a feature of agricultural markets) as only small differences in yield then produce large differences in capital values.

In 'transparent' countries, this methodology commonly relies on capitalisation of the market rents charged, based on a capitalisation rate obtained directly from the market from the relationship between market rents and transaction prices. In areas with more homogeneous agricultural systems, potentially reliable market values can be obtained using this methodology though the ready availability of sale transaction might of itself often tend to reduce the need to use this method.

In 'non-transparent' or 'not fully transparent' countries, it is more difficult to apply the income method based on a market rent, so it is common to resort to indirect methods based on the business and the income it generates. Assessing potential yield, income and costs requires a sound knowledge of production economics, especially for farming given with typically wider range of physical and financial performance between good and bad producers as well as the normal variations between years, that volatility now tending to increase with climate change. Current or future performance may depend on access to particular contracts, which might be for inputs as well as sales. It may be necessary to view any accounts shown by the vendor business with some scepticism.

In this context and depending on the basis of value (market value, synergistic value or fair value), EBITDA (earnings before income, taxes, depreciation and amortisation) may often give a structure for analysis.

It may be appropriate to consider income derived from other activities such as tourism, hunting or fishing in inland waters, or long-term income from the installation of telecommunications antennae or power lines or other rights. Market analysis, including the attitudes of likely buyers, must be carried out to determine whether these factors affect the value of the property. If no market evidence can be gathered to support that conclusion, such as historical records and

inventories demonstrating that those resources are sustainable over time, such income should not be reflected in the determination of value.

The direct capitalisation method involves converting annual income into a capital sum using an appropriate yield. (Methodology section 7.7)

However, permanent crops, such as fruit, olives or vines, do not give a constant, perpetual income but commonly have a production curve. After an initial establishment phase with substantial costs, production begins to give positive cash flows which increases to a stable plateau but then finally declining towards the end of the plants' productive life with costs of renoval. Here, income is variable and time-limited though the cycle may then be repeated, with or without intervening cropping.

The discounted cash flow method relies on determining each year's cash flow over a given period, perhaps the expected life span of a crop, taking the market value of the bare land obtained by market comparison or further production cycle of that crop in perpetuity, deducting the investment needed for the next cycle.

As agricultural production responds to market trends, which change over the years, there may be reason for caution in valuing an agricultural property on the basis of perpetual cycles of a particular crop or to allow for an intervening crop. If there are concerns that that crop might cease to be in demand in the future, it could be appropriate to consider one growing cycle and a terminal value corresponding to the market value of the bare land. This may matter little for crops with longer life spans.

Discount rate

Determining the discount rate is one of the most difficult aspects of valuation of agricultural properties by means of a Discounted Cash Flow. (Methodology section 7.34)

The optimal way of determining the discount rate through analysis of market transactions (Methodology section 7.38 and 7.39). But, as already noted, in many countries this methodology is difficult to apply, and other methods should be used (Methodology section 7.40).

In such circumstances it is common practice to refer to ten-year government bonds as the risk-free rate and adding a market risk premium. For agricultural properties, this adjustment is likely to be quite different from that for other commercial or residential properties. In principle, the issue is the return that an investor might require to hold farmland with its character and need for management compared to holding risk free bonds. The risk premium might, now in particular, include something reflecting the impact or benefit of climate change,

However, these indirect methodologies cannot be applied in isolation from the realities of the property market, or it might simply result in an investment value. The fact remains, that owners of agricultural property will very often be faced

(sometimes after the investment is made) with the dilemma that, if they do not invest in an agricultural operation, even an unprofitable one, their land may end up being abandoned and therefore devalued. Market values may also reflect what can be paid if there are only very limited opportunities to buy convenient land, perhaps not even for several decades, which can be financed across the whole of an enlarged business.

On the seller's side, there may very often be sentiment associated with the land, related to the fact that it may have belonged to the same family for many years, compelling the owner to maintain activity, even if it is not profitable, for reasons going beyond economic rationality. In these situations, parties may often implicitly apply a yield lower than the opportunity cost of funds to them.

Very low rates may also be found on the market in cases where the expected income does not come solely from crop or livestock production, but from other complementary amenities, such as building a house or a rural tourism facility, with farming managing the landscape supporting the business or helping justify the development permission.

It is therefore important to maintain a critical attitude in using indirect methods of determining the discount rates, so that these do not become disconnected from the realities of the specific local market. For agricultural properties, the market premium may often be lower than that for urban properties and there are agricultural markets where the final rates are below long term interest rates.

In areas where there is an identifiable risk that obtaining the hoped-for potential income may not be possible, such as areas at high risk of fire or irrigated areas with heavy restrictions on water distribution as a result of climate change, the application of a specific risk premium is justified, increasing the estimated cost of capital discount rate.

Cost Approach

When considering specialist equipment or buildings, it may, on occasion, be appropriate to assess the Depreciated Replacement Cost (DRC), especially where a reinstatement valuation is required. This will not typically be relevant to other agricultural properties. It is a valuation for the continued use of the building, making it inappropriate where the building might be developed for other purposes such as housing.

This method determines the current market value starting from a value for it as new, commonly as depreciated for age and obsolescence. The reconstruction cost can be estimated as the cost of replacing a new property with equal utility and functions, possibly considering age and obsolescence.

The depreciated replacement cost method aims to determine the market value of a property by adding the market value of agricultural land and the cost of reconstruction of the work, structure or construction, which may be depreciated. In the valuation of agricultural buildings, it should be noted that some land

investments, such as tree plantations and windbreaks, are biological resources that require medium and long-term replanting and reconstitution and do not depreciate.

If the property is located in an area much in demand for the building of secondary residences, as happens in many coastal zones or zones falling within environmentally protected areas, the objective may be to accommodate a housebuilding rather than agroforestry operation, so that in such cases the comparative market method should be favoured when valuing the existing structures.

If the property is intended to be used above all for agroforestry, the depreciated replacement cost method will be the appropriate methodology for valuing the existing structures. Nevertheless, it must be borne in mind that f the production-based income method is being used to value agricultural property, then there should be no valuation of the structures which are key to the production process, since the income in question depends on the existence of those structures and their value is therefore reflected in the income analysis.

Farms reservoirs for irrigating an agricultural property illustrate this. If the agricultural property is valued on the basis of its potential, and so with the possibility of irrigation, using the cost method to value the reservoir would result in over-valuation. Its value is already implicit in the enhanced value of irrigated land, so it should not be valued individually.

4. Determination of Market Value

The valuer will have regard to the matters set out above in establishing the type of agricultural property and the likely pool of potential purchasers.

It is important for the valuer to assess the physical and other characteristics of the property and its potential for agricultural production or other purposes. The valuer must always inspect the property and seek out information relevant to its farming and other history and potential. The inspection is essential for the valuation for forming a direct view of its real condition and relevant matters verifying the state of affairs and comparing it with what is reported in the documents. The inspection should be both internal and external, of the entire property and must always be conducted at the level of detail necessary to provide a professionally adequate assessment for the specific purpose. Inspection checks and assessments should cover:

i) the characteristics of the surrounding area, the degree of accessibility and the provision of infrastructure that influence the value;
ii) access methods and location;
iii) the characteristics and surface size or volume of the property;
iv) the state of maintenance;
v) the type of systems, equipment and services;
vi) environmental factors (whether natural, such as land instability, flood risk, etc. or not, such as pollution)

vii) the source of the measurement of the property (surveyor, maps, land register, other);
viii) verification of the scale of the plans used for the dimensions of the property;
ix) the comparison between the actual condition and that described by a) the cadastral or other official documents, b) the building and urban planning documentation c) the title (or titles) of ownership of the property;
x) determining the progress of current works and their conformity with any permission;
xi) the assessment of the quantitative and qualitative characteristics that influence market price variations;
xii) the features relevant to identifying the market segment;
xiii) the verification of any rights over or benefiting the property and other circumstances that may affect value and/or marketability;
xiv) verification of any tenancies affecting the property;
xv) any other appropriate element to fulfil the mandate received.

The valuer should establish whether there are any matters affecting title to the property. As well as the ownership itself, these might include rights of way, easements, licence, purchase pre-emption agreements, development control conditions or legal agreements, whether benefiting or burdensome on the property. It should be established whether mineral, sporting or other relevant rights are owned with the land, given the problems which may arise if they are owned and exercised separately. It should be checked whether all material buildings and uses have official development control and other authorisation so that their legitimate use by the new owner is not in doubt.

All occupational arrangements, whether by tenancy or licence, documented or oral, including business arrangements, should be established, together with the code of law relevant to each and its implications, including any imposed security of tenure (with tenant's ages and potential successors where relevant) and rent review rules. The valuer should ensure that the valuation is subject to any such occupancy and business rights where they would be effective against a new owner. This should include all residential tenancies and occupancies. It must be established whether the local practice is to value dwellings subject to long term tenancies on an income approach or a proportion of vacant possession value.

The valuer should consider very carefully whether an element of additional hope value should be allowed for possible (but unapproved) alternative uses. This will require careful checks with the appropriate authorities as well as relevant comparable evidence. Any such expectation should be highlighted in the report and appropriately justified.

5. Agricultural Land, Farms and Estates

This section covers the general nature of agricultural land to review:
- tenure, occupation and business arrangements

- the distinctions between:
  - bare farmland,
  - land with farm buildings and dwellings, and
  - agricultural property as part of a larger or more diverse estate
- commonly relevant physical characteristics with regulatory concerns and constraints
- likely sources of information
- valuation methodology
- determination of market value.

The General Nature of Agricultural Property

The main subject of agricultural valuation is likely to be the physical property or real estate itself. Rural or agricultural land is a convenient shorthand reference for generally undeveloped land whose economic activity and use has been largely driven by agricultural or horticultural use or can revert to it.

Its legal nature will be determined by the law of the country in question which can be different from those relating to urban property, businesses and chattels. The interest in the land may be held by an owner or a tenant while access to land may be granted under a licence or other legal right. Others such as mortgagees may have relevant interests.

Most property used for other purposes was once agricultural and, even in time of national crisis, relatively little land usually returns to farming uses. In most European countries, farmland is the major land use by area but this has obviously diminished over time and is likely to continue to do so. Improved technology, skills, machinery and inputs have meant that the potential for agricultural productivity per unit of area has grown substantially in recent decades. In addition to the development of land, some farmland is now taken for forestry or environmental and conservation uses.

The common uses of farmland are the growing of annual or perennial crops, usually for food (human or animal) or drink, or the keeping of livestock for meat or products such as milk or wool, commonly reliant on pasture. There is also a growing interest in farming for non-food uses, such as energy or pharmaceuticals. Farming may be pursued in conjunction with other non-agricultural uses, such as shooting or recreation while, in some circumstances, conservation uses, whether reliant on or replacing farming, can themselves be a source of value.

The countryside will also include forestry or woodland and also generally unproductive areas such as mountain or marsh. Sometimes, these areas will have fallen out of production or still have low level grazing, sometimes recognised as a traditional practice.

There are normally development controls and other regimes regulating changes in the use of farmland to other residential, commercial, leisure or infrastructure uses, often of higher value. These pressures for change of use will reflect the economic development of an area, its population density and commercial circumstances.
These factors will also affect the approach to exploiting value which may reflect:
- the yield from managing biological assets (the approach taken in IAS 41) or

- the opportunities offered by the range and combination of assets owned.

The markets for rural land can be significantly influenced by factors outside farming. These include the appetite among some non-farmers to own parts of the countryside for amenity, pleasure or other reasons as well as each country's taxation system, including its particular agricultural aspects.

More generally, each national taxation system with capital, revenue and transactions taxes typically has specific features for agriculture, some aspects reflecting the particular nature of farming operations and some to encourage or protect particular outcomes (for example in Italy the registration tax for purchases of land by professional farmers is almost zero, while it is 15% of the value for other operators).

The great majority of farming businesses rely on having access, by ownership, lease, licence or other right, to farmland. A few farm enterprises, such as intensive livestock, poultry or mushroom businesses, can rely solely on buildings, buying in feed and other inputs that could be grown on land and taking the waste away.

Across the whole continent, economic and social pressures mean that farming populations have been falling and continue to fall with the restructuring of the continuing farming businesses. In much of Europe, many businesses are seeking greater viability by expansion or developing other sources of income. Many specialist businesses are now dependent on migrant labour and, to a growing extent, on automation. The valuer will need to understand the process of restructuring that affects the farm in question.

Tenure, Occupation and Business Arrangements

Farmland is by no means always held and farmed on a simple basis of owner occupation, with the owner farmer having the benefit of all rights to the land. Different countries have different land tenure systems, different customary arrangements between owners and farmers, and differing limitations on the transfer of property and business rights.

Some countries have official mechanisms (such as SAFER in France) for approving or rejecting land transfers. Some impose limits on how much land can be owned or bought or the extent to which some, especially foreign[10] companies, can own or occupy land and whether there is maximum term for a lease, whether it excludes subsoil so that it is essentially a grant of a right to farm. In some countries, farming neighbours can have the chance to pre-empt a non-agricultural purchase.

National law and administration can limit the freedom to transfer land. There may be laws providing for family rights in land on inheritance or to protect the matrimonial home. In some countries, farming buyers of farmland may have a privileged position, in preference to other possible buyers. Farming tenants may sometimes have a right to buy or of first refusal at a given valuation if the property is to be sold. For example, in Italy, to encourage the expansion of small agricultural businesses, there is a right of pre-emption in

[10] For the EU, 'foreign' means non-EU although new Member States are sometimes granted temporary derogations from EU internal market freedoms concerning agricultural land.

favour of the tenant farmer or the neighbouring farmer; other potential buyers should check that there is no request for pre-emption with its effect on the buying and selling process.

It is important to understand what rights are conveyed by ownership of land. In some countries, ownership of agricultural land or woodland may give little automatic right to exclude the public or reserve sporting. Napoleonic property law, applying in parts of Europe, controls the inheritance of real property, sometimes encouraging the use of corporate structures as vehicles for ownership. There can be substantial practical difficulties or time delays in enforcing property rights in some jurisdictions.

In many countries, there are legal rights of access for some farmers to use open land, often unimproved land such as hill or marsh, for grazing. These may run with particular properties, be freestanding transferable rights or, as with some transhumance systems, simply be customary.

Agricultural Tenancies

Many countries have had systems enabling farmers to lease land as tenants from owners who may be larger estates, former farmers, investors or family members who have inherited farmland. A tenancy can separate the investment needs, risks, opportunities and returns of ownership from those of farming. It can also serve as a means for capital intensive specialist rotational cropping, such as root crops which the farmer's own business cannot handle, to have the use of fresh land each year to avoid crop diseases, pests and other issues.

Where these systems have survived, been reformed or been re-created, most countries have their own tenancy law, usually specific to agriculture. Such laws typically govern use, security of tenure, rent determination, end of tenancy compensation or other rights, possible family succession rights to the tenancy, rights to purchase from the landlord, and other matters. The terms of the actual tenancy agreement will then apply subject to the code of law. Tenants may be limited as to their opportunity to sublet or assign their interest. The length of tenancy can range from the very short (often for specialist cropping, a grazing season or an interim arrangement) to a lifetime or longer.

For valuations, key points usually include:

- the rent and the means of, and relevant factors for, its review
- the likelihood of vacant possession and the opportunities which may or may not be expected to exist then
- liabilities (statutory or contractual) between the parties – repairs, compensation, etc
- the uses permitted to the tenant and matters reserved to the landlord
- the obligations of each party to others by virtue of being landlord or tenant - these may usually include local taxation and charges (such as drainage rates) but there can be apparently unusual or historic liabilities, particularly relating to ownership, as where an estate may have onerous obligations to assist with the maintenance of a church.

The agricultural tenant's use of the land may be regulated by national legislation and then by contract of tenancy on such matters as:

- the length of the lease, some countries setting a maximum term and some a minimum term
- rent review
- the use of the land, whether for agriculture, one form of agriculture only or allowing some downstream or non-agricultural enterprise
- the ability to make improvements and the potential for compensation for them at the end of the tenancy
- the ability to sub-let or assign
- the extent to which and on what terms a landlord can resume possession of all or part of the land
- the extent to which the landlord can claim dilapidations if the property is in poor condition at the end of the tenancy.

Historically, some Mediterranean countries had systems under which the farmer would pay a share of produce to the owner (called "contratto di Mezzadria" in Italy). These or other similar systems may occasionally be met.

The end of the tenancy may be an occasion for the tenant to claim compensation in respect of any improvement made to the property, as to its fertility or its fixed equipment. This might be assessed on a variety of bases under either law or contract, including:
- the value added to property for letting
- the value the improvement offers to an incoming tenant
- the written-down cost of the improvement.

The landlord's interest in the property is often a marketable asset though there may be limitations on who can buy it or a requirement that the tenant have the first right to buy it (then perhaps on a statutorily specified valuation basis).

Other Business Structures

Farming can be undertaken by individual people or by an incorporated body such as a limited company. It can be done directly by the owner or tenant or by using managers or separate contractors. A wide variety of **business arrangements** is possible, some of which can be used to achieve a similar division of roles between the owner or tenant and the contractor as between a landlord and a tenant. However, these are usually matters of contract rather than interests in real property. The variations include:
- **partnership** - where two or more people join together to farm the land, sharing in the business and dividing profits and losses. In some countries a partnership is a separate legal entity; in others, the individual members are simply in association with each other. In practice, they may often be family members but it can be a means to bring money into a farming business or for a landowner to bring in a skilled farmer. National rules on joint liability for debts may be an issue.
- **share farming** – where two businesses (sometimes a land business and a farming business or just separate farming businesses) come together to produce a common output such as grain or milk, dividing gross sales between them

- forming a **company or other legal personality** involving either an owner and a farmer or several farmers to conduct some or all of the farming of identified land, possibly having access to land on a licence or a tenancy
- **contract farming** – this can cover all the variations by which an occupier of land has some or all farming operations done for her/him under an agreed contract. Where whole crops or enterprises are farmed on a such a contract, it can be structured to provide for the division of surpluses or losses between the parties or simply to have work done at fixed rates
- **grazing licences** under which animals will be brought to land to take the grass (sometimes after silage or hay has been taken) or the grass is cut and conserved for the animals. Payment may be on a headage or area basis or even reflect the weight gain made by the animals.

The reasons for choosing the form of tenure and business arrangements will turn on:
- personal circumstances and preferences
- commercial needs
- taxation
- legal advantages and disadvantages of each option in the country in question.

These factors mean that it is important to understand the real nature of any relationships where the farming is not handled directly by the owner of the land. Many arrangements are unrecorded, unclear or not fully implemented and so, in the event of a disagreement, may prove to have created different rights to those originally anticipated.

A farm business may farm different areas of land held on different types of arrangement with different owners, for example, owning some land, renting more and being a contractor elsewhere. Landowners may farm some of the land they own and have tenants on the remainder as well as having partners or contractors for some specific parts of their business. This makes it necessary to consider the relationship between the various land areas held on different arrangements and the available buildings and other fixed equipment (such as reservoirs). Storage buildings on a small area of owned land but servicing a much larger area of land held short term could offer a different, possibly lower, value to that if they accompanied an area of land matching their capacity in the same ownership.

Land: Bare or Equipped?

The subject of the valuation may be a fully equipped farm together with one or more dwellings or it may be bare land, or just have some buildings which may or may not be useful. This will affect its place in the market. Those wanting a fully equipped farm are unlikely to look at bare or partially equipped properties. However, farmers wanting to expand may only want bare land. Persons retiring from farming may want to keep their house but sell or let the land. In some areas, housing and farming are kept separate (as where the houses are in the village but the farming outside) making bare land the norm.

Specialist Buildings

Particular enterprises, from indoor pigs and poultry to glasshouses and controlled environment farming may use intensive buildings, requiring consideration of the age,

construction and condition as well as their usefulness to any other owner or occupier with factors from obsolescence to dependence on a specific produce contract. Compliance with regulation, including any development control requirements, would also matter. In some areas, valuation may be directly by reference to production capacity, such as per bird for a poultry shed, enabling comparison.

Land or Estate?

The valuation may be of a larger property than just a simple farm with perhaps only minor ancillary areas such as a little woodland. An estate is likely to comprise several units of occupation or be a large farm with other properties. As well as a wider variety of assets to manage, it may have a more significant house The owner may farm some of the land directly as well as letting out farms. In some markets where such a larger portfolio of properties may be attractive, it could have a combined value greater than the sum of the values of each part. In other markets, the greatest value might come from selling it in parts.

Pressures to Restructure and Other General Points

Much of European farming is devoted to the production of commodities, such as grain, which are sold onto large undifferentiated world markets with their price movements. Even perishable milk is affected by the Global Dairy Trade price. The economic pressures arising from this are encouraging some farmers and owners to find other sources of income. These include:

- income off the farm from employment or other businesses (sometimes using farm machinery for contracting work). This can result in part-time farming which can range from being an economic activity to a lifestyle use of what is really a residential unit
- finding other uses for farm assets – such as the letting out of buildings for commercial uses, the use of dwellings for agri-tourism, old buildings as livery stables and the land for leisure uses.
- construction of photovoltaic systems, increasingly present on farms; their valuation requires specific skills or working with energy sector experts
- finding specialist areas of production that can exploit niches in the market, whether specific crops (often dependent on limited contracts) or techniques (such as organic)
- seeking to add value by undertaking some or all of the processing or marketing of the produce – as grape and olive growers have long done.

These opportunities can all be relevant to valuation.

The value of the land will vary not only with its physical characteristics but also with its location. Very often land of a given quality will be worth more if it is within easy reach of larger settlements. This will variously reflect:

- greater demand for the land, whether for farming or amenity uses
- a wider variety of possible customers for produce and other activities
- possible opportunities for non-agricultural development
- the effects of capital taxation systems encouraging the rolling-over of the proceeds of sales influenced by non-agricultural factors into further agricultural land

as well as other more local and particular factors, including the strength or weakness of the wider local or national economy. Closeness to key communications points (such as docks or motorway junctions) or corridors can also be relevant. The result is that agricultural property tends to have a higher value nearer to more affluent and more densely populated urban areas.

Commonly Relevant Characteristics

Inspection and assessments - It is important for the valuer to assess the physical and other characteristics of the property and its potential for agricultural production or other purposes. The valuer must always inspect the property and seek out information relevant to its farming and other history and potential. The inspection is essential for the valuation for forming a direct view of its real condition and relevant matters verifying the state of affairs and comparing it with what is reported in the documents. The inspection should be both internal and external, of the entire property and must always be conducted at the level of detail necessary to provide a professionally adequate assessment for the specific purpose. Inspection checks and assessments should cover:

i) the characteristics of the surrounding area, the degree of accessibility and the provision of infrastructure that influence the value;
ii) access methods and location;
iii) the characteristics and surface size or volume of the property;
iv) the state of maintenance;
v) the type of systems, equipment and services;
vi) environmental factors (whether natural, such as land instability, flood risk, etc. or not, such as pollution)
vii) the source of the measurement of the property (surveyor, maps, land register, other);
viii) verification of the scale of the plans used for the dimensions of the property;
ix) the comparison between the actual condition and that described by a) the cadastral or other official documents, b) the building and urban planning documentation c) the title (or titles) of ownership of the property;
x) determining the progress of current works and their conformity with any permission;
xi) the assessment of the quantitative and qualitative characteristics that influence market price variations;
xii) the features relevant to identifying the market segment;
xiii) the verification of any rights over or benefiting the property and other circumstances that may affect value and/or marketability;
xiv) verification of any tenancies affecting the property;
xv) any other appropriate element to fulfil the mandate received.

The inherent **quality of the agricultural land** will reflect factors including:

- soil type – both top soil and sub soil, reviewing
- fertility, including nutrient indices and organic content
- workability, including natural drainage
- soil moisture retention capacity
- topography – slope, aspect, etc
- climate and local weather patterns, including
- rainfall, how much and when
- temperature, maximum and minimum, growing season

- daylight hours
- drought and flood.

The valuer will need to understand the particular characteristics required for relevant farm enterprises. Land suitable for vines may be wholly unsuitable for root vegetables – simple land grading systems can be a very uncertain guide.

The usefulness of the land for some specialist or perennial cropping (and occasionally any cropping) can be limited by the growing pressure on **access to water**. Changing climatic patterns and competing residential, environmental and other demands for water (both from groundwater supplies and aquifers) can deny farms water when they need it and severely compromising potentially high value production and so the value of the land, especially on free-draining sand land. Reliability of water supplies, winter storage and potential for summer irrigation can all be important. Storage can either be more expensive or not be relevant in areas with high evaporation rates. Farms can lose abstraction points for other reasons including development, environmental schemes or coastal changes. It is useful to be aware of both the physical factors bearing on the land and the relevant policy framework.

Disease, pest and contamination issues can be relevant:

- has the land been well kept?
- are there large weed populations and can they be remedied?
- what are the local pests and can they be controlled? Some countries' rules on shooting can make this difficult while proximity to water sources may limit chemical controls.
- any relevant diseases running with the land, whether of crops or livestock
- any history of pollution.

Cropping history can be important. Imprudent specialist vegetable or root cropping can exhaust land or leave it with infestation or disease problems. A history that can be proven to meet the standards for organic certification can open up such opportunities for adding value as may exist at the time of the valuation. The land may have the benefit of specialist cropping under a contract with limited availability which could pass to a new occupier.

The presence of **buildings, services and other infrastructure** can give the farmer more control over use of the land.

Many farmers choose to use crop storage facilities away from the farm (often with co-operatives). This can offer economies of scale, access to buildings with modern technology and meeting modern standards and save capital expenditure that may be hard to justify. Co-operative storage can allow group marketing (with blending of crops) and efficiencies in handling and maintenance. Where this is relevant, the valuer should establish whether a new owner or tenant of the land would have rights to the co-operative or other facility, and whether by right or for payment. The rights may remain with the current farmer, especially if the farmer continues to farm elsewhere in the district. Who (perhaps the co-operative) would decide their transfer? Are there alternative facilities? It is important to assess the logistics of moving crops from field to store and the charges for drying, storing, handling, marketing and other services.

Dwellings (farmhouse, cottages, flats, or other accommodation) may be necessary or convenient for the farming business. They can provide housing for the owner and family or staff. They can be very important where close supervision is required as with some livestock and other businesses. However, they may be subject to existing tenancies or other occupation rights. It may be that secure tenancies have been created or possession is not obtainable in practice. They may have arisen out of past employment rights or by custom. Some development control regimes will only allow new dwellings outside villages if their occupation is limited to those employed in the farming that justified the permission. The appraisal will need to consider the occupation of all dwellings, any rent passing and how it may be reviewed, and the likelihood of possession together with the obligations of the parties.

There is an increasing trend for **non-physical factors**, such as agricultural and environmental policies, contracts, licences, permissions and certification to be relevant to the ability of the farm to produce an income. Organic certification of cultivated land is an example: it is not immediate but is obtained after a conversion process lasting several years and, according to circumstances, may be relevant to the marketability of produce.

For some types of farming, official limits on the volume of production can be important and, where these are associated with land or available on a transfer, they may affect value. Where relevant, the available quantity should be ascertained. A similar approach should be taken to commercial contracts to limited production volumes – as may be the case for sugar.

For some enterprises (such as vineyards), controls over cropping can give access to significant value for relevant land. These controls may operate by limiting the area used or by certification of certain types of protected production (e.g. IGP and DOP for defined districts, often with area controls and specifications as to production). In such cases, it will be necessary to review the documentation (e.g. vineyard registers) attesting to the recognised surface area and the relevant production certification.

The Influence of Agricultural Policies

Agriculture is often the subject of extensive and complex government intervention in markets and practices accompanied by support payments. Where it is the area of land occupied that gives access to particular payments, that potential will bring a value to the land, especially for rent, as has been the case in many countries with the European Union's Basic Payment System with payments given on matching aid entitlements against an equivalent area of eligible land at the claimant's disposal. Where payments are made in another way to farmers, their effects on valuation will typically be much less direct.

The EU's Common Agricultural Policy (CAP) both provides funds and imposes a number of relevant restrictions, coming together for land markets where control of land gives access to payments *(See EVS Part VII European Union Legislation and Property Valuation, section 6 The Common Agricultural Policy)*. Other countries outside the EU have their own regimes. It is in the nature of politically determined controls that their detail will change and, for the CAP, important details will vary between member states – the valuer

will need to establish the relevant position and whether the controls in question limit or benefit the farmer as an individual or future occupiers of the land.

The use of these public funds entails compliance with rules and requirements (under penalty of repayment of the amounts received and other negative impacts); the valuer must report any positive and negative impacts in the valuation.

The CAP has gradually transformed over the last few decades, moving from price support policies to production support measures and then to the current system with near-complete decoupling of support and production. Successive reforms of the CAP have made land area a key limiting factor for the degree of support to individual agricultural producers. As a result, the shift from price support to direct support by means of payments per hectare has been particularly reflected in rents.
The effects of subsidy policies on the land market will vary according to the level of payment that can be obtained by occupying land. This is often less relevant to the sale value of land, where prices are high or other factors prevail in the determination of land value.

The situation is different for the rental market, where rents can vary significantly depending on the availability of aid entitlements. In fact, with the introduction of the Single and now Basic Payment to the person who has the land at their disposal , and not necessarily the owner of the land, the rents responded to the increase in the profitability of farmland where entitlements to payment were available.

Land prices can also be influenced by other types of agricultural policies. For example, production constraints (such as replanting rights for vineyards) or specific environmental constraints create tensions on the land market where they result in demand for suitable land exceeding supply. Similar effects can also be seen with structural or environmental incentive measures that make the cultivation of marginal land more profitable again, or policies creating protected designations of origin that make land in particular areas relatively more attractive.

The importance of these measures is that production without their benefit may appear to be commercially unviable since their economic value can be significant. However, that financial support also often feeds through into farm costs and protects farm structures that would otherwise adapt to real economic circumstances.

Together with the CAP, in the coming years it will be increasingly important to carefully consider the effects of changes underway, including climate change, and environmental and energy policies with their interactions with farm profitability and other objectives of those in the land market.

Other Sources of Value
Market Access - Other non-physical factors can include the availability of **marketing contracts** which may be fundamental to the viability of particular produce. This may apply most particularly where:
- there are integrated supply chains

- processing facilities are expensive, concentrated and perhaps under political control – such as sugar.

Regulatory Controls - Licences or legal rights to take, store and use water are increasingly important, especially as some farmland might have little significant farming use without an assured supply of water.

There may be other relevant limitations imposed by development control regimes, environmental, landscape, wildlife, water management or other policies. The valuer should establish whether any relevant designations or policies apply, such as:

- sites recognised for the quality or rarity of their flora or fauna
- archaeological and other heritage sites and areas
- landscape designations – high landscape quality
- nitrate vulnerable zones.

The EU and each country may have its own Special Areas of Conservation and environmentally sensitive areas. and special areas of conservation, and Eeach country may have its own countryside management schemes, national parks and other designations. Some land is officially recognised as having organic status. **Environmentally-related policies** can not only impose restrictions but may also offer access to payments from the authorities or attract other value.

For some crops (for example table grapes, kiwi, etc.) the valuer must also verify the presence of patents and contractual agreements between the farmer and the supplier of the plants, which can entail advantages but also limitations with respect to cultivation and/or commercial operations.

Farmland is not only valued for its agricultural qualities. Other uses may sustain higher values. **Development** for commercial, residential or some leisure purposes is an obvious example and, subject to local development policies, farmland often offers the easiest supply of such land though better quality land may have some protection. Many countries have strict development control policies to protect land around or between cities and main settlements - similar controls can apply elsewhere to reflect the costs of public services or environmental and landscape considerations. Land close to settlements can suffer from problems of trespass and encroachment, so limiting its agricultural or other potential. In some hill districts, forestry (if permitted) has been an alternative use offering higher sale values.

Buildings as well as land can have alternative uses. There may be opportunities, subject to commercial viability and official permissions, to convert them to residential, commercial or leisure uses. These may most often be viable nearer major urban and prosperous areas or in tourist areas. There can be non-agricultural buyers interested in purchasing farm building complexes for such redevelopment. Development control policies, environmental constraints, highways access and provision of water, electricity and other services can be important limitations.

Development control policies may be stated at national, regional, provincial and local levels.

In some areas, the **amenity** value of land can be greater than its agricultural value. This can apply in attractive but relatively unproductive areas. An attractive property or an attractive landscape offering land that can be occupied with a nice dwelling can command a higher value in these circumstances. The presence of water (whether river, lake, stream or pond) can provide an additional attraction, subject to issues of potential flooding or other nuisance.

Different landscapes will have their own qualities for which they are valued. Relative proximity to major urban or holiday locations is creating such markets in parts of France, Italy, Spain and the United Kingdom among other countries. Indeed, these may provide opportunities to farm and rural businesses to brand the marketing of tourism and local products, unlocking extra value.

In some areas, neighbouring residential owners will be willing to pay higher values to control the land around them, sometimes not only for amenity but also for privacy. However, national and local laws or traditions may entrench rights of public access over certain categories of land.

There is an increasing demand for the equestrian use of land and buildings in locations offering interesting riding. Demand is likely to be greatest in populated or tourist areas where such property can sometimes command a value above its agricultural use.

It is not only the qualities of the land itself that can be relevant. An **attractive farmhouse** can add markedly to the value of the property (for example, the farmhouses on the Tuscan hills in Italy).

Likely Sources of Information

These will vary from country to country, while different sorts of information will be relevant to different farms. The valuer should be aware of the following likely sources or their equivalents:

- the best available detailed official maps showing location, boundaries and features (past maps can also indicate issues such as old pits)
- cadastral or equivalent maps showing parcels and property rights
- register or other assurance as to title and extent
- soil maps
- land quality maps
- environmental designations
- agricultural subsidy regulations
- copy of last completed subsidy application form and base year information
- local and regional development control plans, policies and maps
- land management plans
- cropping and stocking records
- soil indices and surveys

- soil and pest/disease surveys – especially for higher value or specialist cropping
- drainage plans
- available produce sale contracts
- water abstraction permits or licences.
- documentation for lettings and other occupation arrangements
- employment contracts
- certificates for farm assurance, organic farming, etc.
- climatic information.

6. Agricultural Crops and Other Assets

This section covers:
- growing crops
- fertilisers, etc
- goods in store
- crops in store
- other stores
- livestock
- plant and machinery
- intangible items.

The valuer may be required to value farm-based assets other than the land. These could include physical items such as growing crops, the benefits of acts of husbandry, livestock, machinery, goods and crops in store and also intangible items such as the benefit of quotas or contracts and other licences and permissions. These may need to be valued in the context of a sale where the incomer is to pay separately for these items, a dissolution of a business arrangement, the end of a tenancy or for some other reason.

It is likely that different areas will have their own approaches, developed by experience, to handling these issues which may also be governed by relevant national law and custom. However, there may be cases where there is a need to consider first principles. The following comments and principles are offered to assist this process.

Growing Crops

Farmland will not always be sold when it is clear of all crops and so there may be a need to pay a previous occupier for the value of crops left behind (or to allow the previous occupier back to take the crop): a crop that has just started, the growing plants, the crop in progress, the products that are maturing and the products close to being harvested.

Estimating the value of these products consists in establishing their value at an intermediate moment in the production cycle and can be carried out on the basis of market evidence, when there is a free market in which the intermediate product is bought and sold (for example, the sale on the plant of some products - such as table grapes or citrus fruits

- using appropriate sampling methods to estimate the quantity and quality of the product).

In other cases, the estimate takes place through the construction of the cash flow of the crop or product being ripened. Generally speaking, the past (or retrospective) value indicates the sum of the costs incurred from the beginning of the production cycle up to the intermediate moment (the moment of the estimate). Instead, the future (or prospective) value indicates the difference between the expected market value for the expected production and the costs expected from the intermediate moment (the moment of the estimate) to the end of the production cycle.

If the crop is newly established, then its value may be very close to the cost of that work (seeds, other relevant materials and acts of husbandry). This presumption might not apply if the work is poor or there is clear evidence of failure to germinate or of the crop being destroyed by, say, flooding or prejudiced by weeds, pests or disease.

Once it is possible to take a view on the potential of the crop, its value can be based on the anticipated market value with costs yet to be incurred deducted and applying a discount for the remaining risks. There may be market evidence of the sale of standing crops to provide a more direct valuation or assist with the calculations. Such an approach recognises that the crop has a value above the costs invested in it.

Application of Fertilisers, Lime, Soil Conditioners, etc

Unless there are reasons for a different approach, the general principle is that the cost of the operation and material is fully recognised in the first year and then written down over the likely period for which the benefit endures. In some cases, proof of improved soil indices may be needed and where a substantial enhancement can be shown that would suggest a higher value might be due. There may equally be reasons for considering the work inappropriate.

Livestock

In some areas livestock can have a special value to its owner because it has over generations acquired and can transmit a knowledge of its territory in the particular location and greater immunity to local pests allowing it to remain without close supervision on the hill round the year. These qualities can be expensive to create and their value has long been recognised. There may be market evidence of sales of land with and without such hefted animals (or evidence of extra payments by incomers for them) which may allow calculation of the premium they may merit.

Plant and Machinery

Any plant and machinery which can be removed legally can be assessed on its resale value unless the incoming occupier would clearly have reason to pay more. Where it has become legally fixed to the property, it should be valued at the value it has added to that property if a separate valuation is still appropriate – the underlying principle for improvements generally.

For example, farms host plants for energy production from renewable sources (photovoltaic and biogas plants) and their valuation requires specific expertise or working with inter-professional collaboration and operational synergies with relevant experts in the field. In addition, increasingly stringent regulations in terms of sustainability and reduction of soil consumption have led to the need to develop a specific type 'agrivoltaic' of plant. This requires analyses and assessments of a hybrid agronomic and energy nature.

Licences and Approvals
A similar approach should be taken to other sources of value created by political action from water abstraction licences to planning permission and organic certification. If they solely run with the land, the extent to which an incomer has a chance to benefit from the item will be reflected in the price of the land. If the outgoer has some opportunity to retain the benefit or offer it to others, then it may begin to acquire a separate value.
Similar issues may apply to some of the emerging markets in carbon and other environmental transactions though these may also bring liabilities that may burden the land.

7. Perennial Crops

This section considers additional points relating to the valuation of land committed to perennial crops: growing plants whose life cycle covers more than one year. In practice, this is most relevant where they are established for the longer term: vineyards, olive groves, and orchards, than for crops on a shorter rotation such as asparagus. Once planted, established and benefiting from careful nurturing and attendance, they can produce income for many years. The plants have little value apart from the land in which they are rooted but there may be occasions where a separate valuation is required.

Woodland, grown for its timber crop rather than its produce, is normally considered separately.

A common feature is that, being often of higher value, they can be more demanding of infrastructure than annual arable crops. This may include roads, paths, bridges, culverts, drains, reservoirs, pumping stations, water distribution systems as well processing facilities such as presses or packhouses.

The modern nurseries and arboretums can bear very sophisticated and high-performance production facilities compared to the past; species, rootstock, variety, age, planting pattern, fixed and protective structures are important descriptive elements to be noted and analysed in an arboreal plantation. For these types of plants, valuations must take account of the fact that their useful life is much shorter than in the past.

Matters to be Considered When Valuing Perennial Crops
For any particular perennial crop, factors would include the variety, the health and condition of the plants, and the type and state of any infrastructure.
There are often significant costs of establishment and of removal at the end of the crop's useful life. The soil preparation for a new vineyard can be a substantial cost, establishing the conditions for proper drainage and deep rooting and then constructing the trellis

work. Perennial crops can require careful consideration of access, water distribution and other items. They may usually take a period of years before reaching any or full production when convenient access to any necessary processing or storage facilities is important. If these works have been done well, they are likely to be reflected in the sale value of the land as they offer value to a purchaser. However, changes in technology or the marketplace can render expensive works obsolete, for example, the labour imposed by narrow terraces on steep slopes.

The overall area of the crop may be limited by some form of control. In the EU, vineyards in major wine-producing countries are limited by a system of transferable area rights to control production. In other cases, licences may be used to control crop health. It will depend on the particular regime whether the licences are tradable separately from the land.

In some areas, incentives may be available to encourage growers to plant perennial crops and so stay on the land. Where operational, such schemes should be considered with a view to their availability (perhaps to smaller or younger farmers rather than to foreign companies) and whether the crop's viability could be prejudiced by their withdrawal.

It is most important that the farmland can offer an appropriate location for the crop to thrive. Soil type, drainage, aspect and exposure to sun and wind, frost exposure and related factors can all be important, especially if the aim is produce of a premium quality. Local systems of soil classification may be designed with such cropping in mind and can be relevant at a general level. Even within a farm, the judgement of suitable sites will vary by variety. Microclimatic conditions can negate apparently suitable sites while, for example, frost protection measures can add cost. Mobile polytunnels or specific management regimes such as spraying can be required. Aspect can be particularly important whether by offering long hours of light without direct exposure, avoiding wind or encouraging air circulation, or avoiding frosts. As a long term commitment, consideration of detailed forecasts for climate change or the competing demands for water may be appropriate.

The valuer should judge the likely useful productive life of the crop under available management. The valuer will usually be considering an established crop where the results of decisions already taken (and subsequent management) may be evident. The valuer should establish the years of planting, present soil conditions and other relevant factors. Information as to the rootstock can be material as it may limit the life of the plant, though giving vigour during that life. If the crop was established by grafting rather than planting, the valuer will need to understand what has been done (such as the nature of existing rootstock) and form a view on its potential.
It would be usual for the crop to be established on a rotational basis, so that production can be maintained over the years. In some circumstances, established crops can offer shelter to newer plantings.

Such crops can often be labour intensive with annual maintenance and harvesting. Mechanisation has eased matters (at cost) but the burdens and management of

processes such as training and tying in new growth, pruning, thinning, weed and disease control, fertilising and harvesting need to be considered. Is useful labour available?

There may be recent agricultural, agronomic or horticultural reports on the site or the crop.

The valuer should be aware of disease risks that could threaten the crop.

The valuer will also need to understand how the crop is marketed. Is it just a commodity? Can value be added? Does the farm make wine or press olives or does it have an arrangement such as a co-operative or with another producer for this? Is there a cold store and packing house for the fruit? Or any further initial processing (crushing or juicing)? If facilities are on the farm, do they meet modern standards? Is the equipment good? Is the layout right? Does it need further investment? If these facilities are run as a separate business, does the subject business have any transferable rights in it?

If the market is a commodity market, a long term crop will be vulnerable to changes in the market place and technology. Changes in taste or trade policy can affect values.

The valuer should ascertain:

- current and anticipated local and world prices for the crop in the form in which it is most sensibly marketed.
- How have such prices moved in recent years? What has influenced them?
- is there excess production or growing demand?
- is it an easy crop for newcomers to establish?
- what are the prospects for new technology and automation?

and consider how they might move in the future.

Significant price changes can flow from such factors as weather conditions, disease, currency movements or other factors beyond the grower's control. Forming a view on these points will enable the valuer to establish the likely income from the crop, assuming stable conditions, and capitalise it. The risk factors limit the time span for which this is a useful approach.

If the crop is produced organically and marketed as such, this may be relevant if this offers greater profit or more security in the marketplace. Production costs and demands on management may be higher and yields lower and more precarious, but sale prices may be better. In some crops (such as grapes for wine), quality can anyway be related to lower yields. Does the land have an organic history? Could it revert to conventional farming if the organic operation fails?

If the enterprise is no longer commercially viable but the land subject to it would require substantial clearance works, the land may stand at a discount to other agricultural land. The potential re-use of specialist buildings or other fixed equipment will depend on the application of development control policies and the marketplace for those uses - if re-

use is prohibited or not viable, they may be a liability. There may, occasionally, be an economic re-use for the plantation stock.

Approaches to the Valuation of Perennial Crops

Valuation may be by comparison with other sales where this information is available. Otherwise, the net income can be capitalised using Discounted Cash Flow methodology to reflect the risk involved with consideration of the residual value of the land after the crop is exhausted, subject to clearance costs.

8. Forestry

Some European countries have substantial forestry sectors with long traditions of forestry management while others have very limited involvement in commercial forestry. Woodland can also be a residual land use, as where farmland has been abandoned, or be maintained for amenity or environmental or, now, carbon sequestration reasons.

The market for land for new commercial planting will tend to compete more with poorer or more marginal farming uses than the best agricultural land but the balance between farmland and forestry will move with economics. In general, commercial forestry operations are more economic on larger areas.

The ownership and occupation of forestry land may be limited in some countries and is more often subject to specific legislation, distinct from that for agriculture and with its rights and obligations. Without specific legislation, forestry leases would usually be under general commercial law.

In many countries, once woodland has been established it can be hard (as well as expensive) to convert it to other uses, more typically requiring replanting after felling. There may be national regimes regulating the felling and extraction of timber.

The economic logic of commercial forestry lies in timber production, establishing, managing and harvesting the chosen species to obtain maximum value over the long rotation of a timber crop. Wood is a raw material for many uses from paper to construction with some biomass use in energy generation. After a long period of economic stagnation, the value of timber has increased in recent years, now prospectively a raw material for a future low carbon economy.

Trees can absorb and defer carbon emissions, carbon forming half their mass, but, if grown for felling, this is not ultimately a means of sequestration save for the fraction of the tree that might be used in long term construction. In most markets, the value of that deferred carbon would be relatively low in comparison to the prospect of the timber yield.

With their long life cycles and fixed locations, trees are vulnerable to climate change, not only to fire and storm but also more insidiously and importantly to drought stress, weakening them in the face of diseases and pests.

The value of commercial forestry might typically be assessed on an income basis using the DCF method and applying a suitable cost of capital *(see Valuation Methodology in this Guidance Note)*.

As well as the quality of the trees and how they have been managed, an area of forest may then have more or less value according to its accessibility and ease of working. Factors in this might include the steepness of the land, access to public roads and the layout and condition of internal tracks.

There may usually then be an element of value for the bare or "prairie" land under the growing trees which may need to be apportioned and reported separately for some accounting and taxation purposes as well as, in some countries, compulsory purchase.

Where woodland is kept for other reasons than the prospect of felling it, it might then more often be valued by comparison with sales of similar land. In some markets, there is a particular value for small blocks bought for private pleasure. Other areas may find larger scale buyers for environmental reasons.

Partly because of its long life cycle as a crop, with initial cost and long deferred income, and partly for national political or environmental reasons, countries often have specific taxation regimes for forestry which will be relevant to markets.

Valuation of agroforestry holdings for the financial sector
Under the revised EU Capital Requirements Regulation (CRR) valuations must be done on the basis of prudent criteria which can ensure the sustainability of the value over time.

When conducting a valuation of an agroforestry holding for the financial sector, it seems obvious that, in the case of many crops, especially permanent crops, to consider perpetual growing cycles would not be prudent, as there is always an inherent risk that those crops may cease to be in demand. In these cases, it makes sense to consider the value of the bare land, obtained by market comparison, at the end of the crop's life spam.

Here too, the valuer should also take a careful critical look at the use in income analyses of national and EU subsidies, as well as other complementary sources of income, such as hunting and fishing, endeavouring to conduct the analysis from the perspective of sustainability of that income over time.

9. Climate Change

Overview

Agriculture and land management contribute to climate change and are particularly affected by it as:

- agriculture, managing organic processes, is itself a significant (and almost inevitable) producer of greenhouse gases and so policies to mitigate climate change typically require changes in farming practices and rural land use.

- changes in climate drive changes in the local patterns of farming and their potential, partly through changes in water supply and soil erosion
- farming generally faces a greater exposure to a wider range of more extreme conditions, not simply a new warmer equilibrium
- global markets for inputs and produce are affected and have political reactions

Where agricultural property values are largely a function of production potential, they may be affected by changes in that potential and also by any recognition of greater production risks. In those and other areas, new markets based on environmental, forestry, energy or other land uses may provide new sources of value.

Gauging the sustainability of agricultural systems and considering alternatives

In this context, valuers should consider the sustainability of the agricultural systems relevant to the property. Key areas to be considered are cropping and stocking, water, soil, forestry woodland and trees and use of land for renewable energy.

Cropping and Stocking – Long-established crops and varieties may become less suitable (or even practical) as the climate changes.

Water – In regions facing drought, a public or private irrigation scheme could encounter severe water usage restrictions, significantly impacting crop cultivation and subsequently affecting land value.

An indirect approach methodology requires a comprehensive consideration of production income, factoring in existing restrictions. The valuation process should integrate the associated risks of water shortages in the coming years into the considered cost of capital. Addressing these climate-related challenges is crucial for a more accurate and forward-looking assessment of land value.

Vegetable production often needs additional water supplied by irrigation without which some sandy lands might have little commercial use. That water will typically need:

- a source from which it can be taken, in some countries requiring a licence
- a means of storing it such as a reservoir, with more extended hot, dry periods often needing more than one year's capacity
- a means of distributing it efficiently to crops.

It will be increasingly important to have the means and technology for this to be done so that the greatest amount of the water available is used effectively and not lost by evaporation or in other ways.

In regions experiencing a significant decrease in rainfall without access to borehole solutions, there may be a transition in agricultural practices—from irrigated areas to non-irrigated ones—resulting in a subsequent shift in property value.

The greater vulnerability to flood risk for low lying land, whether tributaries converge and with rising sea levels may make some land unsuitable for cropping and require protective measures for buildings and livestock. Reduced river flows and aquifers can make useful water saline.

Ensuring the viability of agricultural systems, whether dependent on average rainfall or irrigation schemes, requires a strategic commitment to increased investments in water reservoirs or boreholes. Valuers should assess whether these investments are needed and integrate their cost thoroughly into their analyses.

Soil - Retention of topsoil from water erosion (especially from heavy rain and flooding) or, for light soils, windblow is important both for the farm with its production and the effect on water quality and biodiversity elsewhere of sediment and nutrient run-off. Sloping land with bare soil poses particular risks with reports of significant losses of soil in some areas.

The reduction in rainfall in some regions can increase the risk of soil contamination, especially considering nitrates and some heavy metals, regarding the reduction of the washing effect.

Forestry, Woodland and Trees - Forestry is a major land use and commercial activity in parts of Europe with the prospects for timber as a key material for the low carbon economy. Elsewhere, trees may be planted for environmental and amenity reasons as well by natural regeneration on abandoned land. They may also be planted for land management reasons as to consolidate sloping land or on old mineral workings or with a view to attenuating flooding or protection of farmland from wind or salt spray.

One key issue in considering any particular site is to understand why trees are being grown or considered as a use. Trees cannot move in the way that other crops can be changed. Once established, they have to live with whatever happens around them. Choices already or now being made about planting are choices made for decades, balancing climate change, genetic diversity and new tree diseases while design may consider wildfire and storm risk.

Where trees are used to offset carbon emissions continuing elsewhere, care should be taken in understanding the agreement and the liabilities associated with it.

Use of Land for Renewable Energy –This offers a new use for farming and rural land, whether producing power for use on the farm or for sale to others. While some properties may be suitable for small scale hydro-electric generation, the main options are:

- wind turbines
- solar panels
- anaerobic digesters to convert farm waste, produce or bought in feedstock to gas or electricity
- growing biomass to power a boiler for heat or power
- growing crops for biofuel.

Such projects can be developed by the farm business or a third party, then typically as a separate operation on a lease. Where a farming operation is energy intensive, as with controlled environment farming or glasshouses, it may often be sensible to provide an on-farm source of renewable power and heat. While a farm might profitably generate its own power to replace bought-in energy, any surpluses either need battery storage or the ability to sell power to others. The export of electricity from the farm requires a convenient connection to wider electricity transmission systems. The difficulties often found in that can make location important, possibly a driver of particular value.

10. Technology, Data and Agricultural Property

Agriculture is seeing a progressive technological revolution with advances in data, genetics, robotics, automation and growing technologies.

As much of this concerns farming practice, it may come to influence who may want to buy or rent agricultural property for what purposes but perhaps has less direct bearing on the asset itself. However, some aspects can be identified as more relevant, including these sometimes overlapping areas:

- the high levels of investment in some forms of protected agriculture
- where automation becomes part of the fixed equipment of the farm
- the relevance of data of purchase or lease of land.

Protected Agriculture – Some forms of farm production have long been indoors, as with many pig and poultry units and some other livestock operations as well mushroom sheds, polytunnels and glasshouses for growing fruit as well as aspects of dairying. This has enabled more precise and effective management, protection from the weather and, in some cases, achievement of high health status. As the buildings might often have little other use, the value of the operation might typically lie in the combination of the quality of the facilities and access to a beneficial sales contract.

The advent of “controlled environment farming” (sometimes called “vertical farming” because it can use several levels like shelves within a building) and modern developments with large glasshouses take this further with highly automated controls, making the building akin to a machine. These may have a high capital cost and require dedicated electricity and water supplies, perhaps using adjacent land.

If using a very limited area of land, the value of the property may lie in the operation itself and how its produce is best marketed. It is more likely to be part of a larger company that would be valued as a business. There may, though, be situations where such a building is part of and has synergies with a larger, more conventional farming operation with consequences for property value.

Automated Infrastructure – From robotic milking parlours to automated ventilation, some farms are seeing automated systems integrated into their fixed equipment and affecting its design and so how it might be viewed by a future purchaser or tenant. Where irrigation matters, efficient integrated systems to control water distribution could have

value. Vegetable and fruit storage may have more value if the system has automated control of the atmosphere rather than being ambient.

Vegetable and fruit farms will often also have facilities for packing and perhaps some early stages of processing, increasingly aided by technology, such as optical sorting lines, in place of labour. Such systems are again a potential source of value.

Data – It is now hard to farm without leaving a paper trial of information, whether from interactions with government, its support systems and regulatory controls or with suppliers and purchasers. The data in that is often of value not only to the current owner or occupier but to any purchaser or subsequent tenant. A new tenant or owner may need information about fields and past cropping and also about such matters as fertiliser applications and soil tests.

The development of precision farming reliant on GPS systems adds enormously to the available data that may be of continuing benefit with yield mapping, soil structure surveys and other exact locational data to inform decision making and efficient operations, bringing value. Aside from farming operations, access to field data and other information may be critical for a new occupier to claim area-based payments in some countries.

While a seller and a purchaser of a farm would usually cooperate over data in their voluntary transaction, there might be no such natural relationship between successive occupiers meaning that the timely transfer of relevant data might be provided for in the tenancy or other agreement if value is to be maximised.

Some of this data may also assist the valuer in understanding the farm and how it might be viewed by the market.

ANNEX

EVS AGRICULTURAL VALUATION REPORT

This template offers a checklist of what might ordinarily be expected in a valuation report to a client on agricultural property. It is always to be adapted to the circumstances and purpose of the valuation with the goal of providing a thorough and explained valuation that can support decision making now and be referred to at a later date.

The valuation report must therefore be complete and understandable, so as to provide sufficient information for those who read it to rely on it, to fully understand the data, reasoning, analysis and conclusions. Consequently, the valuation report must aim to: communicate the estimated value to the reader, confirm the purposes of the valuation; explain the valuation procedures and methods, specify the checks carried out by the expert, indicate any assumptions underlying the valuation and the limiting conditions.

Essential elements of a valuation report

A. BASIS OF THE INSTRUCTION

A.1: The property to be valued

1. **The property – name (if any)**
2. **Address of the property**
3. **Valuer's identification of the property with boundaries on a map**
4. **Land register reference**

A.2: The client

5. **Identification of the instructing client (the client's name, details)**
6. **How the client instructed the valuer and any modification since the date of instruction**
7. **Third party reliance – where it has been agreed that certain identified third parties will be able to rely on the report, those third parties must be identified**

8. **Confidentiality clause including any limitations on the report – the valuer must state any limitations on the use of the report as regards publication**

A.3: The valuer

---

9. **Identification of the valuer. When a company has been instructed, the individual valuer responsible for the report must be identified**
10. **The qualifications of the valuer**
11. **The status of the independent valuer (whether external or internal)**
12. **Confirmation that the valuer has the experience and market knowledge necessary to value the subject property**
13. **Confirmation that there are no potential conflicts of interest. Where potential conflicts exist, the report must state that these were brought to the client's attention and detail the measures taken to ensure the valuer's objectivity was not affected**
14. **Use of specialist valuers or advisers – where the signing valuer has used the services of third party specialists, they must be identified**

A.4: The scope of the work

---

15. **The purpose of the valuation**
16. **The basis of value instructed including full relevant definition (e.g. Market Value with its definition) and the reference to the appropriate valuation standard, law or regulation that defines the basis of the valuation**
17. **The legal interest of the property that is being valued (freehold, leasehold, etc.)**
18. **Limitations and assumptions: In some cases it is possible to disregard normal practice when the client imposes, in compliance with the law, certain exceptions; just as it is possible that the valuer, in order to carry out the task, may need to refer to situations which, although not proven, must be accepted in order to understand the valuation. Any assumptions or limiting conditions must be clearly stated in the valuation report.**
19. **Any special assumptions – state if any special assumptions are to be made**
20. **The investigations carried out**
21. **The dates of the inspection the completion of the valuation report and to which the valuation applies**

A.5: The available information

---

22. **Information received and examined with a list of documents and other information originating from third parties (e.g. land quality, uses, production yields, relevant information about status and history of the property for support schemes, energy performance certificates, building permits, land registry information, current occupancy, leases, etc.), including origin of data and supporting evidence (attached as annexes)**
23. **The valuer must state any important assumptions made as regards documents or information that were not available or about information that could not be verified.**
24. **If a special assumption is being made, the valuer must state that he/she has taken it into account**
25. **Reliance on information obtained from the client and from third parties must be recorded**

A.6: The inspection

26. **Date of the inspection**
27. **Confirmation that the inspection was made by the valuer or by a suitably qualified person under the valuer's responsibility**
28. **The name and qualifications of the person who physically inspected the property, the person's qualifications and the extent of the inspections carried out must be stated. If the inspection has been less complete than usually required for this type of valuation, this must be stated.**
29. **Responsibility for the inspection: the valuer signing the report (identified earlier under A.3.9)**
30. **Measurement basis used (e.g. gross area, net farmable area, area eligible for support schemes, etc.)**
31. **Source of measurement data**

B. DESCRIPTION OF THE PROPERTY

B.1: The location

32. **Description of the area in which the property is situated with factors relevant to potential buyers or tenants**
33. **Identification and judgment of the relevant market for the property**

B.2: The property

34. **Property review (with photographs); description of the land:**
    - general area, configuration, topography, geology, soil (character, quality, condition, depth, pH, erosion, etc.), rainfall, drainage
    - character (including description of fields with sizes, layout and boundaries, permanent pasture, arable, orchard, vineyard, woodland, etc. with field identification, areas, current cropping, etc.; fencing, water supply, drainage, vehicular access)
    - description of fixed equipment such as buildings and structures, reservoirs, irrigation (nature, dimensions and construction, age and usefulness);
    - description of dwellings (construction, scale and layout, EPC, any property tax liabilities, state of repair, attractiveness and character, etc. with photographs as annexes)
    - plant, machinery, livestock, deadstock or contracts passing with the property
    - services/utilities with the parts of the property benefiting from them
    - relevant local processing, storage or marketing facilities
    - relevant observations on the production economics of the property
    - amenity and sporting uses
    - minerals
    - known flood risk, pollution, disease, crop health or other issues or caveats and assumptions made as to these
    - outgoings to which the property is liable
35. **Judgment of the physical characteristics as to quality**
36. **Identification and judgment of current relevant market conditions**

B.3: The legal situation

37. **Tenure – including comment on any covenants, third party rights over the property and rights over third party property, public access, restrictions or obligations that could have an effect on value with the identity of the owner and any occupiers**
38. **Tenancies – information on the main lease terms, the amounts of current rents and any provisions for them to vary during the remaining life of the lease**
39. **Permissions benefiting the property, such as water abstraction licences**
40. **Is the property within or subject to any relevant conservation, environmental protection or similar designations, such as Natura 2000,**

National Parks, Areas of Outstanding Natural Beauty, etc.

41. **Town and country planning and development control – information about current policies and the relevant development plan(s), allowed uses and development potential, and ancient monuments, exposure to compulsory purchase, etc.**
42. **Environmental or other agreements running with the property**

C. VALUATION

C.1: The methodology

43. **Methodology – description of valuation approaches that were considered; which approaches and which methods have been used**
44. **Key assumptions – as regards capital values, rental values and yields adopted. It is recommended that the choice of these key inputs be explained with reference to the comparables listed**
45. **Additional assumptions, special assumptions and caveats – if the instruction requires particular additional assumptions or special assumptions and the valuer considers it appropriate to make caveats, details of these must be stated**

C.2: The research criteria for relevant market data

46. **Comparables, provided to the extent that confidentiality and data protection law permit**
47. **Complementary relevant evidence; the source of the market data must be provided to the extent that confidentiality and data protection law permit.**
48. **Justification of the criteria chosen for selection of comparables (market area, size, type, etc)**
49. **Valuation uncertainty – in those cases where there is a high level of uncertainty about the level of values, the lack of comparables, rents or yields, the valuer must comment on it here**
50. **List of comparables chosen (redacted as appropriate for confidentiality and privacy)**
51. **Justification and judgement of each selection**

52. **Description of each comparable (photos may be included as annexes, chosen as appropriate in terms of confidentiality and privacy)**
53. **Adjustment to the property. The valuer must provide appropriate comment reflecting the logic and reasoning for the adjustments made to the comparables provided**
54. **Adequately supported opinion of market value**

D. CONCLUSION

55. **The reported value must be clearly and unambiguously stated, together with confirmation that sufficient investigation has been undertaken to justify the opinion of value reported**
56. **Confirmation of value**
57. **Indication of limitations and assumptions**
58. **Date of valuation**
59. **A clear statement as to whether transaction costs such as VAT, fees, etc. are or are not included in the reported value**
60. **The valuation report must be signed by the valuer (identified earlier under A.3.9.)**

EVGN 5 Fair Value for Financial Reporting

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

1. Introduction

1.1. European Union legislation has since 1978 prescribed a developing set of accounting rules to assist the consistency and comparability of financial reporting. Most of the International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) have been adopted in European law by European Commission Regulations, in particular Regulation 1255/2012 which adopted IFRS 13 Fair Value Reporting. Since 2005, consolidated accounts of listed companies domiciled in EU member states have had to be prepared in conformity with IFRS financial reporting standards.

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

1.3. Fair Value is one of the two allowed accounting bases for real estate assets (the other is cost accounting). It was originally defined in IAS 40, but questions of its measurement were dealt with in a number of the IFRS standards. A new standard, IFRS 13 *"Fair Value Measurement"*, was introduced in May 2011. IFRS 13 introduces a number of new criteria for Fair Value measurement and reporting that are important to real estate valuers and will have an impact on the way they prepare their valuations and their valuation reports.

2. Scope

This Guidance Note applies to the valuation of properties for the purpose of financial reporting under IFRS (for example, annual valuations for listed property companies). It has no application for the determination of fair value in the sense of the price to be set for a transaction between two known parties, nor for the assessment of Market Value.

3. IFRS 13 Fair Value Measurement

3.1. **Definition of fair value** — IFRS defines fair value as:

"The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

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

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

to be valued individually or as part of a group of assets will depend on the rules for identifying the *"unit of account"* in the appropriate IAS.

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

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

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

4. IFRS 13 Definition of Highest and Best Use

4.1. IFRS 13 paragraph 27 states that *"A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use"*.

4.2. In relation to the interpretation of highest and best use IFRS 13 also provides the following:

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

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

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

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

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

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

5. Fair value hierarchy

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

5.2. It is important to note that the concept of Fair Value hierarchy in IFRS applies to the inputs used or adopted in valuations, not to valuation methods. The inputs are categorised in one of levels 1, 2 or 3, as follows:

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

5.3. **Adjustment to inputs** — The standard states that an adjustment to a significant Level 2 input might result in categorisation of that input as Level 3 if the adjustment uses significant unobservable inputs. This concept is

particularly relevant to the valuation of real property assets, as will be seen below. Valuers should therefore pay particular attention to the concept of adjustments to observable inputs in deciding on the hierarchy level to be ascribed to an input.

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

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

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

5.7. IFRS 13 is clearly aimed more at the valuation of complex financial instruments than real property. This creates difficulties for property valuers in applying the standard to their daily work. In particular, the concepts of *"observable"* and *"unobservable"* inputs lack clarity Market novices will "observe" less than experienced valuers.

5.8. Under IFRS 13, Level 1 inputs are unadjusted quoted prices in active markets for items identical to the asset being measured. Real estate assets are rarely identical to each other not least because no two assets ever occupy exactly the same physical space, which means that even two very similar houses may have different views or orientations. Similarly, an office suite on the top floor of a building will often have more natural light and a better view than a similar-sized suite on a lower floor. As regards *"quoted prices"*, in most property

markets prices achieved on sales or lettings of properties are often not quoted and are thus rarely available to the general public. Also, quoted rents and prices may mask actual transaction details such as onerous lease terms, deferred payments, stepped rents, etc.). For all these reasons, it is therefore considered most unlikely that Level 1 measurements will arise in property valuation. The valuer's choice will therefore most likely be between Levels 2 and 3.

5.9. In virtually all cases the valuer will therefore be deciding whether an input used is to be classified as Level 2 or Level 3. It should be noted that the reporting entity only has to give the hierarchy of inputs that are considered to be *"significant"* to the measurement of value. For an input to be Level 2, sufficient good evidence of the required input must be available from identical or near-identical properties. In particular, this evidence must be sufficiently recent for it to be applied directly without any significant adjustment for the passage of time between the dates of those transactions and the valuation date of the subject property. Even if the evidence comes from very recent transactions, the valuer will still have to be satisfied that the supply and demand situation remains unchanged between the date of the evidence and the valuation date of the subject property. Examples of cases where Level 2 might nevertheless be possible include:

- Sale prices of identical or very similar residential units
- Rents of identical or very similar light industrial units on the same estate
- Rents for suites let on similar floors of the same office building

5.10. Adjustments to inputs occur in the choice of estimated rental values (ERVs) and yields for the great majority of valuations of investment properties, which are amongst those that are the most concerned by IFRS 13. IFRS 13 states that if an adjustment to a Level 2 input is *"significant"*, the input should be considered as thereafter falling in Level 3. The word *"significant"* is not defined in the standard. Valuers will therefore have to judge for themselves what is significant. It is not possible to indicate a range of percentage adjustment that might be considered significant.

5.11. The appreciation of what is significant will vary according to the type of property and the quality and transparency of the market information available. Valuers generally have an idea of the degree of accuracy of the information they have at their disposal, and hence of the degree of accuracy of any value they produce. It is suggested that valuers could measure the significance or otherwise of any adjustment against the level of accuracy that they believe is implied in their value.

5.12. Because of the inherently unique nature of property assets and the limitations on evidence discussed above, valuers are very often required to adjust significant inputs. Therefore in many cases Level 3 is the most likely

conclusion for the main inputs used in the valuation of investment property (particularly ERVs and yields).

6. The role of the valuer in determining fair value hierarchy

6.1. Valuers must discuss reporting requirements in detail with their clients at the earliest opportunity in order to ensure that they provide the required level of service. This will also help the valuer to draft correct terms of engagement and to take account of reporting requirements in determining the appropriate level of remuneration for the instruction.

6.2. The valuer is the closest to the *"measurement"* (i.e. the valuation) and is therefore probably best able to categorise the various inputs. Valuers undertaking fair value valuations for the consolidated accounts of EU listed companies can therefore be expected to be asked to comment on the hierarchy of the main inputs in their valuations. Two possibilities are:

- Where similar valuation methods have been used for a whole portfolio, comments at a general portfolio level, highlighting the exceptions, if any, or
- Comments on a property-by-property basis

6.3. It is the responsibility of the reporting entity to report on the level that will be applied to the value measurement (i.e. the valuation) as a whole. The final Level 2/Level 3 decision should therefore be taken by the reporting entity. The valuer's role is to give sufficient detail about the various inputs for the client to be able to make the final decision on the level to be ascribed to the fair value measurement of each asset. In order to do this, the valuer must state which inputs are significant.

7. Valuation methods

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

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

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

7.4. Valuers therefore use a wide variety of inputs, depending on the valuation method they adopt. Most of these inputs will be based on evidence obtained from the market, whether it be evidence of price, yield, cost, void periods, etc. The quality and reliability of this evidence will vary according to the type of property and also from country to country, city to city and even sub-market to sub-market within a town or city. In addition, in most markets the quantity of such evidence is comparatively limited, as the number of properties that are let or sold each year often represents only a modest percentage of the total stock of such properties. There will nevertheless be exceptions, such as sales of new properties on a sizeable estate of very similar ones.

7.5. The quantity, quality and reliability of the evidence will also vary according to where the valuation date falls in the market cycle. For example, a downward phase of the cycle often starts with a period of much reduced market activity in which few transactions take place and thus little evidence is available to the valuer. In addition, at some stages in the market cycle participants may be more or less inclined to share information about prices or rents achieved and this, too, can affect the quantity, quality and reliability of the evidence available.

EVGN 6 Cost Assessment for Insurance Purposes

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

1. Introduction

1.1. This is guidance on assessing the insurable value and the cost of damage to, or losses on, real properties.

1.2. The valuer must assess the cost of repairing damaged or destroyed buildings or properties as a basis for determining the amount the insured shall be compensated in case of damage or destruction.

1.3. A prospective lender may require an assessment of insurable value as part of a report on the suitability of the property as security for a loan, so that the lender can require that the pledged security be adequately insured.

1.4. On many occasions the valuer must also assess the Rental Value of comparable premises for temporary use by the insured. Notwithstanding any limitations to compensation, the compensation will, under given circumstances, also be assessed on the basis of Market Value. This will occasionally occur when rebuilding is not permitted by law or for other reasons beyond the control of either party.

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

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

2. Scope

This Guidance Note considers the assessment:

- Of the insurable value of buildings for the purposes of the contractual obligations of an insurer should they be damaged or destroyed. It does not consider the other insurances that may be needed against other risks arising from that damage or destruction or the associated disruption of business or those other insurances commonly handled by those managing property
- Of damages to insured buildings

3. Definitions

3.1. The **insurable value** of a property *(see EVS 2)*.

3.2. **Damage** means physical damage and/or, loss of property, including conversion, trespass, nuisance or wrongful interference with the enjoyment of rights over property.

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

3.3.1. Reinstatement means the rebuilding or repair of the property to a condition equal to, but not better or more extensive than, its condition as defined in the insurance contract.

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

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

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

3.7. Full rebuilding value — Full replacement cost — Guaranteed replacement cost — Full coverage

3.7.1. **Full rebuilding value** corresponds to the reconstruction value. The insurable value is based on and set by the insurer or the valuer and should be stipulated in the insurance policy. Any extension or alteration affecting the value of the building must be notified to the insurer so as to to be covered by the insurance. If the insurer is not notified, indemnity will be provided only for the notified part. The same applies to new buildings which have not been notified to the insurer.

3.7.2. **Full replacement cost** is the payable amount limited to the insured value as stated in the insurance policy. If the insured property is destroyed, the insurance company is obliged to fully replace or rebuild the property without any deduction for depreciation.

3.7.3. **Guaranteed replacement cost** is the payable amount limited to the insured value as stated in the insurance policy, but if the damage exceeds the limits on the policy, the insurance company is obliged to fully replace or rebuild it without any deduction for depreciation. In practice, insurers limit the amount that they pay out to replace or rebuild the property to usually no more than 20% above the amount for which the property is insured. If the property appreciates beyond the level of coverage, the policy will not cover that amount.

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

Note — The terms above appear to have differing definitions in different countries. In this document the above definitions are used as typical examples. If the insurance policy does not include settlement over and above the insured value, it is imperative that the insured value be re-considered on a regular basis, so as to avoid the risk of under-insurance.

3.8. **First loss insurance** is a type of insurance of property which covers damage within the stated sum insured.

3.9. **Fixed sum** — The sum insured is stipulated in the insurance policy. A predetermined sum not corresponding to the full rebuilding cost is underinsured.

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

3.11. **Reconstruction value** is understood as the cost of reconstructing a corresponding or essentially corresponding building at the place and date of the damage.

4. The assessment

4.1. The conventional purpose of insurance cover is to make good the loss caused by damage. An assessment of the insurable value or the cost of reinstatement must be based on the full cost of replacement, rather than Market Value or

any other basis, unless the valuer or the insurance contract specifically states otherwise. In such a case the damage report should make clear that the value given is not an assessment of the cost of reinstatement and the actual basis shall be stated.

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

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

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

4.5. Costs associated with improving the energy performance of a qualifying building require consideration. Energy Performance of Buildings Directive 2010/31/EU requires improved energy performance in the event of *"major renovation"* *(see EVIP 1)*. Valuers must include such calculations in their damage reports.

4.6. Fees for architects, surveyors, engineers and other relevant service-providers all need to be taken into account in assessing the insurable value. Fees and costs associated with planning permission and building renovation approval must also be considered. This implies that valuers must also take these factors into account when calculating the value of the claim in their damage reports.

4.7. Building areas are of utmost importance in calculating insurable values and assessing the loss caused by damage. The valuer must ensure that the basis of measurement used is consistent with local practice and with the basis adopted by authors of any recognised cost guides.

4.8. Insurance contracts have differing clauses regarding acceptance and limitations. The valuer must therefore be conversant with the property's insurance contract. The report must take these factors into account in order to provide a proper basis for the insurance settlement.

5. Reporting

The valuer must provide an adequate description of the following:

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

Damage assessment is not included in this EVGN.

MER

Minimum Educational Requirements

1. Introduction

1.1. TEGOVA seeks to ensure high standards of professional competence in valuation. In support of this, TEGOVA requires each Member Association to set educational standards for its members that are at least as demanding as these Minimum Educational Requirements (MER). MER were first introduced by TEGOVA in 2003 as a basic requirement for every valuer elected to practice by a Member Association.

1.2. 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 MER syllabus, though national variations will take account of differing legislation, tax regimes and client requirements.

1.3. TEGOVA provides additional and separate requirements in respect of its Recognised European Valuer (REV) and TEGOVA Residential Valuer (TRV) programmes.

1.4. The subject areas within the MER are grouped into two levels of knowledge expected of the valuer:

(a) General Knowledge

(b) In-depth Knowledge

2. Outline Syllabus

2.1. Valuers should have general knowledge of:

- Principles of Economic Theory
- Business and Finance
- Buildings and Construction
- Statistics

2.2. Valuers should have in-depth knowledge of:

- Law Relevant to Property*
- Applied Real Estate Economics
- Professional Practice
- Valuation
- Sustainability in Real Estate
- Government Policies and Land Use*
- Valuation under Statute*
- European Valuation Standards

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

3. Detailed Syllabus

Section A

General Knowledge

3.1. Principles of Economic Theory

Relevant macro and micro economic concepts and the impact of general economic factors on the real estate market and related subject areas including business management, development and investment, estate agency and professional practice

a) The principal economic factors determining real estate supply and demand
b) The competitive structure and operation of the real estate market and relevant financial markets and understanding of the impact of government economic policies, including fiscal and monetary instruments

3.2. Business and Finance

Business and management structures together with financial accounting principles and analysis of accounts

a) The different ownership and management structures used by businesses in the real estate sector the role and type of estate agency
b) Simple balance sheets and profit and loss accounts
c) Accounting ratios and measures of performance

3.3. Buildings and Construction

a. The key elements in design and construction for the purpose of valuation
b. Assessment of insurable value
c. The functional and legal requirements of building construction
d. The building process from site preparation to building completion
e. How visible building defects impact property value

f. Inspection and preparation of reports for survey and valuation purposes
g. Health and safety regulations and the situations in which they apply

3.4. **Statistics**

a. Statistical concepts and techniques
b. IT skills and computer models for the analysis of data including awareness of common errors

Section B

In-depth Knowledge

3.5. **Property Law**

Legal topics essential to valuation with an explanation of the legal system in the country of study and covering the fundamentals of contract law, criminal and civil liability, law, where relevant the Civil Code, title, land tenure and interests in land including the rights of others over land

a. Principles of the legal system in the country of study practice
b. Reading of legal documents and understanding of their content
c. The valuation-relevant nature of contract, criminal law and, where relevant, the Civil Code as well as the duties and relationships created between parties
d. Land tenure and the way in which it and issues incidents of title can affect the valuation of real property
e. Contracts for the sale and tenancy of property, legal documents, land registration certificates and other documents of title and how title can affect the valuation of real property
f. The various mechanisms available for dispute resolution

3.6. Applied Real Estate Economics

Building on the study of Principles of Economic Theory, study of this subject aims to demonstrate in practical terms how economic forces influence capital and rental values.

a. The application of economics in the property investment market with the principles of portfolio theory, using asset combination to minimise investment risk
b. How economics determine property rental and capital values
c. The relationship between real property markets and other investment markets and the principles that affect the pricing of investments
d. The economic factors affecting the use of real estate by its occupiers
e. Practical appraisal of relevant data to support valuations

3.7. Professional Practice

Study of the practices, objectivity and critical thinking needed to deliver the valuer's services in an ethical, efficient and professional manner, from discussion of instructions to the rendering of the final fee account, as well as providing an appreciation of the liability for and limitations of professional advice in any particular instance

a. The ethical responsibilities of professional status, codes of conduct, conflicts of interest, and complaints handling
b. The procedures required for the conduct of various types of professional work and the management of a professional practice with an awareness of liability for negligence and professional indemnity insurance
c. Preparation of professional reports, fulfilling the requirement for accuracy and attention to detail
d. Company and partnership law, employment law and health and safety at work for the management of a professional practice
e. Differentiation between illegality, mistake and negligence.

3.8. Valuation

Basic principles for valuations, essential theory, framework and application of valuation methods and the development of that knowledge in relation to the area of the valuer's practice

a. Collation of all necessary information and setting out of detailed calculations to establish value, analysis of transactions and carrying out of valuations of interests in property either with vacant possession or subject to leases, with or without rent reviews and in respect of any associated compensation or dilapidations
b. The suitability of the main valuation methods for capital, rental, taxation and other statutory or instructed purposes and setting out of a framework in which to calculate valuations based on comparability, cost of replacement, profitability, development potential and investment

3.9. Valuation under Statute

Knowledge of the statutory occasions for undertaking a valuation in the relevant country. In particular, this will require knowledge of the valuation provisions for property of national and local taxation law, with its assessment, collection, exemptions and reliefs and its effects on the occupation and ownership of property, compulsory purchase and compensation law.

In the circumstances of the valuer’s country or field of practice:

a. Description of the assessment of, and liability to, local and national taxation
b. Preparation of advice concerning a client’s liability to any form of taxation arising from a property transaction, or ownership or occupation of property, including indication of those matters on which the client should take further specialist advice

c. Recognition and detailing of instances where tax is either not payable or capable of being abated
d. Demonstration of how tax issues can affect the bids offered and price achieved for a property
e. The framework of law and procedure for the compulsory purchase of property and rights in property under statutory powers and the undertaking the necessary valuations relating to compensation
f. Statutory valuations of interests in land

3.10. European Valuation Standards

The role of EVS and practice statements covering the core concepts established by those standards as to valuation bases, process, reporting and energy efficiency valuation for the preparation in accordance with those standards and practice statements of valuations of real estate in general and those for secured lending and accounting purposes in particular.

3.11. Sustainability in Real Estate

The national and European legislation governing energy, environmental and resource protection issues as they affect real estate in the context of carbon reduction legislation and sustainable development

a. Impact of energy, environmental and resource protection legislation on real property and valuation
b. Issues relating to land with previous uses, including contamination

3.12. Government Policy and Land Use

Relevant policies of all levels of government regarding the management and development of land, including development control, taxation, energy efficiency and renewable energy policy, conservation regulations and subsidy or grant systems relating to the use and development of real estate

a. The framework of the systems regulating land use and development
b. The relevant subsidy and grant systems that may affect the use, re-use and management of real estate
c. The special planning constraints and appeal procedures relevant to the country and field of practice
d. The relevant code for the licensing of buildings in the locality of the building being valued

EVIP 1 Valuing in Non-transparent Markets

1. Accurately determining the value of a property is crucial for the various parties operating in the real estate market: buyers and sellers, owners and investors, developers and brokers, as well as banks, the state and local authorities, and tax authorities.

2. The practice of property valuation is not universal, but the valuer, regardless of the country in which he or she operates, seeks to access the best market evidence to serve as the basis for the property valuation. In each country, one can find legislation, case law, standards and/or recommendations from professional bodies indicating what comparable market evidence is considered the best.

3. Ideally, market analysis for property valuation is based on transaction prices and characteristics of sold properties from sales contracts or other documents. This is possible for some European countries where property prices are officially recorded.

4. The transaction price of a property is the reliable and actual (real) price of the property sold, derived from the most reliable source, the notarial deed. Property transaction prices are also referred to as transfer prices.

5. The transaction price results from the equation of property supply and demand. **Supply** is usually estimated on the basis of the number of available sales offers. Data on the supply of real estate is not collected by public institutions, which usually only record the existing stock of real estate. The supply of real estate is reported by commercial agencies that constantly monitor the market (reports usually concern prime properties in key locations). Data on supply can be obtained from numerous real estate agencies, as well as from popular portals with property sales offers. Not all countries practise exclusive brokerage agreements, so that the same property is offered for sale repeatedly as a result of being posted by several agents at the same time, sometimes at different prices, and descriptions of the location and features of the property vary. Supply is determined by: the existing stock of properties, the scale of renovations and upgrades carried out, property losses (demolitions) and changes in function, new construction, zoning plans, the timing of building permits, the level of economic activity, the level of prices in the construction industry, etc. **Demand** for real estate is measured by the number of market transactions actually concluded. The main factors shaping real estate demand include: prices (rents, interest rates), specific needs and the level of their satisfaction, economic factors, the state of the labour market, demographic factors, migration processes, preferences, etc.

6. Unfortunately, real estate markets are not transparent in all countries. In transparent markets, valuers have access to direct transactional evidence, often showing a tendency to dismiss offer price information as too different from transactional prices. Offer prices should therefore be treated with caution. However, in markets where

access to real transactions is difficult, offer price information becomes useful. In some countries, there are problems with the availability of transactional data – contracts are not recorded or access to them is expensive, thus unattainable for a single valuer. Sometimes the reliability of information on property prices contained in sales contracts is insufficient. The transaction prices stated in the deeds may be actual prices (equal to the amount for which the property was purchased), or they may be "spurious". Actual prices primarily include market prices, but "amateur prices" also appear, i.e. the actual amounts that were paid for the properties, but influenced by the subjectivity of the seller and/or the buyer. 'Spurious' prices, on the other hand, arise when the parties to a transaction wish to understate or overstate the transaction price. Underpricing may aim to reduce the tax base associated with the purchase of the property, and overpricing may support an overvaluation of the mortgage security or a reduction in the minimum deposit required to obtain a loan.

7. In addition, the information contained in notarial deeds is limited to basic address data and laconic characteristics, which makes it impossible to identify the differentiating features of properties and to study the contribution of the influence of individual features to price formation. Transaction prices are available to valuers with a time lag and this is uneven, making it difficult to analyse price changes over time. There are instances when the market is static and then the level of transaction prices remains unchanged, but the market can also fall or rise.

8. The disadvantages of using only transaction prices for market analysis and property valuation encourage the use of offer prices. The lack of market transparency caused by not disclosing the true consistency of sales prices makes it necessary for valuers to use offer prices as a comparative element or one such element in a market approach.

9. The offer price of a property is the price that is determined by the seller with the assistance of a valuer, real estate agent or independently. The offer price is usually derived from the prices on the market, the amount of demand, the technical and usable condition of the property, its location and other property characteristics. Often the bidder inflates the asking price in order to be able to lower it during negotiations with the potential buyer. The offer price may fluctuate over time, e.g. decrease if there is little interest in the property; or increase if there is strong interest in the offer.

10. Observation of bidder behaviour shows that in some market sectors there is a certain minimum price that determines the decision to sell or, for sellers not in a forced situation, to postpone the sale rather than sell at an unsatisfactory price).

11. Due to the diversity of properties and sellers' expectations, the range of offer prices is large, often greater than that of transaction prices.

12. An obvious problem arising from the use of offer prices for market analysis and property valuation is (usually) the lack of correspondence with actual sale prices. In some countries, depending on the state of the market, asking prices are lower than selling prices. In others, the opposite is the case. This is not only due to the phase of the

business cycle that the market is in at the time, but also to cultural considerations. In some countries, buyers negotiate the price; in others, they make a non-negotiable offer to the seller. By considering the market cycle and its degree of liquidity, a valuer experienced in a given market can judge the relationship between offer prices and the likely sale prices of a property and therefore, in the absence of other reliable price data, the use of offer price information is important and desirable.

13. The international property valuation literature recognises the importance of analysing the relationship between asking prices and sales prices or the time on the market for interpreting the market.

14. The scale of transactions in the market relative to the size of the offer determines whether the market is in equilibrium or a seller's or buyer's market. Some analysts consider a property market to be in relative equilibrium when the current number of listings equals the number of transactions completed in the last four quarters. Others believe that the property market is most often in permanent imbalance, caused, among other things, by the rigidity of offer prices. The long-term maintenance of a high level of asking prices in a situation of excess supply causes long-term imbalances.

15. There are two types of market imbalance: overdemand (seller's market) and over-supply (buyer's market).

16. A seller's market occurs when the demand for properties is higher than the supply. This means a lower number of properties currently offered for sale than the number of property transactions concluded. A small or decreasing difference between asking and transaction prices implies a favourable or improving position for the seller. This type of market signifies the ease of disposing of the property, which manifests itself in the short time required to complete the transaction.

17. A buyer's market occurs when the supply of real estate is higher than the demand for it - this is especially the case when the financial capacity of potential buyers is reduced (e.g. tighter credit policies of banks, economic slowdown or crisis). Here, the number of properties currently offered for sale is higher than the number of transactions concluded. A large or increasing difference between transaction and offer prices means a favourable position for the buyer. In such a situation, customers will expect price discounts (especially customers financing the purchase with their own funds). Sellers must then decide to reduce the price or postpone the sale. The large prevalence of offer prices over transaction prices, combined with the reluctance of sellers to reduce the price or procrastination in doing so, prolongs the exposure period of the property on the market.

18. It should be noted that asking prices are not a tangible result of the forces of supply and demand and are therefore not a fully reliable source of information about the market situation. First and foremost, they reflect the expectations of the supply side of the market. Through comparison with transaction prices, however, they are helpful in identifying the phase of the market cycle.

19. In the case of a seller's market, we are most often dealing with an expansion phase (decreasing prevalence of asking prices over transaction prices) or a boom phase (slight prevalence of asking prices over transaction prices). In addition, in periods of boom or the occurrence of "price bubbles" in the real estate market, some (few) properties may be sold at prices higher than the asking price, which results, for example, from multi-offer "bidding wars".

20. A buyer's market will correspond to a recessionary phase (increasing prevalence of asking prices over transaction prices) or depressed phase (confirmed long-lasting prevalence of asking prices over transaction prices).

21. The price of real estate is subject to market rules, subject to changes due to the influence of factors arising directly from the market as well as external, macroeconomic factors. Transaction prices inform market participants as to whether the allocation of resources they are making will achieve the best possible results. They are therefore a signal indicating the directions of resource flows and an incentive to undertake or abandon activities. Information on concluded transactions and the prices agreed as a result of the parties' negotiations is usually available with a delay. The purchase process can take from a few weeks to even a few months, often depending on the source of financing (shorter time in the case of buyer's equity, longer with bank credit). In addition, due to the dispersion of the real estate market and the legal formalities accompanying property transactions, the time elapsing from the conclusion of the preliminary sale agreement to the moment when the valuer can obtain information on the transaction price included in the final agreement may be as long as half a year.

22. In an environment of dynamic market changes, it is therefore particularly important to keep track of property sales offers despite the fact that these are only a proxy for transaction prices.